Accounting Standards

#ACCOUNTSMAN

Index

Chapter – 1
Accounting Standards

Accounting Standards Introduction

Introduction

Accounting standards are written policy documents issued by

- expert accounting body or
- government or
- other regulatory body

covering the aspects of

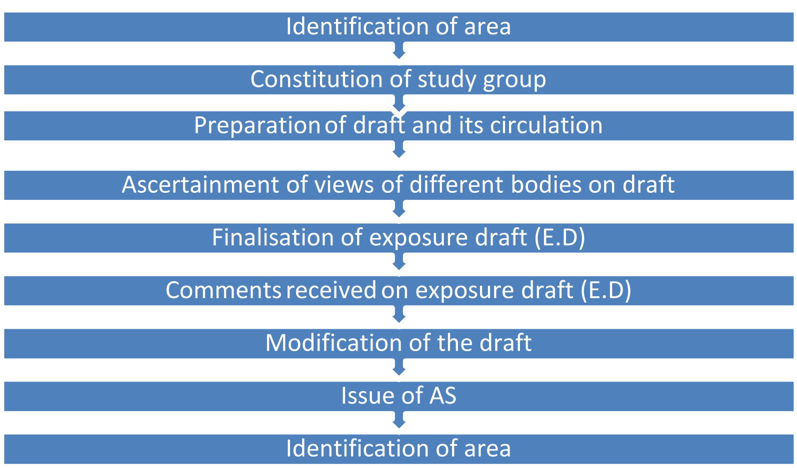
- recognition
- measurement
- presentation and
- disclosure

of accounting transactions in the financial statements.

Accounting Standards in India

Accounting standards in India are issued by the **Institute of Chartered Accountants of India (ICAI).** Accounting Standard Board (ASB) was constituted on 21st April, 1977 to harmonise the diverse accounting policies and practices.

Standard setting process



Advantages of Accounting Standards:

- ***Standardisation:*** Standards reduce or eliminate confusing variations in the accounting treatments used to prepare financial statements.
- ***Additional disclosure:*** Standards may call for additional disclosure beyond the requirement of law.

- ***Comparability:*** Standards would facilitate comparison of financial statements of companies across the globe. Exception being the traditions and legal systems in the country.

Disadvantages of Accounting Standards:

- ***Difficulty in making choice:*** Choice between different alternative accounting treatments is difficult.
- ***Lack of flexibility:***Applying specified set of standards makes it rigid.
- ***Restricted Scope:*** Standards cannot override the statute.
- ***Tradition & Legal System:*** Differences in AS are bound to arise cause of difference in tradition and legal system between the countries across the globe.

Accounting Standard and Companies Act,2013

Section 129(1) – Companies to present their financial statements in accordance with accounting standards notified under section 133 of the Act.

Section 129(5) - Where the financial statements of a company do not comply with accounting standards, the copmany shall disclose in its financial statements

- Deviation from the accounting standards
- Reason for such deviation
- Financial effect if any arising due to such deviation

Section 133 – Central Governement to prescribe Accounting Standards in recommendation with ICAI, in consultation with National Financial Reporting Authority(NFRA).

[Since NFRA to be constituted under section 132 of Companies Act, 2013 is yet to be notified; MCA has clarified by a notification that the existing notified AS as per Companies Act, 1956 shall continue to apply till further order.**]**

Section 143(3)(e)- Auditor's responsibility to report whether, in his opinion, the financial statements comply with the accounting standars notified u/s 133.

Classification of Companies

For this purpose, companies are classified into two categories

- Small & Medium Companies (SMCs)
- Non- SMCs

SMC means a company that satisfies all the following conditions at the end of the relevant accounting year:

- Equity and debt securities of the company are not listed or in the process of being listed in any stock exchange in India or outside.
- Company is not a bank, financial institution or insurance company.
- Company's turnover (excluding other income) does not exceed Rs.50 Crore in the immediately preceding accounting year.
- Company does not have borrowings (including public deposits) in excess of Rs.10 Crore at any time during the immediately preceding accounting year.

- Company is not holding or subsidiary company of a company which is a Non- SMC.

Classification of Non-Corporate Entities

Classification of Non-Corporate Entities is propagated by ICAI. Non-Corporate Entities are classified as:

- Level I
- Level II (Small & Medium Enterprises)
- Level III (Small & Medium Enterprises)

Level I Entities- These are non-corporate entities which fall in any one or more of the following categories, at the end of the relevant accounting period:

- Equity and debt securities of the company are not listed or in the process of being listed in any stock exchange in India or outside.
- Banks, financial institutions or entity carrying on insurance business.
- Entities turnover (excluding other income) does exceeds Rs.50 Crore in the immediately preceding accounting year.
- Entities having borrowings (including public deposits) in excess of Rs.10 Crore at any time during the immediately preceding accounting year.
- Holding or subsidiary entities of any of the above.

Level II Entities- These are non-corporate entities which fall in any one or more of the following categories, at the end of the relevant accounting period:

- Entities turnover (excluding other income) does exceeds Rs.1 Crore but does not exceed Rs.50 Crore in the immediately preceding accounting year.
- Entities having borrowings (including public deposits) in excess of Rs.1 Crore at any time during the immediately preceding accounting year.
- Holding or subsidiary entities of any of the above.

Level II Entities- These are non-corporate entities which don’t fall under Level I and Level II.

Applicability of Accounting Standards

Level I- All the 29 Accounting standards are fully applicable.

Level II and III enterprises (SMEs)- For the purpose of applicability of accounting standard to Level-II enterprises, the case can be divided into three categories: ƒ

- **Accounting standards fully applicable**
  AS-1, AS-2, AS-4, AS-5, AS-6, AS-7, AS-8, AS-9, AS-10, AS-11, AS-12, AS-13, AS-14, AS- 15, AS-16, AS-22, AS-26 and AS-28
- **Accounting standards applicable but relaxation from certain disclosure requirements**
  As prescribed in AS-19, AS-20, and AS-29. ƒ

- **Accounting standards not applicable**
  AS-3, AS-17, AS-18, AS-24, AS-21, AS-23, AS-25 and AS-27 are not applicable because of existing regulation in India.

TABLE SHOWING APPLICABILITY OF TWENTY-NINE (1-29) ACCOUNTING STANDARDS

Number of Accounting Standard (AS)	Title of accounting standard	Whether applicable to small entreprises/non corporate assesses
AS 1	Disclosure of Accounting Policies	Applicable
AS 2 (Revised)	Valuation of Inventories	Applicable
AS 3 (Revised)	Cash Flow Statement	Not Applicable
AS 4 (Revised)	Contingencies and Events Occurring after the Balance Date	Applicable
AS 5 (Revised)	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies	Applicable
AS 6 (Revised)	Depreciation Accounting	Applicable
AS 7 (Revised)	Accounting for Construction Contracts	Applicable
AS 8	Withdrawn and included in AS-26	-
AS 9	Revenue Recognition	Applicable
AS 10	Accounting for Fixed Assets	Applicable
AS 11 (Revised)	The Effect of Changes in Foreign Exchange Rates (Revised 2003)	Applicable but maximum portion of as not relevant to the non corporate assesses
AS 12	Accounting for Government Grants	Applicable but not relevant as most of the non corporate assesses do not get Govt. Grants
AS 13	Accounting for Investments	Applicable
AS 14	Accounting for Amalgamations	Not Applicable
AS 15	Accounting for Retirement Benefits in the Financial Statements of Employers	Applicable
AS 16	Borrowing Costs	Applicable
AS 17	Segment Reporting	Not Applicable
AS 18	Related Party Disclosure	Not Applicable
AS 19	Accounting for Leases	Applicable but relaxation in disclosure requirements
AS 20	Earnings Per Share	Not Applicable
AS 21	Consolidated Financial Statement	Not Applicable
AS 22	Accounting for Taxes on Income	Applicability postponed for sole proprietor and partnership firm till 01.04.2006

AS 23	Accounting for Investment in Associates in Consolidated Financial Statements	Not Applicable
AS 24	Discontinuing Operations	Not much relevant
AS 25	Interim Financial Reporting	Not relevant
AS 26	Intangible Assets	Applicable but maximum portion of As is not relevant
AS 27	Financial Reporting of Interests in Joint Ventures	Applicable but not relevant
AS 28	Impairment of Assets	Applicable but not relevant
AS 29	Provisions, Contingent liabilities and Contingent Assets	Applicable

Question

1. What are the issues, with which Accounting Standards deal?
2. List the criteria to be applied for rating an enterprise as Level-I enterprise for the purpose of compliance of Accounting Standards in India.

ACCOUNTING STANDARD-1
DISCLOSURE OF ACCOUNTING POLICIES

Purpose

- ✓ Promote better understanding of financial statements.
- ✓ Disclosure of significant accounting policies.
- ✓ Facilitate comparison between financial statement of different enterprises for same period and financial statements of same enterprises for different periods.

Accounting Policies

Accounting Policies refer to specific accounting principles and the method of applying those principles adopted by the enterprises in the preparation and presentation of financial statements. Certain areas which have more than one method of accounting treatment enforces accountant to make decision from various options for recording and disclosing.

Areas in which differing accounting policies may be adopted by different enterprises (Not an exhaustive list)

- ✓ Methods of depreciation, depletion and amortization
- ✓ Conversion or translation of foreign currency items
- ✓ Valuation of inventories
- ✓ Treatment of goodwill
- ✓ Valuation of investments
- ✓ Treatment of retirement benefits
- ✓ Recognition of profit on long-term contracts
- ✓ Valuation of fixed assets
- ✓ Treatment of contingent liabilities
- ✓ Treatment of expenditure during construction.

Fundamental Accounting Assumption

Fundamental accounting assumptions are the underling principles in the preparation and presentation of financial statements. Unless otherwise disclosed it is assumed to be complied with. Disclosure is necessary if they are not followed.

- ➢ *Going Concern*- The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation.
- ➢ *Consistency*- It is assumed that accounting policies are consistent from one period to another.
- ➢ *Accrual*- Revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate. (The considerations affecting the process of matching costs with revenues under the accrual assumption are not dealt with in this Standard)

Considerations in the Selection of Accounting Policies

Consideration in the selection of accounting policies is that the financial statements prepared and presented should represent a true and fair view of the state of affairs as at the balance sheet date and of the profit. Major considerations governing the selection and application of accounting policies are—

- ***Prudence*****:** In view of the uncertainty attached to future events, profits are not anticipated but recognised only when realised though not necessarily in cash. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.

