

ACCOUNTING STANDARDS

CRITERIA FOR CLASSIFICATION OF ENTERPRISES

(1) Criteria for classification of non-corporate entities as decided by the Institute of Chartered Accountants of India

Level I Entities

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

- i. Entities whose equity or debt securities are listed or are in the process of listing on any stock exchange, whether in India or outside India.
- ii. Banks (including co-operative banks), financial institutions or entities carrying on insurance business.
- iii. All commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds rupees fifty crore in the immediately preceding accounting year.
- iv. All commercial, industrial and business reporting entities having borrowings (including public deposits) in excess of rupees ten crore at any time during the immediately preceding accounting year.
- v. Holding and subsidiary entities of any one of the above.

Level II Entities (SMEs)

Non-corporate entities which are not Level I entities but fall in any one or more of the following categories are classified as Level II entities:

- i. All commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds rupees forty lakh but does not exceed rupees fifty crore in the immediately preceding accounting year.
- ii. All commercial, industrial and business reporting entities having borrowings (including public deposits) in excess of rupees one crore but not in excess of rupees ten crore at any time during the immediately preceding accounting year.
- iii. Holding and subsidiary entities of any one of the above.

Level III Entities (SMEs)

Non-corporate entities which are not covered under Level I and Level II are considered as Level III entities.

(2) Criteria for classification of companies under the Companies (Accounting Standards) Rules, 2006

Small and Medium-Sized Company (SMC) as defined in Clause 2(f) of the Companies (Accounting Standards) Rules, 2006:

(f) "Small and Medium Sized Company" (SMC) means, a company—

- i. whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;
- ii. which is not a bank, financial institution or an insurance company;

- iii. whose turnover (excluding other income) does not exceed rupees fifty crore in the immediately preceding accounting year;
- iv. which does not have borrowings (including public deposits) in excess of rupees ten crore at any time during the immediately preceding accounting year; and
- v. which is not a holding or subsidiary company of a company which is not a small and medium-sized company.

Explanation: For the purposes of clause (f), a company shall qualify as a Small and Medium Sized Company, if the conditions mentioned therein are satisfied as at the end of the relevant accounting period.

Non-SMCs

Companies not falling within the definition of SMC are considered as Non-SMCs.

HARMONISATION OF DIFFERENCES BETWEEN THE ACCOUNTING STANDARDS ISSUED BY THE ICAI AND THOSE NOTIFIED BY THE CENTRAL GOVERNMENT

The Central Government, on December 7, 2006, notified Accounting Standards in the Companies (Accounting Standards) Rules, 2006. These have been amended twice once in year 2008 with respect to accounting of employee benefits and secondly in year 2009 with respect to accounting of exchange fluctuation. These Accounting Standards were different in certain respects from the Accounting Standards issued by the Council of ICAI. It has now been decided to harmonise these differences and clarify as to the applicability of both the sets of Accounting Standards to various entities.

Harmonisation of Differences caused by Accounting Standards Interpretations (ASIs)

The **consensus** portion of most of the ASIs has been included as ‘**Explanation**’ to the relevant paragraphs in the notified Accounting Standards. The Council has decided to follow the same. Accordingly, Standards issued by ICAI will also have these ASIs inbuilt in the standard itself. Thus, the Standards are being amended to incorporate the consensus portion of the ASIs as explanation to the relevant paragraphs.

Withdrawal of Accounting Standards Interpretations

ASI 2, Accounting for Machinery Spares (Re. AS 2 and AS 10) and ASI 11, Accounting for Taxes on Income in case of an Amalgamation (Re. AS 22) have been withdrawn. These ASIs would not be included in the standards.

Issuance of Guidance Notes in lieu of ASIs

The Council decided to withdraw the following ASIs and issue the same as Guidance Notes.

- ASI 12 Applicability of AS 20 (Re. AS 20)
- ASI 23 Remuneration paid to key management personnel — whether a related party transaction (Re. AS 18)
- ASI 27 Applicability of AS 25 to Interim Financial Results (Re. AS 25)
- ASI 29 Turnover in case of Contractors (Re. AS 7 (Revised 2002))

Harmonisation of Definition of Smaller Companies

The Council has retained three levels of entities, for Non- Corporate Enterprises. However, the ICAI has harmonized the definitions for smaller companies to fall in line with the Companies (Accounting Standards) Rules, 2006.

It must be noted here, that only corporate entities shall be governed by the Accounting Standard provisions contained in the notified Rules.

The applicability of Accounting Standards to various entities is summarized in the following tables.

Note:

- The under mentioned Accounting Standards shall be applicable to **all corporate entities** for accounting periods commencing **on or after December 7, 2006**;
- For **Non-Corporate entities**, it shall be applicable from **1st April 1, 2008** (with standards which are being amended to incorporate changed definitions of SMEs and the consensus portion of the ASIs)

APPLICABILITY OF ACCOUNTING STANDARDS - AN OVERVIEW

<i>Accounting Standards</i>		<i>To all Corporate Entities [As per Companies (Accounting Standards) Rules]</i>	<i>To all Non-Corporate entities [As per ICAI Accounting Standards]</i>
AS 1	Disclosure of Accounting Policies	Y	Y
AS 2	Valuation of Inventories	Y	Y
AS 4	Contingencies and Events Occurring After the Balance Sheet Date	Y	Y
AS 5	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies	Y	Y
AS 6	Depreciation Accounting	Y	Y
AS 7	Construction Contracts (Revised 2002)	Y	Y
AS 9	Revenue Recognition	Y	Y
AS 10	Accounting for Fixed Assets	Y	Y
AS 11	The Effects of Changes in Foreign Exchange Rates (Revised 2003)	Y	Y
AS 12	Accounting for Government Grants	Y	Y
AS 13	Accounting for Investments	Y	Y
AS 14	Accounting for Amalgamations	Y	Y
AS 15	Employee Benefits (Refer Note 1)	Y	Y
AS 16	Borrowing Costs	Y	Y
AS 18	Related Party Disclosures	Y	Not applicable to Level III

AS 19	Leases (Refer Note 2)	Y	Y
AS 20	Earnings Per Share (Refer Note 3)	Y	Y
AS 22	Accounting for Taxes on Income	Y	Y
AS 24	Discontinuing Operations	Y	Not applicable to Level III
AS 25	Interim Financial Reporting (Refer Note 6)	Y	Y
AS 26	Intangible Assets	Y	Y
AS 28	Impairment of Assets (Refer Note 4)	Y	Y
AS 29	Provisions, Contingent Liabilities and Contingent Assets (Refer Note 5)	Y	Y

Note: The Notes referred to in the previous table are given in the table titled "Relaxations of certain requirements for SMCs/Level II & Level III enterprises" below.

The Exemptions available to both, SMCs (i.e., governed by the Rules) and also available to Level II and Level III Enterprises (i.e., governed by the ICAI Accounting Standards) in entirety are given in the following table:

AS 3	Cash Flow Statements
AS 17	Segment Reporting
AS 21*	Consolidated Financial Statements
AS 23*	Accounting for Investments in Associates in Consolidated Financial Statements
AS 27*	Financial Reporting of Interests in Joint Ventures (to the extent of requirement relating to Consolidated Financial Statements)

Note: * AS 21, 23 and 27 are applicable only when relevant regulator requires compliance of these standards

RELAXATIONS OF CERTAIN REQUIREMENTS FOR SMCS / LEVEL II & LEVEL III ENTERPRISES :

Note No.	Accounting Standards	Relaxations available to Small and Medium Companies, Level II Enterprises and Level III Enterprises
1	AS 15, Employee Benefits	• Paragraphs 11-16 dealing with recognition and measurement of short term accumulating compensated absences which are non-vesting • Paragraphs 46 and 139 dealing with discounting of amounts that fall due more than 12 months after the balance sheet date • Paragraphs 50–116 dealing with Defined Benefit plans • Paragraphs 117–123 dealing with actuarial valuations • Paragraphs 129-131 in respect of other long-term benefits

Note: AS 15 (Revised 2005) issued by ICAI exempts Level II enterprises having less than 50 employees from the

application of PUC method, i.e., these enterprises can use other rational method for accrual of liabilities.

However, the Companies (Accounting Standards) Rules, 2006 do not contain such exemption.

2	AS 19, Leases	• Requirements relating to disclosures as given in paragraphs 22(c), (e) and (f); 25(a), (b) and (e); 37(a) and (f); and 46(b) and (d) are not applicable to SMCs and level II/III enterprises. • Further to these relaxations, Level III enterprises are also not required to give Paragraphs 37(g) and 46(e) disclosures.
3	AS 20, Earnings Per Share	• Diluted earnings per share (both including and excluding extraordinary items) is not required to be disclosed for SMCs and level II/III non corporate enterprises. • Further, Information required by paragraph 48(ii) of AS 20 regarding disclosures for parameters used in calculation of EPS, are also not required to be disclosed by Level III entities.
4	AS 28, Impairment of Assets	• Value in use can be based on reasonable estimate instead of computing it by present value technique. Further, information required by paragraph 121(g) relating to discount rate used, need not be disclosed.
5	AS 29, Provisions, Contingent Liabilities and Contingent Assets	• Paragraphs 66 and 67 relating to disclosures for amount and description for each class of provision are not required to be disclosed.
6	AS 25, Interim Financial Reporting	• AS 25 is applicable only if a company/non-corporate entity elects to prepare and present an interim financial report. Only certain Non-SMCs/Level I entities are required by the concerned regulatory to present interim financial results, eg, quarterly financial results required by the SEBI.

