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CHAPTER – 1

ACCOUNTS STANDARDS

AS- Applicability Rules

With regard to the applicability of Accounting standards we have 2 sets of rules-

1. Company AS Rules 2006.
2. Rules laid down by ICAI.

1. Company AS Rules 2006-

a. Company's are of 2 types

i. SMC (Small and Medium sized Cos)

ii. Non SMC (Big Cos)

b. Following are Non SMCs (i.e. Big Cos)

i. Listed Cos,

ii. Turnover > 50 crores,

iii. Borrowing more than 10 crores,

iv. Banking, Insurance, Financial Institutions,

v. Holding and subsidiary of above.

vi. All others are SMCs.

c. Applicability of AS

i. AS not applicable to SMCs – 3 and 17.

ii. Remaining applicable to both SMC and Non SMCs.

2. Rules laid down by ICAI

All the paragraphs mentioned above are same and `Cos' will be replaced by Enterprises (i.e. SME and Non SME) and AS will be applicable only on those whose financial statements are subject to attest functions of the auditors.

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AS-4 (Events occurring after the Balance Sheet date)

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

   Two types of events can be identified:

a. Those which provide further evidence of conditions that existed at the balance sheet date; and

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

2. Adjustments to assets and liabilities are required to be made for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. For example, an adjustment may be made for a loss on a trade receivable account which is confirmed by the insolvency of a customer which occurs after the balance sheet date.

3. Adjustments to assets and liabilities are required to be made for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. An example is the decline in market value of Investments between the balance sheet date and the date on which the financial statements are approved.

4. There are events which, although they take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature. Such items include the amount of dividend proposed or declared by the enterprise after the balance sheet date in respect of the period covered by the financial statements.

5. Events occurring after the balance sheet date may indicate that the enterprise ceases to be a going concern. A deterioration in operating results and financial position, or unusual changes affecting the existence or substratum of the enterprise after the balance sheet date (e.g., destruction of a major production plant by a fire after the balance sheet date) may indicate a need to consider whether it is proper to use the fundamental accounting assumption of going concern in the preparation of the financial statements.

6. 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 with regard to

a. The nature of the event;

b. An estimate of the financial effect, or a statement that such an estimate cannot be made.

NOTICE

AS-5 (Net Profit or Loss for the period, prior period items and changes in accounting policies)

1. This statement does not deal with the tax implications of extraordinary items, prior period items, changes in accounting estimates, and changes in accounting policies for which appropriate adjustments will have to be made depending on the circumstances.
2. 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.
3. 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.
4. 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.
5. 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.
6. The net profit or loss for the period comprises the following components, each of which should be disclosed on the face of the statement of Profit and loss:

   a. Profit or loss from ordinary activities; and

   b. Extraordinary items.
7. 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. Examples of events or transactions that generally give rise to extraordinary items for most enterprises are attachment of property of the enterprise; or an earthquake etc.
8. 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. Some examples are given below:

   i. The write-down of inventories to net realizable value as well as the reversal of such write-downs;

   ii. A restructuring of the activities of an enterprise and the reversal of any provisions for the costs os restructuring;

   iii. Disposals of items of fixed assets;

   iv. Disposals of long-term Investments;

   v. Legislative changes having retrospective application;

   vi. Litigation settlements; and

   vii. Other reversals of provisions.
9. 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 of loss can be perceived.
10. An accounting 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. The revision of the estimate, by its nature, does not bring the adjustment within the definitions of an extraordinary item or a prior period item.
11. The effect of a change in an accounting estimate should be included in the determination of net profit or loss in:

i. The period of the change, if the change affects the period only; or

ii. The period of the change and the future periods, if the change affects both.

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

13. 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.