  Prudence ensures that,

  - Profits and Assets are not overstated
  - Losses and Liabilities are not understated

  Example: Valuing inventory at lower of cost and net realizable value.

  Purchase – 100 units at Rs.15/unit
  Sales -60 units at Rs.20/unit
  Net realizable value is Rs.12/unit
  Then, the value of the unsold stock at the year end is recorded at Rs.12/unit .
  i.e, 40 units at Rs.12/unit = 40*12 = 480 ; thus recognizing loss of Rs.120 [40*(15-12)]

- ***Substance over form***: The accounting treatment and presentation in financial statements of transactions and events should be governed by their substance and not merely by the legal form.

  Example: With respect to Asset purchased under hire purchase scheme. The asset is shown in the books of hire purchaser irrespective of the fact that the hire purchaser is not the legal owner of the assets purchased.

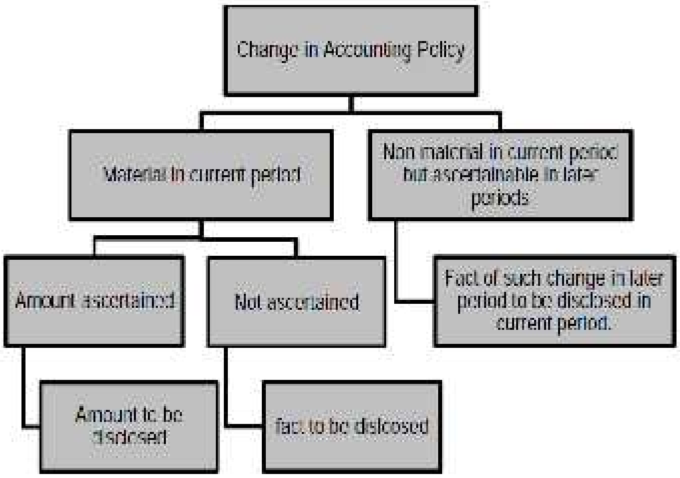
- ***Materiality***: Financial statements should disclose all "material" items, i.e. items the knowledge of which might influence the decisions of the user of the financial statements.

Change in Accounting Policies

Accounting policies should be consistent from one period to another. However, change in accounting policy is allowed on following conditions-

- ✓ Requirement of statute
- ✓ Compliance of Accounting Standard
- ✓ Better presentation of financial statement.

Disclosure



Questions

1. Under what circumstances can an enterprise change its accounting policy?
2. What are the three fundamental accounting assumptions recognised by Accounting Standard (AS1)?
3. Mention six areas in which different accounting policies are followed by companies.
4. Year to year results of a company were not found comparable on the basis of gross profit margin. List out the probable reasons.
   Answer: The probable reasons could be the change in the accounting policy viz.
   - Change in method of recognition of sales revenue from cash basis to accrual basis or vice versa; or
   - Change in valuation of closing inventory by adopting different methods year to year such as LIFO to FIFO to weighted average or vice versa.
5. "Recognizing the need to harmonize the diverse accounting policies and practices, accounting standards are framed." Give examples of areas in which different accounting policies may be adopted by the enterprise.

ACCOUNTING STANDARD – 2

VALUATION OF INVENTORIES

Objective

Determination of value at which inventories are carried in the financial statements.

Applicability

This standard is not applicable in the following cases

- Work in progress under construction contracts, including directly related service contracts (It is specifically covered by Accounting Standard 7)
- Work in progress in the ordinary course of business of service providers;
- Shares, debentures and other financial instruments held as stock-in-trade
- Producers' inventories of livestock, agricultural and forest products, and mineral oils, ores and gases to the extent that they are measured at net realizable value in accordance with well established practices in those industries.

Key Terms

- ➢ **Inventories**

  It is an asset:

  - Held for sale in ordinary course of business(Finished Goods)
  - In the process of production for such sale (WIP and Raw material)
  - In the form of materials or supplies to be consumed in the production process or in the rendering of services (Stores, spares and consumables)

- ➢ **Net realizable value**

  It is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

Measurement of Inventories

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

Composition of cost

Cost consists of :

- ✓ Purchase Cost
- ✓ Conversion Cost
- ✓ Other cost incurred in bringing the inventories to the present location and condition.

Purchase Cost

It comprises of

- Purchase price
- Duties and taxes (other than those subsequently recoverable)
- Freight inwards
- Any other expenditure directly attributable to the acquisition
- Trade discounts, rebates, duty drawbacks and other similar items are deducted.

Cost of conversion

The costs of conversion of inventories include costs directly related to the units of production, such as direct labour, direct material and direct expenses. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods.

- **Fixed production overheads:** They are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings.
- **Variable production overheads**: They are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

- **Allocation of fixed production overheads**:
  - Allocation is based on the normal capacity.
  - Normal capacity is the production expected after taking into account the loss of capacity resulting from planned maintenance.
  - The actual level of production may be used if it approximates normal capacity.

  Amount of fixed production overheads allocated to each unit of production incase of

  - **Low Production:** It is not increased as a consequence of low production or idle plant. Unallocated overheads are recognized as an expense in the period in which they are incurred.
  - **High Production:** In case of abnormally high production, the amount of fixed production overheads allocated to each unit of production is decreased so that inventories are not measured above cost.

- **Allocation of variable production overheads**:
  Variable production overheads are assigned to each unit of production on the basis of the actual use of the production facilities.
  - **If it results in Joint Products:** When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. The allocation may be based, on the relative sales value when the products become separately identifiable.
  - **If it results in By-Products:** By-products as well as scrap or waste materials, by their nature, are immaterial. When this is the case, they are often measured at net realizable value and this value is deducted from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost.

Other Cost

- Cost incurred to bring the inventory to present location and condition
- Interest and borrowing cost, it is usually not considered to be incurred in the process to bring it to present location and condition. It is included in the cost only when the inventory takes substantial period of time to get ready for intended sale. Example – Grape Wine.
- Though standard is silent, treatment of amortization of intangibles should be taken as a part of inventory costs.
- Exchange differences will not form part of inventory costs as per Indian GAAP.

Cost Formula

When the goods lying in the stock can be specifically identified the cost is determined specifically as segregated for producing or purchasing such goods. Where specific identification method cannot be applied, the costs of inventories are determined using:

- First In First Out Method (FIFO Method)
- Weighted Average Cost Method (WAC Method)

Other Techniques of cost measurement

- **Standard Cost-** Standard Cost can used instead of actual cost. It takes into account normal level of consumption of material , labour , efficiency & capacity utilization. It must be reviewed on timely basis.
- **Retail Method-** In retail business, it is difficult to ascertain cost of individual item and the inventories are rapidly changing with similar margins marking it impracticable to use other methods. In such a case retail method is used.

Net Realizable Value

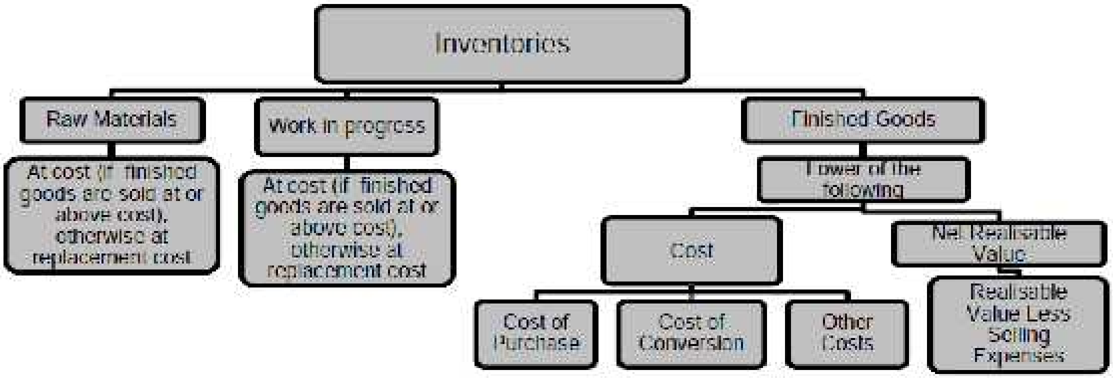
It is the estimated selling price in ordinary course of business, less estimated cost of completion and estimated cost necessary to make the sale.

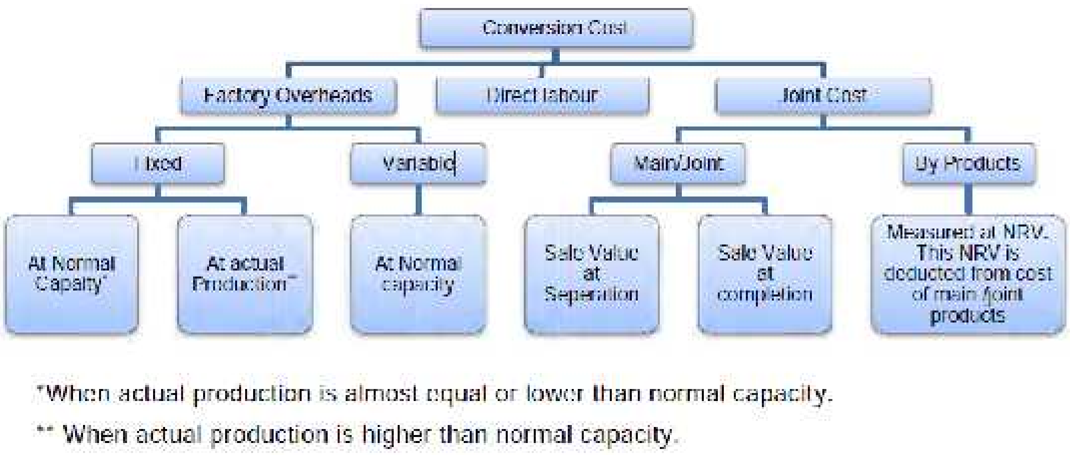
Estimation of Net Realisable Value

NRV is estimated as under:

- **If finished product is sold at or above cost-** Estimated realizable value of raw material and supplies is considered more than its cost. Therefore inventory of raw materials will be valued at cost.
- **If finished product is sold below cost-** Estimated realizable value of raw material and supplies is equal to the replacement price of raw material. The inventory of raw materials will be valued at replacement price.

