AS-1 → Disclosure of Accounting Policies

→ All significant a/cing policies adopted in the preparation & presentation of FSs should be disclosed.

→ Any change in the a/cing policies which has a material effect in the current period
or
which is reasonably expected to have a material effect in later periods } Should be disclosed.

In case of a change in a/cing policies which has a material effect in the current period, the amount by which any item in the FSs is affected by such change should also be disclosed to the extent ascertainable.

Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

→ If the fundamental a/cing assumptions, viz. Going concern, consistency & Accrual are followed in FSs, specific disclosure is not required.

If it is not followed, the fact should be disclosed.

AS-2 → Valuation of Inventories

→ This Standard does "not" apply in accounting for inventories:

(a) WIP arising under construction contracts, including directly related service contracts (AS-7)

(b) WIP arising in the ordinary course of business of service providers.

(c) Shares, debentures & other financial instruments held as stock-in-trade

(d) Producers Inventories of LIVESTOCK, AGRICULTURAL & FOREST PRODUCTS, and MINERAL OILS, ORES & GASES to the extent they are measured at NRV in accordance with well established practices in those industries.

↓

* The inventories are measured at NRV at certain stages of production. for example, when agricultural crops have been harvested or mineral oils, ores & gases have been extracted & sale is assured under a forward contract or a govt guarantee or when a homogenous market exists & there is a negligible risk of failure to sell.

→ Inventories should be Valued at the LOWER of

"COST" OR "NRV"

Inventories

- Raw material → cost or Replacement cost
- WIP → cost or Replacement cost
- Finished Goods (cost or NRV, lower)
  - cost → cost of purchase + cost of conversion + Other costs
  - NRV → Realisable value − Selling Expenses

→ **Cost of purchase**:

COP = Purchase price + All Expenses directly attributable to purchase + Carriage Inward + Loading/unloading.

The following items are to be deducted from "COP":

(a) Duty Drawback
(b) Input tax credit
(c) Trade Discount
(d) Rebates

→ **Cost of Conversion**:-

conversion cost

- Direct Labour
- factory overheads
  - Variable → At Normal capacity
  - Fixed
    - At Normal capacity (when, AC=NC) & AC<NC
    - At Actual capacity (when, AC>NC)
- Joint cost

Accounting treatment for Joint products in case of Valuation of Inventories :

Step 1 :- Calculation of "NRV" of By-product & Scrap.

Step 2 :- Calculation of Joint cost for allocation :-

Particulars	₹
Cost of purchase	xxx
Cost of conversion	xxx
Other costs	xxx
	xxx
Less: NRV of By-product & scrap	(xxx)
Joint cost to be allocated →	xxx

Step 3 :- Apportionment of Joint cost on the basis of SALE VALUE & Determine the cost per unit of main product.

Step 4 :- Determination of Valuation of closing Inventory :-

Closing Inventory (in ₹) = Closing Inventory (in units) × Cost per unit.

Note :-

As per AS-2,

Most of By-products as well as Scrap or waste materials by their nature are immaterial. They are often measured at NRV & the value is deducted from the cost of main product.

→ Valuation of closing stock on "ITEM-by-ITEM BASIS" :

- The cost of inventory of Items that are not ordinarily interchangeable & goods or services produced & segregated for specific projects should be assigned by specific identification of their individual costs.

- As per AS-2, Inventories should be valued at the lower of cost or NRV. Inventories should be written down to NRV on an item-by-item basis.

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→ Exclusions from the Cost of Inventories :-

In the determination of cost of Inventories, it is appropriate to exclude the following costs & recognise them as "EXPENSE" in the period in which they are incurred:

(a) abnormal amounts of wasted materials, labour or other production costs.

(b) Storage costs, unless these costs are necessary in the production process prior to a further production stage.

(c) administrative OHs that do not contribute to bringing the inventories to their present location & condition.

(d) Selling & distribution costs.

→ Net Realisable Value (NRV) :-

- When the NRV of the relevant finished goods is LOWER THAN cost down in this case, the relevant raw materials & WIP should be written down to NRV.

In such circumstances, the Replacement Cost of Materials may be the best available measure of their NRV.

- If the sales contracts are for less than the inventory quantities held, the NRV of the excess inventory is based on General Selling prices.

Ex:- 10,000 units
- Sales contract = 6,000 u, Cost = ₹40 p.u
- Remaining = 4,000 u, cost = ₹45 p.u & NRV = ₹50 p.u

10,000 Units

6000 units ↓ Valuation → cost = ₹40 p.u

4000 units ↓ Valuation: cost or NRV } Lower = ₹45 p.u

→ Inventories do not include Spare parts, Servicing equipment & Standby equipment which meet the definition of property, plant and equipment as per AS-10. Such items are accounted in accordance with AS-10.

Inventory:

Inventories are assets:

(a) held for sale in the ordinary course of business.

(b) in the process of production for such sale; or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

Illustrations:

① Z Ltd. ordered 13,000 kg. of chemicals at ₹90 per kg. The purchase price includes GST of ₹5 per kg. in respect of which full ITC is admissible. freight incurred amounted to ₹30,000.

Normal transit loss is 4%. The company actually received 12,400 kg & consumed 10,000 kg of chemicals. The company has received trade discount later on in the form of their credit note of ₹1 per kg. The chemicals were delivered in containers. The containers were not reusable, hence sold for ₹500. The administrative expenses incurred to bring the chemicals were ₹10,000.

Compute the value of inventory & allocate the material cost as per AS-2. (NOV 2016, RTP)

Ans:

Computation of cost of inventory & allocation of material cost:

Particulars	₹
Purchase price [13,000 kg × ₹(90-1)]	11,57,000
Less: ~~Excise duty~~ GST on which ITC is admissible [13,000 kg × ₹5]	(65,000)
	10,92,000
Add: freight	30,000
Allocated administrative expenses	10,000
Total Material Cost →	11,32,000
Number of units to be normally received (13,000 kg × 96%)	12,480 kg
Normal cost per kg $\left[\frac{11,32,000}{12,480\text{ kg}}\right]$	₹90.705

Allocation of material cost

Particulars	Kg	₹/Kg	₹
Materials consumed	10,000		9,07,050
Cost of Inventory	2,400	90.705	2,17,692
Abnormal loss	80		7,258*
Total material cost →	12,480		11,32,000

* The difference due to rounding off of cost per kg. has been adjusted.

Thus, the inventory will be valued at ₹2,17,692.

Notes:-

(i) Abnormal loss will be recognized as a separate expense.

(ii) Containers are used for delivery of the chemicals and are not reusable. Cost of these containers is treated as selling & distribution expense. The sale value of these containers will be credited to statement of profit & loss and shall not be considered for the purpose of valuation of inventory.

Alternatively, candidates may deduct ₹500, the sales value of container assuming that the same is applicable to the purchases made, while computing material cost. In that case, the material cost will be computed as ₹11,31,500 (₹11,32,000 − ₹500) instead of ₹11,32,000. Accordingly the allocation of material cost will get change.

(2) Hema Ltd. is in the business of manufacturing computers. During the year ended 31st March 2015 the company manufactured 550 computers, it has the policy of valuing finished stock of goods at standard cost of ₹1.8 lakhs per computer. The details of the cost are as under:

	(₹ in lakhs)
Raw material consumed	400
Direct labour	250
Variable production OHs	150
Fixed production OHs (including interest of ₹100 lakhs)	290

Compute the Value of cost per computer for the purpose of closing stock and also comment on the policy of valuation of inventory adopted by Hema Ltd.

(May 2015, RTP)

Ans:

As per AS-2 'Valuation of Inventories', for inclusion in the cost of inventory, allocation of fixed production OHs is based on the normal capacity of the production facilities.

