Accounting for Borrowing Cost
AS – 16

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Applicability of Nature

- ***Applicable*** ***01.04.2000 onwards***
- ***Nature*** ***Mandatory (Compulsory)***

Objective

The main objective of the statement is only to prescribe accounting principles for the accounting of borrowings cost. In addition, it is clearly specify that AS – 16 is not related with cost of Equity shares or Pref shares but only related to borrowing of funds.

Meaning of Borrowing Cost

Borrowing Cost is the interest and other cost which is incurred by an enterprise in relation to borrowing of funds.

The following points should be considered for the purpose of borrowing cost:-

A. ***Interest on short term loans or long term debts should be included as a part of borrowing cost.***

B. ***If any enterprise has incurred ancillary cost (related) for the arrangement of funds than amortized part of such cost should also be included as a part of borrowing cost. (V. Imp)***
For example:- Brokerage, commission, stamp duty charges and any other related cost.

$$\text{Amortized Cost} = \frac{\text{Total Cost}}{\text{Usages Am. During the year}}$$

C. ***Discounts / Premiums which are incurred by an enterprise in relation to arrangement of fund, such amount should not be taken in total but amortised part of Discount & Premium should be included as a part of borrowing cost. (V.V. Imp)***

On the basis of above explanation, premium is also considerable for the purpose of borrowing cost. Such premium can be taken as a part of exp only if it is related to Redemption of funds because premium related to receipt of securities should be considered as Reserve & Surplus not as an exp.

D. ***Amount of Interest should also be included as a part of borrowing cost which is paid or payable for finance lease agreement (AS – 19).***

E. ***Exchange Diff related to Foreign Currency Loans.(AS – 11)***

Meaning of Qualifying Assets

Qualifying assets are those that take substantial period of time to keep ready for use or sale. As per Accounting Standard Interpretation No. 1, substantial period of time is the period of 12 months. But longer period or short term period than specified period may also be considerable as per the interpretation issued by Institute. On the basis of interpretation, it can be said that a fixed period is not explained by interpretation but reasonable judgment based on circumstances should be applied.

The following are the examples of Qualifying Assets.

i). Fixed assets can be taken in the definition of Qualifying assets if these assets are taking substantial period to get ready for the purpose of use.

ii). Investments:– As per AS – 16, Investment can also be recognized as Qualifying assets only if the investments are taking substantial period of time to get ready for the purpose of use or sale on the basis of such explanation only investment properties can be included under the heading of Qualifying assets because condition of substantial period can be satisfied only be these investments.

Investment in shares or debentures can not be recognized as Qualifying assets because conditions of substantial period is not applicable on securities.

iii). Stocks:– Inventories can also be Qualifying assets only if conditions of substantial is satisfied. Regular inventories should not be recognized as qualifying assets because there is no connection between regular inventory and substantial period.

Recognition

As per AS – 16, amount of borrowing cost should be recorded or recognized in the financial statement as follows:-

a). if any borrowing cost is incurred for qualifying assets than amount of borrowing cost should be capitalized in the cost of Q.A.
b) if any borrowing cost is not having any connection with Q.A. than such amount should be transfer to P/L a/c as an exp.

The following journal entries may be considerable:-

Normal Borrowing Cost	Borrowing Cost related to Q.A.
Interest A/c Dr. To Bank To O/s Interest	Same
P/L A/c Dr. To Interest	Q.A. Dr. To Interest

Conditions of AS – 16

As per AS – 16, there are three situations or conditions which are specified in relation to capitalization of borrowing cost.

A. *Commencement of Capitalization*
B. *Suspension of Capitalization*
C. *Cessation of Capitalization*

A. Commencement of Capitalization

As per the provision of accounting standard, any enterprise can capitalized it's borrowing cost only if the following three conditions are satisfied.

(i). Expenditure should be incurred – As per the statement if any enterprise wants to capitalized borrowing cost than it is very necessary that all the borrowed funds have been incurred for Q.A. If any amount is still pending for expenditure purpose out of borrowing funds than the pending amount will not be considered for capitalization purposes.

(ii). Interest cost should be actual – As per the statement borrowing cost can not be capitalized on assumption basis but it should be payable on actual basis outside the enterprise.

(iii). Activities should be continued which are required to complete the production, construction, acquisition of Q.A.

****As per the statement activities may be in the nature of physical or administrative but activities should be related to completion of Q.A.***

B. Suspension

If any enterprise has discontinued the necessary activities then capitalization of borrowing cost can not be made from the date of discontinuation of required activities. Such period of discontinuation should be recognized as Suspension period.

Exception:** **If any stoppage of necessary activities is of temporary in nature then such stoppage can not be covered under suspension of capitalization of borrowing cost. Temporary reason means the enterprises is having proper judgment about continuation of discontinued activities.

Note:- Borrowing cost which are related to the suspension period should be transferred to P/L a/c as an exp.

Borrowing cost can be capitalized from the date from which the necessary activities are continued after discontinuation.

C. Cessation

As per Accounting Standard, borrowing cost can be capitalized in the cost of Q.A. till the date of completion of construction, acquisition or production. It can be also said that if any assets is ready for use or sale, no capitalization can be made after the date of specified purpose of use or sale.

If any Q.A. is completed in parts then it will be recognized that the completed part are dependent or independent from the point of view of their use or sale. The following points may be considerable in relation to capitalization of borrowing cost of specified parts.

a. ***If any part of asset is completed first without completion of others then borrowing cost related to such part should be transferred to P/L a/c if the completed part is independent from the point of view of use or sale.***
b. ***If any part of assets is completed first without completion of others than borrowing cost related to such part can be capitalized only if such part is dependent on others from the point of view of use or sale.***

Important points to be considered

1. *If any enterprise has to recognize any Govt grant in relation to construction, production or acquisition of Q.A. then expenditure on Q.A. will be calculated after deducting such grant out of total expenditure.*
2. *If any enterprise has received any progress payment in relation to completion of Q.A. then such progress payment should be adjusted for the calculation of exp incurred.*
3. *As per AS 19, if any enterprise has earned temporary income by investment of unused borrowed funds that amount of temporary income should be adjusted against total borrowing cost and only thereafter principals of recognition should be applied.*

Types of Borrowing (Imp for Practical Ques.)

Two types of borrowing are specified in the statement as follows:-

a. *Specific Borrowing*
b. *General Borrowing*

***a. Specific Borrowing:-** If any enterprise can recognize direct relationship between Qualifying assets and amount of loan then the situation will be covered under the heading of specific borrowing. In such case the entire borrowing cost can be capitalized to the related assets.*

Exp (1). A ltd has taken Rs. 5,00,000/- for the construction of building for interest rate 10% and the loan was taken in the beginning of the year. The company has to repay the entire amount of loan after 5 years on the date of arrangement of fund the company has incurred Rs. 20,000/- as commission and Rs. 10,000/- as agreement charges. Calculate borrowing cost for the 1st year and also pass journal entries assuming that the entire amount of loan has been incurred during the period.

Ans:-

W.N.1 Calculation of borrowing cost

Interest	=	5,00,000 x 10%	=	50,000
Other Cost (Amortized Part)				
→ Commission (20,000/5)			=	4,000
→ Agreement Charges (10,000/5)			=	2,000
				$\boxed{56,000}$

Journal Entries

1)	Comm A/c	Dr.	20,000	
	Agreement Charges	Dr.	10,000	
	To Bank			30,000
2)	Int A/c	Dr.	50,000	
	To Bank			50,000
3)	Building A/c	Dr.	56,000	
	To Interest			50,000
	To Comm. Exp			4,000
	To A/c Charges Exp.			2,000

Comment: - In the given example there is direct relationship between loan & building. So the entire borrowing cost should be capitalized to the cost of building as per the provisions of AS – 16 as specified in the situation of specific borrowings.

Exp (2) With the help of given information in above exp, calculate amount of capitalization in case the enterprise has incurred Rs. 30,000/- out of the borrowed funds.

Ans:- ***<u>Statement showing capitalized ratio</u>***

Total Borrowing Cost (as calculated above)	=	***56,000***
a) Borrowing cost for exp incurred (56,000 / 5,00,000 X 3,00,000)	=	***33,600***
b) Borrowing cost for pending amount (56,000 / 5,00,000 X 2,00,000)	=	***22,400***

Journal Entries

1)	***Comm A/c***	***Dr.***	***20,000***	
	Agreement Charges	***Dr.***	***10,000***	
	To Bank			***30,000***
2)	***Int A/c***	***Dr.***	***50,000***	
	To Bank			***50,000***
3)	***Building A/c***	***Dr.***	***33,600***	
	P/L A/c	***Dr***	***22,400***	
	To Interest			***50,000***
	To Comm. Exp			***4,000***
	To A/c Charges Exp.			***2,000***

Comments:- In the given example the total borrowing cost can not be capitalized because the enterprise has not incurred entire amount of borrowed funds. So we have capitalized personate borrowing cost with reference to exp incurred to borrowed funds.

<u>b.</u> <u>General Borrowings</u>

In case of General Borrowings there will be no direct relationship between qualifying assets and borrowed funds. In case of general borrowings, there may be more than one Q.A. or more than one type of loan.

In such case capitalization of borrowing cost should be made in the ratio od exp incurred on Q.A.

Exp (3) A Ltd has taken Rs. 10,00,000/- @ 15% in the beginning of the year for the construction of building. In addition to above loan, the company has taken multiple borrowings as follows-

a) 10% Debentures 5,00,000
b) 20% Term Loan 10,00,000
c) 15% Other Loans 5,00,000

The above funds have been utilized by the company in the following assets.

1)	*Building*	*25,00,000*
2)	*Furniture*	*10,00,000*
3)	*Plant*	*40,00,000*
4)	*Factory Shed*	*15,00,000*

Calculate borrowing cost and also passed journal entries related to the situation.

Ans:

W.N.1:-Calculation of borrowing cost (specific)

Loan related to building	*10,00,000*
% of interest	*15%*
Interest Cost	*1,50,000*

W.N.2:-Calculation of borrowing cost (general

a) Debentures (5,00,000 x 10%)	*50,000*
b) Term Loan (10,00,000 x 20%)	*2,00,000*
c) Other Loan (5,00,000 x 15%)	*75,000*
	3,25,000

Treatment of Borrowings

A) Specific Borrowings cost

Borrowing cost of Rs. 1,50,000 which is directly related to building should be capitalized to the cost because it is clearly specified in the provisions of AS-16 that specific borrowing cost should be capitalized to the specific assets.

B) General Borrowing cost

As per the provisions AS, general borrowing cost should be allocated over Q.A. in the ratio of expenditure incurred the following statement should be prepared.

Statement showing allocation of General Borrowing Cost

Assets	*Expenses Incurred*	*Share in Borrowing Cost*
Building	*15,00,000 (10,00,000 specific Cost)*	*3,25,000 x 10/80 = 60,937*
Furniture	*10,00,000*	*3,25,000 x 10/80 = 40,625*
Plant	*40,00,000*	*3,25,000 x 40/80 = 1,62,500*
Factory Shed	*15,00,000*	*3,25,000 x 15/80 = 60,938*
		3,25,000

Ques 6

As per the provisions of As – 16, Q.A. is the assets that takes substantial period of time to get ready for the intended use or sale.

The following assets are covered in the definition of Q.A.

a) *Fixed Assets*
b) *Investment Properties*
c) *Inventories*

On the basis of above explanation, it is clearly specified that investment properties are covered but other investments are not covered in the definition of Q.A.

In the above example R Ltd has invested in shares which are not covered in the meaning of Qualifying Assets.

So interest can't be capitalized in the cost of shares because AS – 16, is not applicable on shares. On the basis of above explanations resolution of Director's of R Ltd is totally incorrect.

Ques 3

As per the Provisions of AS – 16, Borrowing cost can be capitalized till the date of completion of work of Q.A. No other interest or other cost can be capitalized after the date on which Q.A. is ready for use or sale.

In the given example captive power plant is already used for commercial production. It means that Q.A. is already in use for the business activities and definations of Q.A. are not applicable on the used assets.

On the basis of above explanantions the arguments of managements is totally incorrect. Borrowing cost related to the power plant should be transferred to profit & Loss A/c in place of capitalization.

Ques 2

Interest = Rs. 22,00,000 X 12%
= Rs. 2,64,000

Note on Exp: - As per AS – 16, Expenditure should be incurred out of borrowed funds for the purpose of capitalization of borrowing cost. Further expenditure shall include payment in cash for qualifying assets or use of assets which are held by the enterprise internally and not purchased from outside.

In the Ques 2, expenditure incurred shall include both the amounts of cash payments as well as transfer of assets.

Statement showing allocation of Interest over the Phases

Particulars	*Expenditure*	*Share in the Borrowing Cost Interest = 2,64,000*
Phase I	*10,00,000*	*97,778*
Phase II	*9,00,000*	*88,000*
Phase III	*8,00,000*	*78,222*
		2,64,000

Treatment of Borrowing cost

(i) Phase II & III are still in progress and not ready for use or sale. So borrowing cost related to these parts should be capitalized till the date of completion. Borrowing cost of Rs. 88,000 and of Rs. 78,222 should be capitalized in the cost of Phase II & III respectively.

(ii) As per question specification phase I is complete. So borrowing cost related to Phase I should not be capitalized but to be transferred to P & L A/c.

Assumptions

a) Date of completion of Phase I is not mentioned in the question. So we have assumed that date of completion of respective part is the first day in the beginning of year. Alternative assumption can also be taken.

b) We have also assumed that completed part is independent in nature.

Ques 8

(i) We have assumed that accounting year is calendar year.

(ii) We have also assumed that related expenses are given on amortised basis because period of use of borrowing is not mentioned in the question.

Working Notes

(i) ***Calculation of Specific borrowing cost***

Interest on 10 % Term Loan = 200 x 10/100	*= 15 Lakh*
Add : - Related Expenses	*= 2 Lakh*
	17 Lakh

(ii) ***Calculation of General borrowing cost***

Interest on 15 % Debentures = 400 x 15/100	*= 60 Lakh*
Interest on 12 % Term Loan = 300 x 15/100 x 2/12	*= 6 Lakh*
Add : - Related Expenses (1 Lakh + 2.5 Lakh)	*= 3.50 Lakh*
	69.50 Lakh

Treatment of Borrowing Cost

Specific Borrowing Cost: - Borrowing cost of Rs. 17 Lakh should be capitalized to the cost of plant & machinery because 10 % Term Loan is directly related with Plant & Machinery.

General Borrowing Cost: - As per AS – 16, General Borrowing cost should be allocated over qualifying assets in the ratio of expenditure. For the application for such provisions the following Statement will be considered.

Statement showing allocation of general Borrowing Cost

Factory Shed	*100 Lakh*	*1/9*	*7.72 Lakh*
Plant	*700 Lakh (900-200)*	*7/9*	*54.05 Lakh*
Other Fixed Assets	*100 Lakh*	*1/9*	*7.72 Lakh*
			69.50 Lakh

Ques 9

(i) In the given question, amount of general borrowing cost is higher than expenditure incurred on qualifying asset. So full capitalization will not be allowed but proportionate capitalization according to the expenditure should be made.

(ii) General Borrowing cost related to unused borrowed funds should be transferred to P&L A/c.

Working Note

Statement showing calculation of General Borrowing Cost

Total General Borrowing Cost = 28 Lakh + 36 Lakh = 64 Lakh

(a) General Borrowing Cost related to expenditure = 64 Lakh x 400 / 500 = 57.20 Lakh

(b) General Borrowing Cost related to unused amount = 64 Lakh x 100 / 500 = 12.80 Lakh

Capital A/c = Part (a)
P&L A/c = Part (b)

Statement showing allocation of G.B. Cost

Plant	200 Lakh	25.60 Lakh
Internal Road	100 Lakh	12.80 Lakh
Plant II	100 Lakh	12.80 Lakh
	400 Lakh	51.20 Lakh

Comment: - Borrowing cost related to 16% Secured Loan should be capitalized directly to the cost of factory building.

Ques 10

As per AS – 16, Qualifying Asset are those assets which are related to substantial period of time for their completion for the purpose of use of sale. On the basis of such explanation, Inventories can also be covered in the definition of Qualifying Assets. In addition it is also considerable that such inventories should take substantial period of time to get ready for the purpose of sale.

In the given situation, the sugar company has already produced sugar and the specified items are ready for sale. So the produced inventories can't be covered in the meaning of Q.A.

As per the provisions of AS – 16, Interest can be capitalized only if it is related with expenditure on Q.A. So the company can't capitalize to the cost of inventories because the provision of AS – 16, are not applicable on the given situation.

Ques 13
Statement showing Calculation of cost of Asset

Period	Op. WIP	New Exp	Amount of Loans	B. Cost	Cl. WIP
I	----	100 Lakh	60 Lakh	7.20 Lakh	107.20 Lakh
II	107.20 Lakh	100 Lakh	120 Lakh	14.40 Lakh	221.60 Lakh
III	221.60 Lakh	80 Lakh	160 Lakh	19.20 Lakh	320.80 Lakh
IV	320.80 Lakh	60 Lakh	200 Lakh	24.00 Lakh	404.80 Lakh
V	404.80 Lakh	50 Lakh	230 Lakh	26.00 Lakh	482.40 Lakh

Assumption: - In the given ques, date of borrowing is not specified. So we have assumed that borrowings are made by enterprise in the beginning of year.

Ques 1

W.N.1
(i) Calculation of expenditure incurred till 31-03-2001

Op. WIP (450 Lakh + 24 Lakh) on 01-04-2000	=	474 Lakh
Add: Expenditure during the Period		
In Cash		78 Lakh

In Asset	***100 Lakh***
Less: Progress payment Received	***(300 Lakh)***
Total Cost	***352 Lakh***

(ii) Statement showing Capitalization of Borrowing cost

Expenditure incurred till 31-03-2001			=	***352 Lakh***
Total Borrowing till 31-03-2001		=	***400 Lakh***	
Total Borrowing cost (400 x 12 %)		=	***48 Lakh***	
Capitalization of Borrowing Cost	=	***48 x 352/400***	=	***42.24 Lakh***
Expenses of Borrowing Cost	=	***48 x 48/400***	=	***5.76 Lakh***

Notes

(i) As per the provisions of AS – 16, if any progress payment or Govt grants is recognized by the enterprises during the period then the recognized amount should be deducted out of expenditure incurred.

(ii) In the given question date of progress payment is not specified. So we have assumed that date of progress payment is the first day of financial year.

(iii) In the given question, interest of current year is clearly specified of Rs. 48 Lakh. Such amount is calculated on the amount of borrowing of Rs. 400 Lakh @ 12%. It means that interest of previous year has already been paid and not included in the amount of borrowings. So assumptions of outstanding interest will be totally incorrect.

Ques 4

In the given example, there are multiple assets which are purchased out of single borrowed fund. It means that situation will be covered under the heading of General Borrowing and ratio of expenditure should be applied for the allocation of General Borrowing Cost.

Statement showing Allocation of General Borrowing Cost

Building	***120 Lakh***	***10.80 Lakh***
Plant	***350 Lakh***	***31.50 Lakh***
Capital WIP	***70 Lakh***	***6.30 Lakh***
Working Capital	***110 Lakh***	***9.90 Lakh***
	650 Lakh	

Treatment: -

(a) Interest of Rs. 10.80 Lakh and 31.50 Lakh should be capitalized in the cost of building and plant respectively. Because these assets are ready for use at the end of the year.

(b) Interest of Rs. 6.30 Lakh should be also be capitalized in the name of Capital WIP because advance payment for installation of plant has been made and it can be assumed that administrative activities which are required to complete have been in progress.

(c) Working capital is not qualifying asset so interest related to working capital should be transferred to P&L a/c.

Note: ***Wherever in any ques there is difference in the amount of expenditure as well as period of progress then gross borrowing cost should not be allocated in the ratio of expenditure but the following steps should be applied.***

Step1:

First of all average capitalization rate should be calculated on average basis.

$$\textit{Capitalization rate} = \frac{\textit{Total Borrowing cost}}{\textit{Total used amount during the period}} \times 100$$

Step 2:

After calculation of capitalization rate, such rate should be applied on the expenditure of qualifying assets directly with reference to period of construction or progress.

Ques 14

W.N.1 Calculation of Capitalization rate

Total used amount during the period

18%	***Bank Loan***	=	***1000 x 12/12***	=	***1000***
14%	***Debenture***	=	***2000 x 6/12***	=	***1000***
16%	***Term Loan***	=	***3000 x 9/12***	=	***2250***
					4250

$$\textit{Capitalization Rate} = \left(\frac{180 + 140 + 360}{4250}\right) \times 100$$

Statement showing allocation of Gross Borrowing Cost

Factory Shed	***2500 x 16% x 12/12***	=	***400.00***
Plant I	***1500 x 16% x 9/12***	=	***180.00***
Plant II	***1000 x 16% x 7/12***	=	***93.33***
Total Capitalized Cost			***673.33***

Comment:

Total Borrowing cost is of Rs. 680 but cost can be capitalized to the extent of Rs. 673.33 as per above statement. Difference between total cost and capitalized amount should be transferred to P&L a/c because expenditure is lower than total borrowings.

Disclosures: ***(Notes to Account)***

1. ***Accounting policy should be disclosed separately.***
2. ***Amount of borrowing cost which is capitalized during the period should be disclosed separately.***

Difference between AS – 16, IAS – 23 and US GAAP – 34

Difference between the three Statement is not important because such difference is not related to accounting of borrowing cost but it is related to disclosure only.