Gist of measurement of inventories





Disclosure

Following disclosures are to be made in Financial statements of the enterprise:

- Accounting policy adopted to measure value of the inventories
- Cost formulae used
- Total carrying amount of inventories
- Classification adopted by enterprise.

Questions

1. The company deals in three products, A, B and C, which are neither similar nor interchangeable. At the time of closing of its account for the year 2002-03. The Historical Cost and Net Realizable Value of the items of closing stock are determined as follows:

Items	*Historical Cost (Rs. in lakhs)*	*Net Realisable Value (Rs. in lakhs)*
A	40	28
B	32	32
C	16	24

What will be the value of Closing Stock?

Answer:
As per para 5 of AS 2 on Valuation of Inventories, inventories should be valued at the lower of cost and net realizable value. Inventories should be written down to net realizable value on an item-by-item basis in the given case.

Items	*Historical Cost (Rs. in lakhs)*	*Net Realisable Value (Rs. in lakhs)*	*Valuation of closing stock (Rs. in lakhs)*
A	40	28	28
B	32	32	32
C	16	24	16
	88	84	76

Hence, closing stock will be valued at Rs. 76 lakhs.

2. X Co. Limited purchased goods at the cost of Rs.40 lakhs in October, 2005. Till March, 2006, 75% of the stocks were sold. The company wants to disclose closing stock at Rs.10 lakhs. The expected sale value is Rs.11 lakhs and a commission at 10% on sale is payable to the agent. Advise, what is the correct closing stock to be disclosed as at 31.3.2006.

Answer:
As per Para 5 of AS 2 "Valuation of Inventories", the inventories are to be valued at lower of cost and net realizable value.
In this case, the cost of inventory is Rs. 10 lakhs. The net realizable value is 11,00,000 × 90% = Rs. 9,90,000. So, the stock should be valued at Rs. 9,90,000.

3. Items that are to be excluded in determination of the cost of inventories as per AS2.

Answer:
Items that are to be excluded in determination of the cost of inventories as per para 13 of AS 2 on 'Valuation of Inventories' are:

- Abnormal amounts of wasted materials, labour or other production costs.
- Storage costs unless those costs are necessary in the production process prior to a further production stage.

- Administrative overheads that do not contribute to bringing the inventories to their present location and condition; and
- Selling and distribution costs.

4. Sony Pharma ordered 12,000 kg. of certain material at Rs.80 per unit. The purchase price includes excise duty Rs. 4 per kg in respect of which full CENVAT credit is admissible. Freight incurred amounted to Rs. 77,400. Normal transit loss is 3%. The company actually received 11,600 kg. and consumed 10,100 kg. of material. Compute cost of inventory under AS 2 and abnormal loss.

Answer:

	Rs.
Purchase price (12,000 kg × Rs.80)	9,60,000
Less: CENVAT credit (12,000 kg. × Rs.4)	48,000
	9,12,000
Add: Freight	77,400
Total material cost	9,89,400
Number of units after normal loss = 97% of 12,000 kgs.	11,640 Kgs.
Normal cost per kg. $\left(\frac{9,89,400}{11,640}\right)$	Rs.85

Value of closing stock under AS 2 = (11,600 kgs. – 10,100 kgs.) × Rs. 85 = Rs.1, 27,500

Abnormal loss = (11,640 kgs. – 11,600 kgs.) × Rs.85 = Rs.3,400

5. From the following data, find out value of inventory as on 30.04.2012 using

(a) LIFO method, and

(b) FIFO method:

(1)	01.04.2009 Purchased	10 units @ Rs. 70 per unit
(2)	06.04.2009 Sold	6 units @ Rs. 90 per unit
(3)	09.04.2009 Purchased	20 units @ Rs. 75 per unit
(4)	18.04.2009 Sold	14 units @ Rs. 100 per unit

Answer:

(a) Statement showing valuation of closing inventory by LIFO method

Date	***Receipts***			***Issue***			***Balance***		
	Unit	***Cost/unit***	***Amount***	***Unit***	***Cost/unit***	***Amount***	***Unit***	***Cost/unit***	***Amount***
1.4.09	10	70	700				10	70	700

6.4.09				6	70	420	4	70	280
9.4.09	20	75	1500				4 20	70 75	280 1500
18.4.09				14	75	1,050	4 6	70 75	280 450

Value of closing inventory as per LIFO method:
4 units x Rs.70 = Rs.280
6 units x Rs.75 = Rs.450 Rs.730

(b) Statement showing valuation of closing inventory by FIFO method

Date	***Receipts***			***Issue***			***Balance***		
	Unit	***Cost/unit***	***Amount***	***Unit***	***Cost/unit***	***Amount***	***Unit***	***Cost/unit***	***Amount***
1.4.09	10	70	700				10	70	700
6.4.09				6	70	420	4	70	280
9.4.09	20	75	1500				4 20	70 75	280 1500
18.4.09				4 10	70 75	280 750	10	75	750

Value of closing inventory as per FIFO method:
10 nits x Rs.75 = Rs.750

6. Raw materials inventory of a company includes certain material purchased at Rs.100 per kg. The price of the material is on decline and replacement cost of the inventory at the year end is Rs.75 per kg. It is possible to convert the material into finished product at conversion cost of Rs.125. Decide whether to make the product or not to make the product, if selling price is
(i) Rs.175 and
(ii) Rs.225 *Also find out the value of inventory in each case.

Answer:
As per para 24 of AS 2 'Valuation of Inventories', materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value.

i. When selling price is Rs.175
Incremental Profit = Rs.175 – Rs.125 = Rs.50
Current price of the material = Rs.75

Therefore, it is better not to make the product. Raw material inventory would be valued at net realisable value i.e. Rs. 75 because the selling price of the finished product is less than Rs.225 (100+125) per kg.

ii. When selling price is Rs.225

Incremental Profit = Rs.225 – Rs.125 = Rs.100

Current price of the raw material = Rs.75.

Therefore, it is better to make the product.

Raw material inventory would be valued at Rs.100 per kg because the selling price of the finished product is not less than Rs.225.

7. HP is a leading distributor of petrol. A detail inventory of petrol in hand is taken when the books are closed at the end of each month. At the end of month following information is available:

Sales	Rs.	47,25,000
General overheads cost	Rs.	1,25,000
Inventory at beginning		1,00,000 litres @ 15 per litre

Purchases

June 1 two lakh litres @ 14.25

June 30 one lakh litres @ 15.15

Closing inventory 1.30 lakh litres

Compute the following by the FIFO as per AS 2:

i. Value of Inventory on June, 30.

ii. Amount of cost of goods sold for June.

iii. Profit/Loss for the month of June.

Answer:

	Rs.

(i) Cost of closing inventory for 1,30,000 litres as on 30^{th}	
June	15,15,000
1,00,000 litres @ Rs.15.15	4,27,500
30,000 litres @ Rs. 14.25	19,42,500
Total	
(ii) Calculation of cost of goods sold	15,00,000
Opening inventories (1,00,000 litres @ Rs. 15)	28,50,000
Purchases June-1 (2,00,000 litres @ Rs.14.25)	15,15,000
June-30 (1,00,000 litres @ Rs.15.15)	58,65,000
	(19,42,500)
Less: Closing inventories	39,22,500
Cost of goods sold	
(iii) Calculation of profit	47,25,000
Sales (Given) (A)	39,22,500
Cost of goods sold	1,25,000
Add: General overheads	40,47,500
Total cost (B)	6,77,500
Profit (A-B)	

8. Best Ltd. deals in five products, P, Q, R, S, and T which are neither similar nor interchangeable. At the time of closing of its accounts for the year ending 31st March 2010, the historical cost and net realizable value of the items of the closing stock are determined as follows:

Items	***Historical cost Rs.***	***Net realizable value Rs.***
P	5,70,000	4,75,000
Q	9,80,000	10,32,000
R	3,16,000	2,89,000
S	4,25,000	4,25,000
T	1,60,000	2,15,000

What will be the value of closing stock for the year ending 31st March, 2012 as per AS 2 "Valuation of Inventories"?

Answer

As per para 5 of AS 2 "Valuation of Inventories, inventories should be valued at the lower of cost and net realizable value. Inventories should be written down to net realizable value on an item-by-item basis.

Valuation of inventory (item wise) for the year ending 31^{st} March 2012

Item	***Historical Cost***	***Net realizable value***	***Valuation of closing stock***
	Rs.	**Rs.**	**Rs.**
P	5,70,000	4,75,000	4,75,000

Q	9,80,000	10,32,000	9,80,000
R	3,16,000	2,89,000	2,89,000
S	4,25,000	4,25,000	4,25,000
T	1,60,000	2,15,000	1,60,000
			23,29,000

The value of inventory for the year ending 31st March 2012 = Rs.23, 29,000.

ACCOUNTING STANDARD –3

CASH FLOW STATEMENTS

Introduction

Traditional financial statements fail to inform the users the way the reporting enterprise has generated cash and the way these were utilized during the accounting period. This necessitated the preparation of Cash Flow Statements as a part of Financial Statements. CFS is the summary of cash receipts and payments during an accounting period.

Definitions

- **Cash** - It comprises cash on hand and demand deposits with banks.
- **Cash equivalents** - They are short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.
- **Cash flows -** They are inflows and outflows of cash and cash equivalents.
- **Operating activities** - They are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.
- **Investing activities** - Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.
- **Financing activities** - Financing activities are activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowings of the enterprise.

Types of Cash flows

- Cash flow from Operating Activities
- Cash flow from Investing Activities
- Cash flow from Financing Activities

Cash flow from Operating Activities

It comprises of principal revenue producing activities of the enterprises. Cash flow from operating activities can be derived from direct method or indirect method.

- **Direct Method:** In this method, gross receipts and gross payment of cash are disclosed
- **Indirect Method:** In this method, profit and loss account is adjusted for the effects of transaction of non-cash nature.

Examples of cash flow from operating activities are given below:

- Cash payments for purchase of goods
- Cash payments for availing services
- Cash payments to employees
- Cash receipts from sale of goods
- Cash receipts from rendering of services
- Cash receipts of royalties, fees, commissions and other revenue

Cash flow from Investing Activities

They include acquiring or disposal of equity, debt instrument, fixed asset etc; it also includes availing or repayment of loans. Examples of cash flow from investing activities are:

- Receipts from disposals of fixed assets
- Loan given to or recovered from other entities (other than loans by financial enterprises)
- Payments to acquire fixed assets
- Interests and dividends earned (other than interests and dividends earned by financial institutions).