In this case, finished stock has been valued at standard cost of ₹1.8 lakhs per computer which incidentally synchronizes with the value computed on the basis of absorption costing as under:

Particulars		(₹ in Lakhs)
Materials		400
Direct labour		250
Variable production OH		150
Fixed production OH	290	
Less: Interest	(100)	190
	Total cost →	990

Number of computers produced = 550 computers (Assumed to be Normal production)

$$\text{Cost per computer} = \frac{₹990 \text{ Lakhs}}{550 \text{ computers}} = ₹1.80 \text{ Lakhs}.$$

Policy of the company to value closing stock on the basis of standard costing is not as per AS-2. As per AS-2, the techniques of standard cost method may be used for convenience if the result approximates to the actual cost. However, standard cost should be regularly reviewed, if necessary, and be revised in the light of the current conditions. In the instant case, the cost of inventory can be conveniently calculated as per absorption costing. Therefore, there is no reason to adopt standard costing method.

③ From the following information, ascertain the value of stock as on 31st March, 2013:

	₹
Stock as on 01.04.2012	28,500
Purchases	1,52,500
Manufacturing Expenses	30,000
Selling Expenses	12,100
Administration Expenses	6,000
Financial Expenses	4,300
Sales	2,49,000

At the time of valuing stock as on 31st March, 2012 a sum of ₹3,500 was written off on a particular item, which was originally purchased for ₹10,000 and was sold during the year for ₹9,000. Barring the transaction relating to this item, the gross profit earned during the year was 20% on sales.

(NOV 2013, RTP)

Ans:

Statement showing valuation of stock as on 31-03-2013

Particulars	₹	₹
Stock as on 01.04.2012	28,500	
Less: Book value of Abnormal stock (₹10,000 − ₹3,500)	(6500)	22,000
Add: Purchases		1,52,500
Manufacturing expenses		30,000
		2,04,500
Less: Cost of Sales		
Sales as per books	2,49,000	
Less: Sales of Abnormal item	(9,000)	
	2,40,000	
Less: GP@20%	(48,000)	(1,92,000)
Value of stock as on 31st March, 2013 →		12,500

AS-3 → CASH FLOW STATEMENTS

Cash flow during the year is

Net Cash flow from

- Operating Activities
  - Direct method
  - Indirect method
- Investing Activities
- Financing Activities

FORMAT OF CASH FLOW STATEMENT

Cash flow Statement of ---- Ltd. for the year ended March 31, 20XX

(Direct method)

Particulars	₹	₹
Operating Activities:		
Cash received from Sale of goods	xxx	
" Trade Receivables	xxx	
" Sale of services	xxx	xxx
Less:		
Payment for cash purchases	(xxx)	
" Trade Receivables	(xxx)	
" Operating Expenses Eg: Power, Rent, Electricity....	(xxx)	
" wages & salaries	(xxx)	
" Income Tax	(xxx)	(xxx)
		xxx
Adjustment for Extraordinary items		xxx
Net cash flow from OPERATING ACTIVITIES →		xxx

Note:
Direct method is preferred over Indirect Method because Direct method gives us the clear picture of various sources of cash inflows and outflows which helps in estimating the future cash inflows & outflows.

Cash flow Statement of ---- Ltd for the year ended march 31, 20XX

(Indirect Method)

Particulars	₹	₹
Closing balance of P&L A/c	XXX	
Less:- opening balance of P&L A/c	(XXX)	
	XXX	
- Reversal of the effects of profit & loss Appropriation A/c	XXX	
Add:- provision for Income Tax	(XXX)	
- Effects of Extraordinary items	(XXX)	
NET PROFIT BEFORE TAX & EXTRAORDINARY ITEMS →	XXX	
- Reversal of the effects of Non-cash & Non-operating Items (Expenses - ADD, Income - LESS)	XXX	
OPERATING PROFIT BEFORE WORKING CAPITAL CHANGES →	XXX	
- Effects for changes in working capital Except cash & cash Equivalent	XXX	
	XXX	
Less:- payment of Income Tax	(XXX)	
CASH FLOW BEFORE EXTRAORDINARY ITEM →	XXX	
- Adjustment for Extraordinary Item	XXX	
NET CASH FLOW FROM OPERATING ACTIVITIES →	XXX	

→ Definitions:

① **Cash** comprises cash on hand & demand deposits with banks

② **Cash Equivalents** are short term, highly liquid investments (3 month or less from the date of acquisition) that are readily convertible into known amounts of cash & which are subject to an insignificant risk of changes in value.

③ **Cash flows** are inflows & outflows of cash & cash equivalents.

④ **Operating Activities** are the principal revenue-producing activities of the enterprise & other activities that are not investing or financing activities.

⑤ **Investing Activities** are the acquisition & disposal of long-term assets & other investments not included in cash equivalents.

⑥ **Financing Activities** are activities that result in changes in the size & composition of the owner's capital (including preference share capital in the case of a company) & borrowings of the enterprise.

→ **AS would prevail over Schedule III**

- Normally deposits with original maturity of 3 months or less only should be classified as cash equivalents.
- Further, bank balances held as margin money or security against borrowings are neither in the nature of demand deposits, nor readily available for use by the company, and accordingly, do not meet the aforesaid definition of cash equivalents.
- There is apparent conflict b/w AS & Schedule III
- The conflict should be resolved by changing the caption "cash and cash equivalents" to "cash and bank balances" (Sub headings)

ⓐ cash and cash equivalents

ⓑ Other bank balances.

Fixed deposits

	Original maturity (from the date of acquisition)	Maturity from Reporting date	Disclosure
(i)	(≤3) 3 months or less	(≤3) 3 months or less	Cash & cash Equivalents
(ii)	More than 3 months upto 12 Months	3 months or less	Other bank balances
(iii)	~~3 months or less~~ More than 12 months	More than 3 months upto 12 months	Other bank balances
(iv)	~~More than 3 months upto~~ More than 12 months	More than 12 months	Other non-current assets

Illustrations

① XYZ Ltd is having the following Fixed Deposit Receipts:

	Date of FDR	Maturity Date	Amount
Axis Bank Ltd	01 January, 2014	30 April, 2015	10,00,000
Punjab National Bank	01 January, 2014	30 June, 2014	15,00,000
State Bank of India	28 February, 2014	30 May, 2014	10,00,000
ICICI Bank	31 January, 2013	31 January, 2015	10,00,000

Prepare 'Notes to accounts' showing the above deposits in accordance with the requirements of Schedule III (CA Final, Nov 2014)

Ans:

Notes to Accounts

S.No.	Particulars		Amount in ₹
1	Other non-current assets		
	FDR of Axis Bank Ltd.		10,00,000
2	Current Assets		
	Cash and bank balances (Note)		
	(a) Cash and cash equivalents		
	FDR of State Bank of India	10,00,000	
	(b) Other bank balances		
	FDR of ICICI Bank	10,00,000	
	FDR of Punjab National Bank	15,00,000	35,00,000

Note :-

- The above 'Notes to Accounts' have been prepared on the basis of the Guidance Note on Schedule III to the companies Act, 2013.
- It states that in case of bank deposits having maturity of more than 3 months but upto 12 months, the heading "cash and cash equivalents" should be changed to "cash and bank balances" which may have two sub-headings viz "cash and cash equivalents" and "Other bank balances".
- Since AS will prevail over schedule and as per AS 3, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, 3 months or less from the date of acquisition.
- Therefore, even if the remaining maturity of FDR from reporting date is 3 months or less but its original maturity is more than 3 months from the date of acquisition it will be shown under the sub-heading "Other Bank Balances".
- It also states that bank deposits having maturity of more than 12 months should be shown under the heading "Other non-current assets".
- It is assumed that the FDR having maturity of more than 12 months from the reporting date i.e., 31-03-2014 are restricted from being exchanged or used to settle a liability for atleast 12 months after reporting date.

