***ACCOUNTING STANDARDS***

*Accounting Standards are the defined accounting policies issued by Government or expert institute. These standards are issued to bring harmonization in follow up of accounting policies.*

*Presently, Institute of Chartered Accountants of India has issued 29 Accounting Standards as listed below.*

| | |
|---|---|
| ***AS 1.*** | *Disclosure of Accounting Policies* |
| ***AS 2.*** | *Valuation of Inventories* |
| ***AS 3.*** | *Cash Flow Statements* |
| ***AS 4.*** | *Contingencies and Events Occurring After the Balance Sheet Date* |
| ***AS 5.*** | *Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies* |
| ***AS 6.*** | *Depreciation Accounting* |
| ***AS 7.*** | *Construction Contracts* |
| ***AS 8.*** | *Accounting for Research and Development (Not Applicable now)* |
| ***AS 9.*** | *Revenue Recognition* |
| ***AS 10.*** | *Accounting for Fixed Assets* |
| ***AS 11.*** | *Accounting for the Effects of Changes in Foreign Exchange Rates* |
| ***AS 12.*** | *Accounting for Government Grants* |
| ***AS 13.*** | *Accounting for Investments* |
| ***AS 14.*** | *Accounting for Amalgamation* |
| ***AS 15.*** | *Accounting for Retirement Benefits in the financial Statements of Employers* |
| ***AS 16.*** | *Borrowing Costs* |
| ***AS 17.*** | *Segment Reporting* |
| ***AS 18.*** | *Related Party Disclosure* |
| ***AS 19.*** | *Leases* |
| ***AS 20.*** | *Earning Per Share* |
| ***AS 21.*** | *Consolidated Financial Statements* |
| ***AS 22.*** | *Accounting for Taxes on Income* |
| ***AS 23.*** | *Accounting for Investments in Associates in Consolidated Financial Statements* |
| ***AS 24.*** | *Discontinuing Operations* |
| ***AS 25.*** | *Interim Financial Reporting* |
| ***AS 26.*** | *Intangible Assets* |
| ***AS 27.*** | *Financial Reporting of Interests in Joint Ventures* |
| ***AS 28.*** | *Impairment of Assets* |
| ***AS 29.*** | *Provisions, Contingent Liabilities & Contingent Assets* |

***Procedure for Issuing Accounting Standards***

1. *Accounting Standard Board (ASB) determines the broad areas in which Accounting Standards need to be formulated.*
2. *In the preparation of AS, ASB is assisted by Study Groups.*
3. *ASB also holds discussions with representative of Government, Public Sector Undertakings, Industry and other organizations (ICSI/ICWAI) for ascertaining their views.*
4. *An exposure draft of the proposed standard is prepared and issued for comments by members of ICAI and the public at large.*
5. *After taking into consideration the comments received, the draft of the proposed standard will be finalized by ASB and submitted to the council of the Institute.*
6. *The council of the Institute will consider the final draft of the proposed Standard and If found necessary, modify the same in consultation with ASB. The AS on the relevant subject will then be issued under the authority of the council.*

***AS – 1***

*DISCLOSURE OF ACOUNTING POLICY*

***Accounting policies*** *are the specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements.*

- *All significant accounting policies should be disclosed.*
- *Such disclosure form part of financial statements.*
- *All disclosures should be made at one place.*
- *Specific disclosure for the adoption of fundamental accounting assumptions is not required.*
- *Disclosure of accounting policies cannot remedy a wrong or inappropriate treatment of the item in the accounts.*

*Any change in accounting policies which has a material effect in the current period or which is reasonably expected to have material effect in later periods should be disclosed.*
*In the case of a change in accounting policies, which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, the fact should be indicated.*

***Fundamental Accounting Assumption: (GCA) :***

***1] Going Concern***

***2] Consistency***

***3] Accrual***

*Major considerations governing the selection of accounting policies:*

*1] Prudence*

*2] Substance over form (Logic over Law)*

*3] Materiality*

*The following are examples of the areas in which different accounting policies may be adopted by different enterprises:*

- *Methods of depreciation*
- *Methods of translation of foreign currency*
- *Valuation of inventories*
- *Valuation of investments*
- *Treatment of retirement benefits*
- *Treatment of contingent liabilities etc.*

***AS – 2***

***VALUATION OF INVENTORY***

***Inventories** are assets:*

*(a) held for sale in ordinary course of business;*
*(b) in the process of production fro such sale (WIP);*
*(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.*

*However, this standard does not apply to the valuation of following inventories:*

*(a) WIP arising under construction contract (Refer AS – 7);*
*(b) WIP arising in the ordinary course of business of service providers;*
*(c) Shares, debentures and other financial instruments held as stock in trade; and*
*(d) Producers' inventories of livestock, agricultural and forest products, and mineral oils, ores and gases to the extent that they are measured at net realizable value in accordance with well established practices in those industries.*

*Inventories should be valued at the lower of **cost** and **net realizable value.***

*The cost of inventories should comprise*

*(a) all costs of purchase*
*(b) costs of conversion*
*(c) other costs incurred in bringing the inventories to their present location and condition.*

*The **costs of purchase** consist of*

*(a) the purchase price*
*(b) duties and taxes ( other than those subsequently recoverable by the enterprise from the taxing authorities like CENVAT credit)*
*(c) freight inwards and other expenditure directly attributable to the acquisition.*

*Trade discounts (but not cash discounts), rebates, duty drawbacks and other similar items are deducted in determining the costs of purchase.*

*The **costs of conversion** include direct costs and systematic allocation of fixed and variable production overhead.*

*Allocation of fixed overheads is based on the normal capacity of the production facilities. Normal capacity is the production, expected to be achieved on an average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance.*

*Under Recovery: Unallocated overheads are recognized as an expense in the period in which they are incurred.*

*Example: Normal capacity = 20000 units*
*Production = 18000 units*
*Sales = 16000 units*
*Closing Stock = 2000 units*
*Fixed Overheads = Rs. 60000*

*Then, Recovery rate = Rs60000/20000 = Rs 3 per unit*
*Fixed Overheads will be bifurcated into three parts:*
*Cost of sales : 16000*3 = 48000*
*Closing stock : 2000 *3 = 6000*
*Under recovery : Rs 6000 ( to be charged to P/L)*

*(Apparently it seems that fixed cost element in closing stock should be 60000/18000*2000 =Rs 6666.67. but this is wrong as per AS-2)*

*Over Recovery: In period of high production, the amount of fixed production overheads is allocated to each unit of production is decreased so that inventories.*

*Example: Normal capacity = 20000 units*
*Production = 25000 units*
*Sales = 23000 units*
*Closing Stock = 2000 units*
*Fixed Overheads = Rs 60000*

*Recovery Rate = Rs 60000/20000 = Rs 3 per unit*
*But, Revised Recovery rate = Rs 60000/25000 = Rs. 2.40 per unit*

*Cost of sales : 23000*2.4 = Rs 55200*
*Closing Stock : 2000 *2.4 = Rs. 4800*

*Joint or by products:*

*In case of joint or by products, the costs incurred up to the stage of split off should be allocated on a rational and consistent basis. The basis of allocation may be sale value at split off point or sale value at the completion of production. In case of the by products of negligible value or wastes, valuation may be taken at net realizable value. The cost of main product is then joint cost minus net realizable value of by product or waste.*

***The other costs** are also included in the cost of inventory to the extent they contribute in bringing the inventory to its present location and condition.*

*Interest and other borrowing costs are usually not included in cost of inventory. However, AS-16 recommends the areas where borrowing costs are taken as cost of inventory.*

*Certain costs are strictly not taken as cost of inventory.*

*(a) Abnormal amounts of wasted materials, labour, or other production costs;*
*(b) Storage costs, unless those costs are necessary in the production process prior to a further production stage;*

*(c) Administrative overheads that do not contribute to bringing the inventories to their present location and condition; and*
*(d) Selling and Distribution costs.*

***Cost Formula:***

- ⇨ *Specific identification method for determining cost of inventories*
  *Specific identification method means directly linking the cost with specific item of inventories. This method has application in following conditions:*
  - *In case of purchase of item specifically segregated for specific project and is not ordinarily interchangeable.*
  - *In case of goods of services produced and segregated for specific project.*

- ⇨ *Where Specific Identification method is not applicable*
  *The cost of inventories is valued by the following methods;*
  - *FIFO ( First In First Out) Method*
  - *Weighted Average Cost*

***Cost of inventories in certain conditions:***
*The following methods may be used for convenience if the results approximate actual cost.*

- ⇨ *<u>Standard Cost:</u> It takes into account normal level of consumption of material and supplies, labour, efficiency and capacity utilization. It must be regularly reviewed taking into consideration the current condition.*
- ⇨ *<u>Retail Method:</u> Normally applicable for retail trade*
  *Cost of inventory is determined by reducing the gross margin from the sale*
  *value of inventory.*

***Net Realisable Value*** *means the estimated selling price in ordinary course of business, at the time of valuation, less estimated cost of completion and estimated cost necessary to make the sale.*

*<u>Comparison between net realizable value and cost of inventory</u>*

*The comparison between cost and net realizable value should be made on item-by-item basis. (In some cases, group of items-by-group of item basis)*

*For Example:*

| | Cost | NRV | Inventory Value as per AS-2 |
|---|---|---|---|
| *Item A* | *100* | ***90*** | *90* |
| *Item B* | ***100*** | *115* | *100* |
| *Total* | ***200*** | *205* | ~~*200*~~ ***<u>190</u>*** |

*<u>Raw material valuation</u>*
*If the finished goods to which raw material is applied, is sold at profit, RAW MATERIAL is valued at cost irrespective of its NRV level being lower to its costs.*

***AS – 3***

*CASH FLOW STATEMENT*

***Definitions:***

***Cash*** *comprises cash on hand and cash at bank. (Demand Deposits with bank)*

***Cash Equivalents*** *are*

- *Short Term*
- *Highly Liquid Investments (Maturity around 3 months)*
- *Subject to insignificant risk of changes in value.*

***Cash Flows*** *are inflows and outflows of cash and cash equivalents.*

***Cash Flow Statement*** *represents the cash flows during the specified period by operating, investing and financing activities.*

***Operating Activities*** *are the principal revenue-producing activities of the enterprise and other activities that are not investing activities and financing activities.*

*Example:*

*1] Cash receipts from sales of goods/services*

*2] Cash receipts from royalties, fees and other revenue items*

*3] Cash payments for salaries, wages and rent*

*4] Cash payment to suppliers for goods*

*5] Cash payments or refunds of Income Tax unless they can be specifically identified with financing or investing activities*

*6] Cash receipts and payments to future contracts, forward contracts when the contracts are held for trading purposes.*

*Cash from operating activities can be disclosed either by DIRECT METHOD OR BY INDIRECT METHOD.*

***Investing Activities*** *are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.*

*Example:*

*1] Cash payments/receipts to acquire/sale of fixed assets including intangible assets*

*2] Cash payments to acquire shares or interest in joint ventures (other than the cases where instruments are considered as cash equivalents)*

*3] Cash advances and loans made to third parties (Loan sanctioned by a financial enterprise is operating activity)*

*4] Dividends and Interest received*

*5] Cash flows from acquisitions and disposal of subsidiaries*

***Financing Activities*** *are activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowing of the enterprise.*

*Example:*

*1] Cash proceeds from issue of shares and debentures*

*2] Buy back of shares*

*3] Redemption of Preference shares or debentures*

*4] Cash repayments of amount borrowed.*

*5] Dividend and Interest paid*

*An enterprise should report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities.*
*However, cash flows from following activities may be reported on a net basis.*

- *Cash receipts and payments on behalf of customers*
  *For example: Cash collected on behalf of, and paid over to, the owners of properties.*
- *Cash flows from items in which turnover is quick, the amounts are large and the maturities are short.*
  *For example: Purchase and sale of investments*
- *For financial enterprise: Cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date.*
- *For financial enterprise: Deposits placed/withdrawn from other financial enterprises*
- *For financial enterprise: Cash advances and loans made to customers and the repayment of those advances and loans.*