Cash flow from Financing Activities

The financing cash flows are cash flows generated by financing activities. Examples of cash flow from financing activities are:

- Cash proceeds from issuing shares or other similar instruments
- Cash proceeds from issuing debentures, loans, bonds, and other borrowings
- Cash repayments of amounts borrowed.
- Payments of dividend and interest

THIS CHAPTER WOULD BE DEALT IN DETAIL IN CHAPTER-2 CASH FLOW STATEMENT

Questions

1. Garden Ltd. acquired fixed assets viz. plant and machinery for Rs.20 lakhs. During the same year it sold its furniture and fixtures for Rs.5 lakhs. Can the company disclose, net cash outflow towards purchase of fixed assets in the cash flow statement as per AS-3?

Answer

According to Para 21 of AS 3 (Revised) 'Cash Flow Statements', an enterprise should report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows described in paragraphs 22 and 24 are reported on a net basis. Acquisition and disposal of fixed assets is not prescribed in para 22 and 24 of the standard. Hence, the company cannot disclose net cash flow in respect of acquisition of plant and machinery and disposal of furnitures and fixtures.

2. What are the main features of the Cash Flow Statement? Explain with special reference to AS 3.

Answer

According to AS 3 (Revised) on "Cash Flow Statement", cash flow statement deals with the provision of information about the historical changes in cash and cash equivalents of an enterprise during the given period from operating, investing and financing activities. Cash flows from operating activities can be reported using either

(a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(b) the indirect method, whereby net profit or loss is adjusted for the effects of transactions of non–cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

As per para 42 of AS 3 (Revised), an enterprise should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the balance sheet.

A cash flow statement when used in conjunction with the other financial statements, provides information that enables users to evaluate the changes in net assets of an enterprise, its financial structure (including its liquidity and solvency), and its ability to affect the amount and timing of cash flows in order to adapt to changing circumstances and opportunities. This statement also enhances the comparability of the reporting of operating performance by different enterprises because it eliminates the effects of using different accounting treatments for the same transactions and events.

3. X Ltd. purchased debentures of ` 10 lacs of Y Ltd., which are redeemable within three months. How will you show this item as per AS 3 while preparing cash flow statement for the year ended on 31st March, 2011?

Answer

As per AS 3 on 'Cash flow Statement', cash and cash equivalents consists of cash in hand, balance with banks and short-term, highly liquid investments∗. If investment, of ` 10 lacs, made in debentures is for short-term period then it is an item of 'cash equivalents'.

However, if investment of ` 10 lacs made in debentures is for long-term period then as per AS 3, it should be shown as cash flow from investing activities.

ACCOUNTING STANDARD -7

CONSTRUCTION CONTRACTS

Objective

To prescribe accounting treatment of

- Revenue &
- Cost

associated with construction contracts.

Definitions

- **Construction Contracts:** Construction contract is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.
- **Fixed price contract:** It is a type of construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, which in some cases is subject to cost escalation clauses.
- **Cost plus contract:** It is a type of construction contract in which the contractor is reimbursed for allowable or otherwise defined costs, plus percentage of these costs or a fixed fee.
- **Contract revenue:** Contract revenue comprises of
    - Initial amount of revenue agreed in the contract and
    - Variations in contract work, claims and incentive payments:
        - To the extent that it is probable that they will result in revenue and
        - They are capable of being reliably measured.
- **Contract cost:** Contract costs comprises of
    - Costs that relate directly to the specific contract;
    - Costs that are attributable to contract activity in general and can be allocated to the contract; and
    - Other costs as are specifically chargeable to the customer under the terms of the contract.

Measurement of contract revenue

Recognition of revenue and expenses by reference to the stage of completion of a contract is generally referred as the Percentage of Completion Method. Under Percentage completion method, the revenue is recognized in the profit and loss account in the accounting period in which work is performed.

Key formulae

$$\text{Percentage of completion} = \frac{\text{Cost to date}}{\text{Cumulative cost incurred} + \text{Estimated cost to complete}} \times 100$$

Current revenue from contract = (Contract Price $\times$Percentage of completion) - Revenue previously recognised

Determination of stage of completion

Stage of compleiton of a contract can be determined in a variety of ways. Depending on the nature of the contract, the methods may include:

- ✓ *Cost to cost method* – percentage of completion would be estimated by comparing total cost incurred to date with total cost expected to be incurred on the entire contract.
- ✓ *Survey method*- by surveying the work performed is arrived at.
- ✓ Completion of a *physical proportion* of the contract work.

Recognition of contract revenue and expense

Case -1 : When a reliable estimate can be made

When a reliable estimate can be made, contract revenue and contract costs associated with the construction contract should be recognised in accordance with stage of completion of the contract activity at the reporting date. An expected loss on the construction contract should be recognised as an expense immediately. In the case of a

- ➢ **Fixed price contract-** The outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:
  - ✓ total contract revenue can be measured reliably;
  - ✓ it is probable that the economic benefits associated with the contract will flow to the enterprise;
  - ✓ both the contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably; and
  - ✓ the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.

- ➢ **Cost plus contract-** The outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:
  - ✓ it is probable that the economic benefits associated with the contract will flow to the enterprise; and
  - ✓ the contract costs attributable to the contract, whether or not specifically reimbursable, can be clearly identified and measured reliably.

Case -2 : When a reliable estimate cannot be made

When the outcome of a construction contract cannot be estimated reliably:

- revenue should be recognised only to the extent of contract costs incurred of which recovery is probable; and
- contract costs should be recognised as an expense in the period in which they are incurred. An expected loss on the construction contract should be recognised as an expense immediately.

Recognition of Expected Losses

When it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.

Change in estimate

Any change in the estimate of the outcome of a contract, is accounted for as a change in the accounting estimate as per AS-5. The changed estimates are to be used to determine the amount of revenue and expense to be recognised in profit and loss account in the period in which change is made.

Disclosure requirements under the standard

- ✓ amount of contract revenue recognised as revenue in the period
- ✓ amount of costs incurred and recognised profits (less recognised losses) upto the reporting date
- ✓ the methods used to determine the contract revenue recognised in the period
- ✓ the methods used to determine the stage of completion of contracts in progress
- ✓ the amount of advances received
- ✓ the amount of retentions
- ✓ the gross amount due from customers for contract work as an asset
- ✓ the gross amount due to customers for contract work as a liability.

Questions

1. A company took a construction contract for Rs. 100 lakhs in January, 2006. It was found that 80% of the contract was completed at a cost of Rs. 92 lakhs on the closing date i.e. on 31.3.2007. The company estimates further expenditure of Rs. 23 lakhs for completing the contract. The expected loss would be Rs. 15 lakhs. Can the company recognise the loss in the financial statements prepared for the year ended 31.3.2007?

   Answer

   As per paragraphs 31 and 35 of AS 7 on Construction Contracts, an expected loss on the construction contract should be recognized as an expense immediately irrespective of
   - whether or not the work has commenced on the contract; or
   - the stage of completion of the contract; or
   - the amount of profits expected to arise in other contracts.

   Hence, the company must recognize the loss immediately.

2. Explain contract costs as per Accounting Standard-7 related to 'Construction Contracts'.

   Answer

As per para 15 of AS 7 "Construction Contracts (revised 2002)", contract cost should comprise:

- Costs that relate directly to the specific contract

- Costs that are attributable to contract activity in general and can be allocated to the contract
- Such other costs as are specifically chargeable to the customer under the terms of the contract**.**

3. An amount of Rs. 9, 90,000 was incurred on a contract work upto 31-03-2010. Certificates have been received to date to the value of Rs. 12, 00,000 against which Rs. 10, 80,000 has been received in cash. The cost of work done but not certified amounted to Rs. 22,500. It is estimated that by spending an additional amount of Rs. 60,000 (including provision for contingencies) the work can be completed in all respects in another two months. The agreed contract price of work is Rs.12, 50,000. Compute a conservative estimate of the profit to be taken to the Profit and Loss Account as per AS 7.

Answer

Computation of estimate of profit as per AS 7

	Rs.
Expenditure incurred upto 31.3.2010 Estimated additional expenses (including provision for contingency) Estimated cost (A) Contract price (B) Total estimated profit [(B-A)] Percentage of completion (9,90,000 / 10,50,000) x 100	9,90,000 60,000 10,50,000 12,50,000 2,00,000 94.29%

Computation of estimate of the profit to be taken to Profit and Loss Account:

$$\text{Total estimated profit x } \frac{\text{Expenses incurred till 31.3.2010}}{\text{Total estimated cost}}$$

$$2{,}00{,}000 \text{ x } \frac{9{,}90{,}000}{10{,}50{,}000} = \text{Rs. } 1{,}88{,}571$$

According to para 21 of AS 7 'Construction Contracts', when the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to stage of completion of the contract activity at the reporting date. Thus estimated profit amounting Rs. 1,88,571 should be recognised as revenue in the statement of profit and loss.

4. From the following data, show Profit and Loss A/c (Extract) as would appear in the books of a contractor following Accounting Standard-7:

	(Rs. in lakhs)

Contract price (fixed) Cost incurred to date Estimated cost to complete	480.00 300.00 200.00

Answer

Calculation of Estimated Total Cost

	(Rs. in lakhs)
Cost incurred to date Estimate of cost to completion Estimated total cost in completing the contract	300 200 500

Percentage of completion (300/500) x 100 = 60%

Revenue recognised as a percentage to contract price

= 60% of Rs. 480 lakhs = Rs. 288 lakhs

As per para 35 of AS 7 'Construction Contracts', when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately. Accordingly, expenses to be recognized in the Profit and Loss Account will be

	(Rs. in lakhs)
Total foreseeable loss (500-480) Less: Loss for the current year (300-288) Expected loss to be recognized immediately as per para 35 of AS 7	20 (12) 8

Profit and Loss A/c (An Extract)

	(Rs. in lakhs)		*(Rs. in lakhs)*
To Construction cost To Estimated loss on completion of Contract	300 8	By Contract price	288

5. M/s Excellent Construction Company Limited under took a contract to construct a building for Rs. 3 crore on 1st September, 2011. On 31st March, 2012 the company found that it had already spent Rs. 1 crore 80 lakhs on the construction. Prudent estimate of additional cost for completion was Rs. 1 crore 40 lakhs. What amount should be charged, to revenue in the final accounts for the year ended on 31st March, 2012, as per the provisions of Accounting Standard 7 "Construction Contracts (Revised)" ?