Working Note :-

	Amount in ₹	Date of FDR	Maturity Date	Maturity months from the reporting date i.e., 31-03-2014
Axis Bank Ltd.	10,00,000	1-1-2014	30-4-2015	13
Punjab National Bank	15,00,000	1-1-2014	30-6-2014	3
State Bank of India	10,00,000	28-2-2014	30-5-2014	2
ICICI Bank	10,00,000	31-1-2013	31-1-2015	10
	45,00,000			

② A Finance House Ltd purchased commercial paper (CP) of ₹100 crores on 28th February, 2015 for 89 days maturity. There is a ready market for sale/purchase of commercial paper. While preparing cash flow statement for the financial year ended on 31.3.2015, Finance House Ltd. showed CP of ₹100 crores under Investing Activities. (RTP, May 2015)

Ans:- As per AS 3 "cash flow statements", cash payment for acquisition of shares, warrant or debt instruments shall be shown under Investing activities if they are not qualified as cash equivalent.

As per AS 3, an investment shall be qualified as cash equivalent if it is readily convertible to a known amount of cash i.e. it has short maturity of say 3 months or less from the date of acquisition.

It is given in question that the CP purchased by Finance House Ltd has a ready market for its sale/purchase. Therefore, it should be considered as cash equivalent & not to be shown under Investing Activity.

③ Prepare cash flow from Investing Activities of M/s. Creative Furnishings Limited for the year ended 31-3-2015.

Particulars	₹
Plant acquired by the issue of 8% debentures	1,56,000
Claim received for loss of plant in fire	49,600
Unsecured loans given to subsidiaries	4,85,000
Interest on loan received from subsidiary companies	82,500
Pre-acquisition dividend received on investment made	62,400
Debenture interest paid	1,16,000
Term loan repaid	4,25,000
Interest received on investment (TDS of ₹8,200 was deducted on the above interest)	68,000
Book value of plant sold (Loss incurred ₹9,600)	84,000

(IPCC, PM)

Ans:

Cash Flow Statement from Investing Activities of M/S. Creative Furnishings Ltd for the year ended 31-03-2015

Cash generated from Investing Activities	₹	₹
Interest on loan received	82,500	
Pre-acquisition dividend received on investment made	62,400	
Unsecured loans given to subsidiaries	(4,85,000)	
Interest received on investments (gross value)	76,200	
TDS deducted on interest	(8,200)	
Sale of plant	74,400	(1,97,700)
Extraordinary claim received for loss of plant		49,600
Net cash used in investing activities (after extraordinary item)		(1,48,100)

Note:

a) Debenture interest paid and Term loan repaid are financing activities and therefore not considered for preparing cash flow from investing activities.

b) Plant acquired by issue of 8% Debentures does not amount to cash outflow, hence also not considered in the above cash flow statement.

(9) Prepare cash flow statement of Balance Ltd. for the year ended 31st March, 2015 with the help of the following information:

(1) Company sold goods for cash only

(2) Gross profit ratio was 30% for the year, gross profit amounts to ₹ 3,82,500.

(3) Opening inventory was less than closing inventory by ₹35,000

(4) Wages paid during the year ₹4,92,500

(5) Office & selling expenses paid during the year ₹75,000

(6) Dividend paid during the year ₹30,000 (including DDT)

(7) Bank loan repaid during the year ₹2,15,000 (included interest ₹15,000)

(8) Trade payables on 31st March, 2014 exceed the balance on 31st March, 2015 by ₹25,000

(9) Amount paid to trade payables during the year ₹4,60,000

(10) Tax paid during the year amounts to ₹65,000 (provision for taxation as on 31-03-2015 is ₹45,000)

(11) Investment of ₹7,00,000 Sold during the year at a profit of ₹20,000.

(12) Depreciation on fixed assets amounts to ₹85,000

(13) Plant & machinery purchased on 15th November, 2014 for ₹2,50,000

(14) Cash and Cash Equivalents on 31st march, 2014 was ₹2,00,000

(15) Cash and Cash Equivalents on 31st march, 2015 was ₹6,07,500.

(RTP, May 2016)

Ans:-

Balance Ltd.

Cash flow Statement for the year ended 31st march, 2015

(By direct method)

Particulars	₹	₹
Cash flows from operating Activities		
Cash sales (₹3,82,500/0.30)		12,75,000
Less: Cash payments for trade payables	(4,60,000)	
Wages paid	(4,92,500)	
Office & Selling expenses	(75,000)	(10,27,500)
Cash generated from operations		2,47,500
Less: Income tax paid		(65,000)
Net cash generated from operating activities (A)		1,82,500
Cash flows from Investing Activities		
Sale of Investment	7,20,000	
payments for purchase of plant & machinery	(2,50,000)	
Net cash used in Investing Activities (B)		4,70,000
Cash flows from financing Activities		
Bank loan repayment (including interest)	(2,15,000)	
Dividend paid (including DDT)	(30,000)	
Net cash used in financing Activities (C)		(2,45,000)
Net Increase in Cash (A+B+C)		4,07,500
Cash & cash Equivalents at the beginning of the period		2,00,000
Cash & cash Equivalents at the end of the period →		6,07,500

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AS-4 → CONTINGENCIES AND EVENTS OCCURING AFTER THE BALANCE SHEET DATE

Contingency:

→ It is a condition or situation, the ultimate outcome of which gain or loss, will be known or determined only on the occurence or non-occurence, of one or more uncertain future events.

Contingency

Contingent Liabilities

- Not Recognise
- Disclosed by way of Notes in the FSs
- It is disclosed, UNLESS the possibility of an outflow of resources embodying economic benefits is "REMOTE"

Contingent Assets

- Not Recognise
- Not disclosed in the FSs
- But, it is usually disclosed in the Report of BODs/Approving Authority
- when the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.

Contingent Losses

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

Contingent Gains

- Not Recognised in the FSs

Events occuring After the Balance Sheet Date :-

are those significant events, both favourable & unfavourable, that occur b/w the balance sheet date & date on which the FSs are approved by the BODs in case of a company & by the corresponding approving authority in case of any other entity.

Evidence of such condition existed at the BS Date

↓

ADJUSTING EVENT

↓

Adjustment to assets & liabilities is required

↓

DISCLOSURE IN THE FSs is required

No evidence of such condition existed at the BS Date

↓

NON-ADJUSTING EVENT

↓

Adjustment to assets & liabilities is not required.

↓

DISCLOSURE IN THE REPORT OF BODs / APPROVING AUTHORITY is required

↓

To Enable users of FSs to make proper evaluation & decisions.

Notes :-

(1) Assets & liabilities should be adjusted for events occuring after the BS date

(i) that provide additional evidence to assist the estimation of amounts relating to conditions existing at the BS date

or

(ii) that indicate that the fundamental accounting assumption of going concern is not appropriate

(2) There are events which, although they take place after the BS date, are sometimes reflected in the FSs because of statutory requirements or because of their special nature.

For example,
If dividends are declared after the BS date but before the FSs are approved for issue, the dividends are not recognised as a liability at the BS date because NO OBLIGATION EXISTS unless a statute requires otherwise.

Such dividends are disclosed in the Notes.

Illustrations

① A company follows April to march as its financial year. The company recognizes cheques dated 31st march or before, received from customers after balance sheet date, but before approval of FS by debiting 'cheques in Hand Account' and crediting 'Debtors Account'. The 'cheques in hand' is shown in the Balance sheet as an item of cash & cash equivalents. All cheques in hand are presented to bank in the month of April and are also realised in the same month in normal course after deposit in the bank.

State with reasons, whether the collection of cheques bearing date 31st march or before, but received after BS date is an adjusting event and how this fact is to be disclosed by the company? (IPCC, PM)

Ans:-

- Even if the cheques bear the date 31st march or before, the cheques received after 31st march do not represent any condition existing on the BS date i.e., 31st march.
- Thus, the collection of cheques after BS date is not an adjusting event.
- Cheques that are received after the BS date should be accounted for in the period in which they are received even though the same may be dated 31st march or before as per AS-4.
- Moreover, the collection of cheques after BS date does not represent any material change affecting financial position of the enterprise on the BS date, so no disclosure is necessary.