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AS-11 (The Effects of changes in Foreign Exchange Rate)

1. Applicable only to enterprises indulged in activities involving Foreign Exchange.
2. Activities are of 2Types:-

   i. Foreign Currency Transactions (export, import, loan etc.)

   ii. Foreign operations (where we have an establishment outside India e.g.- branches, subsidiaries etc.)
3. For converting Dollar into Rupees- Initial recognition will be done on spot exchange rate. E.g. $2,00,000 credit sale and today 1$= ` 40, then entry-

   Party A/c Dr. 80 lacs

   To Sales A/c 80 lacs
4. If settlement is in the same year, say received $1,00,000 and 1$= ` 43, then entry-

   Bank A/c Dr. 43 lacs

   To Party A/c 40 lacs

   To Foreign Exchange Fluctuation A/c 3 lacs
5. Year-end valuation –

   s Monetary Items- Closing rate

   s Non-monetary Items- Cost '! Date of purchase (fixed asset, stock and investments) and Original value Date of Resale.

   Closing rate- ` 45

   Party A/c Dr. 5 lacs

   To Foreign Exchange Fluctuation A/c5 lacs.
6. Next year settlement – settled, 1$=` 32

   Bank A/c Dr. 32 lacs

   Foreign Exchange Fluctuation A/c 13 lacs

   To Party A/c 45lacs
7. All FEF's at the end of the year are transferred to P/L A/c.
8. Foreign operation types
   i. Integral- a. taken as an extension of original business. Hence all branches are integral. b. FEF affects our day to day cash.
   ii. Non-integral- those not integral are non-integral.
9. Integral of accounting- Already discussed.
10. Non-integral foreign operations accounting- Not in syllabus.

    Note- A forward is a contract to give or to take a fixed rate at a future date. This profit or loss will be booked in P/L A/c on periodicity basis.

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AS-12 (Government Grants)

A kind of assistance, subsidy support either in monetary form or in non-monetary form given either by Central Government, State Government, Municipal Corporation or Foreign Government.

Recognition of Govt. grant-

Grant will be recognized on accrual basis by organization. Following 2conditions are required to be fulfilled

i. Reasonable certainty that grant will be received by organization.

ii. Conditions attached to the receipt of grant will be fulfilled by organization, there is a reasonable certainty which has to be given to auditor.

If there is reasonable certainty no documentary evidence is required because past track record is matching, is consistent.

In Virtual certainty- Documentary evidence is required. 6 Types of Govt. Grant-

1. For specific non-depreciable assets, e.g. Land.

Illustration- Land- 50lacs; Govt. Grant received- 30lacs.

So, MA Ltd. Paid- 20lacs.

Reduce the value	Full value
Land A/c Dr. 20lacs	Land A/c Dr. 50lacs
To Bank A/c 20lacs	To Bank A/c 20lacs
	To Capital Reserve A/c 30lacs

2. For specific depreciable assets, e.g. Building.

Illustration- Building- 50lacs; Govt. Grant received- 30lacs.

So, MA Ltd. Paid- 20lacs. Depn- 10%

Reduce the value	Full value
Building A/c Dr. 20lacs	Building A/c Dr. 50lacs
To Bank A/c 20lacs	To Bank A/c 20lacs
	To Deferred Govt. Grant A/c(DGG) 30lacs

DGG will be written back in P/L in the proportion in which depn is written off in P/L. thus, in both case depn will remain same.

Depn= 20*10% =2	Depn= 50*10%= 5
So, P/L Dr- 2	P/L Dr- 5
	P/L Cr-30*10%- 3
	So, net P/L Dr. -2

Remaining DGG in full value method of ` 30-3= ` 27lacs will appear under a separate heading `DGG' in the Balance sheet as per Schedule VI under liability side.

3. For non specific assets-

Illustration- Cost of establishing factory- 100lacs, Govt. grant- 40lacs, MA Ltd.- 60lacs.