1. ***As per IAS – 23, amount of interest expense which is capitalized or not capitalized during the period should be disclosed separately.***
2. ***As per US GAAP – 34, amount of capitalization is not required but capitalization rate should be disclosed separately.***
3. ***As per AS – 16, if any interest cost is not capitalized during the period then no disclosure will be required. It means that disclosure requirements are applicable only if capitalization of borrowing cost has been made during the period.***

Earning Per Share (EPS)
AS – 20

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Applicability of Nature

- ***Applicable*** — ***01.04.2001 onwards***
- ***Nature*** — ***Mandatory for Level I Enterprises***

**** As per the provisions of AS, if any enterprise calculates EPS which is not covered under mandatory requirements then provisions of AS – 20 should be applied as mandatory requirements on the basis of above explanations, it can be said that calculation of EPS can be made only by the provisions of AS – 20.***

Objective

The main objective of the AS is only to prescribe principles in relation to Calculation & Disclosures of Earning per Share. Such calculation & Disclosures shall improve the comparison of the performance of two different period of the enterprise.

Types of EPS & Important Points

(i) ***Types of EPS: -*** ***As per AS two types of EPS should be calculated as follows: -***
(a) Basic EPS
(b) Diluted EPS

(ii) ***Important Points***
a. ***Calculation of EPS should be made even if enterprise is having NIL earning or Negative earning. It means that level of earning is totally is immaterial for the purpose of EPS calculation otherwise objective of comparison will not be fulfill.***
b. ***Calculation of EPS (Basic & Diluted) should be made with equal prominence.***

Basic Earning per Share

$$\textit{Basic EPS} = \frac{\textit{Earning Available for Equity Shareholders}}{\textit{Weighted Avg. No of Shares}}$$

Meaning of Earning
Earning for Equity Share holders should be calculated & disclosed by a separate working note as follows.

Statement showing Earning

All Incomes (Total)	***xxxx***
Less: All Expenses (Excluding tax)	***xxxx***
PBT	***xxxx***
Less: Income Tax	***xxxx***
PAT	***xxxx***
Less: Pref Dividend + CDT	***xxxx***
Earning for Equity Shareholders	***xxxx***

While preparing income statement for the purpose of earning calculation, the following important points should be considered.
(i) ***Any transferred to mandatory reserve or non mandatory reserve should not be deducted out of earning for the purpose of Basic EPS is calculated from the point of view of total earning.***

(ii) ***If any prior period item is recorded in the accounting records of the current year then such prior period should be taken as a part of basic earning of current year. Such item can not be excluded in the calculation of Basic EPS.***

(iii) ***If any extra ordinary activity has been occurred during the period & also included in the financial statements then such extra ordinary amount should also be included as a part of basic earning of the current period.***

(iv) ***Pref Dividend:- Preference Dividend of every year should be deducted out of profit after tax if such dividend is related cumulative preference shares whether declared by the company or not. But in case of non-cumulative shares dividend can be deducted only if declared by the company.***

(v) ***If any company is having outstanding of previous years on cumulative preference shares then such outstanding amount should not be deducted in the calculation of basic earning of current year. Because dividend on preference shares are provided out of earning on current year basis.***

Weighted Average No. of Shares = No. of Shares o/s during the period X Period of outstanding of Shares

Ex 1. Calculate weighted average of shares assuming accounting year is calendar year.

Op. Balance	=	***1,00,000 Shares***	***(01-01-2005)***
New Issue	=	***50,000 Shares***	***(01-08-2005)***

Ans: Alternative I

a) Opening Balance	=	***1,00,000 x 12/12***	=	***1,00,000***
b) New Issue	=	***50,000 x 5/12***	=	***20,833***
				1,20,833

Alternative II

a) 01-01-2005 to 01-08-2005	=	***1,00,000 x 7/12***	=	***58,333***
b) 01-08-2005 to 31-12-2005	=	***1,50,000 x 5/12***	=	***62,500***
				1,20,833

Ex 2.

Accounting year	-	***Calendar year***
Opening Bal. (01-01-06)	-	***10,000 Shares***
New Issue (01-04-06)	-	***2,000 Shares***
Profit after tax	-	***Rs. 1,00,000***
10% Preference Shares	-	***Rs. 2,00,000***
Transferred to General Reserve	-	***Rs. 20,000***

Calculate Basic EPS.

Ans: W.N.1 Calculation of Basic Earning

Profit after Tax	***1,00,000***
Less: Pref Dividend	***(20,000)***
Basic Earning	***80,000***

W.N.2 Calculation of Weighted Avg. No of Shares

01-01-2006 to 01-04-2006	=	***10,000 x 3/12***	=	***2,500***
01-04-2006 to 31-12-2006	=	***12,000 x 9/12***	=	***9,000***

11,500

Buy Back of Shares

In the situation of buy back shares, weighted average no of shares shall reduce with reference to date of Buy back.

Ex 3.	***Accounting year***	***-***	***Calendar year***
	Opening Bal. (01-01-07)	***-***	***5,00,000 Shares***
	New Issue (01-04-06)	***-***	***1,00,000 Shares***
	Buy back	***-***	***50,000 Shares***
	Basic Earning	***-***	***Rs. 40,00,000***

Calculate Basic EPS.

Ans: W.N. Calculation of Weighted Avg. No of Shares

01-01-2007 to 01-04-2007	***=***	***5,00,000 x 3/12***	***=***	***1,25,000***
01-04-2007 to 01-08-2007	***=***	***6,00,000 x 4/12***	***=***	***2,00,000***
01-08-2007 to 31-12-2007	***=***	***5,50,000 x 5/12***	***=***	***2,29,167***
				5,54,167

Basic EPS $= \frac{4,00,0000}{5,54,167}$ ***X 7.22***

Amalgamation

If any company has issued new equity shares for business taken over then weighted avg of new issue should be calculated with reference to nature of amalgamation. The following points may be considerable.

(i) Amalgamation in the nature of Purchase: - If any business taken over is in the nature of purchase then new issue share should be taken as normal issue & to be taken in the weighted avg calculation with reference to date of issue.

(ii) Amalgamation in the nature of Merger: - If any business taken over is in the nature of merger then new issue of shares should not be included in the weighted avg with reference to date but it will be assumed that new issue of shares was made in the beginning of the year. The main reason of the specified provision is only taking over the reserve & surplus of Vendor Company by purchasing company. The following equation should be applied for the purpose of basic earning calculation of purchasing company.

Calculation of Basic Earning (Purchasing Co.)

	Purchasing Company profit during the period	***xxxxx***
Add:	***Profits of vendor Company of current year***	***xxxxx***
	Basic Earning	***xxxxx***

Ex 4.	***Accounting year***	***-***	***Calendar year***
	Opening Bal. A Ltd (01-01-06)	***-***	***2,00,000 Shares***
	Basic Earning	***-***	***Rs. 20,00,000***
	Opening Bal. B Ltd (01-01-06)	***-***	***1,00,000 Shares***
	Profits of B Ltd (01-06-06)	***-***	***Rs. 4,00,000***

On 01-07-2006 A Ltd has taken over business of B Ltd. Purchase consideration was satisfied by purchasing co. by issue 1 equity share of B Ltd.

Calculate Basic EPS in both the situations of merger & Purchase.

Sol: Purchase

W.N.1 Weighted Average Calculation

(01-01-06 to 30-06-06) 2,00,000 x 6/12 = 1,00,000/-

(01-07-06 to 31-12-06) 2,50,000 x 6/12 = 1,25,000/-
2,25,000/-

Basic EPS $= \frac{20,00,000}{2,25,000} = 8.89/-$

Merger
Basic EPS $= \frac{20,00,000 + 4,00,000}{2,00,000 + 50,000} = 9.60/-$

Ques 4

W.N.1 ***Calculation of No. of shares to be issued by A Ltd***

Value of Business of B Ltd (200 x 30) = 6000 Lakh

Value per share of Purchasing Co. = 120/-

No of shares new issue = 50 Lakh

Purchase

Weighted Average Calculation

(01-04-01 to 01-10-01) 500 x 6/12 = 250/-
(01-10-01 to 31-03-02) 550 x 6/12 = 275/-
525/-

Basic EPS $= \frac{1,200}{525} = 2.29/-$

Merger
Basic EPS $= \frac{1200 + 350}{500 + 50} = 2.82/-$

Partly Paid up Shares

The following steps should be applying situation of partly paid up shares.

***Step1:** First of all, all the shares should be converted into equal basis.*

***Step2:** After calculating equal shares equal EPS should be calculated but after calculation of weighted average no of shares with reference to period of investment.*

$$\text{Equal EPS} = \frac{\text{Basic Earning}}{\text{Weighted Avg of Equal Shares}}$$

***Step 3:** After calculating equal EPS, reconversion according to paid up value of such EPS should be made.*

Example: *Accounting Year is calendar year.*

Op. Bal (01-01-2006) = 10,000 shares @ 10 fully paid up
10,000 shares @ 10 but 8 paid up

Basic Earning = 1,80,0000

Calculate Basic EPS.

Sol.

W.N.1 ***Calculation of Equal Shares (All Shares = 10/-)***

(a)	*10000 x 10/10*	=	*10,000 Shares*
(b)	*10000 x 8/10*	=	*8,000 Shares*
			18,000 Shares

Basic EPS = 1,80,000 / 18,000 = Rs 10/-

Statement showing Reconversion

(a)	*Rs 10 paid up*	=	*10 x 10 / 10*	=	*Rs 10/-*
(b)	*Rs 8 Paid up*	=	*10 x 8/10*	=	*Rs 8/-*

Example: *Accounting Year is calendar year.*

Op. Bal (01-01-2006) = 10,000 shares @ 100 each

New Issue (01-07-2006) = 5,000 shares @ 100, 50 paid up

Basic Earning = 20,00,0000

Calculate Basic EPS.

Sol:

W.N.1 ***Calculation of Equal Shares (All Shares = 10/-)***

(a)	*10000 x 100 / 100*	=	*10,000 Shares*
(b)	*5000 x 50 / 100*	=	*2,500 Shares*
			12,500 Shares

W.N. 2 ***Weighted Average Calculation***

(01-01-06 to 01-07-06)	*10,000 x 6/12*	=	*5,000/-*
(01-07-06 to 31-12-06)	*12,500 x 6/12*	=	*6,250/-*
			11,250/-

Basic EPS = 20,00,000 / 11,250 = Rs 177.78/-

Statement showing Reconversion

(a)	*Rs 100 paid up*	=	*177.78 x 100 / 100*	=	*Rs 177.78/-*
(b)	*Rs 50 Paid up*	=	*177.78 x 50 / 100*	=	*Rs 88.89/-*

Different Nominal Values (Same Dividend Rights)

If any company is having different face value of different no of shares then calculation of EPS will be same as in case of different paid up values.

All the steps should be applied as it is which are specified under the heading of partly paid up shares.

Example: *Accounting Year is calendar year.*

Op. Bal (01-01-2006) = 10,000 shares @ 100 each

15,000 shares @ 80 each

20,000 shares @ 50 each

Basic Earning = 22,00,0000

Calculate basic EPS assuming that same dividend rights are specified for all the same.

Sol.

W.N.1 Calculation of Equal Shares (All shares 100/-)

(a)	***Rs. 100***	***=***	***10000 x 100 / 100***	***=***	***10,000 Shares***
(b)	***Rs. 80***	***=***	***15000 x 80 / 100***	***=***	***12,000 Shares***
(c)	***Rs 50***	***=***	***20000 x 50 / 100***	***=***	***10,000 Shares***
					32,000 Shares

Equal Basic EPS = 22,00,000 / 32,000 = 68.75/-

Statement showing Reconversion

(a)	***Rs 100 Paid up***	***=***	***68.75 x 100 / 100***	***=***	***Rs 68.75/-***
(b)	***Rs 80 Paid up***	***=***	***68.75 x 80 / 100***	***=***	***Rs 55/-***
(c)	***Rs 50 Paid up***	***=***	***68.75 x 50 / 100***	***=***	***Rs 34.37/-***

Different Nominal value (Different Dividend Rights)

If any company is having different nominal values with different dividend rights then the following points may be considerable.

1) ***Calculation of weighted average no. of shares will be same as in above example.***
2) ***In addition to weighted average, equal basic earning should also be calculated by deducting extra dividend out of total earning.***
3) ***Equal EPS should be calculated on the basis of equal basic earning and thereafter reconversion of equal EPS should be made.***
4) ***Extra dividend per share should be added additionally to the reconverted EPS for the purpose for class wise basic EPS.***

Example Accounting Year is calendar year.

Op. Bal	***=***	***1,00,000 shares @ 10 each***	
		2,00,000 shares @ 5 each	
		5,00,000 shares @ 1 each	
Basic Earning		***=***	***50,00,0000***

Calculate basic EPS on the assumption that 5% dividend is payable on 1 Lakh shares additionally in compare to normal rate.

Sol.

W.N.1 Calculation of Equal Shares (All shares 10/-)

(a)	***Rs. 10***	***=***	***100000 x 10 / 10***	***=***	***1,00,000 Shares***
(b)	***Rs. 5***	***=***	***200000 x 5 / 10***	***=***	***1,00,000 Shares***
(c)	***Rs. 1***	***=***	***500000 x 1 / 10***	***=***	***50,000 Shares***
					2,50,000 Shares

W.N.2

	Basic Earning	***=***	***50,00,000***
Less:	***Extra Dividend (1,00,000 x 5%)***	***=***	***50,000***
			49,50,000

Equal Basic EPS = 49,50,000 / 2,50,000 = 19.80/-

Statement showing Reconversion

(a)	*Rs 10 Paid up*	=	*19.80 x 10 / 10*	=	*Rs 19.80/-*
(b)	*Rs 5 Paid up*	=	*19.80 x 5 / 10*	=	*Rs 9.90/-*
(c)	*Rs 1 Paid up*	=	*19.80 x 1 / 10*	=	*Rs 1.98/-*

Statement showing total Basic EPS

	Normal EPS	Extra Dividend per share	Total EPS
a)	*19.80*	*0.50 (50,000/1,00,000)*	*20.30/-*
b)	*9.90*	-	*9.90/-*
c)	*1.98*	-	*1.98/-*

Ques 7

Calculation of Equal EPS

Rs. 10	=	*2,00,00,000 x 10 / 25*	=	*80,00,000*
Rs. 25	=	*1,00,00,000 x 25 / 25*	=	*1,00,00,000*
Rs. 5	=	*6,00,00,000 x 5 / 25*	=	*1,20,00,000*
				3,00,00,000

Basic EPS = 15,00,00,000 / 3,00,00,000

Statement showing Reconversion

(a)	*Rs 10 Paid up*	=	*5 x 10 / 25*	=	*Rs 2/-*
(b)	*Rs 25 Paid up*	=	*5 x 25 / 25*	=	*Rs 5/-*
(c)	*Rs 5 Paid up*	=	*5 x 5 / 25*	=	*Rs 1/-*

Ques 8

W.N.1 ***Calculation of Equal Shares***

Class A	=	*2,00,00,000 x 10 / 25*	=	*80,00,000*
Class B	=	*1,00,00,000 x 25 / 25*	=	*1,00,00,000*
Class C	=	*6,00,00,000 x 5 / 25*	=	*1,20,00,000*
				3,00,00,000

Calculation of Equal Earning

Basic Earning	=	*15,00,00,000*
Less: Extra Dividend		
Class B (1,00,00,000 x 25 x 1%)	=	*25,00,000*
Class C (6,00,00,000 x 5 x 2%)	=	*60,00,000*
		14,15,00,000

Equal Basic EPS = 14,15,00,000 / 3,00,00,000 = 4.72/-

Statement showing Reconversion

(a)	*Rs 10 Paid up*	=	*4.72 x 10 / 25*	=	*Rs 1.89/-*
(b)	*Rs 25 Paid up*	=	*4.72 x 25 / 25*	=	*Rs 4.72/-*
(c)	*Rs 5 Paid up*	=	*4.72 x 5 / 25*	=	*Rs 0.94/-*

Statement showing total Basic EPS

	Normal EPS	Extra Dividend per share	Total EPS
Class A	*1.89*	-	*1.89/-*
Class B	*4.72*	*0.25 (25,00,000 /1,00,00,000)*	*4.97/-*
Class C	*0.94*	*0.10 (60,00,000 /6,00,00,000)*	*1.04/-*

Ques 17

W.N.1		***Calculation of Equal Shares (All shares 10/-)***			
(a)	***Rs. 5***	***=***	***1,00,000 x 5 / 10***	***=***	***50,000 Shares***
(b)	***Rs. 2***	***=***	***1,00,000 x 2 / 10***	***=***	***20,000 Shares***
(c)	***Rs. 3***	***=***	***1,00,000 x 3 / 10***	***=***	***30,000 Shares***

W.N. 2 ***Weighted Average Calculation***

(01-04-01 to 01-07-01)	***5,00,000 x 3 / 12***	***=***	***1,25,000***
(01-07-01 to 30-09-01)	***5,50,000 x 3 / 12***	***=***	***1,37,500***
(01-10-01 to 31-12-01)	***5,70,000 x 3 / 12***	***=***	***1,42,500***
(01-01-02 to 31-03-02)	***6,00,000 x 3 / 12***	***=***	***1,50,000***

Ques 18

Statement showing calculation of Equal Shares on the basis of Class 'A' Shares

Class A		***1,00,000***
Class B	***30,000 x 3 / 2***	***45,000***
Class C	***30,000 x 5 / 2***	***75,000***
Class D	***40,000 x 3 / 1***	***1,20,000***
		3,40,000

Basic EPS equal = 8,00,000 / 3,40,000 = 2.35/-

Statement showing Reconversion

Class A		***=***	***Rs 2.35/-***
Class B	***2.35 x 3 / 2***	***=***	***Rs 3.53/-***
Class C	***2.35 x 5 / 2***	***=***	***Rs 5.87/-***
Class D	***2.35 x 3 / 1***	***=***	***Rs 7.05/-***

Comment: As per AS – 20, Basic earning per share in the situation of Different nominal values should be calculated by calculation of Equal Shares, Equal EPS, Reconversion of EPS.

In the given situation the company has not followed the specified steps which are mentioned in the accounting standard because profits are distributed between the shares on the basis of assumed ratio on any basis in place of specified provisions.

On the basis of above explanation, it can be said that EPS calculation is totally incorrect as per the provisions.

Ques 5

Calculation of Equal Shares (All Rs. 10 base)

a)	***Capital of Rs 99,00,000***	***=***	***99,00,000 / 10 =***		***9,90,000 shares***
b)	***Call in Arrears Rs 50,000***	***=***		***=***	***50,000 shares***
c)	***New shares (partly)***	***=***	***75,00,000 / 10 =***		***7,50,000 shares***
d)	***Call in Arrears Rs 50,000***	***=***		***=***	***50,000 shares***

Weighted Average Calculation

01-04-2000 to 01-06-2000	***=***	***9,90,000 x 2 / 12***	***=***	***1,65,000***
01-06-2000 to 01-10-2000	***=***	***9,95,000 x 4 / 12***	***=***	***3,31,667***
01-10-2000 to 01-03-2001	***=***	***17,45,000 x 5 / 12***	***=***	***7,27,083***

01-03-2001 to 31-03-2001	=	*17,50,000 x 1 / 12*	=	*1,45,833*
				13,69,583

Calculation of Basic Earning

	EBIT	*2,62,00,000*	
Less:	*Interest*		*-*
	EBT	*2,62,00,000*	
Adjustment of Extra ordinary items		*(2,00,000)*	
Tax Provision		*(30,00,000)*	
	EAT	*2,30,00,000*	
Less:	*Preference Dividend*		
	(20,00,000 x 10 % x 9 /12)	*1,50,000*	
	Dividend Distribution Tax (1,50,000 x 10%)		*15,000*
		2,28,35,000	

Basic EPS = 2,28,35,000 / 13,69,583 = 16.67/-

Note on Preference Dividend: Preference shares were issued by company on 1st July. So we have considered preference dividend only for 9 months.

Bonus Shares

If any company has given bonus shares to its shareholders out of accumulated profit, then no weighted average should be applied on these shares but it will be assumed that bonus shares were outstanding in the beginning of year as opening balance.

As per Company Act 1956, Bonus shares should be given out of accumulated profit first and only thereafter the current profit can be used. It means that opening amount of reserve and surplus can be assumed under the heading of share capital.

Example:	*Accounting year is current year*	
	Profit (98-99)	*Rs 20,00,000/-*
	Op balance of shares	*10,000 shares of Rs 100 each*
	Bonus Issue during the the period (01-07-98)	*1 : 1*

Calculate Basic EPS for current year.

Sol:

$$\text{Basic EPS} = \frac{20,00,000}{(10,000 + 10,000)}$$

Restatement of Basic EPS of previous year

As per AS – 20, if any company has made bonus issue during the period, then it is very necessary to adjust Basic EPS of previous year assuming that these bonus shares were also outstanding in the beginning of previous year.

The main reason of the specified provision is only to complete comparison of two years performance.

Ques 10

Basic EPS of 2001

Basic Earning	***Rs 60,00,000/-***
No of shares (20,00,000 + 40,00,000)	***60,00,000***

$$\text{Basic EPS} = \frac{60,00,000}{60,00,000} = \text{Rs } 1.00$$

Restatement of EPS (2000)

Basic Earning	***Rs 18,00,000/-***
No of shares (20,00,000 + 40,00,000)	***60,00,000***

$$\text{Basic EPS} = \frac{18,00,000}{60,00,000} = \text{Rs } 0.30$$

Ques 2

W.N.1 Weighted Average Calculation (Year 2000)

01-01-2000 to 01-03-2000	=	*33,00,000 x 2 / 12*	=	*5,50,000*
01-03-2000 to 01-04-2000	=	*34,00,000 x 1 / 12*	=	*2,83,333*
01-04-2000 to 01-06-2000	=	*36,00,000 x 2 / 12*	=	*6,00,000*
01-06-2001 to 31-12-2000	=	*46,00,000 x 7 / 12*	=	*26,83,333*
				41,16,666

Notes on Share Warrants: No. of shares of share warrants should not be included in the calculation of weighted average because date of conversion of share warrants is not related to current year.