*Foreign Currency Cash Flows:*

*Cash flows arising in foreign currency should be recorded in enterprise' reporting currency applying the exchange conversion rate existing on the date of cash flow.*

*The effect of changes in exchange rates of cash and cash equivalents held in foreign currency should be reported as separate part of the reconciliation of the changes in cash and cash equivalents during the period.*

*Extraordinary Items: These items should be separately shown under respective heads of cash from operating, investing and financing activities.*

*Investing and financing transactions that do not require the use of cash and cash equivalents should be excluded from a cash flow statement. For Example*
*A] The conversion of debt to equity*
*B] Acquisition of an enterprise by means of issue of shares*

*Other Disclosure:*

- *Components of cash and cash equivalents.*
- *Reconciliation of closing cash and cash equivalents with items of balance sheet.*
- *The amount of significant cash and cash equivalent balances held by the enterprise, which are not available for use by it.*

***AS - 4***
*CONTINGENCIES AND EVENTS OCCURRING AFTER THE BALANCE SHEET DATE*

***Contingency*** *: A contingency is a condition or situation, the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence, or non-occurrence, of one or more uncertain future events.*

*Accounting Treatment:*
*If it is likely that a contingency will result in*

***LOSS:*** *It is prudent to provide for that loss in the financial statements.*

***PROFIT:*** *Not recognized as revenue (However, when the realization of a gain is virtually certain, then such gain is not a contingency and accounting for the gain is appropriate.)*

*The estimates of the outcome and of the financial effect of contingencies are determined*
- *by the judgement of the management*
- *by review of events occurring after the balance sheet date*
- *by experience of the enterprise in similar transaction*
- *by reviewing reports from independent experts.*

*If estimation cannot be made, disclosure is made of the existence and nature of the contingency.*

*Provision for contingencies are not made in respect of general or unspecified risks.*

*The existence and amount of guarantees and obligations arising from discounted bills of exchange are generally disclosed by way of note even though the possibility of loss is remote.*

***The amount of a contingent loss should be provided for by a charge in the statement of profit and loss if:***
***(a) it is probable that future events will confirm that, after taking into account any related probable recovery, an asset has been impaired or a liability has been incurred as at the balance sheet date, and***
***(b) a reasonable estimate of the amount of the resulting loss can be made.***

*If either of aforesaid two conditions are not met, e.g where a reasonable estimate of the loss is not practicable, the existence of the contingency should be disclosed by way of note unless the possibility of loss is remote.Such disclosure should provide following information:*

*(a) the nature of the contingency;*
*(b) the uncertainities which may affect the future outcome;*
*(c) an estimate of the financial effect, or a statement that such an estimate cannot be made.*

***Events Occurring after the Balance Sheet Date:***

*Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in the case of any other entity.*

*Two types of events can be identified:*

***Adjusting Event:***
*Those, which provide further evidence of conditions that, existed at the balance sheet date*

*Actual adjustments in financial statements are required for adjusting event.*

*Exceptions:*
*1] Although, not adjusting event, Proposed dividend are adjusted in books of account.*
*2] Adjustments are required for the events, which occur after balance sheet date that indicates that fundamental accounting assumption of going concern is no longer, appropriate.*

***Non-Adjusting Events:***

*Those, which are indicative of conditions that arose subsequent to the balance sheet date.*

*No adjustments are required to be made for such events. But, disclosures should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise. Such disclosure should provide following information:*

*(a) the nature of the events*
*(b) an estimate of the financial effect, or a statement that such an estimate cannot be made.*

***AS-5***

*NET PROFIT OR LOSS FOR THE PERIOD, PRIOR PERIOD ITEMS AND CHANGES IN ACCOUNTING POLICIES*

*All items of income and expense, which are recognized in a period, should be included in the determination of net profit or loss for the period unless an Accounting Standard requires or permits otherwise.*

*The net profit or loss for the period comprises the following components, each of which should be disclosed on the face of the statement of profit and loss:*

*(a) profit or loss from ordinary activities; and*
*(b) extraordinary items.*

***Ordinary Activities** are any activities, which are undertaken by an enterprise as part of its business, and such related activities in which the enterprise engages in furtherance of, incidental to, or arising from, these activities.*

*When items of income and expenses within profit or loss from ordinary activities are of such size, nature that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed properly. Examples of such circumstances are:*
*(Exceptional Items)*

- *disposal of items of fixed assets*
- *litigation settlements*
- *legislative changes having retrospective application*
- *disposal of long term investments*
- *reversal of provisions*

***Extraordinary items** are income or expense that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly. Examples of events or transactions that generally give rise to extraordinary items for most enterprises are:*

- *attachment of property of the enterprise;*
- *an earthquake*

*However, claims from policyholders arising from an earthquake do not qualify as an extraordinary item for an insurance enterprise that insures against such risks.*

*Extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.*

***<u>Prior Period Items:</u>***

*Prior period items are income or expenses that arise in the current period as a result of ERROR or OMMISSIONS in the preparation of the financial statements of one or more prior periods.*

*The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived.*

***Changes in Accounting Policy:***

***Accounting policies*** *are the specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements.*

*A change in an accounting policy should be made only if the adoption of a different accounting policy is required:*

*(a) by statute*
*(b) for compliance with an accounting standard*
*(c) if it is considered that the change would result in a more appropriate presentation of the financial statements of the enterprise.*

*Any change in accounting policy which has a material effect, should be disclosed. Such changes should be disclosed in the statement of profit and loss in a manner that their impact on profit or loss can be perceived.*

*Where the effect of such change is not ascertainable, the fact should be indicated.*

*If a change is made in the accounting policies which has no material effect on the financial statements for the current period but which is reasonably expected to have material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.*

*The following are not changes in accounting policies:*

*(a) the adoption of an accounting policy for events which differ in substance from previously occurring events e.g. introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement; and*
*(b) the adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial.*

***Change in Accounting Estimate:***

*The nature and amount of a change in an accounting estimate which has a material effect in the current period, or which is expected to have a material effect in subsequent periods, should be disclosed. If it is impracticable to quantify the amount, this fact should be disclosed.*

*The effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was previously for the estimate.*
*For example, the effect of a change in an accounting estimate that was previously included as an extraordinary item is reported as an extraordinary item.*

*Clarifications:*

*(a) Change in accounting estimate does not bring the adjustment within the definitions of an extraordinary item or a prior period item.*

(b) *Sometimes, it is difficult to distinguish between a change in an accounting policy and a change in accounting estimate. In such cases, the change is treated as a change in an accounting estimate, with appropriate disclosures.*

## *AS – 6*
## *DEPRECIATION ACCOUNTING*

***Depreciation*** *is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, passage of time or obsolescence through technology and market changes. Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset. Depreciation includes amortisation of assets whose useful life is predetermined.*

- *The <u>depreciable amount</u> of a <u>depreciable asset</u> should be allocated on a systematic basis to each accounting period during the <u>useful life</u> of the asset.*

***Depreciable assets*** *are assets which*
*[1] are expected to be used during more than one accounting period; and*
*[2] have a limited useful life; and*
*[3] are held by an enterprise for use in the production or supply or for administrative purposes*

***Depreciable amount*** *of a depreciable asset is its historical cost, or other amount substituted for historical cost less the estimated residual value.*

***Useful life*** *is the period over which a depreciable asset is expected to be used by the enterprise.*
*The useful life of a depreciable asset is shorter than its physical life.*

- *There are two method of depreciation:*
  *1] Straight Line Method (SLM)*
  *2] Written Down Value Method (WDVM)*
  *Note: <u>A combination of more than one method may be used.</u>*

- *The depreciation method selected should be applied consistently from period to period. The change in method of depreciation should be made only if;*
  - *The adoption of the new method is required by statute; or*
  - *For compliance with an accounting standard; or*
  - *If it is considered that change would result in a more appropriate preparation of financial statement; or*

- *When there is change in method of depreciation, depreciation should be recalculated in accordance with the new method from the date of the assets coming into use. (i.e RETROSPECTIVELY)*
  *The deficiency or surplus arising from such recomputation should be adjusted in the year of change through profit and loss account.*
  *Such change should be treated as a change in accounting policy and its effect should be quantified and disclosed.*

- *The useful lives of major depreciable assets may be reviewed periodically. Where there is a revision of the estimated useful life, the unamortised depreciable amount should be charged over the revised remaining useful life. (i.e. PROSPECTIVELY)*

- *Any addition or extension which becomes an integral part of the existing asset should be depreciated over the remaining useful life of that asset.*
  *The depreciation on such addition may also be applied at the rate applied to the existing asset.*
  *Where an addition or extension retains a separate identity and is capable of being used after the existing asset is disposed of, depreciation should be provided independently on the basis of estimate of its own useful life.*

- *Where the historical cost of a depreciable asset has undergone a change due to increase or decrease in the long term liability on account of exchange fluctuations, price adjustments, changes in duties or similar factors, the depreciation on the revised unamortised depreciable amount should be provided prospectively over the residual useful life of the asset.*

- *This accounting standard is not applied on the following items.*
  - *Forests and plantations*
  - *Wasting assets*
  - *Research and development expenditure*
  - *Goodwill*
  - *Live stock*

- *Disclosure requirements*
  *1] the historical cost*
  *2] total depreciation for each class charged during the period*
  *3] the related accumulated depreciation*
  *4] depreciation method used ( Accounting policy)*
  *5] depreciation rates if they are different from those prescribed by the statute governing the enterprise*

*AS – 7*

## *CONSTRUCTION CONTRACT*

*A **Construction contract** is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.*

***Recognition of contract revenue and contract cost***

*When the outcome of a construction contract can be estimated reliably, contract revenue and contract cost should be recognized as revenue and expenses by reference to the stage of construction. (This accounting standard recommends the use of percentage of completion method)*

*When the outcome of a construction contract cannot be estimated reliably,*

- *Revenue should be recognized only to the extent of contract costs incurred of which recovery is probable. (i.e. Revenue recognized = Costs Incurred )*
- *Contract costs should be recognized as an expense in the period in which they are incurred.*

*The **outcome of a construction contract** can be estimated reliably when all the following conditions are satisfied:*

*(a) total contract revenue can be measured reliably;*
*(b) the receipt of revenue is probable;*
*(c) the contract costs to complete the contract can be measured reliably;*
*(d) the stage of completion at the reporting date can be measured reliably;*
*(e) the contract costs attributable to the contract can be clearly identified.*

***Contract revenue** should comprise:*

*(a) the initial amount of revenue agreed in the contract; and*
*(b) variations in amount to be received*

- *to the extent that it is probable that they will result in revenue; and*
- *they are capable of being reliably measured.*

*( Contract can of two kinds: Fixed Price contract and Cost Plus contract)*

***Contract costs*** *should comprise:*

*(a) costs that relate directly to the specific contract;*
*(b) costs that are attributable to contract activity in general and can be allocated to the contract.*

- *At any stage of contract, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately. The amount of such loss is determined irrespective of:*
    - *whether or not work has commenced on the contract;*
    - *the stage of completion of contract activity; or*
    - *whether outcome of contract is estimated or not*

- *When an uncertainty arises about the collectability of an amount already included in contract revenue, and already recognized in the statement of profit and loss, the uncollectable amount or the amount in respect of which recovery has ceased to be probable is recognized as an expense rather than an adjustment of the amount of contract revenue.*

- *Contract costs that relate to future activity, are recognized as an asset provided it is probable that they will be recovered. Such asset is classified as Contract WIP.*

- *The stage of completion of a contract may be determined by following ways;*
    - *surveys of work done*
    - *completion of physical proportion of the contract work*
    - *the proportion that contract costs incurred for work performed upto the reporting date bear to the estimated total contract costs*