AS-1 — DISCLOSURE OF ACCOUNTING POLICIES

- Significant Accounting Policies followed in preparation of accounts be disclosed at one place along with the financial statements.
- Any change and financial impact of such change should be disclosed.
- If fundamental assumptions (going concern, consistency and accrual) are not followed, the fact to be disclosed. Going concern assumption is assessed for a foreseeable period of one year
- Accounting Policies adopted by the enterprise should represent true and fair view of the state of affairs of the financial statements
- Major considerations governing selection and application of accounting policies are: i) Prudence, ii) Substance over form and iii) Materiality.
- Note — In relation to derivative contracts (e.g. foreign exchange forward contracts) the Institute interpreted on the principles of prudence that the loss (net), if any on each reporting date shall be provided through the statement of profit and loss account.

AS-2 — VALUATION OF INVENTORIES (REVISED)

The cost of inventories should comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

- Inventories are valued at lower of cost or net realisable value. Specific identification method is required when goods are not ordinarily interchangeable. In other circumstances, the enterprise may adopt either weighted average cost method or FIFO methods whichever approximates the fairest possible approximation of cost incurred. Standard Costing Method or Retail Inventory Method can be adopted only as a techniques of measurement provided where the results of these measurements approximates the results that would be arrived at after adopting specific identification method or weighted average method or FIFO method as may be applicable to the circumstances.
- The financial statements should disclose: (a) the accounting policies adopted in measuring inventories, including the cost formula used; and (b) the total carrying amount of inventories and its classification appropriate to the enterprise.

AS-3 — CASH FLOW STATEMENTS

The standard sets out the requirement that where the cash flow statement is presented, it shall disclose a movement in "cash and cash equivalents" segregating various transactions into operating, investing and financing activity. It requires certain specific items to be addressed in the cash flows and certain supplemental disclosures for non-cash transactions.

Cash comprises cash on hand and demand deposits with banks.

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

Operating activities are the principal revenue-generating activities of the enterprise and other activities that are not investing or financing activities. Examples, cash receipts from the sale of goods and the rendering of services; cash receipts from royalties, fees, commissions and other revenue; cash payments to suppliers for goods and services; cash payments to and on behalf of employees.

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents. Examples, cash payments to acquire fixed assets (including intangibles). These payments include those relating to capitalised research and development costs and self-constructed fixed assets; cash receipts from disposal of fixed assets (including intangibles); cash payments to acquire shares, warrants or debt instruments of other enterprises and interests in joint ventures (other than payments for those instruments considered to be cash equivalents and those held for dealing or trading purposes).

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. Example, cash proceeds from issuing shares or other similar instruments; cash proceeds from issuing debentures, loans, notes, bonds, and other short- or long-term borrowings; and cash repayments of amounts borrowed.

Additionally certain items are required to be disclosed separately, like Income Tax, Dividends, etc.

The enterprise can choose either direct method or indirect method for presentation of its cash flows.

Cash flows arising from transactions in a foreign currency should be recorded in an enterprise's reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the cash flow. A rate that approximates the actual rate may be used if the result is substantially the same as would

arise if the rates at the dates of the cash flows were used. The effect of changes in exchange rates on cash and cash equivalents held in a foreign currency should be reported as a separate part of the reconciliation of the changes in cash and cash equivalents during the period.

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

Contingencies

- The amount of a contingent loss should be provided for by a charge in the statement of profit and loss if it is probable that future events will confirm that, after taking into account any related probable recovery, an asset has been impaired or a liability has been incurred as at the balance sheet date, and a reasonable estimate of the amount of the resulting loss can be made.
- The existence of a contingent loss should be disclosed in the financial statements if either of the conditions in above paragraph is not met, unless the possibility of a loss is remote.
- Contingent gains should not be recognised in the financial statements.

Events occurring after the Balance Sheet Date

- Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern (i.e., the continuance of existence or substratum of the enterprise) is not appropriate.
- Dividends stated to be in respect of the period covered by the financial statements, which are proposed or declared by the enterprise after the balance sheet date but before approval of the financial statements, should be adjusted.
- Disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise.

Disclosure

- If disclosure of contingencies is required by paragraph 11 of the Statement, the following information should be provided: the nature of the contingency, the uncertainties which may affect the future outcome, an estimate of the financial effect, or a statement that such an estimate cannot be made.
- If disclosure of events occurring after the balance sheet date in the report of the approving authority is required by the Standard then it shall disclose; the nature of the event, an estimate of the financial effect, or a statement that such an estimate cannot be made.

AS-5 — NET PROFIT/LOSS FOR THE PERIOD, PRIOR PERIOD ITEMS AND CHANGES IN ACCOUNTING POLICIES

- Prominent definitions includes; **Ordinary activities** are any activities which are undertaken by an enterprise as part of its business and such related activities in which the enterprise engages in furtherance of, incidental to, or arising from, these activities. **Extraordinary items** are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly. **Prior period** items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. **Accounting policies** are the specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements.

Accounting treatment and disclosures

- **Ordinary Activities** : When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.
- **Extraordinary Items** should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.
- **Prior Period** : The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived.
- **Accounting Estimate** : The effect of a change in an accounting estimate should be included in the determination of net profit or loss in; (a) the period of the change, if the change affects the period only; or (b) the period of the change and future periods, if the change affects both.
- **Accounting Policy** : Any change in an accounting policy which has a material effect should be disclosed. The impact of, and the adjustments resulting from, such change, if material, should be shown in the financial statements of the period in which such change is made, to reflect the effect of such change. Where the effect of such change is not ascertainable, wholly or in part, the fact should be indicated. If a change is made in the accounting policies which has no material effect on the financial statements for the current period but which is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.
- A change in accounting policy consequent upon the adoption of an Accounting Standard should be accounted for in accordance with the specific transitional provisions, if any, contained in that Accounting Standard. However, disclosures required by paragraph 32 of the Statement should be made unless the transitional provisions of any other Accounting Standard require alternative disclosures in this regard.
- Where any policy was applied to immaterial items in any earlier period but the item is material in the current period, the change in accounting policy, if any, shall not be treated as a change in accounting policy and accordingly no disclosure is required e.g., gravity booked on cash basis in earlier period for relatively insignificant number of employees which in current period has become material and thus provided on basis of report of Actuary.

AS-6 — DEPRECIATION ACCOUNTING

- Allocate depreciable amount of a depreciable assets on systematic basis to each accounting year over useful life of asset, useful life may be reviewed periodically.
- Basis must be consistently followed and disclosed. Any change to be quantified and disclosed.
- Rates of depreciation should be disclosed.
- A change in method followed be made only if required by the statute, compliance to Accounting Standard, appropriate preparation or presentation of the financial statement.
- In cases of extension, revaluation or exchange fluctuation, depreciation to be provided on adjusted figure prospectively over the residual useful life of the asset.
- Deficiency or surplus in case of transfer/change in method be disclosed.
- Historical cost, depreciation for the year and accumulated depreciation be disclosed.

- Revision in method of depreciation be made from date of use. Change in method of charging depreciation is change in accounting policy be disclosed.

AS-7 — ACCOUNTING FOR CONSTRUCTION CONTRACTS

- It may be mentioned that the standard is applicable in accounting of contracts in the books of the contractor. It is not applicable for construction project undertaken by the entity on behalf of its own, for example, a builder constructing flats to be sold. It is also not applicable to Service Contracts which are not related to the construction of asset.
- According to AS-7 (Revised) the enterprise should follow only percentage completion method.
- Where in case the contract revenue or the stage of completion cannot be determined reliably, the cost incurred on the contract may be carried forward as work-in-progress. All foreseen losses must be fully provided for.
- Under percentage of completion method, appropriate allowance for future contingencies shall be made.
- WIP, receipt of progressive payments, advances, retentions, receivables and certain other items are required to be disclosed.

AS-8 — ACCOUNTING FOR RESEARCH AND DEVELOPMENT

- Salaries, wages, personnel costs, depreciation, cost of materials and services, etc. related to research and development, payment to outside institutions, reasonable allocation of overhead costs and amortization of patents and licences be included in R & D cost, and be disclosed in Profit & Loss Account.
- Such cost to be charged as an expense unless the product or process is separately identifiable. It may be then deferred for allocation in future years on systematic basis and to be separately disclosed in Balance Sheet and reviewed at the end of each accounting year. Once written off, it should not be reinstated.

It may be mentioned that the standard has been withdrawn w.e.f. 1-4-2004. The accounting provision of this standard are taken.

AS-9 — REVENUE RECOGNITION

- Revenue from sales or service transactions should be recognised when the requirements as to performance as set out are satisfied, provided that at the time of performance it is not unreasonable to expect ultimate collection. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.
- In a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled: (i) 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 (ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.
- In a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the 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 of other enterprise resources yielding interest, royalties and dividends should only be recognised when no significant uncertainty as to measurability or collectability exists. These revenues are recognised on the following bases:

(i) Interest: on a time proportion basis taking into account the amount outstanding and the rate applicable.

(ii) Royalties: on an accrual basis in accordance with the terms of the relevant agreement.

(iii) Dividends from investments in shares: when the owner's right to receive payment is established.