② Cashier of A-one Limited embezzled cash amounting to ₹6,00,000 during march 2012. However same comes to the notice of the company management during April 2012 only. FSs of the company is not yet approved by the BODs of the company. With the help of provisions of AS-4 decide, whether the embezzlement of cash should be adjusted in the books of a/c's for the year ending March, 2012? What will be your reply, if embezzlement of cash comes to the notice of co. management only after approval of FSs by the BODs of the co.? (IPCC, PM)

Ans:-

- As per AS 4, assets & liabilities should be adjusted for events occuring after the BS date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the BS date.
- Though the theft, by the cashier ₹6,00,000, was detected after the BS date (before approval of FSs) but it is an additional information

materially affecting the determination of the cash amount relating to conditions existing at the BS date.

- Therefore, it is necessary to make the necessary adjustments in the FSs of the co. for the year ended 31st march, 2012 for recognition of loss amounting ₹6,00,000.

- If embezzlement of cash comes to the notice of company management only after approval of FSs by BODs, then the treatment will be done as per AS-5. This being EXTRAORDINARY ITEM should be disclosed in the statement of profit & loss as a part of loss for the year ending march, 2013.

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

(3) Neel Ltd has its corporate office in mumbai & sells its products to stockists all over India. On 31st march 2013, the co. wants to recognize receipt of cheques bearing date 31st march 2013 or before, as "cheques in Hand" by reducing "Trade Receivables." The "cheques in Hand" is shown in the BS as an item of cash & cash equivalents. All cheques are presented to bank in the month of April 2013 and are also realized in the same month in normal course after deposit in the bank. State with reasons, whether each of the following is an adjusting event and how this fact is to be disclosed by the co., with reference to the relevant accounting standard.

(i) Cheques collected by the marketing personnel of the co. from the stockists on or before 31st march, 2013.

(ii) Cheques sent by the stockists through courier on or before 31st march, 2013.

(IPCC, PM)

Ans:

(i) Cheques collected by the marketing personnel of the co. is an adjusting event as the marketing personnels are employees of the co. & therefore, are representatives of the co. Handing over of cheques by the stockist to the marketing employees discharges the liability of the stockist. Therefore, cheques collected by the marketing personnel of the co. on or before 31st march, 2013 require adjustment from the stockists a/c's i.e. from 'Trade Receivables A/c' even though these cheques (dated on or before 31st march, 2013) are presented in the bank in the month of April, 2013 in the normal course. Hence, collection of cheques by the marketing personnel is an adjusting event as per AS-4. Such 'cheques in Hand' will be shown in the BS as 'cash & cash Equivalents' with a disclosure in the Notes to accounts about the accouting policy followed by the company for such cheques.

(ii) Even if the cheque bear the date 31st march or before and are sent by the stockists through courier on or before 31st march, 2013, it is presumed that the cheques will be received after 31st march. collection of cheques after 31st march, 2013 does not represent any condition existing on the BS date i.e., 31st march. Thus, the collection of cheques after BS date is not an adjusting event. cheques that are received after the BS date should be accounted for in the period in which they are received even though the same may be dated 31st march or before as per AS 4. Moreover, the collection of cheques after BS date does not represent any material change affecting financial position of the enterprise, so no disclosure in the Director's Report is necessary.

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

Net profit or loss for the period
(1) Ordinary Activities
(2) Extraordinary Activities
(3) Prior Period Items
(4) Changes in Accounting Estimates
(5) Changes in Accounting policies.

(1) Ordinary Activities:-

- When items of income & expense within profit or loss from ordinary activities are of such size, nature of incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature & amount of such items should be disclosed separately.

- Circumstances of Ordinary Activities:
  (a) the write-down of Inventories to NRV as well as reversal of such write-downs;
  (b) legislative changes having retrospective application e.g., Revision of wages.
  (c) litigation settlements
  (d) re-structuring of the activities of an enterprise & the reversal of any provisions for the costs of restructuring;
  (e) other reversal of provisions
  (f) disposal of items of fixed assets
  (g) disposal of long-term investments.

(2) Extraordinary Items :-

- These items should be disclosed in the statement of profit & loss as a part of net profit or loss for the period.

- The nature & amount of each extraordinary item should be disclosed separately in the statement of profit & loss in a manner that its impact on current profit or loss can be perceived.

(3) Prior Period Items :-

- These are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the FSs of one or more prior periods.

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

Ex:- (a) Mathematical Mistakes (b) oversight

(c) Mistakes in applying a/cing policies (d) misinterpretation of facts

- Prior Period Items are generally infrequent in nature & can be distinguished from changes in a/cing estimates.

Accounting Estimates by their nature are approximations that may need revision as additional information becomes known.

Ex:- Income or Expense recognised on the outcome of contingency which previously could not be estimated reliably does not constitute a prior period Item.

(4) Change in Accounting Estimates :-

- An estimate may have to be revised if changes occur regarding the circumstances on which the estimate is based or as a result of new information, more experience or subsequent developments.

The revision of the estimate, by its nature does not bring the adjustments within the definitions of an extraordinary item or a prior period item.

- Sometimes, it is difficult to distinguish b/w change in an a/cing policy & a change in an accounting estimate. In such cases, the change is treated as change in an a/cing estimate with appropriate disclosure.

- The nature & amount of a change in an a/cing estimate which has a **MATERIAL EFFECT** in the current period or which is expected to have a material effect in subsequent periods, should be disclosed.

If it is impracticable to quantify the amount, this fact should be disclosed.

(5) Change in Accounting Policies :-

- A change in an a/cing policy should be made only if
  (a) it is required by statute or
  (b) for compliance with an a/cing standard or
  (c) if it is considered that the change would result in a more appropriate presentation of the FSs of an enterprise.

- The following are NOT changes in A/cing policies :-
  (a) the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions e.g., Introduction of a formal retirement gratuity scheme by an employer in place of ad-hoc ex-gratia payments to employees on retirement;
  (b) the adoption of new a/cing policy for events or transactions which do not occur previously or that were immaterial.

Change in Accounting policies

Material Effect	No Material Effect
- Any change in a/cing policy which has a material effect should be disclosed. - The impact of & the adjustments resulting from, such change, if material, should be shown in the FSs 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 a/cing policies which has not material effect on the FSs 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.

Illustrations

(i) A company desires to make provision in respect of its non-moving or slow moving items of stock. The following information is available:

(₹ in Lacs)

Particulars	Current year	Previous year
Value of closing stock	169	105
provision based on No. of issues during the year	4.50	4.00
provision based on products technicality	5.50	4.25

The company has been making provision based on number of issues. However, from this year, the management has decided to make provision based on technical evaluation. Explain whether such change will amount to change in 'accounting policy'. Also draw a suitable note, if in your view the proposed change requires the same to be given in the FS of the current year. (CA Final, May 2015)

Ans:-

- As per AS5, due to uncertainties inherent in business activities, many FS items cannot be measured with precision but can only be estimated. The estimation process involves judgments based on the latest information available. An estimate may have to be revised if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments. Accordingly, the basis of provisioning either on 'number of issues' or on 'technical evaluation' is the basis of making estimates.

- The decision of making provision for non-moving inventories on the basis of technical evaluation does NOT amount to change in a/cing policy. A/cing policy of a company may require that provision for non-moving inventories should be made.

- The method of estimating the amount of provision may be changed in case a more prudent estimate can be made. Further, if the co. is able to demonstrate satisfactorily that having regard to circumstances, provision made on the basis of 'technical evaluation' provides more satisfactory results than provision based on 'number of issues' then the co. can change the basis of making the provision.

- In the given case, considering the total value of inventory, the change in the amount of required provision of non-moving/slow moving inventory from ₹4.5 lacs to ₹5.5 lacs is also not material. The following disclosure shall be made for such change in the FSs of the co. for the current year.

- "The co. has provided for non-moving/slow-moving inventories on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the corresponding effect on the year end net assets would have been higher by ₹1 lac."