- *When a contract covers a number of assets, the construction of each asset should be treated as a separate construction of each asset should be treated as separate construction contract when*
    - *separate proposals have been submitted for each asset;*
    - *each asset has been subject to separate negotiation*
    - *the costs and revenues of each asset can be identified.*

- *A group of contracts, whether with a single customer or with several customers, should be treated as a single construction contract when*
    - *the group of contracts is negotiated as a single package;*
    - *the contracts are very closely interrelated*
    - *the contracts are performed concurrently or in a continuous sequence.*

- *The recognition of revenue and expenses in construction contract is based on reliable estimate. This estimate may vary from one accounting year to another accounting year. The effect of change in estimate should be treated as per AS-5. i.e. It should not be treated as prior period item or extraordinary item.*

- ***Disclosure:***
    - *Contract Revenue recognized as revenue*
    - *Method used to determine the contract revenue*
    - *Method used to determine the stage of completion*
    - *Contract costs incurred + Recognised Profit – Recognised Loss*
    - *Amount of advances received*
    - *Amount due from customers*
    - *Amount due to customers*

*AS – 9*

## ***REVENUE RECOGNITION***

***Revenue*** *is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends.*

*Revenue includes:*
- *Proceeds from sale of goods*
- *Proceeds from rendering of services*
- *Interest, royalty and dividends.*

### ***<u>Sale of goods</u>***

*Revenue from sales should be recognized when*
- *All significant risks and rewards of ownership have been transferred to the buyer from the seller.*
- *Ultimate realisability of receipt is reasonably certain.*

### ***<u>Rendering of Services</u>***

*Revenue from service transactions is usually recognized as the service is performed, either by proportionate completion method or by the completed service contract method.*

1) *<u>Proportionate Completion method</u> – This is a method of accounting, which recognises revenue in the statement of profit and loss proportionately with degree of completion of services under a contract.*

    *Revenue is recognised by reference to the performance of each act. The revenue recognised under this method would be determined on the basis of contract value, associated costs, number of acts or other suitable basis.*

2) <u>Completed service contract method</u> – *This is a method of accounting, which recognises revenue in the statement of profit and loss only when the rendering of services under a contract is completed or substantially completed.*

   *Revenue under this method is recognised on completion or substantial completion of the job.*

***<u>Revenue from Interest :</u>*** *Recognised on time proportion basis*

***Revenue from Royalties:*** *Recognised on accrual basis in accordance with the terms of the relevant agreement.*

***<u>Revenue from Dividends</u>****:* *Recognised when right to receive is established*

**<u>Subsequent uncertainty in collection:</u>** *When the uncertainty relating to collectability arises subsequent to the time of sale or the rendering of services, it is more appropriate to make a separate provision to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.*

***<u>Disclosure</u>****: An enterprise should disclose the circumstances in which revenue recognition has been postponed pending the resolution of significant uncertainties.*

*EXAMPLES*

*1] On sale, buyer takes title and accepts billing but delivery is delayed at buyer's request*
   *- Revenue should be recognised notwithstanding that physical delivery has not been completed.*

*2] Delivery subject to installations and inspections*
   *- Revenue should not be recognised until the customer accepts delivery and installation and inspection are complete. However, when installation process is very simple, revenue should be recognised. For example. Television sale subject to installation.*

*3] Sale on approval*
   *- Revenue should not be recognised until the goods have been formally accepted or time for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed.*

*4] Sales with the condition of 'money back if not completely satisfied'*
   *- It may be appropriate to recognize the sale but to make suitable provision for returns based on previous experience.*

*5] Consignment sales*
   *- Revenue should not be recognised until the goods are sold to a third party.*

*6] Installment sales*
   *- Revenue of sale price excluding interest should be recognised on the date of sale.*

*7] Special order and shipments*
   *- Revenue from such sales should be recognized when the goods are identified and ready for delivery.*

*8] Where seller concurrently agrees to repurchase the same goods at a later date*

*- The sale should not be recognised, as this is a financial arrangement.*

*9] Subscriptions received for publications*

*- Revenue received or billed should be deferred and recognised either on a straight-line basis over time or where the items delivered vary in value from period to period, revenue should be based on the sales value of the item delivered.*

*10] Advertisement commission received*

*- It is recognised when the advertisement appears before public.*

*11] Tution fees received*

*- Should be recognised over the period of instruction.*

*12] Entrance and membership fees*

- *Entrance fee is generally capitalized*
- *If the membership fee permits only membership and all other services or products are paid for separately, the fee should be recognised when received. If the membership fee entitles the member to services or publications to be provided during the year, it should be recognised on a systematic and rational basis having regard to the timing and nature of all services.*

*13] Sale of show tickets*

*- Revenue should be recognised when the event takes place.*

*14] Guaranteed sales of agricultural crops*

*- When sale is assured under forward contract or government guarantee, the crops can be recognised at net realizable value although it does not satisfy the criteria of revenue recognition.*

*The above accounting standard is not applicable for:*

- *Revenue arising from construction contracts*
- *Revenue arising from hire purchase, lease agreements*
- *Revenue arising from Government grants and subsidies*
- *Revenue of Insurance companies arising from insurance contracts*
- *Profit or loss on sale of fixed assets*
- *Realised or unrealized gains resulting from changes in foreign exchange rates*

*AS-10*

***ACCOUNTING FOR FIXED ASSETS***

***Definitions:***

***Fixed Asset is*** *an asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business. (It is expected to be used for more than one accounting period.)*

*The* ***cost of fixed asset includes:***

- *Purchase price*
- *Import Duties and other non-refundable taxes*
- *Direct cost incurred to bring the asset to its working condition*
- *Installation cost*
- *Professional fees like fees of architects*
- *General overhead of enterprise when these expenses are specifically attributable to acquisition/preparation of fixed assets*
- *Any expenses before the commercial production, including cost of test run and experimental production*
- *Any expenses before the asset is* ***ready for use not put to use***
- *Loss on deferred payment arising out of foreign currency liability*
- *Price adjustment, changes in duties and similar factors*

*The* ***cost of fixed asset is deducted with:***

- *Trade discounts and rebates*
- *Sale proceeds of test run production*
- *Amount of government grants received/receivable against fixed assets (See AS- 12)*
- *Gain on deferred payment arising out of foreign currency liability*

- ❖ *Similarly, historical cost of self constructed fixed assets will include:*
  - *All cost which are directly related to the specific asset*
  - *All costs that are attributable to the construction activity should be allocated to fixed assets*
  - *Any internal profit included in the cost should be eliminated.*

- ❖ *Any expenses incurred on asset between date of ready for use and put to use is either charged to P&L A/c or treated as deferred revenue expenditure to be amortised in 3-5 years after commencement of production.*

- *When fixed asset is acquired in exchange for another asset, the cost of the asset acquired should be recorded*
    - *either at, fair market value*
    - *or at, the net book value of the assets given up*

  *For this purpose, fair market value may be determined by reference either to the asset given up or to the asset acquired, whichever is more clearly evident.*

  *Fixed asset acquired in exchange for shares or other securities should be recorded at FMV of assets given up or asset acquired, whichever is more clearly evident. (i.e the option of recording the asset at net book value of asset given up is closed)*

  ***Fair market value** is the price that would be agreed to in an open and unrestricted market between knowledgeable and willing parties dealing at arm's length distance.*
- *Subsequent expenditures related to an item of fixed asset should be added to its book value only if they increase the future benefits from the existing asset beyond its previously assessed standard of performance.*
- *Material items retired from active use and held for disposal should be stated at the lower of their net book value and net realizable value and shown separately. Fixed assets should be eliminated from the financial statements on disposal or when no further benefit is expected from its use and disposal. Profit/loss on such disposal or writing off is recognized in the profit and loss account.*
- ***REVALUATION***
  *When the fixed assets are revalued, these assets are shown at revalued price. Revaluation of fixed assets should be restricted to the net recoverable amount of fixed asset.*
  *When a fixed asset is revalued, an entire class of assets should be revalued or selection of assets for revaluation should be made on a systematic basis. That basis must be disclosed.*
  *Accounting treatment of revaluation under different situation:*

  *When revaluation is made upward*

| | | |
|---|---|---|
| *Fixed Assets A/c* | *Dr* | |
| *To Revaluation Reserve* | | |

  *When revaluation is made downward*

| | | |
|---|---|---|
| *P&L A/c* | *Dr* | |
| *To Fixed Assets* | | |

  *When revaluation is made upward subsequent to previous upward revaluation*

| | | |
|---|---|---|
| *Fixed Assets A/c* | *Dr* | |
| *To Revaluation Reserve* | | |

  *When revaluation is made downward subsequent to previous upward revaluation*

| | | |
|---|---|---|
| *Revaluation Reserve A/c* | *Dr* | *(To the extent of carrying amount of R.R)* |
| *P&L A/c* | *Dr* | *(Balancing Figure)* |

*To Fixed assets*

*<u>When revaluation is made upward subsequent to previous downward revaluation</u>*

*Fixed assets A/c Dr*
*To P&L A/c (To the extent of previous downward revaluation)*
*To Revaluation Reserve (Balancing Figure)*

*<u>When revaluation is made downward subsequent to previous downward revaluation</u>*

*P& L A/c Dr*
*To Fixed Assets*

*<u>Accounting treatment on disposal of Fixed Assets</u>:*

*<u>On sale of fixed assets</u>*

*Bank A/c Dr*
*P & L A/c Dr (If Loss)*
*To Fixed Assets*
*To P & L A/c (If Profit)*

*<u>On sale of fixed assets where upward revaluation has taken place</u>*

*On disposal of a previously revalued item of fixed asset, the difference between net disposal proceeds and the net book value is normally charged or credited to the profit and loss account except that, to the extent such a loss is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilized, it is charged directly to that account. The amount standing in revaluation reserve following the retirement or disposal of an asset which relates to that asset may be transferred to general reserve.*

| *If Loss* | *If Profit* |
|---|---|
| *Bank A/c Dr* | *Bank A/c Dr* |
| *Revaluation Reserve A/c Dr* | *To Fixed Assets A/c* |
| *P& L A/c Dr* | *To P/L A/c* |
| *To Fixed Assets* | |
| *Revaluation Reserve A/c Dr* | *Revaluation Reserve A/c Dr* |
| *To General Reserve* | *To General Reserve* |

- *In the case of fixed assets owned by the enterprise jointly with others, the extent of the enterprise's share in such assets, and the proportion of the original cost, accumulated depreciation and WDV should be stated in the B/S.*
  *Alternatively, the pro rata cost of such jointly owned assets may be grouped together with similar fully owned assets with an appropriate disclosure thereof.*

- *Only purchased goodwill should be recorded in books.*

- ***Disclosure:***
    - *Gross and net book value of fixed assets at the beginning and end of period showing additions and disposals*
    - *Revalued amounts substituted for historical costs of fixed assets, the method adopted to compute the same and whether an external valuer was involved.*

*AS - 12*

***ACCOUNTING FOR GOVERNMENT GRANTS***

***Applicability:*** *Mandatory for all enterprises with respect from 01/04/1994.*

***Government Grants*** *are assistance by government in cash or kind for past or future compliance with certain conditions.*

*Government grants may be received in following ways.*

- *Grants related to acquisition of fixed assets*
- *Grants related to revenue*
- *Grants related to promoter's contribution*
- *Grants related to compensation for expenses*

<u>*Government Grants should be recognised*</u>

- *Where there is reasonable assurance that the enterprise will comply with the conditions attached to them;* **and**
- *The grants will be received.*

<u>*Amount of Grant:*</u>

*Monetary Grant: Amount earned should be the value of grant.*

*Non- Monetary Grant:*

- *Where grants are given at concessional rate, then such assets are accounted for at their acquisition cost.*
- *Where grants are given free of cost, then such assets are recorded at nominal value.*