Disclosure

- In addition to the disclosures required by Accounting Standard 1 on 'Disclosure of Accounting Policies' (AS-1), an enterprise should also disclose the circumstances in which revenue recognition has been postponed pending the resolution of significant uncertainties.
- In cases where revenue cycle of the entity involves collection of excise duty the enterprise is required to disclose revenue at gross as reduced by excise amount thereby finally arriving net sales on the face of the profit and loss account.
- The standard is followed by an appendix that though is not part of the Standard, illustrate the application of the Standard to a number of commercial situation deals with various situations in an endeavour to assist in clarifying application of the Standard.

AS-10 — ACCOUNTING FOR FIXED ASSETS

- The cost of a fixed asset should comprise its purchase price and any attributable cost of bringing the asset to its working condition for its intended use.
- Self-constructed asset shall be accounted at cost.
- In case of exchange of asset, fair value of asset acquired or the net book value of asset given up whichever is more clearly evident shall be considered.
- Revaluation is permitted provided it is done for the entire class of assets. The basis of revaluation should be disclosed.
- Increase in value on revaluation shall be credited to Revaluation Reserve while the decrease should be charged to Profit and Loss Account.
- Goodwill to be accounted only when paid for.
- Assets acquired on hire purchase shall be recorded at its fair value.
- Gross and net book values at beginning and end of year showing additions, deletions and other movements is required to be disclosed.
- Assets should be eliminated from books on disposal or when of no utility value.
- Profit/loss on disposal be recognised on disposal to Profit and Loss Account.
- Machinery spares that can be used only in conjunction of specific asset shall be capitalised.

AS-11 (REVISED) — ACCOUNTING FOR EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

- Applicable to all enterprises for which accounting period commences on or after 1-4-2004. It is applicable to transactions in foreign currency and translating financial statements of foreign subsidiary/branches.
- Monetary items denominated in Foreign Currency shall be reported using closing rates.
- Non monetary items carried in terms of historical cost in foreign currency shall be reported at the exchange rate on the date of the transaction.
- Exchange differences shall be recognised as income/expenses in the period in which they arise except in case of fixed assets and differences on account of forward contracts.
- Translation of foreign exchange transaction of revenue items except opening/closing inventories and depreciation shall be made by applying rate at the date of the transactions. For convenience purposes an average rate or weighted average rate may be used, provided it approximates the rate of exchange. Opening and closing inventories shall be translated at rates prevalent on opening and closing dates, respectively and depreciation amount shall be converted by applying the rate used for translation of the asset.
- Translation gains and losses for branches/subsidiaries forming integral part of operations of the entity shall be accounted as stated in above. However translation gains and losses for non-integral operations shall be directly credited to reserves. It may be mentioned that that the method of arriving translation gains or losses shall be different from that stated above; i.e., all assets and liabilities are converted at closing rates and revenue items are converted at average rates, where it approximates the rates at the date of transactions. Integral foreign operation is a foreign operation, the activities of which are an integral foreign operation is a foreign operation, the activities of which are an integral part of those of the reporting enterprise.
- Exchange differences arising on repayment of liabilities incurred for purchase of fixed assets shall be expensed through profit and loss account. {Note, in case of a Company (read as required by Schedule VI), where the fixed asset is purchased from outside India, the related exchange gains and loss, if any, are required to be capitalized}. Also in case of a company, other exchange differences arising out of long-term monetary items can be initially deferred and later amortized over the period up to March 31, 2012 or the life of the related long-term monetary asset whichever is lower with corresponding adjustments in balance sheet through "Foreign Currency Monetary Item Translation Difference Account".
- Gains or losses on accounting of forward contracts is recognised through profit and loss account (unless it relates to fixed assets as described in above for a Company).

However, measurement of gains or losses on forward contract depends upon the intention for which it is taken. Where it is not for trading or speculative purposes the premium/discount is amortised over the term of the contracts. Where these are held for either speculative or trading purposes, the gain or loss is arrived at each reporting date after comparing the FAIR VALUE of contract for its remaining term of maturity with the carrying amount at the reporting date.

- Profit/Loss on cancellation or renewal of forward exchange contract shall be recognised as income/expenses of the respective period (unless it relates to fixed assets as described in above for a Company).
- Amount of exchange difference included in Profit & Loss Account adjusted in carrying forward or amount of fixed assets or due to forward contracts recognised in Profit & Loss Account for one or more accounting period must be disclosed.

AS-12 — ACCOUNTING FOR GOVERNMENT GRANTS

- Grants should not be recognised unless reasonably assured to be realised. Grants towards specific assets be presented as deduction from its gross value. Alternatively, be treated as deferred income in Profit & Loss Account on rational basis over the useful life of the asset when depreciable. For non-depreciable asset requiring fulfilment of any obligations, it be credited to Profit & Loss Account during the concerned period to fulfil obligations.
- Balance of deferred income be disclosed appropriately as to promoter's contribution, be credited to capital reserves and considered as shareholders' funds
- Grants in the form of non monetary assets given at concessional rate be accounted at their acquisition cost. Asset given free of cost be recorded at nominal value.
- Grants receivable as compensation of losses/expenses incurred be recognised and disclosed in Profit & Loss Account in the year it is receivable and shown as extraordinary item if appropriately read with AS-5.
- Contingency related to grant be treated in accordance with AS-4. Grants when become refundable, be shown as extraordinary item read with AS-5.
- Grants related to revenue on becoming refundable be adjusted first against unamortised deferred credit balance of the grant and then be charged to Profit & Loss Account.
- Grants against specific assets on becoming refundable be recorded by increasing the value of the respective assets or by reducing Capital Reserve/Deferred Income balance of the grant.
- Grant to promoter's contribution when refundable be reduced from the Capital Reserve.
- Accounting policy adopted for grants including method of presentation, extent of recognition in financial statements, at concession/free of cost be disclosed.

AS-13 — ACCOUNTING FOR INVESTMENTS

- Current investments and long-term investments shall be disclosed distinctly with further sub-classification.
- Cost of investment to include acquisition charges, e.g., brokerage, fees and duties.
- Current investments shall be disclosed at lower of costs and fair value.
- Long-term investments shall be disclosed at cost.
- Provision for decline (other than temporary) to be made.
- Adequate disclosure is required for: the accounting policy adopted — classification of investments — income from investments, profit/loss on disposal and changes in carrying amount of such investment — aggregate amount of quoted and unquoted investments giving aggregate market value of quoted investments.
- Significant restrictions on right of ownership, realisation of investment and remittance of income and proceeds of disposal thereof be disclosed.

AS-14 — ACCOUNTING FOR AMALGAMATION

- The Accounting Standard is applicable only where it is made in pursuant to a scheme sanctioned by statute.
- The accounting method to be adopted depends whether the amalgamation is in the nature of merger or not as defined in para 3(e) of the Standard. The definitions list out five criteria, all of which must be satisfied for an

amalgamation to be accounted on the basis of "Pooling of Interest Method". If any criterion is not met then the amalgamation is accounted on by using "Purchase Method". It may be mentioned that these criteria relates to mode of payment of consideration of merger, shareholding pattern pre and Post Merger, intention to carry-on business after the merger, pooling of all assets and liabilities after the merger and an intention to continue to carry the carrying amounts of assets and liability after the merger.

- Under Purchase Method, all assets and liabilities of the transferor company is recorded either at existing carrying amount or consideration is allocated to individual identifiable assets and liabilities on basis of its fair values at date of amalgamation. The excess or shortfall of consideration over value of net assets is recognised as goodwill or capital reserve.
- Under the Pooling of Interest Method, assets, liabilities and reserves of the transferor company be recorded at existing carrying amount and in the same form as on date of amalgamation. In case of conflicting accounting policies existing in transferor and transferee company a uniform policy be adopted on amalgamation, as per AS-5.
- Certain specific disclosures as discussed in the questionnaire below are required to be made in financial statements after amalgamation. In case of amalgamation effected after Balance Sheet date but before issue of financial statements of either party, the event be only specifically disclosed and not given effect in such statements.

AS-15 — ACCOUNTING FOR RETIREMENT BENEFITS IN THE FINANCIAL STATEMENT OF EMPLOYERS

- The method of accounting of retirement benefits depends on the nature of retirement benefits and in practice it may not be incorrect to say that it also depends on the mode of funding.
- On the basis of nature, a retirement benefit scheme can be classified either as defined benefit plan or defined contribution plan.

Defined contribution schemes are schemes where the amounts to be paid as retirement benefits are determined by contributions to a fund together with earnings thereon; e.g., provident fund schemes. Defined benefit schemes are retirement benefit schemes under which amounts to be paid as retirement benefits are determinable usually by reference to employee's earnings and/or years of service; e.g., gratuity schemes.

For defined contribution schemes, contribution payable by employer is charged to Profit & Loss Account.

- For defined benefit schemes, accounting treatment will depend on the type of arrangements which the employer has made.
- If payment for retirement benefits is made out of employers funds, appropriate charge to Profit & Loss Account to be made through a provision for accruing liability, calculated according to actuarial valuation.
- If liability for retirement benefit is funded through creation of trust, the excess/shortfall of contribution paid against amount required to meet accrued liability as certified by actuary is treated as pre-payment or charged to Profit & Loss Account.
- If liability for retirement benefit is funded through a scheme administered by an insurer, an actuarial certificate or confirmation from insurer is obtained. The excess/shortfall of the contribution paid against the amount required to meet accrued liability as confirmed by insurer is treated as pre-payment or charged to Profit & Loss Account.
- Any alteration in the retirement benefit cost should be charged or credited to Profit & Loss Account and change in actuarial method is to be disclosed.
- Financial statements to disclose method by which retirement benefit cost have been determined.