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(2) At March 31, 2015, High Ltd was holding long-lived assets, which it intended to sell. The company appropriately recognized a loss in 2014-15 related to these assets. State whether on High Ltd's Income statement for the year ended March 31, 2015, this loss should be reported as

(a) An extraordinary item

(b) A component of income from continuing operations before income-taxes to be disclosed separately.

(c) A separate component of selling or general & administrative expenses, disclosed net of tax benefit.

(d) A component of gain (loss) from sale of discontinued operations, disclosed net of income-taxes.

(May 2015, RTP)

Ans:-

(a) Incorrect

Losses on long-lived assets to be disposed of are neither unusual nor infrequent occurences. Hence, it cannot be considered as an extraordinary item.

(b) correct

As per AS 5, losses associated with long-lived assets, which are to be disposed of, are to be reported as a component of income from continuing operations before income taxes for entities preparing income statements and are disclosed separately.

(c) Incorrect

These losses are not part of selling or general administrative expenses and they are not disclosed net of tax.

(d) Incorrect

Discontinued operations result from disposal of a business & not from the disposal of long-lived assets held for resale.

(3) closing stock for the year ending on 31st march, 2013 is ₹1,50,000 which includes stock damaged in a fire in 2011-12. On 31st march, 2012, the estimated NRV of the damaged stock was ₹12,000. The revised estimate of NRV of damaged stock included in closing stock at 2012-13 is ₹4,000. Find the value of closing stock to be shown in statement of profit & loss for the year 2012-13, using the provisions of AS-5

(IPCC, PM)

Ans:- - The fall in estimated NRV of damaged stock ₹8,000 is the effect of change in a/cing estimate

- As per AS 5, the effect of a change in a/cing estimate should be classified using the same classification in the statement of profit & loss as was used previously for the estimate.

- It is presumed that the loss by fire in the year ended 31-03-2012, i.e., difference of cost & NRV was shown in the statement of profit & loss as an extra-ordinary item.

- Therefore, in the year 2012-13, revision in a/cing estimate should also be classified as extra-ordinary item in the statement of profit & loss and closing stock should be shown excluding the value of damaged stock.

- Value of closing stock for the year 2012-13 will be as follows:

Particulars	₹
closing stock (including damaged goods)	1,50,000
Less:- Revised value of damaged goods	(4,000)
closing stock (excluding damaged goods) →	1,46,000

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AS-7 → CONSTRUCTION CONTRACTS

→ Provisions relating to combining of construction contracts:

- When a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:
  (a) Separate proposals have been submitted for each asset;
  (b) each asset has been subject to separate negotiation & the contractor & customer have been able to accept or reject that part of the contract relating to each asset; &
  (c) the costs & revenues of each asset can be identified.
- A group of contracts whether with a single customer or with several customers, should be treated as a single construction contract when:
  (a) the group of contracts is negotiated as a single package.
  (b) the contracts are so closely interrelated that they are, in effect, part of single project with an overall profit margin; &
  (c) the contracts are performed concurrently or in a continuous sequence.

→ Contract Revenue:

Contract Revenue should comprise:
(a) the initial amount of revenue in the contract; &
(b) Variations in contract work, claims & incentive payments;
  (i) to the extent that is probable that they will result in revenue; &
  (ii) they are capable of being reliably measured.

* Variation in contract work:

- A variation is an instruction by the customer for a change in scope of the work to be performed under the contract.
- A variation may lead to an increase or decrease in contract revenue.
- Examples of variations are
  (i) changes in the specifications or design of the asset &
  (ii) changes in the duration of the contract.
- A variation is included in contract revenue when:
  (a) it is probable that the customer will approve the variation & the amount of revenue arising from the variation; &
  (b) the amount of revenue can be reliably measured.

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* Claim :

- A claim is an amount that the contractor seeks to collect from the customer or another party as reimbursements for costs not included in the contract price.
- A claim may arise from, for example,
  (i) customer cause delays,
  (ii) errors in specifications or design, &
  (iii) disputed variations in contract work.
- The measurement of the amounts of revenue arising from claims is subject to a high level of uncertainty & often depends on the outcome of negotiations.
- claims are only included in contract revenue when:
  (a) negotiations have reached an advanced stage such that it is probable that the customer will accept the claim; &
  (b) the amount that it is probable will be accepted by the customer can be measured reliably.

* Incentive Payments :

- Incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded.
- For example, a contract may allow for an incentive payment to the contractor for early completion of the contract.
- Incentive payments are included in contract revenue when:
  (a) the contract is sufficiently advanced that is probable that the specified performance standards will be met or exceeded; &
  (b) the amount of incentive payment can be measured reliably.

→ Contract costs :

contract costs should comprise:

(a) costs that relate directly to the specific contract;

(b) costs that are attributable to contract activity in general & can be allocated to the contract; &

(c) such other costs as are specifically chargeable to the customer under the terms of the contract

* costs that relate directly to the specific contract include:

(a) site labour contracts, including site supervision;

(b) cost of materials used in construction

(c) depreciation of plant & equipment used on the contract;

(d) cost of moving plant & equipment & materials to & from the contract site;

(e) costs of hiring plant & equipment

(f) costs of design & technical assisstance that is directly related to the contract;

(g) the estimated costs of rectification & guarantee work, including expected warranty costs; &

(h) claims from third parties.

These costs may be reduced by any incidental income that is not included in contract revenue, for example,

(i) income from the sale of surplus materials &

(ii) disposal of plant & equipment at the end of the contract.

* costs that may be attributable to contract activity in general & can be allocated to specific contracts include:

(a) insurance

(b) costs of design & technical assistance that is not directly related to a specific contract

(c) construction overheads include costs such as the preparation & processing of construction personnel payroll.

(d) Borrowing costs as per AS-16.

* costs that are specifically chargeable to the customer under the terms of the contract may include:

- some general administration costs &
- development costs.

for which reimbursement is specified in the terms of the contract.

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* costs that cannot be attributed to contract activity or cannot be allocated to a contract are excluded from the cost of a construction contract :-

(a) general administration costs for which reimbursement is not specified in the contract;

(b) selling costs;

(c) R&D costs for which reimbursement is not specified in the contract; &

(d) depreciation of idle plant & equipment that is not used on a particular contract

* contract cost include the costs attributable to a contract for the period

from the date of securing the contract
to
final completion of the contract

* when costs incurred in securing a contract are recognised as an expense in the period in which they are incurred, they are not included in contract costs when the contract is obtained in a subsequent period.

* costs that relate directly to a contract and which are incurred in securing the contract are also included as part of the contract costs if

- they can be separately identified & measured reliably &
- it is probable that the contract will be obtained.

→ Recognition of "Expected Losses":-

- when it is probable that total contract costs will exceed total contract revenue, the "EXPECTED LOSS" should be recognised as an expense immediately.

* Expected Loss = Total contract costs - Total contract revenue

(work certified + work uncertified + Estimated costs to complete the project)

"uncertainty" in contract revenue :-

→ - when an uncertainty arises about the collectability of an amount already included in the contract revenue & already recognised in the statement of profit & loss, the uncollectable amount or the amount in respect of which recovery has ceased to be probable is recognised as an "EXPENSE" rather than as an adjustment to the amount of contract revenue

→ Recognition of Contract Revenue & Expenses :-

- When the outcome of a construction contract can be estimated reliably, contract revenue & contract costs associated with the construction contract should be recognised as revenue & expenses respectively by reference to the stage of completion of the contract activity at the reporting date.

- In case of ------ contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:-

fixed price contract	cost plus contract
(a) total contract revenue can be measured reliably;	(a) it is probable that the economic benefits associated with the contract will flow to the enterprise; &
(b) it is probable that the economic benefits associated with the contract will flow to the enterprise;	(b) the contract costs attributable to the contract, whether or not specifically reimbursable, can be clearly identified & measured reliably.
(c) both the contract costs to complete the contract & the stage of contract completion at the reporting date can be measured reliably; &	
(d) the contract costs attributable to the contract can be clearly identified & measured reliably so that actual contract costs can be compared with prior estimates.	