W.N.2 Calculation of Basic Earning

	Net Income	*1,14,00,000*
Less:	*Interest (1,00,00,000 x 12% x 3 / 12)*	*3,00,000*
Less:	*Pref. Dividend*	
	a) 1,00,000 x 12 (p.a.)	*12,00,000*
	b) 5,00,000 x 3 (per quarter completed)	*15,00,000*
	Basic Earning	*84,00,000*

Basic EPS = 84,00,000 / 41,16,666 = 2.04

Notes:

1. Income tax rate is not specified in the question so we have ignored amount of income tax.

2. CDT on preference dividend is also not specified in the question so we have also ignored amount of CDT.

3. Payment of Preference Dividend is to be made on quarter basis. So we have calculated dividend of 1st quarter on 5,00,000 shares.

Right Shares

As per AS – 20, if any company has made right issue then following required steps should be applied.

Step1: First of all, Ex-theoretical right price should be calculated.

Ex price = No of share before Right Issue X Mkt price per share before Right Issue + No of Right X Right Price

Total no of Shares (Original + Right)

Step 2: ***After calculating Right Price, calculate Right Adjustment Factor (R.A. Factor)***

R.A. Factor = Market Price before Right issue / Ex Right Price

Step 3: ***Value of R.A. factor should be applied on no of shares according to the period which were outstanding before right issue. Such working is specified by the AS only to exclude variation of investment amount of the shareholders in the company because investment was higher before right issue due to higher market price in compare to ex-theoretical price.***

Ex: ***Accounting year is Calendar year.***

Op Bal	***(01-01-06)***	***=***	***100000 shares***
Right Issue	***(01-07-06)***	***=***	***50000 shares***
Right price offered		***=***	***Rs 50/-***
Mkt price on the date of right issue		***=***	***Rs 80/-***

Calculate weighted average no of shares.

Ans:

W.N.1 ***Calculation of Ex Right price = $\frac{100000 \times 80 + 50000 \times 50}{100000 + 50000}$ = Rs 70/-***

W.N.2 ***Calculation of R.A. Factor = 80 / 70 = 1.14%***

Statement showing Weighted Average

01-01-2006 to 01-07-2006	***=***	***100000 x 1.14 x 6 / 12***	***=***	***57000 Shares***
01-07-2006 to 31-12-2006	***=***	***150000 x 6 / 12***	***=***	***75000 Shares***
				132000 Shares

Note: Application of R.A. Factor should be made only on no of shares which were outstanding before right issue because variation of investment can be analyzed only before right issue. After right issue all the shares should be classified of equal shares and no variation after right issue can be analyzed.

Ques 12

W.N.1 ***Calculation of Ex price = $\frac{500000 \times 21 + 100000 \times 15}{600000}$ = Rs 20/-***

W.N.2 ***Calculation of R.A. Factor = 21 / 20 = 1.05%***

Statement showing Weighted Average

01-01-2001 to 01-03-2001	***=***	***500000 x 1.05 x 2 / 12***	***=***	***87500 Shares***
01-04-2001 to 31-12-2001	***=***	***600000 x 10 / 12***	***=***	***500000 Shares***
				587500 Shares

Basic EPS = 15,00,000 / 587500 = Rs 2.55/-

Restatement of EPS under Right Issue

As per the provisions every company shall restate EPS of previous year in the situation of right issue because it is assumed by the statement market price before right issue was also same in the previous year.

By such assumption variation in investment shall also arise in the previous year. So no of shares should be adjusted by RA factor to exclude variations in investment.

Basic EPS in 2000 (Original)	*=*	*11,00,000 / 500000*
		Rs 2.20/-
Basic EPS (re-stated)	*=*	*11,00,000 / (500000 x 1.05)*
		Rs 2.09/-

<u>Diluted Earning Per Share</u>

<u>Meaning of EPS</u>

Diluted EPS is calculated only for potential equity shares. As per AS, Potential Equity Shares are those shares which are not existing equity shares but expected equity shares on balance sheet date.

These expected shares should be analyzed out of convertible items such as convertible debentures, preference shares, ESOP or any other similar item of convertible nature.

The following equation should be applied for the calculation of diluted EPS:-
Diluted EPS = Adjusted Basic Earning / Adjusted no of shares

<u>Calculation of Adjusted no of shares</u>

	Weighted Average (used in Basic EPS)	*xxxx*
Add:	*Increase in shares due to converted debentures*	*xxxx*
Add:	*Increase in shares due to converted Pref. shares*	*xxxx*
Add:	*Increase in shares due to ESOP*	*<u>xxxx</u>*
	Adjusted No of Shares	*<u>XXX</u>*

<u>Calculation of Basic Earning (Adjusted)</u>

	Basic Earning (used in Basic EPS)	*xxxx*	
Add:	*Saving in Interest (Net of Tax)*	*xxxx*	
Add:	*Saving in Pref. Dividend & Corporate Dividend Tax*		*<u>xxxx</u>*
	Adjusted Basic Earning	*<u>XXX</u>*	

Note: Diluted EPS is calculated only to analyze maximum reduction in Basic EPS on the assumption of conversion of all potential shares.

If any calculated amount is higher than the Basic EPS, such amount should be recognized as Anti-Diluted EPS. (As per the provisions of AS 20, disclosure of Anti Diluted EPS is not required)

Ex	*Basic Earning*	*Rs 2,00,000*	
	No of Shares	*20000 Shares*	
	Basic EPS	*Rs 10/-*	

10% Convertible Debentures (Rs 100 each)	*Rs 10,00,000*
Conversion Ratio	*1 debenture into 5 equity shares*
Tax rate	*30%*

Calculate Diluted EPS.

Sol.

	Adjusted Earning		Adjusted Shares
Basic Earning	***2,00,000***	***Weighted Average***	***20000***
Add: Interest		***Add: Increase***	
(10 Lakh x 10%)	***1,00,000***	***(10000 x 5)***	***50000***
Less: Tax on Int saving	***(30,000)***		
	2,70,000		***70000***

Diluted EPS = 2,70,000 / 70000
= Rs 3.86/-

Ex. ***Basic Earning*** ***Rs 5,00,000***
Weighted Average ***50000 Shares***
Basic EPS ***Rs 10/-***

20% Pref. Shares of Rs 100 each(Convertible) ***Rs 20,00,000***
Conversion Ratio ***1 Pref Share into 2 Equity Shares***
CDT Rate ***10%***
Sol.

	Adjusted Earning		Adjusted Shares
Basic Earning	***5,00,000***	***Weighted Average***	***50000***
Add: Saving in		***Add: Increase***	
Pref Dividend	***4,00,000***	***(20000 x 2)***	***40000***
Add: Saving in CDT	***40,000***		
	9,40,000		***90000***

Diluted EPS = 9,40,000 / 90000 = Rs 10.44/-

Comment: In the given example calculated EPS can't be defined as Diluted EPS because such EPS is higher than basic EPS. Disclosure of such EPS should not be made.

<u>Multiple Potential Shares</u>

It may be possible that company is having multiple potential shares which are outstanding on balance sheet date. In such case the following steps should be applied.

Step1: First of all incremental EPS should be calculated for every type of potential shares.

Step2: After calculating incremental EPS, ranks should be provided to every EPS on lower to higher basis.

Step3: Adjustment in earning and shares should be made rank wise and diluted EPS should be calculated on every step of adjustment.

Ex. ***Basic EPS*** ***Rs 4/-***
Basic Earning ***Rs 4,00,000***
No of shares ***1,00,000 shares***

a) 10% Convertible Debentures of Rs 100 each = Rs 10,00,000
b) 15% Convertible Pref Shares of Rs 100 each = Rs 15,00,000
Calculate Diluted EPS assuming 1 Pref share and 1 Debenture are convertible into 2 Equity shares.

Sol.
W.N.1 Calculation of Incremental EPS

a)	*Debenture*	=	*1,00,000 / 20000*	=	*Rs 5/-*
b)	*Pref Share*	=	*2,25,000 / 30000*	=	*Rs 7.5/-*

Statement showing Diluted EPS

Particulars	*Adjusted Basic Earning*	*Adjusted Shares*	*Diluted EPS*
Basic Earning & Shares	*4,00,000*	*100000*	*4*
Add: Debenture	*1,00,000*	*20000*	
	5,00,000	*120000*	*4.16*

Comment: As per AS disclosure of Anti Diluted EPS is not required so complete calculation of anti diluted EPS should not be made.

Employee Stock Option Plan (ESOP)

If any company is having ESOP which are outstanding on Balance Sheet date then following steps should be applied for the purpose of diluted EPS calculation.

Step1: First of all % of discount should be calculated by the difference of offered price and market price on balance sheet.

% of Discount = (Market Price – Offered Price) / Market Price x 100

Step2: % of discount should be applied on total no of shares covered by ESOP for the purpose of free shares.

Free Shares = ESOP x % of Discount

Step3: Due to free shares there will be no increase in the earning but no of shares will only be increased. It means that incremental EPS for these shares will always be zero.

Incremental EPS = Saving due to free shares / Free Shares

Note: Incremental EPS for the ESOP will be always be zero due to which these shares will always be 100% Diluted.

Ques 20

W.N.1	*% of Discount*	=	*(20-15) / 20*	=	*25%*
W.N.2	*Free Shares*	=	*100000 x 25%*	=	*25000 shares*

Calculation of Shares

		Earning	*Shares*	*EPS*
	Basic	*12,00,000*	*500000*	*2.40*
Add:	*ESOP*	*0*	*25000*	*0*

	12,00,000	*525000*	*2.29*

Ques 21

W.N.1 Calculation of Incremental EPS

(a)	***Pref Share***	***=***	***64,00,000 / 16,00,000***	***=***	***Rs 4/-***	***Rank I***
(b)	***Debentures***	***=***	***12,00,000 / 4,00,000 x 70%***	***=***	***Rs 2.10***	***Rank II***
(c)	***ESOP***	***=***	***0 / 20000***	***=***	***Rs 0***	***Rank III***

Calculation of Diluted EPS

Particulars	***Earning***	***Share***	***EPS***
Basic	***1,00,00,000***	***20,00,000***	***Rs 5.00***
ESOP	***0***	***20,000***	
	1,00,00,000	***20,20,000***	***Rs 4.95***
Debentures	***8,40,000***	***4,00,000***	
	1,08,40,000	***24,20,000***	***Rs 4.48***
Pref. Shares	***64,00,000***	***16,00,000***	
	1,72,40,000	***40,20,000***	***Rs 4.29***

Comment: Maximum reduction in basic EPS is calculated after adjustment of Pref shares. Diluted EPS of Rs 4.29 should be disclosed because provisions of AS – 20 requires maximum reduction in basic EPS.

Ques 28

W.N.1 Ex-price = (10,00,000 x 25 + 2,50,000 x 20) / 12,50,000
= Rs 24

W.N.2 R.A. Factor = 25 / 24 = 1.04

W.N.3 Weighted Average calculation

01-01-2003 to 31-03-03	***=***	***10,00,000 x 1.04 x 3 / 12***	***=***	***2,60,000***
01-04-2003 to 31-12-03	***=***	***12,50,000 x 9 / 12***	***=***	***9,37,500***
				11,97,500

Basic EPS (2003) = 30,00,000 / 11,97,500 = Rs 2.51

Basic EPS (2002 Restated) = 20,00,000 / (10,00,000 x 1.040 = Rs 1.92

Ques 27

As per the provisions of AS – 20, if any company has issued bonus shares during the period then no weighted average with reference to date of issue is recognized because it is the assumption of AS that these shares are always issued out of old profits.

In addition to above provisions, basic EPS of previous years should also be restated by assuming that these bonus shares were also outstanding in the previous year.

In given situation, company has calculated accurate basic EPS of current year but basic EPS of previous year is not adjusted by the company as per the specified.

On the basis of above explanation basic EPS for the year ending 31-03-2003 should be adjusted by bonus issue. After such adjustment it will be Rs 4.25 per share (Rs 8.50 crore / 2 crore Shares).

Ques 28

In the given situation is having negative profit. As per the provisions of AS – 20, basic EPS and diluted EPS should be calculated equal prominence irrespective of level of earning so calculation of diluted EPS should be made as follows:

W.N.1 ***Calculation of Free Shares***

Free Shares = (100-60) x 400 shares / 100 = 160 Shares

	Earning	Shares	EPS
Basic EPS	***(12,00,000)***	***2000***	***(600)***
ESOP	***0***	***160***	
	(12,00,000	***2160***	***(555.56) [Anti Diluted]***

Comment: In the above statement basic EPS as well as diluted EPS are calculated by the available information. Diluted EPS should not be disclosed in the financial statements because it is Anti diluted. The calculated amount is the reduction in loss not in profits.

Ques 25

As per the provisions of AS – 20, Diluted EPS is calculated for all potential equity shares outstanding on the date of Balance sheet. Period of conversion of the potential equity shares is totally immaterial.

In the given situation, the company has ignored the total option but considered only vested options. Treatment of the company is not accurate as per the provisions.

On the basis of above discussion the company should include total options in the calculation of diluted EPS.

Ques 23

W.N.1 ***Calculation of Incremental EPS***

	Saving	Shares	EPS	
Pref. Share	***950***	***600***	***1.58***	***III***
Debentures	***1845***	***2000***	***0.92***	***II***
ESOP	***0***	***25***	***0***	***I***

Calculation of Diluted EPS

	Earning	Share	EPS	
Basic	***1500***	***1000***	***1.5***	
ESOP	***0***	***25***		
	1500	***1025***	***1.46***	
Debenture	***1845***	***2000***		
	3345	***3025***	***1.11***	
Pref.	***950***	***600***		
	4295	***3625***	***1.18***	***Anti Diluted***

Ques 15

As per the provisions of AS – 20, Basic EPS should be calculated with reference to basic earning and weighted average no of shares.

Further basic earning should not be effected by transfer to reserve because requirement of AS is related to disclosure of earning not the available distribution of amount.

In the given situation the company has transferred appropriate amount to sinking fund which is a mandatory reserve as per section 117C of Companies Act 1956. Such matter is not relevant for the purpose of basic EPS because such transfer is also to be included as a part of shareholders fund after redemption of debentures.

On the basis of above explanation, transfer to sinking fund should not be deducted out of basic earning for the purpose of basic EPS.

Applicability of AS - 20

If any company is required to present information in part IV of Schedule VI then calculation of EPS will be mandatory and all the provisions of AS should be applied even if the company is not covered under the heading of Level 1 Enterprise.

Construction Contracts
AS – 7

Contents

- *Applicability & Nature*
- *Meaning of Construction Contracts*
- *Types of Contracts*
- *Contracts Revenue & Expenses*
- *Recognition Principles*
- *Para 22, 23*
- *Para 31, 35*
- *Disclosures*
- *Differences*

Applicability & Nature

Applicable : 01-04-2001
Nature : Mandatory for Contractors only

Meaning of Construction Contracts

As per AS Construction means formation of asset or group of assets which are inter related. For example construction of Building, Dam, Bridges, Roads, or any other similar assets.

As per AS the following additional points should also be considered for the understanding of meaning of construction.

(i) If any agreement has been entered into between the parties for formation or demolition of old assets then such agreement should also be covered in the meaning of construction contract.

(ii) If any contract has been entered into between the parties in relation to formation of design & specification, then such agreement should also be recognized as Construction Contract.

(The main objective of AS is to distribute the total contract price over the life of contract on accrual basis.)

Types of Contract

Fixed Price Contracts ***Cost Plus Contracts***

<u>Meaning of Fixed Price Contracts</u>

Under Fixed Price Contracts, Price of Construction is decided between Contractor & Customer on the date of agreement. It means that selling price of contractor is fixed which is to be compared with actual cost & difference will be loss or profit of the contractor.

<u>Meaning of Cost Plus Contract</u>

If any situation of construction can't be estimated by the contractor for the purpose of Fixed Price then Cost Plus Contract can take place under these contracts. Total cost is incurred by Contractor and Contractor receives a fixed percentage (%) of profit (Comm.) on the basis of cost incurred.

Contractor Profit = Total Cost Incurred x % of profit

There will be no loss to the contractor under Cost Plus Contract. (Recognition principles of AS are not applicable on Cost Plus Contract because objective of AS is to distribute total contract price over the life of contract and there is no contract price under these types of contract.)

<u>Contract Revenue & Expenditure</u>

<u>Revenue:</u>

<u>Fixed Price Contract</u>

Contract Price		***xxx***
Claims	***xxx***	
Incentive	***xxx***	
Cost Escalation	***xxx***	
Less: Penalties		***xxx***
Total Revenue	***xxx***	

<u>Cost Plus Contract</u>

% of Profit on Cost		***xxx***
Claims	***xxx***	
Incentive	***xxx***	
Less: Penalties		***xxx***
Total Revenue		***xxx***

<u>Meaning of Claim</u>

If any customer makes any default in providing necessary designs, guidance or other specification due to which extra cost is paid by contractor then such extra cost can be recovered by contractor from customer as per agreement. Such recovery of extra cost should be recognized as inflow for contractor in the name of claim.

<u>Meaning of Incentive</u>

If any customer has paid extra amount in addition to contract price for the performance of Contractor then extra payment should be recorded in the books of Contractor as additional inflow.

<u>Meaning of Cost Escalation</u>

It may be possible that prices of material & wages are expected to increase in future on the date of agreement. In such situation recovery of increased cost may be possible by cost escalation clause. The recovered cost should be recorded in the credit side of the P&L a\c as an income.

<u>Penalties</u>

Amount of penalties are decided between the penalties only to complete the work during specified period. If any delay in completion of work takes place the amount of penalty should be deducted out of contract price. Amount of penalty can be decided on per day basis, weak basis or month basis.

Contract Expenses

Direct Expenses ***Common Expenses*** ***Specific Expenses***

Direct Expenses

If any expenditure is directly related to a contract then amount of related expenses should be debited to the related contract. Direct expenses may include Direct material, Direct wages, Depreciation on plant, Hire charges for the plant or any other similar cost.

Common Expenses

If any expenditure is incurred by contractor on behalf of all the contracts then such common expenses should be divided between the contracts on some reasonable basis.

Specific Expenditure

If any expenditure is incurred by contractor as per the requirement of customer in relation to a particular contract then the required cost should be allocated to the related contract.

Recognition Principles

As per AS, Recognition Principles are based on existence or non-existence of 'Outcome'. If Outcome is available, accounting should be made as per Para 22, 23 otherwise Para 31 will be applicable. The following conditions should be satisfied to prove the existence of Outcome.

(i) ***Contract price should be available.***
(ii) ***Actual cost during the period should also be available.***
(iii) ***Estimated cost to complete the contract should also be available.***
(iv) ***Ultimate collection from customer should also be certain.***

Para 22, 23

If any contractor is having existence of outcome, completion method can be applied for accounting purpose.

Step 1: ***First of all, % of completion of contract should be calculated.***

$$\% \text{ of Completion} = \frac{\text{Actual cost during the period}}{\text{Total Estimated Cost}} \times 100$$

Step 2: ***% of completion should be applied on total contract price for calculation of Revenue Recognition.***

$$\text{Revenue} = \text{Contract Price} \times \% \text{ of Completion}$$

Exception: There may be difference between calculated completion & physical completion. In such situation amount of revenue should be recognized as per Surveyor certificate.

Para 31

If any company or contractor is not having required information for completion method then income should be recognized equal to expenses. In such case no profit or loss will be recognized.

Para 35

Para 35 is not related to income recognition. Such provision is applicable only if total estimation cost is higher than contract price. In such situation provisions should be created for the expected loss from the contract on the date of higher estimation.

<u>Change in Estimation</u>

As per AS total estimated cost or contract price can be changed over the construction period. In such situation, adjustments should be made on prospective basis as per provisions of AS – 5, Changes in Estimates.

<u>Ques 1</u> ***Contract Price = 900 Cr***

Other information

	I	II	III
Actual Cost during the period (Cumulative)	***161***	***574***	***820***
Total Estimated Cost	***805***	***820***	***-***
Increase in Contract Price	***-***	***20***	***-***

Calculate Amount of Profit or Loss over construction period assuming that contract is completed in 3rd year.

Sol: Period I

W.N. <u>Calculation of % of completion</u>

% of Completion = 161 Cr / 805 Cr

<u>Income Recognition (Profit/Loss)</u>

Contract Price (900 x 20%)	***=***	***180 Cr***
Less: Expense	***=***	***161 Cr***
		19 Cr

<u>Period II</u>

% of Completion = 574/820 X 100= 70%

<u>Income Recognition (Profit/Loss)</u>

Contract Price (920 x 70%-180)	***=***	***464 Cr***	
Less: Exp of Current Year (574-161)		***=***	***413 Cr***
		51 Cr	

<u>Period III</u>

Contract Price		***=***	***920 Cr***
Less: Total Contract Price (Already recognized)	***=***	***644 Cr***	
		276 Cr	
Less: Exp of 3rd year (820-574)	***=***	***246 Cr***	
		30 Cr	

<u>Disclosures</u>

(i) Accounting policies should be disclosed separately

(ii) Classification of contract under the heading of fixed price and cost plus contracts should also be made separately.