Answer

Calculation of Estimated Cost of Construction

	(Rs. in lakhs)
Cost of construction incurred till date	1.80
Add: Estimated future cost	1.40
Total estimated cost of construction	3.20

Percentage of completion of contract till date to total estimated cost of construction

= Rs. (1.80/3.20)×100 = 56.25%

Proportion of total contract value recognised as revenue as per AS 7 (Revised)

= Contract price x percentage of completion

= Rs. 3 crores x 56.25% = Rs. 1.6875 crores

6. What are the disclosure requirements of AS-7 (Revised)?

Answer

According to paragraphs 38, 39 and 41 of AS 7, an enterprise should disclose:

- The amount of contract revenue recognized as revenue in the period;
- The methods used to determine the contract revenue recognized in the period; and
- The methods used to determine the stage of completion of contracts in progress.

In case of contract still in progress the following disclosures are required at the reporting date:

- The aggregate amount of costs incurred and recognised profits (less recognised losses) upto the reporting date;
- The amount of advances received; and
- The amount of retentions.

An enterprise should also present:

- The gross amount due from customers for contract work as an asset; and
- The gross amount due to customers for contract work as a liability.

7. B Ltd. undertook a construction contract for ` 50 crores in April, 2010. The cost of construction was initially estimated at ` 35 crores. The contract is to be completed in 3 years. While executing the contract, the company estimated the cost of completion of the contract at ` 53 crores. Can the company provide for the expected loss in the book of account for the year ended 31st March, 2011?

Answer

As per para 35 of AS 7 “Construction Contracts”, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately. Therefore, The foreseeable loss of ` 3 crores (` 53 crores less ` 50 crores) should be recognised as an expense immediately in the year ended 31st March, 2011. The amount of loss is determined irrespective of

- Whether or not work has commenced on the contract
- Stage of completion of contract activity or

- The amount of profits expected to arise on other contracts which are not treated as a single construction contract in accordance with para 8 of AS 7.

8. M/s Excellent Construction Company Limited undertook a contract to construct a building for ` 3 crore on 1st September, 2011. On 31st March, 2012 the company found that it had already spent ` 1 crore 80 lakhs on the construction. Prudent estimate of additional cost for completion was ` 1 crore 40 lakhs. What amount should be charged, to revenue in the final accounts for the year ended on 31st March, 2012, as per the provisions of Accounting Standard 7 "Construction Contracts (Revised)"?

Answer

	Rs. in crores
Cost of construction incurred till date	1.80
Add: Estimated future cost	1.40
Total estimated cost of construction	3.20

Percentage of completion till date to total estimated cost of construction
= (1.80/3.20)×100 = 56.25%
Proportion of total contract value recognised as revenue as per AS 7 (Revised)
= Contract price x percentage of completion
= ` 3 crores x 56.25% = ` 1.6875 crores

Amount of foreseeable loss	***(Rs. In crores)***
Total cost of construction	3.20
Less: Total contract price	(3.00)
Total foreseeable loss to be recognized as expense	0.20

According to of AS 7 (Revised 2002), when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

ACCOUNTING STANDARD – 9

REVENUE RECOGNITION

Objective

Standard deals with the basis for recognition of revenue in the statement of profit and loss of an enterprise. The Standard is concerned with the recognition of revenue arising in the course of the ordinary activities of the enterprise from

- the sale of goods,
- the rendering of services, and
- the use by others of enterprise resources yielding interest, royalties and dividends.

Applicability

This Standard does not deal with the following aspects of revenue recognition to which special considerations(i.e, separate standard has been issued to govern the same) apply:

- Revenue arising from construction contracts;
- Revenue arising from hire-purchase, lease agreements;
- Revenue arising from government grants and othersimilarsubsidies;
- Revenue of insurance companies arising from insurance contracts.

Examples of items not included within the definition of "revenue" for the purpose of this Standard are:

- Realised or unrealised gains resulting from non-current assets like appreciation in the value of fixed assets;
- Unrealised holding gains resulting from the change in value of current assets, and the natural increases in agricultural and forest products;
- Realised or unrealised gains from changes in foreign exchange rates and adjustments arising on the translation of foreign currency financial statements;
- Realised gains resulting from the discharge of an obligation at less than its carrying amount;
- Unrealised gains resulting from the restatement of the carrying amount of an obligation.

Revenue

Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from

- ✓ the sale of goods,
- ✓ the rendering of services, and
- ✓ the use by others of enterprise resources yielding interest, royalties and dividends.

Recognition of Revenue

In general revenue from sale or service is to be recognized at the time of sale or rendering of service. However, if at the time of rendering of service or at the time of sale there is significant uncertainty in ultimate collection of the revenue, then the revenue recognition should be postponed to the date of collection. And if the uncertainty arises subsequent to recognizing the revenue then separate provision is to be created to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.

- **Recognition on sale of goods**
  Revenue is recognized on the fulfillment of following conditions:
  - The seller of goods has transferred to the buyer
    - the property in the goods for a price or
    - all significant risks and rewards of ownership and the seller retains no effective control of the goods.
  - No significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.
- **Recognition on rendering of services**
  Revenue recognition on rendering of services is measured by either of the two methods:
  - completed service contract method
  - proportionate completion method

  Whichever relates the revenue to the work accomplished. Such performance should be regarded as being achieved when no significant uncertainty exists regarding the amount of the consideration that will be derived from rendering the service.

- **Revenue arising from the use by others of enterprise resources yielding interest, royalties and dividends**
  It should only be recognized when no significant uncertainty as to measurability or collectability exists. These revenues are recognized on the following basis:
  - **Interest** - on a time proportion basis taking into account the amount outstanding and the rate applicable.
  - **Royalties** - on an accrual basis in accordance with the terms of the relevant agreement.
  - **Dividends** - when the owner's right to receive is established

Disclosures

In addition to the disclosures required by AS 1 on 'Disclosure of Accounting Policies', an enterprise should also disclose the circumstances in which revenue recognition has been postponed cause of significant uncertainties.

Questions

1. Arjun Ltd. sold farm equipments through its dealers. One of the conditions at the time of sale is, payment of consideration in 14 days and in the event of delay interest is chargeable @ 15% per annum. The Company has not realized interest from the dealers in the past. However, for the year ended 31.3.2006, it wants to recognise interest due on the balances due from dealers. The amount is ascertained at Rs. 9 lakhs. Decide whether the income by way of interest from dealers is eligible for recognition as per AS 9.

   Answer

   As per AS 9 "Revenue Recognition", where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, the revenue recognition is postponed to the extent of uncertainty inverted. In such cases, the revenue is recognized only when it is reasonably certain that the ultimate collection will be made.

   In this case, the company never realized interest for the delayed payments make by the dealers. Hence, it has to recognize the interest only if the ultimate collection is certain. The interest income hence is not to be recognized.
2. Y Ltd. used certain resources of X Ltd. In return X Ltd. receives Rs. 10 lakhs and Rs. 15 lakhs as interest and royalties respectively, from Y Ltd. during the year 2007 –2008. State on what basis X Ltd. should recognize their revenue, as per AS 9.

   Answer

   As per AS 9 on 'Revenue Recognition', interest of Rs.10 lakhs received in the year 2007-2008 should be recognized on the time basis, whereas royalty of Rs. 15 lakhs received in the same year should be recognized on accrual basis as per the terms of relevant agreement.
3. According to Accounting Standard 9, when revenue from sales should be recognised?

   Answer

   As per para 11 of AS 9 'Revenue Recognition', revenue from sales should be recognized only when requirements as to performance are satisfied provided that at the time of performance it is not unreasonable to expect ultimate collection. These requirements can be given as follows:

   - The seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and
   - No significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

4. M/s. Sea Ltd. recognized Rs. 5.00 lakhs, on accrual basis, income from dividend during the year 2010-11, on shares of the face value of Rs. 25.00 lakhs held by it in Rock Ltd. as at 31st March, 2011. Rock Ltd. proposed dividend @ 20% on 10th April, 2011. However,

dividend was declared on 30th June, 2011. Please state with reference to relevant Accounting Standard, whether the treatment accorded by Sea Ltd. is in order.

Answer

Para 8.4 of AS 9 "Revenue Recognition" states that dividend from investments in shares are not recognized in the statement of Profit and Loss until the right to receive dividend isestablished.

In the given case, the dividend is proposed on 10th April, 2011, while it was declared on 30th June, 2011. Hence, the right to receive dividend is established on 30th June, 2011 only. Therefore, on applying the provisions stated in the standard, income from dividend on shares should be recognized by Sea Ltd. in the financial year 2011-2012 only. Therefore, the recognition of income from dividend of Rs. 5 lakhs, on accrual basis, in the financial year 2010-11 is not in accordance with AS 9.

5. M/s. Moon Ltd. sold goods worth Rs. 6,50,000 to Mr. Star. Mr. Star asked for a trade discount amounting to Rs. 53,000 and same was agreed to by M/s. Moon Ltd. The sale was effected and goods were dispatched. On receipt of goods, Mr. Star has found that goods worth Rs. 67,000 are defective. Mr. Star returned defective goods to M/s. Moon Ltd. And made payment due amounting to Rs. 5,30,000. The accountant of M/s. Moon Ltd. Booked the sale for Rs. 5,30,000. Discuss the contention of the accountant with reference to Accounting Standard (AS) 9.

Answer

As per AS 9 'Revenue Recognition', revenue is the gross inflow of cash, receivable or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods. However, trade discounts and volume rebates given in the ordinary course of business should be deducted in determining revenue. Revenue from sales should be recognized at the time of transfer of significant risks and rewards. If the delivery of the sales is not subject to approval from customers, then the transfer of significant risks and rewards would take place when the sale is affected and goods are dispatched. In the given case, if trade discounts allowed by M/s. Moon Ltd. are given in the ordinary course of business, M/s. Moon Ltd. should record the sales at Rs. 5,97,000 (i.e. Rs. 6,50,000 – Rs. 53,000) and goods returned worth Rs. 67,000 are to be recorded in the form of sales return. However, when trade discount allowed by M/s. Moon Ltd. is not in the ordinary course of business, M/s. Moon Ltd. should record the sales at gross value of Rs. 6,50,000. Discount of Rs. 53,000 in price and return of goods worth Rs. 67,000 are to be adjusted by suitable provisions. M/s Moon Ltd. might have sent the credit note of Rs. 1,20,000 to Mr. Star to account for these adjustments. In both the cases, the contention of the accountant to book the sales for Rs. 5,30,000 is not correct.