- Stage of completion of a contract is often referred to as the "PERCENTAGE OF COMPLETION METHOD".

- The stage of completion of a contract may be determined in a variety of ways. The enterprise uses the method that measures reliably the work performed. Depending on the nature of the contract, the methods may include:
  (a) the proportion that contract costs incurred for work performed upto the reporting date bear to the estimated total contract costs; or
  (b) Surveys of work performed; or
  (c) completion of a physical proportion of the contract work.

PROGRESS PAYMENTS & ADVANCES RECEIVED FROM CUSTOMERS may NOT necessarily reflect the work performed.

→ When the stage of completion is determined by reference to the contract costs incurred upto the reporting date, only those contract costs that reflect the work performed are included in costs incurred upto reporting date. Examples of contract costs which are excluded:

(a) Payments made to subcontractors in advance of work performed under the subcontract

(b) Contract costs that relate to future activity on the contract, such as costs of materials that have been delivered to a contract site or setaside for use in a contract but not yet installed, used or applied during contract performance, unless the materials have been made specially for the contract.

→ Disclosures:

① An enterprise should disclose:

(a) the amount of contract revenue recognised as revenue in the period;

(b) the methods used to determine the contract revenue recognised in the period; &

(c) the methods used to determine the stage of completion of contracts in progress.

② An enterprise should disclose the following for contracts in progress at the reporting date:

(a) the aggregate amount of cost incurred & recognised profits (less recognised losses) upto the reporting date;

(b) the amount of advances received; &

(c) the amount of retentions.

③ An enterprise should present:

(a) gross amount due from customers for contract work as an "ASSET"

↳ (cost Incurred + Recognised profits) − (Progress billings + Recognised losses)

(b) gross amount due to customers for contract work as an "LIABILITY"

↳ (Progress Billings + Recognised losses) − (cost Incurred + Recognised profits)

④ An enterprise discloses any contingencies in accordance with AS 4. contingencies may arise from such items such as warranty costs, penalities or possible losses.

* Advances are amounts received by the contractor before the related work is performed.

* Progress Billings are amounts billed for work performed on a contract whether or not they have been paid by the customer.

* Retentions are amounts of progress billings which are not paid until the satisfication of conditions specified in the contract for the payment of such amounts or until defects have been rectified.

Illustrations

(1) Pius constructions undertake to construct a bridge for the Govt. of Uttar Pradesh. The construction commenced during the fy ending 31.03.2016 & is likely to be completed by the next fy. The contract is for a fixed price of ₹12 crore with an escalation clause. The cost to complete the whole contract is estimated at ₹9.50 crore. You are given the following information for the year ended 31.03.2016:

Costs incurred upto 31.03.2016	₹4 crore
Costs estimated to complete the contract	₹6 crore

Escalation in cost is 5% & accordingly the contract prices increased by 5%. You are required to ascertain the stage of completion & also to state the revenue & profit to be recognized for the year as per AS-7 (RTP, NOV 2016)

Ans: Calculation of total estimated cost of construction

Particulars	₹ in crore
Cost of construction of bridge incurred upto 31-03-16	4.00
Add: Estimated future cost	6.00
Total estimated cost of construction →	10.00
Contract price (12 crore x 1.05)	12.60 crore.

Stage of completion

Percentage of completion till date to total estimated cost of construction

$= \frac{4}{10} \times 100 = 40\%$

Revenue & profit to be recognised for the year ended 31st march, 2016

a) proportion of total contract value recognized as revenue

= contract price x percentage of completion

= ₹12.60 crore x 40% = ₹5.04 crore.

b) Profit for the year ended 31st march, 2016 = ₹5.04 crore − ₹4 crore

= ₹1.04 crore.

(2) M/s. Highway constructions undertook the construction of a highway on 01-04-2003. The contract was to be completed in 2 years. The contract price was estimated at ₹150 crores. Up to 31-03-2014 the company incurred ₹120 crores on the construction. The engineers involved in the project estimated that a further ₹45 crores would be incurred for completing the work.

What amount should be charged to revenue for the year 2013-14 as per the provisions of AS 7 "construction contracts"? Show the extract of the profit & Loss A/c in the books of M/s. Highway constructions. (IPCC, PM)

Ans: Statement showing the amount to be charged to Revenue as per AS-7

Particulars	₹ in crores
cost of construction incurred upto 31-03-2014	120
Add: Estimated future cost	45
Total Estimated cost of construction →	165
Degree of completion ($\frac{120}{165}$ x100)	72.73%
Revenue recognized (150 x 72.73%)	109
Total foreseeable losses (165-150)	15
Less: Loss for the current year (120-109)	11
Loss to be provided for →	4

Profit and Loss Account (Extract)

	(₹ in crores)		(₹ in crores)
To construction costs	120	By contract price	109
To provision for loss	4	By Net Loss	15
	124		124

(3) A construction contractor has a fixed price contract for ₹13,500 lakhs to build a railway tunnels. The contractor's initial estimate of contract costs is ₹12,000 lakhs. It will take 3yrs to build the tunnel.

By the end of year 1, the contractor's estimate of contract costs has increased to ₹12,075 lakhs.

In year 2, the Railway Authority approves a variation resulting in an increase in contract revenue of ₹300 lakhs & estimated additional contract costs of ₹225 lakhs. At the end of year 2, costs incurred include ₹200 lakhs for materials at site to be used fully in year 3, to complete the work.

Contract costs incurred upto the reporting date of

Year 1	–	₹3139 lakhs
Year 2	–	₹9102 lakhs
Year 3	–	₹12300 lakhs

You are required to find out the amount of revenue, expenses & profit to be recognised in the statement of profit & loss in all three years. (NOV 2016, RTP)

Ans: Statement showing stage of completion in percentage (₹ in lakhs):

Particulars	Year 1	Year 2	Year 3
Initial amount of revenue agreed in contract	13,500	13,500	13,500
Variation	–	300	300
Total contract revenue → (A)	13,500	13,800	13,800
Contract costs incurred upto reporting date	3,139	9,102	12,300
Contract costs to complete	8,936	3,198	–
Total estimated contract costs → (B)	12,075	12,300	12,300
Estimated profit (A−B)	1,425	1500	1500
Stage of completion ($\frac{A}{B}\times100$)	26%	72.37% *	100%

* Note: The stage of completion for year 2 i.e., 72.37% is determined by excluding from contract costs incurred for work performed upto the reporting date, ₹200 lakhs of materials stored at the site for use in year 3.

The amount of revenue, expenses & profit, recognised in the statement of profit & loss in three years are as follows:

	Total	Recognised in prior years	Recognised in current year
Year 1			
Revenue (13,500×26%)	3,510	–	3,510
Expenses	3,139	–	3,139
Profit →	371	–	371
Year 2			
Revenue (13800×72.37%)	9,987	3510	6477
Expenses	8,902	3,139	5,763
Profit →	1,085	371	714
Year 3			
Revenue	13,800	9,987	3,813
Expenses	12,300	8902	3398
Profit →	1,500	1,085	415

AS-9 → REVENUE RECOGNITION

→ This standard deals with the bases for recognition of revenue in the Statement of profit & loss of an enterprise.

→ This standard concerned with the recognition of revenue arising in the course of ordinary activities of the enterprise from

(a) sale of goods

(b) rendering of services

(c) use by others of enterprise resources yielding interest, royalities & dividends.

→ This standard does not deal with :

(1) Revenue arising from

- construction contracts (AS-7)
- hire purchase, lease agreements (AS-19)
- govt. grants & other similar subsidies (AS-12)

(2) Revenue of Insurance ~~contracts~~ co. arising from Insurance contracts.

→ Example of items not included within the definition of revenue for the purpose of this standard are :

(1) - Realised gains resulting from the disposal of non-current assets &
- unrealised gains resulting from the holding of non-current assets.

Ex: appreciation in the value of fixed assets.

(2) - unrealised holding gains from the change in the value of current assets &
- Natural increases in herds & agricultural & forest produce.