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Bank A/c Dr. 40lacs

To Capital reserve A/c 40lacs

(If Govt. grant is in the nature of promoter's contribution and amount is received not for specific asset)

4. For meeting revenue expenditure of organization-

Salary payable- 100lacs, Govt. grant- 60lacs, MA Ltd.- 40lacs

Salary A/c Dr. 40lacs OR 1. Salary A/c Dr. 100lacs

To Cash A/c 40lacs To Cash A/c 40lacs

To Grant A/c 60lacs

2. Grant A/c Dr. 60lacs

To P/L A/c 60lacs

5. For accumulated losses-

Losses- 5lacs; Grant- 4lacs

1. Bank A/c Dr. 4lacs

To Grant 4 lacs

2. Grant A/c Dr. 4lacs

To P/L A/c (accumulated loss) 4lacs

6. For future years-

Salary received for future (5 years) by Govt.

1. Bank A/c Dr. 5

To DGG A/c 5

2. Write DGG in future years for which the grant has been received.

7. If Govt. gives land (asset) directly either free of cost or at concessional rate then reduced value method can only be followed.

Illustration- Govt. gives 50lacs building to MA Ltd. At ` 20lacs

Building A/c Dr. 20lacs

To Bank A/c 20lacs

Note- if above building was given free of cost, then nominal value of asset is recorded.

Building A/c Dr. 100lacs

To Reserves and surplus A/c 100lacs

Further points to be noted-

If any condition is attached by the Govt. while giving any sort of grant, its failure to comply will lead to reversing of the entries passed.

Govt. grant A/c Dr.

To Bank A/c

For forfeiture of Govt. grant thus, we always reverse the entry.

Illustration- Govt. grant- 30lacs; Building- 50lacs; MA Ltd.- 30lacs, Depn @10%.

After 2years of failure to fulfill any condition. Govt. takes back the grant. Pass entries.

1st Year-

1. Building A/c Dr. 50

To Bank A/c 20

To DGG A/c 30

2.	P/L A/c Dr.	5	
	To Depn A/c		5(50*10%)
3.	DGG A/c Dr.	3(30*10%)	
	To P/L A/c	3	

<u>2nd Year-</u>

1.	P/L A/c Dr.	5	
	To Depn A/c		5
2.	DGG A/c Dr.	3	
	To P/L A/c		3
3.	DGG A/c Dr.	24 (30-6)	
	P/L A/c Dr.		6
	To Bank A/c (grant refunded)	30	

<u>Following disclosures are required-</u>

1. Amount of grant
2. Nature of grant
3. Treatment of grant.

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AS-19 (Leases)

1. Lease is an agreement between lessor and lessee whereby the lessor transfers the Right to use of the asset to the lessee against a payment on a series of payment. Lease can be either Finance Lease or Operating Lease.

   A Finance lease is a lease that transfers substantially all the risks and rewards in favour of the lessee which are incident to ownership.

A lease which is not a Finance lease is an Operating lease.

2. Some of the situations which normally lead a lease being classified as Finance lease are as follows

i. At the end of the lease term the asset's ownership will be transferred to the lessee.

ii. The lease term is for the major part (as per IFRS 75%) of the economic life of the asset (even though the title is not transferred).

iii. The present value of minimum lease payments amounts to atleast substantially all (as per IFRS 90%) of the F.V. of the asset.

Sale and Leaseback Transactions-

1. If the Sale and Leaseback Transaction results into Finance lease, profit or loss on sale shall not be transferred to P/L A/c immediately, rather it should be treated as a Deferred income or a Deferred loss.

   Thereafter, this Deferred income/loss shall be transferred to P/L A/c in accordance with the rate of depreciation.

2. If Sale and Leaseback Transaction results into Operating lease-Situation-1

   If the F.V. < Carrying amount, book the loss immediately, otherwise ignore it. This should be done immediately before the sale.

   Thereafter 3 situations will arise,

a. If S.P. = F.V. – If there is any profit recognize it, losses cannot arise. e.g.