- The institute has issued AS-15 which is broadly on lines of IFRS-19. It is applicable for accounting periods commencing after December 7, 2007. The Standard improves the existing practices mainly in the following areas.

— It is broad in its applicability as it covers all short-term and long term employee benefits. For example, annual paid leave (though not encashable), long-term service rewards, subsidised goods or services, etc. are also covered

— Additional disclosures are required in relation to any defined benefits plans including:

- (i) The reconciliation of (opening to closing) of Projected Benefit Obligation.
- (ii) The reconciliation of (opening to closing) of Fair Value of Plan Assets.
- (iii) The reconciliation of (opening to closing) of Net Liability/Prepaid Asset.
- (iv) Components of charge during the year.
- (v) Principal actuarial assumptions.

AS-16 — BORROWING COSTS

- Borrowing costs that are directly attributable to the acquisition, construction or production of any qualifying asset (assets that takes a substantial period of time to get ready for its intended use or sale) should be capitalised.
- Borrowing costs that can be capitalised are interest and other costs that are directly attributable to the acquisition, construction and production of a qualifying asset.
- Income on the temporary investment of the borrowed funds to be deducted from borrowing costs.
- Capitalisation of borrowing costs should be suspended during extended periods in which development is interrupted.
- Capitalisation should cease when completed substantially or if completed in parts, in respect of that part, all the activities for its intended use or sale are complete.
- Statement does not deal with the actual or imputed cost of owner's equity/preference capital are treated as borrowing costs.
- Financial statements to disclose accounting policy adopted for borrowing cost and also the amount of borrowing costs capitalised during the period.

AS-17 — SEGMENT REPORTING

- Requires reporting of financial information about different types of products and services an enterprise provides and different geographical areas in which it operates.
- A business segment is distinguishable component of an enterprise providing a product or service or group of products or services that is subject to risks and returns that are different from other business segments.
- A geographical segment is distinguishable component of an enterprise providing products or services in a particular economic environment that is subject to risks and returns that are different from components operating in other economic environments.
- Internal financial reporting system is normally the basis for identifying the segments.
- The dominant source and nature of risk and returns of an enterprise should govern whether its primary reporting format will be business segments or geographical segments.

- A business segment or geographical segment is a reportable segment if (a) revenue from sales to external customers and from transactions with other segments exceed 10% of total revenues (external and internal) of all segments; or (b) segment result, whether profit or loss is 10% or more of (i) combined result of all segments in profit or (ii) combined result of all segments in loss whichever is greater in absolute amount; or (c) segment assets are 10% or more of all the assets of all the segments.
- If total external revenue attributable to reportable segment constitutes less than 75% of total revenues then additional segments should be identified.
- Under primary reporting format for each reportable segment the enterprise should disclose external and internal segment revenue, segment result, amount of segment assets and liabilities, cost of fixed assets, acquired, depreciation, amortisation of assets and other non-cash expenses.
- Reconciliation between information about reportable segments and information in financial statements of the enterprise is also to be provided.
- Secondary segment information is also required to be disclosed. This includes information about revenues, assets and cost of fixed assets acquired.
- When primary format is based on geographical segments, certain further disclosures are required.
- Disclosures are also required relating to intra-segment transfers and composition of the segment.
- In case, by applying the definitions of ‘business segment’ and ‘geographical segment’, contained in AS-17, it is concluded that there is neither more than one business segment nor more than one geographical segment, segment information as per AS-17 is not required to be disclosed.
- It may be mentioned that the illustrative disclosure attached to Standard as appendix (though not forming part of the Standard) illustrate in detail; determination of reportable segments, information about business segments and summary of required disclosures.

AS-18 — RELATED PARTY DISCLOSURES

- Parties are considered to be related if, at any time during the reporting period, one party has ability to control or exercise significant influence over the other party in making financial and/or operating decisions.
- The statement deals with following related party relationships: (a) Enterprises that directly or indirectly, through one more intermediaries, control or are controlled by or are under common control with the reporting enterprise (b) Associates, Joint Ventures of the reporting entity, investing party or venturer in respect of which reporting enterprise is an associate or a joint venture, (c) Individuals owning voting power giving control or significant influence over the enterprise and relatives of any such individual, (d) Key management personnel and their relatives, and (e) Enterprises over which any of the persons in (c) or (d) are able to exercise significant influence. Other relationship is not covered by this Standard.
- Following are not deemed related parties (a) Two companies simply because of common director, (b) Customer, supplier, franchiser, distributor or general agent merely by virtue of economic dependence; and (c) Financiers, trade unions, public utilities, government departments and bodies merely by virtue of their normal dealings with the enterprise.
- Disclosure under the Standard is not required in the following cases (i) If such disclosure conflicts with duty of confidentiality under statute, duty cast by a regulator or a component authority; (ii) In consolidated financial statements in respect of intragroup transactions, and (iii) In case of State-controlled enterprises regarding related party relationships and transactions with other State-controlled enterprises.

- Relative (in relation to an individual) means spouse, son, daughter, brother, sister, father and mother who may be expected to influence, or be influenced by, that individual in dealings with the reporting entity.
- Standard also defines *inter alia* control, significant influence, associate, joint venture and key management personnel.
- If there are transactions between the related parties, during the existence of relationship, certain information is to be disclosed, viz.; name of the related party, description of the nature of relationship, nature of transaction and its volume (as an amount or proportion), other elements of transaction if necessary for understanding, amount or appropriate proportion outstanding pertaining to related parties, provision for doubtful debts from related parties, amounts written off or written back in respect of debts due from or to related parties.
- Names of the related party and nature of related party relationship to be disclosed even where there are no transactions but the control exists.
- Items of similar nature may be aggregated by type of the related party.

AS-19 — LEASES

- The Standard applies in accounting for all leases other than —

(a) lease agreements to explore for or use natural resources,

(b) licensing agreements for items such as motion pictures, films, video recordings plays, etc. and

(c) lease agreements to use lands.

- Leases are classified as finance lease or operating lease.
- A finance lease is defined to mean a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Examples of situations which normally lead to a lease being classified as a finance lease are —

(a) lessor transferring the ownership at the end of the lease term,

(b) lessee has an option to purchase the asset at a price which is sufficiently lower than the fair value at the date the option becomes exercisable,

(c) lease term is for substantial part of economic life of the asset,

(d) present value of minimum lease payment at the inception of the lease is substantially equal to the assets fair value and

(e) the asset leased is of specialised nature such that only lessee can use it without major modifications made to it.

- An operating lease is defined to mean a lease other than a finance lease.

Treatment in the books of lessee

In case of finance lease —

- At the inception of the finance the lessee should recognise the lease as an asset and a liability. The asset should be recognised at an amount equal to the fair value of leased asset at the inception. If the fair value exceeds the present value of the minimum lease payment from the stand point of the lessee, the amount to recorded as asset and liability reckoned with the present value of the minimum lease payments that may be calculated on the basis

of interest rate implicit in the lease, if practicable to determine and if not, then at lessee's incremental borrowing rate.

- Lease payments should be apportioned between finance charges and the reduction of outstanding.
- The depreciation policy for leased asset should be consistent with that for depreciable assets that are owned. AS-6 (Depreciation Accounting) applies in such cases.
- Disclosure should be made of —

- (a) assets acquired under finance lease,
- (b) net carrying amount at the balance sheet date,
- (c) reconciliation between the total minimum lease payments at balance sheet date and their present value,
- (d) total minimum lease payments at balance sheet date and their present value for periods specified,
- (e) contingent rent recognised as income,
- (f) the total of future minimum sub-lease payments expected to be received, and
- (g) general description of significant leasing arrangements.

In case of operating lease —

- The lease payments should be recognised as an expense on straight line basis, unless other systematic basis is more representative of the time pattern of the user's benefit.
- Disclosures should be made of —

- (a) the total of future minimum lease payments for the periods specified,
- (b) the total of future minimum sub-lease payments expected to be received,
- (c) lease payments recognised in the statement of Profit & Loss, with separate amounts of minimum lease payments and contingent rents,
- (d) sub-lease payments recognised in the statement of Profit & Loss, and
- (e) general description of significant leasing arrangements.

Treatment in the books of lessor

In case of finance lease —

- The lessor should recognise the asset in its balance sheet as a receivable at an amount equal to net investment in the lease.
- The recognition of finance income should be based on a pattern reflecting a constant periodic return on the net investment of the lessor outstanding.
- In case of any reduction in the unguaranteed residual values, income allocation over the remaining lease term should be revised.
- Initial direct cost are either recognised immediately in the profit and loss statement or allocated against the finance income over the lease term.

• Disclosure should be made of —

- (a) total gross investment in lease and the present value of the minimum lease payments at specified periods and a reconciliation thereof at the balance sheet date,
- (b) unearned finance income,
- (c) accruing unguaranteed residual value benefit,
- (d) accumulated provision for uncollectible minimum lease payments receivable,
- (e) contingent rent recognised,
- (f) general description of significant leasing arrangements and
- (g) accounting policy adopted in respect of initial direct costs.