(iii) ***As per AS difference between actual sale & billing amount should be disclosed separately in Balance sheet.***
(iv) ***Difference between billed and cash received should also be disclosed separately. (Such difference can also be recognized as retention money)***

Ques 2 ***Contract Price = 5 Lakh***

Additional information (in Lakh)

	I	II	III
Cumulative cost (actual)	***1.50***	***3.60***	***4.05***
Estimated Cost (further)	***3.00***	***0.40***	***-***
Billed Amount (Respective)	***1.00***	***3.70***	***0.30***
Collection Amount (Respective)	***0.75***	***3.00***	***1.25***

Calculate amount of profit / loss over the construction period and also calculate relevant disclosures as per the requirements of AS – 7.

Sol:

W.N.1 ***Calculation of % of Completion of Contract***

	I	II	III
Actual Cost	***1.50***	***3.60***	***4.05***
Total Estimated Cost	***4.50***	***4.00***	***-***
% of Completion	***33.33%***	***90%***	***100%***

W.N. 2 ***Calculation of Contract Revenue to be Recognized***

		I	II	III
	Contract Price	***5.00***	***5.00***	***5.00***
	% of Completion	***33.33%***	***90%***	***100%***
	Contract Revenue	***1.66***	***4.50***	***5.00***
Less:	***Previous Revenue***	***-***	***1.66***	***4.50***
	Net Contract Revenue	***1.66***	***2.84***	***0.50***

Statement of Profit / Loss

		I	II	III
	Contract Revenue	***1.66***	***2.84***	***0.50***
Less:	***Expenses***	***1.50***	***2.10***	***0.45***
	Profit / Loss	***0.16***	***0.74***	***0.05***

Statement showing Retention Money

		I	II	III
	Amount Billed	***1.00***	***3.70***	***0.30***
Less:	***Collection***	***0.75***	***3.00***	***1.25***
	Retention Money	***0.25***	***0.70***	***0.95***

Comment: In the Balance Sheet of 1st year & 2nd year Retention money should be disclosed of Rs. 25,000 & Rs. 95,000

Statement showing Difference in Sales (Cumulative)

		I		II		III	
	Sales (AS – 7)	*1.66*		*4.50*		*5.00*	
Less:	*Amount Billed*		*1.00*		*4.70*		*5.00*
	Difference	*0.66*		*(0.20)*		*0.00*	

Note: As per AS difference in sale should be calculated on cumulative basis because adjustment of period wise information will be made automatically.

Ques 3

Projects	***X***	***Y***
Contract Price	***6 Lakh***	***8 Lakh***
Date of Contract	***01-04-05***	***01-04-05***

Additional Information

(i) ***Completion period for Project X has been decided between the parties of 2 yrs. (Completion date 31-03-07).***

(ii) ***To complete the project X during the decided time, there is a provision of penalty of Rs. 10,000 per day.***

(iii) ***Completion time for project Y has been decided of 3 yrs.***

(iv) ***Cost information***

	X	***Y***
Period I		
Actual Cost	***3.60 Lakh***	***4.10 Lakh***
(Further) Estimated Cost	***0.40 Lakh***	***4.10 Lakh***
Period II		
Actual Cost (Cumulative)	***4.50 Lakh***	***7.20 Lakh***
(Further) Estimated Cost	***-***	***1.80 Lakh***

Calculate amount of profit/loss for project X and Y for the 2 different periods assuming that Project X is completed by the contractor in time but actual possession is given after 4 days.

Sol: ***Calculation of Profit / Loss of Project X***

	I	***II***
Actual Cost (Cumulative)	***3.60 Lakh***	***4.50 Lakh***
Add: Estimated	***0.40 Lakh***	***-***
	4.00 Lakh	***4.50 Lakh***
% of Completion	***90%***	***100 %***

Statement of Profit / Loss

	I	***II***
Contract Price	***6.00 Lakh***	***6.00 Lakh***
Less: Penalty Amount		
(10000 X 4)	***-***	***0.40 Lakh***
Less: Previous Recognition	***-***	***5.40 Lakh***
	6.00 Lakh	***0.20 Lakh***

% of Completion	***90%***	***100 %***
Income Recognition	***5.40 Lakh***	***0.20 Lakh***
Less: Expense (Respective)	***3.60 Lakh***	***0.90 Lakh***
Profit / Loss	***1.80 Lakh***	***(0.70 Lakh)***

Project Y

Para 35

As per AS provision should be created if total estimated cost is higher than contract price. In the given situation total estimation is higher than contract price.

Statement of Expected Cost

	I	***II***
Contract Price	***8.00 Lakh***	***8.00 Lakh***
Total Estimated Cost	***8.20 Lakh***	***9.00 Lakh***
Provision Required	***0.20 Lakh***	***1.00 Lakh***

Additional Provision is of Rs. 80,000/-

Difference between AS/IAS/US GAAP:

As per AS – 7, Completion Method is specified for accounting purpose. In other statement completed method is also specified for accounting of contract. Under completed method income can be recognized only if contract is completed by the contractor at the end of completion period.

Government Grants
AS – 12

Contents

- ***Applicability & Nature***
- ***Definations***
- ***Recognition of Govt Grants***
- ***Types of Govt grants***
- ***Refund of Grants***
- ***Disclosures***

Applicability & Nature

Applicable	***:***	***01-04-1994***
Nature	***:***	***Mandatory***

Meaning of Government

Govt may include Central Govt, State Govt, Local Authority or Foreign Govt.

Meaning of Grant

As pre Accounting Standard, Grant is a financial assistance which is provided by Govt to fulfillment of certain conditions attached to it. The following points should be considered for the meaning of the grant:-

(i) Amount of grant should not be related to trading & operating benefits. It means that benefits of grant should be arisen in addition to trading benefits. For example Income tax benefits, Excise benefits or any other tax benefits can not be recognized as Govt grant because these benefits are related to operating activities.

(ii) Financial assistance may be in cash or kind.

Recognition of Grants

As Per AS any enterprise can recognize amount of any grant in its books only if the following two conditions are satisfied.

(i) It should be certain that the attached conditions will be fulfilled by the enterprise.

(ii) It should also be certain that ultimate collection of the grant will be completed.

At the time of recognition of grant the following journal entries shall take place.

Cash/Bank/Grant Receivable	***Dr.***
To Govt Grant	

Types of Grants

(i) Grant related to the Promoters Contribution

(ii) Grant related to Expenses

(iii) Grant related to Fixed Assets

(iv) Non-monetary Grants

(i) <u>Grant related to Promoters Contribution</u>

If any grant is direct related to capital investment then such benefit should be recognized as capital profits & to be taken to capital reserve.

(a) Cash/Bank/Grant Receivable Dr
To Govt Grant

(b) Govt Grant Dr
To Capital Reserve

Note: Amount of capital reserve can't be used for the distribution of dividends, bonds or any other recognized use. Amount of capital reserve shall be disclosed in the Balance Sheet under the heading of Reserve & Surplus on Permanent basis.

(ii) <u>Grant related to Expenses</u>

As per AS if any enterprise has received any grant from Govt towards expenses then amount of expense should not be transferred to P&L A/c, but to be adjusted against grant amount.

Note: If amount of expense is lower than amount of grant the difference should be disclosed in B/S under the head of Reserve & Surplus.

(a) Cash/Bank/Grant Receivable Dr
To Govt Grant

(b) Exp A/c Dr
To Cash/Bank

(c) Govt Grant Dr
To P&L A/c (Reverse)

(d) P&L A/c Dr
To Expenses

As per disclosure requirements adjustments of expense should not be made directly to grant, but such transaction should be adjusted by way of P&L A/c. Amount of expense should be recorded in debit side of P&L A/c and amount of grant should be recorded in credit side of P&L A/c.

<u>Refund of Grants</u>: It may be possible that the conditions which are related to grant are not fulfilled by enterprise. In such case refund of grant which was previous recognized shall take place. The journal entry should be recorded:

<u>Refund of Promoters Contribution</u>
Capital Reserve Dr
To Bank/Cash

<u>Refund of Expense</u>
P&L A/c Dr
Govt Dr
To Cash/Bank

(If enterprise has recorded the total benefit in P&L A/c then complete reversal should be made to P&L A/c)

<u>Non-Monetary Grants</u> (Assets at Concessional rate)

As per AS, if any asset is provided by Govt at concessional rate then cost of asset in the books of enterprise should be recognized at concessional rate. No separate recognition of Govt grant is recognized. There will be no refund in case of discounted assets.

(If any asset is provided by Govt at Free of cost then such asset should be disclosed in the balance sheet separately, but amount of disclosure will be Nominal Nil value.)

(iii) <u>Grant related to Fixed Assets</u>

Depreciable ***Non-Depreciable***

Non-depreciable Asset: If any grant related to non-depreciable asset than benefit should be transferred to capital reserve:

(a) Cash/Bank/Grant Receivable Dr
To Govt Grant

(b) Govt Grant Dr
To Capital Reserve

Refund: Capital Reserve Dr
To Cash/Bank/Receivable Grant

Depreciable Assets:

Net Approach ***Gross Approach***

<u>Net Approach</u>: Amount of grant which is related to depreciable fixed assets should be adjusted directly to the cost of assets. After such adjustment cost of assets will be reduced. It can also be said that benefit of grant should be adjusted in P&L A/c by reducing amount of depreciation expenses.

(a) Cash/Bank/Grant Receivable Dr
To Govt Grant

(b) Fixed Assets Dr
To Cash/Bank

(c) Govt Grant Dr
To Fixed Assets

Note: On adjustments of grant after date of purchase, it may be possible that benefit of grant is not provided by the Govt on the date of purchase of fixed assets but such benefits is to be recognized after the date of purchase. If such situation arise adjustment of grant in the book value of asset should be made after/or the date of recognition and amount of Depreciation should also be adjusted on prospective basis.

***Refund of Grant*:- As per AS, Refund of grant under Net Approach method should be recorded by reversal of book value of Fixed assets.**

Fixed Assets Dr
To Cash/Bank/Grant Receivable

After such reversal amount of depreciation will be reduced on prospective basis.

Ex.	***Plant Purchased***	***=***	***Rs.10,00,000/-***	***Useful life = 10 year***
	P.A. Depreciation	***=***	***Rs. 1,00,000/-***	***Amount of Grant = Rs. 5,00,000***

(1) Benefit of Grant to be recognized in the beginning of 4th year.
(2) Refund of Grant to be recorded in the beginning of 8th year.
Calculate amount of depreciation after recognition of grant as well as refund of Grant.

Sol:

W.N.	***Book Value on the date of receipt of grant***	***=***	***10,00,000***
	Less: Depreciation	***=***	***3,00,000***
			7,00,000

Calculation of Depreciation after Recognition of Grant

Book Value 4th year	***=***	***7,00,000***
Less: Grant	***=***	***5,00,000***
Adjusted Book Value	***=***	***2,00,000***

Remaining Life of assets = 7 year
Depreciation p.a. = 2,00,000 / 7year = 28,571/-

Calculation of Depreciation after Refund of Grant

Book Value 4th year	***=***	***2,00,000***	
Less: Depreciation (28,571 x 4)	***=***	***1,14,284***	
		85,716	
Add: Refund of Grant		***=***	***5,00,000***
		5,85,716	

Remaining Life of Asset = 3 year
Depreciation p.a. = 5,85,716 / 3 year = 1,95,239

Grant Related to Depreciable Asset (Gross Approach)

As per AS, Grant related to depreciable asset can also be recorded by gross approach. The following points should be considered at the time of accounting of grant as per gross approach.

(1) Amount of grant should not be adjusted directly to fixed assets but such amount should be transferred to a separate account in the name of Deferred Grant a/c.

(2) Amount of Deferred grant a/c should be taken to P&L A/c in the ratio of depreciation saving as calculated under Net Approach.

(3) Journal Entries

(i) Cash/Bank/Grant Receivable Dr
To Govt Grant

(ii) Grant A/c Dr
To Deferred Grant A/c (It is transferred to reserve &surplus)

(iii) Deferred Grant A/c Dr
To P&L A/c

Refund of Grant:
Deferred Grant A/c (O/s Bal) Dr
P&L A/c (which is already used) Dr
To Cash/Bank/Grant Receivable

Note: At the time of refund of grant total benefit should be reversed in the current period in total irrespective the effect of these transaction on current year profits.

Disclosure:

(i) Accounting policy should be disclosed separately in relation to classification of nature of grant.
(ii) If any refund has been made during the period then amount of refund should be also disclosed.

Difference between AS/IAS/US GAAP:

If any grant is related to promoter's contributions then accounting of such grant should be made as capital profits as per as-12. The same grant should be recognized as revenue profits as per other statements. Revenue profits should be recognized on deferred basis as per management intention.

Intangible Assets
AS – 26

Contents

- ***Applicability & Nature***
- ***Meaning of Intangible Assets***
- ***Explanation of Meaning***
- ***Out of Scope***
- ***Recognition of Intangible Assets***
- ***Different Situation of Recognition***
- ***Internally Generated Intangible Assets***
- ***Subsequent Recognition***
- ***Carrying amount of Amortization***
- ***Review of Policy***
- ***Impairment Loss***
- ***Retirement & Disposals***
- ***Disclosure***
- ***Computer Software***
- ***Transitional Provisions***

Applicability & Nature

Applicable	***:***	***Level I***	***01-04-2003***
		Level II, III	***01-04-2004***
Nature	***:***	***Mandatory***	

(From 01-04-2003, Accounting Standard – 8, shall stand withdrawn and all the provisions of AS – 26, will be applicable)

Meaning of Intangible Assets

An Intangible Asset is identifiable non-monetary assets without having physical substance and held by enterprise for the purpose of sale or supply of goods of services.

As per AS – 20, if any asset is to be recognized as an intangible asset the following conditions should be satisfied.

(i) Identifiability
(ii) No physical substance
(iii) Controlled by enterprise
(iv) There should be Future Economic Benefit

Explanation of Meanings

Meaning of Identifiability: Any asset can be recognized as identifiable asset if the asset can be sold or can be exchanged or can be given for the purpose of rent. These transactions are also directly related to existence of assets.

Meaning of Control: If benefit of asset can be used by an enterprise and such enterprise can restrict the other organization to take the benefit then it will be assumed that asset is controlled by the enterprise.
Meaning of Future Benefit: Intangible Assets can be recognized as per definition only if there is future economic benefit. These benefits can also be defined as expected inflows or cost savings.

Out of Scope

AS – 20 is not applicable on the following intangible asset.

(i) If any intangible asset is acquired under amalgamation scheme, then AS – 26 shall not be applicable for the asset taken over. (It will be valued as AS – 14)
(ii) Misc Expenditure such as discount on issue of Share, Debenture or preliminary expenses.
(iii) Deferred Tax Assets as per AS – 22
(iv) Investment in Lease
(v) Accounting of Investment (AS 13, 23, 27 & 21)

Recognition of Asset

An asset can be recognized in the accounting books only if the following conditions are satisfied

(i) It should be certain that there will be future economic benefit on the basis of suitable assumption and estimation.

Cost of purchase of intangible asset is available in accurate amount.

Intangible asset	***Dr.***	***xxx***	
To Cash			***xxx***

Different Situation of Recognition

***Cash Purchase**: If any intangible asset is purchased in cash then cost of intangible can be calculated by the following statement.*

Statement showing cost

	Purchase Price		*xxxx*
Add:	*Stamp duty*	*xxxx*	
	Brokerage Commission	*xxxx*	
	Any other Expenses (Non-recoverable Duties & taxes)	*xxxx*	
Less:	*Rebate & Discount*	*xxxx*	
		Xxxx	

Purchase by Shares

Cost of Intangible Assets

Fair value I.A. taken *or* *Fair Value of share issued*

Whichever is clearly evident

Notes:

(1) If shares of the company are listed on stock exchange then market price can be used directly for the shares issued.

(2) If shares of the company are not listed then fair value of intangible asset acquired can be used.

(3) If fair value of intangible taken & share issued both are available then fair value of taken assets should be preferred.

Exchange by Assets

If any intangible asset is exchanged by asset then fair value of given asset should be recognized as cost of intangible. In the absence of such fair value, book value should be recorded of given asset.

***Note**: Provisions of AS – 26 are not similar under specified heading as in AS – 13 & AS – 10. As per AS – 26, fair value of given asset or book value of given asset can be used for recognition and no settlement in cash will be considered.*

As per AS – 10 & 13, settlement in cash can take place at the time of exchange of asset because fair value of asset taken as well as fair value of asset given are considerable.

Taken in Amalgamation

If any intangible is taken over under the scheme of amalgamation then the following points may be applied.

(i) First Recognition

Fair Value available

Should be recognized separately By fair value (subject to conditions

Fair value not available

Should not be recognized separately and should be included in Goodwill *specified below)*

(ii) Fair value of intangible asset can be recognized by active market or latest transaction price.
(iii) If active market is available then full amount of intangible asset should be recognized.
(iv) If latest transaction price is used for recognition then cost can be recognized to the extent by which capital reserve is not created. (The above provision can be applicable only for amalgamation in the nature of purchase)

Purchased by Govt Grant

If any intangible asset is purchased by Govt grant then cost of intangible asset can be recorded by net approach or gross approach specified in AS – 12.

Balance Sheet (Disclosure) [Net Approach]

		Intangible Asset	xxxx	
		Less: Grant	xxxx	xxxx

Balance Sheet (Disclosure) [Gross Approach]

Deferred Grant	xxxx	Intangible Asset (Full amount)	xxxx

Internally Generated Intangible Asset

If any intangible asset is generated internally by the enterprise, then it is generated under two different phases.

1) *Research Phase: Research phase is the planed investigation carried by enterprise to create new application of business activities. Research activities may include invention of new products, production techniques, technical system or any other finding for cost saving or future benefits to enterprise. (All the expenses during research phase should be written off in P&L a/c immediately because it is not certain during research phase that any result will be obtained or not from research.)*

2) *Development Phase: Development phase is the verified application of research activities and all the expenses during the development phase should be capitalized in the cost of intangible asset. Before capitalizing the expenditure during development phase the following conditions should be satisfied.*
   - *Technical should be available with the enterprise.*
   - *The Enterprise is having intention to complete the intangible assets for use or sell.*
   - *After completion of intangible the enterprise should be able to use or sell intangible.*
   - *Future economic benefit should be measured by suitable assumption.*
   - *Financial Resources should be proper to complete the asset.*
   - *There will be proper system to record the cost during development phase.*

Discontinuing Operations
AS – 24

Contents

- *Applicability & Nature*
- *Meaning of Discontinuing Operations*

- ***Explanation of Meaning***
- ***Initial Disclosure Events***
- ***Disclosure***

Applicability & Nature

Applicable	***:***	***Level I***	***01-04-2004***
		Level II, III	***01-04-2005***
Nature	***:***	***Mandatory***	

Meaning of Discontinuing Operations

As per AS – 24, Discontinuing Operation is the operation which is expected to be discontinued in future period, but at present such operation is not a discontinued operation. The following conditions should be satisfied to classify an operation as discontinuing operation.

Segment: If any operation is to be classified under the heading of discontinuing operation then such operation should be a business segment or geographical segment. On the basis of such explanation, it can be said that discontinuing operation can be a product of any business area.

Operational & Functional information: Discontinuing operation should be classified separately from the point of view of operation as well as financial performance. It can be said that the following amounts should be available in relation to discontinuing operation.

1. ***Assets of Discontinuing Operation***
2. ***Liabilities of Discontinuing Operation***
3. ***Income of Discontinuing Operation***
4. ***Expenses of Discontinuing Operation***

Note: If any amount out of specified amounts is not available then application of AS – 24 should not be made.

Sale & Abandonment

1. Single Transaction: If all the items of discontinuing operation are sold to a single buyer and procedure for single transaction has been started then it will be assumed that conditions of AS – 24 have been satisfied.

2. Multiple Transactions: If items of Discontinuing operation are not transferred to a single buyer but these items are to be sold to multiple buyers and procedure for these transaction has been started then such operation can be classified as discontinuing operation.

3. Abandonment: In the case of Abandonment, items of discontinuing operation have not sold to outsiders but usages of these items are stopped by locking the factory. The main condition of the abandonment that unused item can not be used for any income by way of rental or any production plant.

Following items should be excluded out of Discontinuing Operation.

(i) Change in location of Production
(ii) Change in production plant
(iii) Sale of shares by holding co which were held in subsidiary co
(iv) The Abandon factory used for rental purpose or production of any other product.

Initial Disclosure Events

Formal plan is announced by BOD ***or*** ***Single Transaction agreement has taken place***

Which ever is earlier

Important Points in Formal Plan

(a) Contents of Formal Plan

- ***Name of Discontinuing operation***
- ***Name of related assets or liabilities***
- ***Expected date of the completion of procedure***
- ***Expected realizable value from the transaction***
- ***Amount of compensation which is expected to be paid of the effected employees***

(b) Announcement: Information of formal plan should be given to the related parties & loan providers as well as Trade Creditors.

Disclosure (Notes to Accounts)

1. ***Nature of Initial Disclosure Events***
2. ***Date of Initial Disclosure Events***
3. ***Carrying amount of Assets & Liabilities of discontinuing operation should also be disclosed.***
4. ***Expected Realizable value of Assets & expected payment of Liabilities should be disclosed.***
5. ***If any profit has been generated by the discontinuing operation during the period then such profit should also be disclosed.***
6. ***Cash Flow statement of discontinuing operation should be prepared additionally to normal cash flow statement of the remaining business.***

Fixed Assets

AS – 10

Contents

- ***Applicability & Nature***
- ***Meaning of Fixed Assets***
- ***Cost of Purchase***
  - ***Cash Purchase***
  - ***Purchase by Shares***
  - ***Exchange***

- ❖ *Consolidated Price*
- ❖ *Self Construction*
- ❖ *Joint Ownership*

- ➢ *Disposal of Fixed Assets*
- ➢ *Disclosure*

Applicability & Nature

Applicable	*:*	*01-04-1993*
Nature	*:*	*Mandatory*

Meaning of Fixed Assets

Fixed Assets are the assets which are acquired by the enterprise for the purpose of use but these assets are not acquired for the purpose of resale.