   Carrying amount(CA)= 10, FV= 8, SP= 8 Step1- As FV<CA

i. P/L A/c Dr. 2

   To Asset A/c 2

   Step2-

ii. Bank A/c Dr. 8

   To Asset A/c 8

NOTICE

AS - 20 - EPS (Earning Per Share)

This is applicable only to companies both public & private co. EPS is of 2 types :-

(i) BASIC EPS (Strong)

(ii) DILUTED EPS (Weak)

(1) Public Co. have 2 show both Basic and diluted EPS on the face of P/L with equal prominance.

(2) Private Co. are exempted to show diluted EPS on face of P/L. They have to show only Basis EPS on the face of P/L.

BASIC EPS :-

PAFESH → Net Profitor loss Available for Equity shareholders

No. of shares → Weighted Avg. No. of shares (WANOS).

ILLUSTRATION :

Net Loss = 100; No. of shares = 10

$$\text{EPS} = \frac{\text{PAFESH}}{\text{WANOS}} = \frac{(100)}{10} = ` (10)$$

so whether EPS is positive or negative it has to be disclosed at the face of P/L.

For COMPUTATION Of PAFESH following items need to be adjusted :-

(1) Cumulative Pref. Dividend (-
) (whether declared or not)
[i.e. it is the case when the co. incurrs a loss/profit)

(2) Non Cumulative Pref. Dividend (-
) (only if declared)

(3) Taxes

(4) Deferred Tax Asset (+)

(5) Deferred Tax Liability (-)

(6) Prior Period Items (Income) (+)

(7) Prior Period Items (Exp) (-)

(8) Extra ordinary Items.

Note : For extra-ordinary item 2 separate EPS has to be computed i.e. on ebefore its adjustment and one after its adjustments for the benefit of the financial user as EPS found out by taking PAFESH after Extra ordinary items adjustment may not be maintainable in future.

ILL - 2 :

08-09 → loss incurred

Cumulative Pref. Div. not declared. Will it be taken in computation of PAFESH?

Ans : Yes, as it is cumulative pref. dividend they have to be deducted to compute PAFESH for 08-09.

However, in 09-10 when profit is earned then pref. dividend for last yr. will also be declared

in 09-10 but for computing PAFESH of 09-10 only current year’s proposed dividend has to be deducted.

WANOS :-

Comp. of WANOS :- At the time of issue :-

O/S shares X Time Weighing

Factor. ILL-1

1.4.08 - 10 lacs (shares)

31.3.09 - 10 lacks shares

issued 31.3.09 - 20 lacs

WANOS = $10 \times \frac{12}{12} + 20 \times \frac{0}{12}$

= 10 lacs shares

ILL -2

1.4.08 - 10 lacs

1.7.08 - 5 lacs sh. issued

WANO3 = $10 \times \frac{3}{12} + 15 \times \frac{9}{12}$

= 13.75 lacs shares.

(2) WANOS - BUY BACK :-

ILL - 1 (Shares)

1.4.8 - 10 lacs

1.7.08 - 5 lacs buyback

Ans : WANOS = $(10 \times \frac{3}{12}) + (5 \times \frac{9}{12})$ = 6.25 l shares.

ILL - 2

1.4.8 - 10 lacs

1.7.8 - 5 lacs buyback

1.10.08 - 10 lacs sh. issued.

Ans : WANOS cannot be compuled as once buy-back is done fresh issue of shares cannot take place for next 6 months (i.e. in the cooling period).

ILL - 3

1.4.8 - 10 lacs

1.7.08 - 5 lacs issued

1.10.08 - 2 lacs buy-back

WANO3 = $(10 \times \frac{3}{12} + 15 \times \frac{3}{12} + 13 \times \frac{6}{12})$

= 12.75lacs shares

(3) **WANOS - BONUS ISSUE :-**

1.4.08 - 10 lacs

1.8.8 - 1:2 Bonus

WANOS = $(10 \times \frac{12}{12}) + 5 = 15$ lacs shares

As no money iszaised by issue of bonus issue. EPS of previous inancial yr. will be re-stated by taking into account the bonus - issue.