<u>*Accounting Treatment:*</u>

<u>***Grants related to Depreciable assets:***</u>

<u>*EITHER,*</u> *Grants are shown as deduction from Gross value of assets*

*Bank A/c Dr*
*To Government Grant*

*Government Grant Dr*
*To Fixed Assets*

*(When grant is equal to book value of asset, fixed asset is shown at nominal value.)*

*OR, Grants are treated as deferred income*

*Bank A/c Dr*
*To Grant*

*[In this case, Grants are recognised as profit in P&L A/c on a systematic and rational basis over the useful life of assets (i.e. in proportion to the amount of depreciation charged over period)]*

*{Net effect on Profit & Loss A/c will remain same in both cases}*

***Grants related to Non-Depreciable assets:***

*EITHER, Grants are shown as deduction from Gross value of assets*

*Bank A/c Dr*
*To Government Grant*

*Government Grant Dr*
*To Fixed Assets*

*(When grant is equal to book value of asset, fixed asset is shown at nominal value.)*

*OR, shown as reserves*

- *When no future obligations are to be fulfilled*

  *Bank A/c Dr*
  *To Gov. Grant*

  *Gov. Grant Dr*
  *To Capital Reserve*

- *When grant requires fulfillment of certain obligations:*

  *Bank A/c Dr*
  *To Gov. Grant*

  *Gov. Grant Dr (Should be credited to income over the same period over which the cost of*
  *To P&L A/c meeting such expense is charged to revenue)*
  *(In respective years)*

*The deferred income balance should be separately disclosed in the financial statement.*

***Grants related to revenue***

*Government grants related to revenue should be recognised on a systematic basis in the profit and loss account over the periods necessary to match with the related costs, which they are intended to compensate.*

***Grants related to promoter's contribution***

*Grant should be treated as Capital Reserve.*

*Bank A/c Dr*
*To Gov Grant*

*Gov Grant A/c Dr*

*To Capital Reserve*

***<u>Grants related to compensation for expenses</u>***

*Government grants receivable as compensation for expenses or losses (with no further costs) should be recognised as an income in the year of receivable as an Extra-ordinary item.*

***<u>REFUND OF GOVERNMENT GRANT</u>***

*Government grants sometimes become refundable because certain conditions are not fulfilled. The grant refundable is treated as an extraordinary item.*

*The amount refundable in respect of a government grant related to a specific asset is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. (Where the book value of asset is increased, the depreciation should be provided on new asset value prospectively)*

*Where the amount refundable is in respect of a government grant related to revenue, the refund is applied first against any unamortised deferred credit remaining in respect of the grant. Rest amount of refund should be charged to profit and loss account.*

*Where, the amount refundable is in respect of promoter's contribution, the capital reserve should be reduced by the amount refundable.*

*<u>Contingency related to Govt. Grant</u>*

*A contingency related to Govt. grant receivable and refundable should be treated in accordance with AS-4.*

***Disclosures:***

- *The accounting policy adopted*
- *The nature and extent of gov. grants recognised in the financial statements.*

*AS - 13*

***ACCOUNTING FOR INVESTMENTS (Revised in 2003)***

***Applicability:*** *Mandatory for all enterprises.*

*Investments are classified as Long Term Investments and Short Term Investments.*

***Current Investment*** *is intended to be held for not more than one year and readily realisable.*

***Long term Investment*** *is an investment other than a current investment.*

*The carrying amount of current investments is* ***lower of cost and fair value.***

*It is prudent to carry investments individually at the lower of cost and fair value. But, such comparison can also be made category-wise.*

*The carrying amount of long-term investments is carried at* ***cost.*** *However, when there is permanent decline in the value of a long-term investment, the carrying amount is reduced to recognize the decline. The carrying amount of long-term investments should be determined on individual basis.*

*Any reduction or reversal of reduction in value of investment is adjusted through P&L A/c.*

- ***Cost of Investments:***

*The cost of an investment should include acquisition charges such as brokerage, fees and duties.*

*If an investment is acquired-*

- *by issue of shares or other securities; then the investments should be valued at the fair value of the issued security. (i.e. Issue price determined by statutory authority)*
- *By exchange of another asset; then the investments should be valued at fair value of the asset given up or asset acquired, whichever is more clearly evident.*

- *Investment property is investment in land or buildings that is not intended to be occupied substantially for use by, or in the operations of, the investing enterprise. An investment property is classified as long-term investment.*

- *Disposal of Investments : On disposal, the difference between the carrying amount and the disposal proceeds, net of expenses, is recognized in the profit and loss statement.*

❖ *<u>Reclassification of investments:</u>*

*Long-term to short-term: Transfers from one class to another class are made at lower of cost and carrying amount at the date of transfer.*

*Current to long-term: Transfers are made at lower of cost and fair value at the date of transfer.*

❖ *<u>Disclosure:</u>*

*1] Accounting policies for determination of carrying amount*

*2] Classification of Investments*

*3] The amounts included in Profit and loss statement*

- *profits or losses on disposal and changes in carrying amount of current and longterm investments*
- *interest, dividends (showing separately dividends from subsidiary) and rentals on investments showing separately such income from current and long term investments.*
- *Gross Income should be disclosed (i.e. The amount of TDS should be shown under advance taxes paid)*

*4] Aggregate amount of quoted and unquoted investments giving the aggregate market value of quoted investments.*

*AS- 15*

## ***ACCOUNTING FOR RETIREMENT BENEFITS***

*(Revised in 2005 & titled as Employees Benefit)*

***Applicability****: It is mandatory for all enterprises.*
*Retirement Benefits consists of :*

1. *Provident Fund*
2. *Superannuation / Pension*
3. *Gratuity*
4. *Leave Encashment Benefit*
5. *Other Retirement Benefits*

*Accounting treatment under Defined Contribution Scheme/ Provident Fund*

- *Contribution payable by the employer in a year is charged to profit & loss account.*

*Accounting treatment under Defined Benefit Scheme/ Gratuity/ Leave Encashment*

- *Payment of Retirement Benefit out of its own fund*

  *Appropriate provision for accruing liability is created through profit & loss account. Accruing liability is calculated by actuarial method.*

  *Note: Actuarial valuation is the process used by an actuary (expert) to estimate the present value of benefits to be paid under a retirement benefit scheme. Actuarial valuation should normally be conducted at least once in every three years. Differences arising after fresh actuary valuation should be adjusted through Profit & Loss account in the year in which fresh actuary valuation is conducted.*

- *Benefits funded through creation of a trust*

  *Amount to be contributed to the trust every year is provided through profit & loss account. The amount to be contributed is calculated by actuarial valuation.*

- *Benefits funded through a scheme administrated by the insurer*

  *The premium paid to the insurer is charged to profit & loss account. Such premium is calculated through actuarial valuation.*

*Review of Actuarial Method/Assumption*

*Any alterations in the retirement benefit costs, arising due to change in method/ assumption, are*

- *EITHER, charged to credited to profit and loss account in the year of change in accordance with Accounting Standard 5. "Prior Period and extra ordinary item and changes in accounting policies."*
- *OR, spread over a period not more than the expected remaining working lives of the participating Employees.*

*Disclosure:*

- *Method by which retirement benefit costs for the period have been defined*
- *When accounting is made as per actuarial valuation, date on which such valuation was conducted.*

***AS-17***

***SEGMENTAL REPORTING***

*A **BUSINESS SEGMENT** is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments.*

*A **GEOGRAPHICAL SEGMENT** is a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic environments.*

*The risks and returns of an enterprise are both by the geographical*

*(1) location of production or service facilities and other assets of an enterprise and*
*(2) location of its customers.*

*The definition allows geographical segments to be based on any of the two.*

*A **REPORTABLE SEGMENT** is a business segment or a geographical segment identified on the basis of foregoing definitions for which segment information is required to be disclosed by the standard.*

***ENTERPRISE REVENUE** is revenue is revenue from sales to external customers as reported in the statement of profit and loss. (i.e. Sales made to external customers by all segments)*

***SEGMENT REVENUE** is the aggregate of*

*(f) revenue directly attributable to segments*
*(g) revenue reasonably allocated to segment; and*
*(h) revenue from transactions with other segments.*

***SEGMENT EXPENSE** is the aggregate of*

*(a) operating expense directly attributable to segment*
*(b) expenses reasonably allocated to segment; and*
*(c) expenses relating to transactions with other segments.*

*However, SEGMENT REVENUE/EXPENSE does not include*

*(a) Extraordinary items as defiened in AS-5*
*(b) Interest or dividend ( including earned/incurred on loans to other segment) unless the operations of the segment are primarily of a financial nature*
*(c) Gains on sales of investments or on extinguishments of debt (Capital gain/loss) unless the operations of the segment are primarily of a financial nature.*
*(d) General administration expenses, head office expenses and other expenses that arise at the enterprise level and relate to the enterprise as a whole.*

***SEGMENT RESULT** is segment revenue less segment expenses.*

***SEGMENT ASSETS** are those operating assets that are employed by a segment in its operating activities and that either are directly attributable the segment or can be allocated to the segment on a reasonable basis.*

***SEGMENT LIABILITIES*** *are those operating liabilities that result from operating activities and that either are directly attributable the segment or can be allocated to the segment on a reasonable basis.*

*( If the segment result of a segment includes interest expense, its segment liabilities include the related interest-bearing liabilities and vice versa.)*

- ⇨ *(Segment liabilities do not include income tax liabilities and vice versa.)*

*Similarly, if depreciation segment expenses then related assets comes under segment assets.*

*Primary segment and Secondary segment*

*One among the two, Business Segment and Geographical Segment, is primary segment and other becomes secondary segment. The reporting requirements for the primary and secondary segments are different.*

*Basis for identifying primary and secondary segments*

*Risks and returns are the main criteria for identifying primary and secondary segments.*

- ⇨ *If the risks and returns of an enterprise are affected predominantly by differences in the products, business segments are recognized as primary segments and geographical segments as secondary segments and vice versa.*
- ⇨ *If the risks and returns of an enterprise are affected both by differences in the products as well as differences in the locations in which it operates, then the enterprise should use business segments as its primary segment and geographical segment as its secondary segment.*
- ⇨ *If risks and returns of an enterprise are affected neither by differences in products/services nor by differences in geographical areas of operations, the management may elect any of the two as primary with other being secondary segment.*

*(Internal organization and management structure of an enterprise and its system of internal financial reporting to the board of directors and the CEO should normally be the basis for identifying the predominant source and nature of risks and differing rates of return facing the enterprise.)*

*Reportable Segments*

*A business segment or geographical segment should be identified as reportable segment if:*

***(a) its revenue from sales to external customers and from transactions with other segments is 10% or more of the total revenue, external and internal, of all segments; or***

***(b) its segment result, whether profit or loss, is 10% or more of-***

***(1) the combined result of all segments in profit, or***

***(2) the combined result of all segments in loss,***

***whichever is greater in absolute amount; or***

***(c ) its segment assets are 10% or more of the total assets of all segments.***

*A business/reportable segment that is not a reportable segment as per above, may be recognized as reportable segment despite its size at the discretion of the management of the enterprise.*

*If total external revenue attributable to reportable segments constitutes less than 75% of the total enterprise revenue, additional segments should be identified as reportable segments, even if they do not* *meet 10% thresholds as above, until at least 75% percent of the total enterprise revenue is included in reportable segments.*

*A segment identified as a reportable segment in the immediately preceding period because it satisfied the relevant 10% thresholds should continue to be a reportable segment for the current period notwithstanding that its revenue, result, and assets no longer meet the 10% thresholds.*

*<u>Primary Reporting Format</u>*

*The following disclosures are required for each reportable segment of primary segment:*

(1) *Segment revenue, (with classification of external and internal)*
(2) *Segment result*
(3) *Total carrying amount of segment assets*
(4) *Total amount of segment liabilities*
(5) *Total cost incurred during the period to acquire segment assets*
(6) *Depreciation and amortisation recognized as expense, and*
(7) *Total non cash expenses other than Dep. And amortisation recognized as expense.*