Usage of Fixed Assets may be in production or in the supply of goods or services. On the basis of above definition, AS has covered all the usable assets of factory premises as well as administration or selling department.

Cost of Purchase

(a) By Cash: If any enterprise has purchase fixed assets by cash then the following statement should be prepared to calculate cost of Fixed Assets.

Statement of Cost

	Purchase Price		*xxxx*
Add:	*Taxes & Duties*	*xxxx*	
	Transportation Exp	*xxxx*	
	Loading & Unloading Exp	*xxxx*	
	Sight Preparation Exp		*xxxx*
	Installation Charges	*xxxx*	
	Professional Charges	*xxxx*	
	Cost of Trial Run (Net of scrap)	*xxxx*	
	Any other exp which is directly related to purchase of assets	*xxxx*	
		xxxx	

Important Points

(1) In the calculation of cost, refundable part of taxes & duties should not be included.

(2) If any scrap value is realized from the sale of simple unit then cost of trial run should be capitalized only after adjustment of scrap value.

(3) If any Govt grant is to be recognized as per AS – 12 in relation to fixed assets, then amount of grant should be adjusted in the calculation of original cost.

(b) Consolidated Price: If any enterprise has purchased group of assets by payment in single price then such consolidated price should be divided between the assets as per valuer certificate. If any fee is paid to such valuer for such dividation of price then capitalization of fees should be made as per valuer certificate.

(c) Joint Ownership: If any fixed asset is purchased by two or more enterprise in joint ownership then cost of fixed assets should be recorded in the books of parties with respect to amount of ownership. Depreciation should be calculated as per the recorded value.

(d) ***Self Construction**: If any asset is self constructed by the enterprise then all the exp should be included in the cost of fixed asset which are directly related to construction of fixed asset.*

(e) ***Purchase by exchange of assets**: Same provision as AS – 13,*

(f) ***Purchase by share**: If any payment for purchase of fixed asset is made by issue of shares then recognition of fixed asset should be carried at its fair value. Market price of share issue should be ignored.*

Difference between fair value of fixed asset & face value of shares should be considered as discount or premium on issue of shares.

Disposal of Fixed Asset

(i) If any depreciable asset is disposed off then profit/loss on disposal should be transfer to P/L account.

(ii) Profit/Loss on sale of non-depreciable assets should be transfer to capital reserve.

(iii) If any revaluation reserve is outstanding in the balance sheet & asset is disposed off then at the time of disposal amount of revaluation reserve should be also reversed.

Disclosure

(i) Gross block value & net block value should be disclosed separately in balance sheet.

(ii) If any profit/loss has been arisen during the period on the disposal of fixed asset then amount should be disclosed separately.

Cash Flow Statement
AS – 3

Contents

- ***Meaning of Cash Flow Statement (CFS)***
- ***Presentation of CFS***
- ***Method to prepare CFS***
- ***Explanation of Methods***
- ***Important Points***

Meaning of CFS

Cash flow statement is the summery of cash a/c which is prepared to analysis annual cash inflows & annual cash outflows. Cash flow statement is prepared under three separate heading as follows:

Cash Flow from Operating Activities
Cash Flow from Investing Activities
Cash Flow from Financing Activities

Cash Flow Statement

Cash Flow from Operating Activities		*xxxx*
Cash Flow from Investing Activities	*xxxx*	
Cash Flow from Financing Activities		*xxxx*
	xxxx	
Add: Opening Balance	*xxxx*	
	xxxx	

Note: Opening balance & closing balance in cash flow statement shall include cash balance, bank balance & cash equivalent

Cash Equivalents are the Investments which are having maturity period up to 3 months. If any investment has been made by the enterprise in cash equivalents then such investments should be disclosed under the heading of Current Assets & AS – 13 can't be applied for these investments.

Comments on CFS

As per AS – 24, if any enterprise is having discontinuing operation then cash flow statement should be prepared separately for such discontinuing operation in addition to normal cash flow statement.

Transaction to be covered under the headings

Financing Activities

- ***Issue of Share Capital***
- ***Redemption or Buyback of Capital***
- ***Receipt of Loans***
- ***Repayment of Loans***
- ***Dividend paid / Interest paid***

Note: As per AS – 3, if any transaction is related to share capital & loans then such transactions should be covered under the heading of Financing activities.

Investing Activities

- ***Purchase or sale of Fixed assets***
- ***Purchase or sale of Investments***
- ***Dividend, Rental, Interest Received***

Note: All the transactions which are related to fixed assets & Investments should be covered under investing activities.

Operating Activities

If any transaction can't be disclosed under the heading of Financing & Investing then such transaction should be covered under operating activities.

Methods of CFS

Direct Method

Under the Direct method Cash Flow statement is prepared directly from Cash account. Such method should be applied only if no of cash transactions are lower.

Example:

Cash A/c			
To Bal b/d	***10000***	***By Creditors***	***80000***
To Debtors	***50000***	***By Wages***	***20000***
To Equity Capital	***200000***	***By Tax***	***100000***
		By Bal c/d	***60000***
	260000		***260000***

Prepare CFS by direct method.

Sol.

CFS		
Cash From Operations Activities		
Debtors	***50000***	
Creditors	***(80000)***	
Wages	***(20000)***	
Tax	***(100000)***	***(150000)***
Cash From Investing Activities		***Nil***
Cash From Financing Activities		
Equity Share Capital	***200000***	***200000***
		50000
Add: Opening Balance		***10000***
Closing Balance		***60000***

Indirect Method

Indirect method should be applied if no of cash transactions are higher. As per AS – 3, application of indirect method is mandatory for level 1 enterprises.

Indirect method is applied only for the presentation of operating activities because reserve, current assets, current liabilities & miscellaneous expenses are not related to Financing & Investing activities.

The following steps should be applied for cash flow statement by Indirect method.

Step1. Take net profit as a base under operating activities.

Step2. Amount of depreciation is a non cash item and payment of such expense is not required in cash. Such amount should be added back to net profit for the purpose of cash profits.

Step3. Loss on sale of asset should be added back to net profits because such loss is also a non cash item.

***Step4.** Profit on sale of asset should be deducted out of net profits because such profits should be transferred to investing activities by including such profits in the selling price.*

***Step5.** Amount of interest expense should be added back to net profits because such expense can't be deducted under operating activities but such items should be deducted under financing activities.*

***Step6.** Amount of interest/dividend/rental should be added under the heading of Investing activities due to which the specified amount should be deducted out of net profits.*

***Step7.** Amount of tax provision is a non cash item and such item should be added back to net profit but actual payment of tax should be deducted because such payment is a cash item.*

***Step8.** Amount of miscellaneous expense which has been written off during the period, should be added to amount of net profits assuming non cash item but actual payment fro miscellaneous expense should be deducted out of net profits.*

***Step9.** After adjusting the specified points, working capital adjustment should also be recorded under operating activities.*

(a)	***Increase in Current Assets***	***Less***
(b)	***Decrease in Current Assets***	***Add***
(c)	***Increase in Current Liabilities***	***Add***
(d)	***Decrease in Current Liabilities***	***Less***

Additional Points

***(1)** As per AS – 3, amount of tax paid should be disclosed as a last item under operating activities.*
***(2)** Cash from extraordinary items should be disclosed separately under every heading of Operating, Investing & Financing.*
***(3)** If any Capital Gain Tax is paid by the enterprise then amount of such tax should be disclosed under Investing activities.*
***(4)** If any new capital or any other security has been issued at premium then amount of security premium which is realized from such issue should be disclosed under Financing activities.*
***(5)** Amount of CDT should be disclosed under Financing activities because related to payment of dividend.*

Accounting Policy
AS – 1

Contents

- ***Applicability & Nature***
- ***Meaning of Accounting Policy***
- ***Fundamental Assumption***
- ***Important factors to be considered***

Applicability & Nature

Applicable	***:***	***01-04-1991***	***Companies***
		01-04-1993	***All Enterprises***
Nature	***:***	***Mandatory***	

Meaning of Accounting Policy

As per AS – 1 Accounting Policy are the basic principles on the basis of which financial statements are prepared by the enterprise. Different accounting policies are available in different accounting areas. For example Depreciation accounting may be based on SLM or WDV, Stock valuation may be based on FIFO, Weighted avg, Retail value method or any other method specified by AS – 2.

Every enterprise should select appropriate accounting policy for the presentation of financial statement at the time of selection of policy. Fundamental accounting assumption & important factors should be considered.

Accounting Policy

Assumption	***Factors***
Going Concern	***Prudence***
Accrual Basis	***Actual Transaction***
Consistency	***Materiality (AAS – 13)***

***Going Concern:** It should be assumed that the enterprise will not be liquidated in the future.*

***Accrual Basis:** After assuming going concern the enterprise should apply accrual basis of accounting & cash basis should be ignored.*

***Consistency:** It should be assumed that accounting policies will be applied on constant basis in the preparation of financial statement.*

***Prudence:** At the time of selection of policy concept of prudence should be considered. Prudence means reasonable estimation of items. It means that enterprise should select reasonable accounting policy that can reasonable estimate the items.*

Accounting policy should be selected that can cover all the actual transaction; legal status of the transaction is totally immaterial. If any accounting policy is not covering all the actual transactions then selection of such policy should not be made.

***Material Items:** The selected accounting policies should cover all the Material items (AAS – 13)*

Accounting for Investment in Joint Ventures

AS – 27

Contents

- ***Applicability & Nature***
- ***Meaning of Joint Venture***
- ***Types of Joint Ventures***
- ***Accounting & Disclosures in Joint Ventures***
- ***Note on Operating Fees***

Applicability & Nature

Applicable	***:***	***01-04-2002***
Nature	***:***	***Investment in joint venture should be recorded & disclosed as per the provisions of AS – 27 in separate books as well as CFS. (It can be said that provisions of AS – 13 may not be applicable for investment in***

Joint Venture)

Meaning of Joint Venture

Joint venture is the contractual arrangement where by two or more parties undertake an economic activity subject to joint control.

Joint Control

Joint control is the agreed % of share in control. (If any party has invested in joint venture with out sharing joint control then such party should be consider as an investor and such party can't be classified as a venturer)

Types of Joint Venturers

Jointly Controlled Operations

JCO are created only for particular products line with out formation of any new enterprise on the basis of above explanation the following important points should be considered.

(a) Amount of assets & liabilities which are used in relation to joint venture should be disclosed under heading of investment & such investment will be change during the period.

(b) Every enterprise will carry other transaction as normal business which are not related to J.V.

(c) In the preparation of separate books and Consolidate Financial Statement (CFS) the following disclosure should be made.

- ***Assets & liabilities which are used in joint venture should be disclosed separately.***
- ***Income & Expenses which are related to joint venture should be disclosed separately in income statement.***
- ***Amount of profit / loss which is related to joint venture should also be disclosed separately.***

Jointly Controlled Assets

JCA are the joint venture by which two or more enterprises acquire a particular asset for mutual benefits. Share in ownership should be disclosed by every party under the heading of investment and the following disclosure is also required in separate books as well as CFS.

(a) Amount of depreciation which is related to such asset should be disclosed separately in P&L A/c.

(b) Benefits & Expenses which are related to these assets should also be disclosed separately.

Jointly Controlled Entities

If any ventures have invested in joint venture by creating a new enterprise in the name of company, partnership firm or proprietary business. In such case investment made by venturers will be the capital of joint venture in the separate books and CFS, separate provisions are applicable.

Separate Books of Venturers

In the separate books accounting will be made as per the provisions of AS – 13.

CSF of Venturers

If Venturer party is preparing CFS then disclosure of investment in JV should be made by proportionate consolidation.

Example

	A Ltd	***B Ltd***	***C Ltd (J.V.)***
Share Capital	***10000***	***20000***	***5000***
Reserve & Surplus	***2000***	***3000***	***1000***

Loans	*2000*	*3000*	*1000*
	14000	*26000*	*7000*
FA	*2000*	*4000*	*1500*
Investment in JV	*2500*	*2500*	*-*
Working Capital (NCA)	*9500*	*19500*	*5500*
	14000	*26000*	*7000*

Complete Proportionate consolidation assuming A Ltd & B Ltd have to prepare CFS.

Sol.

	A Ltd	*B Ltd*	
Share Capital	*10000*	*20000*	
Reserve & Surplus	*2500*	*3500*	*(Add 50% - 50%)*
Loans	*2500*	*3500*	*(Add 50% - 50%)*
	15000	*27000*	
FA	*2750*	*4750*	*(Investment has been cancelled*
Working Capital (NCA)	*12250*	*22250*	*by share capital)*
	15000	*27000*	

Operator Fees

If any operator fee is payable to any venturer for extra efforts then such operator fees should be considered as an expense for joint venture.

Retirement Benefits (Revised 2005)
AS – 15

Contents

- ***Applicability & Nature***
- ***Meaning of Employees Benefits & Types of Benefits***
- ***Accounting Treatments***

Applicability & Nature

Applicable : 01-04-2006
Nature : Mandatory for Level – 1

Note: In addition to Level 1, if any enterprise is having more than 50 employees then such enterprise will also be covered under the applications of AS – 15.

Meaning of Employees Benefits

Employees benefit shall include all the expenses which are incurred by the enterprise for the benefits of employees or for relatives of employees. As per AS – 15, two types of benefits should be covered for accounting purpose.

Types of Benefits

Short Term Benefits

Short term benefits are the payments which are expected to be settled in the same period of service or within twelve months after balance sheet date. The following types of amount can be included under the heading of short term benefits.

(a) Wages & Salaries
(b) Profit Sharing / Bonus
(c) Leave Encashment
(d) Non – Monetary Benefits (Car, Housing, Medical etc)

Accounting of Short Term Benefits

(a) Wages & salaries: Amount of wages & salaries should be written off in P&L a/c equal to amount of service used by enterprise during the period. Difference between actual payment & value of service should be considered as prepaid expenses or outstanding expenses.

(b) Profit sharing / Bonus: If any bonus or profit is payable by the enterprise to its worker as per the agreement then payable amount should be provided in P&L a/c of same year.

If any payment is based on the condition of continuation of service during the particular period then provision for payment should not be required for those workers or employees that are not in continuation in service.

(c) Leave Encashment: If any employee is allowed leaves with pay then accumulation and non accumulation will be considered.

Accumulation Leaves: It may be possible that employee has not used the entire benefit which is provided by the company during the period. In such case the unused benefit should be carried forward and to be added to the allowed benefit of next year. Value of unused benefit should be provided by creating a provision & amount of used benefit should be written off in P&L a/c.

Non Accumulation Leaves: If any leave encashment is in the nature of non accumulation then value of unused benefit should not be carried forward to the next year & no provision is required for such unused benefit. Amount of used benefit should be considered as an expense of the same accounting period.

(d) Non – Monetary Benefits: Value of non monetary benefits which are provided by company to its employees or worker should be written off in the same accounting period of the benefit provided.

Long Term Benefits

Multi Employer Plans

Multi Employer plans are formed by two or more employers for the benefits of their employees. If any contribution is made by any employer during the period under the specified plans then amount of contribution should be written off in the same period.

Insurance Plans

If any employer has invested in the insurance plans for the retirement of employees then amount of premium paid should be considered as a normal expense and to be written off in the same period.

State Plans

If any plan is to be created as per Govt guidelines whether State Govt or Local Govt then amount of contribution should be written off in the same accounting period.

Valuation of Inventory
AS – 2

Contents

- ***Applicability & Nature***
- ***Meaning of Inventory***
- ***Valuation of Inventory***
- ***Steps in Valuation Procedure.***
- ***Valuation Method***
- ***Important Points***
- ***Disclosures***

Applicability & Nature

Applicable	***:***	***01-04-1999 (Revised)***
Nature	***:***	***Mandatory for all***

Meaning of Inventory

Held for Sale | *Held in production process* | *Held for consumption*
Finished Goods | *Work in Process* | *Raw Material & Supplies*

Meaning of Supplies

As per AS – 2, stock of loosed tools or spare parts should also be covered under the accounting principle of AS. The main condition for the application of AS – 2 of these stocks is only the common use in the production departments. As per ASI – 2 if any spare part is related to a particular fixed assets rather than common use, amount of such spare parts should not be covered under the accounting principle of AS – 2 but principle of AS – 10 should be applied.

Valuation of Inventory

Cash or NRV whichever is lower.

Note: As per AS if any stock is to be valued at NRV then loss on valuation should be written off in P&L A/c of the same year.

Steps in Valuation Procedure

Step1: Cost Calculation
Step2: NRV Calculation
Step3: Comparison

Cost Calculation

Finished Goods: Purchase Price of Raw Material + Direct Wages + Factory Overheads = Total Cost
WIP: Purchase Price of Raw Material + Direct Wages + Factory Overheads = Total Cost
Raw Material: Purchase Price of Raw Material = Total Cost

Meaning / Calculation of Purchase Price of Raw Material

In the calculation of purchase price of material all the expenses should be included which are directly incurred for the purchase of material. For Example: Purchase price, Taxes & duty, Freight inward, Material handlings charges or any other expense related to purchase. In the calculation of purchase price amount of trade discount & refundable taxes or duties should not be included.

Meaning of Direct Wages

Amount of direct wages can be used directly from payroll sheets which are prepared in factory premises at the time of payment of wages.

Meaning of Factory Overheads

Variable Overhead

Variable overhead are always per unit fixed & amount of these overhead will be changed by change in production units. Amount of variable expenses should be calculated on the basis of actual production because these expenses are always incurred according to the size of production.

Fixed Overhead

Situation 1: Actual Production is lower than Normal Production

If any enterprise has produced lower no of units than normal capacity, per unit fixed overhead should be calculated on the basis of normal capacity & such rate should be applied on actual production. If any amount remain unallocated then such amount should be transferred to P&L a/c. but can't be included as a part of production cost.

Example:	***Fixed Overhead***	***Rs. 2,00,000***
	Normal Production	***10,000 units***
	Actual Production	***8,000 units***
	Calculate production cost	

Sol: ***2,00,000 / 10,000 = Rs 20 per unit***
Production cost = 8,000 x Rs 20/- = Rs 1,60,000

Situation 2: Actual Production is higher than Normal Production

If actual production is higher than normal production, the total amount of actual expenses should be included as a part of production cost and rate per unit should not be calculated by normal production.

Important note: In the calculation of cost of inventories only factory cost is considered and amount of administration overhead or selling overhead should not be considered in the calculation of cost.

NRV Calculation

Net Realizable Value = Market Price – Estimated cost to complete sale

[Comment: In the calculation of NRV the entire cost which is expected to complete the sale should be deducted because market value is not comparable directly to factory cost. Amount of administrative expense & selling overhead which are expected to be incurred should be deducted out of market value to convert such price equal to factory cost.]

Comparison

(1) Finished Goods

Example	***Material***	***2,00,000***
	Wages	***1,00,000***
	Factory Overhead (Variable)	***1,00,000***
		4,00,000
	Factory Overhead (Fixed)	***4,00,000***
	Normal Capacity	***1,00,000 units***
	Actual Capacity	***80,000 units***

Out of 80,000 units, the enterprise has sold the 70,000 units. Calculate value of 10,000 units which are held in the stocks assuming market price Rs 50 per unit & estimated cost to complete the sale of Rs 25,000.

Sol: Calculation of Fixed cost

Material	***2,00,000***		
Wages	***1,00,000***		
Factory Overhead (V)		***1,00,000***	
Factory Overhead (F)		***3,20,000***	***(400000 / 100000 x 80000)***
	7,20,000		

Cost of 10000 units = 720000 / 80000 x 10000 = Rs 90,000
NRV = 500000 – 25000 = Rs 4,75,000

Valuation = Cost or NRV whichever is lower
= Rs 90,000

(2) <u>Raw Material</u>
Example: *Finished goods are valued at cost.*
Raw Material (10000) Rs 10/- Cost
Raw Material Rs 8/- S.P.
Valuation of RM ?

Comments: In the given case valuation of raw material should be carried at cost only even if market price of such material is lower than cost. Raw material are purchased only for consumption purpose and after consumption such material will be converted into finished goods which are valued at cost. It means that there is no loss on finished goods due to which loss can't be recorded on direct material.

Example: *Finished goods are valued at NRV*

	Raw Material (cost)	*Rs 10/-*
(i)	*Market Price*	*Rs 12/-*
(ii)	*Market Price*	*Rs 8/-*

Comments: Finished goods are valued at NRV due to which valuation of raw material should be made as per valuation principle. In the first case valuation should be carried at Rs 10 per unit because cost is lower. In second case valuation should be made at market price because cost is higher.

(3) <u>Working in Process</u>
Valuation of WIP should always be made at cost because market price estimation may not be accurate for these goods.

<u>Important Points</u>
(1) If any enterprise is having units of contract sale then independent market price should be ignored for the valuation of contract sale of unit. Valuation of these units should be considered only by contract price.
(2) As per AS – 2 interest can't be capitalized in the cost of inventory because such amount is not related to production but interest can be capitalized in the cost of inventory as per the provision of AS – 16.