In case of operating lease —

- Lessors to present an asset given on lease under fixed assets. Lease income should be recognised on a straight line basis over the lease term or other systematic basis, if representative of the time pattern over which benefit derived gets diminished.
- Costs, including depreciation, incurred are recognised as an expense.
- Initial direct cost are either deferred and allocated to income over the lease term in proportion to rent income recognised or are recognised immediately in the profit and loss statement.
- Disclosure should be made of —

- (a) gross carrying amount of the leased assets, accumulated depreciation and impairment loss at the balance sheet date and depreciation and impairment loss recognised or reversed for the period,
- (b) the future minimum lease payments in aggregate and for the periods specified,
- (c) total contingent rent recognised as income,
- (d) a general description of the significant leasing arrangements, and
- (e) accounting policy for initial direct costs.

Lease by manufacturer or dealer

- The manufacturer or dealer lessor should recognise the transaction in accordance with policy followed for outright sales. Initial direct costs should be recognised as an expense at the inception of the lease. Artificial low rates of interests are quoted, profit on sale should be restricted to that which would apply if a commercial rate of interest were charged.

Sale and leaseback transactions

- If the transaction of sale and leaseback results in a finance lease, any excess or deficiency of sale proceeds over the carrying amount, it should be deferred and amortised over the lease term in proportion to the depreciation of the leased assets.
- If the transaction result in an operating lease and it is clearly established to be at fair value, profit or loss should be recognised immediately. If the sale price is below the fair value, any profit or loss should be recognised

immediately, except that, if the loss is compensated by future lease payments at market price, it should be deferred and amortised in proportion to the lease payments over the period for which asset is expected to be used. If the sales price is above fair value, the excess over the fair value should be deferred and amortised over period of expected use of asset.

- In an operating lease, if the fair value at the time of sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value should be recognised immediately.

AS-20 — EARNINGS PER SHARE

- Basic and diluted EPS is required to be presented on the face of Profit and Loss Statement with equal prominence for all the periods presented. EPS is required to be presented even when it is negative.
- Basic EPS should be calculated by dividing net profit or loss for the period attributable to equity shareholders by weighted average of equity shares outstanding during the period.
- In arriving earnings attributable to equity shareholders preference dividend for the period and the attributable tax are to be excluded.
- The weighted average number of shares, for all the periods presented, is adjusted for bonus issue or any element thereof in rights issue, share split and consolidation of shares.
- For calculating diluted EPS, net profit or loss attributable to equity shareholders and the weighted average number of shares are adjusted for the effects of dilutive potential equity shares (i.e., assuming conversion into equity of all dilutive potential equity).
- Potential equity shares are treated as dilutive when, and only when, their conversion into equity would result in a reduction in profit per share from continuing ordinary operations.
- The effects of anti-dilutive potential equity shares are ignored in calculating diluted EPS.
- For the purpose of calculating diluted EPS, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares.
- The amounts of earnings used as numerators for computing basic and diluted EPS and a reconciliation of those amounts with Profit and Loss Statement, the weighted average number of equity shares used as the denominator in calculating the basic and diluted EPS and the reconciliation between the two EPS and the nominal value of shares along with EPS per share figure need to be disclosed.

AS-21 — CONSOLIDATED FINANCIAL STATEMENTS

- To be applied in the preparation and presentation of consolidated financial statements for a group of enterprises under the control of a parent.
- Control means the ownership of more than one-half of the voting power of an enterprise or control of the composition of the board of directors or such other governing body.
- Control of composition implies power to appoint or remove all or a majority of directors.
- Consolidated financial statements to be presented in addition to separate financial statements.

- All subsidiaries, domestic and foreign to be consolidated except where control is intended to be temporary or the subsidiary operates under severe long-term restriction impairing transfer of funds to the parent.
- Consolidation to be done on a line by line basis by adding like items of assets, liabilities, income and expenses which involve.
- Elimination of cost to the parent of the investment in the subsidiary and the parent's portion of equity of the subsidiary at the date of investment.
- Excess of cost over parent's portion of equity, to be shown as goodwill.
- Where cost to the parent is less than its portion, of equity, difference to be shown as capital reserve.
- Minority interest in the net income to be adjusted against income of the group.
- Minority interest in net assets to be shown separately as a liability.
- Intra group balances and intra-group transactions and resulting unrealised profits should be eliminated in full. Unrealised losses should also be eliminated unless cost cannot be recovered.
- Where two or more investments are made in a subsidiary, equity of the subsidiary to be generally determined on a step by step basis.
- Financial statements used in consolidation should be drawn up to the same reporting date. If reporting dates are different, adjustments for the effects of significant transactions/events between the two dates to be made.
- Consolidation should be prepared using same accounting policies. If the accounting policies followed are different, the fact should be disclosed together with proportion of such items.
- In the year in which parent subsidiary relationship ceases to exist, consolidation to be made up-to-date of cessation.
- Disclosure is to be of all subsidiaries giving name, country of incorporation, residence, proportion of ownership and voting power if different, nature of relationship between parent and subsidiary, effect of the acquisition and disposal of subsidiaries on the financial position, names of subsidiaries whose reporting dates are different than that of the parent.
- When the consolidated statements are presented for the first time figures for the previous year need not be given.
- While preparing consolidated financial statements, the tax expense to be shown in the consolidated financial statements should be the aggregate of the amounts of tax expense appearing in the separate financial statements of the parent and its subsidiaries.
- 'Near Future' should be considered as not more than twelve months from acquisition of relevant investments unless a longer period can be justified on the basis of facts and circumstances of the case.
- When there are more than one investor in a company in which one of the investors controls the composition of board of directors and some other investor holds more than half of the voting power, both these investors are required to consolidate the accounts of the investee in accordance with this Standard.

Note: Not all the notes appearing in standalone financial statements is required to be disclosed in the consolidated financial statements. Typically notes that are not required to be included are, managerial remuneration, CIF value of import, capacity, quantitative details, etc.

AS-22 — ACCOUNTING FOR TAXES ON INCOME

- This statement should be applied in accounting for taxes on income. This includes the determination of the amount of the expense or saving related to taxes on income in respect of an accounting period and the disclosure of such an amount in the financial statements.
- The expense for the period, comprising current tax and deferred tax should be included in the determination of the net profit or loss for the period.
- Deferred tax should be recognised for all the timing differences, subject to the consideration of prudence in respect of deferred tax assets as set out in paragraph below.
- Except in the situations stated in paragraph 5, deferred tax assets should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised.
- Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognised only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised.
- Current tax should be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the applicable tax rates and tax laws.
- Deferred tax assets and liabilities should be measured using the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.
- Deferred tax assets and liabilities should not be discounted to their present value.
- The carrying amount of deferred tax assets should be reviewed at each balance sheet date. An enterprise should write-down the carrying amount of a deferred tax asset to the extent that it is no longer reasonably certain or virtually certain, as the case may be that sufficient future taxable income will be available against which deferred tax asset can be realised. Any such writedown may be reversed to the extent that it becomes reasonably certain or virtually certain, as the case may be that sufficient future taxable income will be available.
- An enterprise should offset assets and liabilities representing current tax if the enterprise:

1. (a) Has a legally enforceable right to set off the recognised amounts; and

2. (b) Intends to settle the asset and the liability on a net basis.

- An enterprise should offset deferred tax assets and deferred tax liabilities if:

1. (a) The enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and

2. (b) The deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the same governing taxation laws.

- Deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities.
- The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balances should be disclosed in the notes to accounts.

- The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.
- On the first occasion that the taxes on income are accounted for in accordance with this statement, the enterprise should recognise, in the financial statement, the deferred tax balance that has accumulated prior to the adoption of this statement as deferred tax asset/liability with a corresponding credit/charge to the revenue reserve, subject to the consideration of prudence in case of deferred tax assets. The amount so credited/charged to the revenue reserve should be the same as that which would have resulted if this statement had been in effect from the beginning.

AS-23 — ACCOUNTING FOR INVESTMENT IN ASSOCIATES IN CONSOLIDATED FINANCIAL STATEMENT

- This statement should be applied in accounting for investments in associates in the preparation and presentation of consolidated financial statements by an investor. An investment in an associate should be accounted for in a consolidated financial statement under the equity method except when:
 1. (a) The investment is acquired and held exclusively with a view to its subsequent disposal in the near future, or
 2. (b) The associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to its investors. Investment in such associates should be accounted for in accordance with the Accounting Standard (AS)-13, Accounting for Investments. The reason for not applying the equity methods in accounting for investments in an associate should be disclosed in the consolidated financial statements.
- An investor should discontinue the use of equity method from the date that:
 1. (a) It ceases to have significant influence in an associate but retains, either in whole or in part, its investments, or
 2. (b) The use of the equity method is no longer appropriate because the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investors. From the date of discontinuing the use of equity method, investments in such associates should be accounted for in accordance with Accounting Standard (AS)-13, Accounting for Investments. For this purpose, the carrying amount of investments at that date should be regarded as the cost thereafter.
- Goodwill/capital reserve arising on the acquisition of an associate by an investor should be included in the carrying amount of investment in the associate but should be disclosed separately.
- In using equity method for accounting for investment in an associate, unrealised profits and losses resulting from transactions between the investor (or its consolidated subsidiaries) and the associate should be eliminated to the extent of the investor's interest in the associate. Unrealised losses should not be eliminated if and to the extent the cost of the transferred asset cannot be recovered.
- The carrying amount of investment in an associate should be reduced to recognise a decline, other than temporary, in the value of the investment, such reduction being determined and made for each investment individually.
- In addition to the disclosures required by paragraphs 2 and 4, an appropriate listing and description of associates including the proportion of ownership interest and, if different, the proportion of voting power held should be disclosed in the consolidated financial statements.
- Investments in associates accounted for using the equity method should be classified as long-term investments and disclosed separately in the consolidated balance sheet. The investor's share of the profits or losses of such investments should be disclosed separately in the consolidated statement of profit and loss. The investor's share of any extraordinary or prior period items should also be separately disclosed.