*Disclosers required pursuant to clause (6) and (7) above, need not be made in respect of a segment, if the enterprise reports cash flows arising from operating, investing and financing activities for such segment.*

*An enterprise should present a reconciliation between the information disclosed for reportable segments and aggregated information in the enterprise financial statements (in respect of clause 1 to 4 above)*

*<u>Secondary Reporting Format</u>*

- ⇨ *<u>Where primary segments are business segments</u>*
  (1) *Segment revenue from external customers for each geographical segment whose revenue from sales to external customers is 10% or more of enterprise's revenue;*
  (2) *The total carrying amount of segment assets for each geographical segment whose segment assets is 10% or more of the total assets of all geographical segments;*
  (3) *New assets acquired for each geographical segment whose segment assets is 10% or more of the total assets of all geographical segments.*
- ⇨ *<u>Where primary segments are geographical segments based on location of assets</u>*
  *The following information (point "1" to "3")should be disclosed for each business segment whose revenue from sales to external customers is 10% or more of enterprise revenue or whose segment assets are 10% or more of the total assets of all business segments*
    (1) *segment revenue from external customers;*
    (2) *the total carrying amount of segment assets; and*
    (3) *new segment assets acquired;*
    (4) *if location of customers is different from location of its assets, then the enterprise should also report revenue from sales to external customers for each customers based geographical segment whose revenue from sales to external customers is 10% or more of enterprise revenue.*
- ⇨ *<u>Where primary segments are geographical segments based on location to customers</u>*
  *Points 1 to 3 as above.*
    (5) *If locations of assets are different from locations of customers, then the enterprise is required to report the following segment information for each asset based geographical*

*segment whose revenue from sales to external customers is 1% or more of enterprise revenue or whose segment assets are 10% or more of total enterprise assets*

I. *The total carrying amount of segment assets by geographical location of the assets; and*
II. *New segment assets acquired by location of assets.*

*Other Disclosures:*
*In measuring and reporting segment revenue from transactions with other segments, inter-segment transfers should be measured on the basis that the enterprise actually used to price those transfers. The transfer-pricing basis should be disclosed in the financial statements.*

*An enterprise should indicate the types of products and services included in each reported business segment and indicate the composition of each reported geographical segment, primary and secondary, if not otherwise disclosed in the financial statements.*

## *AS-16*
## *BORROWING COSTS*

***Applicability:*** *Mandatory for all enterprises w.e.f. 01/04/2000.*

***Borrowing Costs*** *include:*

1. *Interest and commitment charges on borrowings*
2. *Amortization of discounts or premiums relating to borrowings*
3. *Amortisation of ancillary costs incurred in connection with the arrangement of borrowings*
4. *Exchange difference arising from borrowings to the extent it amounts to interest costs.*

*Borrowing costs should be recognized as an expense in the period in which they are incurred.*

*Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of that asset.*

***Qualifying Asset** is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. e.g. Heavy Plant & Machinery.*

*BORROWING COST ELIGIBLE FOR CAPITALISATION*

*Specific Borrowing for acquisition of qualifying asset: Borrowing cost to be capitalised*

*Amount of borrowing cost = Specific Borrowing Cost – Income from temporary investment*

*General Borrowing and used for acquisition of qualifying asset: Borrowing cost should be capitalised with the following amount;*

*Amount of Borrowing Cost = Expenditure cost on asset or Asset cost * Capitalisation rate*

*Capitalisation Rate = Weighted Average Borrowing costs on general borrowing (i.e. Excluding cost of specific borrowing)*

*Note: When with the capitalization of borrowing cost, the cost exceeds the net recoverable amount, the carrying amount is written down to net recoverable amount as per the recommendation of other accounting standards.*

*COMMENCEMENT OF CAPITALISATION*

*Capitalisation of Borrowing should commence when **all** the following conditions are satisfied*

1. *Expenditure for the acquisition of a qualifying asset is being incurred*
2. *Borrowing costs are being incurred; and*
3. *Activities that are necessary to prepare the asset for its intended use or sale are in progress*

*SUSPENSION OF CAPITALISATION*

*Capitalisation of borrowing costs should be suspended during extended periods in which active development is interrupted.*

*However capitalization should not be suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.*

*Example:*

⇨ *Borrowing costs incurred while land is under development are capitalized during the period in which activities related to the development are being undertaken. However, it should not be capitalized when land acquired for building purposes is held without use.*

*<u>CESSATION OF CAPITALISATION</u>*

*Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.*

*When the construction of a qualifying asset is completed in parts*
*and a completed part is capable of being used while construction continues for the other parts,*
*capitalization of borrowing costs in relation to that part should cease*
*when substantially all the activities necessary to prepare that part for its intended use or sale are complete.*
*Example:*
*Housing complex comprising several buildings: If individual building can be used separately, its capitalisation should cease.*
*Disclosure:*

1. *The Accounting Policies adopted for borrowing costs.*
2. *The amount of borrowing costs capitalized during the period.*

*AS-18*

***RELATED PARTY DISCLOSURES***

***(revised in 2003)***

***Applicability:*** *Mandatory for all enterprises with respect from 01/04/2004*

***Related party*** *is considered to be related if <u>at any time</u> during the reporting period*

*one party has the ability to <u>control</u> the other party or exercise <u>significant influence</u> over the other party in making financial and/or operating decisions. The following related party relationship are covered under AS-18:*

1. *Enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with the reporting enterprise ( e.g. Holding companies, subsidiaries*
   *and fellow subsidiaries)*
2. *Associates and joint ventures of the reporting enterprise*
3. *Individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual;*
4. *Key management personnel and relatives of such personnel; and*
5. *Enterprises over which any person described in (4) or (5) is able to exercise significant influence.*

***Key Management Personnel***
*Those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise.*

*The following are not deemed to be related party:*

1. *Two companies simply because they have common director*
2. *A single customer/supplier with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence*
3. *Providers of finance*
4. *Trade Unions*
5. *Public Utilities*
6. *Government departments and Government sponsored bodies*

***<u>DISCLOSURE</u>***
*If there have been transactions between related parties, during the existence of a related party relationships, the reporting enterprise should disclose the followings:*

1. *Name of the transacting related party*
2. *Description of the relationship*
3. *Description of nature of transaction*
4. *Volume of transaction ( Amount wise or proportion wise)*
5. *Any other information necessary for understanding financial statements*
6. *Outstanding ( Amount wise or proportion wise) and any provision for doubtful debt due from such party*
7. *Amounts written off or written back in respect of debts due from or to related parties.*

*The followings are the examples of the related party transactions*
*Purchase or sale of goods*
*Rendering or receiving services*
*Purchases or sales of fixed assets*
*Licence agreements*

*Leasing or hire purchase agreements*
*Guarantees and collaterals*
*Management contracts including for deputation of employees.*

*AS-19*

## ***LEASES***

***Applicability:-*** *Mandatory for all enterprises w.e.f. 1.04.2001.*

*It should be applied in accounting for all leases other than:*

*a) lease agreements to explore for or use natural resources;*
*b) licensing agreements for items such as plays, manuscripts, patents and copyrights; and*
*c) lease agreements to use lands.*

***Lease :*** *A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.*
***Finance Lease :*** *All risks and rewards incident to ownership of an asset is transferred.*
***Operating Lease :*** *Lease other than finance lease; i.e. which does not transfer all the risk and reward incidental to ownership.*

***Minimum Lease Payments :***

⇨ *For lessor – Total Lease rent to be paid over the lease term*
+
*Any Guaranteed Residual Value by or on behalf of Lessee*
+
*Residual Value Guaranteed by Third Party*
*(-)*
*Contingent Rent*
*(-)*
*Cost for Service and tax to be paid by and reimbursed to lessor*

⇨ *For lessee - Total Lease rent to be paid over the lease term*
+
*Any Guaranteed Residual Value by or on behalf of Lessee*

*(-)*
*Contingent Rent*
*(-)*
*Cost for Service and tax to be paid by and reimbursed to lessor*

***Accounting for Finance Lease – In the books of lessee***

*The lessee should recognize the lease as an asset at lower of the following*

- *Fair Value of the leased asset*
- *Present value of minimum lease payments*

*(In calculating the present value of the minimum lease payments, the discount rate is the interest rate implicit in the lease. If implicit rate is not known, the lessee's incremental borrowing rate should be used.) Entry required to be passed:*

*Lease Assets A/c Dr*
*To Lessor*

*All lease payments should then be apportioned between the finance charge and the reduction of the outstanding liability. Finance charge should be debited to P&L A/c.*

*Lessor A/c Dr*
*P&L A/c Dr (With the amount of finance charge)*
*To Bank A/c (With the amount of lease payment)*

*The lessee as per AS-6 should depreciate the leased asset.*

***Accounting for Finance Lease – In the books of lessor***

*The lessor should recognize the transaction as sale with the cash price. If artificially low rates of interest are quoted, profit on sale should be restricted to that which would apply if a commercial rate of interest were charged.*
*The cost of sale recognized at the commencement of the lease term is the cost/carrying amount less the present value of the unguaranteed residual value.*

***Accounting for Operating Lease – In the books of lessee***

*Lease payments (excluding costs for services such as insurance and maintenance) are recognized as an expense in the statement of profit or loss on a straight-line basis unless another systematic basis is more appropriate.*

***Accounting for Operating Lease – In the books of lessor***

*Lease receipts are recognized as an income in the statement of profit or loss on a straight-line basis unless another systematic basis is more appropriate. The lessor should present an asset given under operating lease in its balance sheet under fixed assets.*

*Initial direct costs incurred specifically to earn revenues from an operating lease are*

- *Either, deferred and allocated to income over the lease term in proportion of income*
- *Or, recognized as an expense in the statement of current year profit and loss.*

***SALE AND LEASEBACK TRANSACTIONS***

*A sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the same asset back to the vendor.*

*If sale and leaseback transaction results in* ***finance lease:***

*Excess or deficiency of sale proceeds over the carrying amount should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset. It should not be immediately recognized as income or loss in the financial statements.*

*If sale and leaseback transaction results in* ***operating lease:***

*If the sale price is equal to fair value*

- *Any profit or loss should be recognized immediately.*

*If the sale price is below fair value*

- *Any profit or loss should be recognized immediately, except that, if the loss is compensated by future lease payments at below market price*
- *If the loss is compensated by future lease payments at below market price, the profit or loss should be deferred and amortised in proportion to the lease payments.*

*If the sale price is above fair value*

- *The excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.*

*Further, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value should be recognized immediately.*

***Disclosure Requirements:***

*In the books of lessee in case of financial lease*

1. *Assets acquired under finance lease*
2. *Reconciliation between the total of minimum lease payments and their present value as at the balance sheet date with following segregation*
   - *not later than one year*
   - *later than one year and not later than five years*
   - *later than five years*
3. *Contingent rents recognized as expense*
4. *Future minimum sublease payments expected to be received under non-cancellable subleases*
5. *General description of the leasing arrangements*

*In the books of lessor in case of financial lease*

1. *General description of the significant leasing arrangement*
2. *Accounting policy for initial direct cost*
3. *Reconciliation of total gross investment in lease and present value of minimum lease payment (MLP) receivable at the balance sheet date*
4. *MLP receivable in following categories*
   - *not later than one year*
   - *later than one year and not later than five years*
   - *later than five years*

*In the books of lessee in case of operating lease*

1. *General description of the significant leasing arrangement*
2. *Total of future minimum lease payments in the following period*
    - *not later than one year*
    - *later than one year and not later than five years*
    - *later than five years*
3. *Lease payments recognized in profit & loss account for the period*

*In the books of lessor in case of operating lease*

1. *General description of the significant leasing arrangement*
2. *Accounting policy for the initial direct payment*
3. *Future lease payments in aggregate classified as :*
    - *not later than one year*
    - *later than one year and not later than five years*
    - *later than five years*