<u>Valuation Method</u>
FIFO
Weighted Average
Retail Value (For Mall)

Example: ***<u>Retail Value</u>***

Particulars	*RV*	*Cost*
Op. Stock	*10000*	*2000*
Purchase	*<u>50000</u>*	*<u>25000</u>*
	<u>60000</u>	*<u>27000</u>*

Retail Value Sold = Rs 50000

Stock value	***=***	***25000 / 50000 x 10000 = Rs 5000***
Avg base	***=***	***27000 / 60000 x 10000 = Rs 4500***

Disclosures

(1) Accounting policy should be disclosed. (FIFO / Weighted Avg / Retail Value)

(2) If any stock has been valued at NRV then description of such stock should also given in the note to accounts.

Taxes on Income
AS – 22

Contents

- ***Applicability & Nature***
- ***Definitions***
- ***Situation in AS – 22***
- ***Para 15, 17***
- ***Presentations & Disclosures***
- ***ASI***

Applicability & Nature

Applicable	***:***	***01-04-2001***	***Listed Companies***
		01-04-2002	***All Companies***
		01-04-2006	***All Enterprises***
Nature	***:***	***Mandatory***	

Definitions

Accounting Profits

Accounting profits are the profits which are calculated in Trading & P&L a/c and such profit is before Tax (PBT).

Taxable Profits

Taxable profit is the income which is calculated as per the provisions of Income Tax Act.

Tax Expense

Tax Expense = Current Tax + Deferred Tax

Current Tax

Current Tax = Taxable Income x Tax Rate

Deferred Tax

Deferred Tax = Timing Difference x Tax Rate

Timing Difference

Timing Difference is those differences which are same by amount under Income Tax Act & accounting records. But these items are different only by periods. Timing difference are also known as reversible differences because differences are the differences of period.

Permanent Difference

Permanent Difference is those differences which are not reversible in future because these differences are not covered by time but related to amount. Calculation of Deferred tax should not be made for these differences & provisions of AS – 22 are not applicable on these items.

Example of Difference

Timing Difference

(1) ***Difference in Depreciation rates***
(2) ***Difference in Depreciation method***
(3) ***Development expenses: As per AS – 26 Development expenditure should be written off over a period of 10 years but 100% amount is deductible as per Income Tax in the first year. Such difference can also be classified as Timing Difference.***

Permanent Difference: All the items which are totally disallowed whether income or expense then disallowed items should be covered under permanent difference.

Accounting Procedure

(1) ***Creation of Deferred Tax***
(2) ***Reversal of Deferred Tax***

Creation of Deferred Tax

Situation 1: Accounting Profit is higher than Taxable Income

Example:	***Accounting Income***	***50000***
	Taxable Income	***30000***
	Tax Rate	***50%***

Assumption: All differences are Timing Difference
Calculate current tax, deferred tax & Tax expense.

Sol: ***Current Tax = 30000 x 50%***
= 15000

Deferred Tax = Timing Difference x Tax Rate

Statement showing calculation of Deferred Tax

Accounting Income	***50000***

Taxable Income ***(30000)***
Difference ***20000***
Tax Rate ***50%***
Deferred Tax Liability 10000

Journal Entries

1 P&L A/c Dr. 15000
To Current Tax 15000

2 P&L A/c Dr 10000
To Deferred Tax Liability 10000

Tax Expense = 15000 + 10000
= 25000

Situation 2: Accounting Profit is lower than Taxable Income

Example: Accounting Income 200000
Taxable Income 300000
Tax Rate 30%

Assumption: All differences are Timing Difference
Calculate current tax, deferred tax.

Sol: Current Tax = 300000 x 30%
= 90000

Deferred Tax Assets = (300000 – 200000) x 30%
= 30000

Journal Entries

1 P&L A/c Dr. 90000
To Current Tax 90000

2 Deferred Tax Assets Dr 30000
To P&L A/c 30000

Situation 3: Accounting Loss but Taxable Income

Example: Accounting Loss (50000)
Taxable Income 100000
Tax Rate 50%

Calculate tax expense assuming timing difference.

Sol: Current Tax = 100000 x 50%
= 50000

Deferred Tax Assets = [100000 – (-50000)] x 50%
= 75000

Journal Entries

1 P&L A/c Dr. 50000
To Current Tax 50000

2 Deferred Tax Assets Dr 75000
To P&L A/c 75000

Situation 4: Accounting Income but Taxable Loss

Example:	***Accounting Income***	***200000***
	Taxable Loss	***(100000)***
	Tax Rate	***30%***

Calculate tax expense assuming timing difference.

Sol: ***Current Tax = NIL***

Deferred Tax Liability = [200000 – (-100000)] x 30%
= 90000

Note: Wherever in any situation taxable loss is specified, Deferred Tax Asset should be calculated on taxable losses because taxable loss can be adjusted against future income.

DTA on taxable loss = 100000 x 30% = 30000

Provisions of Para 15 & 17

(a) Para 15: As per AS – 22, any enterprise can calculate deferred tax asset on timing difference only if reasonable certainties exits.

(b) Para 17: Deferred Tax Assets on taxable losses can be created only if enterprise is having convincing evidence in relation to future taxable income against which taxable losses can be set off. As per ASI 9, Convincing Evidence may be project reports, cash flow calculation, export order or any other document that can be used as a proof of future profits.

Situation 5: Accounting loss is higher than Taxable Loss

Example:	***Accounting Loss***	***(20000)***
	Taxable Loss	***(10000)***
	Tax Rate	***50%***

Calculate tax expense assuming timing difference.

Sol: ***Current Tax = NIL***

Deferred Tax Assets on Timing Difference = 10000 x 50% = 5000
Deferred Tax Assets on Taxable Losses = 10000 x 50% = 5000

Deferred Tax Assets Dr. 10000
To P&L A/c 10000

Situation 6: Accounting loss is lower than Taxable Loss

Example:	***Accounting Loss***	***(200000)***
	Taxable Loss	***(400000)***
	Tax Rate	***50%***

Calculate tax expense assuming timing difference.

Sol: ***Current Tax = NIL***

Deferred Tax Liability on Timing Difference = 200000 x 50% = 100000
Deferred Tax Assets on Taxable Losses = 400000 x 50% = 200000

Presentation & Disclosures

Balance Sheet

Share Capital	***Fixed Assets***
Reserve & Surplus	***Investments***
Loan Funds	***Deferred Tax Assets***
Deferred Tax Liability	***Current Assets***
Current Liability	

As per AS – 22, disclosures in Balance Sheet is mandatory and DTL & DTA should be disclosed separately. Calculation of Current Tax & Deferred Tax is mandatory as per the provisions of AS – 22. But the following interpretations are also considerable.

(i) 80IA, 80IB, 10A & 10B: If any enterprise is covered under specified sections then application of AS – 22 is not mandatory during tax holiday period.
(ii) Long Term Capital Loss: DTA on LTCL can be created only if enterprise is having convincing evidence in relation to future LTCG.
(iii) 115JB (MAT): If any company has calculated current tax as per the section 115JB (MAT) then calculation of deferred tax should not be made by MAT rate but normal tax rate should be applied for timing difference.

Example: ***Accounting Income 200000***
Taxable Income 40000
Tax Rate 50%
Book profit (115JB) 400000
MAT rate 10%

Calculate tax expense assuming timing difference.

Sol: ***Current Tax = Higher of 50% of 40,000 or 10% of 4,00,000***
= 40,000
Deferred Tax Liability on Timing Difference = 160000 x 50% = 80000

P&L A/c Dr. 1,20,000
To Current Tax 40,000
To DTL 80,000

Example: ***Accounting Income 200000***
Taxable Income 40000
Tax Rate 50%
Book profit (115JB) 400000

MAT rate 10%

Calculate tax expense assuming timing difference.

Sol: *Current Tax = Higher of 50% of 40,000 or 10% of 4,00,000*
= 40,000

Deferred Tax Liability on Timing Difference = 160000 x 50% = 80000

P&L A/c	*Dr.*	*1,20,000*	
To Current Tax			*40,000*
To DTL			*80,000*

Example:

Accounting Income before Dep.	*2,00,000*
Taxable Income before Dep.	*2,00,000*
Tax rate	*50%*

The company has incurred Rs 1,50,000 for purchase of a machinery which is having a useful life of 3 years. The same expenditure is eligible for 100% deduction as per Income Tax Act. Calculate amount of deferred tax & current tax over a period of 3 years upto the life of asset.

Sol:

W.N.1 ***Calculation of Accounting Income***

	1st Year	*2nd Year*	*3rd Year*
Accounting Income	*200000*	*200000*	*200000*
Less: Dep. (150000 / 3)	*(50000)*	*(50000)*	*(50000)*
Net Accounting Income	*150000*	*150000*	*150000*

W.N.2 ***Calculation of Taxable Income***

	1st Year	*2nd Year*	*3rd Year*
Taxable Income	*200000*	*200000*	*200000*
Less: Dep.	*(150000)*	*-*	*-*
Net Accounting Income	*50000*	*200000*	*200000*

1st Year

Accounting Income	*1,50,000*
Taxable Income	*50,000*

(a) Current Tax = 50000 x 50% = 25,000
(b) DTL = 100000 x 50% = 50,000
75,000

(1)	*P&L A/c*	*Dr.*	*25000*	
	To Current Tax			*25000*
(2)	*P&L A/c*	*Dr.*	*50000*	
	To DTL			*50000*

2nd Year

Accounting Income	*1,50,000*
Taxable Income	*2,00,000*

(a) Current Tax = 200000 x 50% = 1,00,000

(b)	***Reversal of DTL***	*=*	***50000 x 50%***	*=*	***(25,000)***
					75,000

(1)	***P&L A/c***	***Dr.***	***100000***	
		To Current Tax		***100000***
(2)	***DTL***	***Dr.***	***25000***	
		To P&L A/c		***25000***

3rd Year

	Accounting Income		***1,50,000***		
	Taxable Income		***2,00,000***		
(a)	***Current Tax***	*=*	***200000 x 50%***	*=*	***1,00,000***
(b)	***Reversal of DTL***	*=*	***50000 x 50%***	*=*	***(25,000)***
					75,000

(1)	***P&L A/c***	***Dr.***	***100000***	
		To Current Tax		***100000***
(2)	***DTL***	***Dr.***	***25000***	
		To P&L A/c		***25000***

Notes: As per AS all the journal entries which are related to reversal are mandatory for recording purpose for the enterprises. As per the requirements of AS reversal of deferred tax should also be recorded in addition to creation of deferred tax.

In the given example difference of Rs 1,00,000 has been recorded in the 1st year out of which Rs 50,000 have been reversed every year. In the first year DTL a/c has been opened in the same year. Account has been reversed in the next two year.

Example 2 Calculate Tax expense by following informations.

	Accounting Income	***200000***
Less:	***Dividend Income***	***(20000)***
Less:	***Tax free profits***	***(40000)***
Add:	***Rent in advance***	***10000***
	Taxable Income	***150000***
	Tax Rate	***50%***

Sol:

(a)	***Current Tax***	*=*	***150000 x 50%***	*=*	***75,000***
(b)	***DTA***	*=*	***10000 x 50%***	*=*	***(5,000)***
					70,000

(1)	***P&L A/c***	***Dr.***	***75000***	
		To Current Tax		***75000***
(2)	***DTA***	***Dr.***	***5000***	
		To P&L A/c		***5000***

Note: As per AS permanent difference should be ignored for accounting purpose. So Dividend income and tax free profits are not included in the specified workings.

Example 3 Calculate DTA / DTL for the following items.

		Account	Tax
(1)	***Prepaid Exp.***	***10000***	***-***
(2)	***Outstanding Exp***	***-***	***2000***
(3)	***Advance Income***	***20000***	***-***

Tax Rate 50%

(a)	***DTL on Prepaid Exp***	=	***10000 x 50%***	=	***5000***
(b)	***DTL on O/s Exp***	=	***2000 x 50%***	=	***1000***
(c)	***DTA on Advance income***	=	***20000 x 50%***	=	***10000***

Example 4 Accounting Income & Taxable Income is same & there is no limits difference and permanent difference.

	Period I	Period II	Period III
AI / TI	***(1,00,000)***	***(1,00,000)***	***2,50,000***

Tax rate is 50%. Pass journal entries for all periods.

Sol:

1st Year

Current Tax NIL

Timing Difference NIL

DTA on Taxable Loss = 100000 x 50%

= 50000

DTA	***Dr.***	***50000***	
To P&L A/c			***50000***

Comment: Any enterprise can record deferred tax asset on taxable losses subject to the conditions of Para 17 (Convincing evidence). In the given example we have assumed that conditions of para 17 are satisfied.

2nd Year

DTA	***Dr.***	***50000***	
To P&L A/c			***50000***

3rd Year

	Taxable income	***250000***
Less:	***Adjustment of previous loss***	***200000***
		50000
	Tax rate	***50%***
	Current Tax	***25000***

P&L A/c	***Dr.***	***125000***	
To Current Tax			***25000***
To DTA			***100000***

Comment: In the 3rd year current tax should be calculated only on adjusted taxable income after setting off previous losses. Due to taxable profits deferred tax assets should also be reversed because taxable losses have been adjusted against taxable profits.

Example 5 — ***Calculation of Accounting Income***

	1st Year	2nd Year	3rd Year
Accounting Income	200000	200000	200000
Less: Dep. (150000 / 3)	(50000)	(50000)	(50000)
Net Accounting Income	150000	150000	150000

	1st Year	2nd Year	3rd Year
Taxable Income	200000	200000	200000
Less: Dep.	(150000)	-	-
Net Accounting Income	50000	200000	200000
Tax rate	30%	35%	40%

Calculate Tax Expense

Sol: Accounting for 1st year

Taxable Income	50000
Accounting Income	150000

Current Tax	=	50000 x 30% =	15000
DTL	=	100000 x 30% =	30000
			45000

2nd Year

Taxable Income	200000
Accounting Income	150000

Reversal of Deferred Tax = 30000 – (50000 x 40%) = 30000 – 20000 = 10000*

Note: As per the provisions of AS – 22 the following steps should be applied in the situations of different tax rates.

Step1: Calculate current tax & deferred tax by tax rate which is effective for the current year.

Step2: Reversal of timing difference should not be calculated but these amounts will be the balancing figures after applying the following equations.

Total Deferred Tax – (Timing difference of next year x Tax rate of next year) = Reversal (Bal figure)

**** Timing difference of Rs 50000 will be reversed in 3rd year and tax rate will be 40% in the 3rd year. It means that deferred tax should be carried in the 3rd year of Rs 20000 and balance amount can be reversed.***

3rd Year

In the last year the total amount will be reversed because there will be no timing difference for reversal in the 4th year.

Accounting for Associates in Consolidated Financial Statements
AS – 23

Contents

- ***Applicability & Nature***
- ***Meaning of Associates***
- ***Accounting for Associate***
- ***Important Points***
- ***Same Accounting Policies & Reporting Periods***
- ***Disclosures***

Applicability & Nature

Applicable	***:***	***01-04-2002***
Nature	***:***	***Mandatory****

***Mandatory: AS – 23 is applicable only if consolidated financial statements have been prepared as per AS – 21. In the separate books of investor accounting for associates should be carried as per the provisions of AS – 13. On the basis of above explanation it can be said that AS – 23 can be applied only if application of AS – 21 exists.*

Meaning of Associate

Any Enterprise can be classified as an associate if investor is having significant influence in the enterprise.

Meaning of Significant Influence

Significant influence is the power to participate in the operating & financial decisions of the enterprise but not to control these decisions.

Example of Participation

(a) Representation of Board of Directors
(b) Voting Rights
(c) Interchange of Technical Information
(d) Interchange of Managerial Personnel

***Note:** In normal situation if any investor is having 20% to 50% voting power of any other enterprise then it will be assumed that the other enterprise is an associate of the investor.*

If any investor is having 20% to 50% share with out power of participation then definition of Associate & Application of AS – 23 should not be made.

Accounting of Associate

Step1: Initial recording should be made on cost basis, identify goodwill / capital reserve on the same date.
(As per AS disclosure of investment in associates should be made in CFS at cost at the time of purchase of Investment but share in equity & goodwill / capital reserve should also be made disclosed in CFS on the same date)

Example: A Ltd purchased 40% share of B Ltd on 1-1-99. Cost of investment is of Rs 10,00,000. Following position is available as on 1-1-99:-

Equity Share Capital	2500000
P&L A/c	400000
General Reserve	200000
Capital Reserve	300000
Revaluation Reserve	100000
	3500000

Disclose Investment in CFS on the date of Investment.

Sol:
W.N.1 Calculation of Goodwill / Capital Reserve

	Cost of Investment	1000000
Less:	Share in Equity (3500000 x 40%)	1400000
		(400000)

CFS (A Ltd + B Ltd)

	Investment in B Ltd Share in Equity 1400000 Less: Capital Reserve (400000) 1000000

Example: With the help of same example disclose investment in CFS assuming that cost of Investment is of Rs. 1600000
Sol:
W.N.1 Calculation of Goodwill / Capital Reserve

	Cost of Investment	1600000
Less:	Share in Equity (3500000 x 40%)	1400000
	Goodwill	200000

CFS (A Ltd + B Ltd)

	Investment in B Ltd *Share in Equity 1400000* *Add: Goodwill <u>200000</u> 1600000*

Step2: Adjust post acquisition changes in cost of investment by post acquisition profits or losses. (In case of post profit value of investment will be increased in the asset side & revaluation reserve should be created in liabilities side. If situation is in loss then value of investment should be reduced and amount of reduction should be adjusted first against revaluation reserve & in the absence of revaluation reserve Consolidated P&L A/c should be used.)

Example: ***D.O.A*** ***1-1-99***
COI (30%) ***200000***
<u>Position of Associate</u>
Equity Share Capital ***200000***
Reserve ***400000***

During 99 Associate has earned a profit of Rs 80000. Disclose investment in CFS as on 31-12-99.

Sol: ***CFS***

Investment Revaluation Reserve 24000	*Investment in Associate* *Share in Equity 180000* *Add: Goodwill 20000* *Add: Increase in Equity <u>24000</u> 224000* *(80000 x 30%)*

Example: Same above example. Assuming Loss during 99 of Rs 80000.

Sol: ***CFS***

Consolidated P&L A/c *Less: Loss due to reduction (24000)*	*Investment in Associate* *Share in Equity 180000* *Add: Goodwill 20000* *Less: Decrease in Equity <u>(24000)</u> 176000* *(80000 x 30%)*

Step3: Actual distribution received should be deducted out of share in equity. (If any associate has proposed any dividend during the period then amount of proposed dividend should be ignored.)

Example: ***D.O.A*** ***1-1-2004***
COI ***500000***
% of Investment ***40%***
<u>Position of Associate</u>
Equity Share Capital ***1000000***
Reserve & Surplus ***800000***

During 04 the associate company has earned a profit of Rs 5 Lakh out of which Rs 2 Lakh have been proposed / paid.

Sol:

CFS (Proposed)

Investment Revaluation Reserve 200000	***Investment in B Ltd*** ***Share in Equity 720000*** ***Less: Capital Reserve (220000)*** ***Add: Increase in Equity 200000 700000*** ***(500000 x 40%)***

CFS (Paid)

Investment Revaluation Reserve 120000	***Investment in B Ltd*** ***Share in Equity 720000*** ***Less: Capital Reserve (220000)*** ***Add: Increase in Equity 120000 620000*** ***(300000 x 40%)***

Important Points

(1) If any associate company is having losses then investor party can recognize share in losses to the extent of cost of Investment.

If any loss is higher than cost of investment then such loss can't be written off out of Consolidated P&L A/c.

(2) If any associate is having preference share capital then share in equity should be calculated only after providing preference dividend.

(3) If any associate company is having different accounting policies which are not used by the investor party in the preparation of CFS then it is the responsibility of associate company to provide required amounts to the investor for consolidation purpose otherwise reasons should be disclosed.

(4) Accounting period of associate company & investor party should be same for the purpose of consolidation. If in case period are different, it is the responsibility of associate company to provide required information to the investor otherwise reasons should be disclosed.

(5) Investment in Associate should be long term investment otherwise application of AS – 23 is not required.

Disclosures

(1) ***Classify Investment as long term investments.***

(2) ***Accounting period & accounting policies should be disclosed.***

Foreign Currency Transactions
AS – 11

Contents

- ***Applicability & Nature***
- ***Objective***
- ***Definitions***
- ***Accounting for transactions***
- ***Accounting for Operations***

Applicability & Nature

Applicable	***:***	***01-04-2003***
Nature	***:***	***Mandatory for all***

Objective

- ***Accounting for foreign currency transactions***
- ***Accounting for foreign operations***

Definitions

Monetary Items: Monetary items are the items which are payable or receivable in a fixed amount. For example sundry debtors, sundry creditors, bills receivable, bills payable, prepaid expenses, outstanding expenses, loans or any other similar items.

Non monetary Items: non monetary items are the assets & liabilities which are not fixed from the point of view of receivable & payable. For example fixed assets, investments, stocks or any other similar items.

Foreign Operations: As per AS – 11 Foreign Operations are those business which are carried by an enterprise outside India. Foreign Operations can be classified under two separate heading as follows.

(a) Integral Foreign Operations (IFO):

IFO is the operation which is carried by an enterprise as a part of business and all the transaction of such operation should be considered as a part of business of the enterprise. Under the definitions of Integral Foreign Operations only Foreign branches are covered.

(b) Non Integral Foreign Operations:

Such operations can't be considered as a part of business of the enterprise but control & significant influence may be exercised by the enterprise. For example foreign subsidiary, foreign associate, foreign joint venture.

Foreign Currency Transactions

- ***Settlement in same year***
- ***Settlement in next year***

Settlement in same year:

(i) Initial recognition of the transaction should be made by Spot rate.