(3) - Realised or unrealised gains resulting from changes in foreign exchange rates &
- Adjustments arising on the translation of foreign currency FSs.

(4) Realised gains resulting from the discharge of an obligation at less than its carrying amount

(5) Unrealised gains resulting from the restatement of the carrying amount of an obligation.

→ Revenue:

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

- Sale of goods,
- rendering of services, &
- use by others of enterprise resources yielding interest, royalities & dividends.

① Sale of goods

Transfer of property (TOP)

=

Transfer of significant risks & rewards of ownership (TSRRO)

↓

for consideration

↓

Revenue Recognition = TOP

TOP ≠ TSRRO

↓

for consideration

↓

Revenue Recognition = TSRRO

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 & 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 consideration that will be derived from the sale of goods.

② use by others of enterprise resources yielding interest, Royalities & dividends

Revenue is recognised

Interest

↓

On a time proportion basis taking into account the amt outstanding & the rate applicable.

Royalities

↓

on a accrual basis in accordance with the terms of relevant agreement.

Dividend

↓

when the owner's right to receive the payment is established

When interest, royalities & dividends from foreign countries require exchange permission & uncertainty in remittance is anticipated, revenue recognition may need to be postponed.

③

Rendering of services

Proportionate completion method

↓

Recognises revenue in the statement of profit & loss proportionately with **degree of completion** of services under a contract

↓

Performance consists of execution of <u>more than</u> one act

↓

Practically revenue is recognised on SLM basis

Completed service contract method

↓

Recognises revenue in the statement of profit & loss only when the rendering of services under a contract is **completed or substantially completed**.

↓

Performance consists of execution of a <u>single</u> act.

↓

Revenue is recognised when the final act is completed & services are chargeable.

→ <u>Effect of uncertainities on Revenue Recognition:-</u>

(i) Recognition of Revenue requires that revenue is **measurable** & that at the time of sale or rendering of services it would not be unreasonable to expect **ultimate collection**

(ii) – where the ability to assess the ultimate collection with reasonable certainty is lacking at the time **raising any claim** e.g., for escalation of price, export incentives, interest etc., revenue recognition is postponed to the extent of uncertainty involved.

– In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that ultimate collection will be made

– Where there is no uncertainty as to ultimate collection, revenue is recognised at the time of sale or rendering of service EVEN THOUGH payments are made by INSTALMENTS

(iii) when the uncertainty relating to collectability arises subsequent to the time of sale or the rendering of service, it is more appropriate to make a **separate provision** to reflect the uncertainty <u>rather than to adjust</u> the amount of revenue originally recorded.

(iv) when recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is properly recognised

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(v) - An essential criterion for the recognition of revenue is that the consideration receivable for the sale of goods, the rendering of services or from the use by others of enterprise resources is reasonably ~~expected~~ determinable.

- When such consideration is not determinable within the reasonable limits, the recognition of revenue is postponed.

→ Disclosure:

① In addition to the disclosures required by AS-1, an enterprise should also disclose the circumstances in which revenue recognition has been postponed pending the resolution of significant uncertainties.

② - The amount of revenue from sales transactions (Turnover) should be disclosed in the following manner on the face of the statement of profit & Loss:

Turnover (Gross)	XXX	
Less: Excise duty	XXX	
Turnover (Net)		XXX

- The amount of excise duty to be deducted from the turnover should be the total excise duty for the year EXCEPT the excise duty related to the difference b/w the closing stock & opening stock.
- The excise duty related to the difference b/w the closing stock & opening stock should be recognised separately in the statement of profit & loss, with an EXPLANATORY NOTES in the NOTES TO ACCOUNTS to explain the nature of the two amounts of excise duty.

* Note:
- This standard does not require Basic customs Duty (BCD) as deduction from sales. BCD is an EXPENSE of the company & should have been shown a charge in the statement of profit & loss. Showing BCD as a deduction from sales will tantamount to contradiction of GAAP.

- As per the definition of revenue in the Guidance Note on Terms used in FS, "It excludes amounts collected on behalf of third parties such as certain taxes."

Illustrations

(A) Sale of Goods (B) Rendering of services

(A) Sale of Goods:

(1) Consignment sales i.e., a delivery is made whereby the recipient undertakes to sell the goods on behalf of the consignor.

Revenue should not be recognised until the goods are sold to third party.

(2) Cash on Delivery Sales

Revenue should not be recognised until cash is received by the seller or his agent.

(3) Instalment sales

- When the consideration is receivable in instalments, revenue attributable to the sales price EXCLUSIVE OF INTEREST should be recognised **at the date of sale.**
- The interest element should be recognised as revenue, **PROPORTIONATELY** to the unpaid balance to the seller.

(4) Trade discounts & volume rebates

- Trade discounts & volume rebates are not encompassed within the definition of revenue, since they represent a **reduction of cost.**
- It should be deducted in determining revenue.

(5) Subscriptions for publications

- Revenue received or billed should be **DEFERRED** & recognised either on a straight line basis over time.
- When the items delivered vary in value from period to period, revenue should be based on the sales value of the item delivered in relation to the total sales value of all items covered by the subscription.

(6) Sales to intermediate parties

- Where goods are sold to distributors, dealers or others for resale.
- Revenue from such sales can generally be recognised if significant risks of ownership **have passed.**

(7) Sales/repurchase agreements i.e., where seller concurrently agrees to repurchase the goods at a later date.

For such transactions that are in substance a financing agreement, the resulting cash inflow is NOT REVENUE as defined & should not be recognised as revenue.

(8) Special order & shipments i.e., where payment (or partial payment) is received for goods not presently held in stock eg. the stock is still to be manufactured or is to be delivered directly to the customer from a third party

Revenue from such sales should not be recognised until goods are manufactured, identified & ready for delivery to the buyer by the third party.

(9) Sales where the purchase makes a series of instalment payments to the seller & the seller delivers the goods only when the final payment is received.

Revenue from such sales should not be recognised until goods are delivered

(10) Guaranteed Sales i.e., delivery is made giving the buyer an unlimited right of return.

Recognition of revenue in such circumstances will depend on the substance of the agreement.

In case of retail stores offering a guarantee of "money back if not completely satisfied" it may be appropriate to recognise the sale but to make a SUITABLE PROVISION for returns based on previous experience.

(11) Delivery is delayed at buyer's request & buyer takes title & accepts billing.

Revenue should be recognised when buyer takes title & accepts billing.

(12) Delivery Subject to conditions:-

(a) Installation & Inspection i.e., goods are sold subject to installation, inspection etc.

Revenue should normally not be recognised until the customer accepts delivery & installation & inspection are complete

(b) On Approval

Revenue should not be recognised until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed.

(B) Rendering of Services

(1) Installation fees

In case where installation fees are other than incidental to the sale of a product, they should be recognised as revenue only when the equipment is installed & accepted by the customer.

(2) Tuition fees

Revenue should be recognised over the period of instructions.

(3) Admission fees

- Revenue from artistic performances, banquets, & other special events should be recognised when the event takes place.
- When a subscription to a number of events is sold, the fee should be allocated to each event on a systematic & rational basis.

(4) Entrance & membership fees

- Entrance fees received is generally capitalised.
- If the membership fees permits only membership & all other services or products ~~sold~~ are paid for separately or if there is a separate annual subscription, the fee should be recognised when received.
- If the membership fees entitles the member to services or publication to be provided during the year, it should be recognised on a systematic & rational basis having regard to the timing & nature of all services provided.

(5) Advertising & Insurance Agency commissions

- Insurance Agency Commissions should be recognised on the effective commencement or renewal dates of the related policies.
- Advertising Agency commissions should be recognised when the service is completed.

(6) Financial Service Commission

- A financial Service may be rendered as a SINGLE ACT or may be provided OVER A PERIOD OF TIME.
- The recognition of such revenue have regard to:
  (a) whether the service has been provided "once and for all" or is on a "continuing basis";
  (b) the incidence of the costs relating to the service;
  (c) when the payment for the service will be received.