*AS-20*
***EARNINGS PER SHARE***
*(Revised in 2004)*

***Applicability:-*** *Mandatory w.e.f. 1.04.2001 in respect of enterprises whose equity shares or potential equity shares are listed on a recognized stock exchange in India.*

*An enterprise should present BASIC & DILUTED EPS on the face of the statement of profit and loss account for each class of equity shares that has a different right to share in the net profit for the period. EPS to be calculated & presented even in case of losses.*

***Basic EPS*** = ***Net profit/loss*** *for the period attributable to equity shareholders* / *Weighted Average No. of Equity Shares*

***Diluted EPS*** =
***Adjusted Net profit/loss*** *for the period attributable to equity shareholders* / *Weighted Average No. of (Equity Shares + Dilutive Potential Equity Shares)*

*Where net profit/loss for equity shareholders = PAT less Preference Dividend including CDT*

*(Preference Dividend should be deducted whether or not provided in case of <u>Cumulative Preference Shares).</u>*

*Date from which the shares are included for calculation of weighted no. of shares:*

| | |
|---|---|
| *Equity shares issued for cash* | *Date on which cash is received* |
| *Debentures converted to cash* | *Date of conversion* |
| *Equity shares issued in exchange for settlement Of a liability* | *Date when settlement becomes effective* |
| *Equity shares issued for rendering of services* | *Date on which services are rendered* |
| *Equity Shares issued in course of Amalgamation in the nature of Purchase* | *Date of the Acquisition* |
| *Equity Shares issued in course of Amalgamation in the nature of Purchase* | *Beginning of the reporting period* |

*Partly paid equity shares are treated as a fraction of an equity share to the extent that they were entitled to participate in dividends relative to a fully paid equity shares.*
*Where an enterprise has equity shares of different nominal values but with the same dividend rights, the number of equity shares is calculated by converting all such equity shares into equivalent number of shares of the same nominal value.*

*<u>BONUS ISSUE, SHARE SPLIT, REVERSE SHARE SPLIT etc.</u>*
*In these cases, shares are issued to existing shareholders for no additional consideration. Therefore, the number of equity shares outstanding is increased without an increase in resources.*

*<u>RIGHTS ISSUE</u>*
*In rights issue, the exercise price is often less than the fair value of the shares. Therefore, a right issue generally includes a bonus element. Hence, number of equity shares to be taken for calculating Basic EPS should be:*
*Right Shares + (Equity Shares prior to right * conversion factor)*
*Where, conversion factor = <u>Fair value per share immediately prior to the exercise of rights</u>*
*Theoretical ex-rights fair value per share*
*Where, Theoretical ex-rights fair value = <u>(Fair value of Prior shares + Right Proceeds)</u>*
*Post Right total no. of equity shares*

***<u>DILUTED EARNINGS PER SHARE</u>***

***Diluted EPS =***
*<u>**Adjusted Net profit/loss** for the period attributable to equity shareholders</u>*
*Weighted Average No. of (Equity Shares + Dilutive Potential Equity Shares)*

*In calculating diluted EPS, the net profit (considered for BASIC EPS) is adjusted with the corresponding changes in profits that shall arise when dilutive potential shares are issued. For example: When debentures are converted to shares, the net profit should be added with interest amount and further adjusted with related tax expense.*

*Potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations.*

***DISCLOSURE***

- *Basic & Diluted EPS*
- *Amount used as numerator & reconciliation with PAT*
- *Number used as denominator for Basic & Diluted EPS & reconciliation thereon*
- *Nominal value of shares along with EPS figures*

## *AS – 22*
## *ACCOUNTING FOR TAXES ON INCOME*

***Applicability :-*** *a) Mandatory w.e.f. 1-04-2001 in respect of the following:*
*1.Enterprises whose equity or debt securities are listed on a recognized stock exchange in India;*
*2.All the enterprises of a group, if the parent presents consolidated financial statements.*
*b) Mandatory w.e.f. 1.04.2002, in respect of companies not covered by a);*
*c) Mandatory w.e.f. 1.04.2006 in respect of all other enterprises.*

*Accounting income (loss) is the net profit or loss for a period, as reported in the statement of profit and loss, before deducting income tax expense or adding income tax saving. (i.e. PBT as per P/L A/c)*

*Taxable income (tax loss) is the amount of income (loss) for a period, determined in accordance with the tax laws, based upon which income tax payable (recoverable) is determined. (i.e. GTI)*

*Tax expense (tax saving) is the aggregate of current tax and deferred tax charged or credited to the statement of profit and loss for the period. (i.e. tax which is to be debited or credited to P/L A/c)*

*Current tax is the amount of income tax determined to be payable (recoverable) in respect of the taxable income (tax loss) for a period. (i.e. tax as per Income tax Act)*

*Deferred tax is the tax effect of timing differences. Model journal entries to be passed in books of account should be as under:*

*Current Tax A/c ………..Dr*
*To Provision for Current Tax*

*Deferred Tax A/c ………Dr*
*To Deferred Tax Liability A/c*

*OR*

*Deferred Tax Assets A/c …….Dr*
*To Deferred Tax A/c*

*Tax Expense A/c……Dr*
*Deferred Tax A/c……Dr* *(In case DTA is created)*
*To Current Tax A/c*
*To Deferred Tax A/c* *(In case DTL is created)*

*P/L A/c………………Dr*
*To Current Tax A/c*

*<u>Permanent differences</u> are the differences between taxable income and accounting income for a period that originate in one period and do not reverse subsequently.*
*<u>Examples:</u>*

- *Expenditure disallowed as per Income Tax Act (Forever)*
- *Excess expenditure allowed by Income Tax Act, 1961 in respect of Scientific Expenditure*

*<u>Timing differences</u> are the differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods.*
*<u>Examples:</u>*

- *Depreciation rate/method different as per Accounts and Income tax Calculation*
- *Expenditure of the nature mentioned in Section 43B (e.g. sales tax charged in account on accrual basis but not paid; such sales tax will be an allowable expenditure in the year of payment and a disallowable expenditure in the year in which accrued)*

*<u>Hints for creation of DTL or DTA</u>*

*When accounting profit/ loss is higher than taxable profit/loss: Deferred Tax liability is created or Deferred tax asset is reversed.*

*When accounting profit/loss is less than taxable profit/loss: Deferred tax asset is created or Deferred Tax Liability is reversed.*

*When taxable loss is carried forward for set off: Deferred Tax Asset is created.*

*When carried forward taxable loss is set off : Deferred Tax Asset is reversed.*

*However, Deferred Tax Asset (DTA) should be recognized and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be reversed/ realized.*
*Example: Deferred Tax Asset should be created in respect of taxable loss being carried forward, when there is reasonable certainty that carried forward taxable loss will be set off. (i.e. Adequate taxable profit is expected in future)*

*The carrying amount of deferred tax assets should be reviewed at each balance sheet date. An enterprise should write down the carrying amount of deferred tax asset to the extent that it is no longer reasonably certain that sufficient profits will be available.*

*Such, written down value can be re-stated if it becomes virtually certain that sufficient profits will be available (for set off).*

*Also at each balance sheet date, an enterprise re-assesses unrecognized deferred tax assets. The enterprise recognizes previously unrecognized deferred tax assets to the extent that it has become reasonably certain that sufficient future taxable income will be available against which such deferred tax assets can be realized.*

***<u>Presentation & Disclosure</u>***

*In the Balance Sheet, a Deferred Tax Asset should be shown after the head "INVESTMENT" and Deferred Tax Liability should be shown after the head "UNSECURED LOAN".*

*Current Tax assets and liabilities should be separately shown with Deferred Tax assets and liabilities.*

*Deferred Tax asset is set-off with deferred tax liabilities when*

- *the enterprise has a legally enforceable right to set-off assets against liabilities representing current tax; and*
- *the deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the same governing taxation laws.*

*The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.*

***AS – 24***

## ***DISCONTINUING OPERATIONS***

*A **<u>discontinuing operation</u>** is a component of an enterprise:*

*(a) that the enterprise, pursuant to a **<u>single plan</u>**, is:*

- *disposing of substantially in its entirety (example – demerger)*
- *disposing of piecemeal (selling and settling assets and liabilities one by one)*
- *terminating through abandonment; and*

*(b) that represents a separate major line of business or geographical area of operations; and*

*( c) that can be distinguished operationally and for financial reporting purposes.*

*Examples of activities that may not satisfy criteria (a) above but that can be discontinuing operations in combination with other circumstances include:*

- *gradual or evolutionary phasing out of a product line or class of service;*
- *discontinuing, even if relatively abruptly, several products within an ongoing line of business;*
- *shifting of some production or marketing activities for a particular line of business from one location to another; and*
- *closing of a facility to achieve productivity improvements or other cost savings;*
- *Selling shares of subsidiary whose activities are similar to those of the parent or other subsidiaries. (In case of Consolidated Financial Statements)*

*A reportable business segment or geographical segment as defined in AS-17 would normally satisfy criteria (b) above.*

*A component that can be distinguished operationally and for financial reporting purposes {criteria [c] above} – if all the following conditions are met:*

1. *the operating assets and liabilities of the component can be directly attributed to it;*
2. *its revenue can be directly attributed to it;*
3. *at least a majority of its operating expenses can be directly attributed to it.*

***Presentation and Disclosure***

*An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs and up to and including the period in which discontinuance is completed.:*

***INITIAL DISCLOSURE:***

1. *A description of the discontinuing operation(s);*
2. *the business or geographical segment(s) in which it is reported as per AS – 17*
3. *the date and nature of the initial disclosure event;*
4. *the date or period in which the discontinuance is expected to be completed if known or determinable;*
5. *the carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;*
6. *revenue and expenses from such discontinuing operation in current reporting period;*
7. *pre-tax profit/loss from discontinuing operation during the current financial reporting period, and income tax expense.*
8. *net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.*

*With respect to a discontinuing operation, the* ***initial disclosure event*** *is the occurrence of one of the following, whichever occurs earlier*

(a) *the enterprise has entered into a binding sale agreement for substantially all of the assets of the discontinuing operation; or*
(b) *the enterprise's board of directors or similar governing body has both*
    (i) *approved a formal plan; and*

*(ii) made an announcement of the plan.*

***Other Disclosures***

*When an enterprise disposes of assets or settles liabilities attributable to a discontinuing operation or enters into binding agreements for the sale of such assets or the settlement of such liabilities, it should include, in its financial statements, the following information when the event occurs.*

*(a) Gain or loss recognized on such disposal.*
*(b) Net selling prices (or range of prices) of those assets for whih the enterprise has entered into binding contract, the expected timing of receipt of cash flow and the carrying amount of those assets.*

*The disclosures required above should be presented in the notes to the financial statements except the following, which should be shown on the face of the statements of profit or loss;*

*(a) pre-tax profit/loss from ordinary activities of discontinuing operation and related income tax expense*
*(b) pre-tax gain or loss recognized on disposal of assets or settlement of liabilities.*

*If an enterprise abandons or withdraws from a plan that was previously reported as a discontinuing operation, that fact, reason therefor and its effect should be disclosed.*

*Comparative information for prior periods in respect of discontinuing operations should also be deemed as discontinuing operations.*

## ***AS-28***
## ***IMPAIRMENT OF ASSETS***

*Impairment of Assets means weakening in the value of asset. An enterprise should assess at each balance sheet date whether there is any **indication** that an **asset** may be impaired. If any such indication exists, the enterprise should estimate the **recoverable amount** of the asset.*

***Indication of Impairment of an asset***

- ***External Sources of Information***

- *Market value has declined significantly more than that would be expected as a result of depreciation.*
- *Adverse effect on the enterprise due to change in technology, market conditions, etc.*
- *Change in interest rates.*
- *The carrying amount of the net assets of the reporting enterprise is more than its market capitalization.*

- ***Internal Sources of Information***
  - *Physical damage of asset*
  - *Significant change in style or extent of use of asset.*
  - *Internal Reporting indicates that the economic performance of an asset is, or will be, worse than expected.*