6. A Ltd. entered into a contract with B Ltd. to despatch goods valuing Rs. 25,000 every month for 4 months upon receipt of entire payment. B Ltd. accordingly made the

payment of Rs. 1,00,000 and A Ltd. started despatching the goods. In third month, due to a natural calamity, B Ltd. requested A Ltd. not to despatch goods until further notice though A Ltd. is holding the remaining goods worth Rs. 50,000 ready for despatch. A Ltd. Accounted Rs. 50,000 as sales and transferred the balance to Advance Received against Sales. Comment upon the treatment of balance amount with reference to the provisions of Accounting Standard 9.

Answer

As per para 11 of AS 9 "Revenue Recognition", in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

- The seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and
- No significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods. In the given case, transfer of property in goods results in or coincides with the transfer of significant risks and rewards of ownership to the buyer. Also, the sale price has been recovered by the seller. Hence, the sale is complete but delivery has been postponed at buyer's request. A Ltd. should recognize the entire sale of Rs. 1,00,000 (Rs. 25,000 x 4) and no part of the same is to be treated as Advance Receipt against Sales.

7. X Limited has recognized ` 10 lakhs on accrual basis income from dividend on units of mutual funds of the face value of ` 50 lakhs held by it as at the end of the financial year 31st March, 2011. The dividends on mutual funds were declared at the rate of 20% on 15th June, 2011. The dividend was proposed on 10th April, 2011 by the declaring company. Whether the treatment is as per the relevant Accounting Standard? You are asked to answer with reference to provisions of Accounting Standard.

Answer

Paragraph 8.4 and 13 of Accounting Standard 9 'Revenue Recognition' states that dividends from investments in shares are not recognised in the statement of profit and loss until a right to receive payment is established.

In the given case, the dividend is proposed on 10th April, 2011, while it is declared on 15th June, 2011. Hence, the right to receive payment is established on 15th June, 2011. As per the above mentioned paragraphs, income from dividend on units of mutual funds should be recognized by X Ltd. in the financial year ended 31st March, 2012.

The recognition of ` 10 lakhs on accrual basis in the financial year 2010-2011 is not as per AS 9 'Revenue Recognition'.

8. The Board of Directors of X Ltd. decided on 31.3.2011 to increase sale price of certain items of goods sold retrospectively from 1st January, 2011. As a result of this decision the company has to receive ` 5 lakhs from its customers in respect of sales made from 1.1.2011 to 31.3.2011. But the Company's Accountant was reluctant to make-up his mind. You are asked to offer your suggestion.

Answer

As per para 10 of AS 9 'Revenue Recognition', the additional revenue on account of increase in sales price with retrospective effect, as decided by Board of Directors of X Ltd., of ` 5 lakhs to be recognised as income for financial year 2010-11, only if the company is able to assess the ultimate collection with reasonable certainty. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

ACCOUNTING STANDARD – 13

ACCOUNTING FOR INVESTMENTS

Applicability of AS

This Statement does not deal with:

- The bases for recognition of interest, dividends and rentals earned on investments which are covered by AS 9.
- Operating or finance leases covered by AS 19.
- Investments of retirement benefit plans and life insurance enterprises covered by AS 15
- Mutual funds and/or the related asset management companies, banks and public
- Financial institutions formed under a Central or State Government Act or so declared under the Companies Act, 2013.

Definitions

- **Investments** are assets held by an enterprise for earning income by way of dividends, interest, and rentals, for capital appreciation, or for other benefits to the investing enterprise. Assets held as stock-in-trade are not 'investments'.
- **Current investment** is an investment that is by its nature readily realizable and is intended to be held for not more than one year from the date on which such investment is made.
- **Long term investment** is an investment other than a current investment.
- **Fair value** is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction. Under appropriate circumstances, market value or net realizable value provides an evidence of fair value.
- **Market value** is the amount obtainable from the sale of an investment in an open market, net of expenses necessarily to be incurred on or before disposal.

Classification of Investment

Investments are classified into:

- Long-term Investments
- Current Investments
- **Current Investments**
  - A current Investment is an investment that is by its nature readily realizable and is intended to be held for not more than one year from the date on which such investment is made.
  - The carrying amount for current investments is the lower of cost and fair value.
  - Fair Value is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction. Under appropriate circumstances, market value or net realisable value provides an evidence of fair value.
  - Market Value is the amount obtainable from the sale of an investment in an open market, net of expenses necessarily to be incurred on or before disposal.
  - Any reduction to fair value and any reversals of such reductions are included in the statement of profit and loss.
- **Long Term Investments**

- A long-term investment is an investment other than a current investment.
- Long term investments are usually carried at cost.
- If there is a permanent decline in the value of a long term investment; the carrying amount is reduced to recognize the decline.
- The reduction in carrying amount is charged to the statement of profit and loss.
- The reduction in carrying amount is reversed when there is a rise in the value of the investment, or if the reasons for the reduction no longer exist.

Cost of Investments

- **Broker, fees and duties** - The cost of an investment includes acquisition charges such as brokerage, fees and duties.
- **Non-cash consideration**-If an investment is acquired, or partly acquired, by the issue of shares or other securities or another asset, the acquisition cost is the fair value of the securities issued or assets given up. The fair value may not necessarily be equal to the nominal or par value of the securities issued. It may be appropriate to consider the fair value of the investment acquired if it is more clearly evident.
- **Interest, dividend etc** - Interest, dividends and other receivables in connection with an investment are generally regarded as income, being the return on the investment. However, in some circumstances, such inflows represent a recovery of cost and do not form part of income. If it is difficult to make such an allocation, the cost of investment is normally reduced by dividends receivable only if they clearly represent a recovery of a part of the cost.
- **Right Shares** - When right shares offered are subscribed for, the cost of the right shares is added to the carrying amount of the original holding. If rights are not subscribed for but are sold in the market, the sale proceeds are taken to the profit and loss statement. However, where the investments are acquired on cum-right basis and the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired, it may be appropriate to apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value.

Carrying Amount of Investments

- ➢ **With respect to Current Investments**

  The more prudent and appropriate method is to carrying current investments individually at the lower of
  - ✓ Cost &
  - ✓ Fair value

  Any reduction to fair value and any reversals of such reductions are included in the Profit & Loss Statement.
- ➢ **With respect to Long-term Investments**

  Long-term investments are usually carried at cost. They are carried at a lower cost when there is a decline, other than temporary in nature. The resultant reduction in the carrying amount is charged to the profit and loss statement. The reduction in carrying amount is reversed when there is a rise in the value of the investment, or if the reasons for the reduction no longer exist.

Disposal of Investments

On disposal of an investment, the difference between the carrying amount and the disposal proceeds, net of expenses, is recognized in the profit and loss statement.

Reclassification of Investments

Where long-term investments are reclassified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.

Where investments are reclassified from current to long-term, transfers are made at the lower of cost and fair value at the date of transfer.

Disclosure

The following disclosures are to be made in financial statements in relation to investments:

- ✓ The accounting policies applied to determine carrying amount of investments.
- ✓ The amounts included in profit and loss statement for:
  - Interest, dividends (showing separately dividends from subsidiary companies)
  - Rentals on investments (showing separately such income from long term and current investments)
  - Amount of income tax deducted at source being included under Advance Taxes Paid.
  - Profits and losses on disposal of current investments and changes in carrying amount of such investments.
  - Profits and losses on disposal of long term investments and changes in the carrying amount of such investments.
- ✓ Significant restrictions on the right of ownership, realisability of investments or the remittance of income and proceeds of disposal.
- ✓ The aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments.
- ✓ Other disclosures as specifically required by the relevant statute governing the enterprise.

Practical Application of AS 13 will be dealt in detail in Chapter-12.

Questions

1 Mention two categories of investments defined by AS 13 and also state their valuation principles.

Answer

As per para 7 and 8 of AS 13 on ‘Accounting for Investments’, there are two categories of investments, viz., Current Investments and Long Term Investments. According to para 14 of the standard, the carrying amount for current investments is the lower of cost and fair value whereas para 17 states that Long Term Investments are valued at cost less permanent diminutions in value of investment. For current investments, para 16 of the standard states that, any reduction to fair value and any reversals of such reductions are included in the profit and loss statement.

2 MY Ltd. had acquired 200 equity shares of YZ Ltd. at Rs. 105 per share on 01.01.2009 and paid Rs. 200 towards brokerage, stamp duty and STT. On 31st March, 2009, shares of YZ Ltd. were traded at Rs. 110 per share. At what value investment is to be shown in the Balance Sheet of MY Ltd. as at 31st March, 2009.(2 Marks each, November, 2009) (IPCC)

Answer

	Rs.
Purchase price of Equity shares of YZ Ltd.(200 shares x Rs. 105 per share)	21,000 200
Cost of investment	21,200

If the investment is a long term investment than it will be shown at cost. Therefore value of investment will be Rs. 21,200. However, if the investment is a current investment, then it will be shown at lower of cost (i.e. Rs. 21,200) or net realizable value (i.e. Rs. 200 x 110 = Rs. 22,000). Therefore value of investment will be Rs. 21,200.

3 Rose Ltd. had made an investment of Rs. 500 lakhs in the equity shares of Nose Ltd. On 10.01.2009. The realisable value of such investment on 31.03.2009 became Rs. 200 lakhs as Nose Ltd. lost a case of patent rights. Rose Ltd. follows financial year as accounting year. How will you recognize this reduction in financial statements for the year 2008-09. (4 Marks each, November, 2009) (IPCC)

Answer

Recognition of reduction in value of investment would depend upon the nature of investment and nature of decline as per Accounting Standard 13 “Accounting for Investments”. As per provisions of the standard, if the investments were acquired for long term and decline is temporary in nature, reduction in value will not be recognized and investments would be carried at cost. If the decline is of permanent nature, it will be charged to profit and loss account. If the investments are current investments, then the reduction should be recognized and charged to Profit and Loss Account as the current investments are carried at cost or fair value, whichever is less.