ILL - 2

1.4.08 - 10 lacs

1.6.08 - 5 lacs issue; 1.7.08 - Bonus 1:2; 1.8.08 - B.B - 1 lac

Ans : WANOS -

$$\left(10 \times \frac{2}{12}\right) + \left(15 \times \frac{2}{12}\right) + \left(14 \times \frac{8}{12}\right) + \underset{(15\ \ 2)}{7.5}$$

$= 20.97$ lacs shares

(4) WANOS - RIGHT SHARES :-

1.4.8 - 12 lacs; 1.7.08 - Right Issue @ ` 40. Cum. Right Price - ` 10 per share

Ans: (i) Ex Right Price :-

$$\frac{2 \times 70 + 1 \times 40}{3} = \text{` } 60\text{/sh.}$$

(ii) Adjustment factor :-

$$\frac{\text{Cum. Right}}{\text{Ex. Right}} = \frac{70}{60} = 1.1667$$

(iii) $\text{WANOS} = \left(1.1667 \times 12 \times \frac{3}{12} + 18 \times \frac{9}{12}\right)$

DILUTED EPS :-

$$= \frac{\text{PAFESH} \quad \text{after considering effect of potential instrument}}{\text{WANOS} \quad \text{after considering effect of potential instrument}}$$

Potential Instruments are such instruments which can be converted into equity shares. E.g. convertible Pre/Sh., Conv. Deb.

<u>ILL :-</u>

1.4.08 - 10 lacs eq. shares

1 lac 10% Conv. Pref. Shares @ ` 10 each

(1:1) 2 lac 10% Conv. Deb @ ` 10 each (1:2)

PAFESH :- 100 lacs; Tax Rate - 30% ; CDT :-

10% Compute EPS. (Dlute)

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AS-26 (Intangible Assets)

There are 4 characteristics of Intangible Assets

i. An intangible asset is identifiable i.e. it has future economic benefits.

ii. It must be a non-monetary asset i.e. realizable value not fixed.

iii. Intangible Asset must not have any physical substance.

iv. Intangible Asset is held for use.

Future economic benefits not only means future revenues, a reduction in cost is also a future economic benefit.

<u>Recognition of Intangible Asset – It must further satisfy following 2conditions-</u>

1. There must be certainty that economic benefits flowing from the asset will flow to enterprise.
2. Cost on asset should be measurable.

If title evidence for Intangible Asset is there with the organization then it is good but if not then the organization is required to prove to the auditor that inspite of having ownership it can generate future benefits to its own organization only.

<u>Cost at which Intangible Asset is to be recognized-</u>

<u>Illustrations-</u>

1. MA Ltd. Appoints a software engineer to make TALLY 92 for ` 50lacs. the engineer also charges ` 1000 for the disc in which Tally 92 is stored. Compute total cost of Intangible Asset i.e. Tally 92 here.

Ans- COST= ` 50lacs + ` 1000

Though ` 1000 forms the cost of tangible asset but since it forms negligible part of total cost of Intangible Asset it will not be recorded separately.

2. If Intangible Asset purchased- shares are given or other assets then the F.M.V. of asset given will be the cost.
3. If company purchased and Intangible Asset of that company acquired, then identify the F.V. of Intangible Asset in purchase method and in B.V. at merger method.
4. Intangible Asset- Research and Development

a) Research cost-

It is a planned and scientific investigation to find unknown technology and cost incurred on it should be written to P/L and not form the Intangible Asset.

b) <u>Development cost-</u> Capitalized only if 5criterias fulfilled

i. The asset which we are making is technically feasible to be produced.

ii. Organization has adequate resources to do it.

iii. Asset's product will have a market from where revenue will be derived.

iv. Enterprise has an intention to do it.

v. Development cost is measurable.