- The name(s) of the associate(s) of which reporting date(s) is/are different from that of the financial statements of an investor and the differences in reporting dates should be disclosed in the consolidated financial statements.
- In case an associate uses accounting policies other than those adopted for the consolidated financial statements for transactions and events in similar circumstances and it is not practicable to make appropriate adjustments to the associate's financial statements, the fact should be disclosed along with a brief description of the differences in the accounting policies.
- On the first occasion when investment in an associate is accounted for in consolidated financial statements in accordance with this statement, the carrying amount of investment in the associate should be brought to the amount that would have resulted had the equity method of accounting been followed as per this statement since the acquisition of the associate. The corresponding adjustment in this regard should be made in the retained earning in the consolidated financial statements.
- Adjustments to the carrying amount of investment in an associate arising from changes in the associate's equity that have not been included in the statement of profit and loss of the associate should be directly made in the carrying amount of investment without routing it through the consolidated statement of profit and loss. The corresponding debit/credit should be made in the relevant head of the equity interest in the consolidated balance sheet. For example, in case the adjustment arises because of revaluation of fixed assets by the associate, apart from adjusting the carrying amount of investment to the extent of proportionate share of the investor in the revalued amount, the corresponding amount of revaluation reserve should be shown in the consolidated balance sheet.

AS-24 — DISCONTINUING OPERATIONS

- The objective of this statement is to establish principles for reporting information about discontinuing operations, thereby enhancing the ability of users of financial statements to make projections of an enterprise's cash flows, earnings-generating capacity, and financial position by segregating information about discontinuing operations from information about continuing operations.
- A discontinuing operation is a component of an enterprise that the enterprise, pursuant to a single plan, is: (1) disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders; or (2) disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or (3) terminating through abandonment; and that represents a separate major line of business or geographical area of operations; and that can be distinguished operationally and for financial reporting purposes.
- With respect to a discontinuing operation, the initial disclosure event is the occurrence of one of the following, whichever occurs earlier (a) the enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or (b) the enterprise's board of directors or similar governing body has both (i) approved a detailed, formal plan for the discontinuance and (ii) made an announcement of the plan.
- An enterprise should apply the principles of recognition and measurement that are set out in other Accounting Standards for the purpose of deciding as to when and how to recognise and measure the changes in assets and liabilities and the revenue, expenses, gains, losses and cash flows relating to a discontinuing operation.
- When an enterprise disposes of assets or settles liabilities attributable to a discontinuing operation or enters into binding agreements for the sale of such assets or the settlement of such liabilities, it should include, in its financial statements, the following information when the events occur (a) for any gain or loss that is recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation, (i) the amount of the pre-tax gain or loss and (ii) income tax expense relating to the gain or loss; and (b) the net selling price or range of

prices (which is after deducting expected disposal costs) of those net assets for which the enterprise has entered into one or more binding sale agreements, the expected timing of receipt of those cash flows and the carrying amount of those net assets on the balance sheet date.

- Any disclosures required by this statement should be presented separately for each discontinuing operation. The disclosures requirements may be quickly assessed by referring to questionnaire below.
- An appendix to the Standard (though not a part of the Standard) sets out detailed illustration explaining significant disclosure requirements of the Standard.

AS-25 — INTERIM FINANCIAL REPORTING

- Accounting Standard (AS)-25, 'Interim Financial Reporting', issued by the Council of the Institute of Chartered Accountants of India, comes into effect in respect of accounting periods commencing on or after 1-4-2002. If an enterprise is required to prepare and present an interim financial report, it should comply with this Standard.
- The objective of this Statement is to prescribe the minimum content of an interim financial report and to prescribe the principles for recognition and measurement in a complete or condensed financial statements for an interim period. Timely and reliable interim financial reporting improves the ability of investors, creditors, and others to understand an enterprise's capacity to generate earnings and cash flows, its financial condition and liquidity.
- Interim period is a financial reporting period shorter than a full financial year. Interim financial report means a financial report containing either a complete set of financial statements or a set of condensed financial statements (as described in this Statement) for an interim period.
- An interim financial report should include, at a minimum, the following components

(a) condensed balance sheet;

(b) condensed statement of profit and loss;

(c) condensed cash flow statement; and

(d) selected explanatory notes.

- An enterprise should include the following information, as a minimum, in the notes to its interim financial statements, if material and if not disclosed elsewhere in the interim financial report:

(a) a statement that the same accounting policies are followed in the interim financial statements as those followed in the most recent annual financial statements or, if those policies have been changed, a description of the nature and effect of the change;

(b) explanatory comments about the seasonality of interim operations;

(c) the nature and amount of items affecting assets, liabilities, equity, net income, or cash flows that are unusual because of their nature, size, or incidence, net profit or loss for the period, prior period items and changes in accounting policies);

(d) the nature and amount of changes in estimates of amounts reported in prior interim periods of the current financial year or changes in estimates of amounts reported in prior financial years, if those changes have a material effect in the current interim period;

(e) issuances, buy-backs, repayments and restructuring of debt, equity and potential equity shares; (f) dividends, aggregate or per share (in absolute or percentage terms), separately for equity shares and other shares;

(f) segment revenue, segment capital employed (segment assets minus segment liabilities) and segment result for business segments or geographical segments, whichever is the enterprise's primary basis of segment reporting (disclosure of segment information is required in an enterprise's interim financial report only if the enterprise is required, in terms of AS-17, Segment Reporting, to disclose segment information in its annual financial statements);

(g) the effect of changes in the composition of the enterprise during the interim period, such as amalgamations, acquisition or disposal of subsidiaries and long-term investments, restructurings, and discontinuing operations; and

(h) material changes in contingent liabilities since the last annual balance sheet date.

- Interim reports should include interim financial statements (condensed or complete) for periods as

(a) balance sheet as of the end of the current interim period and a comparative balance sheet as of the end of the immediately preceding financial year;

(b) statements of profit and loss for the current interim period and cumulatively for the current financial year to date, with comparative statements of profit and loss for the comparable interim periods (current and year-to-date) of the immediately preceding financial year;

(c) cash flow statement cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year.

- An enterprise should apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements. However, the frequency of an enterprise's reporting (annual, half-yearly, or quarterly) should not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes should be made on a year-to-date basis.
- Users may refer four appendices attached to the Standard (which though not a part of the Standard) set out detailed illustrations explaining *inter alia*;

1. Illustrative format of Condensed Balance Sheet, Condensed Profit and Loss Account, Condensed Cash Flows.

2. Illustration of periods required to be presented.

3. Examples of applying the recognition and measurement principles.

- Examples of use of estimates. _ It may be mentioned that the companies required to disclose quarterly results are not required to follow the disclosure-related requirements of the Standard. Thus presentation format is not mandatory. However, it is a normal practice to adopt the recognition and measurement principles.

AS-26 — INTANGIBLE ASSETS

- The Standard is applicable w.e.f. April 1, 2003, to enterprises that are listed companies and/or having turnover exceeding Rs. 50 crores. For all other enterprises these are applicable from April 1, 2004.
- This Standard should be applied by all enterprises in accounting for intangible assets, except intangible assets that are covered by another Accounting Standard; financial assets; mineral rights and expenditure on the exploration for, or development and extraction of minerals, oil, natural gas and similar non-regenerative resources; intangible assets arising in insurance enterprises from contracts with policyholders and expenditure in respect of termination benefits.
- Prominent concepts introduced/emphasised by the standard includes; **An asset** is a resource; (a) controlled by an enterprise as a result of past events; and (b) from which future economic benefits are expected to flow to the

enterprise. **An intangible asset** is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. **Research** is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding. **Development** is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

- An acquired intangible asset is recognised if it is (a) identifiable, (b) controllable by enterprise, (c) where future benefit is expected and (d) cost of acquisition can be measured reliably.
- Expenditure incurred on internally generated intangible asset is expensed to the extent that it related to Research Phase.
- An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an enterprise can demonstrate all of the following:

1. The technical feasibility of completing the intangible asset so that it will be available for use or sale;
 2. Its intention to complete the intangible asset and use or sell it;
 3. Its ability to use or sell the intangible asset;
 4. How the intangible asset will generate probable future economic benefits. Among other things, the enterprise should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;
 5. The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
 6. Its ability to measure the expenditure attributable to the intangible asset during its development reliably.
- The standard is supplemented with two appendix one of which covers exhaustive illustration on accounting of website development cost and software generated for internal use and other one covers various examples on application of various aspect of the standard.