***Assets*** - ***This AS does not apply to***

1. *Inventories (AS-2)*
2. *Assets arising from Const. Contracts (AS-7)*
3. *Financial Assets including Investments (AS-13)*

   *A Financial Asset is any asset that is :-*
   - *Cash ;*
   - *A contractual right to receive cash or another financial asset from another enterprise;*
   - *A contractual right to exchange financial instruments with another enterprise under conditions that are potentially favorable; or*
   - *An ownership interest in another enterprise.*
4. *Deferred tax Asset (AS-22)*

***RECOVERABLE AMOUNT*** *: (of asset or cash generating unit)*
*HIGHER OF*
- *NET SELLING PRICE OF ASSET*
- *VALUE IN USE*

***Net Selling Price*** *: It is the amount obtainable from sale of an asset in an arm's length transaction between knowledgeable, willing parties less the costs of disposal.*

***Value in use*** *: It is the present value of estimated future Cash flow expected to arise from continue use of an asset and from its disposal at the end of its useful life.*

***Estimating the value in use of an asset involves the following steps :-***
- *Estimation of future cash inflows & Outflows.*
- *Application of appropriate discount rate.*

*Projection of cash flow should be based on*
- *Most recent financial budgets/forecasts.*
- *Reasonable and supportable assumptions on the economic conditions. Giving more weights to external evidence.*
- *Steady or declining growth rate for the period beyond the period covered by most recent budgets/forecasts.*

*Increasing growth rate can be taken when it can be properly justified. However, growth rate should not exceed the long-term average growth rate for the products/industries/countries in which the enterprise operates.*

*Future cash flows should be estimated for the asset in its current condition. Estimates of future cash flows should not include estimated future cash inflows or outflows that are expected to arise from :-*

- *a future restructuring to which an enterprise is not yet committed ; or*
- *future capital expenditure that will improve or enhance the asset in excess of its originally assessed standard of performance.*

***Estimates of future cash flows should not include*** *;*

- *Cash inflows or outflows from financing activities ; or*
- ***Income tax*** *receipts or payments.*

*Foreign Currency Future Cash Flows : Future cash flows are estimated in the currency in which they will be generated and then discounted using a discount rate appropriate for the currency. An enterprise translates the present value obtained using the exchange rate at the balance sheet date (describe in Accounting standard (AS)11, Accounting for the Effects of changes in Foreign Exchange rates, as the closing rate).*

*DISCOUNT RATE : The discount rate should be* ***PRE TAX RATE****. That reflects current market assessments of the time value of money & the risk specific to the asset.*
*As a starting point the enterprise may take into account the following rates :-*

- *Weighted average cost of capital.*
- *Market borrowing rate.*
- *Enterprises incremental Borrowing rates.*

***IMPAIRMENT LOSS***

*An Impairment Loss is the amount by which the carrying amount of an asset exceeds its recoverable amount i.e.*

*Impairment loss = Carrying amount (-) Recoverable amount.*

*An impairment loss or a revalued asset is recognized as an expense in the statement of Profit or Loss. However, an impairment loss on a revalued asset is recognized directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for the same asset.*

*When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an enterprise should recognize a liability if, and only if, that is required by another Accounting Standards.*

*Accounting entries required to be passed on recognition of Impairment loss :-*

*Impairment Loss A/c - Dr.*
*To Assets A/c.*

*P/L A/c / revaluation reserve A/c - Dr.*
*To Impairment Loss.*

*After such recognition Depreciation should be calculated prospectively considering such loss :*

*<u>CASH GENERATING UNIT</u>*

*Cash generating unit is the*
- *smallest identifiable group of assets.*
- *that generates cash inflows.*
- *That are largely independent of the cash inflows from other assets.*

*If there is any indication that an asset may be impaired, the recoverable amount should be estimated for the individual asset.*
*If it is not possible to estimate the recoverable amount of the individual asset, an enterprise should determine the recoverable amount of the cash – generating unit to which the asset belongs (the asset's cash – generating unit).*

*The recoverable amount of an individual asset cannot be determined if:*
1) *The assets value in use cannot be estimated (to be close to its net selling price) ; and*
2) *The asset does not generate cash inflow from continuing use that is largely independent from others.*

*<u>Example : -</u>*

*A bus company provides services under contract with a municipality that requires minimum service on each of five separate routes. Assets devoted to each route and the cash flows from each route can be identified separately. One of the routes operates at a significant loss.*
*Because the enterprise does not have the option to curtail any one bus route, the lowest level of identifiable cash inflows from continuing use that are largely independent of the cash inflows from other assets or group of assets is the cash inflows generated by the five routes together. <u>The cash-generating unit for each route is the bus company as a whole</u>*

*If an active market exists for the output produced by an asset or a group of asset, this asset on group of assets should be identified as a separate cash-generating unit, even if output is used internally.*
*In such case, future market price should be considered while calculating future cash inflows and cash outflows.*

*Cash – generating units should be identified consistently from period to period for the same asset or types of assets; unless a change is justified.*

*Allocation of Goodwill & Corporate Assets*

*Corporate Assets ; are assets other than goodwill that contribute to the future cash flows of both the cash generating unit under review and other cash generating units.*
*The Goodwill and Corporate Assets are allocated to cash generating unit on a Reasonable and Consistent basis to the CGU under review.*
*Then, the recoverable amount of the CGU under review is compared with the carrying amount of CGU (including allocated goodwill & corporate assets). (BOTTOM UP TEST).*

*The impairment loss should be allocated to reduce the carrying amount of the assets of the unit in the following order :*

*(a) first, to allocated goodwill, and*
*(b) then, to the other asset of the CGU on a pro-rata basis based on carrying amount of individual assets.*

*Entry to be passed :-*

*P/L A/c Dr. (with the amount of impairment loss)*
*To Goodwill (up to the allocated amount)*
*" Other Assets (on pro-rata basis)*

*The carrying amount should not be reduced below to zero. The excess loss (i.e. beyond zero) should be allocated to other assets on pro-rata basis.*
*A liability should be recognized for any remaining amount of an impairment loss for a CGU that is required by another Accounting Standard.*
*If, in performing the 'bottom up test' the enterprise could not allocate the carrying amount of goodwill/Corporate on a reasonable and consistent basis to the CGU under review, the enterprise should also perform a top-down test :- i.e.*

1) *Identify the smallest cash generating unit that includes the cash-generating unit under review and to which the carrying amount of goodwill/Corporate assets can be allocated on a reasonable and consistent basis (i.e. the large CGU is identified)*
2) *Then, compare the RA of the larger CGU with CA of larger CGU.*
   *If; CA > RA, identify impairment loss and allocate it first to goodwill and then to other assets on pro-rata basis.*

*Example – Application of the 'Bottom-Up' and 'Top-Down' Tests to Goodwill*

*In this example, tax effects are ignored.*

*At the end of 20X0, enterprise M acquired 100% of enterprise Z for Rs. 3,000 lakhs. Z has 3 cash-generating units A, B and C with net fair values of Rs. 1,200 lakhs, Rs. 800 lakhs and Rs. 400 lakhs respectively. M recognizes goodwill of rs. 600 lakhs (Rs. 3,000 lakhs less Rs. 2,400 lakhs) that relates to Z.*

*At the end of 20X4, A makes significant losses. Its recoverable amount is estimated to be Rs. 1,350 lakhs. Carrying amounts are detailed below.*

*Carrying amounts at the end of 20X4 (Amount in Rs. lakhs)*

| *End of 20X4* | *A* | *B* | *C* | *Goodwill* | *Total* |
|---|---|---|---|---|---|
| *Net carrying amount* | *1,300* | *1,200* | *800* | *120* | *3,420* |

*A-* ***Goodwill Can be Allocated on a reasonable and Consistent Basis***

*At the date of acquisition of Z, the net fair values of A, B and C are considered a reasonable basis for a pro-rata allocation of the goodwill to A, B and C.*

*Allocation of goodwill at the end of 20X4*

| | A | B | C | Total |
|---|---|---|---|---|
| *End of 20X0* | | | | |
| *Net fair values* | *1,200* | *800* | *400* | *2,400* |
| *Pro-rata* | *50%* | *33%* | *17%* | *100%* |
| *End of 20X4* | | | | |
| *Net carrying amount* | *1,300* | *1,200* | *800* | *3,300* |
| *Allocation of goodwill (using the pro-rata above)* | *60* | *40* | *20* | *120* |
| *Net carrying amount (after allocation of goodwill)* | *1,360* | *1,240* | *820* | *3,420* |

*In accordance with the 'bottom-up' test , M computes A's recoverable amount to its carrying amount after the allocation of the carrying amount of goodwill.*

| *Application of 'bottom-up' test (Amount in Rs. lakhs)* | *End of 20X4* |
|---|---|
| *Carrying amount after allocation of goodwill (Schedule 2)* | *1,360* |
| *Recoverable amount* | *1,350* |
| *Impairment loss* | *10* |

*M recognizes an impairment loss of Rs. 10 lakhs for A. The impairment loss is fully allocated to the goodwill.*

*B- **Goodwill Cannot Be Allocated on a Reasonable and Consistent Basis***

*There is no reasonable way to allocate the goodwill that arose on the acquisition of Z to A, B and C. At the end of 20X4, Z's recoverable amount is estimated to be Rs. 3,400 lakhs.*
*At the end of 20X4, M first applies the 'bottom-up' test. It compares A's recoverable amount to its carrying amount excluding the goodwill.*

*Application of 'bottom-up' test (Amount in Rs. lakhs)*

| *End of 20X4* | *A* |
|---|---|
| *Carrying amount* | *1,300* |
| *Recoverable amount* | *1,350* |
| *Impairment loss* | *0* |

*Therefore, no impairment loss is recognized for A as a result of the 'bottom-up' test.*

*Since the goodwill could not be allocated on a reasonable and consistent basis to A, M also performs a 'top-down' test. It compares the carrying amount of Z as a whole to its recoverable amount (Z as a whole is the smallest cash-generating unit that includes A and to which goodwill can be allocated on a reasonable and consistent basis).*

*Application of the 'top-down' test (Amount in Rs. lakhs)*

| End of 20X4 | A | B | C | Goodwill | Z |
|---|---|---|---|---|---|
| Carrying amount | 1,300 | 1,200 | 800 | 120 | 3,420 |
| Impairment loss arising from the 'bottom-up' test | 0 | - | - | - | 0 |
| Carrying amount after the 'bottom-up' test | 1,300 | 1,200 | 800 | 120 | 3,420 |
| Recoverable amount | | | | | 3,400 |
| Impairment loss arising from 'top-down' test | | | | | 20 |

*Therefore, M recognizes an impairment loss of Rs. 20 lakhs that it allocates fully to goodwill.*

*Reversal of an Impairment Loss*
*An enterprise should assess at each balance sheet date whether there is any indication that an impairment loss recognized in prior accounting period may no longer exist or may have decreased.*

*If any such indication exists, the enterprise should estimate the recoverable amount of that asset.*
*Indications of such change are known through External & Internal sources of information.*

*Impairment loss recognized earlier is reversed.*
*Such reversal is recognized as income in Profit/loss statement. For Revalued asset, it should be credited to revaluation reserve(As per AS-10) if earlier revaluation reserve A/c has been debited on recognition of impairment loss.*

*Reversal of an Impairment Loss for a Cash Generating Unit*

- *First, reversal should be made to increase the carrying amount of assets* ***other than goodwill; and***
- *Then, to goodwill allocated to cash generating unit.*

*Impairment in case of Discontinuing Operations*

*If the enterprise wants to sell the discontinuing operation in its entirety, then the recoverable amount for the entire unit is compared with the carrying amount of entire unit.*

*If the enterprise wants to dispose the discontinuing operation in piecemeal, then the recoverable amount of individual assets are determined and compared with carrying amount of individual assets.*

*If the enterprise abandons the discontinuing operation, the recoverable amount of individual assets are determined and compared with carrying amount of individual assets.*