(ii) At the time of settlement, difference between settlement rate & spot rate should be transferred to profit & loss a/c whether exchange profit or exchange loss.

Settlement in next year:

(i) Initial recording should be made by Spot rate.

(ii) Balance Sheet Date: If any transaction is pending on balance sheet date then such pending item should be classified into monetary and non monetary items. If classified item is a non monetary item then disclosure will be made at same amount which was recorded at the time of initial recognition. In case classified item is a monetary item then disclosure will be made at balance rate. Difference between actual rate & balance sheet rate should be transferred to P&L a/c of the same year.

(iii) At the time of settlement the following points should be considered.

- ***Non monetary item: Settlement of non monetary item should be adjusted in P&L A/c by the difference of settlement rate & actual rate.***
- ***Monetary item: At the time of settlement of monetary item difference between balance sheet rate & settlement rate should be adjusted in P&L A/c.***

Accounting for Foreign Operations

- ***Integral Foreign Operations***
- ***Non Integral Foreign Operations – Refer foreign subsidiary for translation rules.***

Translation rules for foreign branch:

(1) Current Asset, Current Liabilities, Loans = Closing rate

(2) Fixed Assets = Actual rate

(3) Income & Expenses = Average rate

(Depreciation should not be converted by average rate because depreciation is calculated on fixed assets which are converted into original cost by actual rate.)

(4) All the transactions between Head Office & Branch is not required to be converted because these transaction can be used directly from Head office books.

(5) After conversion of branch trial balance, difference between debit side & credit side should be transferred to P&L A/c assuming exchange profit or loss.

Statement showing Conversion of Trial Balance

	Dr.	***Cr.***	***Working***
Current Asset	***Xxxx***	***-***	***Closing rate***
Current Liability	***-***	***xxxx***	***Closing rate***
Loan	***-***	***xxxx***	***Closing rate***
Fixed Asset	***Xxxx***	***-***	***Actual rate***
Income	***-***	***xxxx***	***Average rate***
Expense	***Xxxx***	***-***	***Average rate***
Depreciation	***Xxxx***	***-***	***Actual rate***
	Xxxxxx	***xxxxxx***	

Difference of Total of Debit side & Credit Side will be transferred to P&L A/c.

Announcement of ICAI

If any enterprise has purchased fixed asset by raising foreign currency loan then exchange fluctuation on outstanding loan should not be capitalized as per the latest announcement made by ICAI in September 2007. In such case exchange fluctuation on foreign currency loan should be transferred to P&L A/c.

Accounting for Contingent Liabilities & Assets
AS – 29

Contents

- ***Applicability & Nature***
- ***Provisions***
- ***Contingent Liability***
- ***Contingent Asset***

Applicability & Nature

Applicable	***:***	***01-04-2004***
Nature	***:***	***Mandatory for Level I, II & III***

Contingent Liability

(i) ***Meaning of Contingent Liabilities***
(ii) ***Recognition & Disclosures***
(iii) ***Important points***

Meaning of Contingent Liabilities

Contingent Liabilities are the possible obligation that arises out of past events carried by business and these obligations will be confirmed by one or more uncertain events in future which are totally out of control of the management.

Possible Obligation: It is the liability which is not probable at the date of balance sheet and such event should also not be remote. (It means that contingent liabilities are the reasonable events for which reasonable estimation is available.)

For example: If any enterprise is liable for any damage by court's order, then such damage should not be provided in Accounting books, if decision of court is pending at balance sheet date and chances of result of case are not probable.

Recognition & Disclosures

Any contingent liabilities can be recognized in the Notes to Accounts only if the following conditions are satisfied.

a. Possible obligation should be related to past events and should be exist on balance sheet date.
b. It should not be probable because probable items are covered under the heading of provision.
c. If any item is remote, then no disclosure will be required for such item.
d. All the uncertainties related to contingent liabilities should also be disclosed and recognized.

Disclosures of Contingent Liabilities

a. Contingent liabilities should not be recorded in Financial Statement but should be disclosed in the Notes to Accounts.
b. Estimated amount of possible obligation should be disclosed.
c. If any chance of reimbursement of the obligation exists then should be disclosed.

Important Points

a. If any possible obligation is shared by more than one enterprise, every enterprise shall disclose its own share in possible obligation.
b. If any disclosure of contingent liability creates confusion or misunderstanding between the shareholders then such item should not be disclosed.

Contingent Assets

Contingent asset is a possible receivable or gain that arises out of past events and these gains will be confirmed by one or more uncertain future events which are totally out of control. (Contingent gains are based on same definitions which is applicable for contingent liabilities)

Contingent gain should not be recorded in the Financial Statement and also not be disclosed in the Notes to Accounts but disclosure in Director's Report should be made.

Provisions

Contents

- *Meaning of Provision*
- *Meaning of Present Obligation*
- *Meaning of Liabilities*
- *Conditions of Provisions before recognition*
- *Reimbursement*
- *Review of Provisions*
- *Disclosure*
- *Some Example of AS*

Meaning of Provision

Provision is a liability which can be measured by satisfied information available.

Balance Sheet

Liabilities	Amount	Assets	Amount
Provisions (Provisions in Liability side will be under AS – 29)	xxxxx	Assets Less: Provisions (not covered in AS – 29, but covered in AS – 4)	xxxxx

Meaning of Liabilities

Liability is a present obligation that arises out of past events but expected to be settled in future by outflow of enterprise's resources.

Meaning of Present Obligation

Present obligation is the outstanding item at Balance Sheet date which is probable. (Meaning of probable is not specified by AS but it is specified that it should be more than not)

Note: Provisions are covered by AS – 4, but all the provisions which are in the form of liability should be covered under AS – 29. On the basis of definition of AS – 29, it can be said that if any provisions is not covered by liability side of B/S but is deducted out of Asset side will be covered by AS – 4. For example provision for Debtors.

Condition for Recognition

As per AS – 29 any provision can be recognized in Accounting Books only if the following conditions are satisfied:

1. ***It should be current obligation not future obligation.***

2. ***Current obligation should be exist on B/S date.***

3. ***It should be probable and to be settled by outflow.***

4. ***it is immaterial that current obligation is payable to a single person or large public.***

5. ***Provision should be recorded on total basis not item wise.***

6. ***Amount should be certain before providing provision because in the absence of amount, entry can not take place.***

Re-imbursement of Provision

As per AS – 29, if any re-imbursement is available in relation to present obligation, then net amount should be provided in P&L a/c.

Review of Provisions

All the provisions should be reviewed at every B/S date. If any provision is not recognized at B/S date, then such provision should be reversed.

Disclosure

(i) ***Disclosure of provision should be made in B/S as follows.***

BALANCE SHEET			
Provisions xxxxxxx ***Less: Re-imbursement xxxxxxx***	***xxxxxx***		

(ii) ***Statement of provisions should be prepared in "Notes to Accounts" as follows.***

Statement showing provisions	
Particulars	***Amount***
Opening Balance	***xxxxx***

Add: Additions	***xxxxx***
Less: Written Off	***xxxxx (used)***
Less: Reversed	***xxxxx***
Closing Balance	***xxxxxx***

<u>Examples of Provisions</u>

A Ltd - Guarantee
B Ltd - Liquidation

1. If any enterprise has given guarantee for other enterprise, then in the situation of insolvency or liquidation of other enterprise, the given guarantee can become payable. So provision should be created, if actual liquidation or insolvency takes place.

2. If any Act is passed by Govt in relation to Oil companies for contamination of land then provision should be created for the estimated cost required for cleaning up the land. Before creating provision it is very important that applicability of Act should exist on B/S date not in future date.

3. If any company is having past experience in relation to rejected sale then the company should provide for such rejected sale at B/S date for outstanding sale.

4. If any company is required to Smoke fitters to control the pollution then estimated cost should be provided in advance.

Debtor's A/c	***xxxx***	
To Sale A/c		***xxx***
P& L A/c	***xxxx***	
To Provision for Sale		***xxx***

BALANCE SHEET			
Liabilities	***Amount***	***Assets***	***Amount***
Provision for Sale	***xxxxx***	***Debtor***	***xxxxx***

Note: As per AS – 29 accounting for provisions is mandatory for accurate financial statements and accurate disclosures of EPS. Contingent Liabilities should be disclosed for the presentation of future payments which are expected in the next financial period.

Related Party Disclosures
AS – 18

Contents

- ***Applicability & Nature***
- ***Objective***
- ***Definitions***
- ***Paragraph 3 – Relationships***
- ***Out of Scope***
- ***Disclosures***
- ***ASI***
- ***Differences***

Applicability & Nature

Applicable	***:***	***01-04-2001***
Nature	***:***	***Mandatory for Level I enterprises***

Objective

The main objective of the accounting standard is to disclose the related party relationship and related party transactions.

Definitions

Meaning of Related Party
Related Party is the enterprise that is having control or Significant Influence over the other enterprise during the period.

Note:- Control or Significant Influence is not required on balance sheet date but such relationship should exists during the period at anytime.

Meaning of Control
Control is the power to operate financial and operating policies of the other enterprise. Such power can be exercised by acquisitions of voting rights more than 50% of other enterprise.

<u>Meaning of Holding Company & Subsidiary Company</u>
Holding company is the enterprise that is having one subsidiary or more subsidiaries.

Subsidiary company is the enterprise that is controlled by Holding Company.

<u>Meaning of Significant Influence</u>
Significant Influence is the power to participate in the operating & financial decisions of the company but not to control over these decisions. Power to participate can be recognized by 20% equity share or more than 20% share but up to 50% share.

<u>Meaning of Associate</u>
If any enterprise is having significant influence in the other enterprise than the other enterprise should be recognized as an associate of the Investor party.

<u>Meaning of Joint Venture</u>
Joint Venture is the venture by which two or more parties undertake an economic activity for economic benefit subject to joint control (The Investor parties of the joint venture are known as Ventures)

<u>Meaning of Key Management Personnel</u>
Key Management Personnel is the person that is having the powers of planning, directing and controlling. On the basis of such definitions, designation of employee is not important but existence of three powers as specified above is important.

As per ASI 21, Non-executive director can be covered under the heading of key management if such person is having power of planning directing and controlling.

<u>Meaning of Relative</u>
As per AS 18, the following persons are covered in the meaning of relative.
a) Spouse
b) Father / Mother
c) Brother / Sister
d) Son / Daughter

<u>Meaning of State Controlled Enterprises</u>
If any enterprise is controlled by state govt or central govt then such enterprise should be classified as State Controlled Enterprise.

<u>Relationships (Paragraph 3)</u>

A. If any enterprise (directly or indirectly by way of subsidiaries) <u>Control</u>, <u>Controlled by</u> or <u>under Common Control</u> with Reporting Enterprise.

If any enterprise

Control	***Controlled By***	***Under Common Control***
R.E.	***R.E.***	***R.E.***

<u>Note:</u> On the basis of above explanation it can be said that if any reporting enterprise is having holding company, subsidiary company or fellow subsidiaries then all these parties should be disclosed as related party.

Ques 1. A Ltd is having 60% stake in B Ltd & 70% stake in C Ltd.

Ans
Related party if A is R.E.:- B Ltd & C Ltd both are related parties of A Ltd because these enterprises are controlled by A Ltd.

Related party if C is R.E.:- If C Ltd is the R.E. then A Ltd & B Ltd both are related parties because A Ltd controls C Ltd and B Ltd is under common control with C Ltd.

Ques 2. A Ltd is having 70% stake in B Ltd & 80% stake in C Ltd. B Ltd is having 80% stake in D Ltd & C Ltd is having 70% stake in E Ltd.

Ans
If R.E. is D Ltd then the following points may be considerable for related party relationship.

(I) A Ltd is related party of D Ltd becoz A Ltd controls D Ltd indirectly through B Ltd. It should be recognized Holding Company.

(II) B Ltd, C Ltd, E Ltd all the parties are related becoz these enterprises are covered under common control of A Ltd with D Ltd.

Ques 3. A Ltd is having 80% stake in B Ltd, 70% stake in C Ltd & 20% stake in D Ltd. B Ltd is having 40% stake in D Ltd & C Ltd is having 90% stake in E Ltd.

<u>Comments:</u> If D Ltd is R.E.
(a) A Ltd is the related party because such company controls D Ltd directly and indirectly by having 60% voting rights.

(b) B Ltd, C Ltd, E Ltd all the enterprises are also related party because these enterprises are under common control with D Ltd.

B.
(i) If any enterprise is associate of Reporting Enterprise or Reporting Enterprise is associate with of other enterprise.

(ii) If any enterprise is joint venture of R.E. or R.E. is joint venture of other enterprise.

Ques 1 C Ltd is joint venture of A Ltd & B Ltd.

<u>Comments:</u>
(a) If R.E. is A Ltd then C Ltd should be recognized as related party but there is no relationship between A Ltd and B Ltd becoz not covered by relationship defined by AS.

(b) If R.E. is C Ltd, then all the parties will be related parties becoz C Ltd is a JV of A Ltd & B Ltd.

Ques 2 C Ltd is joint venture of A Ltd & B Ltd. It has 25% stake in D Ltd and 60% stake in E Ltd.

Comments:

(a) ***If A Ltd is the reporting enterprise then C Ltd should be recognized as related party. No other enterprise can be covered in the meaning of related party becoz provisions of para 3 are not applicable.***

(b) ***If R.E. is C Ltd, then all the parties should be recognized as related parties. A & B are ventures, D Ltd is an associate and E Ltd is subsidiary.***

(c) ***If R.E. is D Ltd then C Ltd will be the single related party because R.E. is an associate of C Ltd.***

C. ***Key Management Personnel and their relatives.***

D. ***If any Individual is having control or significant influence in the Reporting Enterprise then such individual will be related party of Reporting Enterprise including his relatives.***

E. ***If any enterprise is having Common Persons with Reporting Enterprise as specified in para 3 [C] & [D] then such enterprise should also be recognized as related party of reporting enterprise.***

For example A is Key Management personnel in A Ltd & B Ltd. A Ltd is R.E. Therefore B Ltd is related party.

Notes: For the purpose of related party relationships as per Point E, it is very necessary for the disclosure that the common person should be covered under Point C and Point D. Such Person should be recognized as common person even if he is Key Management in one company and individual investor in the other company.

Out of Scope

The following parties are specifically stated out of the coverage of AS – 18.

(a) ***Loan providers***
(b) ***Single buyer or agent or franchiser should not be covered under related party.***
(c) ***Trade Unions***
(d) ***All the provisions of AS – 18 should not be applied on state controlled enterprise.***

Disclosures

As per the AS provisions, Disclosures requirements are difference in the Existence of Control and Absence of Control in the situation of relationship.

Existence of Control: ***If any R.E. is having related parties due to existence of control in the relationship then the disclosure should be made whether related party transaction have been occurred during the period or not.***

Absence of Control: ***If any R.E. is having related parties without existence of control in the relationship then disclosure requirement shall be applied only if related party transaction has taken place during the period between the enterprises.***

- ***Name of Related Parties***
- ***Nature of Relationship***
- ***Nature of transactions***

- ***Amount of transactions***
- ***Bad debts related to transactions***
- ***Recovery of Bad debts related to transactions***
- ***Any other information can be disclosed by the enterprise based on judgment if require to improve the presentation of financial statement.***

Meaning of Nature of transaction

Related party transaction is the change in resources of the enterprise whether price is negotiated or not.

The following are the examples of the transactions.

a) ***Sale of Goods***
b) ***Purchase of Goods***
c) ***Receiving or rendering of services.***
d) ***Loan providing***
e) ***Hire purchase or Lease agreement***
f) ***Any other transaction.***

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As per Interpretation, if any Enterprise has paid managerial remuneration or any other amount to its Key Management Personnel then such payment should be recognized as related party transaction and to be disclosed in the disclosure statement as specified above.

Difference between AS, IAS & US GAAP

1. Meaning of Relative is not same under Indian AS and IAS or US GAAP. 7 relationships are defined as per AS 18 but as per other statements no specific relative is defined. As per IAS or US GAAP in the meaning of relative only close members are to be disclosed in the statement of related party.

2. As per AS 18 disclosure requirements are different in the existence of control and absence of control but disclosure of other statements is not based on existence or absence of control.

3. As per AS 18, all the transactions should be disclosed whether negotiations in price has taken place or not but as per other statements disclosure is required only for those transactions which are negotiated. It means that if any transaction has taken place at normal selling price then transactions not to be disclosed in the statements of related party.

4. State controlled enterprises are not covered under the application of AS 18 but there is no provision in relation to state controlled enterprise under IAS and US GAAP.

5. As per AS 18 pricing policy of the company is not required to be disclosed but such disclosure is mandatory as per other statement.

Segment Reporting
AS – 17

Contents

- ***Applicability & Nature***
- ***Objective***
- ***Definitions***
- ***Identification of Segments***
- ***Reportable Segments***
- ***Important Points***
- ***Primary Segment / Secondary Segment***
- ***Disclosures***
- ***Differences***

Applicability & Nature

Applicable	***:***	***01-04-2001***
Nature	***:***	***Mandatory for Level I enterprises***

Objective

AS 17 require disclosure of information relating to product and areas in which the company is involved. Information of products should be disclosed separately and information of areas should also be prepared separately only to improve the financial statement presentation and comparison.

Definitions

(i) Meaning of Segment Reporting: Segment reporting is a disclosure statement which is prepared to disclose two types of segments.

- ***(a) Business Segment***
- ***(b) Geographical Segment***

(ii) Meaning of Business Segment: Business Segment is the different product of the enterprise which is having different risk and returns from other products.

(iii) Meaning of Geographical Segment: Geographical Segment is the different area of the enterprise which is having different risk and returns from other areas.

Identifications of Segments

If risk and returns of products and areas are not helpful in classification of segment then following points can be considered.

Business Segment

(a) Nature of Products
(b) Production Process
(c) Class of customer
(d) Distribution system of goods

Geographical Segment

(a) Political Boundaries
(b) Foreign currency risk
(c) FEMA
(d) As per AS any area can be disclosed by the enterprise. If management wants to disclose any particular by ignoring the above points (On the basis of such explanation disclose can be made country wise, city wise, town wise, state wise or any other minor disclosure)

Reportable Segments

All the identified segments are not to be disclosed. The identified segment can be disclosed in segment reporting only if at least one condition out of 3 conditions is satisfied.

Condition 1: If segment sale is 10% or more of total sale then such segment should be included in segment reporting. Sale can be external or internal.

OR

Condition 2: If segment assets are 10% or more of total assets.

OR

Condition 3: If Segment Result is 10% or more of Total Results in Profits or Total Results in Loss whichever is higher.

Ex.	A	B	C	D	E
Profit (Loss)	1 Lakh	(0.50 Lakh)	1 Lakh	(2.50 Lakh)	(0.50 Lakh)

Total Profit = A + C = 2 Lakh
Total Loss = B + D + E = 3.50 Lakh

Higher amount is Rs 3,50,000/-

% of Results	28.57%	14.27%	28.57%	71.43%	14.28%
On Loss	(1L/3.50L)	(0.50L/3.5L)	(1L / 3.50L)	(2.50L / 3.50L)	(0.50L / 3.50L)
	R	R	R	R	R

Important Points

(1) If any segment is not covered under conditions of reportable segment then such segment should be recognized as unreportable segment. Disclosure of such unreportable segments can be made if management desirous to include such segment in the report even if conditions are not fulfilled.

(2) 75% of external sales of the enterprise should be covered by reportable segment. If disclosure of 75% of external sale is not covered by reportable then additional segment should be classified as reportable segment even if conditions of 10% are not satisfied.

Example

	A	***B***	***C***	***D***	***E***	***F***
Sale	***10000***	***20000***	***50000***	***6000***	***7000***	***7000***
% of Total Sale	***10%***	***20%***	***50%***	***6%***	***7%***	***7%***
	R	***R***	***R***	***UR***	***UR***	***UR***

Comment: In the above example 80% sale is covered by reportable segments and minimum disclosure is required of 75%. So condition of 75% is satisfied.

(3) If any segment is reportable in the current year but was unreportable segment in the previous year then segment reporting of previous year should be revised for comparison purpose.

(4) If any segment is unreportable in the current year but was reportable in the previous year then the disclosure of such unreportable segment should be read in the current year even if it is unreportable according to the conditions.

Ques1:
(In Lacs)

	A	***B***	***C***	***D***	***E***
Seg. Revenue	***150***	***200***	***200***	***50***	***300***
% of Total Rev.	***16.67%***	***22.22%***	***22.22%***	***5.55%***	***33.33%***
	R	***R***	***R***	***UR***	***R***

OR

	A	***B***	***C***	***D***	***E***
Segment Result	***50***	***(70)***	***80***	***10***	***(25)***

Total Profit = 50 + 80 + 10 = 140
Total Loss = 70 + 25 = 95

Higher Amount is 95.

Segment Result	***35.70%***	***50%***	***57.14%***	***7.14%***	***17.86***
	R	***R***	***R***	***UR***	***R***

OR

	A	***B***	***C***	***D***	***E***
Segment Assets	***40***	***65***	***140***	***20***	***35***
% of Total Assets	***13.33%***	***21.66%***	***46.67%***	***6.66%***	***11.66%***
	R	***R***	***R***	***UR***	***R***

Comments: All the segments are reportable segments except Segment D because Segment D has not fulfilled any conditions as specified in the provisions of AS – 17.

Ques4.