AS-27 — FINANCIAL REPORTING OF INTERESTS IN JOINT VENTURES

- The standards defines what is a joint venture. Some of the important concepts includes; **joint venture** is a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control. **Joint control** is the contractually agreed sharing of control over an economic activity.
- **Control** is the power to govern the financial and operating policies of an economic activity so as to obtain benefits from it.

Proportionate consolidation is a method of accounting and reporting whereby a venturer's share of each of the assets, liabilities, income and expenses of a jointly controlled entity is reported as separate line items in the venturer's financial statements.

- The accounting treatments depends on the nature of joint venture which can be one of the three, i.e. Jointly Controlled Entity or Jointly Controlled Operations or Jointly Controlled Assets.
- In respect of its interests in jointly controlled operations, a venturer should recognise in its separate financial statements and consequently in its consolidated financial statements: (a) the assets that it controls and the

liabilities that it incurs; and (b) the expenses that it incurs and its share of the income that it earns from the joint venture.

- In respect of its interest in jointly controlled assets, a venturer should recognise, in its separate financial statements, and consequently in its consolidated financial statements: its share of the jointly controlled assets, classified according to the nature of the assets; any liabilities which it has incurred; its share of any liabilities incurred jointly with the other venturers in relation to the joint venture; any income from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and any expenses which it has incurred in respect of its interest in the joint venture.
- In respect of jointly controlled operations the accounting treatment depends upon whether it is to be accounted in stand-alone financial statements or consolidated financial statement. In case of standalone financial statements the investments are accounted at cost in accordance with AS-13 whereas in case of consolidated financial statements where these are prepared (or required to be prepared) the investment in joint venture is accounted using proportionate consolidation method unless these are subsidiaries in which case these are consolidated under AS-21.

AS-28 — IMPAIRMENT OF ASSETS

- This Standard should be applied in accounting for the impairment of all assets, other than: 1) Inventories (see AS-2, Valuation of Inventories); 2) Assets arising from construction contracts (see AS-7, Accounting for Construction Contracts); 3) Financial assets, including investments that are included in the scope of AS-13, Accounting for Investments; and 4) Deferred tax assets (see AS-22, Accounting for Taxes on Income). — Prominent concepts introduced by the standards includes: **An impairment loss** is the amount by which the carrying amount of an asset exceeds its recoverable amount. **Recoverable amount** is the higher of an asset's net selling price and its value in use. — **Value in use** is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life. — **Carrying amount** is the amount at which an asset is recognised in the balance sheet after deducting any accumulated depreciation (amortisation) and accumulated impairment losses thereon. **A cash-generating unit** is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets.
- **Corporate assets** are assets other than goodwill that contribute to the future cash flows of both the cash-generating unit under review and other cash-generating units.
- At each balance sheet date it needs to be assessed as to whether there is triggering event that requires the impairment testing to be made. Triggering event shall be assessed based on external information like fall in interest rate or industry growth rate, change in law, etc., and internal information like forecasts, obsolescence, damage, etc. Where there is a triggering event the impairment loss needs to be assessed at the level of each Cash Generating Unit. Where all the assets of the enterprise are allocated to cash generating unit, only bottom-up testing method is applied and in case there is some portion of asset that is not allocated or corporate assets, then bottom-up testing method coupled with and followed by top-down testing method is applied.
- In measuring value in use the Standard specifies certain factors that needs to be considered in arriving the discount rate and cash flow projection.
- Discount rate shall be independent of capital structure of the enterprise or its incremental borrowing cost. As a starting point, the enterprise may take into account the following rates: the enterprise's weighted average cost of capital determined using techniques such as the Capital Asset Pricing Model; the enterprise's incremental borrowing rate; and other market borrowing rates. These rates are adjusted: to reflect the way that the market would assess the specific risks associated with the projected cash flows; and to exclude risks that are not relevant to the projected cash flows.

Consideration is given to risks such as country risk, currency risk, price risk and cash flow risk

- Cash flow projections should be based on reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset. Greater weight should be given to external evidence; cash flow projections should be based on the most recent financial budgets/forecasts that have been approved by management. Projections based on these budgets/forecasts should cover a maximum period of five years, unless a longer period can be justified; and cash flow projections beyond the period covered by the most recent budgets/forecasts should be estimated by extrapolating the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified. This growth rate should not exceed the long-term average growth rate for the products, industries, or country or countries in which the enterprise operates, or for the market in which the asset is used, unless a higher rate can be justified. Project cash flows shall not consider impact of future capital expenditure or restructuring unless these are committed.
- Reversal of impairment loss is allowed to an extent that would be additional carrying amount of asset had there be no-impairment.

However in case of reversal of impairment loss relating to goodwill additional condition needs to be satisfied.

- The detailed text of the standard spreads across 124 paragraphs and is supplemented with 8 examples (which are not part of the Standard). Users are expected to go through it in detail before applying the Standard.

AS-29 — PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

The Standard prescribes the accounting and disclosure for all provisions, contingent liabilities and contingent assets, except:

- (a) Those resulting from financial instruments that are carried at fair value;
- (b) Those resulting from executory contracts, except where the contract is onerous. Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent;
- (c) Those arising in insurance entities from contracts with its policyholders; or
- (d) Those covered by another Standard.

Provisions

The Standard defines provisions as a liability which can be measured only by using a substantial degree of estimation. — A provision should be recognised when, and only when:

1. (a) An entity has a present obligation (legal or constructive) as a result of a past event;
 2. (b) It is probable (i.e., more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation; and
 3. (c) A reliable estimate can be made of the amount of the obligation. The Standard notes that it is only in extremely rare cases that a reliable estimate will not be possible.
- The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date.
 - The provisions shall not be discounted.

- Gains from the expected disposal of assets should not be taken into account, even if the expected disposal is closely linked to the event giving rise to the provision.
- An entity may expect reimbursement of some or all of the expenditure required to settle a provision (for example, through insurance contracts, indemnity clauses or suppliers' warranties). An entity should: (a) recognise a reimbursement when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The amount recognised for the reimbursement should not exceed the amount of the provision; and (b) recognise the reimbursement as a separate asset. In the income statement, the expense relating to a provision may be presented net of the amount recognised for a reimbursement.
- Provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed.
- A provision should be used only for expenditures for which the provision was originally recognised.
- Provisions should not be recognised for future operating losses. An expectation of future operating losses is an indication that certain assets of the operation may be impaired. In this case, an entity tests these assets for impairment under AS-28 Impairment of Assets.
- The Standard defines a restructuring as a programme that is planned and controlled by management, and materially changes either: (a) the scope of a business undertaken by an entity; or (b) the manner in which that business is conducted.
- A provision for restructuring costs is recognised only when the general recognition criteria for provisions are met.

Contingent Liabilities

The Standard defines a contingent liability as:

1. (a) A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
- (b) A present obligation that arises from past events but is not recognised because:
 - (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
 - (ii) the amount of the obligation cannot be measured with sufficient reliability.

An entity should not recognise a contingent liability.

Summary of Companies (Accounting Standard) Rules, 2006

The rules are applicable to Companies whose accounting periods commence on or after December 7, 2006. The key features of the rules are;

- Codified, almost all the accounting standards, accounting standard interpretations and limited revision in one single document
- Reworded certain jargons, like "Preface to Accounting Standards" is now referred as "General Instructions",
- Introduced new definition on SME enterprises. (only 2 levels as against present practice of 3 levels)

AS 30, 31, & 32 — FINANCIAL INSTRUMENTS — NOT MANDATORY FOR YEAR ENDED MARCH 31, 2011

Applicability of AS 30, 31 and 32

These standards are not mandatory but earlier adoption is encouraged. It may be mentioned that it has not been adopted by NACAS and thus in case of a company an earlier adoption of these standards might not comply with certain standards like

AS-13 investment: A Company needs to consult accounting experts in such situation. Needless to mention that in case the company wishes to adopt the standard than it shall adopt the entire standard and not a part of it.

ICAI Clarification – Principle of Prudence

Under situation where an item of financial instrument is suffering from losses, than based on principle of prudence the entity shall provide for such losses through its profit and loss account.

Objectives and scope

Financial instruments are addressed in three standards: AS-31, which deals with distinguishing debt from equity and with netting; AS 30, which contains requirements for recognition and measurement; and AS-32, which deals with disclosures. The objective of the three standards is to establish requirements for all aspects of accounting for financial instruments, including distinguishing debt from equity, netting, recognition, derecognition, measurement, hedge accounting and disclosure. The scope of the standards is wide-ranging. The standards cover all types of financial instrument, including receivables, payables, investments in bonds and shares, borrowings and derivatives. They also apply to certain contracts to buy or sell non-financial assets (such as commodities) that can be net settled in cash or another financial instrument.

Nature and characteristics of financial instruments

Financial instruments include a wide range of assets and liabilities. They can mostly be exchanged for cash. They are recognised and measured according to AS-30 requirements and are disclosed in accordance with AS-32. Financial instruments represent contractual rights or obligations to receive or pay cash or other financial asset. A financial asset is cash; a contractual right to receive cash or another financial asset; a contractual right to exchange financial assets or liabilities with another entity under conditions that are potentially favourable; or an equity instrument of another entity. A financial liability is a contractual obligation to deliver cash or another financial asset or to exchange financial instruments with another entity under conditions that are potentially unfavourable. An equity instrument is any contract that evidences a residual interest in the entity's assets after deducting all its liabilities. A derivative is a financial instrument that derives its value from an underlying price or index, requires little or no initial investment and is settled at a future date. In some cases contracts to receive or deliver a company's own equity can also be derivatives.