4 An unquoted long-term investment is carried in the books at cost of Rs. 2 lacs. The published accounts of unlisted company received in May, 2009 showed that the company has incurred cash losses with decline market share and the long-term investment may not fetch more than Rs. 20,000. How you will deal with it in the financial statement of investing company for the year ended 31.3.2009?

Answer

As per para 32 of AS 13 ‘Accounting for Investments’, investment classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. As per para 17 of the standard, indicators of the value of an investment are obtained by reference to its market value, the investee’s assets and results and the expected cash flows from the investment.

The facts of given case clearly suggest that there is decline in the market share of the company and the investment will not fetch more than Rs.20,000. Therefore, the provision of Rs.1,80,000 should be made to reduce the carrying amount of long term investment to Rs.20,000 in the financial statements for the year ended 31st March, 2009.

5 M/s Innovative Garments Manufacturing Company Limited invested in the shares of another company on 1st October, 2011 at a cost of Rs. 2,50,000. It also earlier purchased Gold of Rs. 4,00,000 and Silver of Rs. 2,00,000 on 1st March, 2009. Market value as on 31st March, 2012 of above investments are as follows:

	Rs.
Shares	2,25,000
Gold	6,00,000
Silver	3,50,000

How above investments will be shown in the books of accounts of M/s Innovative Garments Manufacturing Company Limited for the year ending 31st March, 2012 as per the provisions of Accounting Standard 13 "Accounting for Investments"?

Answer

As per AS 13 Accounting for Investments’, for investment in shares - if shares are purchased with an intention to hold for short-term period then it will be shown at the realizable value of Rs. 2,25,000 as on 31st March, 2012.

However, if equity shares are acquired with an intention to hold for long term period then it will be shown at cost of Rs. 2,50,000 in the Balance Sheet of the company. However, provision for diminution shall be made to recognize a decline, if other than temporary, in the value of shares.

As per the standard, investment acquired for long term period shall be shown at cost. Gold and silver are generally purchased with an intention to hold it for long term period untill and unless given otherwise. Hence, the investment in Gold and Silver (purchased on 1st March, 2009) shall continue to be shown at cost as on 31st March, 2012 i.e., Rs. 4,00,000 and Rs. 2,00,000 respectively, though their realizable values have been increased.

6 Briefly explain disclosure requirements for Investments as per AS-13.

Answer

The disclosure requirements as per para 35 of AS 13 are as follows:

(i) Accounting policies followed for valuation of investments.

(ii) Classification of investment into current and long term in addition to classification as per Schedule VI

of Companies Act in case of company.

(iii) The amount included in profit and loss statements for

(a) Interest, dividends and rentals for long term and current investments, disclosing therein gross income and tax deducted at source thereon;

(b) Profits and losses on disposal of current investment and changes in carrying amount of such investments;

(c) Profits and losses and disposal of long term investments and changes in carrying amount of investments.

(iv) Aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments;

(v) Any significant restrictions on investments like minimum holding period for sale/disposal, utilisation of sale proceeds or non-remittance of sale proceeds of investment held outside India.

(vi) Other disclosures required by the relevant statute governing the enterprises.

7 M/s Innovative Garments Manufacturing Company Limited invested in the shares of another company on 1st October, 2011 at a cost of ` 2,50,000. It also earlier purchased Gold of ` 4,00,000 and Silver of ` 2,00,000 on 1st March, 2009. Market value as on 31st March, 2012 of above investments are as follows:

	Rs.
Shares	2,25,000
Gold	6,00,000
Silver	3,50,000

How above investments will be shown in the books of accounts of M/s Innovative Garments Manufacturing Company Limited for the year ending 31st March, 2012 as per the provisions of Accounting Standard 13 "Accounting for Investments"?

Answer

As per AS 13 'Accounting for Investments', for investment in shares - if the investment is purchased with an intention to hold for short-term period then it will be shown at the realizable value of ` 2,25,000 as on 31st March, 2012.

If equity shares are acquired with an intention to hold for long term period then it will continue to be shown at cost in the Balance Sheet of the company. However, provision for diminution shall be made to recognize a decline, if other than temporary, in the value of the investments.

As per the standard, investment acquired for long term period shall be shown at cost. Gold and silver are generally purchased with an intention to hold it for long term period until and unless given otherwise. Hence, the investment in Gold and Silver (purchased on 1st March, 2009) shall continue to be shown at cost as on 31st March, 2012 i.e., ` 4,00,000 and ` 2,00,000 respectively, though their realizable values have been increased.

8 ABC Ltd. wants to re-classify its investments in accordance with AS 13. Decide and state on the amount of transfer, based on the following information:

(1) A portion of current investments purchased for ` 20 lakhs, to be reclassified as long term investment, as the company has decided to retain them. The market value as on the date of Balance Sheet was ` 25 lakhs.

(2) Another portion of current investments purchased for ` 15 lakhs, to be reclassified as long term investments. The market value of these investments as on the date of balance sheet was ` 6.5 lakhs.

(3) Certain long term investments no longer considered for holding purposes, to be reclassified as current investments. The original cost of these was ` 18 lakhs but had been written down to ` 12 lakhs to recognize permanent decline as per AS 13.

Answer

As per AS 13, where investments are reclassified from current to long-term, transfers are made at the lower of cost and fair value at the date of transfer.

(1) In the first case, the market value of the investment is ` 25 lakhs, which is higher than its cost i.e. ` 20 lakhs. Therefore, the transfer to long term investments should be carried at cost i.e. ` 20 lakhs.

(2) In the second case, the market value of the investment is ` 6.5 lakhs, which is lower than its cost i.e. ` 15 lakhs. Therefore, the transfer to long term investments should be carried in the books at the market value i.e. ` 6.5 lakhs. The loss of ` 8.5 lakhs should be charged to profit and loss account.

As per AS 13, where long-term investments are re-classified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.

(3) In the third case, the book value of the investment is ` 12 lakhs, which is lower than its cost i.e. ` 18 lakhs. Here, the transfer should be at carrying amount and hence this reclassified current investment should be carried at ` 12 lakhs.

ACCOUNTING STANDARD - 14

ACCOUNTIG FOR AMALGAMATIONS

Applicability

The standard deals with accounting to be made in the books of Transferee company in case of amalgamation.

- Standard is not applicable to cases of acquisition of shares where the acquired company is not disallowed and continues to exist.
- Standard is applicable where acquired company is dissolved and separate entity ceased to exist.

Key Terms

- **Transferor Company** means the company which is amalgamated into another company.
- **Transferee Company** means the company into which a transferor company is amalgamated.

Nature of Amalgamation

- **Amalgamation in the nature of merger**:
  It is an amalgamation which satisfies all the following conditions.
  - ✓ All the assets and liabilities of the transferor company become the assets and liabilities of the transferee company after amalgamation.
  - ✓ Shareholders holding not less than 90% of the face value of the equity shares of the transferor company become equity shareholders of the transferee company by virtue of the amalgamation.
  - ✓ The consideration to equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged wholly by the issue of equity shares in the transferee company, except that cash for fractional shares.
  - ✓ The business of the transferor company is intended to be carried on by the transferee company after amalgamation.
  - ✓ Assets and liabilities of the transferor company should be taken over and incorporated in financial statements of transferee company at book value, except to ensure uniformity of accounting policies.
- **Amalgamation in the nature of purchase**:
  It is an amalgamation which does not satisfy any one or more of the five conditions specified above.

Methods of Accounting for Amalgamations

There are two main methods of accounting for amalgamations:

- Pooling of interests method; and
- Purchase method.

Disclosure

For all amalgamations, following disclosures should be made in the first financial statements:

- ✓ Names and general nature of business of the amalgamating companies.

- ✓ Effective date of amalgamation for accounting purposes.
- ✓ Method of accounting used to reflect the amalgamation.
- ✓ Particulars of the scheme sanctioned under a statute.

For amalgamations accounted for under the pooling of interests method, the following additional disclosures should be made in the first financial statements following the amalgamation:

- ✓ Description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation;
- ✓ Amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.

For amalgamations accounted for under the purchase method, the following additional disclosures should be made in the financial statements following the amalgamation:

- ✓ Consideration for the amalgamation and a description of the consideration paid or contingently payable
- ✓ Amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof including the period of amortization of any goodwill arising on amalgamation.

Questions

1 Name two methods of accounting for amalgamations as contemplated by AS 14.

Answer

Two methods of accounting for amalgamation as contemplated by AS 14 are:

(a) The pooling of interests method and

(b) The purchase method

2 X Co. Ltd. having share capital of Rs. 50 lakhs divided into equity shares of Rs. 10 each was taken over by Y Co. Ltd. X Co. Ltd. has General Reserve of Rs. 10,00,000 and Profit and Loss account Cr.Rs. 5,00,000. Y Co. Ltd. issued 11 equity shares of Rs. 10 each for every 10 shares of X Co. Ltd. How the Journal entry would be passed in the books of Y Co. Ltd. for the shares issued under the 'Pooling of interest method' of amalgamation. (2 Marks each, November, 2009) (IPCC)

Answer

In the books of Y Co. Ltd.

Journal Entries

	Rs.	***Rs.***
Business Purchase A/c Dr. To Liquidator of X Co. Ltd. (Being business of X Co. Ltd. purchased)	55,00,000	 55,00,000
Assets A/c (Bal. Fig.) Dr. To Business Purchase A/c To General Reserve A/c (10,00,000 – 5,00,000) To Profit and Loss A/c (Being assets and reserves and surplus taken over)	65,00,000	 55,00,000 5,00,000 5,00,000

Liquidator of X Co. Ltd. Dr. To Equity share capital A/c (Being purchase consideration discharged through equity shares of Y Co. Ltd.)	55,00,000	 55,00,000

Purchase consideration	Rs. 55,00,000
Less : Share capital of X Co. Ltd.	Rs. 50,00,000
To be adjusted from general reserve	Rs. 5,00,000

3 As per Accounting Standard-14, what are the conditions which must be satisfied for an amalgamation in the nature of merger?