Illustrations

(1) A infrastructure company has constructed a mall & entered into agreement with tenants towards license-fee (monthly rental) and variable license fee, a percentage on the turnover of the tenant (on an annual basis). Cheif finance officer (CFO) wants to account/recognize license fee as income for 12 months during current year under audit and variable license fee as income during next year, since invoice is raised in the subsequent year. comment whether the treatment desired by the CFO is correct or not (NOV 2017, RTP)

Ans:-

- AS 9 on Revenue Recognition, is mainly concerned with the timing of recognition of revenue in the Statement of profit & Loss of an enterprise. The amount of revenue arising on a transaction is usually determined by agreement b/w the parties involved in the transaction. However, when uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.
- Further, as per accrual concept of fundamental accounting assumptions given in AS-1, revenue should be recognised as & when it is accrued i.e. recorded in the FSs of the periods to which they relate.
- In the present case, monthly rental towards licence fee & variable licence fee as a percentage on the turnover of the tenant though on annual basis is the income related to common financial year. Therefore, recognising the fee as revenue cannot be deferred simply because the invoice is raised in subsequent period. Hence it should be recognised in the FY of accrual.
- Therefore, the contention of the CFO is NOT in accordance with AS-9.

(2) When will the revenue be recognized in the case of inter-divisional transfers?
(May 2015, RTP)

Ans:-

The Accounting Standard Board of ICAI has come up with an announcement in the earlier years wherein it clarified that the inter-divisional transfers/sales are not revenue as per AS-9 "Revenue Recognition". According to it, in case of inter-divisional transfers, risks & rewards remain within the enterprise and also there is no consideration from the point of view of the enterprise as a whole. Therefore, the recognition criteria for revenue recognition are also not fulfilled in respect of inter divisional transfers. Hence, no revenue is recognized in the case of inter-divisional transfers.

(3) Sarita Publications publishes a monthly magazine on the 15th of every month. It sells advertising space in the magazine to advertisers on the terms of 80% sale value payable in advance and the balance within 30 days of the release of the publication. The sale of space for the march 2015 issue was made in february 2015. The magazine was published on its scheduled date. It received ₹2,40,000 on 10.03.2015 and ₹60,000 on 10.4.2015 for the March 2015 issue.

Discuss in the context of AS 9 the amount of revenue to be recognized & the treatment of the amount received from advertisers for the year ending 31-03-2015. What will be the treatment if the publication is delayed till 2.4.2015?
(May 2015, RTP)

Ans:-

- As per AS9, 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 as the service is performed, whichever relates the revenue to the work accomplished
- In the given case, income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is published & hence revenue is recognized on the date. In this case, 15-03-2015 is the date of publication of the magazine.
- Hence, ₹3,00,000 (₹2,40,000 + ₹60,000) is recognized as income in March, 2015. The terms of payment are not relevant for considering the date on which revenue is to be recognized. Since, the revenue of ₹3,00,000 will be recognised in March 2015, ₹60,000 will be treated as "amount due from advertisers" as on 31-03-2015 and ₹2,40,000 will be treated as "payment received against the sale."

- However, if the publication is delayed till 02-04-2015 revenue recognition is also be delayed till the advertisements get published in the magazine. In that case revenue of ₹3,00,000 will be recognized in the year ended 31-03-2016 after the magazine is published on 02-04-2015. The amount received from sale of advertising space on 10-03-2015 of ₹2,40,000 will be considered as an advance from advertisers as on 31-03-2015.

(4) Given the following information of M/s. Paper Products Ltd.

(i) Goods of ₹60,000 were sold on 20-03-2015 but at the request of the buyer these were delivered on 10-4-2015

(ii) On 15-1-2015 goods of ₹1,50,000 were sent on consignment basis of which 20% of the goods unsold are lying with the consignee as on 31-3-2015

(iii) ₹1,20,000 worth of goods were sold on approval basis on 1-12-2014. The period of approval was 3 months after which they were considered sold. Buyer sent approval for 75% goods up to 31-1-2015 & no approval or disapproval received for the remaining goods till 31-3-2015.

(iv) Apart from the above, the company has made cash sales of ₹7,80,000 (gross). Trade discount of 5% was allowed on the cash sales.

You are required to advise the accountant of M/s. Paper Products Ltd., with valid reasons, the amount to be recognized as revenue in above cases in the context of AS-9 & also determine the total revenue to be recognized for the year ending 31-03-2015 (IPCC, PM)

Ans:-
As per AS9, in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions are fulfilled:

(i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks & rewards of ownership have been transferred to the buyer & 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.

Case (i)

The sale is complete but delivery has been postponed at buyer's request. M/s. Paper Products Ltd. should recognize the entire sale of ₹60,000 for the year ended 31^{st} march, 2015.

Case (ii)

20% goods lying unsold with consignee should be treated as closing inventory & sales should be recognized for ₹1,20,000 (80% of ₹1,50,000). In case of consignment sales revenue should not be recognized until the goods are sold to a third party.

Case (iii)

In case of goods sold on approval basis, revenue should not be recognized until the goods have been formally accepted by buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed.
Therefore, revenue should be recognized for the total sales amounting to ₹1,20,000 as the time period for rejecting the goods had expired.

Case (iv)

Trade discounts given should be deducted in determining revenue. Thus, ₹39,000 should be deducted from the amount of turnover of ₹7,80,000 for the purpose of recognition of revenue. Thus, revenue should be ₹7,41,000.

Thus total revenue amounting ₹10,41,000 (60,000+1,20,000+1,20,000 +7,41,000) will be recognized for the year ended 31st March, 2015 in the books of M/s Paper products Ltd.

(5) A company sells the goods with "right to return". The following pattern has been observed;

Timeframe of return from date of purchase	% of cumulative sales
within 10 days	5%
Between 11 days & 20 days	7%
Between 21 days & 30 days	8%
Between 31 days & 45 days	9%

company has made sale of ₹30 lacs in the month of February 2015 and of ₹36 lacs in the month of March, 2015. The total sales for the FY have been ₹450 lacs & the cost of sales was ₹360 lacs.

Determine the amount of provision to be made & revenue to be recognised in accordance with AS 9. A year may be considered of 360 days.

(CA Final, May 2015)

Ans:

Accounting treatment for recognition of revenue

- Revenue in respect of sale of goods is recognised fully at the time of sale itself assumed that the co. has complied with the conditions stated in AS 9 relating to recognition of revenue in the case of sale of goods.
- AS 9 also provides that in case of retail sales offering a guarantee of 'money back', if not completely satisfied, it may be appropriate to recognize the sale but to make a suitable provisions for returns based on previous experiences.
- Therefore, sale of ₹30,00,000 & ₹36,00,000 made in the month of february and march 2015 will be recognized at full value.

Amount of provision

- The goods are sold with a right to return. The existence of such right gives rise to a present obligation on the company as per AS-29.
- As per AS 29, a provision should be created on the Balance sheet date, for sales returns after the Balance sheet date, at the best estimate of the loss expected, along with any estimated incremental cost that would be necessary to resell the goods expected to be returned.
- It is assumed that the sales has been made evenly throughout the month & every month is of 30 days based on the information given in the question i.e., a year of 360 days.

Sales during	Sales value (₹ in lacs)	Sales value (cumulative) (₹ in lacs)	Likely returns (%)	Likely returns (₹ in lacs)	Provision @ 20% (₹ in lacs) (Refer WN)
Last 10 days of March	36/3 or 12	12	5%	0.600	0.120
Previous 10 days of March	36/3 or 12	24	7%	1.680	0.336
Previous 10 days of March	36/3 or 12	36	8%	2.880	0.576
Last 15 days of February	30/2 or 15	51	9%	4.590	0.918
		Total →		9.75	1.950

Working Note:-

Calculation of profit (%) on sales

	(₹ in lacs)
Sales for the year	450
Less:- cost of sales	(360)
Profit →	90

Profit markup on sales $\left(\frac{90}{450} \times 100\right) = 20\%$