Embedded derivatives in host contracts

Some financial instruments and other contracts combine, in a single contract, both a derivative element and a non-derivative element. The derivative part of the contract is referred to as an 'embedded derivative' and its effect is that some of the cash flows of the contract will vary in a similar way to a standalone derivative. For example, the principal amount of a bond may vary with changes in a stock market index. In this case, the embedded derivative is an equity derivative on the relevant stock market index.

Embedded derivatives that are not 'closely related' to the rest of the contract are separated and accounted for as if they were stand-alone derivatives (ie, measured at fair value, generally with changes in fair value recognised in profit or loss). An embedded derivative is not closely related if its economic characteristics and risks are different from those of the rest of the contract. AS-30 sets out examples to help determine when this test is (and is not) met. Analysing contracts for potential embedded derivatives and accounting for them is one of the more challenging aspects of AS-30.

Classification of financial instruments

The way that financial instruments are classified under AS-30 drives how they are subsequently measured and where changes in measurement are accounted for.

There are four classes of financial asset under AS-30: available for sale, held to maturity, loans and receivables, and fair value through profit or loss. The factors taken into account in classifying financial assets include:

- The cashflows arising from the instrument — are they fixed or determinable? Does the instrument have a maturity date?
- Are the assets held for trading; does management intend to hold the instruments to maturity?
- Is the instrument a derivative or does it contain an embedded derivative?
- Is the instrument quoted on an active market?
- Has management designated the instrument into a particular classification at inception?

Financial liabilities are classified as fair value through profit or loss if they are so designated (subject to various conditions) or if they are held for trading. Otherwise they are classed as 'other liabilities'. Financial assets and liabilities are measured either at fair value or at amortised cost, depending on this classification. Changes are taken to either the income statement or directly to equity.

Financial liabilities and equity

The classification of a financial instrument by the issuer as either a liability (debt) or equity can have a significant impact on an entity's reported earnings, its borrowing capacity, and debt-to-equity and other ratios that could affect the entity's debt covenants. The substance of the contractual arrangements of a financial instrument, rather than its legal form, governs its classification. This means, for example, that since a preference share redeemable (puttable) by the holder is economically the same as a bond, it is accounted for in the same way as the bond. Therefore, the redeemable preference share is treated as a liability rather than equity, even though legally it is a share of the issuer. The critical feature of debt is that under the terms of the instrument the issuer is, or can be, required to deliver either cash or another financial asset to the holder and cannot avoid this obligation. For example, a debenture, under which the issuer is required to make interest payments and redeem the debenture for cash, is a financial liability. An instrument is classified as equity when it represents a residual interest in the issuer's assets after deducting all its liabilities. Ordinary shares or common stock, where all the payments are at the discretion of the issuer, are examples of equity of the issuer. A special exception exists to the general principal of classification for certain subordinated redeemable (puttable) instruments that participate in the *pro rata* net assets of the entity. Where specific criteria are met such instruments would be classified as equity of the issuer. Some instruments contain features of both debt and equity. For these instruments, an analysis of the terms of each instrument in light of the detailed classification requirements will be necessary. Such instruments, such as bonds that are convertible into a fixed number of equity shares either mandatorily or at the holder's option, must be split into debt and equity (being the option to convert) components. A financial instrument, including a derivative, is not an equity instrument solely because it may result in the receipt or delivery of the entity's own equity instruments. The classification of contracts that will or may be settled in the entity's own equity instruments is dependent on whether there is variability in either the number of own equity delivered and/or variability in the amount of cash or other financial assets received, or whether both are fixed. The treatment of interest, dividends, losses and gains in the income statement follows the classification of the related instrument. So, if a preference share is classified as debt, its coupon is shown as interest. But the dividend payments on an instrument that is treated as equity are shown as a distribution.

Recognition and derecognition

Recognition

Recognition issues for financial assets and financial liabilities tend to be straightforward. An entity recognises a financial asset or a financial liability at the time it becomes a party to a contract.

Derecognition

Derecognition is the term used for ceasing to recognise a financial asset or financial liability on an entity's balance sheet. The rules here are more complex.

Assets

An entity that holds a financial asset may raise finance using the asset as security for the finance, or as the primary source of cash flows from which to repay the finance. The derecognition requirements of AS 30 determine whether the transaction is a sale of the financial assets (and, therefore, the entity ceases to recognise the assets) or whether finance secured on the assets has been raised (and the entity recognises a liability for any proceeds received). This evaluation might be straightforward. For example, it is clear with little or no analysis that a financial asset is derecognised in an unconditional transfer of it to an unconsolidated third party with no risks and rewards of the asset being retained. Conversely, it is clear that derecognition is not allowed where an asset has been transferred, but it is clear that substantially all the risks and rewards of the asset have been retained through the terms of the agreement. However, in many other cases, the analysis is more complex. Securitisation and debt factoring are examples of more complex transactions where derecognition will need careful consideration.

Liabilities

An entity may only cease to recognize (derecognise) a financial liability when it is extinguished — that is, when the obligation is discharged, cancelled or expired, or when the debtor is legally released from the liability by law or by the creditor agreeing to such a release.

Measurement of financial assets and liabilities

Under AS 30, all financial instruments are measured initially at fair value. The fair value of a financial instrument is normally the transaction price — that is, the amount of the consideration given or received. However, in some circumstances, the transaction price may not be indicative of fair value. In that situation, an appropriate fair value is determined using data from current observable transactions in the same instrument or based on a valuation technique whose variables include only data from observable markets.

The measurement of financial instruments after initial recognition depends on their initial classification. All financial assets are measured at fair value except for loans and receivables, held-to-maturity assets and, in rare circumstances, unquoted equity instruments whose fair values cannot be measured reliably or derivatives linked to and which must be settled by the delivery of such unquoted equity instruments that cannot be measured reliably. Loans and receivables and held-to-maturity financial assets are measured at amortised cost. The amortised cost of a financial asset or liability is measured using the 'effective interest method'. Available-for-sale financial assets are measured at fair value with changes in fair value recognised in equity. For available-for-sale debt securities, interest is recognised in income using the 'effective interest method'. Available-for-sale equity securities dividends are recognised in income as the holder becomes entitled to them. Derivatives (including separated embedded derivatives) are measured at fair value. All fair value gains and losses are recognised in profit or loss except where they qualify as hedging instruments in cash flow hedges. Financial liabilities are measured at amortised cost using the effective interest method unless they are measured at fair value through profit or loss. Financial assets and liabilities that are designated as hedged items may require further adjustments under the hedge accounting requirements. All financial assets, except those measured at fair value through profit or loss, are subject

to review for impairment. Therefore, where there is objective evidence that such a financial asset may be impaired, the impairment loss is calculated and recognised in profit or loss.

Hedge accounting

‘Hedging’ is the process of using a financial instrument (usually a derivative) to mitigate all or some of the risk of a hedged item. ‘Hedge accounting’ changes the timing of recognition of gains and losses on either the hedged item or the hedging instrument so that both are recognised in profit or loss in the same accounting period. To qualify for hedge accounting, an entity (a) at the inception of the hedge, formally designates and documents a hedge relationship between a qualifying hedging instrument and a qualifying hedged item; and (b) both at inception and on an ongoing basis, demonstrates that the hedge is highly effective.

There are three types of hedge relationship

- Fair value hedge: a hedge of the exposure to changes in the fair value of a recognised asset or liability, or a firm commitment.
- Cash flow hedge: a hedge of the exposure to variability in cash flows of a recognised asset or liability, a firm commitment or a highly probable forecast transaction.
- Net investment hedge: a hedge of the foreign currency risk on a net investment in a foreign operation.

For a fair value hedge, the hedged item is adjusted for the gain or loss attributable to the hedged risk. That element is included in the income statement where it will offset the gain or loss on the hedging instrument. For a cash flow hedge, gains and losses on the hedging instrument, to the extent it is an effective hedge, are initially included in equity. They are reclassified to the profit or loss when the hedged item affects the income statement. If the hedged item is the forecast acquisition of a non-financial asset or liability, the entity may choose an accounting policy of adjusting the carrying amount of the non-financial asset or liability for the hedging gain or loss at acquisition.

Hedges of a net investment in a foreign operation are accounted for similarly to cash flow hedges.

Presentation and disclosure

There have been significant developments in risk management concepts and practices in recent years. New techniques have evolved for measuring and managing exposures to risks arising from financial instruments. The need for more relevant information and improved transparency about an entity’s exposures arising from financial instruments and how those risks are managed has become greater. Financial statement users and other investors need such information to make more informed judgements about risks that entities run from the use of financial instruments and their associated returns. However, the disclosures in IAS 30 (disclosure requirements for banks and similar financial institutions) and AS 31 were no longer in keeping with such developments, and there was a need to revise and enhance the disclosure framework for risks arising from financial instruments. AS 32, ‘Financial instruments: disclosures’, was issued to address this need. AS 32 sets out disclosure requirements that are intended to enable users to evaluate the significance of financial instruments for an entity’s financial position and performance and to understand the nature and extent of risks arising from those financial instruments to which the entity is exposed. AS 32 does not just apply to banks and financial institutions. All entities that have financial instruments are affected, even simple instruments such as borrowings, accounts payable and receivable, cash and investments..