Answer

According to AS 14 "Accounting for Amalgamations", Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions:

- All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.
- Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.
- The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.
- The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.
- No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

4 The abstract of the Balance Sheet of the AXE Ltd. as at 31st March 2010, are as follows:

Liabilities	***Rs.***
Equity share capital (Rs. 100 each)	15,00,000
12% Preference share capital (Rs. 100 each)	8,00,000
13% Debentures	3,00,000

On 31st March, 2010, BXE Ltd. agreed to take over AXE Ltd. on the following terms:

1. For each preference share in AXE Ltd., Rs. 10 in cash and one 9% preference share of Rs. 100 in BXE Ltd.
2. For each equity share AXE Ltd. Rs. 20 in cash and one equity share in BXE Ltd. Of Rs. 100 each. It was decided that the share in BXE Ltd. will be issued at market price Rs. 140 per share.
3. Liquidation expenses of AXE Ltd. are to be reimbursed by BXE Ltd. to the extent of Rs. 10,000. Actual expenses amounted to Rs. 12,500. You are required to compute the amount of purchase consideration.

Answer

Calculation of purchase consideration

		Rs.	***Rs.***
I	Payment made to shareholders of 8,000preference shares of AXE Ltd. :		
	Cash @ Rs. 10 per share (8,000 preference shares x Rs. 10)	80,000	
	9% Preference shares in BXE Ltd. @ Rs. 100 each	8,00,000	8,80,000
II	Payment made to Equity shareholders of 15,000equity shares of AXE Ltd. :		
	Cash @ Rs. 20 per share (15,000 shares x Rs. 20)	3,00,000	
	Equity shares in BXE Ltd. issued at market price Rs. 140 each (15,000 shares x Rs. 140)	21,00,000	24,00,000
	Total purchase consideration		32,80,000

Note: Re-imbursement of liquidation expenses of AXE Ltd. to the extent of Rs. 10,000, will not be included in the calculation of purchase consideration.

$$^{*}\left(\frac{8,00,000}{100}\right) = = 8,000 \text{ preference shares}$$

$$^{*}\left(\frac{15,00,000}{100}\right) = = 15,000 \text{ equity shares}$$

5 What disclosures should be made in the first financial statements following the amalgamation?

Answer

Para 24 of AS 14 ‘Accounting for Amalgamations’ states that for all amalgamations (whether for amalgamations accounted for under the pooling of interests method or amalgamations accounted for under the purchase method), the following disclosures are considered appropriate in the first financial statements following the amalgamation:

(a) Names and general nature of business of the amalgamating companies;

(b) Effective date of amalgamation for accounting purposes;
(c) The method of accounting used to reflect the amalgamation; and
(d) Particulars of the scheme sanctioned under a statute.

6 Briefly explain the types of Amalgamations?

Answer

As per AS 14, 'Accounting for Amalgamations' there are two types of amalgamation. In first type of amalgamation there is a genuine pooling not merely of assets and liabilities of the amalgamating companies but also of the shareholders' interests and of the businesses of the companies. Such amalgamations are amalgamations which are in the nature of 'merger' and the accounting treatment of such amalgamations should ensure that the resultant figures of assets, liabilities, capital and reserves more or less represent the sum of the relevant figures of the amalgamating companies. In the second category are those amalgamations which are in effect a mode by which one company acquires another company and, as a consequence, the share holders of the company which is acquired normally do not continue to have a proportionate share in the equity of the combined company, or the business of the company which is acquired is not intended to be continued. Such amalgamations are amalgamations in the nature of 'purchase'.

Note: It is possible to answer this question by specifying all the conditions to be satisfied for an amalgamation to be an amalgamation in the nature of merger. The amalgamation would to be an amalgamation in the nature of purchase if any one or more of the said conditions are not satisfied.

7 A Ltd. is amalgamating with B Ltd. They are undecided on the method of accounting to be followed. You are required to advice the management of B Ltd. on the method of accounting that can be adopted under AS-14.

Answer

An amalgamation may be either – an amalgamation in the nature of merger, or an amalgamation in the nature of purchase. The selection of method of accounting for amalgamation (pooling of interests or purchase method) is to be judged after considering the intentions of the both the companies. If genuine pooling of all assets, liabilities, shareholders' interest is intended; separate businesses of both the companies are continued and their amalgamation scheme satisfies all the conditions necessary for merger as specified in AS 14 "Accounting for Amalgamations", pooling of interests method is adopted.

However, if B Ltd. or A Ltd. wants to acquire the other company, then purchase method needs to be adopted. In that case, the shareholders of the acquired company don't continue to have proportional share in equity of the combined company and the business of the acquired company is not intended to be continued. The object of the purchase method is to account for the amalgamation by applying the same principles as are applied in the normal purchase of assets. Thus choice of accounting method depends on the fact whether B Ltd. wants to continue its business or not.

8 Briefly describe the disclosure requirements for amalgamation including additional disclosure, if any, for different methods of amalgamation as per AS 14.

Or

What disclosures should be made in the first financial statements following the amalgamation?

Answer

The disclosure requirements for amalgamations have been prescribed in paragraphs 43 to 46 of AS 14 on Accounting for Amalgamation.

For all amalgamations, the following disclosures should be made in the first financial statements following the amalgamation:

(a) names and general nature of business of the amalgamating companies;

(b) the effective date of amalgamation for accounting purpose;

(c) the method of accounting used to reflect the amalgamation; and

(d) particulars of the scheme sanctioned under a statute.

For amalgamations accounted under the pooling of interests method, the following additional disclosures should be made in the first financial statements following the amalgamation:

(a) description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation; and

(b) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.

For amalgamations, accounted under the purchase method, the following additional disclosures should be made in the first financial statements following the amalgamation;

(a) consideration for the amalgamation and a description of the consideration paid or contingently payable; and

(b) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof including the period of amortisation of any goodwill arising on amalgamation.

9 Briefly explain the methods of accounting for amalgamation as per Accounting Standard-14.

Answer

As per AS 14 on 'Accounting for Amalgamations', there are two main methods of accounting for amalgamations:

(i) The Pooling of Interest Method: Under this method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts (after making the necessary adjustments).

If at the time of amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies is adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies are reported in accordance with AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'.

(ii) The Purchase Method: Under the purchase method, the transferee company accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company. Where assets and liabilities are restated on the basis of their fair values, the determination of fair values may be influenced by the intentions of the transferee company.

10 List the conditions to be fulfilled as per Accounting Standard 14 for an amalgamation to be in the nature of merger, in the case of companies.

Answer

An amalgamation should be considered to be an amalgamation in the nature of merger if the following conditions are satisfied:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

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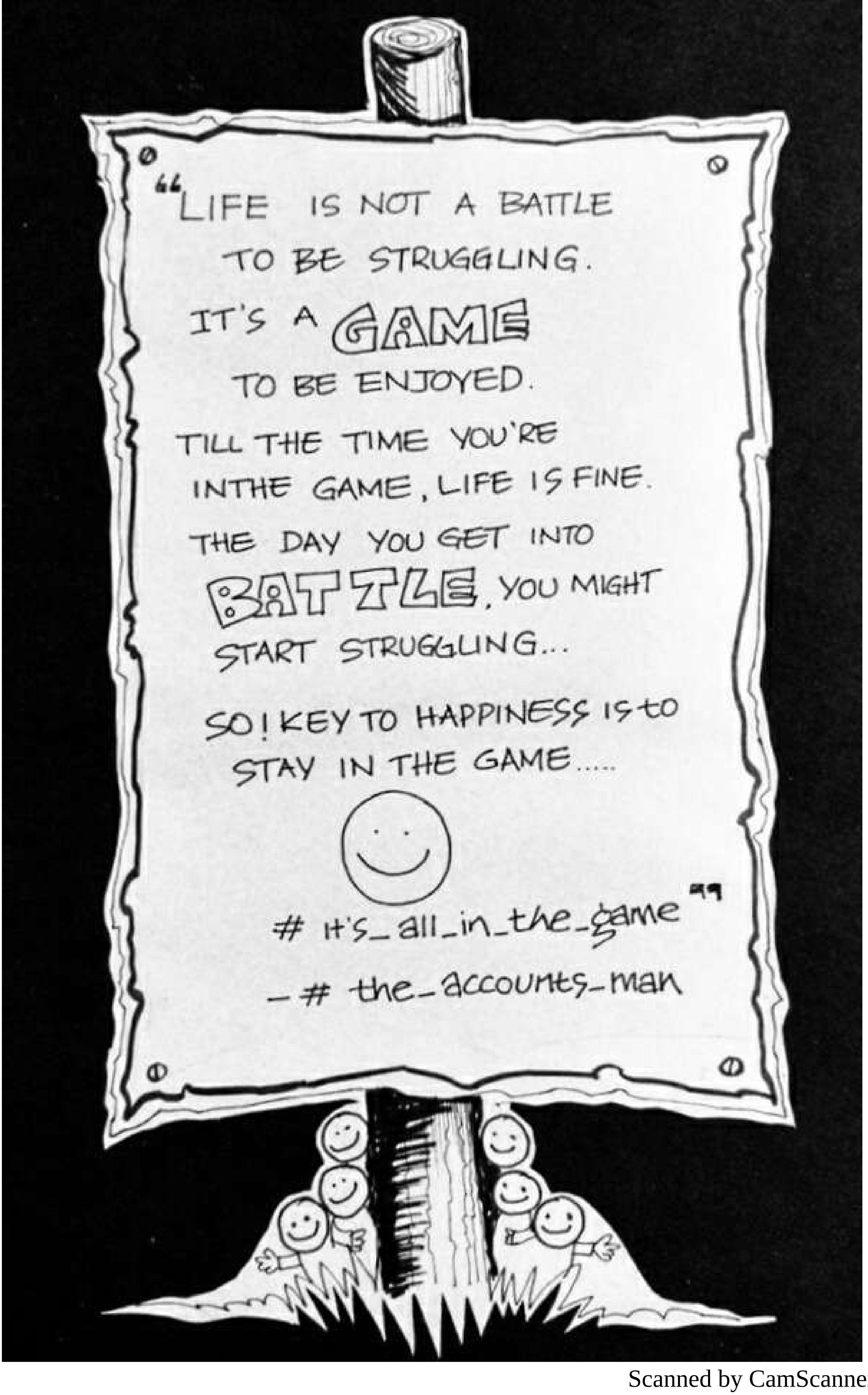
"LIFE IS NOT A BATTLE
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