***AS-29***
***PROVISIONS, CONTIGENT LIABILITIES AND CONTINGENT ASSETS***

***PROVISION****:*
*A provision is a liability which can be measured only by using a substantial degree of estimation.*

***Treatment*** *: A provision should be recognized when:*

(a) *An enterprise has a present obligation as a result of past event*
(b) *It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and*
(c) *A reliable estimate can be made of the amount of the obligation.*

***Present Obligation****: An obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered Probable, i.e. more likely than not.*

***Past Event:*** *A Past event that leads to a present obligation is called an obligating event.*

***CONTINGENT LIABILITY:***

*1] A contingent liability is*

- *A possible obligation that arises from past events*
- *And; existence of which will be confirmed by the occurrence or non occurrence of future events not wholly within the control of the enterprise*

*2] A contingent liability is*

- *A present obligation that arises from past events*
- *And; not recognized because of lower probability of outflow of resources or non-availability of reliable estimate*

***Possible Obligation****: An obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered* *Not Probable.*

***Treatment:*** *An enterprise should not recognize a contingent liability.*
*It should be disclosed in financial statements unless the possibility of outflow is remote.*

***CONTINGENT ASSETS:***

*A contingent assets is a possible asset that arises from past events of the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.*

***Treatment:*** *An enterprise should not recognize a contingent asset.*
*An enterprise should not be disclosed in financial statements.*
*It may be disclosed in the report of approving authority, where an inflow is probable.*

***Other Important Issues:***

1. *Provisioning is required for only those liabilities that exist at the balance sheet date. ( i.e. No provision is required for costs that need to be incurred to operate in future.)*
2. *Where details of a proposed new law have yet to be finalized, an obligation arises only when the legislation is virtually certain to be enacted. For example, huge penalty shall be imposed on the enterprise if the proposed law is enacted. No provisioning is required unless the virtual certainty of the enactment of the law is established.*
3. *Where there are a number of similar obligations (e.g. product warranties) the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole.*
4. *If the reliable estimate of the liability cannot be made, it should be disclosed as a contingent liability.*
5. *Where an enterprise is jointly & severally liable for an obligation:*
   - *Provision should be made for the portion on which enterprise has direct liability.*
   - *The balance amount should be disclosed as contingent liability.*
6. *Gains from the expected disposal of assets should not be taken into account in measuring a provision.*
7. *Reimbursement for expenditure of which provision is created, should be recognized when and only when it is virtually certain that the reimbursement shall be received on settlement of liability.*

   *Such Reimbursement may be shown as a net figure in Profit & Loss statement but should be presented in balance sheet as a separate asset (i.e. net provision not to be shown)*

8. *A provision should be used only for expenditures for which the provision was originally recognized. Provisions should also be reviewed at each balance sheet date and if no longer required, it should be reversed.*
9. *Provision should not be recognized for future operating losses as it neither meets the criteria of liability nor meets the criteria for recognition of provision.*

***RESTRUCTURING:***

*A restructuring is a program that is planned and controlled by management and materially changes either:*

- *(a) the scope of a business undertaken by an enterprise; or*
- *(b) the manner in which the business is expected.*

*Restructuring may include the following:*

- *(a) sale or termination of a line of business;*
- *(b) the closure of business location in a region*
- *(c) eliminating a layer of management;*

***Treatment:*** *A provision for recognition criteria is recognized only when the recognition criteria for provision is met.*

*A restructuring provision should include only the direct expenditures arising from the restructuring, which are those that are both;*

- *(a) necessarily entailed by the restructuring; and*
- *(b) not associated with the ongoing activities of the enterprise.*

*Restructuring provision does not include costs like*

- *(a) retraining or relocating continuing staff*
- *(b) marketing expenses*
- *(c) investments in new systems and distribution networks.*

*Identifiable future operating losses up to the date of a restructuring and gains on disposal of assets (even if it is included as part of restructuring) are not included in provisions.*

***DISCLOSURES:***

*The enterprise should disclose for each class of provision:*

- *(a) the carrying amount at the beginning & end of the period*
- *(b) additional provision made during the period*
- *(c) amount used during the period*
- *(d) amount reversed during the period*
- *(e) nature of obligation & and expected time of incurrence*
- *(f) indication about the uncertainties attached to the provisions*

*The enterprise should disclose for each class of contingent liabilities:*

- *(a) an estimate of its financial effects*
- *(b) an indication of the uncertainties relating to any outflow*
- *(c) the possibility of any reimbursement*

*Where any of the information required is not disclosed because it is not practicable to do so, that fact should be stated.*

*In extremely rare cases, disclosures can be expected to seriously harm the enterprise in a dispute with other parties. In such cases, instead of detailed information, general nature of dispute together with the reason of non-disclosures should be disclosed.*

***Example 1: Warranties***

*A manufacturer gives warranties et the time of sale to purchasers of its product. Under the terms of the contract for the manufacturer undertakes to make good, by repairs or replacement, manufacturer defects that become apparent within three years from the date of sale. On past experience, it is probable (i.e. more likely than not) that there will be some claims under the warranties.*

***Present obligation as a result of a past obligating even****t- The obligating event is the sale of the product with a warranty, which gives rise to an obligation*

*An outflow of resources embodying economics benefits in settlement- Probable for the warranties as a whole.*

***Conclusion*** *– A provision is recognized for the best estimate of the costs of making good under the warranty products sold before the balance sheet date.*

*Example 2 Contaminated Land- Legislation Virtually Certain to be Enacted*

*An enterprise in the oil industry causes contaminated but does not clean up because there is no legislation requiring cleaning up, and the enterprise has been contaminating land for several years. At 31 March 2005 it is virtually certain that a law requiring a clean up of land already contaminated will be enacted shortly after the year end.*

*Present obligation as a result of a past obligating event- he obligating event is the contamination of the land because of the virtually certainty of legislation requiring cleaning up.*

*An outflow of resources embodying economics benefits in settlement- Probable.*

***Conclusion*** *- A provision is recognized for the best estimate of the costs of the clean up.*

*Example 3: Offshore Oilfield*

*An enterprise operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Ninety percent of the eventual cost related to the removal of the oil rig and restoration of damage caused by building it, and ten percent arise through the extraction of oil. At the balance sheet date, the rig has been constructed but no oil has been extracted.*

*Present obligation as a result of past obligating event- The construction of the oil rig created an obligation under the terms of the license to remove the rig and restore the seabed and is thus as obligating event. At the balance sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of oil.*

*An outflow of resources embodying economics benefits in settlement- Probable.*

*Conclusion- A provision is recognized for the best estimate of ninety percent of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. There coasts are included as part of the cost of the oil rig. The ten percent of costs that arise through the extraction of oil are recognized as a liability when the oil is extracted.*

*Example 4: Refunds Policy*

*A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known.*
*Present obligation as a result of a past obligating event- The obligating event is the sale of the product, which gives rise to an obligation because obligating also arise from normal business practice, custom and a desire to a maintain good business relations or act in an equitable manner*
*Outflows of resources embodying economic benefit in settlement–Probable, a proportion of goods are returned for refund.*

***Conclusion** – A provision is recognized for the best estimate of the costs of refunds.*

*Example 5: Legal Requirement to Fit Smoke Filters*

*Under new legislation, an enterprise is required to fit smoke filters to its factories by 30 September 2005. The enterprise has not fitted the smoke filters.*

*(a) At the balance sheet date of 31 March 2005*

*Present obligation as a result of a past obligating event – There is no obligation because there is no obligating event either for the costs of fitting smoke filters or for fines under the legislation*

***Conclusion** – No provision is recognized for the cost of fitting the smoke filters.*

*(b) At the balance sheet date of 31 March 2006*

*Present obligations as a result of a past obligating event – There is still no obligation for the costs of fitting smoke filters because no obligating event has occurred (the fitting of the filters). However, an obligation might arise to pay fines o penalties under the legislation because the obligating event has occurred (the non-complaint operation of the factory).*

*An outflow of resources embodying economic benefits in settlement - Assessment of probability of incurring fines and fines and penalties by non-compliant operation depends on the details of the legislation and the stringency of the enforcement regime.*

***Conclusion*** *– No provision is recognized for the costs of fitting smoke filters. However, a provision is recognized for the best estimate of any fines and penalties that are more likely than not to be imposed.*

*Example 6: Staff retraining as a Result of Changes in the Income Tax System*

*The government introduces a number of changes to the income tax system. As a result of these changes, an enterprise in the financial services sector will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with financial services regulation. At the balance sheet date, no retraining of staff has taken place.*

*Present obligation as a result of past obligating event – There is no obligation because no obligating event (retraining) has taken place.*

*Conclusion – No provision is recognized.*

*Example 7: A Single Guarantee*

*During 2004-05, Enterprise A gives a guarantee of certain borrowing of Enterprise B, whose financial condition at that time is sound. During 2005-06, the financial condition of Enterprise B deteriorates and at 30 September 2005 Enterprise B goes into liquidation..*

*(a) At 31 March 2005*

*Present obligation as a result of a past obligating event – The obligating event is the giving of the guarantee, which gives rise to an obligation.*

*An outflow of resources embodying economics benefits in settlement – No outflow of benefits is probable at 31 March 2005.*
*Conclusion – No provision is recognized. The guarantee is disclosed as a contingent liability unless the probability of any is regarded as remote At 31 March 2006*

*Present obligation as a result of a past obligating event – The obligating event is the giving of the guarantee, which gives to a legal obligation.*

*Conclusion – A provision is recognized for the best estimate of the obligation.*
*Note: This example deals with a single guarantee. If an enterprise has a portfolio of similar guarantee, it will assess that portfolio as a whole in determining whether an outflow of resources embodying economic benefit is probable. Where an enterprise gives guarantees in exchange for a fee, revenue is recognized under AS 9, Revenue recognition.*

*Example 8: A Court Case*

*After a wedding in 2004-05, ten people died, possibly as a result of food poisoning from products sold by the enterprise. Legal proceedings are started seeking damages from the* *enterprise but it disputes liability. Up to the date of approval of the financial statements for the year 31 March 2005, the enterprise's lawyers advice that it is probable that the enterprise will not be found liable. However, when the enterprise prepares the financial statements for the year 31 March 2006, its lawyer's advice that, owing to developments in the case, it is probable that the enterprise will be found liable.*

*(a) At 31 March 2005*

*Present obligation as a result of a past obligating event – On the basis of the evidence available when the financial statements were approved, there is no present obligation as a result of past events.*
*Conclusion – No provision is recognized. The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote*

*(b) At 31 March 2006*

*Present obligation as a result of a past obligating event – On the basis of the evidence available, there is a present obligation.*
*An outflow of resources embodying economic benefits in settlement – Probable.*

***Conclusion** – A provision is recognized for the best estimate of the amount to settle the obligation.*

*Example 9A: Refurbishment Costs – No Legislative Requirement*

*A furnace has a lining that needs to be replaced every five years for technical reasons. At the balance sheet date, the lining has been in use for three years.*
*Present obligation as a result of a past obligating event- There is no present obligation.*
*Conclusion – No provision is recognized.*

*The cost of replacing the lining is not recognized because, at the balance sheet date, no obligation to replace the lining exits independently of the company's future actions – even the intention to incur the expenditure depends on the company deciding to continue operating the furnace or to replace the lining.*

*Example 9B: Refurbishment Costs – Legislative Requirement*

*An Airline is required by law to overhaul its aircraft once every three years.*

*Present obligation as a result of a past obligating event – There is no present obligation.*
*Conclusion – No provision is recognized.*

*The costs of overhauling aircraft are not recognized as a provision for the same reason as the cost of replacing the lining is not recognized as a provision in example 9A. Even a legal requirement to overhaul does not make the cost of the overhaul a liability, because no obligation exits to overhaul the aircraft independently of the enterprise's future actions – the enterprise could avoid the future expenditure by its future actions, for example by selling the aircraft.*