<u>Statement showing Reportable Segment</u>

(In Lacs)

Particulars	***A***	***B***	***C***	***D***	***E***	***F***	***G***	***H***
Seg. Sale	***200***	***630***	***90***	***30***	***30***	***100***	***50***	***70***
%	***16.67%***	***52.56%***	***7.50%***	***2.50%***	***2.50%***	***8.33%***	***4.17%***	***5.83%***
	R	***R***	***UR***	***UR***	***UR***	***UR***	***UR***	***UR***

OR

Particulars	***A***	***B***	***C***	***D***	***E***	***F***	***G***	***H***
Seg. Assets	***45***	***141***	***15***	***33***	***9***	***15***	***15***	***27***
%	***15%***	***47%***	***5%***	***11%***	***3%***	***5%***	***5%***	***9%***
	R	***R***	***UR***	***R***	***UR***	***UR***	***UR***	***UR***

OR

Particulars	***A***	***B***	***C***	***D***	***E***	***F***	***G***	***H***
Seg. Result	***10***	***(180)***	***30***	***(10)***	***16***	***(10)***	***10***	***14***

Total Profit = 10 + 30 + 16 + 10 + 14 = 80

Total Loss = (180) + (10) + (10) = 200

Higher amount is 200.

%	***5%***	***90%***	***15%***	***5%***	***8%***	***5%***	***5%***	***7%***
	R	***R***	***R***	***R***	***UR***	***UR***	***UR***	***UR***

<u>W.N.</u> Calculation of External Sale in Reportable Segment

Total External Sale = 800 Lacs

Minimum Disclosure
Of Sale = 75% of 800 Lacs
= 600 Lacs

Total Sale covered by
Reportable Segments = A + B + C + D + E
= 510 + 30 + 20 + 30
= 590 Lacs

<u>Comment</u>

(1) Segment A, B C and D are reportable segments becoz condition of 10% as specified by AS is satisfied from the point of view of sales, assets and profit or loss.

(2) ***Segment E is unreportable segment as per conditions of 10% as specified in the statement. Such segment should be disclosed even if it is unreportable becoz the specified segment was reported in the previous year.***

(3) ***As per the statement 75% of external sale should be covered by segment reporting. As per specified conditions minimum disclosure of Rs 600 Lacs out of Rs 800 Lacs is required. But total of reportable external sale is of Rs 590 Lacs which is lower than 600 Lacs. So additional segment should be recognized for the purpose of segment reporting. For such purpose any segment out of F, G, and H can be disclosed.***

Important Calculations

(1) ***Meaning of Segment Result***

Segment Result = Segment Revenue – Segment Expenses

(2) ***Meaning of Segment Revenue***

As per AS, calculation of segment revenue is very important. The following points should be considered in the calculation of segment revenue.

Items to be included:-

External Sale	***xxxx***
Internal Sale	***xxxx***
Share in Common Income*	***xxxx***
Segment Revenue	***xxxxx***

**** Share in common income should be calculated on same reasonable basis. Selection of reasonable base is in the hands of management.***

Items to be excluded:-

(a) ***Extraordinary items.***
(b) ***Investment Income (Dividend, Interest and Rental)****
(c) ***Profit or Loss on sale of investment.***
(d) ***If any common income can't be divided between the segment in the absence of reasonable base then such income should not be included under the heading of segment revenue. Such income should be recognized as unallocated income or enterprise income.***

**** Investment income and Profit or loss on sale of investment can be included in the meaning of segment revenue if company is carrying the business as an investment company.***

(3) ***Meaning of Segment Exp***

Items to be Included:-

(a) ***Directly related with segment***
(b) ***Share in common expense on reasonable basis***

***Items to be Included*:-**

(a) ***Extraordinary Expense***
(b) ***Interest Expense***
(c) ***Tax Provision***
(d) ***Un allocated Expense***

(4) Meaning of Segment Assets

(a) In the calculation of Segment Asset, all the asset should be included which are directly related with segment.

(b) If any asset is used on common basis for all the segments then such common asset should be divided between the segments on reasonable basis. If in case reasonable basis is not available then such assets should be recognized as unallocated or corporate assets.

(c) If any goodwill is available in the balance sheet then such goodwill should also be included in segment reporting by dividing such amount on some reasonable basis. In the absence of reasonable base amount of goodwill should also be recognized as business assets.

(d) If any deferred tax assets are available in the balance sheet then these assets should not be included in the meaning of segment assets.

(e) In the calculation of segment assets only the carrying amount should be used in place of original value.

(5) Meaning of Segment Liabilities

(a) If any liability is directly related or can be distributed on some reasonable basis between the segments then specified amount should be included in the meaning of segment liabilities.

(b) Income tax liabilities should not be included in the calculation of segment liabilities.

(c) If any liability can't be distributed on some reasonable basis then such liability should be recognized as corporate liability.

SEGMENT REPORTING

1.

Particulars	Seg A	Seg B	Seg C	Inter Seg Sale	Total
External Sale	xxx	xxx	xxx	-	xxxx
Inter Segment Sale	xxx	xxx	xxx	xxx	-
Total Sale	xxxx	xxxx	xxxx	xxxx	xxxxx
Less: Segment Exp	xx	xx	xx	xx	Xx
Segment Result	xxx	xxx	xxx	xxx	xxxx
Add: Corporate Income					xxxx
Less: Corporate Expenses					xxxx
Less: Income Tax					xxx

Corporate Income					***xxxx***

2.

Segment Asset	***xxx***	***xxx***	***xxx***	***-***	***xxxx***

3.

Corporate Assets	***-***	***-***	***-***	***-***	***xxxx***

4.

Segment Liabilities	***xxx***	***xxx***	***xxx***	***-***	***xxxx***

5.

Corporate Liabilities	***-***	***-***	***-***	***-***	***xxxx***

Ques7.
Segment Reporting

Particulars	***Seg A***	***Seg B***	***Seg C***	***Inter Seg Sale***	***Total***
External Sale					
Export	***4090***	***200***	***180***	***-***	***4470***
Local	***60***	***-***	***-***	***-***	***60***
Total External Sale	***4150***	***200***	***180***	***-***	***4530***
Internal Sale	***3050***	***30***	***-***	***3080***	***-***
Total Sales	***7200***	***230***	***180***	***3080***	***4530***
Profit (Loss)	***160***	***20***	***(8)***	***-***	***172***
Less: Allocated Cost	***(48)***	***(24)***	***(24)***	***-***	***(96)***
Net Amount	***112***	***(4)***	***(32)***	***-***	***(76)***
Less: Interest cost					***(10)***
Business / Corporate Profit					***66***

Fixed Assets	***200***	***40***	***120***	***-***	***360***
Net Current Assets	***120***	***40***	***90***	***-***	***250***
Total	***320***	***80***	***210***	***-***	***610***

Corporate Assets

Fixed Assets	***-***	***-***	***-***	***-***	***50***
Net Current Assets	***-***	***-***	***-***	***-***	***48***
Total	***-***	***-***	***-***	***-***	***98***

Long Term Liabilities	***20***	***10***	***120***	***-***	***150***

Corporate Liabilities	***-***	***-***	***-***	***-***	***38***

Ques 9.
Segment Reporting

Particulars	Seg A	Seg B	Seg C	Seg D	Inter Seg Sale	Total
External Sale	5595	553	324	155	-	6627
Internal Sale	55	72	21	7	155	-
Total Sale	5650	625	345	162	155	6627
Less: Segment Exp.	(3335)	(425)	(222)	(200)	(122)	(4060)
Profit (Loss)	2315	200	123	(38)	33	2567
Add: Income from Investment	-					132
Less: General Exp						(562)
Less: Interest						(65)
	Business / Corporate Profit					2072
Segment Assets	7320	1320	1050	665	-	10355
Corporate Assets	-	-	-	-	-	722

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As per Interpretation, no segment reporting will be required if any Level 1 enterprise is having one business segment or one geographical segment. In such case financial statements of the enterprise will be used as segment reporting.

Primary Segment & Secondary Segment

At the time of disclosure, business segment or geographical segment are to be disclosed in the sequence on the basis of principle as specified by the statements.

Disclosures P / S

Particulars		Primary Segment	Secondary Segment
(a)	If product is dominant Source of the enterprise	Business	Geographical
(b)	If Ares is dominant Source	Geographical	Business
(c)	If Product & Area both are dominant	Business	Geographical
(d)	If Product & Area both are not dominant	Business or Geographical	- do -

Comment

Meaning of Dominant source is not explained in the provision of AS but the total responsibility to explain dominant source is on management.

Disclosures

(a) Disclosures for Primary Segment

(i) External Sale
(ii) Inter Segment Sale
(iii) Segment Expenses
(iv) Segment Profit or Losses
(v) Corporate Income
(vi) Corporate Expenses
(vii) Segment Assets
(viii) Segment Liabilities
(ix) Corporate Assets & Corporate Liabilities
(x) Depreciation (Segment wise & Corporate wise Fixed Assets)
(xi) Any other non-cash exp.

(b) Disclosures for Secondary Segment

(i) External Sale
(ii) Internal Sale
(iii) Segment Result
(iv) Segment Assets

Differences AS / IAS / US GAAP

1. Under US GAAP disclosure of 10 segments is assumed practical disclosure. In case reportable segment are higher than 10 segments then disclosure can be reduced by ignoring the provisions. No such provisions as specified above is given in the AS and IAS.

2. As per AS and IAS accounting policies should be same which are used for the preparation of financial statement and segment reporting. As per US GAAP these accounting policies may be different in the financial statement and segment reporting. It can be said that different accounting policies can be used for final accounts and segment reporting.

3. A special requirement is also specified under the provisions of US GAAP in relation to disclose of customer name in segment reporting that is having 10% or more share in total external sale. Such disclosure is not required as per AS or IAS.

Accounting for Lease Transactions
AS – 19

Contents

- ***Definitions***
  - ***Meaning of Lease***
  - ***Types of Lease***
  - ***Meaning of Operating Lease***
  - ***Meaning of Finance Lease***
  - ***Meaning of MLP***
  - ***Meaning of RV***
  - ***Meaning of Gross Investment***
  - ***Meaning of Net Investment***
  - ***Meaning of IRR Investment***
- ***Accounting in the books of parties***
- ***Sale & Lease Back Transactions***
- ***Manufactures or Dealers***
- ***Disclosures***

Definitions

Meaning of Lease

Lease is an agreement whereby Lessor conveys to the Lessee right to an asset for agreed period of time in return of a payment or series of payments.

Types of Lease

As per AS, Lease agreement can be classified under two separate heading as follows.

Operating Lease:* *Operating Lease agreement is the agreement which can't be recognized as finance lease.

Finance Lease:* *Finance Lease is the agreement whereby all the risks and rewards incidental to ownership are transferred by Lessor to Lessee.

The following situations conditions should be considered before classification of Lease agreement.

❖ ***If major part of life of the asset is covered by lease agreement then agreement can be classified as finance lease agreement (Meaning of major part is not explained in the provisions of AS but in practical questions more than 2/3rd can be considered as major part)***

❖ ***If any option to purchase is specified in the lease agreement at the end of lease period then agreement can be classified as finance lease agreement.***

❖ ***If any lessee is bound to purchase the leased asset at the end of lease period then agreement can be classified as finance lease agreement.***

❖ ***If nature of asset is only useable for lessee without modification then agreement related to such asset should be classified as finance lease agreement.***

❖ ***Present value of MLP should be equal to or higher than cost of Lessor (fair value) then agreement can be classified as finance lease agreement.***

***Imp Notes:** At least 3 conditions should be satisfied out of 5 conditions as specified above to classify an agreement as finance lease agreement.*

Ques 3.

As per AS – 19 any lease agreement can be claimed as finance lease agreement if the 3 conditions out of 5 conditions are satisfied. These conditions are discussed above.

In the given situation only two conditions can be analyzed. Total life of the asset is 12 yrs but lease agreement covers only 5 yrs which is not a major part of life. Further amount of rental is not equal to fair value of assets.

On the basis of available situations the lease agreement should be classified as operating lease agreement because features of agreement are not in the favour of finance lease agreement.

Ques 6.

W.N.1 Calculation of Present Value of Rental

Period	Rental	PVF (18%)	P. Value
0	40000	1	40000
1	25000	0.847	21175
2	15000	0.718	10770
3	10000	0.609	6090
		Total	78035

***Comment:** Present value of rental is not equal to fair value of the asset on the date of lease agreement. On the basis of such calculation agreement should be classified as operating lease agreement. Other conditions are not specified in the question so other conditions should be ignored.*

Accounting for Operating Lease

- ***Books of Lessor***
- ***Books of Lessee***

Books of Lessor

As per AS, accounting in the books of Lessor under operating lease should be made with the help of following steps.

***Step 1:** First of all Lessor shall receive amount of rentals which are payable by lessee at the time of receipt of rental the following journal entry shall take place.*

Bank A/c Dr.
To Lease Rental

***Step 2:** Amount of rentals should be recognized as normal income for lessor and to be taken to P&L A/c.*

Lease Rental Dr.
To Profit & Loss A/c

***Exception of Step 2**: It may be possible that amount of Lease Rental is not equal over the lease period. In such case income from lease rental in the books of lessor can be recognized only by SLM. It means that equal income can be recognized over the lease period. (Difference between actual collection and income should be recognized as advance income or receivable income.)*

Receivable Income	***Dr.***	***(B.F.)***	
Lease Rental	***Dr.***	***(Actual)***	
To P&L A/c			***(SLM)***
To Advance Income			***(B.F.)***

Ex:

Period	***Lease Rental***
1	***25000***
2	***30000***
3	***5000***

Pass journal entries in the books of lessor assuming operating lease.

Ans:

W.N. 1 ***Calculation of SLM rental***

1	***25000***	
2	***30000***	***SLM = 60000 / 3 = 20000***
3	***5000***	

Journal Entry

1st Year

Bank A/c	***Dr.***	***25000***	
To Lease Rental			***25000***
Lease Rental	***Dr.***	***25000***	
To P&L A/c			***20000***
To Advance Income			***5000***

2nd Year

Bank A/c	***Dr.***	***30000***	
To Lease Rental			***30000***
Lease Rental	***Dr.***	***25000***	
To P&L A/c			***15000***
To Advance Income			***10000***

3rd Year

Bank A/c	***Dr.***	***5000***	
To Lease Rental			***5000***
Lease Rental	***Dr.***	***5000***	

Advance Income Dr. 15000
To P&L A/c 20000

<u>Imp Note</u>: It may be possible that technique SLM is not accurate for the presentation of financial statements. In such a case lease rental can be divided between different periods on the basis of systematic allocation.

<u>Ex.</u> ***Lease Rental = 5 yrs***
Rentals = Rs 10 Lakhs p.a.
Cost of Lessor on the date of Lease agreement = 100 Lakhs
Life of Assets = 10 Yrs
Assumed Int. rate on Investment = 10%
Prepare a statement on the basis of systematic allocation.

<u>Ans:</u> ***Statement showing Systematic allocation***

Period	Investment use By Lessee	Interest (Assumed)	Rental (S.A.)
1	100 Lakhs	10 Lakhs	10 / 40 x 50 = 12.50 Lakhs
2	90 Lakhs	9 Lakhs	9 / 40 x 50 = 11.25 Lakhs
3	80 Lakhs	8 Lakhs	8 / 40 x 50 = 10.00 Lakhs
4	70 Lakhs	7 Lakhs	7 / 40 x 50 = 8.75 Lakhs
5	60 Lakhs	6 Lakhs	6 / 40 x 50 = 7.50 Lakhs
			50 Lakhs

<u>Books of Lessee</u>

(a) ***First of all Lessee shall record the payments of rental according to Lease agreement.***
Lease Rental a/c Dr.
To Bank

(b) ***Amount of Lease rental should be written off in P&L a/c as normal expenses.***
P&L A/c Dr.
To Lease Rental

<u>Exception:</u> It may be possible that Lease rentals over the lease period are not same. In such case amount of expense should be written off on SLM basis. (Difference between actual payments & SLM amount should be recognized as prepaid expense or outstanding expense.)

<u>Ex.</u>

Lease Period	Amount
1	10,000
2	2,000
3	8,000
4	10,000

<u>Ans</u>
W.N.1 ***<u>Calculation of SLM Exp</u>***
10,000 + 2,000 + 8,000 + 10,0000 = 30,000

SLM = 30,000 / 4 = 7,500

Entries

1st year	***Lease Rental A/c***	***Dr.***	***10,000***	
	To Bank			***10,000***
	P&L A/c	***Dr.***	***7,500***	
	Prepaid Exp	***Dr.***	***2,500***	
	To Lease Rental A/c			***10,000***
2nd year	***Lease Rental A/c***	***Dr.***	***2,000***	
	To Bank			***2,000***
	P&L A/c	***Dr.***	***7,500***	
	To Lease Rental			***2,000***
	To Prepaid Exp.			***2,500***
	To O/s Exp.			***3,000***
3rd year	***Lease Rental***	***Dr.***	***8,000***	
	To Bank			***8,000***
	P&L A/c	***Dr.***	***7,500***	
	O/S Exp.	***Dr.***	***500***	
	To Lease Rental			***8,000***
4th year	***Lease Rental***	***Dr.***		***10,000***
	To Bank			***10,000***
	P&L A/c	***Dr.***	***7,500***	
	O/S Exp.	***Dr.***	***2,500***	
	To Lease Rental			***10,000***

Accounting for Operating Lease

Meaning of M.L.P. (Minimum Lease Payment)

MLP are the amounts which are payable by lessee to the lessor over the lease period. Amount of MLP shall include only two amounts.

(a) Lease Rentals
(b) GRV (Guaranteed Residual Value)

Meaning of G.R.V.

GRV is the minimum price or amount which is require to be paid by lessee at the end of lease period to lessor in addition to lease rentals. GRV can be different from residual value which is actually available at the end of lease period.

The following points may be considerable in practical questions at the time of difference between GRV & RV:-

If RV is lower than GRV: If residual value is lower than GRV then difference will be paid by lessee assuming extra use of asset than estimated use in such case the lessee has to pay such difference in cash and also to return the assets if he is not interested to purchase the asset.

In case lessee is interested to purchase the assets the end of lease period then lessee shall pay amount of GRV to the Lessor for the purchase of assets.

If RV is higher than GRV: If residual value is higher than GRV, difference should be recognized UGRV. Benefit of UGRV will be given to lessor only because he is the actual owner of the asset.

In case of UGRV, no additional cash will be paid by lessee at the time of return of asset. But Lessor shall charge total residual value at the time of sale of asset. (UGRV = RV – GRV)

Meaning of Gross Investment

Gross Investment is the tool of inflow which is expected to be included or received from the point of view of lessor. Total inflows of the lessor shall include amount of lease rental + amount of GRV + amount of UGRV.

Meaning of Net Investment

Net Investment is the amount of outflow which is invested by lessor on the date of lease agreement. Net Investment can also be recognized equal to face value of the assets on the date of lease agreement.

Meaning of Finance Income

Difference between inflow and outflow should be recognized as Finance Income from the point of view of lessor because it is assumed by Finance Lease that assumed ownership is transfer by lessor to lessee on the date of lease agreement.

Meaning of I.R.R. (Implicit or Internal Rate of Return)

Internal rate of return is the rate at which gross investment & net investment will be equal. It can also be said that IRR is the rate at which inflow & outflow of the lessor will be equal.

Calculation of IRR

Step – 1: ***Assume any two rates***
Step – 2: ***Calculate PV factors at the assumed rates***
Step – 3: ***Calculate present values of inflows by the PV factors of assumed rate.***
Step – 4: ***Calculate difference between inflow & outflow by taking present value at the assumed rate.***
Step – 5: ***After calculating difference apply the following equation:***

$$IRR = \text{Lower Rate} + \frac{\text{Lower rate Diff(NPV)}}{\text{Lower Rate Diff} - \text{Higher rate diff}} \times \text{Diff in Rates}$$

Ex.

Lease Period	=	***4 years***
Lease Rental	=	***5 Lakhs p.a***
G.R.V.	=	***1,00,000***
R.V.	=	***3,00,000***
F.V.	=	***16,00,000***

Calculate IRR.

Ans.

Calculation of NPV

Period	*Inflow*	*PVF 10%*	*PVF 15%*	*PV 10%*	*PV 15%*
1	*5,00,000*	*0.909*	*0.870*	*4,54,500*	*4,35,000*
2	*5,00,000*	*0.826*	*0.756*	*4,13,000*	*3,78,000*
3	*5,00,000*	*0.751*	*0.658*	*3,75,500*	*3,29,000*
4	*5,00,000*	*0.683*	*0.572*	*3,41,500*	*2,86,000*
4	*3,00,000*	*0.683*	*0.572*	*2,04,900*	*1,71,600*
		Total		*17,89,400*	*15,99,600*
		Less: P.V. of Outflow		*(16,00,000)*	*(16,00,000)*
		Difference		*1,89,400*	*(400)*

IRR = 10% + 189400 / [189400 – (-400)] X 5
= 14.98%

Books of Lessee

As per AS Accounting for Lease in the books of Lessee should be made by considering the following steps:-

Step – 1: ***First of all Lessee shall recognized purchase of asset as well as liability to lessor.***

Assets on Lease A/c Dr.
To Lessor A/c

Step – 2: ***Lessee will recognize the assets & liabilities as recorded above as lower amount out of following:***

PV of MLP or Fair value

Step – 3: ***After recognition of assets & liabilities, lease rentals as per lease agreement will be paid by the Lessee. The following journal entry should be recorded.***

Lease Rental A/c Dr.
To Bank

Step – 4: ***Amount of lease rental should be divided between payment to Lessor and Interest expenses (finance charge)***

Interest Exp = Balance O/S in Lessor account x IRR

Lessor Payment = Rental – Interest

Interest Exp. A/c Dr.
Lessor A/c Dr.
To Lease Rental

P&L A/c Dr.
To Interest

Step – 5: