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Government of India
Ministry of Corporate Affairs

NOTIFICATION

New Delhi the 23rd June, 2021

G.S.R……. (E).— In exercise of the powers conferred by section 133 read with section 469 of the Companies Act, 2013 (18 of 2013) and in supersession of the Companies (Accounting Standards) Rules, 2006, published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section (i), vide number G.S.R. 739 (E), dated the 07th December, 2006 [and amended from time to time vide numbers G.S.R. No. 212(E), dated the 27th March, 2008, G.S.R. 225(E), dated the 31st March, 2009, G.S.R. 378(E), dated the 11th May, 2011, G.S.R. 913(E), dated the 29th December, 2011, G.S.R. 914(E), dated the 29th December, 2011, G.S.R. 364(E), dated the 30th March, 2016 and G.S.R. 569(E) dated the 18th June, 2018], except as respects things done or omitted to be done before such supersession, the Central Government, after consultation with the National Financial Reporting Authority constituted under section 132 of the said Act, hereby makes the following rules, namely:—

1. **Short title and commencement.-** (1) These rules may be called the **Companies (Accounting Standards) Rules, 2021.**

(2) They shall come into force on the date of their publication in the Official Gazette.

2. **Definitions.-** (1) In these rules, unless the context otherwise requires,-

(a) "Accounting Standards" means the standards of accounting or any addendum thereto as specified in rule 3;

(b) "Act" means the Companies Act, 2013 (18 of 2013);

(c) "Annexure" in relation to these rules means the Annexure containing the Accounting Standards (AS) appended to these rules;

(d) "Enterprise" means a 'company' as defined in clause (20) of section 2 of the Act;

(e) "Small and Medium Sized Company" (SMC) means, a company-

(i) whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;

(ii) which is not a bank, financial institution or an insurance company;

(iii) whose turnover (excluding other income) does not exceed two hundred and fifty crore rupees in the immediately preceding accounting year;

(iv) which does not have borrowings (including public deposits) in excess of fifty crore rupees at any time during the immediately preceding accounting year; and

(v) which is not a holding or subsidiary company of a company which is not a small and medium-sized company.

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

(2) Words and expressions used and not defined in these rules but defined in the Act shall have the meanings respectively assigned to them in the Act.

3. **Accounting Standards.-** (1) The Central Government hereby specifies Accounting Standards 1 to 5, 7 and 9 to 29 as recommended by the Institute of Chartered Accountants of India, which are specified in the Annexure to these rules.

(2) The Accounting Standards shall come into effect in respect of accounting periods commencing on or after the 1st day of April, 2021.

4. **Obligation to comply with Accounting Standards.-** (1) Every company, other than companies on which Indian Accounting Standards as notified under Companies (Indian Accounting Standards) Rules, 2015 are applicable, and its auditor(s) shall comply with the Accounting Standards in the manner specified in the Annexure.

(2) The Accounting Standards shall be applied in the preparation of Financial Statements.

5. **Qualification for exemption or relaxation in respect of SMC.-** An existing company, which was previously not a Small and Medium Sized Company (SMC) and subsequently becomes a SMC, shall not be qualified for exemption or relaxation in respect of Accounting Standards available to a SMC until the company remains a SMC for two consecutive accounting periods.

[F. No. 17/151/2013-CL-V (Pt.)]

23/6/21

K. V. R. MURTY, Jt. Secy.

ANNEXURE

(See rule 3)

ACCOUNTING STANDARDS

A. General Instructions

1. SMCs shall follow the following instructions while complying with Accounting Standards under these rules:-

1.1 the SMC which does not disclose certain information pursuant to the exemptions or relaxations given to it shall disclose (by way of a note to its financial statements) the fact that it is an SMC and has complied with the Accounting Standards insofar as they are applicable to an SMC on the following lines:

"The Company is a Small and Medium Sized Company (SMC) as defined in the Companies (Accounting Standards) Rules, 2021 notified under the Companies Act, 2013. Accordingly, the Company has complied with the Accounting Standards as applicable to a Small and Medium Sized Company."

1.2 Where a company, being a SMC, has qualified for any exemption or relaxation previously but no longer qualifies for the relevant exemption or relaxation in the current accounting period, the relevant standards or requirements become applicable from the current period and the figures for the corresponding period of the previous accounting period need not be revised merely by reason of its having ceased to be an SMC. The fact that the company was an SMC in the previous period and it had availed of the exemptions or relaxations available to SMCs shall be disclosed in the notes to the financial statements.

1.3 If an SMC opts not to avail of the exemptions or relaxations available to an SMC in respect of any but not all of the Accounting Standards, it shall disclose the standard(s) in respect of which it has availed the exemption or relaxation.

1.4 If an SMC desires to disclose the information not required to be disclosed pursuant to the exemptions or relaxations available to the SMCs, it shall disclose that information in compliance with the relevant accounting standard.

1.5 The SMC may opt for availing certain exemptions or relaxations from compliance with the requirements prescribed in an Accounting Standard: Provided that such a partial exemption or relaxation and disclosure shall not be permitted to mislead any person or public.

2. Accounting Standards, which are prescribed, are intended to be in conformity with the provisions of applicable laws. However, if due to subsequent amendments in the law, a particular accounting standard is found to be not in conformity with such law, the provisions

of the said law will prevail and the financial statements shall be prepared in conformity with such law.

3. Accounting Standards are intended to apply only to items which are material.

4. The accounting standards include paragraphs set in bold italic type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. An individual accounting standard shall be read in the context of the objective, if stated, in that accounting standard and in accordance with these General Instructions.

B. Accounting Standards

Accounting Standard (AS) 1

Disclosure of Accounting Policies

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of the General Instructions contained in part A of the Annexure to the Notification.)*

Introduction

1. This Standard deals with the disclosure of significant accounting policies followed in preparing and presenting financial statements.

2. The view presented in the financial statements of an enterprise of its state of affairs and of the profit or loss can be significantly affected by the accounting policies followed in the preparation and presentation of the financial statements. The accounting policies followed vary from enterprise to enterprise. Disclosure of significant accounting policies followed is necessary if the view presented is to be properly appreciated.

3. The disclosure of some of the accounting policies followed in the preparation and presentation of the financial statements is required by law in some cases.

4. Accounting Standards require the disclosure of certain accounting policies, e.g., translation policies in respect of foreign currency items.

5. In recent years, a few enterprises in India have adopted the practice of including in their annual reports to shareholders a separate statement of accounting policies followed in preparing and presenting the financial statements.

6. In general, however, accounting policies are not at present regularly and fully disclosed in all financial statements. Many enterprises include in the Notes on the Accounts, descriptions of some of the significant accounting policies. But the nature and degree of disclosure vary considerably between the corporate and the non-corporate sectors and between units in the same sector.

7. Even among the few enterprises that presently include in their annual reports a separate statement of accounting policies, considerable variation exists. The statement of accounting policies forms part of accounts in some cases while in others it is given as supplementary information.

8. The purpose of this Standard is to promote better understanding of financial statements by establishing through an accounting standard the disclosure of significant accounting policies and the manner in which accounting policies are disclosed in the financial statements. Such disclosure would also facilitate a more meaningful comparison between financial statements of different enterprises.

Explanation

Fundamental Accounting Assumptions

9. Certain fundamental accounting assumptions underlie the preparation and presentation of

financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.

10. The following have been generally accepted as fundamental accounting assumptions:—

a. Going Concern

The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.

b. Consistency

It is assumed that accounting policies are consistent from one period to another.

c. Accrual

Revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate. (The considerations affecting the process of matching costs with revenues under the accrual assumption are not dealt with in this Standard.)

Nature of Accounting Policies

11. The accounting policies refer to the specific accounting principles and the methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements.

12. There is no single list of accounting policies which are applicable to all circumstances. The differing circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles acceptable. The choice of the appropriate accounting principles and the methods of applying those principles in the specific circumstances of each enterprise calls for considerable judgement by the management of the enterprise.

13. The Accounting Standards combined with the efforts of government and other regulatory agencies and progressive managements have reduced in recent years the number of acceptable alternatives particularly in the case of corporate enterprises. While continuing efforts in this regard in future are likely to reduce the number still further, the availability of alternative accounting principles and methods of applying those principles is not likely to be eliminated altogether in view of the differing circumstances faced by the enterprises.

Areas in Which Differing Accounting Policies are Encountered

14. The following are examples of the areas in which different accounting policies may be adopted by different enterprises:

(a) Methods of depreciation, depletion and amortisation

(b) Treatment of expenditure during construction

(c) Conversion or translation of foreign currency items

(d) Valuation of inventories

(e) Treatment of goodwill

(f) Valuation of investments

(g) Treatment of retirement benefits

(h) Recognition of profit on long-term contracts

(i) Valuation of fixed assets

(j) Treatment of contingent liabilities.

15. The above list of examples is not intended to be exhaustive.

Considerations in the Selection of Accounting Policies

16. The primary consideration in the selection of accounting policies by an enterprise is that the financial statements prepared and presented on the basis of such accounting policies should represent a true and fair view of the state of affairs of the enterprise as at the balance sheet date and of the profit or loss for the period ended on that date.

17. For this purpose, the major considerations governing the selection and application of accounting policies are:—

a. Prudence

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

b. Substance over Form

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

c. Materiality

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

Disclosure of Accounting Policies

18. To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.

19. Such disclosure should form part of the financial statements.

20. It would be helpful to the reader of financial statements if they are all disclosed as such in one place instead of being scattered over several statements, schedules and notes.

21. Examples of matters in respect of which disclosure of accounting policies adopted will be required are contained in paragraph 14. This list of examples is not, however, intended to be exhaustive.

22. Any change in an accounting policy which has a material effect should be disclosed. The amount by which any item in the financial statements 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 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.

23. Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item in the accounts.

Main Principles

24. All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.

25. The disclosure of the significant accounting policies as such should form part of the financial statements and the significant accounting policies should normally be disclosed in one place.

26. Any change in the accounting 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 the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements 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.

27. If the fundamental accounting assumptions, viz. Going Concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

Accounting Standard (AS) 2

Valuation of Inventories

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the General Instructions contained in part A of the Annexure to the Notification.)*

Objective

A primary issue in accounting for inventories is the determination of the value at which inventories are carried in the financial statements until the related revenues are recognised. This Standard deals with the determination of such value, including the ascertainment of cost of inventories and any write-down thereof to net realisable value.

Scope

1. This Standard should be applied in accounting for inventories other than:

(a) work in progress arising under construction contracts, including directly related service contracts (see Accounting Standard (AS) 7, Construction Contracts);

(b) work in progress arising in the ordinary course of business of service providers;

(c) shares, debentures and other financial instruments held as stock-in-trade; and

(d) producers' inventories of livestock, agricultural and forest products, and mineral oils, ores and gases to the extent that they are measured at net realisable value in accordance with well established practices in those industries.

2. The inventories referred to in paragraph 1(d) are measured at net realisable value at certain stages of production. This occurs, for example, when agricultural crops have been harvested or mineral oils, ores and gases have been extracted and sale is assured under a forward contract or a government guarantee, or when a homogenous market exists and there is a negligible risk of failure to sell. These inventories are excluded from the scope of this Standard.

Definitions

3. The following terms are used in this Standard with the meanings specified:

3.1. <u>Inventories</u> 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.

3.2. <u>Net realisable value</u> is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

4 Inventories encompass goods purchased and held for resale, for example, merchandise purchased by a retailer and held for resale, computer software held for resale, or land and other property held for resale. Inventories also encompass finished goods produced, or work in progress being produced, by the enterprise and include materials, maintenance supplies, consumables and loose tools awaiting use in the production process. Inventories do not include spare parts, servicing equipment and standby equipment which meet the definition of property, plant and equipment as per AS 10, *Property, Plant and Equipment*. Such items are accounted for in accordance with Accounting Standard (AS) 10, *Property, Plant and Equipment*.

Measurement of Inventories

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

Cost of Inventories

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

Costs of Purchase

7. The costs of purchase consist of the purchase price including duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates, duty drawbacks and other similar items are deducted in determining the costs of purchase.

Costs of Conversion

8. The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

9. The allocation of fixed production overheads for the purpose of their inclusion in the costs of conversion is based on the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on an average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. The amount of fixed production overheads allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognised as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed production overheads allocated to each unit of production is decreased so that inventories are not measured above cost. Variable production overheads are assigned to each unit of production on the basis of the actual use of the production facilities.

10. A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product. When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production. Most by-products as well as scrap or waste materials, by their nature, are immaterial. When this is the case, they are often measured at net realisable value and this value is deducted from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost.

Other Costs

11. Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. For example, it may be appropriate to include overheads other than production overheads or the costs of designing products for specific customers in the cost of inventories.

12. Interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and are, therefore, usually not included in the cost of inventories.

Exclusions from the Cost of Inventories

13. In determining the cost of inventories in accordance with paragraph 6, it is appropriate to exclude certain costs and recognise them as expenses in the period in which they are incurred. Examples of such costs are:

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

(b) storage costs, unless those costs are necessary in the production process prior to a further production stage;

(c) administrative overheads that do not contribute to bringing the inventories to their present location and condition; and

(d) selling and distribution costs.

Cost Formulas

14. The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects should be assigned by specific identification of their individual costs.

15. Specific identification of cost means that specific costs are attributed to identified items of inventory. This is an appropriate treatment for items that are segregated for a specific project, regardless of whether they have been purchased or produced. However, when there are large numbers of items of inventory which are ordinarily interchangeable, specific identification of costs is inappropriate since, in such circumstances, an enterprise could obtain predetermined effects on the net profit or loss for the period by selecting a particular method of ascertaining the items that remain in inventories.

16. The cost of inventories, other than those dealt with in paragraph 14, should be assigned by using the first-in, first-out (FIFO), or weighted average cost formula. The formula used

should reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition.

17. A variety of cost formulas is used to determine the cost of inventories other than those for which specific identification of individual costs is appropriate. The formula used in determining the cost of an item of inventory needs to be selected with a view to providing the fairest possible approximation to the cost incurred in bringing the item to its present location and condition. The FIFO formula assumes that the items of inventory which were purchased or produced first are consumed or sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced. Under the weighted average cost formula, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the enterprise.

Techniques for the Measurement of Cost

18. Techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method, may be used for convenience if the results approximate the actual cost. Standard costs take into account normal levels of consumption of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of current conditions.

19. The retail method is often used in the retail trade for measuring inventories of large numbers of rapidly changing items that have similar margins and for which it is impracticable to use other costing methods. The cost of the inventory is determined by reducing from the sales value of the inventory the appropriate percentage gross margin. The percentage used takes into consideration inventory which has been marked down to below its original selling price. An average percentage for each retail department is often used.

Net Realisable Value

20. The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined. The cost of inventories may also not be recoverable if the estimated costs of completion or the estimated costs necessary to make the sale have increased. The practice of writing down inventories below cost to net realisable value is consistent with the view that assets should not be carried in excess of amounts expected to be realised from their sale or use.

21. Inventories are usually written down to net realisable value on an item-by-item basis. In some circumstances, however, it may be appropriate to group similar or related items. This may be the case with items of inventory relating to the same product line that have similar purposes or end uses and are produced and marketed in the same geographical area and cannot be practicably evaluated separately from other items in that product line. It is not appropriate to write down inventories based on a classification of inventory, for example, finished goods, or all the inventories in a particular business segment.

22. Estimates of net realisable value are based on the most reliable evidence available at the time the estimates are made as to the amount the inventories are expected to realise. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the balance sheet date to the extent that such events confirm the conditions existing at the balance sheet date.

23. Estimates of net realisable value also take into consideration the purpose for which the

inventory is held. For example, the net realisable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price. If the sales contracts are for less than the inventory quantities held, the net realisable value of the excess inventory is based on general selling prices. Contingent losses on firm sales contracts in excess of inventory quantities held and contingent losses on firm purchase contracts are dealt with in accordance with the principles enunciated in Accounting Standard (AS) 4, *Contingencies and Events Occurring After the Balance Sheet Date*[1].

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

25. An assessment is made of net realisable value as at each balance sheet date.

Disclosure

26. The financial statements should disclose:

(a) the accounting policies adopted in measuring inventories, including the cost formula used; and

(b) the total carrying amount of inventories and its classification appropriate to the enterprise.

27. Information about the carrying amounts held in different classifications of inventories and the extent of the changes in these assets is useful to financial statement users. Common classifications of inventories are:

(a) Raw materials and components

(b) Work-in-progress

(c) Finished goods

(d) Stock-in-trade (in respect of goods acquired for trading)

(e) Stores and spares

(f) Loose tools

(g) Others (specify nature)

[1] All paragraphs of AS 4 deal with contingencies are applicable only to the extent not covered by other Accounting Standards prescribed by the Central Government. For example, the impairment of financial assets such as impairment of receivables (commonly known as provision for bad and doubtful debts) is governed by AS 4.

Accounting Standard (AS) 3

Cash Flow Statements

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the General Instructions contained in part A of the Annexure to the Notification.)*

As per the definition of 'financial statements' under the Companies Act, 2013, financial statements include cash flow statement. In case of one person company, small company and dormant company, financial statements may not include cash flow statements.

Objective

Information about the cash flows of an enterprise is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilise those cash flows. The economic decisions that are taken by users require an evaluation of the ability of an enterprise to generate cash and cash equivalents and the timing and certainty of their generation.

The Standard deals with the provision of information about the historical changes in cash and cash equivalents of an enterprise by means of a cash flow statement which classifies cash flows during the period from operating, investing and financing activities.

Scope

1. An enterprise should prepare a cash flow statement and should present it for each period for which financial statements are presented.

2. Users of an enterprise's financial statements are interested in how the enterprise generates and uses cash and cash equivalents. This is the case regardless of the nature of the enterprise's activities and irrespective of whether cash can be viewed as the product of the enterprise, as may be the case with a financial enterprise. Enterprises need cash for essentially the same reasons, however different their principal revenue-producing activities might be. They need cash to conduct their operations, to pay their obligations, and to provide returns to their investors.

Benefits of Cash Flow Information

3. A cash flow statement, when used in conjunction with the other financial statements, provides information that enables users to evaluate the changes in net assets of an enterprise, its financial structure (including its liquidity and solvency) and its ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities. Cash flow information is useful in assessing the ability of the enterprise to generate cash and cash equivalents and enables users to develop models to assess and compare the present value of the future cash flows of different enterprises. It also enhances the comparability of the reporting of operating performance by different enterprises because it eliminates the effects of using different accounting treatments for the same transactions and events.

4. Historical cash flow information is often used as an indicator of the amount, timing and certainty of future cash flows. It is also useful in checking the accuracy of past assessments of future cash flows and in examining the relationship between profitability and net cash flow and the impact of changing prices.

Definitions

5. The following terms are used in this Standard with the meanings specified:

5.1. Cash comprises cash on hand and demand deposits with banks.

5.2. Cash equivalents are short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

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

5.4. Operating activities are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.

5.5 Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

5.6 Financing activities are activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowings of the enterprise.

Cash and Cash Equivalents

6. Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. For an investment to qualify as a cash equivalent, it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Investments in shares are excluded from cash equivalents unless they are, in substance, cash equivalents; for example, preference shares of a company acquired shortly before their specified redemption date (provided there is only an insignificant risk of failure of the company to repay the amount at maturity).

7. Cash flows exclude movements between items that constitute cash or cash equivalents because these components are part of the cash management of an enterprise rather than part of its operating, investing and financing activities. Cash management includes the investment of excess cash in cash equivalents.

Presentation of a Cash Flow Statement

8. The cash flow statement should report cash flows during the period classified by operating, investing and financing activities.

9. An enterprise presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business. Classification by activity provides information that allows users to assess the impact of those activities on the financial position of the enterprise and the amount of its cash and cash equivalents. This

information may also be used to evaluate the relationships among those activities.

10. A single transaction may include cash flows that are classified differently. For example, when the instalment paid in respect of a fixed asset acquired on deferred payment basis includes both interest and loan, the interest element is classified under financing activities and the loan element is classified under investing activities.

Operating Activities

11. The amount of cash flows arising from operating activities is a key indicator of the extent to which the operations of the enterprise have generated sufficient cash flows to maintain the operating capability of the enterprise, pay dividends, repay loans and make new investments without recourse to external sources of financing. Information about the specific components of historical operating cash flows is useful, in conjunction with other information, in forecasting future operating cash flows.

12. Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the enterprise. Therefore, they generally result from the transactions and other events that enter into the determination of net profit or loss. Examples of cash flows from operating activities are:

(a) cash receipts from the sale of goods and the rendering of services;

(b) cash receipts from royalties, fees, commissions and other revenue;

(c) cash payments to suppliers for goods and services;

(d) cash payments to and on behalf of employees;

(e) cash receipts and cash payments of an insurance enterprise for premiums and claims, annuities and other policy benefits;

(f) cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities; and

(g) cash receipts and payments relating to futures contracts, forward contracts, option contracts and swap contracts when the contracts are held for dealing or trading purposes.

13. Some transactions, such as the sale of an item of plant, may give rise to a gain or loss which is included in the determination of net profit or loss. However, the cash flows relating to such transactions are cash flows from investing activities.

14. An enterprise may hold securities and loans for dealing or trading purposes, in which case they are similar to inventory acquired specifically for resale. Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities. Similarly, cash advances and loans made by financial enterprises are usually classified as operating activities since they relate to the main revenue-producing activity of that enterprise.

Investing Activities

15. The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for

resources intended to generate future income and cash flows. Examples of cash flows arising from investing activities are:

(a) cash payments to acquire fixed assets (including intangibles).These payments include those relating to capitalized research and development costs and self-constructed fixed assets;

(b) cash receipts from disposal of fixed assets (including intangibles) ;

(c) cash payments to acquire shares, warrants or debt instruments of other enterprises and interests in joint ventures (other than payments for those instruments considered to be cash equivalents and those held for dealing or trading purposes);

(d) cash receipts from disposal of shares, warrants or debt instruments of other enterprises and interests in joint ventures (other than receipts from those instruments considered to be cash equivalents and those held for dealing or trading purposes);

(e) cash advances and loans made to third parties (other than advances and loans made by a financial enterprise);

(f) cash receipts from the repayment of advances and loans made to third parties (other than advances and loans of a financial enterprise);

(g) cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and

(h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

16. When a contract is accounted for as a hedge of an identifiable position, the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged.

Financing Activities

17. The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of funds (both capital and borrowings) to the enterprise. Examples of cash flows arising from financing activities are:

(a) cash proceeds from issuing shares or other similar instruments;

(b) cash proceeds from issuing debentures, loans, notes, bonds, and other short or long-term borrowings; and

(c) cash repayments of amounts borrowed.

Reporting Cash Flows from Operating Activities

18. An enterprise should report cash flows from operating activities using either:

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

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

19. The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method and is, therefore, considered more appropriate than the indirect method. Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either:

(a) from the accounting records of the enterprise; or

(b) by adjusting sales, cost of sales (interest and similar income and interest expense and similar charges for a financial enterprise) and other items in the statement of profit and loss for:

i) changes during the period in inventories and operating receivables and payables;

ii) other non-cash items; and

iii) other items for which the cash effects are investing or financing cash flows.

20. Under the indirect method, the net cash flow from operating activities is determined by adjusting net profit or loss for the effects of:

(a) changes during the period in inventories and operating receivables and payables;

(b) non-cash items such as depreciation, provisions, deferred taxes, and unrealised foreign exchange gains and losses; and

(c) all other items for which the cash effects are investing or financing cash flows.

Alternatively, the net cash flow from operating activities may be presented under the indirect method by showing the operating revenues and expenses excluding non-cash items disclosed in the statement of profit and loss and the changes during the period in inventories and operating receivables and payables.

Reporting Cash Flows from Investing and Financing Activities

21. An enterprise should report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows described in paragraphs 22 and 24 are reported on a net basis.

Reporting Cash Flows on a Net Basis

22. Cash flows arising from the following operating, investing or financing activities may be reported on a net basis:

(a) cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the enterprise; and

(b) cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.

23. Examples of cash receipts and payments referred to in paragraph 22(a) are:

(a) the acceptance and repayment of demand deposits by a bank;

(b) funds held for customers by an investment enterprise; and

(c) rents collected on behalf of, and paid over to, the owners of properties.

Examples of cash receipts and payments referred to in paragraph 22(b) are advances made for, and the repayments of:

(a) principal amounts relating to credit card customers;

(b) the purchase and sale of investments; and

(c) other short-term borrowings, for example, those which have a maturity period of three months or less.

24. Cash flows arising from each of the following activities of a financial enterprise may be reported on a net basis:

(a) cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;

(b) the placement of deposits with and withdrawal of deposits from other financial enterprises; and

(c) cash advances and loans made to customers and the repayment of those advances and loans.

Foreign Currency Cash Flows

25. Cash flows arising from transactions in a foreign currency should be recorded in an enterprise's reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the cash flow. A rate that approximates the actual rate may be used if the result is substantially the same as would arise if the rates at the dates of the cash flows were used. The effect of changes in exchange rates on cash and cash equivalents held in a foreign currency should be reported as a separate part of the reconciliation of the changes in cash and cash equivalents during the period.

26. Cash flows denominated in foreign currency are reported in a manner consistent with Accounting Standard (AS) 11, *The Effects of Changes in Foreign Exchange Rates*. This permits the use of an exchange rate that approximates the actual rate. For example, a weighted average exchange rate for a period may be used for recording foreign currency transactions.

27. Unrealised gains and losses arising from changes in foreign exchange rates are not cash flows. However, the effect of exchange rate changes on cash and cash equivalents

held or due in a foreign currency is reported in the cash flow statement in order to reconcile cash and cash equivalents at the beginning and the end of the period. This amount is presented separately from cash flows from operating, investing and financing activities and includes the differences, if any, had those cash flows been reported at the end-of-period exchange rates.

Extraordinary Items

28. The cash flows associated with extraordinary items should be classified as arising from operating, investing or financing activities as appropriate and separately disclosed.

29. The cash flows associated with extraordinary items are disclosed separately as arising from operating, investing or financing activities in the cash flow statement, to enable users to understand their nature and effect on the present and future cash flows of the enterprise. These disclosures are in addition to the separate disclosures of the nature and amount of extraordinary items required by Accounting Standard (AS) 5, *Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.*

Interest and Dividends

30. Cash flows from interest and dividends received and paid should each be disclosed separately. Cash flows arising from interest paid and interest and dividends received in the case of a financial enterprise should be classified as cash flows arising from operating activities. In the case of other enterprises, cash flows arising from interest paid should be classified as cash flows from financing activities while interest and dividends received should be classified as cash flows from investing activities. Dividends paid should be classified as cash flows from financing activities.

31. The total amount of interest paid during the period is disclosed in the cash flow statement whether it has been recognised as an expense in the statement of profit and loss or capitalised in accordance with Accounting Standard (AS) 16, *Borrowing Costs*.

32. Interest paid and interest and dividends received are usually classified as operating cash flows for a financial enterprise. However, there is no consensus on the classification of these cash flows for other enterprises. Some argue that interest paid and interest and dividends received may be classified as operating cash flows because they enter into the determination of net profit or loss. However, it is more appropriate that interest paid and interest and dividends received are classified as financing cash flows and investing cash flows respectively, because they are cost of obtaining financial resources or returns on investments.

33. Some argue that dividends paid may be classified as a component of cash flows from operating activities in order to assist users to determine the ability of an enterprise to pay dividends out of operating cash flows. However, it is considered more appropriate that dividends paid should be classified as cash flows from financing activities because they are cost of obtaining financial resources.

Taxes on Income

34. Cash flows arising from taxes on income should be separately disclosed and should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.

35. Taxes on income arise on transactions that give rise to cash flows that are classified

as operating, investing or financing activities in a cash flow statement. While tax expense may be readily identifiable with investing or financing activities, the related tax cash flows are often impracticable to identify and may arise in a different period from the cash flows of the underlying transactions. Therefore, taxes paid are usually classified as cash flows from operating activities. However, when it is practicable to identify the tax cash flow with an individual transaction that gives rise to cash flows that are classified as investing or financing activities, the tax cash flow is classified as an investing or financing activity as appropriate. When tax cash flow are allocated over more than one class of activity, the total amount of taxes paid is disclosed.

Investments in Subsidiaries, Associates and Joint Ventures

36. When accounting for an investment in an associate or a subsidiary or a joint venture, an investor restricts its reporting in the cash flow statement to the cash flows between itself and the investee/joint venture, for example, cash flows relating to dividends and advances.

Acquisitions and Disposals of Subsidiaries and Other Business Units

37. The aggregate cash flows arising from acquisitions and from disposals of subsidiaries or other business units should be presented separately and classified as investing activities.

38. An enterprise should disclose, in aggregate, in respect of both acquisition and disposal of subsidiaries or other business units during the period each of the following:

(a) the total purchase or disposal consideration; and

(b) the portion of the purchase or disposal consideration discharged by means of cash and cash equivalents.

39. The separate presentation of the cash flow effects of acquisitions and disposals of subsidiaries and other business units as single line items helps to distinguish those cash flows from other cash flows. The cash flow effects of disposals are not deducted from those of acquisitions.

Non-cash Transactions

40. Investing and financing transactions that do not require the use of cash or cash equivalents should be excluded from a cash flow statement. Such transactions should be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

41. Many investing and financing activities do not have a direct impact on current cash flows although they do affect the capital and asset structure of an enterprise. The exclusion of non-cash transactions from the cash flow statement is consistent with the objective of a cash flow statement as these items do not involve cash flows in the current period. Examples of non-cash transactions are:

(a) the acquisition of assets by assuming directly related liabilities;

(b) the acquisition of an enterprise by means of issue of shares; and

(c) the conversion of debt to equity.

Components of Cash and Cash Equivalents

42. An enterprise should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the balance sheet.

43. In view of the variety of cash management practices, an enterprise discloses the policy which it adopts in determining the composition of cash and cash equivalents.

44. The effect of any change in the policy for determining components of cash and cash equivalents is reported in accordance with Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

Other Disclosures

45. An enterprise should disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the enterprise that are not available for use by it.

46. There are various circumstances in which cash and cash equivalent balances held by an enterprise are not available for use by it. Examples include cash and cash equivalent balances held by a branch of the enterprise that operates in a country where exchange controls or other legal restrictions apply as a result of which the balances are not available for use by the enterprise.

47. Additional information may be relevant to users in understanding the financial position and liquidity of an enterprise. Disclosure of this information, together with a commentary by management, is encouraged and may include:

(a) the amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities; and

(b) the aggregate amount of cash flows that represent increases in operating capacity separately from those cash flows that are required to maintain operating capacity.

48. The separate disclosure of cash flows that represent increases in operating capacity and cash flows that are required to maintain operating capacity is useful in enabling the user to determine whether the enterprise is investing adequately in the maintenance of its operating capacity. An enterprise that does not invest adequately in the maintenance of its operating capacity may be prejudicing future profitability for the sake of current liquidity and distributions to owners.

Illustration I

Cash Flow Statement for an Enterprise other than a Financial Enterprise

This illustration does not form part of the accounting standard. Its purpose is to illustrate the application of the accounting standard.

1. The illustration shows only current period amounts.

2. Information from the statement of profit and loss and balance sheet is provided to show how the statements of cash flows under the direct method and the indirect method have been derived. Neither the statement of profit and loss nor the balance sheet is presented in conformity with the disclosure and presentation requirements of applicable laws and accounting standards. The working notes given towards the end of this illustration are intended to assist in understanding the manner in which the various figures appearing in the cash flow statement have been derived. These working notes do not form part of the cash flow statement and, accordingly, need not be published.

3. The following additional information is also relevant for the preparation of the statement of cash flows (figures are in Rs.'000).

(a) An amount of 250 was raised from the issue of share capital and a further 250 was raised from long term borrowings.

(b) Interest expense was 400 of which 170 was paid during the period. 100 relating to interest expense of the prior period was also paid during the period.

(c) Dividends paid were 1,200.

(d) Tax deducted at source on dividends received (included in the tax expense of 300 for the year) amounted to 40.

(e) During the period, the enterprise acquired fixed assets for 350. The payment was made in cash.

(f) Plant with original cost of 80 and accumulated depreciation of 60 was sold for 20.

(g) Foreign exchange loss of 40 represents the reduction in the carrying amount of a short-term investment in foreign-currency designated bonds arising out of a change in exchange rate between the date of acquisition of the investment and the balance sheet date.

(h) Sundry debtors and sundry creditors include amounts relating to credit sales and credit purchases only.

Balance Sheet as at 31.12.1996

(Rs. '000)

		1996		*1995*
Assets				
Cash on hand and balances with banks		200		25
Short-term investments		670		135
Sundry debtors		1,700		1,200
Interest receivable		100		–
Inventories		900		1,950
Long-term investments		2,500		2,500
Fixed assets at cost	2,180		1,910	
Accumulated depreciation	(1,450)		(1,060)	
Fixed assets (net)		730		850
Total assets		6,800		6,660
Liabilities				
Sundry creditors		150		1,890
Interest payable		230		100
Income taxes payable		400		1,000
Long-term debt		1,110		1,040
Total liabilities		1,890		4,030
Shareholders' Funds				
Share capital		1,500		1,250
Reserves		3,410		1,380
Total shareholders' funds		4,910		2,630
Total liabilities and shareholders' funds		6,800		6,660

Statement of Profit and Loss for the period ended 31.12.1996

	(Rs. '000)
Sales	30,650
Cost of sales	(26,000)
Gross profit	4,650
Depreciation	(450)
Administrative and selling expenses	(910)
Interest expense	(400)
Interest income	300
Dividend income	200
Foreign exchange loss	(40)
Net profit before taxation and extraordinary item	3,350
Extraordinary item – Insurance proceeds from earthquake disaster settlement	180
Net profit after extraordinary item	3,530
Income-tax	(300)
Net profit	3,230

Direct Method Cash Flow Statement [Paragraph 18(a)]

		(Rs. '000) 1996
Cash flows from operating activities		
Cash receipts from customers	30,150	
Cash paid to suppliers and employees	(27,600)	
Cash generated from operations	2,550	
Income taxes paid	(860)	
Cash flow before extraordinary item	1,690	
Proceeds from earthquake disaster settlement	180	
Net cash from operating activities		1,870
Cash flows from investing activities		
Purchase of fixed assets	(350)	
Proceeds from sale of equipment	20	
Interest received	200	
Dividends received	160	
Net cash from investing activities		30
Cash flows from financing activities		
Proceeds from issuance of share capital	250	
Proceeds from long-term borrowings	250	
Repayment of long-term borrowings	(180)	
Interest paid	(270)	
Dividends paid	(1,200)	
Net cash used in financing activities		(1,150)
Net increase in cash and cash equivalents		750
Cash and cash equivalents at beginning of period (see Note 1)		160
Cash and cash equivalents at end of period (see Note 1)		910

Indirect Method Cash Flow Statement [Paragraph 18(b)]

		(Rs. '000) 1996
Cash flows from operating activities		
Net profit before taxation, and extraordinary item	3,350	
Adjustments for:		
Depreciation	450	
Foreign exchange loss	40	
Interest income	(300)	
Dividend income	(200)	
Interest expense	400	
Operating profit before working capital changes	3,740	

Increase in sundry debtors	(500)	
Decrease in inventories	1,050	
Decrease in sundry creditors	(1,740)	
Cash generated from operations	2,550	
Income taxes paid	(860)	
Cash flow before extraordinary item	1,690	
Proceeds from earthquake disaster settlement	180	
Net cash from operating activities		1,870
Cash flows from investing activities		
Purchase of fixed assets	(350)	
Proceeds from sale of equipment	20	
Interest received	200	
Dividends received	160	
Net cash from investing activities		30
Cash flows from financing activities		
Proceeds from issuance of share capital	250	
Proceeds from long-term borrowings	250	
Repayment of long-term borrowings	(180)	
Interest paid	(270)	
Dividends paid	(1,200)	
Net cash used in financing activities		(1,150)
Net increase in cash and cash equivalents		750
Cash and cash equivalents at beginning of period (see Note 1)		160
Cash and cash equivalents at end of period (see Note 1)		910

Notes to the cash flow statement
(direct method and indirect method)

1. *Cash and Cash Equivalents*

Cash and cash equivalents consist of cash on hand and balances with banks, and investments in money-market instruments. Cash and cash equivalents included in the cash flow statement comprise the following balance sheet amounts.

	1996	**1995**
Cash on hand and balances with banks	200	25
Short-term investments	670	135
Cash and cash equivalents	870	160
Effect of exchange rate changes	40	–
Cash and cash equivalents as restated	910	160

Cash and cash equivalents at the end of the period include deposits with banks of 100 held by a branch which are not freely remissible to the company because of currency exchange restrictions.

The company has undrawn borrowing facilities of 2,000 of which 700 may be used only for future expansion.

2. Total tax paid during the year (including tax deducted at source on dividends received) amounted to 900.

Alternative Presentation (indirect method)

As an alternative, in an indirect method cash flow statement, operating profit before working capital changes is sometimes presented as follows:

Revenues excluding investment income	30,650	
Operating expense excluding depreciation	(26,910)	
Operating profit before working capital changes		3,740

Working Notes

The working notes given below do not form part of the cash flow statement and, accordingly, need not be published. The purpose of these working notes is merely to assist in understanding the manner in which various figures in the cash flow statement have been derived. (Figures are in Rs. '000.)

1. Cash receipts from customers

Sales		30,650
Add: Sundry debtors at the beginning of the year		1,200
		31,850
Less : Sundry debtors at the end of the year		1,700
		30,150

2. Cash paid to suppliers and employees

Cost of sales		26,000
Administrative and selling expenses		910
		26,910
Add: Sundry creditors at the beginning of the year	1,890	
Inventories at the end of the year	900	2,790
		29,700
Less:Sundry creditors at the end of the year	150	
Inventories at the beginning of the year	1,950	2,100
		27,600

3. Income taxes paid (including tax deducted at source from dividends received)

Income tax expense for the year (including tax deducted at source from dividends received)	300
Add : Income tax liability at the beginning of the year	1,000
	1,300
Less: Income tax liability at the end of the year	400
	900

Out of 900, tax deducted at source on dividends received (amounting to 40) is included in cash flows from investing activities and the balance of 860 is included in cash flows from operating activities (see paragraph 34).

4. Repayment of long-term borrowings

Long-term debt at the beginning of the year	1,040

Add : Long-term borrowings made during the year	250
	1,290
Less : Long-term borrowings at the end of the year	1,110
	180

5. Interest paid

Interest expense for the year	400
Add: Interest payable at the beginning of the year	100
	500
Less: Interest payable at the end of the year	230
	270

Illustration II

Cash Flow Statement for a Financial Enterprise

This illustration does not form part of the accounting standard. Its purpose is to illustrate the application of the accounting standard.

1. The illustration shows only current period amounts.
2. The illustration is presented using the direct method.

Cash flows from operating activities	**(Rs. '000)** **1996**
Interest and commission receipts	28,447
Interest payments	(23,463)
Recoveries on loans previously written off	237
Cash payments to employees and suppliers	(997)
Operating profit before changes in operating assets	4,224
(Increase) decrease in operating assets:	
Short-term funds	(650)
Deposits held for regulatory or monetary control purposes	234
Funds advanced to customers	(288)
Net increase in credit card receivables	(360)
Other short-term securities	(120)
Increase (decrease) in operating liabilities:	
Deposits from customers	600
Certificates of deposit	(200)
Net cash from operating activities before income tax	3,440
Income taxes paid	(100)
Net cash from operating activities	3,340
Cash flows from investing activities	
Dividends received	250
Interest received	300
Proceeds from sales of permanent investments	1,200
Purchase of permanent investments	(600)
Purchase of fixed assets	(500)
Net cash from investing activities	650
Cash flows from financing activities	
Issue of shares	1,800
Repayment of long-term borrowings	(200)
Net decrease in other borrowings	(1,000)
Dividends paid	(400)
Net cash from financing activities	200
Net increase in cash and cash equivalents	4,190
Cash and cash equivalents at beginning of period	4,650
Cash and cash equivalents at end of period	8,840

Accounting Standard (AS) 4*

Contingencies and Events Occurring After the Balance Sheet Date

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of the General Instructions contained in part A of the Annexure to the Notification.)*

Introduction

1. This Standard deals with the treatment in financial statements of

   (a) contingencies, and

   (b) events occurring after the balance sheet date.

2. The following subjects, which may result in contingencies, are excluded from the scope of this Standard in view of special considerations applicable to them:

   (a) liabilities of life assurance and general insurance enterprises arising from policies issued;

   (b) obligations under retirement benefit plans; and

   (c) commitments arising from long-term lease contracts.

Definitions

3. The following terms are used in this Standard with the meanings specified:

3.1 A <u>contingency</u> is a condition or situation, the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence, or non-occurrence, of one or more uncertain future events.

3.2 <u>Events occurring after the balance sheet date</u> 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.

* All paragraphs of this Standard that deal with contingencies are applicable only to the extent not covered by other Accounting Standards prescribed by the Central Government. For example, the impairment of financial assets such as impairment of receivables (commonly known as provision for bad and doubtful debts) is governed by this Standard.

Explanation

4. Contingencies

4.1 The term "contingencies" used in this Standard is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur.

4.2 Estimates are required for determining the amounts to be stated in the financial statements for many on-going and recurring activities of an enterprise. One must, however, distinguish between an event which is certain and one which is uncertain. The fact that an estimate is involved does not, of itself, create the type of uncertainty which characterises a contingency. For example, the fact that estimates of useful life are used to determine depreciation, does not make depreciation a contingency; the eventual expiry of the useful life of the asset is not uncertain. Also, amounts owed for services received are not contingencies as defined in paragraph 3.1, even though the amounts may have been estimated, as there is nothing uncertain about the fact that these obligations have been incurred.

4.3 The uncertainty relating to future events can be expressed by a range of outcomes. This range may be presented as quantified probabilities, but in most circumstances, this suggests a level of precision that is not supported by the available information. The possible outcomes can, therefore, usually be generally described except where reasonable quantification is practicable.

4.4 The estimates of the outcome and of the financial effect of contingencies are determined by the judgement of the management of the enterprise. This judgement is based on consideration of information available up to the date on which the financial statements are approved and will include a review of events occurring after the balance sheet date, supplemented by experience of similar transactions and, in some cases, reports from independent experts.

5. Accounting Treatment of Contingent Losses

5.1 The accounting treatment of a contingent loss is determined by the expected outcome of the contingency. If it is likely that a contingency will result in a loss to the enterprise, then it is prudent to provide for that loss in the financial statements.

5.2 The estimation of the amount of a contingent loss to be provided for in the financial statements may be based on information referred to in paragraph 4.4.

5.3 If there is conflicting or insufficient evidence for estimating the amount of a contingent loss, then disclosure is made of the existence and nature of the contingency.

5.4 A potential loss to an enterprise may be reduced or avoided because a contingent liability is matched by a related counter-claim or claim against a third party. In such cases, the amount of the provision is determined after taking into account the probable recovery under the claim if no significant uncertainty as to its measurability or collectability exists. Suitable disclosure regarding the nature and gross amount of the contingent liability is also made.

5.5 The existence and amount of guarantees, obligations arising from discounted bills of exchange and similar obligations undertaken by an enterprise are generally disclosed in financial statements by way of note, even though the possibility that a loss to the enterprise will occur, is remote.

5.6 Provisions for contingencies are not made in respect of general or unspecified business risks since they do not relate to conditions or situations existing at the balance sheet date.

6. Accounting Treatment of Contingent Gains

Contingent gains are not recognised in financial statements since their recognition may result in the recognition of revenue which may never be realised. However, when the realisation of a gain is virtually certain, then such gain is not a contingency and accounting for the gain is appropriate.

7. Determination of the Amounts at which Contingencies are included in Financial Statements

7.1 The amount at which a contingency is stated in the financial statements is based on the information which is available at the date on which the financial statements are approved. Events occurring after the balance sheet date that indicate that an asset may have been impaired, or that a liability may have existed, at the balance sheet date are, therefore, taken into account in identifying contingencies and in determining the amounts at which such contingencies are included in financial statements.

7.2 In some cases, each contingency can be separately identified, and the special circumstances of each situation considered in the determination of the amount of the contingency. A substantial legal claim against the enterprise may represent such a contingency. Among the factors taken into account by management in evaluating such a contingency are the progress of the claim at the date on which the financial statements are approved, the opinions, wherever necessary, of legal experts or other advisers, the experience of the enterprise in similar cases and the experience of other enterprises in similar situations.

7.3 If the uncertainties which created a contingency in respect of an individual transaction are common to a large number of similar transactions, then the amount of the contingency need not be individually determined, but may be based on the group of similar transactions. An example of such contingencies may be the estimated uncollectable portion of accounts receivable. Another example of such contingencies may be the warranties for products sold. These costs are usually incurred frequently and experience provides a means by which the amount of the liability or loss can be estimated with reasonable precision although the particular transactions that may result in a liability or a loss are not identified. Provision for these costs results in their recognition in the same accounting period in which the related transactions took place.

8. Events Occurring after the Balance Sheet Date

8.1 Events which occur between the balance sheet date and the date on which the financial statements are approved, may indicate the need for adjustments to assets and liabilities as at the balance sheet date or may require disclosure.

8.2 Adjustments to assets and liabilities are required 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.

8.3 Adjustments to assets and liabilities are not appropriate 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. Ordinary fluctuations in market values do not normally relate to the condition of the investments at the balance sheet date, but reflect circumstances which have occurred in the following period.

8.4 Events occurring after the balance sheet date which do not affect the figures stated in the financial statements would not normally require disclosure in the financial statements although they may be of such significance that they may require a disclosure in the report of the approving authority to enable users of financial statements to make proper evaluations and decisions.

8.5 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. For example, if dividends are declared after the balance sheet date but before the financial statements are approved for issue, the dividends are not recognised as a liability at the balance sheet date because no obligation exists at that time unless a statute requires otherwise. Such dividends are disclosed in the notes.

8.6 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.

9. Disclosure

9.1 The disclosure requirements herein referred to apply only in respect of those contingencies or events which affect the financial position to a material extent.

9.2 If a contingent loss is not provided for, its nature and an estimate of its financial effect are generally disclosed by way of note unless the possibility of a loss is remote (other than the circumstances mentioned in paragraph 5.5). If a reliable estimate of the financial effect cannot be made, this fact is disclosed.

9.3 When the events occurring after the balance sheet date are disclosed in the report of the approving authority, the information given comprises the nature of the events and an estimate of their financial effects or a statement that such an estimate cannot be made.

Main Principles

Contingencies

10. The amount of a contingent loss should be provided for by a charge in the statement of profit and 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.

11. The existence of a contingent loss should be disclosed in the financial statements if either of the conditions in paragraph 10 is not met, unless the possibility of a loss is remote.

12. Contingent gains should not be recognised in the financial statements.

Events Occurring after the Balance Sheet Date

13. Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the

balance sheet date or that indicate that the fundamental accounting assumption of going concern (i.e., the continuance of existence or substratum of the enterprise) is not appropriate.

14. If an enterprise declares dividends to shareholders after the balance sheet date, the enterprise should not recognise those dividends as a liability at the balance sheet date unless a statute requires otherwise. Such dividends should be disclosed in notes.

15. Disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise.

Disclosure

16. If disclosure of contingencies is required by paragraph 11 of this Standard, the following information should be provided:

(a) the nature of the contingency;

(b) the uncertainties which may affect the future outcome;

(c) an estimate of the financial effect, or a statement that such an estimate cannot be made.

17. If disclosure of events occurring after the balance sheet date in the report of the approving authority is required by paragraph 15 of this Standard, the following information should be provided:

(a) the nature of the event;

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

Accounting Standard (AS) 5

Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the General Instructions contained in part A of the Annexure to the Notification.)*

Objective

The objective of this Standard is to prescribe the classification and disclosure of certain items in the statement of profit and loss so that all enterprises prepare and present such a statement on a uniform basis. This enhances the comparability of the financial statements of an enterprise over time and with the financial statements of other enterprises. Accordingly, this Standard requires the classification and disclosure of extraordinary and prior period items, and the disclosure of certain items within profit or loss from ordinary activities. It also specifies the accounting treatment for changes in accounting estimates and the disclosures to be made in the financial statements regarding changes in accounting policies.

Scope

1. This Standard should be applied by an enterprise in presenting profit or loss from ordinary activities, extraordinary items and prior period items in the statement of profit and loss, in accounting for changes in accounting estimates, and in disclosure of changes in accounting policies.

2. This Standard deals with, among other matters, the disclosure of certain items of net profit or loss for the period. These disclosures are made in addition to any other disclosures required by other Accounting Standards.

3. This Standard 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.

Definitions

4. The following terms are used in this Standard with the meanings specified:

4.1 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.

4.2 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.

4.3 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.

4.4 <u>Accounting policies</u> are the specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements.

Net Profit or Loss for the Period

5. All items of income and expense which are recognised in a period should be included in the determination of net profit or loss for the period unless an Accounting Standard requires or permits otherwise.

6. Normally, all items of income and expense which are recognised in a period are included in the determination of the net profit or loss for the period. This includes extraordinary items and the effects of changes in accounting estimates.

7. 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.

Extraordinary Items

8. 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.

9. Virtually all items of income and expense included in the determination of net profit or loss for the period arise in the course of the ordinary activities of the enterprise. Therefore, only on rare occasions does an event or transaction give rise to an extraordinary item.

10. Whether an event or transaction is clearly distinct from the ordinary activities of the enterprise is determined by the nature of the event or transaction in relation to the business ordinarily carried on by the enterprise rather than by the frequency with which such events are expected to occur. Therefore, an event or transaction may be extraordinary for one enterprise but not so for another enterprise because of the differences between their respective ordinary activities. For example, losses sustained as a result of an earthquake may qualify as an extraordinary item for many enterprises. However, claims from policyholders arising from an earthquake do not qualify as an extraordinary item for an insurance enterprise that insures against such risks.

11. 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.

Profit or Loss from Ordinary Activities

12. 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.

13. Although the items of income and expense described in paragraph 12 are not extraordinary items, the nature and amount of such items may be relevant to users of financial statements in understanding the financial position and performance of an enterprise and in making projections about financial position and performance. Disclosure of such information is sometimes made in the notes to the financial statements.

14. Circumstances which may give rise to the separate disclosure of items of income and expense in accordance with paragraph 12 include:

(a) the write-down of inventories to net realisable value as well as the reversal of such write-downs;

(b) a restructuring of the activities of an enterprise and the reversal of any provisions for the costs of restructuring;

(c) disposals of items of fixed assets;

(d) disposals of long-term investments;

(e) legislative changes having retrospective application;

(f) litigation settlements; and

(g) other reversals of provisions.

Prior Period Items

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

16. The term 'prior period items', as defined in this Standard, refers only to 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. The term does not include other adjustments necessitated by circumstances, which though related to prior periods, are determined in the current period, e.g., arrears payable to workers as a result of revision of wages with retrospective effect during the current period.

17. Errors in the preparation of the financial statements of one or more prior periods may be discovered in the current period. Errors may occur as a result of mathematical mistakes, mistakes in applying accounting policies, misinterpretation of facts, or oversight.

18. Prior period items are generally infrequent in nature and can be distinguished from changes in accounting estimates. Accounting estimates by their nature are approximations that may need revision as additional information becomes known. For example, income or expense recognised on the outcome of a contingency which previously could not be estimated reliably does not constitute a prior period item.

19. Prior period items are normally included in the determination of net profit or loss for the

current period. An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss. In either case, the objective is to indicate the effect of such items on the current profit or loss.

Changes in Accounting Estimates

20. As a result of the uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated. The estimation process involves judgments based on the latest information available. Estimates may be required, for example, of bad debts, inventory obsolescence or the useful lives of depreciable assets. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

21. 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. 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.

22. Sometimes, it is difficult to distinguish between a change in an accounting policy and a change in an accounting estimate. In such cases, the change is treated as a change in an accounting estimate, with appropriate disclosure.

23. The effect of a change in an accounting estimate should be included in the determination of net profit or loss in:

(a) the period of the change, if the change affects the period only; or

(b) the period of the change and future periods, if the change affects both.

24. A change in an accounting estimate may affect the current period only or both the current period and future periods. For example, a change in the estimate of the amount of bad debts is recognised immediately and therefore affects only the current period. However, a change in the estimated useful life of a depreciable asset affects the depreciation in the current period and in each period during the remaining useful life of the asset. In both cases, the effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods, is recognised in future periods.

25. The effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate.

26. To ensure the comparability of financial statements of different periods, the effect of a change in an accounting estimate which was previously included in the profit or loss from ordinary activities is included in that component of net profit or loss. The effect of a change in an accounting estimate that was previously included as an extraordinary item is reported as an extraordinary item.

27. 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.

Changes in Accounting Policies

28. Users need to be able to compare the financial statements of an enterprise over a period of time in order to identify trends in its financial position, performance and cash flows. Therefore, the same accounting policies are normally adopted for similar events or transactions in each period.

29. A change in an accounting policy should be made only if the adoption of a different accounting policy is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate presentation of the financial statements of the enterprise.

30. A more appropriate presentation of events or transactions in the financial statements occurs when the new accounting policy results in more relevant or reliable information about the financial position, performance or cash flows of the enterprise.

31. The following are not changes in accounting 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 adhoc ex-gratia payments to employees on retirement; and

(b) the adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial.

32. 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.

33. A change in accounting policy consequent upon the adoption of an Accounting Standard should be accounted for in accordance with the specific transitional provisions, if any, contained in that Accounting Standard. However, disclosures required by paragraph 32 of this Standard should be made unless the transitional provisions of any other Accounting Standard require alternative disclosures in this regard.

Accounting Standard (AS) 7

Construction Contracts*

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the General Instructions contained in part A of the Annexure to the Notification.)*

Objective

The objective of this Standard is to prescribe the accounting treatment of revenue and costs associated with construction contracts. Because of the nature of the activity undertaken in construction contracts, the date at which the contract activity is entered into and the date when the activity is completed usually fall into different accounting periods. Therefore, the primary issue in accounting for construction contracts is the allocation of contract revenue and contract costs to the accounting periods in which construction work is performed. This Standard uses the recognition criteria established in the Framework for the Preparation and Presentation of Financial Statements to determine when contract revenue and contract costs should be recognised as revenue and expenses in the statement of profit and loss. It also provides practical guidance on the application of these criteria.

Scope

1. This Standard should be applied in accounting for construction contracts in the financial statements of contractors.

Definitions

2. The following terms are used in this Standard with the meanings specified:

2.1 A construction contract is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.

2.2 A fixed price contract is a construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, which in some cases is subject to cost escalation clauses.

2.3 A cost plus contract is a construction contract in which the contractor is reimbursed for allowable or otherwise defined costs, plus percentage of these costs or a fixed fee.

3. A construction contract may be negotiated for the construction of a single asset such as a bridge, building, dam, pipeline, road, ship or tunnel. A construction contract may also deal with the construction of a number of assets which are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use; examples of such contracts include those for the construction of refineries and other complex pieces of

* In respect of contracts entered into prior to the effective date of the notification prescribing Accounting Standard (AS) 7 as part of Companies (Accounting Standards) Rules, 2006, the applicability of this Standard would be determined on the basis of the Accounting Standard (AS) 7, revised by the ICAI in 2002.

plant or equipment.

4. For the purposes of this Standard, construction contracts include:

(a) contracts for the rendering of services which are directly related to the construction of the asset, for example, those for the services of project managers and architects; and

(b) contracts for destruction or restoration of assets, and the restoration of the environment following the demolition of assets.

5. Construction contracts are formulated in a number of ways which, for the purposes of this Standard, are classified as fixed price contracts and cost plus contracts. Some construction contracts may contain characteristics of both a fixed price contract and a cost plus contract, for example, in the case of a cost plus contract with an agreed maximum price. In such circumstances, a contractor needs to consider all the conditions in paragraphs 22 and 23 in order to determine when to recognise contract revenue and expenses.

Combining and Segmenting Construction Contracts

6. The requirements of this Standard are usually applied separately to each construction contract. However, in certain circumstances, it is necessary to apply the Standard to the separately identifiable components of a single contract or to a group of contracts together in order to reflect the substance of a contract or a group of contracts.

7. 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 and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

8. 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 a single project with an overall profit margin; and

(c) the contracts are performed concurrently or in a continuous sequence.

9. A contract may provide for the construction of an additional asset at the option of the customer or may be amended to include the construction of an additional asset. The construction of the additional asset should be treated as a separate construction contract when:

(a) the asset differs significantly in design, technology or function from the asset or assets covered by the original contract; or

(b) the price of the asset is negotiated without regard to the original contract price.

Contract Revenue

10. Contract revenue should comprise:

(a) the initial amount of revenue agreed in the contract; and

(b) variations in contract work, claims and incentive payments:

(i) to the extent that it is probable that they will result in revenue; and
(ii) they are capable of being reliably measured.

11. Contract revenue is measured at the consideration received or receivable. The measurement of contract revenue is affected by a variety of uncertainties that depend on the outcome of future events. The estimates often need to be revised as events occur and uncertainties are resolved. Therefore, the amount of contract revenue may increase or decrease from one period to the next. For example:

(a) a contractor and a customer may agree to variations or claims that increase or decrease contract revenue in a period subsequent to that in which the contract was initially agreed;

(b) the amount of revenue agreed in a fixed price contract may increase as a result of cost escalation clauses;

(c) the amount of contract revenue may decrease as a result of penalties arising from delays caused by the contractor in the completion of the contract; or

(d) when a fixed price contract involves a fixed price per unit of output, contract revenue increases as the number of units is increased.

12. A variation is an instruction by the customer for a change in the scope of the work to be performed under the contract. A variation may lead to an increase or a decrease in contract revenue. Examples of variations are changes in the specifications or design of the asset and 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 and the amount of revenue arising from the variation; and

(b) the amount of revenue can be reliably measured.

13. A claim is an amount that the contractor seeks to collect from the customer or another party as reimbursement for costs not included in the contract price. A claim may arise from, for example, customer caused delays, errors in specifications or design, and disputed variations in contract work. The measurement of the amounts of revenue arising from claims is subject to a high level of uncertainty and often depends on the outcome of negotiations. Therefore, 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; and

(b) the amount that it is probable will be accepted by the customer can be measured reliably.

14. 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 it is probable that the specified performance standards will be met or exceeded; and

(b) the amount of the incentive payment can be measured reliably.

Contract Costs

15. Contract costs should comprise:

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

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

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

16. Costs that relate directly to a specific contract include:

(a) site labour costs, including site supervision;

(b) costs of materials used in construction;

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

(d) costs of moving plant, equipment and materials to and from the contract site;

(e) costs of hiring plant and equipment;

(f) costs of design and technical assistance that is directly related to the contract;

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

(h) claims from third parties.

These costs may be reduced by any incidental income that is not included in contract revenue, for example, income from the sale of surplus materials and the disposal of plant and equipment at the end of the contract.

17. Costs that may be attributable to contract activity in general and can be allocated to specific contracts include:

(a) insurance;

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

(c) construction overheads.

Such costs are allocated using methods that are systematic and rational and are applied consistently to all costs having similar characteristics. The allocation is based on the normal level of construction activity. Construction overheads include costs such as the preparation and processing of construction personnel payroll. Costs that may be attributable to contract

activity in general and can be allocated to specific contracts also include borrowing costs as per Accounting Standard (AS) 16, *Borrowing Costs*.

18. Costs that are specifically chargeable to the customer under the terms of the contract may include some general administration costs and development costs for which reimbursement is specified in the terms of the contract.

19. Costs that cannot be attributed to contract activity or cannot be allocated to a contract are excluded from the costs of a construction contract. Such costs include:

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

(b) selling costs;

(c) research and development costs for which reimbursement is not specified in the contract; and

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

20. Contract costs include the costs attributable to a contract for the period from the date of securing the contract to the final completion of the contract. However, 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 and measured reliably and it is probable that the contract will be obtained. 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.

Recognition of Contract Revenue and Expenses

21. When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date. An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 35.

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

(a) total contract revenue can be measured reliably;

(b) it is probable that the economic benefits associated with the contract will flow to the enterprise;

(c) both the contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably; and

(d) the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.

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

(a) it is probable that the economic benefits associated with the contract will flow to the enterprise; and

(b) the contract costs attributable to the contract, whether or not specifically reimbursable, can be clearly identified and measured reliably.

24. The recognition of revenue and expenses by reference to the stage of completion of a contract is often referred to as the percentage of completion method. Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion of work completed. This method provides useful information on the extent of contract activity and performance during a period.

25. Under the percentage of completion method, contract revenue is recognised as revenue in the statement of profit and loss in the accounting periods in which the work is performed. Contract costs are usually recognised as an expense in the statement of profit and loss in the accounting periods in which the work to which they relate is performed. However, any expected excess of total contract costs over total contract revenue for the contract is recognised as an expense immediately in accordance with paragraph 35.

26. A contractor may have incurred contract costs that relate to future activity on the contract. Such contract costs are recognised as an asset provided it is probable that they will be recovered. Such costs represent an amount due from the customer and are often classified as contract work in progress.

27. When an uncertainty arises about the collectability of an amount already included in contract revenue, and already recognised in the statement of profit and 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 of the amount of contract revenue.

28. An enterprise is generally able to make reliable estimates after it has agreed to a contract which establishes:

(a) each party's enforceable rights regarding the asset to be constructed;

(b) the consideration to be exchanged; and

(c) the manner and terms of settlement.

It is also usually necessary for the enterprise to have an effective internal financial budgeting and reporting system. The enterprise reviews and, when necessary, revises the estimates of contract revenue and contract costs as the contract progresses. The need for such revisions does not necessarily indicate that the outcome of the contract cannot be estimated reliably.

29. 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 and advances received from customers may not necessarily reflect the work performed.

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

(a) contract costs that relate to future activity on the contract, such as costs of materials that have been delivered to a contract site or set aside 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; and

(b) payments made to subcontractors in advance of work performed under the subcontract.

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

(a) revenue should be recognised only to the extent of contract costs incurred of which recovery is probable; and

(b) contract costs should be recognised as an expense in the period in which they are incurred.

An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 35.

32. During the early stages of a contract it is often the case that the outcome of the contract cannot be estimated reliably. Nevertheless, it may be probable that the enterprise will recover the contract costs incurred. Therefore, contract revenue is recognised only to the extent of costs incurred that are expected to be recovered. As the outcome of the contract cannot be estimated reliably, no profit is recognised. However, even though the outcome of the contract cannot be estimated reliably, it may be probable that total contract costs will exceed total contract revenue. In such cases, any expected excess of total contract costs over total contract revenue for the contract is recognised as an expense immediately in accordance with paragraph 35.

33. Contract costs recovery of which is not probable are recognised as an expense immediately. Examples of circumstances in which the recoverability of contract costs incurred may not be probable and in which contract costs may, therefore, need to be recognised as an expense immediately include contracts:

(a) which are not fully enforceable, that is, their validity is seriously in question;

(b) the completion of which is subject to the outcome of pending litigation or legislation;

(c) relating to properties that are likely to be condemned or expropriated;

(d) where the customer is unable to meet its obligations; or

(e) where the contractor is unable to complete the contract or otherwise meet its obligations under the contract.

34. When the uncertainties that prevented the outcome of the contract being estimated reliably no longer exist, revenue and expenses associated with the construction contract should be recognised in accordance with paragraph 21 rather than in accordance with

paragraph 31.

Recognition of Expected Losses

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

36. The amount of such a loss is determined irrespective of:

(a) whether or not work has commenced on the contract;

(b) the stage of completion of contract activity; or

(c) the amount of profits expected to arise on other contracts which are not treated as a single construction contract in accordance with paragraph 8.

Changes in Estimates

37. The percentage of completion method is applied on a cumulative basis in each accounting period to the current estimates of contract revenue and contract costs. Therefore, the effect of a change in the estimate of contract revenue or contract costs, or the effect of a change in the estimate of the outcome of a contract, is accounted for as a change in accounting estimate (see Accounting Standard (AS) 5, *Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies*). The changed estimates are used in determination of the amount of revenue and expenses recognised in the statement of profit and loss in the period in which the change is made and in subsequent periods.

Disclosure

38. 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; and

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

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

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

(b) the amount of advances received; and

(c) the amount of retentions.

40. Retentions are amounts of progress billings which are not paid until the satisfaction of conditions specified in the contract for the payment of such amounts or until defects have been rectified. Progress billings are amounts billed for work performed on a contract whether or not they have been paid by the customer. Advances are amounts received by the contractor before the related work is performed.

41. An enterprise should present:

(a) the gross amount due from customers for contract work as an asset; and

(b) the gross amount due to customers for contract work as a liability.

42. The gross amount due from customers for contract work is the net amount of:

(a) costs incurred plus recognised profits; less

(b) the sum of recognised losses and progress billings

for all contracts in progress for which costs incurred plus recognised profits (less recognised losses) exceeds progress billings.

43. The gross amount due to customers for contract work is the net amount of:

(a) the sum of recognised losses and progress billings; less

(b) costs incurred plus recognised profits

for all contracts in progress for which progress billings exceed costs incurred plus recognised profits (less recognised losses).

44. An enterprise discloses any contingencies in accordance with Accounting Standard (AS) 4, *Contingencies and Events Occurring After the Balance Sheet Date*[2]. Contingencies may arise from such items as warranty costs, penalties or possible losses.

[2] All paragraphs of AS 4 that deal with contingencies are applicable only to the extent not covered by other Accounting Standards prescribed by the Central Government. For example, the impairment of financial assets such as impairment of receivables (commonly known as provision for bad and doubtful debts) is governed by AS 4.

Illustration

This illustration does not form part of the Accounting Standard. Its purpose is to illustrate the application of the Accounting Standard to assist in clarifying its meaning.

Disclosure of Accounting Policies

The following are illustrations of accounting policy disclosures:

Revenue from fixed price construction contracts is recognised on the percentage of completion method, measured by reference to the percentage of labour hours incurred upto the reporting date to estimated total labour hours for each contract.

Revenue from cost plus contracts is recognised by reference to the recoverable costs incurred during the period plus the fee earned, measured by the proportion that costs incurred upto the reporting date bear to the estimated total costs of the contract.

The Determination of Contract Revenue and Expenses

The following illustration illustrates one method of determining the stage of completion of a contract and the timing of the recognition of contract revenue and expenses (see paragraphs 21 to 34 of the Standard). (Amounts shown herein below are in Rs. lakhs)

A construction contractor has a fixed price contract for Rs. 9,000 to build a bridge. The initial amount of revenue agreed in the contract is Rs. 9,000. The contractor's initial estimate of contract costs is Rs. 8,000. It will take 3 years to build the bridge.

By the end of year 1, the contractor's estimate of contract costs has increased to Rs. 8,050.

In year 2, the customer approves a variation resulting in an increase in contract revenue of Rs. 200 and estimated additional contract costs of Rs. 150. At the end of year 2, costs incurred include Rs. 100 for standard materials stored at the site to be used in year 3 to complete the project.

The contractor determines the stage of completion of the contract by calculating the proportion that contract costs incurred for work performed upto the reporting date bear to the latest estimated total contract costs. A summary of the financial data during the construction period is as follows:

(amount in Rs. lakhs)

	Year 1	Year 2	Year 3
Initial amount of revenue agreed in contract	9,000	9,000	9,000
Variation	—	200	200
Total contract revenue	9,000	9,200	9,200
Contract costs incurred upto the reporting date	2,093	6,168	8,200
Contract costs to complete	5,957	2,032	—
Total estimated contract costs	8,050	8,200	8,200
Estimated Profit	950	1,000	1,000

Stage of completion	26%	74%	100%

The stage of completion for year 2 (74%) is determined by excluding from contract costs incurred for work performed upto the reporting date, Rs. 100 of standard materials stored at the site for use in year 3.

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

	Upto the Reporting Date	Recognised in prior years	Recognised in current year
Year 1			
Revenue (9,000x .26)	2,340	—	2,340
Expenses (8,050x .26)	2,093	—	2,093
Profit	247	—	247
Year 2			
Revenue (9,200 x .74)	6,808	2,340	4,468
Expenses (8,200 x .74)	6,068	2,093	3,975
Profit	740	247	493
Year 3			
Revenue (9,200 x 1.00)	9,200	6,808	2,392
Expenses	8,200	6,068	2,132
Profit	1,000	740	260

Contract Disclosures

A contractor has reached the end of its first year of operations. All its contract costs incurred have been paid for in cash and all its progress billings and advances have been received in cash. Contract costs incurred for contracts B, C and E include the cost of materials that have been purchased for the contract but which have not been used in contract performance upto the reporting date. For contracts B, C and E, the customers have made advances to the contractor for work not yet performed.

The status of its five contracts in progress at the end of year 1 is as follows:

	Contract					
	(amount in Rs. lakhs)					
	A	B	C	D	E	Total
Contract Revenue recognised in accordance with paragraph 21	145	520	380	200	55	1,300
Contract Expenses recognised in accordance with paragraph 21	110	450	350	250	55	1,215
Expected Losses recognised in accordance with paragraph 35	—	—	—	40	30	70
Recognised profits less recognised losses	35	70	30	(90)	(30)	15
Contract Costs incurred in the period	110	510	450	250	100	1,420
Contract Costs incurred recognised as contract expenses in the period in accordance with paragraph 21	110	450	350	250	55	1,215
Contract Costs that relate to future activity recognised as an asset in accordance with paragraph 26	—	60	100	—	45	205
Contract Revenue (see above)	145	520	380	200	55	1,300
Progress Billings (paragraph 40)	100	520	380	180	55	1,235
Unbilled Contract Revenue	45	—	—	20	—	65
Advances (paragraph 40)	—	80	20	—	25	125

The amounts to be disclosed in accordance with the Standard are as follows:

Contract revenue recognised as revenue in the period [paragraph 38(a)]	1,300
Contract costs incurred and recognised profits (less recognised losses) upto the reporting date [paragraph 39(a)]	1,435
Advances received [paragraph 39(b)]	125
Gross amount due from customers for contract work— presented as an asset in accordance with paragraph 41(a)	220
Gross amount due to customers for contract work— presented as a liability in accordance with paragraph 41(b)	(20)

The amounts to be disclosed in accordance with paragraphs 39(a), 41(a) and 41(b) are calculated as follows:

(amount in Rs. lakhs)

	A	B	C	D	E	Total
Contract Costs incurred	110	510	450	250	100	1,420
Recognised profits less recognised losses	35	70	30	(90)	(30)	15
	145	580	480	160	70	1,435
Progress billings	100	520	380	180	55	1,235
Due from customers	45	60	100	—	15	220
Due to customers	—	—	—	(20)	—	(20)

The amount disclosed in accordance with paragraph 39(a) is the same as the amount for the current period because the disclosures relate to the first year of operation.

Accounting Standard (AS) 9

Revenue Recognition[3]

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of the General Instructions contained in part A of the Annexure to the Notification.)*

Introduction

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

— the sale of goods,

— the rendering of services, and

— the use by others of enterprise resources yielding interest, royalties and dividends.

2. This Standard does not deal with the following aspects of revenue recognition to which special considerations apply:

(i) Revenue arising from construction contracts;[4]

(ii) Revenue arising from hire-purchase, lease agreements;

(iii) Revenue arising from government grants and other similar subsidies;

(iv) Revenue of insurance companies arising from insurance contracts.

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

(i) Realised gains resulting from the disposal of, and unrealised gains resulting from the holding of, non-current assets e.g. appreciation in the value of fixed assets;

(ii) Unrealised holding gains resulting from the change in value of current assets, and the natural increases in herds and agricultural and forest products;

(iii) Realised or unrealised gains resulting from changes in foreign exchange rates and adjustments arising on the translation of foreign currency financial statements;

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

[3] It is reiterated that this Accounting Standard (as is the case of other accounting standards) assumes that the three fundamental accounting assumptions i.e., going concern, consistency and accrual have been followed in the preparation and presentation of financial statements.

[4] Refer to AS 7 on '*Construction Contracts*'.

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

Definitions

4. The following terms are used in this Standard with the meanings specified:

4.1 Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends. Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration.

4.2 Completed service contract method is a method of accounting which recognises revenue in the statement of profit and loss only when the rendering of services under a contract is completed or substantially completed.

4.3 Proportionate completion method is a method of accounting which recognises revenue in the statement of profit and loss proportionately with the degree of completion of services under a contract.

Explanation

5. Revenue recognition is mainly concerned with the timing of recognition of revenue in the statement of profit and loss of an enterprise. The amount of revenue arising on a transaction is usually determined by agreement between the parties involved in the transaction. When uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

6. Sale of Goods

6.1 A key criterion for determining when to recognise revenue from a transaction involving the sale of goods is that the seller has transferred the property in the goods to the buyer for a consideration. The transfer of property in goods, in most cases, results in or coincides with the transfer of significant risks and rewards of ownership to the buyer. However, there may be situations where transfer of property in goods does not coincide with the transfer of significant risks and rewards of ownership. Revenue in such situations is recognised at the time of transfer of significant risks and rewards of ownership to the buyer. Such cases may arise where delivery has been delayed through the fault of either the buyer or the seller and the goods are at the risk of the party at fault as regards any loss which might not have occurred but for such fault. Further, sometimes the parties may agree that the risk will pass at a time different from the time when ownership passes.

6.2 At certain stages in specific industries, such as when agricultural crops have been harvested or mineral ores have been extracted, performance may be substantially complete prior to the execution of the transaction generating revenue. In such cases when sale is assured under a forward contract or a government guarantee or where market exists and there is a negligible risk of failure to sell, the goods involved are often valued at net realisable value. Such amounts, while not revenue as defined in this Standard, are sometimes recognised in the

statement of profit and loss and appropriately described.

7. Rendering of Services

7.1 Revenue from service transactions is usually recognised as the service is performed, either by the proportionate completion method or by the completed service contract method.

(i) ***Proportionate completion method***—Performance consists of the execution of more than one act. Revenue is recognised proportionately by reference to the performance of each act. The revenue recognised under this method would be determined on the basis of contract value, associated costs, number of acts or other suitable basis. For practical purposes, when services are provided by an indeterminate number of acts over a specific period of time, revenue is recognised on a straight line basis over the specific period unless there is evidence that some other method better represents the pattern of performance.

(ii) ***Completed service contract method***—Performance consists of the execution of a single act. Alternatively, services are performed in more than a single act, and the services yet to be performed are so significant in relation to the transaction taken as a whole that performance cannot be deemed to have been completed until the execution of those acts. The completed service contract method is relevant to these patterns of performance and accordingly revenue is recognised when the sole or final act takes place and the service becomes chargeable.

8. The Use by Others of Enterprise Resources Yielding Interest, Royalties and Dividends

8.1 The use by others of such enterprise resources gives rise to:

(i) interest—charges for the use of cash resources or amounts due to the enterprise;

(ii) royalties—charges for the use of such assets as know-how, patents, trademarks and copyrights;

(iii) dividends—rewards from the holding of investments in shares.

8.2 Interest accrues, in most circumstances, on the time basis determined by the amount outstanding and the rate applicable. Usually, discount or premium on debt securities held is treated as though it were accruing over the period to maturity.

8.3 Royalties accrue in accordance with the terms of the relevant agreement and are usually recognised on that basis unless, having regard to the substance of the transactions, it is more appropriate to recognise revenue on some other systematic and rational basis.

8.4 Dividends from investments in shares are not recognised in the statement of profit and loss until a right to receive payment is established.

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

9. Effect of Uncertainties on Revenue Recognition

9.1 Recognition of revenue requires that revenue is measurable and that at the time of sale or

the rendering of the service it would not be unreasonable to expect ultimate collection.

9.2 Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of 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 the 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.

9.3 When the uncertainty relating to collectability arises subsequent to the time of sale or the rendering of the service, it is more appropriate to make a separate provision to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.

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

9.5 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.

Main Principles

10. Revenue from sales or service transactions should be recognised when the requirements as to performance set out in paragraphs 11 and 12 are satisfied, provided that at the time of performance it is not unreasonable to expect ultimate collection. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

Explanation:

The amount of revenue from sales transactions (turnover) should be disclosed in the following manner on the face of the statement of profit or loss:

Turnover (Gross)	***XX***	
<u>Less:</u> Excise Duty	***<u>XX</u>***	
Turnover (Net)		***XX***

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 between the closing stock and opening stock. The excise duty related to the difference between the closing stock and opening stock should be recognised separately in the statement of profit or loss, with an explanatory note in the notes to accounts to explain the nature of the two amounts of excise duty.

11. In a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

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

buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

12. In a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished. Such performance should be regarded as being achieved when no significant uncertainty exists regarding the amount of the consideration that will be derived from rendering the service.

13. Revenue arising from the use by others of enterprise resources yielding interest, royalties and dividends should only be recognised when no significant uncertainty as to measurability or collectability exists. These revenues are recognised on the following bases:

(i) Interest	***:***	***on a time proportion basis taking into account the amount outstanding and the rate applicable.***
(ii) Royalties	***:***	***on an accrual basis in accordance with the terms of the relevant agreement.***
(iii) Dividends from investments in shares	***:***	***when the owner's right to receive payment is established.***

Disclosure

14. In addition to the disclosures required by Accounting Standard (AS) 1, Disclosure of Accounting Policies, an enterprise should also disclose the circumstances in which revenue recognition has been postponed pending the resolution of significant uncertainties.

Illustrations

These illustrations do not form part of the Accounting Standard. Their purpose is to illustrate the application of the Standard to a number of commercial situations in an endeavour to assist in clarifying application of the Standard.

A. Sale of Goods

1. Delivery is delayed at buyer's request and buyer takes title and accepts billing

Revenue should be recognised notwithstanding that physical delivery has not been completed so long as there is every expectation that delivery will be made. However, the item must be on hand, identified and ready for delivery to the buyer at the time the sale is recognised rather than there being simply an intention to acquire or manufacture the goods in time for delivery.

2. Delivered subject to conditions

(a) installation and inspection i.e. goods are sold subject to installation, inspection etc.

Revenue should normally not be recognised until the customer accepts delivery and installation and inspection are complete. In some cases, however, the installation process may be so simple in nature that it may be appropriate to recognise the sale notwithstanding that

installation is not yet completed (e.g. installation of a factory-tested television receiver normally only requires unpacking and connecting of power and antennae).

(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.

(c) 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 the case of retail sales 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. In other cases, the substance of the agreement may amount to a sale on consignment, in which case it should be treated as indicated below.

(d) 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 a third party.

(e) cash on delivery sales

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

3. Sales where the purchaser makes a series of instalment payments to the seller, and the seller delivers the goods only when the final payment is received

Revenue from such sales should not be recognised until goods are delivered. However, when experience indicates that most such sales have been consummated, revenue may be recognised when a significant deposit is received.

4. Special order and shipments i.e. where payment (or partial payment) is received for goods not presently held in stock e.g. 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 and ready for delivery to the buyer by the third party.

5. Sale/repurchase agreements i.e. where seller concurrently agrees to repurchase the same goods at a later date

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

6. Sales to intermediate parties i.e. 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; however in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.

7. Subscriptions for publications

Revenue received or billed should be deferred and recognised either on a straight line basis over time or, where 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.

8. 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 due to the seller.

9. Trade discounts and volume rebates

Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.

B. Rendering of Services

1. Installation Fees

In cases 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 and accepted by the customer.

2. Advertising and insurance agency commissions

Revenue should be recognised when the service is completed. For advertising agencies, media commissions will normally be recognised when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency, as opposed to production commission, which will be recognised when the project is completed. Insurance agency commissions should be recognised on the effective commencement or renewal dates of the related policies.

3. Financial service commissions

A financial service may be rendered as a single act or may be provided over a period of time. Similarly, charges for such services may be made as a single amount or in stages over the period of the service or the life of the transaction to which it relates. Such charges may be settled in full when made or added to a loan or other account and settled in stages. The recognition of such revenue should therefore 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.

In general, commissions charged for arranging or granting loan or other facilities should be recognised when a binding obligation has been entered into. Commitment, facility or loan management fees which relate to continuing obligations or services should normally be recognised over the life of the loan or facility having regard to the amount of the obligation outstanding, the nature of the services provided and the timing of the costs relating thereto.

4. Admission fees

Revenue from artistic performances, banquets and 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 and rational basis.

5. Tuition fees

Revenue should be recognised over the period of instruction.

6. Entrance and membership fees

Revenue recognition from these sources will depend on the nature of the services being provided. Entrance fee received is generally capitalised. If the membership fee permits only membership and all other services or products are paid for separately, or if there is a separate annual subscription, the fee should be recognised when received. If the membership fee entitles the member to services or publications to be provided during the year, it should be recognised on a systematic and rational basis having regard to the timing and nature of all services provided.

Accounting Standard (AS) 10

Property, Plant and Equipment

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of General Instructions contained in part A of the Annexure to the Notification.)*

Objective

1. The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment so that users of the financial statements can discern information about investment made by an enterprise in its property, plant and equipment and the changes in such investment. The principal issues in accounting for property, plant and equipment are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognised in relation to them.

Scope

2. This Standard should be applied in accounting for property, plant and equipment except when another Accounting Standard requires or permits a different accounting treatment.

3. This Standard does not apply to:

(a) biological assets related to agricultural activity other than bearer plants. This Standard applies to bearer plants but it does not apply to the produce on bearer plants; and

(b) wasting assets including mineral rights, expenditure on the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources.

However, this Standard applies to property, plant and equipment used to develop or maintain the assets described in (a) and (b) above.

4. Other Accounting Standards may require recognition of an item of property, plant and equipment based on an approach different from that in this Standard. For example, AS 19, *Leases,* requires an enterprise to evaluate its recognition of an item of leased property, plant and equipment on the basis of the transfer of risks and rewards. However, in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed by this Standard.

5. Investment property, as defined in AS 13, *Accounting for Investments*, should be accounted for only in accordance with the cost model prescribed in this standard.

Definitions

6. The following terms are used in this Standard with the meanings specified:

***Agricultural Activity** is the management by an enterprise of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets.*

***Agricultural Produce** is the harvested product of biological assets of the enterprise.*

***Bearer plant** is a plant that*

(a) is used in the production or supply of agricultural produce;

(b) is expected to bear produce for more than a period of twelve months; and

(c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.

The following are not bearer plants:

(i) plants cultivated to be harvested as agricultural produce (for example, trees grown for use as lumber);

(ii) plants cultivated to produce agricultural produce when there is more than a remote likelihood that the entity will also harvest and sell the plant as agricultural produce, other than as incidental scrap sales (for example, trees that are cultivated both for their fruit and their lumber); and

(iii) annual crops (for example, maize and wheat).

When bearer plants are no longer used to bear produce they might be cut down and sold as scrap, for example, for use as firewood. Such incidental scrap sales would not prevent the plant from satisfying the definition of a bearer plant.

Biological Asset is a living animal[5] or plant.

Carrying amount is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other Accounting Standards.

Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Enterprise-specific value is the present value of the cash flows an enterprise expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.

Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

Gross carrying amount of an asset is its cost or other amount substituted for the cost in the books of account, without making any deduction for accumulated depreciation and accumulatedimpairment losses.

An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount.

Property, plant and equipment are tangible items that:

[5] An Accounting Standard on Agriculture is under formulation, which will, inter alia, cover accounting for livestock. Till the time, the Accounting Standard on Agriculture is issued, accounting for livestock meeting the definition of Property, Plant and Equipment, will be covered as per AS 10, *Property, Plant and Equipment.*

(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) are expected to be used during more than a period of twelve months.

Recoverable amount is the higher of an asset's net selling price and its value in use.

The residual value of an asset is the estimated amount that an enterprise would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

Useful life is:

(a) the period over which an asset is expected to be available for use by an enterprise; or

(b) the number of production or similar units expected to be obtained from the asset by an enterprise.

Recognition

7. The cost of an item of property, plant and equipment should be recognised as an asset if, and only if:

(a) it is probable that future economic benefits associated with the item will flow to the enterprise; and

(b) the cost of the item can be measured reliably.

8. Items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this Standard when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory.

9. This Standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to specific circumstances of an enterprise. An example of a 'unit of measure' can be a 'project' of construction of a manufacturing plant rather than individual assets comprising the project in appropriate cases for the purpose of capitalisation of expenditure incurred during construction period. Similarly, it may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies and to apply the criteria to the aggregate value. An enterprise may decide to expense an item which could otherwise have been included as property, plant and equipment, because the amount of the expenditure is not material.

10. An enterprise evaluates under this recognition principle all its costs on property, plant and equipment at the time they are incurred. These costs include costs incurred:

(a) initially to acquire or construct an item of property, plant and equipment; and

(b) subsequently to add to, replace part of, or service it.

Initial Costs

11. The definition of 'property, plant and equipment' covers tangible items which are held for use or for administrative purposes. The term 'administrative purposes' has been used in wider sense to include all business purposes other than production or supply of goods or services or for rental for others. Thus, property, plant and equipment would include assets used for selling and distribution, finance and accounting, personnel and other functions of an enterprise. Items of property, plant and equipment may also be acquired for safety or environmental reasons. The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits of any particular existing item of property, plant and equipment, may be necessary for an enterprise to obtain the future economic benefits from its other assets. Such items of property, plant and equipment qualify for recognition as assets because they enable an enterprise to derive future economic benefits from related assets in excess of what could be derived had those items not been acquired. For example, a chemical manufacturer may install new chemical handling processes to comply with environmental requirements for the production and storage of dangerous chemicals; related plant enhancements are recognised as an asset because without them the enterprise is unable to manufacture and sell chemicals. The resulting carrying amount of such an asset and related assets is reviewed for impairment in accordance with AS 28, *Impairment of Assets*.

Subsequent Costs

12. Under the recognition principle in paragraph 7, an enterprise does not recognise in the carrying amount of an item of property, plant and equipment the costs of the day-to-day servicing of the item. Rather, these costs are recognised in the statement of profit and loss as incurred. Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts. The purpose of such expenditures is often described as for the 'repairs and maintenance' of the item of property, plant and equipment.

13. Parts of some items of property, plant and equipment may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of use, or aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe. Similarly, major parts of conveyor system, such as, conveyor belts, wire ropes, etc., may require replacement several times during the life of the conveyor system. Items of property, plant and equipment may also be acquired to make a less frequently recurring replacement, such as replacing the interior walls of a building, or to make a non-recurring replacement. Under the recognition principle in paragraph 7, an enterprise recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognised in accordance with the derecognition provisions of this Standard (see paragraphs 74-80).

14. A condition of continuing to operate an item of property, plant and equipment (for example, an aircraft) may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognised.

15. The derecognition of the carrying amount as stated in paragraphs 13-14 occurs regardless of whether the cost of the previous part / inspection was identified in the transaction in which the item was acquired or constructed. If it is not practicable for an enterprise to determine the carrying amount of the replaced part/ inspection, it may use the cost of the replacement or the estimated cost of a future similar inspection as an indication of what the cost of the replaced part/ existing inspection component was when the item was acquired or constructed.

Measurement at Recognition

16. An item of property, plant and equipment that qualifies for recognition as an asset should be measured at its cost.

Elements of Cost

17. The cost of an item of property, plant and equipment comprises:

(a) its purchase price, including import duties and non–refundable purchase taxes,, after deducting trade discounts and rebates.

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

(c) the initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as 'decommissioning, restoration and similar liabilities', the obligation for which an enterprise incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

18. Examples of directly attributable costs are:

(a) costs of employee benefits (as defined in AS 15, *Employee Benefits*) arising directly from the construction or acquisition of the item of property, plant and equipment;

(b) costs of site preparation;

(c) initial delivery and handling costs;

(d) installation and assembly costs;

(e) costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and

(f) professional fees.

19. An enterprise applies AS 2, *Valuation of Inventories,* to the costs of obligations for dismantling, removing and restoring the site on which an item is located that are incurred during a particular period as a consequence of having used the item to produce inventories during that period. The obligations for costs accounted for in accordance with AS 2 or AS 10 are recognised and measured in accordance with AS 29, *Provisions, Contingent Liabilities and Contingent Assets.*

20. Examples of costs that are not costs of an item of property, plant and equipment are:

(a) costs of opening a new facility or business, such as, inauguration costs;

(b) costs of introducing a new product or service (including costs of advertising and promotional activities);

(c) costs of conducting business in a new location or with a new class of customer (including costs of staff training); and

(d) administration and other general overhead costs.

21. Recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an item are not included in the carrying amount of that item. For example, the following costs are not included in the carrying amount of an item of property, plant and equipment:

(a) costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity;

(b) initial operating losses, such as those incurred while demand for the output of an item builds up; and

(c) costs of relocating or reorganising part or all of the operations of an enterprise.

22. Some operations occur in connection with the construction or development of an item of property, plant and equipment, but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the construction or development activities. For example, income may be earned through using a building site as a car park until construction starts. Because incidental operations are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised in the statement of profit and loss and included in their respective classifications of income and expense.

23. The cost of a self-constructed asset is determined using the same principles as for an acquired asset. If an enterprise makes similar assets for sale in the normal course of business, the cost of the asset is usually the same as the cost of constructing an asset for sale (see AS 2). Therefore, any internal profits are eliminated in arriving at such costs. Similarly, the cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset. AS 16, *Borrowing Costs*, establishes criteria for the recognition of interest as a component of the carrying amount of a self-constructed item of property, plant and equipment.

24. Bearer plants are accounted for in the same way as self-constructed items of property, plant and equipment before they are in the location and condition necessary to be capable of operating in the manner intended by management. Consequently, references to 'construction' in this Standard should be read as covering activities that are necessary to cultivate the bearer plants before they are in the location and condition necessary to be capable of operating in the manner intended by management.

Measurement of Cost

25. The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised as interest over the period of credit unless such interest is capitalised in accordance with AS 16.

26. One or more items of property, plant and equipment may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The following discussion refers simply to an exchange of one non-monetary asset for another, but it also applies to all exchanges described in the preceding sentence. The cost of such an item of property, plant and equipment is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset(s) received nor the asset(s) given up is reliably measurable. The acquired item(s) is/are measured in this manner even if an enterprise cannot immediately derecognise the asset given up. If the acquired item(s) is/are not measured at fair value, its/their cost is measured at the carrying amount of the asset(s) given up.

27. An enterprise determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:

(a) the configuration (risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or

(b) the enterprise-specific value of the portion of the operations of the enterprise affected by the transaction changes as a result of the exchange;

(c) and the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

For the purpose of determining whether an exchange transaction has commercial substance, the enterprise-specific value of the portion of operations of the enterprise affected by the transaction should reflect post-tax cash flows. In certain cases, the result of these analyses may be clear without an enterprise having to perform detailed calculations.

28. The fair value of an asset is reliably measurable if (a) the variability in the range of reasonable fair value measurements is not significant for that asset or (b) the probabilities of the various estimates within the range can be reasonably assessed and used when measuring fair value. If an enterprise is able to measure reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure the cost of the asset received unless the fair value of the asset received is more clearly evident.

29. Where several items of property, plant and equipment are purchased for a consolidated price, the consideration is apportioned to the various items on the basis of their respective fair values at the date of acquisition. In case the fair values of the items acquired cannot be measured reliably, these values are estimated on a fair basis as determined by competent valuers.

30. The cost of an item of property, plant and equipment held by a lessee under a finance lease is determined in accordance with AS 19, Leases.

31. The carrying amount of an item of property, plant and equipment may be reduced by government grants in accordance with AS 12, Accounting for Government Grants.

Measurement after Recognition

32. An enterprise should choose either the cost model in paragraph 33 or the revaluation model in paragraph 34 as its accounting policy and should apply that policy to an entire class of property, plant and equipment.

Cost Model

33. After recognition as an asset, an item of property, plant and equipment should be carried at its cost less any accumulated depreciation and any accumulated impairment losses.

Revaluation Model

34. After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably should be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations should be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.

35. The fair value of items of property, plant and equipment is usually determined from market-based evidence by appraisal that is normally undertaken by professionally qualified valuers.

36. If there is no market-based evidence of fair value because of the specialised nature of the item of property, plant and equipment and the item is rarely sold, except as part of a continuing business, an enterprise may need to estimate fair value using an income approach (for example, based on discounted cash flow projections) or a depreciated replacement cost approach which aims at making a realistic estimate of the current cost of acquiring or constructing an item that has the same service potential as the existing item.

37. The frequency of revaluations depends upon the changes in fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is required. Some items of property, plant and equipment experience significant and volatile changes in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for items of property, plant and equipment with only insignificant changes in fair value. Instead, it may be necessary to revalue the item only every three or five years.

38. When an item of property, plant and equipment is revalued, the carrying amount of that asset is adjusted to the revalued amount. At the date of the revaluation, the asset is treated in one of the following ways:

(a) the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset. For example, the gross carrying amount may be restated by reference to observable market data or it may be restated proportionately to the change in the carrying amount. The accumulated depreciation at the date of the revaluation is adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses; or

(b) the accumulated depreciation is eliminated against the gross carrying amount of the asset.

The amount of the adjustment of accumulated depreciation forms part of the increase or decrease in carrying amount that is accounted for in accordance with paragraphs 42 and 43.

39. If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs should be revalued.

40. A class of property, plant and equipment is a grouping of assets of a similar nature and use in operations of an enterprise. The following are examples of separate classes:

(a) land;

(b) land and buildings;

(c) machinery;

(d) ships;

(e) aircraft;

(f) motor vehicles;

(g) furniture and fixtures;

(h) office equipment; and

(i) bearer plants.

41. The items within a class of property, plant and equipment are revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the financial statements that are a mixture of costs and values as at different dates. However, a class of assets may be revalued on a rolling basis provided revaluation of the class of assets is completed within a short period and provided the revaluations are kept up to date.

42. An increase in the carrying amount of an asset arising on revaluation should be credited directly to owners' interests under the heading of revaluation surplus. However, the increase should be recognised in the statement of profit and loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in the statement of profit and loss.

43. A decrease in the carrying amount of an asset arising on revaluation should be charged to the statement of profit and loss. However, the decrease should be debited directly to owners' interests under the heading of revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that asset.

44. The revaluation surplus included in owners' interests in respect of an item of property, plant and equipment may be transferred to the revenue reserves when the asset is derecognised. This may involve transferring the whole of the surplus when the asset is retired or disposed of. However, some of the surplus may be transferred as the asset is used by an enterprise. In such a case, the amount of the surplus transferred would be the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on its original cost. Transfers from revaluation surplus to the revenue reserves are not made through the statement of profit and loss.

Depreciation

45. Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately.

46. An enterprise allocates the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciates each such part separately. For example, it may be appropriate to depreciate separately the airframe and engines of an aircraft, whether owned or subject to a finance lease.

47. A significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.

48. To the extent that an enterprise depreciates separately some parts of an item of property, plant and equipment, it also depreciates separately the remainder of the item. The remainder consists of the parts of the item that are individually not significant. If an enterprise has varying expectations for these parts, approximation techniques may be necessary to depreciate the remainder in a manner that faithfully represents the consumption pattern and/or useful life of its parts.

49. An enterprise may choose to depreciate separately the parts of an item that do not have a cost that is significant in relation to the total cost of the item.

50. The depreciation charge for each period should be recognised in the statement of profit and loss unless it is included in the carrying amount of another asset.

51. The depreciation charge for a period is usually recognised in the statement of profit and loss. However, sometimes, the future economic benefits embodied in an asset are absorbed in producing other assets. In this case, the depreciation charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the depreciation of manufacturing plant and equipment is included in the costs of conversion of inventories (see AS 2). Similarly, the depreciation of property, plant and equipment used for development activities may be included in the cost of an intangible asset recognised in accordance with AS 26, *Intangible Assets*.

Depreciable Amount and Depreciation Period

52. The depreciable amount of an asset should be allocated on a systematic basis over its useful life.

53. The residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) should be accounted for as a change in an accounting estimate in accordance with AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

54. Depreciation is recognised even if the fair value of the asset exceeds its carrying amount, as long as the asset's residual value does not exceed its carrying amount. Repair and maintenance of an asset do not negate the need to depreciate it.

55. The depreciable amount of an asset is determined after deducting its residual value.

56. The residual value of an asset may increase to an amount equal to or greater than its carrying amount. If it does, depreciation charge of the asset is zero unless and until its residual value subsequently decreases to an amount below its carrying amount.

57. Depreciation of an asset begins when it is available for use, *i.e.*, when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases at the earlier of the date that the asset is retired from active use and is held for disposal and the date that the asset is derecognised. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use (but not held for disposal) unless the asset is fully depreciated. However, under usage methods of depreciation, the depreciation charge can be zero while there is no production.

58. The future economic benefits embodied in an asset are consumed by an enterprise principally through its use. However, other factors, such as technical or commercial obsolescence and wear and tear while an asset remains idle, often result in the diminution of the economic benefits that might have been obtained from the asset. Consequently, all the following factors are considered in determining the useful life of an asset:

(a) expected usage of the asset. Usage is assessed by reference to the expected capacity or physical output of the asset.

(b) expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.

(c) technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset. Expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technical or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.

(d) legal or similar limits on the use of the asset, such as the expiry dates of related leases.

59. The useful life of an asset is defined in terms of its expected utility to the enterprise. The asset management policy of the enterprise may involve the disposal of assets after a specified time or after consumption of a specified proportion of the future economic benefits embodied in the asset. Therefore, the useful life of an asset may be shorter than its economic life. The estimation of the useful life of the asset is a matter of judgement based on the experience of the enterprise with similar assets.

60. Land and buildings are separable assets and are accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated. Buildings have a limited useful life and therefore are depreciable assets. An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.

61. If the cost of land includes the costs of site dismantlement, removal and restoration, that portion of the land asset is depreciated over the period of benefits obtained by incurring those costs. In some cases, the land itself may have a limited useful life, in which case it is depreciated in a manner that reflects the benefits to be derived from it.

Depreciation Method

62. The depreciation method used should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise.

63. The depreciation method applied to an asset should be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern. Such a change should be accounted for as a change in an accounting estimate in accordance with AS 5.

64. A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. Straight-line depreciation results in a constant charge over the useful life if the residual value of the asset does not change. The diminishing balance method results in a decreasing charge over the useful life. The units of production method results in a charge based on the expected use or output. The enterprise selects the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits or that the method is changed in accordance with the statute to best reflect the way the asset is consumed.

65. A depreciation method that is based on revenue that is generated by an activity that includes the use of an asset is not appropriate. The revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits of the asset. For example, revenue is affected by other inputs and processes, selling activities and changes in sales volumes and prices. The price component of revenue may be affected by inflation, which has no bearing upon the way in which an asset is consumed.

Changes in Existing Decommissioning, Restoration and Other Liabilities

66. The cost of property, plant and equipment may undergo changes subsequent to its acquisition or construction on account of changes in liabilities, price adjustments, changes in duties, changes in initial estimates of amounts provided for dismantling, removing, restoration and similar factors and included in the cost of the asset in accordance with paragraph 16. Such changes in cost should be accounted for in accordance with paragraphs 67–68 below.

67. If the related asset is measured using the cost model:

(a) subject to (b), changes in the liability should be added to, or deducted from, the cost of the related asset in the current period.

(b) the amount deducted from the cost of the asset should not exceed its carrying amount. If a decrease in the liability exceeds the carrying amount of the asset, the excess should be recognised immediately in the statement of profit and loss.

(c) if the adjustment results in an addition to the cost of an asset, the enterprise should consider whether this is an indication that the new carrying amount of the asset may not be fully recoverable. If it is such an indication, the enterprise should test the asset for impairment by estimating its recoverable amount, and should account for any impairment loss, in accordance with AS 28.

68. If the related asset is measured using the revaluation model:

(a) changes in the liability alter the revaluation surplus or deficit previously recognised on that asset, so that:

(i) a decrease in the liability should (subject to (b)) be credited directly to revaluation surplus in the owners' interest, except that it should be recognised in the statement of profit and loss to the extent that it reverses a revaluation deficit on the asset that was previously recognised in the statement of profit and loss;

(ii) an increase in the liability should be recognised in the statement of profit and loss, except that it should be debited directly to revaluation surplus in the owners' interest to the extent of any credit balance existing in the revaluation surplus in respect of that asset.

(b) in the event that a decrease in the liability exceeds the carrying amount that would have been recognised had the asset been carried under the cost model, the excess should be recognised immediately in the statement of profit and loss.

(c) a change in the liability is an indication that the asset may have to be revalued in order to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date. Any such revaluation should be taken into account in determining the amounts to be taken to the statement of profit and loss and the owners' interest under (a). If a revaluation is necessary, all assets of that class should be revalued.

69. The adjusted depreciable amount of the asset is depreciated over its useful life. Therefore, once the related asset has reached the end of its useful life, all subsequent changes in the liability should be recognised in the statement of profit and loss as they occur. This applies under both the cost model and the revaluation model.

Impairment

70. To determine whether an item of property, plant and equipment is impaired, an enterprise applies AS 28, *Impairment of Assets*. AS 28 explains how an enterprise reviews the carrying amount of its assets, how it determines the recoverable amount of an asset, and when it recognises, or reverses the recognition of, an impairment loss.

Compensation for Impairment

71. Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up should be included in the statement of profit and loss when the compensation becomes receivable.

72. Impairments or losses of items of property, plant and equipment, related claims for or payments of compensation from third parties and any subsequent purchase or construction of replacement assets are separate economic events and are accounted for separately as follows:

(a) impairments of items of property, plant and equipment are recognised in accordance with AS 28;

(b) derecognition of items of property, plant and equipment retired or disposed of is determined in accordance with this Standard;

(c) compensation from third parties for items of property, plant and equipment that were impaired, lost or given up is included in determining profit or loss when it becomes receivable; and

(d) the cost of items of property, plant and equipment restored, purchased or constructed as replacements is determined in accordance with this Standard.

Retirements

73. Items of property, plant and equipment retired from active use and held for disposal should be stated at the lower of their carrying amount and net realisable value. Any write-down in this regard should be recognised immediately in the statement of profit and loss.

Derecognition

74. The carrying amount of an item of property, plant and equipment should be derecognised

(a) on disposal; or

(b) when no future economic benefits are expected from its use or disposal.

75. The gain or loss arising from the derecognition of an item of property, plant and equipment should be included in the statement of profit and loss when the item is derecognised (unless AS 19, Leases, requires otherwise on a sale and leaseback). Gains should not be classified as revenue, as defined in AS 9, Revenue Recognition.

76. However, an enterprise that in the course of its ordinary activities, routinely sells items of property, plant and equipment that it had held for rental to others should transfer such assets to inventories at their carrying amount when they cease to be rented and become held for sale. The proceeds from the sale of such assets should be recognised in revenue in accordance with AS 9, Revenue Recognition.

77. The disposal of an item of property, plant and equipment may occur in a variety of ways (e.g. by sale, by entering into a finance lease or by donation). In determining the date of disposal of an item, an enterprise applies the criteria in AS 9 for recognising revenue from the sale of goods. AS 19, *Leases*, applies to disposal by a sale and leaseback.

78. If, under the recognition principle in paragraph 7, an enterprise recognises in the carrying amount of an item of property, plant and equipment the cost of a replacement for part of the item, then it derecognises the carrying amount of the replaced part regardless of whether the replaced part had been depreciated separately. If it is not practicable for an enterprise to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed.

79. The gain or loss arising from the derecognition of an item of property, plant and equipment should be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

80. The consideration receivable on disposal of an item of property, plant and equipment is recognised in accordance with the principles enunciated in AS 9.

Disclosure

81. The financial statements should disclose, for each class of property, plant and equipment:

(a) the measurement bases (i.e., cost model or revaluation model) used for determining the gross carrying amount;

(b) the depreciation methods used;

(c) the useful lives or the depreciation rates used. In case the useful lives or the depreciation rates used are different from those specified in the statute governing the enterprise, it should make a specific mention of that fact;

(d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and

(e) a reconciliation of the carrying amount at the beginning and end of the period showing:

(i) additions;

(ii) assets retired from active use and held for disposal;

(iii) acquisitions through business combinations;

(iv) increases or decreases resulting from revaluations under paragraphs 34, 42 and 43 and from impairment losses recognised or reversed directly in revaluation surplus in accordance with AS 28;

(v) impairment losses recognised in the statement of profit and loss in accordance with AS 28;

(vi) impairment losses reversed in the statement of profit and loss in accordance with AS 28;

(vii) depreciation;

(viii) the net exchange differences arising on the translation of the financial statements of a non-integral foreign operation in accordance with AS 11, The Effects of Changes in Foreign Exchange Rates; and

(ix) other changes.

82. The financial statements should also disclose:

(a) the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;

(b) the amount of expenditure recognised in the carrying amount of an item of property, plant and equipment in the course of its construction;

(c) the amount of contractual commitments for the acquisition of property, plant and equipment;

(d) if it is not disclosed separately on the face of the statement of profit and loss, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in the statement of profit and loss; and

(e) the amount of assets retired from active use and held for disposal.

83. Selection of the depreciation method and estimation of the useful life of assets are matters of judgement. Therefore, disclosure of the methods adopted and the estimated useful lives or depreciation rates provides users of financial statements with information that allows them to review the policies selected by management and enables comparisons to be made with other enterprises. For similar reasons, it is necessary to disclose:

(a) depreciation, whether recognised in the statement of profit and loss or as a part of the cost of other assets, during a period; and

(b) accumulated depreciation at the end of the period.

84. In accordance with AS 5, an enterprise discloses the nature and effect of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in subsequent periods. For property, plant and equipment, such disclosure may arise from changes in estimates with respect to:

(a) residual values;

(b) the estimated costs of dismantling, removing or restoring items of property, plant and equipment;

(c) useful lives; and

(d) depreciation methods.

85. If items of property, plant and equipment are stated at revalued amounts, the following should be disclosed:

(a) the effective date of the revaluation;

(b) whether an independent valuer was involved;

(c) the methods and significant assumptions applied in estimating fair values of the items;

(d) the extent to which fair values of the items were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques; and

(e) the revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

86. In accordance with AS 28, an enterprise discloses information on impaired property, plant and equipment in addition to the information required by paragraph 81(e)(iv), (v) and (vi).

87. An enterprise is encouraged to disclose the following:

(a) the carrying amount of temporarily idle property, plant and equipment;

(b) the gross carrying amount of any fully depreciated property, plant and equipment that is still in use;

(c) for each revalued class of property, plant and equipment, the carrying amount that would have been recognised had the assets been carried under the cost model;

(d) the carrying amount of property, plant and equipment retired from active use and not held for disposal.

Transitional Provisions[6]

[6] Transitional Provisions given in Paragraphs 88-91 are relevant only for standards notified under Companies (Accounting Standards) Rules, 2006, as amended from time to time.

88. Where an entity has in past recognized an expenditure in the statement of profit and loss which is eligible to be included as a part of the cost of a project for construction of property, plant and equipment in accordance with the requirements of paragraph 9, it may do so retrospectively for such a project. The effect of such retrospective application of this requirement, should be recognised net-of-tax in revenue reserves.

89. The requirements of paragraphs 26-28 regarding the initial measurement of an item of property, plant and equipment acquired in an exchange of assets transaction should be applied prospectively only to transactions entered into after this Standard becomes mandatory.

90. On the date of this Standard becoming mandatory, the spare parts, which hitherto were being treated as inventory under AS 2, Valuation of Inventories, and are now required to be capitalised in accordance with the requirements of this Standard, should be capitalised at their respective carrying amounts. The spare parts so capitalised should be depreciated over their remaining useful lives prospectively as per the requirements of this Standard.

91. The requirements of paragraph 32 and paragraphs 34 – 44 regarding the revaluation model should be applied prospectively. In case, on the date of this Standard becoming mandatory, an enterprise does not adopt the revaluation model as its accounting policy but the carrying amount of item(s) of property, plant and equipment reflects any previous revaluation it should adjust the amount outstanding in the revaluation reserve against the carrying amount of that item. However, the carrying amount of that item should never be less than residual value. Any excess of the amount outstanding as revaluation reserve over the carrying amount of that item should be adjusted in revenue reserves.

Accounting Standard (AS) 11*

The Effects of Changes in Foreign Exchange Rates

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the General Instructions contained in part A of the Annexure to the Notification.)*

Objective

An enterprise may carry on activities involving foreign exchange in two ways. It may have transactions in foreign currencies or it may have foreign operations. In order to include foreign currency transactions and foreign operations in the financial statements of an enterprise, transactions must be expressed in the enterprise's reporting currency and the financial statements of foreign operations must be translated into the enterprise's reporting currency.

The principal issues in accounting for foreign currency transactions and foreign operations are to decide which exchange rate to use and how to recognise in the financial statements the financial effect of changes in exchange rates.

Scope

1. This Standard should be applied:

(a) in accounting for transactions in foreign currencies; and

(b) in translating the financial statements of foreign operations.

2. This Standard also deals with accounting for foreign currency transactions in the nature of forward exchange contracts.[1]

3. This Standard does not specify the currency in which an enterprise presents its financial statements. However, an enterprise normally uses the currency of the country in which it is domiciled. If it uses a different currency, this Standard requires disclosure of the reason for using that currency. This Standard also requires disclosure of the reason for any change in the reporting currency.

4. This Standard does not deal with the restatement of an enterprise's financial statements from its reporting currency into another currency for the convenience of users accustomed to that currency or for similar purposes.

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* In respect of accounting for transactions in foreign currencies entered into by the reporting enterprise itself or through its branches before the effective date of the notification prescribing Accounting Standard (AS) 11 as part of Companies (Accounting Standards) Rules, 2006, the applicability of this Standard would be determined on the basis of the Accounting Standard (AS) 11 revised by the ICAI in 2003.

[1] This Standard is applicable to exchange differences on all forward exchange contracts including those entered into to hedge the foreign currency risk of existing assets and liabilities and is not applicable to exchange difference arising on forward exchange contracts entered into to hedge the foreign currency risk of future transactions in respect of which a firm commitments are made or which are highly probable forecast transactions. A 'firm commitment' is a binding agreement for the exchange of a specified quantity of resources at a specified price on a specified future date or dates and a 'forecast transaction' is an uncommitted but anticipated future transaction.

5. This Standard does not deal with the presentation in a cash flow statement of cash flows arising from transactions in a foreign currency and the translation of cash flows of a foreign operation (see AS 3, *Cash Flow Statements*).

6. This Standard does not deal with exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs (see paragraph 4(e) of AS 16, *Borrowing Costs*).

Definitions

7. The following terms are used in this Standard with the meanings specified:

7.1 Average rate is the mean of the exchange rates in force during a period.

7.2 Closing rate is the exchange rate at the balance sheet date.

7.3 Exchange difference is the difference resulting from reporting the same number of units of a foreign currency in the reporting currency at different exchange rates.

7.4 Exchange rate is the ratio for exchange of two currencies.

7.5 Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

7.6 Foreign currency is a currency other than the reporting currency of an enterprise.

7.7 Foreign operation is a subsidiary[8], associate[9], joint venture[10] or branch of the reporting enterprise, the activities of which are based or conducted in a country other than the country of the reporting enterprise.

7.8 Forward exchange contract means an agreement to exchange different currencies at a forward rate.

7.9 Forward rate is the specified exchange rate for exchange of two currencies at a specified future date.

7.10 Integral foreign operation is a foreign operation, the activities of which are an integral part of those of the reporting enterprise.

7.11 Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

7.12 Net investment in a non-integral foreign operation is the reporting enterprise's share in the net assets of that operation.

7.13 Non-integral foreign operation is a foreign operation that is not an integral foreign operation.

7.14 Non-monetary items are assets and liabilities other than monetary items.

7.15 Reporting currency is the currency used in presenting the financial statements.

Foreign Currency Transactions

[8] As defined in AS 21, *Consolidated Financial Statements*.

[9] As defined in AS 23, *Accounting for Investments in Associates in Consolidated Financial Statements*.

[10] As defined in AS 27, *Financial Reporting of Interests in Joint Ventures*.

Initial Recognition

8. A foreign currency transaction is a transaction which is denominated in or requires settlement in a foreign currency, including transactions arising when an enterprise either:

(a) buys or sells goods or services whose price is denominated in a foreign currency;

(b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency;

(c) becomes a party to an unperformed forward exchange contract; or

(d) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

9. A foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount, the exchange rate between the reporting currency and the foreign currency at the date of the transaction.

10. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is unreliable.

Reporting at Subsequent Balance Sheet Dates

11. At each balance sheet date:

(a) foreign currency monetary items should be reported using the closing rate. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realised from, or required to disburse, a foreign currency monetary item at the balance sheet date, e.g., where there are restrictions on remittances or where the closing rate is unrealistic and it is not possible to effect an exchange of currencies at that rate at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realised from, or required to disburse, such item at the balance sheet date;

(b) non-monetary items which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange rate at the date of the transaction; and

(c) non-monetary items which are carried at fair value or other similar valuation denominated in a foreign currency should be reported using the exchange rates that existed when the values were determined.

12. Cash, receivables and payables are examples of monetary items. Fixed assets, inventories and investments in equity shares are examples of non-monetary items. The carrying amount of an item is determined in accordance with the relevant Accounting Standards. For example, certain assets may be measured at fair value or other similar valuation (e.g., net realisable value) or at historical cost. Whether the carrying amount is determined based on fair value or other similar valuation or at historical cost, the amounts so determined for foreign currency items are then reported in the reporting currency in accordance with this Standard. The contingent liability denominated in foreign currency at the balance sheet date is disclosed by using the closing rate.

Recognition of Exchange Differences

13. Exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as expenses in the period in which they arise, with the exception of exchange differences dealt with in accordance with paragraph 15.

14. An exchange difference results when there is a change in the exchange rate between the transaction date and the date of settlement of any monetary items arising from a foreign currency transaction. When the transaction is settled within the same accounting period as that in which it occurred, all the exchange difference is recognised in that period. However, when the transaction is settled in a subsequent accounting period, the exchange difference recognised in each intervening period up to the period of settlement is determined by the change in exchange rates during that period.

Net Investment in a Non-integral Foreign Operation

15. Exchange differences arising on a monetary item that, in substance, forms part of an enterprise's net investment in a non-integral foreign operation should be accumulated in a foreign currency translation reserve in the enterprise's financial statements until the disposal of the net investment, at which time they should be recognised as income or as expenses in accordance with paragraph 31.

16. An enterprise may have a monetary item that is receivable from, or payable to, a non-integral foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, an extension to, or deduction from, the enterprise's net investment in that non-integral foreign operation. Such monetary items may include long-term receivables or loans but do not include trade receivables or trade payables.

Financial Statements of Foreign Operations

Classification of Foreign Operations

17. The method used to translate the financial statements of a foreign operation depends on the way in which it is financed and operates in relation to the reporting enterprise. For this purpose, foreign operations are classified as either "integral foreign operations" or "non-integral foreign operations".

18. A foreign operation that is integral to the operations of the reporting enterprise carries on its business as if it were an extension of the reporting enterprise's operations. For example, such a foreign operation might only sell goods imported from the reporting enterprise and remit the proceeds to the reporting enterprise. In such cases, a change in the exchange rate between the reporting currency and the currency in the country of foreign operation has an almost immediate effect on the reporting enterprise's cash flow from operations. Therefore, the change in the exchange rate affects the individual monetary items held by the foreign operation rather than the reporting enterprise's net investment in that operation.

19. In contrast, a non-integral foreign operation accumulates cash and other monetary items, incurs expenses, generates income and perhaps arranges borrowings, all substantially in its local currency. It may also enter into transactions in foreign currencies, including transactions in the reporting currency. When there is a change in the exchange rate between the reporting currency and the local currency, there is little or no direct effect on the present and future cash flows from operations of either the non-integral foreign operation or the reporting enterprise. The change in the exchange rate affects the reporting enterprise's net investment in the non-integral foreign operation rather than the individual monetary and non-

monetary items held by the non-integral foreign operation.

20. The following are indications that a foreign operation is a non-integral foreign operation rather than an integral foreign operation:

(a) while the reporting enterprise may control the foreign operation, the activities of the foreign operation are carried out with a significant degree of autonomy from those of the reporting enterprise;

(b) transactions with the reporting enterprise are not a high proportion of the foreign operation's activities;

(c) the activities of the foreign operation are financed mainly from its own operations or local borrowings rather than from the reporting enterprise;

(d) costs of labour, material and other components of the foreign operation's products or services are primarily paid or settled in the local currency rather than in the reporting currency;

(e) the foreign operation's sales are mainly in currencies other than the reporting currency;

(f) cash flows of the reporting enterprise are insulated from the day-to-day activities of the foreign operation rather than being directly affected by the activities of the foreign operation;

(g) sales prices for the foreign operation's products are not primarily responsive on a short-term basis to changes in exchange rates but are determined more by local competition or local government regulation; and

(h) there is an active local sales market for the foreign operation's products, although there also might be significant amounts of exports.

The appropriate classification for each operation can, in principle, be established from factual information related to the indicators listed above. In some cases, the classification of a foreign operation as either a non-integral foreign operation or an integral foreign operation of the reporting enterprise may not be clear, and judgement is necessary to determine the appropriate classification.

Integral Foreign Operations

21. The financial statements of an integral foreign operation should be translated using the principles and procedures in paragraphs 8 to 16 as if the transactions of the foreign operation had been those of the reporting enterprise itself.

22. The individual items in the financial statements of the foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself. The cost and depreciation of tangible fixed assets is translated using the exchange rate at the date of purchase of the asset or, if the asset is carried at fair value or other similar valuation, using the rate that existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when those costs were incurred. The recoverable amount or realisable value of an asset is translated using the exchange rate that existed when the recoverable amount or net realisable value was determined. For example, when the net realisable value of an item of inventory is determined in a foreign currency, that value is translated using the exchange rate at the date as at which the net realisable value is determined. The rate used is therefore usually the closing rate. An adjustment may be required to reduce the carrying amount of an asset in the financial statements of the reporting enterprise

to its recoverable amount or net realisable value even when no such adjustment is necessary in the financial statements of the foreign operation. Alternatively, an adjustment in the financial statements of the foreign operation may need to be reversed in the financial statements of the reporting enterprise.

23. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is unreliable.

Non-integral Foreign Operations

24. In translating the financial statements of a non-integral foreign operation for incorporation in its financial statements, the reporting enterprise should use the following procedures:

(a) the assets and liabilities, both monetary and non-monetary, of the non-integral foreign operation should be translated at the closing rate;

(b) income and expense items of the non-integral foreign operation should be translated at exchange rates at the dates of the transactions; and

(c) all resulting exchange differences should be accumulated in a foreign currency translation reserve until the disposal of the net investment.

25. For practical reasons, a rate that approximates the actual exchange rates, for example an average rate for the period, is often used to translate income and expense items of a foreign operation.

26. The translation of the financial statements of a non-integral foreign operation results in the recognition of exchange differences arising from:

(a) translating income and expense items at the exchange rates at the dates of transactions and assets and liabilities at the closing rate;

(b) translating the opening net investment in the non-integral foreign operation at an exchange rate different from that at which it was previously reported; and

(c) other changes to equity in the non-integral foreign operation. These exchange differences are not recognised as income or expenses for the period because the changes in the exchange rates have little or no direct effect on the present and future cash flows from operations of either the non-integral foreign operation or the reporting enterprise. When a non- integral foreign operation is consolidated but is not wholly owned, accumulated exchange differences arising from translation and attributable to minority interests are allocated to, and reported as part of, the minority interest in the consolidated balance sheet.

27. Any goodwill or capital reserve arising on the acquisition of a non- integral foreign operation is translated at the closing rate in accordance with paragraph 24.

28. A contingent liability disclosed in the financial statements of a non- integral foreign operation is translated at the closing rate for its disclosure in the financial statements of the reporting enterprise.

29. The incorporation of the financial statements of a non-integral foreign operation in those of the reporting enterprise follows normal consolidation procedures, such as the elimination of intra-group balances and intra- group transactions of a subsidiary (see AS 21, *Consolidated*

Financial Statements, and AS 27, *Financial Reporting of Interests in Joint Ventures*). However, an exchange difference arising on an intra-group monetary item, whether short-term or long-term, cannot be eliminated against a corresponding amount arising on other intra-group balances because the monetary item represents a commitment to convert one currency into another and exposes the reporting enterprise to a gain or loss through currency fluctuations. Accordingly, in the consolidated financial statements of the reporting enterprise, such an exchange difference continues to be recognised as income or an expense or, if it arises from the circumstances described in paragraph 15, it is accumulated in a foreign currency translation reserve until the disposal of the net investment.

30. When the financial statements of a non-integral foreign operation are drawn up to a different reporting date from that of the reporting enterprise, the non-integral foreign operation often prepares, for purposes of incorporation in the financial statements of the reporting enterprise, statements as at the same date as the reporting enterprise. When it is impracticable to do this, AS 21, *Consolidated Financial Statements*, allows the use of financial statements drawn up to a different reporting date provided that the difference is no greater than six months and adjustments are made for the effects of any significant transactions or other events that occur between the different reporting dates. In such a case, the assets and liabilities of the non-integral foreign operation are translated at the exchange rate at the balance sheet date of the non-integral foreign operation and adjustments are made when appropriate for significant movements in exchange rates up to the balance sheet date of the reporting enterprises in accordance with AS 21. The same approach is used in applying the equity method to associates and in applying proportionate consolidation to joint ventures in accordance with AS 23, *Accounting for Investments in Associates in Consolidated Financial Statements* and AS 27, *Financial Reporting of Interests in Joint Ventures*.

Disposal of a Non-integral Foreign Operation

31. On the disposal of a non-integral foreign operation, the cumulative amount of the exchange differences which have been deferred and which relate to that operation should be recognised as income or as expenses in the same period in which the gain or loss on disposal is recognised.

32. An enterprise may dispose of its interest in a non-integral foreign operation through sale, liquidation, repayment of share capital, or abandonment of all, or part of, that operation. The payment of a dividend forms part of a disposal only when it constitutes a return of the investment. Remittance from a non-integral foreign operation by way of repatriation of accumulated profits does not form part of a disposal unless it constitutes return of the investment. In the case of a partial disposal, only the proportionate share of the related accumulated exchange differences is included in the gain or loss. A write- down of the carrying amount of a non-integral foreign operation does not constitute a partial disposal. Accordingly, no part of the deferred foreign exchange gain or loss is recognised at the time of a write-down.

Change in the Classification of a Foreign Operation

33. When there is a change in the classification of a foreign operation, the translation procedures applicable to the revised classification should be applied from the date of the change in the classification.

34. The consistency principle requires that foreign operation once classified as integral or non-integral is continued to be so classified. However, a change in the way in which a foreign operation is financed and operates in relation to the reporting enterprise may lead to a change in the classification of that foreign operation. When a foreign operation that is integral to the operations of the reporting enterprise is reclassified as a non-integral foreign operation, exchange differences arising on the translation of non-monetary assets at the date of the reclassification are accumulated in a foreign currency translation reserve. When a

non-integral foreign operation is reclassified as an integral foreign operation, the translated amounts for non-monetary items at the date of the change are treated as the historical cost for those items in the period of change and subsequent periods. Exchange differences which have been deferred are not recognised as income or expenses until the disposal of the operation.

All Changes in Foreign Exchange Rates

Tax Effects of Exchange Differences

35. Gains and losses on foreign currency transactions and exchange differences arising on the translation of the financial statements of foreign operations may have associated tax effects which are accounted for in accordance with AS 22, *Accounting for Taxes on Income*.

Forward Exchange Contracts[10]

36. An enterprise may enter into a forward exchange contract or another financial instrument that is in substance a forward exchange contract, which is not intended for trading or speculation purposes, to establish the amount of the reporting currency required or available at the settlement date of a transaction. The premium or discount arising at the inception of such a forward exchange contract should be amortised as expense or income over the life of the contract. Exchange differences on such a contract should be recognised in the statement of profit and loss in the reporting period in which the exchange rates change. Any profit or loss arising on cancellation or renewal of such a forward exchange contract should be recognised as income or as expense for the period.

37. The risks associated with changes in exchange rates may be mitigated by entering into forward exchange contracts. Any premium or discount arising at the inception of a forward exchange contract is accounted for separately from the exchange differences on the forward exchange contract. The premium or discount that arises on entering into the contract is measured by the difference between the exchange rate at the date of the inception of the forward exchange contract and the forward rate specified in the contract. Exchange difference on a forward exchange contract is the difference between (a) the foreign currency amount of the contract translated at the exchange rate at the reporting date, or the settlement date where the transaction is settled during the reporting period, and (b) the same foreign currency amount translated at the latter of the date of inception of the forward exchange contract and the last reporting date.

38. A gain or loss on a forward exchange contract to which paragraph 36 does not apply should be computed by multiplying the foreign currency amount of the forward exchange contract by the difference between the forward rate available at the reporting date for the remaining maturity of the contract and the contracted forward rate (or the forward rate last used to measure a gain or loss on that contract for an earlier period). The gain or loss so computed should be recognised in the statement of profit and loss for the period. The premium or discount on the forward exchange contract is not recognised separately.

39. In recording a forward exchange contract intended for trading or speculation purposes, the premium or discount on the contract is ignored and at each balance sheet date, the value of the contract is marked to its current market value and the gain or loss on the contract is recognised.

Disclosure

40. An enterprise should disclose:

(a) the amount of exchange differences included in the net profit or loss for the period; and

[10] See footnote 1 of AS 11.

(b) net exchange differences accumulated in foreign currency translation reserve as a separate component of shareholders' funds, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.

41. When the reporting currency is different from the currency of the country in which the enterprise is domiciled, the reason for using a different currency should be disclosed. The reason for any change in the reporting currency should also be disclosed.

42. When there is a change in the classification of a significant foreign operation, an enterprise should disclose:

(a) the nature of the change in classification;

(b) the reason for the change;

(c) the impact of the change in classification on shareholders' funds; and

(d) the impact on net profit or loss for each prior period presented had the change in classification occurred at the beginning of the earliest period presented.

43. The effect on foreign currency monetary items or on the financial statements of a foreign operation of a change in exchange rates occurring after the balance sheet date is disclosed in accordance with AS 4, *Contingencies and Events Occurring After the Balance Sheet Date.*

44. Disclosure is also encouraged of an enterprise's foreign currency risk management policy.

Transitional Provisions[11]

45. On the first time application of this Standard, if a foreign branch is classified as a non-integral foreign operation in accordance with the requirements of this Standard, the accounting treatment prescribed in paragraphs 33 and 34 of the Standard in respect of change in the classification of a foreign operation should be applied.

46. In respect of accounting periods commencing on or after 7th December, 2006 and ending on or before 31st March, 2020[12], at the option of the enterprise (such option to be irrevocable and to be exercised retrospectively for such accounting period, from the date this transitional provision comes into force or the first date on which the concerned foreign currency monetary item is acquired, whichever is later, and applied to all such foreign currency monetary items), exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a depreciable capital asset, can be added to or deducted from the cost of the

[11] Transitional Provisions given in Paragraphs 45 are relevant only for standards notified under Companies (Accounting Standards) Rules, 2006, as amended from time to time. Transitional Provisions given in Paragraphs 46-46A are relevant for standards notified under Companies (Accounting Standards) Rules, 2006 (as amended from time to time) as well as Companies (Accounting Standards) Rules, 2021.

[12] Initially the period mentioned was "31st March, 2011" which was substituted by "31st March, 2012" by Notification dated 11th May, 2011, published by Ministry of Corporate Affairs, Government of India. Subsequently, "31st March, 2012" was substituted by "31st March, 2020" by Notification dated 29th December, 2011, published by Ministry of Corporate Affairs, Government of India.

asset and shall be depreciated over the balance life of the asset, and in other cases, can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortized over the balance period of such long-term asset/liability but not beyond 31st March, 2020[13], by recognition as income or expense in each of such periods, with the exception of exchange differences dealt with in accordance with paragraph 15. For the purposes of exercise of this option, an asset or liability shall be designated as a long-term foreign currency monetary item, if the asset or liability is expressed in a foreign currency and has a term of 12 months or more at the date of origination of the asset or liability. Any difference pertaining to accounting periods which commenced on or after 7th December, 2006, previously recognized in the profit and loss account before the exercise of the option shall be reversed in so far as it relates to the acquisition of a depreciable capital asset by addition or deduction from the cost of the asset and in other cases by transfer to "Foreign Currency Monetary Item Translation Difference Account" in both cases, by debit or credit, as the case may be, to the general reserve. If the option stated in this paragraph is exercised, disclosure shall be made of the fact of such exercise of such option and of the amount remaining to be amortized in the financial statements of the period in which such option is exercised and in every subsequent period so long as any exchange difference remains unamortized.

46A. (1) In respect of accounting periods commencing on or after the 1st April, 2011, for an enterprise which had earlier exercised the option under paragraph 46 and at the option of any other enterprise (such option to be irrevocable and to be applied to all such foreign currency monetary items), the exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a depreciable capital asset, can be added to or deducted from the cost of the asset and shall be depreciated over the balance life of the asset, and in other cases, can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortized over the balance period of such long term asset or liability, by recognition as income or expense in each of such periods, with the exception of exchange differences dealt with in accordance with the provisions of paragraph 15 of the said rules.

(2) To exercise the option referred to in sub-paragraph (1), an asset or liability shall be designated as a long-term foreign currency monetary item, if the asset or liability is expressed in a foreign currency and has a term of twelve months or more at the date of origination of the asset or the liability:

Provided that the option exercised by the enterprise shall disclose the fact of such option and of the amount remaining to be amortized in the financial statements of the period in which such option is exercised and in every subsequent period so long as any exchange difference remains unamortized.

[13] ibid

Accounting Standard (AS) 12

Accounting for Government Grants

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of the General Instructions contained in part A of the Annexure to the Notification.)*

Introduction

1. This Standard deals with accounting for government grants. Government grants are sometimes called by other names such as subsidies, cash incentives, duty drawbacks, etc.

2. This Standard does not deal with:

(i) the special problems arising in accounting for government grants in financial statements reflecting the effects of changing prices or in supplementary information of a similar nature;

(ii) government assistance other than in the form of government grants;

(iii) government participation in the ownership of the enterprise.

Definitions

3. The following terms are used in this Standard with the meanings specified:

3.1 <u>Government</u> refers to government, government agencies and similar bodies whether local, national or international.

3.2. <u>Government grants</u> are assistance by government in cash or kind to an enterprise for past or future compliance with certain conditions. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the enterprise.

Explanation

4. The receipt of government grants by an enterprise is significant for preparation of the financial statements for two reasons. Firstly, if a government grant has been received, an appropriate method of accounting therefor is necessary. Secondly, it is desirable to give an indication of the extent to which the enterprise has benefited from such grant during the reporting period. This facilitates comparison of an enterprise's financial statements with those of prior periods and with those of other enterprises.

Accounting Treatment of Government Grants

5. Capital Approach versus Income Approach

5.1 Two broad approaches may be followed for the accounting treatment of government grants: the 'capital approach', under which a grant is treated as part of shareholders' funds, and the 'income approach', under which a grant is taken to income over one or more periods.

5.2 Those in support of the 'capital approach' argue as follows:

(i) Many government grants are in the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in the case of such grants. These should, therefore, be credited directly to shareholders' funds.

(ii) It is inappropriate to recognise government grants in the profit and loss statement, since they are not earned but represent an incentive provided by government without related costs.

5.3 Arguments in support of the 'income approach' are as follows:

(i) Government grants are rarely gratuitous. The enterprise earns them through compliance with their conditions and meeting the envisaged obligations. They should therefore be taken to income and matched with the associated costs which the grant is intended to compensate.

(ii) As income tax and other taxes are charges against income, it is logical to deal also with government grants, which are an extension of fiscal policies, in the profit and loss statement.

(iii) In case grants are credited to shareholders' funds, no correlation is done between the accounting treatment of the grant and the accounting treatment of the expenditure to which the grant relates.

5.4 It is generally considered appropriate that accounting for government grant should be based on the nature of the relevant grant. Grants which have the characteristics similar to those of promoters' contribution should be treated as part of shareholders' funds. Income approach may be more appropriate in the case of other grants.

5.5 It is fundamental to the 'income approach' that government grants be recognised in the profit and loss statement on a systematic and rational basis over the periods necessary to match them with the related costs. Income recognition of government grants on a receipts basis is not in accordance with the accrual accounting assumption (see Accounting Standard (AS) 1, *Disclosure of Accounting Policies*).

5.6 In most cases, the periods over which an enterprise recognises the costs or expenses related to a government grant are readily ascertainable and thus grants in recognition of specific expenses are taken to income in the same period as the relevant expenses.

6. Recognition of Government Grants

6.1 Government grants available to the enterprise are considered for inclusion in accounts:

(i) where there is reasonable assurance that the enterprise will comply with the conditions attached to them; and

(ii) where such benefits have been earned by the enterprise and it is reasonably certain that the ultimate collection will be made.

Mere receipt of a grant is not necessarily a conclusive evidence that conditions attaching to the grant have been or will be fulfilled.

6.2 An appropriate amount in respect of such earned benefits, estimated on a prudent basis, is credited to income for the year even though the actual amount of such benefits may be finally settled and received after the end of the relevant accounting period.

6.3 A contingency related to a government grant, arising after the grant has been recognised, is treated in accordance with Accounting Standard (AS) 4, *Contingencies and Events Occurring After the Balance Sheet Date*[14].

6.4 In certain circumstances, a government grant is awarded for the purpose of giving immediate financial support to an enterprise rather than as an incentive to undertake specific expenditure. Such grants may be confined to an individual enterprise and may not be available to a whole class of enterprises. These circumstances may warrant taking the grant to income in the period in which the enterprise qualifies to receive it, as an extraordinary item if appropriate (see Accounting Standard (AS) 5, *Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies*).

6.5 Government grants may become receivable by an enterprise as compensation for expenses or losses incurred in a previous accounting period. Such a grant is recognised in the income statement of the period in which it becomes receivable, as an extraordinary item if appropriate (see Accounting Standard (AS) 5, *Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies*).

7. Non-monetary Government Grants

7.1 Government grants may take the form of non-monetary assets, such as land or other resources, given at concessional rates. In these circumstances, it is usual to account for such assets at their acquisition cost. Non-monetary assets given free of cost are recorded at a nominal value.

8. Presentation of Grants Related to Specific Fixed Assets

8.1 Grants related to specific fixed assets are government grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire such assets. Other conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.

8.2 Two methods of presentation in financial statements of grants (or the appropriate portions of grants) related to specific fixed assets are regarded as acceptable alternatives.

8.3 Under one method, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Where the grant equals the whole, or virtually the whole, of the cost of the asset, the asset is shown in the balance sheet at a nominal value.

8.4 Under the other method, grants related to depreciable assets are treated as deferred income which is recognised in the statement of profit and loss on a systematic and rational basis over the useful life of the asset. Such allocation to income is usually made over the periods and in the proportions in which depreciation on related assets is charged. Grants related to non-depreciable assets are credited to capital reserve under this method, as there is usually no charge to income in respect of such assets. However, if a grant related to a non-depreciable asset requires the fulfillment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income. The deferred income is suitably disclosed in the balance sheet pending its apportionment to statement of profit and loss.

[14] All paragraphs of AS 4 that deal with contingencies are applicable only to the extent not covered by other Accounting Standards prescribed by the Central Government. For example, the impairment of financial assets such as impairment of receivables (commonly known as provision for bad and doubtful debts) is governed by AS 4.

8.5 The purchase of assets and the receipt of related grants can cause major movements in the cash flow of an enterprise. For this reason and in order to show the gross investment in assets, such movements are often disclosed as separate items in the statement of changes in financial position regardless of whether or not the grant is deducted from the related asset for the purpose of balance sheet presentation.

9. Presentation of Grants Related to Revenue

9.1 Grants related to revenue are sometimes presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, they are deducted in reporting the related expense.

9.2 Supporters of the first method claim that it is inappropriate to net income and expense items and that separation of the grant from the expense facilitates comparison with other expenses not affected by a grant. For the second method, it is argued that the expense might well not have been incurred by the enterprise if the grant had not been available and presentation of the expense without offsetting the grant may therefore be misleading.

10. Presentation of Grants of the nature of Promoters' contribution

10.1 Where the government grants are of the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

11. Refund of Government Grants

11.1 Government grants sometimes become refundable because certain conditions are not fulfilled. A government grant that becomes refundable is treated as an extraordinary item (see Accounting Standard (AS) 5, *Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies*).

11.2 The amount refundable in respect of a government grant related to revenue is applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement.

11.3 The amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. In the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value is provided prospectively over the residual useful life of the asset.

11.4 Where a grant which is in the nature of promoters' contribution becomes refundable, in part or in full, to the government on non-fulfillment of some specified conditions, the relevant amount recoverable by the government is reduced from the capital reserve.

12. Disclosure

12.1 The following disclosures are appropriate:

(i) the accounting policy adopted for government grants, including the methods of presentation in the financial statements;

(ii) the nature and extent of government grants recognised in the financial statements, including grants of non-monetary assets given at a concessional rate or free of cost.

Main Principles

13. Government grants should not be recognised until there is reasonable assurance that (i) the enterprise will comply with the conditions attached to them, and (ii) the grants will be received.

14. Government grants related to specific fixed assets should be presented in the balance sheet by showing the grant as a deduction from the gross value of the assets concerned in arriving at their book value. Where the grant related to a specific fixed asset equals the whole, or virtually the whole, of the cost of the asset, the asset should be shown in the balance sheet at a nominal value. Alternatively, government grants related to depreciable fixed assets may be treated as deferred income which should be recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset, i.e., such grants should be allocated to income over the periods and in the proportions in which depreciation on those assets is charged. Grants related to non-depreciable assets should be credited to capital reserve under this method. However, if a grant related to a non-depreciable asset requires the fulfillment of certain obligations, the grant should be credited to income over the same period over which the cost of meeting such obligations is charged to income. The deferred income balance should be separately disclosed in the financial statements.

15. Government grants related to revenue should be recognised on a systematic basis in the profit and loss statement over the periods necessary to match them with the related costs which they are intended to compensate. Such grants should either be shown separately under 'other income' or deducted in reporting the related expense.

16. Government grants of the nature of promoters' contribution should be credited to capital reserve and treated as a part of shareholders' funds.

17. Government grants in the form of non-monetary assets, given at a concessional rate, should be accounted for on the basis of their acquisition cost. In case a non-monetary asset is given free of cost, it should be recorded at a nominal value.

18. Government grants that are receivable as compensation for expenses or losses incurred in a previous accounting period or for the purpose of giving immediate financial support to the enterprise with no further related costs, should be recognised and disclosed in the profit and loss statement of the period in which they are receivable, as an extraordinary item if appropriate (see Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies).

19. A contingency related to a government grant, arising after the grant has been recognised, should be treated in accordance with Accounting Standard (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date. [15]

20. Government grants that become refundable should be accounted for as an extraordinary item (see Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies).

21. The amount refundable in respect of a grant related to revenue should be applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount should be charged to profit and loss statement. The amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as

[15] See footnote 14.

appropriate, by the amount refundable. In the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

22. Government grants in the nature of promoters' contribution that become refundable should be reduced from the capital reserve.

Disclosure

23. The following should be disclosed:

(i) the accounting policy adopted for government grants, including the methods of presentation in the financial statements;

(ii) the nature and extent of government grants recognised in the financial statements, including grants of non-monetary assets given at a concessional rate or free of cost.

Accounting Standard (AS) 13

Accounting for Investments

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of the General Instructions contained in part A of the Annexure to the Notification.)*

Introduction

1. This Standard deals with accounting for investments in the financial statements of enterprises and related disclosure requirements.[1]

2. This Standard does not deal with:

(a) the bases for recognition of interest, dividends and rentals earned on investments which are covered by Accounting Standard 9 on *Revenue Recognition*;

(b) operating or finance leases;

(c) investments of retirement benefit plans and life insurance enterprises; and

(d) mutual funds and venture capital funds and/or the related asset management companies, banks and public financial institutions formed under a Central or State Government Act or so declared under the Companies Act, 2013.

Definitions

3. The following terms are used in this Standard with the meanings assigned:

3.1 Investments are assets held by an enterprise for earning income by way of dividends, interest, and rentals, for capital appreciation, or for other benefits to the investing enterprise. Assets held as stock-in-trade are not 'investments'.

3.2 A current investment is an investment that is by its nature readily realisable and is intended to be held for not more than one year from the date on which such investment is made.

3.3 A long term investment is an investment other than a current investment.

3.4 An investment property is an investment in land or buildings that are not intended to be occupied substantially for use by, or in the operations of, the investing enterprise.

3.5 Fair value is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction. Under appropriate circumstances, market value or net realisable value provides an evidence of fair value.

[1] Shares, debentures and other securities held as stock-in-trade (i.e., for sale in the ordinary course of business) are not 'investments' as defined in this Standard. However, the manner in which they are accounted for and disclosed in the financial statements is quite similar to that applicable in respect of current investments. Accordingly, the provisions of this Standard, to the extent that they relate to current investments, are also applicable to shares, debentures and other securities held as stock-in-trade, with suitable modifications as specified in this Standard.

3.6 <u>Market value</u> is the amount obtainable from the sale of an investment in an open market, net of expenses necessarily to be incurred on or before disposal.

Explanation

Forms of Investments

4. Enterprises hold investments for diverse reasons. For some enterprises, investment activity is a significant element of operations, and assessment of the performance of the enterprise may largely, or solely, depend on the reported results of this activity.

5. Some investments have no physical existence and are represented merely by certificates or similar documents (e.g., shares) while others exist in a physical form (e.g., buildings). The nature of an investment may be that of a debt, other than a short or long term loan or a trade debt, representing a monetary amount owing to the holder and usually bearing interest; alternatively, it may be a stake in the results and net assets of an enterprise such as an equity share. Most investments represent financial rights, but some are tangible, such as certain investments in land or buildings.

6. For some investments, an active market exists from which a market value can be established. For such investments, market value generally provides the best evidence of fair value. For other investments, an active market does not exist and other means are used to determine fair value.

Classification of Investments

7. Enterprises present financial statements that classify fixed assets, investments and current assets into separate categories. Investments are classified as long term investments and current investments. Current investments are in the nature of current assets, although the common practice may be to include them in investments.[17]

8. Investments other than current investments are classified as long term investments, even though they may be readily marketable.

Cost of Investments

9. The cost of an investment includes acquisition charges such as brokerage, fees and duties.

10. If an investment is acquired, or partly acquired, by the issue of shares or other securities, the acquisition cost is the fair value of the securities issued (which, in appropriate cases, may be indicated by the issue price as determined by statutory authorities). The fair value may not necessarily be equal to the nominal or par value of the securities issued.

11. If an investment is acquired in exchange, or part exchange, for another asset, the acquisition cost of the investment is determined by reference to the fair value of the asset given up. It may be appropriate to consider the fair value of the investment acquired if it is more clearly evident.

12. Interest, dividends and rentals receivables in connection with an investment are generally regarded as income, being the return on the investment. However, in some circumstances, such inflows represent a recovery of cost and do not form part of income. For example, when unpaid interest has accrued before the acquisition of an interest-bearing investment and is therefore included in the price paid for the investment, the subsequent receipt

[17] Shares, debentures and other securities held for sale in the ordinary course of business are disclosed as 'stock-in-trade' under the head 'current assets'.

of interest is allocated between pre-acquisition and post-acquisition periods; the pre-acquisition portion is deducted from cost. When dividends on equity are declared from pre-acquisition profits, a similar treatment may apply. If it is difficult to make such an allocation except on an arbitrary basis, the cost of investment is normally reduced by dividends receivable only if they clearly represent a recovery of a part of the cost.

13. When right shares offered are subscribed for, the cost of the right shares is added to the carrying amount of the original holding. If rights are not subscribed for but are sold in the market, the sale proceeds are taken to the profit and loss statement. However, where the investments are acquired on cum-right basis and the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired, it may be appropriate to apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value.

Carrying Amount of Investments

Current Investments

14. The carrying amount for current investments is the lower of cost and fair value. In respect of investments for which an active market exists, market value generally provides the best evidence of fair value. The valuation of current investments at lower of cost and fair value provides a prudent method of determining the carrying amount to be stated in the balance sheet.

15. Valuation of current investments on overall (or global) basis is not considered appropriate. Sometimes, the concern of an enterprise may be with the value of a category of related current investments and not with each individual investment, and accordingly the investments may be carried at the lower of cost and fair value computed category-wise (i.e. equity shares, preference shares, convertible debentures, etc.). However, the more prudent and appropriate method is to carry investments individually at the lower of cost and fair value.

16. For current investments, any reduction to fair value and any reversals of such reductions are included in the profit and loss statement.

Long-term Investments

17. Long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long term investment, the carrying amount is reduced to recognise the decline. Indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. The type and extent of the investor's stake in the investee are also taken into account. Restrictions on distributions by the investee or on disposal by the investor may affect the value attributed to the investment.

18. Long-term investments are usually of individual importance to the investing enterprise. The carrying amount of long-term investments is therefore determined on an individual investment basis.

19. Where there is a decline, other than temporary, in the carrying amounts of long term investments, the resultant reduction in the carrying amount is charged to the profit and loss statement. The reduction in carrying amount is reversed when there is a rise in the value of the investment, or if the reasons for the reduction no longer exist.

Investment Properties

20. An investment property is accounted for in accordance with cost model as prescribed in Accounting Standard (AS) 10, *Property, Plant and Equipment.* The cost of any shares in a

co-operative society or a company, the holding of which is directly related to the right to hold the investment property, is added to the carrying amount of the investment property.

Disposal of Investments

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

22. When disposing of a part of the holding of an individual investment, the carrying amount to be allocated to that part is to be determined on the basis of the average carrying amount of the total holding of the investment.[3]

Reclassification of Investments

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

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

Disclosure

25. The following disclosures in financial statements in relation to investments are appropriate:—

(a) the accounting policies for the determination of carrying amount of investments;

(b) the amounts included in profit and loss statement for:

(i) interest dividends (showing separately dividends from subsidiary companies[4]), and rentals on investments showing separately such income from long term and current investments. Gross income should be stated, the amount of income tax deducted at source being included under Advance Taxes Paid;

(ii) profits and losses on disposal of current investments and changes in carrying amount of such investments;

(iii) profits and losses on disposal of long term investments and changes in the carrying amount of such investments;

(c) significant restrictions on the right of ownership, realisability of investments or the remittance of income and proceeds of disposal;

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

(e) other disclosures as specifically required by the relevant statute governing the enterprise.

Main Principles

[3] In respect of shares, debentures and other securities held as stock-in-trade, the cost of stocks disposed of is determined by applying an appropriate cost formula (e.g. first-in, first-out; average cost, etc.). These cost formulae are the same as those specified in Accounting Standard (AS) 2, in respect of Valuation of Inventories.

[4] As defined in AS 21, *Consolidated Financial Statements*.

Classification of Investments

26. An enterprise should disclose current investments and long term investments distinctly in its financial statements.

27. Further classification of current and long-term investments should be as specified in the statute governing the enterprise. In the absence of a statutory requirement, such further classification should disclose, where applicable, investments in:

(a) Government or Trust securities

(b) Shares, debentures or bonds

(c) Investment properties

(d) Others—specifying nature.

Cost of Investments

28. The cost of an investment should include acquisition charges such as brokerage, fees and duties.

29. If an investment is acquired, or partly acquired, by the issue of shares or other securities, the acquisition cost should be the fair value of the securities issued (which in appropriate cases may be indicated by the issue price as determined by statutory authorities). The fair value may not necessarily be equal to the nominal or par value of the securities issued. If an investment is acquired in exchange for another asset, the acquisition cost of the investment should be determined by reference to the fair value of the asset given up. Alternatively, the acquisition cost of the investment may be determined with reference to the fair value of the investment acquired if it is more clearly evident.

Investment Properties

30. An enterprise holding investment properties should account for them in accordance with cost model as prescribed in AS 10, Property, Plant and Equipment.

Carrying Amount of Investments

31. Investments classified as current investments should be carried in the financial statements at the lower of cost and fair value determined either on an individual investment basis or by category of investment, but not on an overall (or global) basis.

32. Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually.

Changes in Carrying Amounts of Investments

33. Any reduction in the carrying amount and any reversals of such reductions should be charged or credited to the profit and loss statement.

Disposal of Investments

34. On disposal of an investment, the difference between the carrying amount and net disposal proceeds should be charged or credited to the profit and loss statement.

Disclosure

35. The following information should be disclosed in the financial statements:

(a) the accounting policies for determination of carrying amount of investments;

(b) classification of investments as specified in paragraphs 26 and 27 above;

(c) the amounts included in profit and loss statement for:

(i) interest, dividends (showing separately dividends from subsidiary companies), and rentals on investments showing separately such income from long-term and current investments. Gross income should be stated, the amount of income tax deducted at source being included under Advance Taxes Paid;

(ii) profits and losses on disposal of current investments and changes in the carrying amount of such investments; and

(iii) profits and losses on disposal of long-term investments and changes in the carrying amount of such investments;

(d) significant restrictions on the right of ownership, realisability of investments or the remittance of income and proceeds of disposal;

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

(f) other disclosures as specifically required by the relevant statute governing the enterprise.

Accounting Standard (AS) 14

Accounting for Amalgamations

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of the General Instructions contained in part A of the Annexure to the Notification.)*

Introduction

1. This standard deals with accounting for amalgamations and the treatment of any resultant goodwill or reserves. This Standard is directed principally to companies although some of its requirements also apply to financial statements of other enterprises.

2. This standard does not deal with cases of acquisitions which arise when there is a purchase by one company (referred to as the acquiring company) of the whole or part of the shares, or the whole or part of the assets, of another company (referred to as the acquired company) in consideration for payment in cash or by issue of shares or other securities in the acquiring company or partly in one form and partly in the other. The distinguishing feature of an acquisition is that the acquired company is not dissolved and its separate entity continues to exist.

Definitions

3. The following terms are used in this standard with the meanings specified:

(a) Amalgamation means an amalgamation pursuant to the provisions of the Companies Act, 2013 or any other statute which may be applicable to companies and includes 'merger'.

(b) Transferor company means the company which is amalgamated into another company.

(c) Transferee company means the company into which a transferor company is amalgamated.

(d) Reserve means the portion of earnings, receipts or other surplus of an enterprise (whether capital or revenue) appropriated by the management for a general or a specific purpose other than a provision for depreciation or diminution in the value of assets or for a known liability.

(e) Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions.

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

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries[1] or their nominees) become equity shareholders of the transferee

[1] As defined in AS 21, *Consolidated Financial Statements.*

company by virtue of the amalgamation.

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

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

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

(f) Amalgamation in the nature of purchase is an amalgamation which does not satisfy any one or more of the conditions specified in sub-paragraph (e) above.

(g) Consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.

(h) Fair value is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.

(i) Pooling of interests is a method of accounting for amalgamations the object of which is to account for the amalgamation as if the separate businesses of the amalgamating companies were intended to be continued by the transferee company. Accordingly, only minimal changes are made in aggregating the individual financial statements of the amalgamating companies.

Explanation

Types of Amalgamations

4. Generally speaking, amalgamations fall into two broad categories. In the first category are those amalgamations where there is a genuine pooling not merely of the assets and liabilities of the amalgamating companies but also of the shareholders' interests and of the businesses of these companies. Such amalgamations are amalgamations which are in the nature of 'merger' and the accounting treatment of such amalgamations should ensure that the resultant figures of assets, liabilities, capital and reserves more or less represent the sum of the relevant figures of the amalgamating companies. In the second category are those amalgamations which are in effect a mode by which one company acquires another company and, as a consequence, the shareholders of the company which is acquired normally do not continue to have a proportionate share in the equity of the combined company, or the business of the company which is acquired is not intended to be continued. Such amalgamations are amalgamations in the nature of 'purchase'.

5. An amalgamation is classified as an 'amalgamation in the nature of merger' when all the conditions listed in paragraph 3(e) are satisfied. There are, however, differing views regarding the nature of any further conditions that may apply. Some believe that, in addition to an exchange of equity shares, it is necessary that the shareholders of the transferor company obtain a substantial share in the transferee company even to the extent that it should not be

possible to identify any one party as dominant therein. This belief is based in part on the view that the exchange of control of one company for an insignificant share in a larger company does not amount to a mutual sharing of risks and benefits.

6. Others believe that the substance of an amalgamation in the nature of merger is evidenced by meeting certain criteria regarding the relationship of the parties, such as the former independence of the amalgamating companies, the manner of their amalgamation, the absence of planned transactions that would undermine the effect of the amalgamation, and the continuing participation by the management of the transferor company in the management of the transferee company after the amalgamation.

Methods of Accounting for Amalgamations

7. There are two main methods of accounting for amalgamations:

(a) the pooling of interests method; and

(b) the purchase method.

8. The use of the pooling of interests method is confined to circumstances which meet the criteria referred to in paragraph 3(e) for an amalgamation in the nature of merger.

9. The object of the purchase method is to account for the amalgamation by applying the same principles as are applied in the normal purchase of assets. This method is used in accounting for amalgamations in the nature of purchase.

The Pooling of Interests Method

10. Under the pooling of interests method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts (after making the adjustments required in paragraph 11).

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

The Purchase Method

12. Under the purchase method, the transferee company accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company.

13. Where assets and liabilities are restated on the basis of their fair values, the determination of fair values may be influenced by the intentions of the transferee company. For example, the transferee company may have a specialised use for an asset, which is not available to other potential buyers. The transferee company may intend to effect changes in the activities of the transferor company which necessitate the creation of specific provisions for the expected costs, e.g. planned employee termination and plant relocation costs.

Consideration

14. The consideration for the amalgamation may consist of securities, cash or other assets. In determining the value of the consideration, an assessment is made of the fair value of its elements. A variety of techniques is applied in arriving at fair value. For example, when the consideration includes securities, the value fixed by the statutory authorities may be taken to be the fair value. In case of other assets, the fair value may be determined by reference to the market value of the assets given up. Where the market value of the assets given up cannot be reliably assessed, such assets may be valued at their respective net book values.

15. Many amalgamations recognise that adjustments may have to be made to the consideration in the light of one or more future events. When the additional payment is probable and can reasonably be estimated at the date of amalgamation, it is included in the calculation of the consideration. In all other cases, the adjustment is recognised as soon as the amount is determinable [see Accounting Standard (AS) 4, *Contingencies and Events Occurring After the Balance Sheet Date*].

Treatment of Reserves on Amalgamation

16. If the amalgamation is an 'amalgamation in the nature of merger', the identity of the reserves is preserved and they appear in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company. Thus, for example, the General Reserve of the transferor company becomes the General Reserve of the transferee company, the Capital Reserve of the transferor company becomes the Capital Reserve of the transferee company and the Revaluation Reserve of the transferor company becomes the Revaluation Reserve of the transferee company. As a result of preserving the identity, reserves which are available for distribution as dividend before the amalgamation would also be available for distribution as dividend after the amalgamation. The difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company is adjusted in reserves in the financial statements of the transferee company.

17. If the amalgamation is an 'amalgamation in the nature of purchase', the identity of the reserves, other than the statutory reserves dealt with in paragraph 18, is not preserved. The amount of the consideration is deducted from the value of the net assets of the transferor company acquired by the transferee company. If the result of the computation is negative, the difference is debited to goodwill arising on amalgamation and dealt with in the manner stated in paragraphs 19-20. If the result of the computation is positive, the difference is credited to Capital Reserve.

18. Certain reserves may have been created by the transferor company pursuant to the requirements of, or to avail of the benefits under, the Income-tax Act, 1961; for example, Development Allowance Reserve, or Investment Allowance Reserve. The Act requires that the identity of the reserves should be preserved for a specified period. Likewise, certain other reserves may have been created in the financial statements of the transferor company in terms of the requirements of other statutes. Though, normally, in an amalgamation in the nature of purchase, the identity of reserves is not preserved, an exception is made in respect of reserves of the aforesaid nature (referred to hereinafter as 'statutory reserves') and such reserves retain their identity in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company, so long as their identity is required to be maintained to comply with the relevant statute. This exception is made only in those amalgamations where the requirements of the relevant statute for recording the statutory reserves in the books of the transferee company are complied with. In such cases the statutory reserves are recorded in the financial statements of the transferee company by a corresponding debit to a suitable account head (e.g., 'Amalgamation Adjustment Reserve') which is presented as a separate line item. When the identity of the

statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account are reversed.

Treatment of Goodwill Arising on Amalgamation

19. Goodwill arising on amalgamation represents a payment made in anticipation of future income and it is appropriate to treat it as an asset to be amortised to income on a systematic basis over its useful life. Due to the nature of goodwill, it is frequently difficult to estimate its useful life with reasonable certainty. Such estimation is, therefore, made on a prudent basis. Accordingly, it is considered appropriate to amortise goodwill over a period not exceeding five years unless a somewhat longer period can be justified.

20. Factors which may be considered in estimating the useful life of goodwill arising on amalgamation include:

(a) the foreseeable life of the business or industry;

(b) the effects of product obsolescence, changes in demand and other economic factors;

(c) the service life expectancies of key individuals or groups of employees;

(d) expected actions by competitors or potential competitors; and

(e) legal, regulatory or contractual provisions affecting the useful life.

Balance of Profit and Loss Account

21. In the case of an 'amalgamation in the nature of merger', the balance of the Profit and Loss Account appearing in the financial statements of the transferor company is aggregated with the corresponding balance appearing in the financial statements of the transferee company. Alternatively, it is transferred to the General Reserve, if any.

22. In the case of an 'amalgamation in the nature of purchase', the balance of the Profit and Loss Account appearing in the financial statements of the transferor company, whether debit or credit, loses its identity.

Treatment of Reserves Specified in A Scheme of Amalgamation

23[2]. The scheme of amalgamation sanctioned under the provisions of the Companies Act, 1956 or any other statute may prescribe the treatment to be given to the reserves of the transferor company after its amalgamation. Where the treatment is so prescribed, the same is followed. In some cases, the scheme of amalgamation sanctioned under a statute may prescribe a different treatment to be given to the reserves of the transferor company after amalgamation as compared to the requirements of this Standard that would have been followed had no treatment been prescribed by the scheme. In such cases, the following disclosures are made in the first financial statements following the amalgamation:

(a) A description of the accounting treatment given to the reserves and the reasons for following the treatment different from that prescribed in this Standard.

(b) Deviations in the accounting treatment given to the reserves as prescribed by the scheme of amalgamation sanctioned under the statute as compared to the

[2] Paragraph 23 shall not apply to any scheme of amalgamation approved under the Companies Act, 2013.

requirements of this Standard that would have been followed had no treatment been prescribed by the scheme.

(c) The financial effect, if any, arising due to such deviation.

Disclosure

24. For all amalgamations, the following disclosures are considered appropriate in the first financial statements following the amalgamation:

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

(b) effective date of amalgamation for accounting purposes;

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

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

25. For amalgamations accounted for under the pooling of interests method, the following additional disclosures are considered appropriate in the first financial statements following the amalgamation:

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

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

26. For amalgamations accounted for under the purchase method, the following additional disclosures are considered appropriate in the first financial statements following the amalgamation:

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

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

Amalgamation after the Balance Sheet Date

27. When an amalgamation is effected after the balance sheet date but before the issuance of the financial statements of either party to the amalgamation, disclosure is made in accordance with AS 4, *Contingencies and Events Occurring After the Balance Sheet Date*, but the amalgamation is not incorporated in the financial statements. In certain circumstances, the amalgamation may also provide additional information affecting the financial statements themselves, for instance, by allowing the going concern assumption to be maintained.

Main Principles

28. An amalgamation may be either –

(a) an amalgamation in the nature of merger, or

(b) an amalgamation in the nature of purchase.

29. An amalgamation should be considered to be an amalgamation in the nature of merger when all the following conditions are satisfied:

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

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

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

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

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

30. An amalgamation should be considered to be an amalgamation in the nature of purchase, when any one or more of the conditions specified in paragraph 29 is not satisfied.

31. When an amalgamation is considered to be an amalgamation in the nature of merger, it should be accounted for under the pooling of interests method described in paragraphs 33–35.

32. When an amalgamation is considered to be an amalgamation in the nature of purchase, it should be accounted for under the purchase method described in paragraphs 36–39.

The Pooling of Interests Method

33. In preparing the transferee company's financial statements, the assets, liabilities and reserves (whether capital or revenue or arising on revaluation) of the transferor company should be recorded at their existing carrying amounts and in the same form as at the date of the amalgamation. The balance of the Profit and Loss Account of the transferor company should be aggregated with the corresponding balance of the transferee company or transferred to the General Reserve, if any.

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

35. The difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company should be adjusted in reserves.

The Purchase Method

36. In preparing the transferee company's financial statements, the assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or, alternatively, the consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation. The reserves (whether capital or revenue or arising on revaluation) of the transferor company, other than the statutory reserves, should not be included in the financial statements of the transferee company except as stated in paragraph 39.

37. Any excess of the amount of the consideration over the value of the net assets of the transferor company acquired by the transferee company should be recognised in the transferee company's financial statements as goodwill arising on amalgamation. If the amount of the consideration is lower than the value of the net assets acquired, the difference should be treated as Capital Reserve.

38. The goodwill arising on amalgamation should be amortised to income on a systematic basis over its useful life. The amortisation period should not exceed five years unless a somewhat longer period can be justified.

39. Where the requirements of the relevant statute for recording the statutory reserves in the books of the transferee company are complied with, statutory reserves of the transferor company should be recorded in the financial statements of the transferee company. The corresponding debit should be given to a suitable account head (e.g., 'Amalgamation Adjustment Reserve') which should be presented as a separate line item. When the identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account should be reversed.

Common Procedures

40. The consideration for the amalgamation should include any non-cash element at fair value. In case of issue of securities, the value fixed by the statutory authorities may be taken to be the fair value. In case of other assets, the fair value may be determined by reference to the market value of the assets given up. Where the market value of the assets given up cannot be reliably assessed, such assets may be valued at their respective net book values.

41. Where the scheme of amalgamation provides for an adjustment to the consideration contingent on one or more future events, the amount of the additional payment should be included in the consideration if payment is probable and a reasonable estimate of the amount can be made. In all other cases, the adjustment should be recognised as soon as the amount is determinable [see Accounting Standard (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date].

Treatment of Reserves Specified in A Scheme of Amalgamation

42.[3] Where the scheme of amalgamation sanctioned under a statute prescribes the treatment to be given to the reserves of the transferor company after amalgamation, the same should be followed. Where the scheme of amalgamation sanctioned under a statute prescribes a different treatment to be given to the reserves of the transferor company after amalgamation as compared to the requirements of this Standard that would have been followed had no treatment been prescribed by the scheme, the following disclosures should be made in the first financial statements following the amalgamation:

[3] Paragraph 42 shall not apply to any scheme of amalgamation approved under the Companies Act, 2013.

(a) A description of the accounting treatment given to the reserves and reasons for following the treatment different from that prescribed in this Standard.

(b) Deviations in the accounting treatment given to the reserves as prescribed by the scheme of amalgamation sanctioned under the statute as compared to the requirements of this Standard that would have been followed had no treatment been prescribed by the scheme.

(c) The financial effect, if any, arising due to such deviation.

Disclosure

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

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

(b) effective date of amalgamation for accounting purposes;

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

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

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

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

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

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

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

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

Amalgamation after the Balance Sheet Date

46. When an amalgamation is effected after the balance sheet date but before the issuance of the financial statements of either party to the amalgamation, disclosure should be made in accordance with AS 4, Contingencies and Events Occurring After the Balance Sheet Date, but the amalgamation should not be incorporated in the financial statements. In certain circumstances, the amalgamation may also provide additional information affecting the financial statements themselves, for instance, by allowing the going concern assumption to be maintained.

Accounting Standard (AS) 15

Employee Benefits

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the General Instructions contained in part A of the Annexure to the Notification.)*

Objective

The objective of this Standard is to prescribe the accounting and disclosure for employee benefits. The Standard requires an enterprise to recognise:

(a) a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and

(b) an expense when the enterprise consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

Scope

1. This Standard should be applied by an employer in accounting for all employee benefits, except employee share-based payments[17].

2. This Standard does not deal with accounting and reporting by employee benefit plans.

3. The employee benefits to which this Standard applies include those provided:

   (a) under formal plans or other formal agreements between an enterprise and individual employees, groups of employees or theirrepresentatives;

   (b) under legislative requirements, or through industry arrangements, whereby enterprises are required to contribute to state, industry or other multi-employer plans; or

   (c) by those informal practices that give rise to an obligation. Informal practices give rise to an obligation where the enterprise has no realistic alternative but to pay employee benefits. An example of such an obligation is where a change in the enterprise's informal practices would cause unacceptable damage to its relationship with employees.

4. Employee benefits include:

   (a) short-term employee benefits, such as wages, salaries and social security contributions (e.g., contribution to an insurance company by an employer to pay for medical care of its employees), paid annual leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;

[17] The accounting for such benefits is dealt with in the Guidance Note on Accounting for Employee Share-based Payments issued by the Institute of Chartered Accountants of India.

(b) post-employment benefits such as gratuity, pension, other retirement benefits, post-employment life insurance and post-employment medical care;

(c) other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation; and

(d) termination benefits.

Because each category identified in (a) to (d) above has different characteristics, this Standard establishes separate requirements for each category.

5. Employee benefits include benefits provided to either employees or their spouses, children or other dependants and may be settled by payments (or the provision of goods or services) made either:

(a) directly to the employees, to their spouses, children or other dependants, or to their legal heirs or nominees; or

(b) to others, such as trusts, insurance companies.

6. An employee may provide services to an enterprise on a full-time, part-time, permanent, casual or temporary basis. For the purpose of this Standard, employees include whole-time directors and other management personnel.

Definitions

7. The following terms are used in this Standard with the meanings specified:

7.1 Employee benefits are all forms of consideration given by an enterprise in exchange for service rendered by employees.

7.2 Short-term employee benefits are employee benefits (other than termination benefits) which fall due wholly within twelve months after the end of the period in which the employees render the related service.

7.3 Post-employment benefits are employee benefits (other than termination benefits) which are payable after the completion of employment.

7.4 Post-employment benefit plans are formal or informal arrangements under which an enterprise provides post-employment benefits for one or more employees.

7.5 Defined contribution plans are post-employment benefit plans under which an enterprise pays fixed contributions into a separate entity (a fund) and will have no obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

7.6 Defined benefit plans are post-employment benefit plans other than defined contribution plans.

7.7 Multi-employer plans are defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that:

(a) pool the assets contributed by various enterprises that are not under common control; and

(b) use those assets to provide benefits to employees of more than one enterprise, on the basis that contribution and benefit levels are determined without regard to the identity of the enterprise that employs the employees concerned.

7.8 Other long-term employee benefits are employee benefits (other than post-employment benefits and termination benefits) which do not fall due wholly within twelve months after the end of the period in which the employees render the related service.

7.9 Termination benefits are employee benefits payable as a result of either:

(a) an enterprise's decision to terminate an employee's employment before the normal retirement date; or

(b) an employee's decision to accept voluntary redundancy in exchange for those benefits (voluntary retirement).

7.10 Vested employee benefits are employee benefits that are not conditional on future employment.

7.11 The present value of a defined benefit obligation is the present value, without deducting any plan assets, of expected future payments required to settle the obligation resulting from employee service in the current and prior periods.

7.12 Current service cost is the increase in the present value of the defined benefit obligation resulting from employee service in the current period.

7.13 Interest cost is the increase during a period in the present value of a defined benefit obligation which arises because the benefits are one period closer to settlement.

7.14 Plan assets comprise:

(a) assets held by a long-term employee benefit fund; and

(b) qualifying insurance policies.

7.15 Assets held by a long-term employee benefit fund are assets (other than non-transferable financial instruments issued by the reporting enterprise) that:

(a) are held by an entity (a fund) that is legally separate from the reporting enterprise and exists solely to pay or fund employee benefits; and

(b) are available to be used only to pay or fund employee benefits, are not available to the reporting enterprise's own creditors (even in bankruptcy), and cannot be returned to the reporting enterprise, unless either:

(i) the remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting enterprise; or

(ii) the assets are returned to the reporting enterprise to reimburse it for employee benefits already paid.

7.16 A qualifying insurance policy is an insurance policy issued by an insurer that is not a related party (as defined in AS 18, Related Party Disclosures) of the reporting enterprise, if the proceeds of the policy:

(a) can be used only to pay or fund employee benefits under a defined benefit plan; and

(b) are not available to the reporting enterprise's own creditors (even in bankruptcy) and cannot be paid to the reporting enterprise, unless either:

(i) the proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or

(ii) the proceeds are returned to the reporting enterprise to reimburse it for employee benefits already paid.

7.17 Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction.

7.18 The return on plan assets is interest, dividends and other revenue derived from the plan assets, together with realised and unrealised gains or losses on the plan assets, less any costs of administering the plan and less any tax payable by the plan itself.

7.19 Actuarial gains and losses comprise:

(a) experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and

(b) the effects of changes in actuarial assumptions.

7.20 Past service cost is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits. Past service cost may be either positive (where benefits are introduced or improved) or negative (where existing benefits are reduced).

Short-term Employee Benefits

8. Short-term employee benefits include items such as:

(a) wages, salaries and social security contributions;

(b) short-term compensated absences (such as paid annual leave) where the absences are expected to occur within twelve months after the end of the period in which the employees render the related employee service;

(c) profit-sharing and bonuses payable within twelve months after the end of the period in which the employees render the related service; and

(d) non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.

9. Accounting for short-term employee benefits is generally straight- forward because no actuarial assumptions are required to measure the obligation or the cost and there is no possibility of any actuarial gain or loss. Moreover, short-term employee benefit obligations are measured on an undiscounted basis.

Recognition and Measurement

All Short-term Employee Benefits

10. When an employee has rendered service to an enterprise during an accounting period, the enterprise should recognise the undiscounted amount of short-term employee benefits expected to be paid in exchange for that service:

(a) as a liability (accrued expense), after deducting any amount already paid. If the amount already paid exceeds the undiscounted amount of the benefits, an enterprise should recognise that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund; and

(b) as an expense, unless another Accounting Standard requires or permits the inclusion of the benefits in the cost of an asset (see, for example, AS 10, Property, Plant and Equipment).

Paragraphs 11, 14 and 17 explain how an enterprise should apply this requirement to short-term employee benefits in the form of compensated absences and profit-sharing and bonus plans.

Short-term Compensated Absences

11. An enterprise should recognise the expected cost of short-term employee benefits in the form of compensated absences under paragraph 10 as follows:

(a) in the case of accumulating compensated absences, when the employees render service that increases their entitlement to future compensated absences; and

(b) in the case of non-accumulating compensated absences, when the absences occur.

12. An enterprise may compensate employees for absence for various reasons including vacation, sickness and short-term disability, and maternity or paternity. Entitlement to compensated absences falls into two categories:

(a) accumulating; and

(b) non-accumulating.

13. Accumulating compensated absences are those that are carried forward and can be used in future periods if the current period's entitlement is not used in full. Accumulating compensated absences may be either vesting (in other words, employees are entitled to a cash payment for unused entitlement on leaving the enterprise) or non-vesting (when employees are not entitled to a cash payment for unused entitlement on leaving). An obligation arises as employees render service that increases their entitlement to future compensated absences. The obligation exists, and is recognised, even if the compensated absences are non-vesting, although the possibility that employees may leave before they use an accumulated non-vesting entitlement affects the measurement of that obligation.

14. An enterprise should measure the expected cost of accumulating compensated absences as the additional amount that the enterprise expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date.

15. The method specified in the previous paragraph measures the obligation at the amount of the additional payments that are expected to arise solely from the fact that the benefit accumulates. In many cases, an enterprise may not need to make detailed computations to estimate that there is no material obligation for unused compensated absences. For example, a leave obligation is likely to be material only if there is a formal or informal understanding that unused leave may be taken as paid vacation.

Example Illustrating Paragraphs 14 and 15

An enterprise has 100 employees, who are each entitled to five working days of leave for each year. Unused leave may be carried forward for one calendar year. The leave is taken first out of the current year's entitlement and then out of any balance brought forward from the previous year (a LIFO basis). At 31 December 20X4, the average unused entitlement is two days per employee. The enterprise expects, based on past experience which is expected to continue, that 92 employees will take no more than five days of leave in 20X5 and that the remaining eight employees will take an average of six and a half days each.

The enterprise expects that it will pay an additional 12 days of pay as a result of the unused entitlement that has accumulated at 31 December 20X4 (one and a half days each, for eight employees). Therefore, the enterprise recognises a liability, as at 31 December 20X4, equal to 12 days of pay.

16. Non-accumulating compensated absences do not carry forward: they lapse if the current period's entitlement is not used in full and do not entitle employees to a cash payment for unused entitlement on leaving the enterprise. This is commonly the case for maternity or paternity leave. An enterprise recognises no liability or expense until the time of the absence, because employee service does not increase the amount of the benefit.

Provided that a Small and Medium-sized Company, as defined in the Notification, may not comply with paragraphs 11 to 16 of the Standard to the extent they deal with recognition and measurement of short-term accumulating compensated absences which are non-vesting (i.e., short-term accumulating compensated absences in respect of which employees are not entitled to cash payment for unused entitlement on leaving).

Profit-sharing and Bonus Plans

17. An enterprise should recognise the expected cost of profit-sharing and bonus payments under paragraph 10 when, and only when:

(a) the enterprise has a present obligation to make such payments as a result of past events; and

(b) a reliable estimate of the obligation can be made.

A present obligation exists when, and only when, the enterprise has no realistic alternative but to make the payments.

18. Under some profit-sharing plans, employees receive a share of the profit only if they remain with the enterprise for a specified period. Such plans create an obligation as employees render service that increases the amount to be paid if they remain in service until the end of the specified period. The measurement of such obligations reflects the possibility that some employees may leave without receiving profit-sharing payments.

Example Illustrating Paragraph 18

A profit-sharing plan requires an enterprise to pay a specified proportion of its net profit for the year to employees who serve throughout the year. If no employees leave during the year, the total profit-sharing payments for the year will be 3% of net profit. The enterprise estimates that staff turnover will reduce the payments to 2.5% of net profit.

The enterprise recognises a liability and an expense of 2.5% of net profit.

19. An enterprise may have no legal obligation to pay a bonus. Nevertheless, in some cases, an enterprise has a practice of paying bonuses. In such cases also, the enterprise has an obligation because the enterprise has no realistic alternative but to pay the bonus. The measurement of the obligation reflects the possibility that some employees may leave without receiving a bonus.

20. An enterprise can make a reliable estimate of its obligation under a profit-sharing or bonus plan when, and only when:

(a) the formal terms of the plan contain a formula for determining the amount of the benefit; or

(b) the enterprise determines the amounts to be paid before the financial statements are approved; or

(c) past practice gives clear evidence of the amount of the enterprise's obligation.

21. An obligation under profit-sharing and bonus plans results from employee service and not from a transaction with the enterprise's owners. Therefore, an enterprise recognises the cost of profit-sharing and bonus plans not as a distribution of net profit but as an expense.

22. If profit-sharing and bonus payments are not due wholly within twelve months after the end of the period in which the employees render the related service, those payments are other long-term employee benefits (see paragraphs 127-132).

Disclosure

23. Although this Standard does not require specific disclosures about short-term employee benefits, other Accounting Standards may require disclosures. For example, where required by AS 18, *Related Party Disclosures* an enterprise discloses information about employee benefits for key management personnel.

Post-employment Benefits: Defined Contribution Plans and Defined Benefit Plans

24. Post-employment benefits include:

(a) retirement benefits, e.g., gratuity and pension; and

(b) other benefits, e.g., post-employment life insurance and post- employment medical care.

Arrangements whereby an enterprise provides post-employment benefits are post-employment benefit plans. An enterprise applies this Standard to all such arrangements whether or not they involve the establishment of a separate entity to receive contributions and to pay benefits.

25. Post-employment benefit plans are classified as either defined contribution plans or defined benefit plans, depending on the economic substance of the plan as derived from its principal terms and conditions. Under defined contribution plans:

(a) the enterprise's obligation is limited to the amount that it agrees to contribute to the fund. Thus, the amount of the post-employment benefits received by the employee is determined by the amount of contributions paid by an enterprise (and also by the employee) to a post-employment benefit plan or to an insurance company, together with investment returns arising from the contributions; and

(b) in consequence, actuarial risk (that benefits will be less than expected) and investment risk (that assets invested will be insufficient to meet expected benefits) fall on the employee.

26. Examples of cases where an enterprise's obligation is not limited to the amount that it agrees to contribute to the fund are when the enterprise has an obligation through:

(a) a plan benefit formula that is not linked solely to the amount of contributions; or

(b) a guarantee, either indirectly through a plan or directly, of a specified return on contributions; or

(c) informal practices that give rise to an obligation, for example, an obligation may arise where an enterprise has a history of increasing benefits for former employees to keep pace with inflation even where there is no legal obligation to do so.

27. Under defined benefit plans:

(a) the enterprise's obligation is to provide the agreed benefits to current and former employees; and

(b) actuarial risk (that benefits will cost more than expected) and investment risk fall, in substance, on the enterprise. If actuarial or investment experience are worse than expected, the enterprise's obligation may be increased.

28. Paragraphs 29 to 43 below deal with defined contribution plans and defined benefit plans in the context of multi-employer plans, state plans and insured benefits.

Multi-employer Plans

29. An enterprise should classify a multi-employer plan as a defined contribution plan or a defined benefit plan under the terms of the plan (including any obligation that goes beyond the formal terms). Where a multi-employer plan is a defined benefit plan, an enterprise should:

(a) account for its proportionate share of the defined benefit obligation, plan assets and cost associated with the plan in the same way as for any other defined benefit plan; and

(b) disclose the information required by paragraph 120.

30. When sufficient information is not available to use defined benefit accounting for a multi-employer plan that is a defined benefit plan, an enterprise should:

(a) account for the plan under paragraphs 45-47 as if it were a defined contribution plan;

(b) disclose:

(i) the fact that the plan is a defined benefit plan; and

(ii) the reason why sufficient information is not available to enable the enterprise to account for the plan as a defined benefit plan; and

(c) to the extent that a surplus or deficit in the plan may affect the amount of future contributions, disclose in addition:

(i) any available information about that surplus or deficit;

(ii) the basis used to determine that surplus or deficit; and

(iii) the implications, if any, for the enterprise.

31. One example of a defined benefit multi-employer plan is one where:

(a) the plan is financed in a manner such that contributions are set at a level that is expected to be sufficient to pay the benefits falling due in the same period; and future benefits earned during the current period will be paid out of future contributions; and

(b) employees' benefits are determined by the length of their service and the participating enterprises have no realistic means of withdrawing from the plan without paying a contribution for the benefits earned by employees up to the date of withdrawal. Such a plan creates actuarial risk for the enterprise; if the ultimate cost of benefits already earned at the balance sheet date is more than expected, the enterprise will have to either increase its contributions or persuade employees to accept a reduction in benefits. Therefore, such a plan is a defined benefit plan.

32. Where sufficient information is available about a multi-employer plan which is a defined benefit plan, an enterprise accounts for its proportionate share of the defined benefit obligation, plan assets and post-employment benefit cost associated with the plan in the same way as for any other defined benefit plan. However, in some cases, an enterprise may not be able to identify its share of the underlying financial position and performance of the plan with sufficient reliability for accounting purposes. This may occur if:

(a) the enterprise does not have access to information about the plan that satisfies the requirements of this Standard; or

(b) the plan exposes the participating enterprises to actuarial risks associated with the current and former employees of other enterprises, with the result that there is no consistent and reliable basis for allocating the obligation, plan assets and cost to individual enterprises participating in the plan.

In those cases, an enterprise accounts for the plan as if it were a defined contribution plan and discloses the additional information required by paragraph 30.

33. Multi-employer plans are distinct from group administration plans. A group administration plan is merely an aggregation of single employer plans combined to allow participating employers to pool their assets for investment purposes and reduce investment management and administration costs, but the claims of different employers are segregated for the sole benefit of their own employees. Group administration plans pose no particular accounting problems because information is readily available to treat them in the same way as any other single employer plan and because such plans do not expose the participating enterprises to actuarial risks associated with the current and former employees of other enterprises. The definitions in this Standard require an enterprise to classify a group administration plan as a defined contribution plan or a defined benefit plan in accordance with the terms of the plan (including any obligation that goes beyond the formal terms).

34. Defined benefit plans that share risks between various enterprises under common control, for example, a parent and its subsidiaries, are not multi-employer plans.

35. In respect of such a plan, if there is a contractual agreement or stated policy for charging the net defined benefit cost for the plan as a whole to individual group enterprises, the enterprise recognises, in its separate financial statements, the net defined benefit cost so charged. If there is no such agreement or policy, the net defined benefit cost is recognised in the separate financial statements of the group enterprise that is legally the sponsoring employer for the plan. The other group enterprises recognise, in their separate financial statements, a cost equal to their contribution payable for the period.

36. AS 29, *Provisions, Contingent Liabilities and Contingent Assets* requires an enterprise to recognise, or disclose information about, certain contingent liabilities. In the context of a multi-employer plan, a contingent liability may arise from, for example:

(a) actuarial losses relating to other participating enterprises because each enterprise that participates in a multi-employer plan shares in the actuarial risks of every other participating enterprise; or

(b) any responsibility under the terms of a plan to finance any shortfall in the plan if other enterprises cease to participate.

State Plans

37. An enterprise should account for a state plan in the same way as for a multi-employer plan (see paragraphs 29 and 30).

38. State plans are established by legislation to cover all enterprises (or all enterprises in a particular category, for example, a specific industry) and are operated by national or local government or by another body (for example, an autonomous agency created specifically for this purpose) which is not subject to control or influence by the reporting enterprise. Some plans established by an enterprise provide both compulsory benefits which substitute for benefits that would otherwise be covered under a state plan and additional voluntary benefits. Such plans are not state plans.

39. State plans are characterised as defined benefit or defined contribution in nature based on the enterprise's obligation under the plan. Many state plans are funded in a manner such that contributions are set at a level that is expected to be sufficient to pay the required benefits falling due in the same period; future benefits earned during the current period will be paid out of future contributions. Nevertheless, in most state plans, the enterprise has no obligation to pay those future benefits: its only obligation is to pay the contributions as they fall due and if the enterprise ceases to employ members of the state plan, it will have no obligation to pay the benefits earned by such employees in previous years. For this reason, state plans are normally defined contribution plans. However, in the rare cases when a state plan is a defined benefit plan, an enterprise applies the treatment prescribed in paragraphs 29 and 30.

Insured Benefits

40. An enterprise may pay insurance premiums to fund a post-employment benefit plan. The enterprise should treat such a plan as a defined contribution plan unless the enterprise will have (either directly, or indirectly through the plan) an obligation to either:

(a) pay the employee benefits directly when they fall due; or

(b) pay further amounts if the insurer does not pay all future employee benefits relating to employee service in the current and prior periods.

If the enterprise retains such an obligation, the enterprise should treat the plan as a defined benefit plan.

41. The benefits insured by an insurance contract need not have a direct or automatic relationship with the enterprise's obligation for employee benefits. Post-employment benefit plans involving insurance contracts are subject to the same distinction between accounting and funding as other funded plans.

42. Where an enterprise funds a post-employment benefit obligation by contributing to an insurance policy under which the enterprise (either directly, indirectly through the plan, through the mechanism for setting future premiums or through a related party relationship with the insurer) retains an obligation, the payment of the premiums does not amount to a defined contribution arrangement. It follows that the enterprise:

(a) accounts for a qualifying insurance policy as a plan asset (see paragraph 7); and

(b) recognises other insurance policies as reimbursement rights (if the policies satisfy the criteria in paragraph 103).

43. Where an insurance policy is in the name of a specified plan participant or a group of plan participants and the enterprise does not have any obligation to cover any loss on the policy, the enterprise has no obligation to pay benefits to the employees and the insurer has sole responsibility for paying the benefits. The payment of fixed premiums under such contracts is, in substance, the settlement of the employee benefit obligation, rather than an investment to meet the obligation. Consequently, the enterprise no longer has an asset or a liability. Therefore, an enterprise treats such payments as contributions to a defined contribution plan.

Post-employment Benefits: Defined Contribution Plans

44. Accounting for defined contribution plans is straightforward because the reporting enterprise's obligation for each period is determined by the amounts to be contributed for that period. Consequently, no actuarial assumptions are required to measure the obligation or the expense and there is no possibility of any actuarial gain or loss. Moreover, the obligations are measured on an undiscounted basis, except where they do not fall due wholly within twelve months after the end of the period in which the employees render the related service.

Recognition and Measurement

45. When an employee has rendered service to an enterprise during a period, the enterprise should recognise the contribution payable to a defined contribution plan in exchange for that service:

(a) as a liability (accrued expense), after deducting any contribution already paid. If the contribution already paid exceeds the contribution due for service before the balance sheet date, an enterprise should recognise that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund; and

(b) as an expense, unless another Accounting Standard requires or permits the inclusion of the contribution in the cost of an asset (see, for example, AS 10, Property, Plant and Equipment).

46. Where contributions to a defined contribution plan do not fall due wholly within twelve months after the end of the period in which the employees render the related service, they should be discounted using the discount rate specified in paragraph 78.

Provided that a Small and Medium-sized Company, as defined in the Notification, may not discount contributions that fall due more than 12 months after the balance sheet date.

Disclosure

47. An enterprise should disclose the amount recognised as an expense for defined contribution plans.

48. Where required by AS 18, *Related Party Disclosures* an enterprise discloses information about contributions to defined contribution plans for key management personnel.

Post-employment Benefits: Defined Benefit Plans

49. Accounting for defined benefit plans is complex because actuarial assumptions are required to measure the obligation and the expense and there is a possibility of actuarial gains and losses. Moreover, the obligations are measured on a discounted basis because they may be settled many years after the employees render the related service. While the Standard requires that it is the responsibility of the reporting enterprise to measure the obligations under the defined benefit plans, it is recognised that for doing so the enterprise would normally use the services of a qualified actuary.

Recognition and Measurement

50. Defined benefit plans may be unfunded, or they may be wholly or partly funded by contributions by an enterprise, and sometimes its employees, into an entity, or fund, that is legally separate from the reporting enterprise and from which the employee benefits are paid. The payment of funded benefits when they fall due depends not only on the financial position and the investment performance of the fund but also on an enterprise's ability to make good any shortfall in the fund's assets. Therefore, the enterprise is, in substance, underwriting the actuarial and investment risks associated with the plan. Consequently, the expense recognised for a defined benefit plan is not necessarily the amount of the contribution due for the period.

51. Accounting by an enterprise for defined benefit plans involves the following steps:

(a) using actuarial techniques to make a reliable estimate of the amount of benefit that employees have earned in return for their service in the current and prior periods. This requires an enterprise to determine how much benefit is attributable to the current and prior periods (see paragraphs 68-72) and to make estimates (actuarial assumptions) about demographic variables (such as employee turnover and mortality) and financial variables (such as future increases in salaries and medical costs) that will influence the cost of the benefit (see paragraphs 73-91);

(b) discounting that benefit using the Projected Unit Credit Method in order to determine the present value of the defined benefit obligation and the current service cost (see paragraphs 65-67);

(c) determining the fair value of any plan assets (see paragraphs 100-102);

(d) determining the total amount of actuarial gains and losses (see paragraphs 92-93);

(e) where a plan has been introduced or changed, determining the resulting past service cost (see paragraphs 94-99); and

(f) where a plan has been curtailed or settled, determining the resulting gain or loss (see paragraphs 110-116).

Where an enterprise has more than one defined benefit plan, the enterprise applies these procedures for each material plan separately.

52. For measuring the amounts under paragraph 51, in some cases, estimates, averages and simplified computations may provide a reliable approximation of the detailed computations.

Accounting for the Obligation under a Defined Benefit Plan

53. An enterprise should account not only for its legal obligation under the formal terms of a defined benefit plan, but also for any other obligation that arises from the enterprise's informal practices. Informal practices give rise to an obligation where the enterprise has no realistic alternative but to pay employee benefits. An example of such an obligation is where a change in the enterprise's informal practices would cause unacceptable damage to its relationship with employees.

54. The formal terms of a defined benefit plan may permit an enterprise to terminate its obligation under the plan. Nevertheless, it is usually difficult for an enterprise to cancel a plan if employees are to be retained. Therefore, in the absence of evidence to the contrary, accounting for post-employment benefits assumes that an enterprise which is currently promising such benefits will continue to do so over the remaining working lives of employees.

Balance Sheet

55. The amount recognised as a defined benefit liability should be the net total of the following amounts:

(a) the present value of the defined benefit obligation at the balance sheet date (see paragraph 65);

(b) minus any past service cost not yet recognised (see paragraph 94);

(c) minus the fair value at the balance sheet date of plan assets (if any) out of which the obligations are to be settled directly (see paragraphs 100-102).

56. The present value of the defined benefit obligation is the gross obligation, before deducting the fair value of any plan assets.

57. An enterprise should determine the present value of defined benefit obligations and the fair value of any plan assets with sufficient regularity that the amounts recognised in the financial statements do not differ materially from the amounts that would be determined at the balance sheet date.

58. The detailed actuarial valuation of the present value of defined benefit obligations may be made at intervals not exceeding three years. However, with a view that the amounts recognised in the financial statements do not differ materially from the amounts that would be determined at the balance sheet date, the most recent valuation is reviewed at the balance sheet date and updated to reflect any material transactions and other material changes in circumstances (including changes in interest rates) between the date of valuation and the balance sheet date. The fair value of any plan assets is determined at each balance sheet date.

59. The amount determined under paragraph 55 may be negative (an asset). An enterprise should measure the resulting asset at the lower of:

(a) the amount determined under paragraph 55; and

(b) the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. The present value of these economic benefits should be determined using the discount rate specified in paragraph 78.

60. An asset may arise where a defined benefit plan has been overfunded or in certain cases where actuarial gains are recognised. An enterprise recognises an asset in such cases because:

(a) the enterprise controls a resource, which is the ability to use the surplus to generate future benefits;

(b) that control is a result of past events (contributions paid by the enterprise and service rendered by the employee); and

(c) future economic benefits are available to the enterprise in the form of a reduction in future contributions or a cash refund, either directly to the enterprise or indirectly to another plan in deficit.

Example Illustrating Paragraph 59

	(Amount in Rs.)
A defined benefit plan has the following characteristics:	
Present value of the obligation	1,100
Fair value of plan assets	(1,190)
	(90)
Unrecognised past service cost	(70)
Negative amount determined under paragraph 55	(160)
Present value of available future refunds and reductions in future contributions	90
Limit under paragraph 59 (b)	90

Rs. 90 is less than Rs. 160. Therefore, the enterprise recognises an asset of Rs. 90 and discloses that the limit reduced the carrying amount of the asset by Rs. 70 (see paragraph 120(f)(ii)).

Statement of Profit and Loss

61. An enterprise should recognise the net total of the following amounts in the statement of profit and loss, except to the extent that another Accounting Standard requires or permits their inclusion in the cost of an asset:

(a) current service cost (see paragraphs 64-91);

(b) interest cost (see paragraph 82);

(c) the expected return on any plan assets (see paragraphs 107-109) and on any reimbursement rights (see paragraph 103);

(d) actuarial gains and losses (see paragraphs 92-93);

(e) past service cost to the extent that paragraph 94 requires an enterprise to recognise it;

(f) the effect of any curtailments or settlements (see paragraphs 110 and 111); and

(g) the effect of the limit in paragraph 59 (b), i.e., the extent to which the amount determined under paragraph 55 (if negative) exceeds the amount determined under paragraph 59 (b).

62. Other Accounting Standards require the inclusion of certain employee benefit costs within the cost of assets such as tangible fixed assets (see AS 10, *Property, Plant and Equipment*). Any post-employment benefit costs included in the cost of such assets include the appropriate proportion of the components listed in paragraph 61.

Illustration

63. Illustration I attached to the Standard illustrates describing the components of the amounts recognised in the balance sheet and statement of profit and loss in respect of defined benefit plans.

Recognition and Measurement: Present Value of Defined Benefit Obligations and Current Service Cost

64. The ultimate cost of a defined benefit plan may be influenced by many variables, such as final salaries, employee turnover and mortality, medical cost trends and, for a funded plan, the investment earnings on the plan assets. The ultimate cost of the plan is uncertain and this uncertainty is likely to persist over a long period of time. In order to measure the present value of the post-employment benefit obligations and the related current service cost, it is necessary to:

(a) apply an actuarial valuation method (see paragraphs 65-67);

(b) attribute benefit to periods of service (see paragraphs 68-72); and

(c) make actuarial assumptions (see paragraphs 73-91).

Actuarial Valuation Method

65. An enterprise should use the Projected Unit Credit Method to determine the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost.

66. The Projected Unit Credit Method (sometimes known as the accrued benefit method pro-rated on service or as the benefit/years of service method) considers each period of service as giving rise to an additional unit of benefit entitlement (see paragraphs 68-72) and measures each unit separately to build up the final obligation (see paragraphs 73-91).

67. An enterprise discounts the whole of a post-employment benefit obligation, even if part of the obligation falls due within twelve months of the balance sheet date.

Example Illustrating Paragraph 66

A lump sum benefit, equal to 1% of final salary for each year of service, is payable on termination of service. The salary in year 1 is Rs. 10,000 and is assumed to increase at 7% (compound) each year resulting in Rs. 13,100 at the end of year 5. The discount rate used is 10% per annum. The following table shows how the obligation builds up for an employee who is expected to leave at the end of year 5, assuming that there are no changes in actuarial assumptions. For simplicity, this example ignores the additional adjustment needed to reflect the probability that the employee may leave the enterprise at an earlier or later date.

					(Amount in Rs.)
Year	*1*	*2*	*3*	*4*	*5*
Benefit attributed to:					
- prior years	*0*	*131*	*262*	*393*	*524*
- current year (1% of final salary)	*131*	*131*	*131*	*131*	*131*
- current and prior years	*131*	*262*	*393*	*524*	*655*
Opening Obligation (see note 1)	*-*	*89*	*196*	*324*	*476*
Interest at 10%	*-*	*9*	*20*	*33*	*48*
Current Service Cost (see note 2)	*89*	*98*	*108*	*119*	*131*
Closing Obligation (see note 3)	*89*	*196*	*324*	*476*	*655*

Notes:

1. The Opening Obligation is the present value of benefit attributed to prior years.

2. *The Current Service Cost is the present value of benefit attributed to the current year.*
3. *The Closing Obligation is the present value of benefit attributed to current and prior years.*

Attributing Benefit to Periods of Service

68. In determining the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost, an enterprise should attribute benefit to periods of service under the plan's benefit formula. However, if an employee's service in later years will lead to a materially higher level of benefit than in earlier years, an enterprise should attribute benefit on a straight-line basis from:

(a) the date when service by the employee first leads to benefits under the plan (whether or not the benefits are conditional on further service); until

(b) the date when further service by the employee will lead to no material amount of further benefits under the plan, other than from further salary increases.

69. The Projected Unit Credit Method requires an enterprise to attribute benefit to the current period (in order to determine current service cost) and the current and prior periods (in order to determine the present value of defined benefit obligations). An enterprise attributes benefit to periods in which the obligation to provide post-employment benefits arises. That obligation arises as employees render services in return for post-employment benefits which an enterprise expects to pay in future reporting periods. Actuarial techniques allow an enterprise to measure that obligation with sufficient reliability to justify recognition of a liability.

Examples Illustrating Paragraph 69

1. A defined benefit plan provides a lump-sum benefit of Rs. 100 payable on retirement for each year of service.

A benefit of Rs. 100 is attributed to each year. The current service cost is the present value of Rs. 100. The present value of the defined benefit obligation is the present value of Rs. 100, multiplied by the number of years of service up to the balance sheet date.

If the benefit is payable immediately when the employee leaves the enterprise, the current service cost and the present value of the defined benefit obligation reflect the date at which the employee is expected to leave. Thus, because of the effect of discounting, they are less than the amounts that would be determined if the employee left at the balance sheet date.

2. A plan provides a monthly pension of 0.2% of final salary for each year of service. The pension is payable from the age of 60.

Benefit equal to the present value, at the expected retirement date, of a monthly pension of 0.2% of the estimated final salary payable from the expected retirement date until the expected date of death is attributed to each year of service. The current service cost is the present value of that benefit. The present value of the defined benefit obligation is the present value of monthly pension payments of 0.2% of final salary, multiplied by the number of years of service up to the balance sheet date. The current service cost and the present value of the defined benefit obligation are discounted because pension payments begin at the age of 60.

70. Employee service gives rise to an obligation under a defined benefit plan even if the benefits are conditional on future employment (in other words they are not vested). Employee service before the vesting date gives rise to an obligation because, at each successive balance sheet date, the amount of future service that an employee will have to render before becoming entitled to the benefit is reduced. In measuring its defined benefit obligation, an enterprise considers the probability that some employees may not satisfy any vesting requirements. Similarly, although certain post- employment benefits, for example, post-employment medical benefits, become payable only if a specified event occurs when an employee is no longer employed, an obligation is created when the employee renders service that will provide entitlement to the benefit if the specified event occurs. The probability that the specified event will occur affects the measurement of the obligation, but does not determine whether the obligation exists.

Examples Illustrating Paragraph 70

1. A plan pays a benefit of Rs. 100 for each year of service. The benefits vest after ten years of service.

A benefit of Rs. 100 is attributed to each year. In each of the first ten years, the current service cost and the present value of the obligation reflect the probability that the employee may not complete ten years of service.

2. A plan pays a benefit of Rs. 100 for each year of service, excluding service before the age of 25. The benefits vest immediately.

No benefit is attributed to service before the age of 25 because service before that date does not lead to benefits (conditional or unconditional). A benefit of Rs. 100 is attributed to each subsequent year.

71. The obligation increases until the date when further service by the employee will lead to no material amount of further benefits. Therefore, all benefit is attributed to periods ending on or before that date. Benefit is attributed to individual accounting periods under the plan's benefit formula. However, if an employee's service in later years will lead to a materially higher level of benefit than in earlier years, an enterprise attributes benefit on a straight-line basis until the date when further service by the employee will lead to no material amount of further benefits. That is because the employee's service throughout the entire period will ultimately lead to benefit at that higher level.

Examples Illustrating Paragraph 71

1. A plan pays a lump-sum benefit of Rs. 1,000 that vests after ten years of service. The plan provides no further benefit for subsequent service.

A benefit of Rs. 100 (Rs. 1,000 divided by ten) is attributed to each of the first ten years. The current service cost in each of the first ten years reflects the probability that the employee may not complete ten years of service. No benefit is attributed to subsequent years.

2. A plan pays a lump-sum retirement benefit of Rs. 2,000 to all employees who are still employed at the age of 50 after twenty years of service, or who are still employed at the age of 60, regardless of their length of service.

For employees who join before the age of 30, service first leads to benefits under the plan at the age of 30 (an employee could leave at the age of 25 and return at the age of 28, with no effect on the amount or timing of benefits). Those benefits are conditional on further service. Also, service beyond the age of 50 will lead to no material amount of further benefits. For these employees, the enterprise attributes benefit of Rs. 100 (Rs. 2,000 divided by 20) to each year from the age of 30 to the age of 50.

For employees who join between the ages of 30 and 40, service beyond twenty years will lead to no material amount of further benefits. For these employees, the enterprise attributes benefit of Rs. 100 (Rs. 2,000 divided by 20) to each of the first twenty years.

For an employee who joins at the age of 50, service beyond ten years will lead to no material amount of further benefits. For this employee, the enterprise attributes benefit of Rs. 200 (Rs. 2,000 divided by 10) to each of the first ten years.

For all employees, the current service cost and the present value of the obligation reflect the probability that the employee may not complete the necessary period of service.

3. A post-employment medical plan reimburses 40% of an employee's post-employment medical costs if the employee leaves after more than ten and less than twenty years of service and 50% of those costs if the employee leaves after twenty or more years of service.

Under the plan's benefit formula, the enterprise attributes 4% of the present value of the expected medical costs (40% divided by ten) to each of the first ten years and 1% (10% divided by ten) to each of the second ten years. The current service cost in each year reflects the probability that the employee may not complete the necessary period of service to earn part or all of the benefits. For employees expected to leave within ten years, no benefit is attributed.

4. A post-employment medical plan reimburses 10% of an employee's post-employment medical costs if the employee leaves after more than ten and less than twenty years of service and 50% of those costs if the employee leaves after twenty or more years of service.

Service in later years will lead to a materially higher level of benefit than in earlier years. Therefore, for employees expected to leave after twenty or more years, the enterprise attributes benefit on a straight-line basis under paragraph 69. Service beyond twenty years will lead to no material amount of further benefits. Therefore, the benefit attributed to each of the first twenty years is 2.5% of the present value of the expected medical costs (50% divided by twenty).

For employees expected to leave between ten and twenty years, the benefit attributed to each of the first ten years is 1% of the present value of the expected medical costs. For these employees, no benefit is attributed to service between the end of the tenth year and the estimated date of leaving.

For employees expected to leave within ten years, no benefit is attributed.

72. Where the amount of a benefit is a constant proportion of final salary for each year of service, future salary increases will affect the amount required to settle the obligation that exists for service before the balance sheet date, but do not create an additional obligation. Therefore:

(a) for the purpose of paragraph 68(b), salary increases do not lead to further benefits, even though the amount of the benefits is dependent on final salary; and

(b) the amount of benefit attributed to each period is a constant proportion of the salary to which the benefit is linked.

Example Illustrating Paragraph 72

Employees are entitled to a benefit of 3% of final salary for each year of service before the age of 55.

Benefit of 3% of estimated final salary is attributed to each year up to the age of 55. This is the date when further service by the employee will lead to no material amount of further benefits under the plan. No benefit is attributed to service after that age.

Actuarial Assumptions

73. Actuarial assumptions comprising demographic assumptions and financial assumptions should be unbiased and mutually compatible. Financial assumptions should be based on market expectations, at the balance sheet date, for the period over which the obligations are to be settled.

74. Actuarial assumptions are an enterprise's best estimates of the variables that will determine the ultimate cost of providing post-employment benefits. Actuarial assumptions comprise:

(a) demographic assumptions about the future characteristics of current and former employees (and their dependants) who are eligible for benefits. Demographic assumptions deal with matters such as:

(i) mortality, both during and after employment;

(ii) rates of employee turnover, disability and early retirement;

(iii) the proportion of plan members with dependants who will be eligible for benefits; and

(iv) claim rates under medical plans; and

(b) financial assumptions, dealing with items such as:

(i) the discount rate (see paragraphs 78-82);

(ii) future salary and benefit levels (see paragraphs 83-87);

(iii) in the case of medical benefits, future medical costs, including, where material, the cost of administering claims and benefit payments (see paragraphs 88-91); and

(iv) the expected rate of return on plan assets (see paragraphs 107- 109).

75. Actuarial assumptions are unbiased if they are neither imprudent nor excessively conservative.

76. Actuarial assumptions are mutually compatible if they reflect the economic relationships between factors such as inflation, rates of salary increase, the return on plan assets and discount rates. For example, all assumptions which depend on a particular inflation level (such as assumptions about interest rates and salary and benefit increases) in any given future period assume the same inflation level in that period.

77. An enterprise determines the discount rate and other financial assumptions in nominal (stated) terms, unless estimates in real (inflation- adjusted) terms are more reliable, for example, where the benefit is index- linked and there is a deep market in index-linked bonds of the same currency and term.

Actuarial Assumptions: Discount Rate

78. The rate used to discount post-employment benefit obligations (both funded and unfunded) should be determined by reference to market yields at the balance sheet date on government bonds. The currency and term of the government bonds should be consistent with the currency and estimated term of the post-employment benefit obligations.

79. One actuarial assumption which has a material effect is the discount rate. The discount rate reflects the time value of money but not the actuarial or investment risk. Furthermore, the discount rate does not reflect the enterprise-specific credit risk borne by the enterprise's creditors, nor does it reflect the risk that future experience may differ from actuarial assumptions.

80. The discount rate reflects the estimated timing of benefit payments. In practice, an enterprise often achieves this by applying a single weighted average discount rate that reflects the estimated timing and amount of benefit payments and the currency in which the benefits are to be paid.

81. In some cases, there may be no government bonds with a sufficiently long maturity to match the estimated maturity of all the benefit payments. In such cases, an enterprise uses current market rates of the appropriate term to discount shorter term payments, and estimates the discount rate for longer maturities by extrapolating current market rates along the yield curve. The total present value of a defined benefit obligation is unlikely to be particularly sensitive to the discount rate applied to the portion of benefits that is payable beyond the final maturity of the available government bonds.

82. Interest cost is computed by multiplying the discount rate as determined at the start of the period by the present value of the defined benefit obligation throughout that period, taking account of any material changes in the obligation. The present value of the obligation will differ from the liability recognised in the balance sheet because the liability is recognised after deducting the fair value of any plan assets and because some past service cost are not recognised immediately. [Illustration I attached to the Standard illustrates the computation of interest cost, among other things]

Actuarial Assumptions: Salaries, Benefits and Medical Costs

83. Post-employment benefit obligations should be measured on a basis that reflects:

(a) estimated future salary increases;

(b) the benefits set out in the terms of the plan (or resulting from any obligation that goes beyond those terms) at the balance sheet date; and

(c) estimated future changes in the level of any state benefits that affect the benefits payable under a defined benefit plan, if, and only if, either:

(i) those changes were enacted before the balance sheet date; or

(ii) past history, or other reliable evidence, indicates that those state benefits will change in some predictable manner, for example, in line with future changes in general price levels or general salary levels.

84. Estimates of future salary increases take account of inflation, seniority, promotion and other relevant factors, such as supply and demand in the employment market.

85. If the formal terms of a plan (or an obligation that goes beyond those terms) require an enterprise to change benefits in future periods, the measurement of the obligation reflects those changes. This is the case when, for example:

(a) the enterprise has a past history of increasing benefits, for example, to mitigate the effects of inflation, and there is no indication that this practice will change in the future; or

(b) actuarial gains have already been recognised in the financial statements and the enterprise is obliged, by either the formal terms of a plan (or an obligation that goes beyond those terms) or legislation, to use any surplus in the plan for the benefit of plan participants (see paragraph 96(c)).

86. Actuarial assumptions do not reflect future benefit changes that are not set out in the formal terms of the plan (or an obligation that goes beyond those terms) at the balance sheet date. Such changes will result in:

(a) past service cost, to the extent that they change benefits for service before the change; and

(b) current service cost for periods after the change, to the extent that they change benefits for service after the change.

87. Some post-employment benefits are linked to variables such as the level of state retirement benefits or state medical care. The measurement of such benefits reflects expected changes in such variables, based on past history and other reliable evidence.

88. Assumptions about medical costs should take account of estimated future changes in the cost of medical services, resulting from both inflation and specific changes in medical costs.

89. Measurement of post-employment medical benefits requires assumptions about the level and frequency of future claims and the cost of meeting those claims. An enterprise estimates future medical costs on the basis of historical data about the enterprise's own experience, supplemented where necessary by historical data from other enterprises, insurance companies, medical providers or other sources. Estimates of future medical costs consider the effect of technological advances, changes in health care utilisation or delivery patterns and changes in the health status of plan participants.

90. The level and frequency of claims is particularly sensitive to the age, health status and sex of employees (and their dependants) and may be sensitive to other factors such as geographical location. Therefore, historical data is adjusted to the extent that the demographic mix of the population differs from that of the population used as a basis for the historical data. It is also adjusted where there is reliable evidence that historical trends will not continue.

91. Some post-employment health care plans require employees to contribute to the medical costs covered by the plan. Estimates of future medical costs take account of any such contributions, based on the terms of the plan at the balance sheet date (or based on any obligation that goes beyond those terms). Changes in those employee contributions result in past service cost or, where applicable, curtailments. The cost of meeting claims may be reduced by benefits from state or other medical providers (see paragraphs 83(c) and 87).

Actuarial Gains and Losses

92. Actuarial gains and losses should be recognised immediately in the statement of profit and loss as income or expense (see paragraph 61).

92A. Paragraph 145(b)(iii) explains the need to consider any unrecognised part of the transitional liability in accounting for subsequent actuarial gains.

93. Actuarial gains and losses may result from increases or decreases in either the present value of a defined benefit obligation or the fair value of any related plan assets. Causes of actuarial gains and losses include, for example:

(a) unexpectedly high or low rates of employee turnover, early retirement or mortality or of increases in salaries, benefits (if the terms of a plan provide for inflationary benefit increases) or medical costs;

(b) the effect of changes in estimates of future employee turnover, early retirement or mortality or of increases in salaries, benefits (if the terms of a plan provide for inflationary benefit increases) or medical costs;

(c) the effect of changes in the discount rate; and

(d) differences between the actual return on plan assets and the expected return on plan assets (see paragraphs 107-109).

Past Service Cost

94. In measuring its defined benefit liability under paragraph 55, an enterprise should recognise past service cost as an expense on a straight- line basis over the average period until the benefits become vested. To the extent that the benefits are already vested immediately following the introduction of, or changes to, a defined benefit plan, an enterprise should recognise past service cost immediately.

95. Past service cost arises when an enterprise introduces a defined benefit plan or changes the benefits payable under an existing defined benefit plan. Such changes are in return for employee service over the period until the benefits concerned are vested. Therefore, past service cost is recognised over that period, regardless of the fact that the cost refers to employee service in previous periods. Past service cost is measured as the change in the liability resulting from the amendment (see paragraph 65).

Example Illustrating Paragraph 95

An enterprise operates a pension plan that provides a pension of 2% of final salary for each year of service. The benefits become vested after five years of service. On 1 January 20X5 the enterprise improves the pension to 2.5% of final salary for each year of service starting from 1 January 20X1. At the date of the improvement, the present value of the additional benefits for service from 1 January 20X1 to 1 January 20X5 is as follows:

Employees with more than five years' service at 1/1/X5	Rs.150
Employees with less than five years' service at 1/1/X5 (average period until vesting: three years)	Rs. 120
	Rs. 270

The enterprise recognises Rs. 150 immediately because those benefits are already vested. The enterprise recognises Rs. 120 on a straight-line basis over three years from 1 January 20X5.

96. Past service cost excludes:

(a) the effect of differences between actual and previously assumed salary increases on the obligation to pay benefits for service in prior years (there is no past service cost because actuarial assumptions allow for projected salaries);

(b) under and over estimates of discretionary pension increases where an enterprise has an obligation to grant such increases (there is no past service cost because actuarial assumptions allow for such increases);

(c) estimates of benefit improvements that result from actuarial gains that have already been recognised in the financial statements if the enterprise is obliged, by either the formal terms of a plan (or an obligation that goes beyond those terms) or legislation, to use any surplus in the plan for the benefit of plan participants, even if the benefit increase has not yet been formally awarded (the resulting increase in the obligation is an actuarial loss and not past service cost, see paragraph 85(b));

(d) the increase in vested benefits (not on account of new or improved benefits) when employees complete vesting requirements (there is no past service cost because the estimated cost of benefits was recognised as current service cost as the service was rendered); and

(e) the effect of plan amendments that reduce benefits for future service (a curtailment).

97. An enterprise establishes the amortisation schedule for past service cost when the benefits are introduced or changed. It would be impracticable to maintain the detailed records needed to identify and implement subsequent changes in that amortisation schedule. Moreover, the effect is likely to be material only where there is a curtailment or settlement. Therefore, an enterprise amends the amortisation schedule for past service cost only if there is a curtailment or settlement.

98. Where an enterprise reduces benefits payable under an existing defined benefit plan, the resulting reduction in the defined benefit liability is recognised as (negative) past service cost over the average period until the reduced portion of the benefits becomes vested.

99. Where an enterprise reduces certain benefits payable under an existing defined benefit plan and, at the same time, increases other benefits payable under the plan for the same employees, the enterprise treats the change as a single net change.

Recognition and Measurement: Plan Assets

Fair Value of Plan Assets

100. The fair value of any plan assets is deducted in determining the amount recognised in the balance sheet under paragraph 55. When no market price is available, the fair value of plan assets is estimated; for example, by discounting expected future cash flows using a discount rate that reflects both the risk associated with the plan assets and the maturity or expected disposal date of those assets (or, if they have no maturity, the expected period until the settlement of the related obligation).

101. Plan assets exclude unpaid contributions due from the reporting enterprise to the fund, as well as any non-transferable financial instruments issued by the enterprise and held by the fund. Plan assets are reduced by any liabilities of the fund that do not relate to employee benefits, for example, trade and other payables and liabilities resulting from derivative financial instruments.

102. Where plan assets include qualifying insurance policies that exactly match the amount and timing of some or all of the benefits payable under the plan, the fair value of those insurance policies is deemed to be the present value of the related obligations, as described in paragraph 55 (subject to any reduction required if the amounts receivable under the insurance policies are not recoverable in full).

Reimbursements

103. When, and only when, it is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation, an enterprise should recognise its right to reimbursement as a separate asset. The enterprise should measure the asset at fair value. In all other respects, an enterprise should treat that asset in the same way as plan assets. In the statement of profit and loss, the expense relating to a defined benefit plan may be presented net of the amount recognised for a reimbursement.

104. Sometimes, an enterprise is able to look to another party, such as an insurer, to pay part or all of the expenditure required to settle a defined benefit obligation. Qualifying insurance policies, as defined in paragraph 7, are plan assets. An enterprise accounts for qualifying insurance policies in the same way as for all other plan assets and paragraph 103 does not apply (see paragraphs 40-43 and 102).

105. When an insurance policy is not a qualifying insurance policy, that insurance policy is not a plan asset. Paragraph 103 deals with such cases: the enterprise recognises its right to reimbursement under the insurance policy as a separate asset, rather than as a deduction in determining the defined benefit liability recognised under paragraph 55; in all other respects, including for determination of the fair value, the enterprise treats that asset in the same way as plan assets. Paragraph 120(f)(iii) requires the enterprise to disclose a brief description of the link between the reimbursement right and the related obligation.

Example Illustrating Paragraphs 103-105

	(Amount in Rs.)
Liability recognised in balance sheet being the present value of obligation	1,258
Rights under insurance policies that exactly match the amount and timing of some of the benefits payable under the plan. Those benefits have a present value of Rs. 1,092	1,092

106. If the right to reimbursement arises under an insurance policy that exactly matches the amount and timing of some or all of the benefits payable under a defined benefit plan, the fair value of the reimbursement right is deemed to be the present value of the related obligation, as described in paragraph 55 (subject to any reduction required if the reimbursement is not recoverable in full).

Return on Plan Assets

107. The expected return on plan assets is a component of the expense recognised in the statement of profit and loss. The difference between the expected return on plan assets and the actual return on plan assets is an actuarial gain or loss.

108. The expected return on plan assets is based on market expectations, at the beginning of the period, for returns over the entire life of the related obligation. The expected return on plan assets reflects changes in the fair value of plan assets held during the period as a result of actual contributions paid into the fund and actual benefits paid out of the fund.

109. In determining the expected and actual return on plan assets, an enterprise deducts expected administration costs, other than those included in the actuarial assumptions used to measure the obligation.

Example Illustrating Paragraph 108

At 1 January 20X1, the fair value of plan assets was Rs. 10,000. On 30 June 20X1, the plan paid benefits of Rs. 1,900 and received contributions of Rs. 4,900. At 31 December 20X1, the fair value of plan assets was Rs. 15,000 and the present value of the defined benefit obligation was Rs. 14,792. Actuarial losses on the obligation for 20X1 were Rs. 60.

At 1 January 20X1, the reporting enterprise made the following estimates, based on market prices at that date:

% Interest and dividend income, after tax payable by the fund	9.25
Realised and unrealised gains on plan assets (after tax)	2.00
Administration costs	(1.00)
Expected rate of return	10.25

For 20X1, the expected and actual return on plan assets are as follows:	*(Amount in Rs.)*
Return on Rs. 10,000 held for 12 months at 10.25%	*1,025*
Return on Rs. 3,000 held for six months at 5% (equivalent to 10.25% annually, compounded every six months)	*150*
Expected return on plan assets for 20X1	*1,175*
Fair value of plan assets at 31 December 20X1	*15,000*
Less fair value of plan assets at 1 January 20X1	*(10,000)*
Less contributions received	*(4,900)*
Add benefits paid	*1,900*
Actual return on plan assets	*2,000*

The difference between the expected return on plan assets (Rs. 1,175) and the actual return on plan assets (Rs. 2,000) is an actuarial gain of Rs. 825. Therefore, the net actuarial gain of Rs. 765 (Rs. 825 – Rs. 60 (actuarial loss on the obligation)) would be recognised in the statement of profit and loss.

The expected return on plan assets for 20X2 will be based on market expectations at 1/1/X2 for returns over the entire life of the obligation.

Curtailments and Settlements

110. An enterprise should recognise gains or losses on the curtailment or settlement of a defined benefit plan when the curtailment or settlement occurs. The gain or loss on a curtailment or settlement should comprise:

(a) any resulting change in the present value of the defined benefit obligation;

(b) any resulting change in the fair value of the plan assets;

(c) any related past service cost that, under paragraph 94, had not previously been recognised.

111. Before determining the effect of a curtailment or settlement, an enterprise should remeasure the obligation (and the related plan assets, if any) using current actuarial assumptions (including current market interest rates and other current market prices).

112. A curtailment occurs when an enterprise either:

(a) has a present obligation, arising from the requirement of a statute/ regulator or otherwise, to make a material reduction in the number of employees covered by a plan; or

(b) amends the terms of a defined benefit plan such that a material element of future service by current employees will no longer qualify for benefits, or will qualify only for reduced benefits.

A curtailment may arise from an isolated event, such as the closing of a plant, discontinuance of an operation or termination or suspension of a plan. An event is material enough to qualify as a curtailment if the recognition of a curtailment gain or loss would have a material effect on the financial statements. Curtailments are often linked with a restructuring. Therefore, an enterprise accounts for a curtailment at the same time as for a related restructuring.

113. A settlement occurs when an enterprise enters into a transaction that eliminates all further obligations for part or all of the benefits provided under a defined benefit plan, for example, when a lump-sum cash payment is made to, or on behalf of, plan participants in exchange for their rights to receive specified post-employment benefits.

114. In some cases, an enterprise acquires an insurance policy to fund some or all of the employee benefits relating to employee service in the current and prior periods. The acquisition of such a policy is not a settlement if the enterprise retains an obligation (see paragraph 40) to pay further amounts if the insurer does not pay the employee benefits specified in the insurance policy. Paragraphs 103-106 deal with the recognition and measurement of reimbursement rights under insurance policies that are not plan assets.

115. A settlement occurs together with a curtailment if a plan is terminated such that the obligation is settled and the plan ceases to exist. However, the termination of a plan is not a curtailment or settlement if the plan is replaced by a new plan that offers benefits that are, in substance, identical.

116. Where a curtailment relates only to some of the employees covered by a plan, or where only part of an obligation is settled, the gain or loss includes a proportionate share of the previously unrecognised past service cost (and of transitional amounts remaining unrecognised under paragraph 145(b)). The proportionate share is determined on the basis of the present value of the obligations before and after the curtailment or settlement, unless another basis is more rational in the circumstances.

Example Illustrating Paragraph 116

An enterprise discontinues a business segment and employees of the discontinued segment will earn no further benefits. This is a curtailment without a settlement. Using current actuarial assumptions (including current market interest rates and other current market prices) immediately before the curtailment, the enterprise has a defined benefit obligation with a net present value of Rs. 1,000 and plan assets with a fair value of Rs. 820 and unrecognised past service cost of Rs. 50. The enterprise had first adopted this Standard one year before. This increased the net liability by Rs. 100, which the enterprise chose to recognise over five years (see paragraph 145(b)). The curtailment reduces the net present value of the obligation by Rs. 100 to Rs. 900.

Of the previously unrecognised past service cost and transitional amounts, 10% (Rs. 100/Rs. 1000) relates to the part of the obligation that was eliminated through the curtailment. Therefore, the effect of the curtailment is as follows:

			(Amount in Rs.)
	Before curtailment	*Curtailment gain*	*After curtailment*
Net present value of obligation	*1,000*	*(100)*	*900*
Fair value of plan assets	*(820)*	*-*	*(820)*
	180	*(100)*	*80*
Unrecognised past service cost	*(50)*	*5*	*(45)*
Unrecognised transitional amount (100x4/5)	*(80)*	*8*	*(72)*
Net liability recognised in balance sheet	*(50)*	*(87)*	*(37)*

An asset of Rs. 37 will be recognised (it is assumed that the amount under paragraph 59(b) is higher than Rs. 37).

Provided that a Small and Medium-sized Company as defined in the Notification, may not apply the recognition and measurement principles laid down in paragraphs 50 to 116 in respect of accounting for defined benefit plans. However, such company should actuarially determine and provide for the accrued liability in respect of defined benefit plans as follows:

- ***The method used for actuarial valuation should be the Projected Unit Credit Method ; and***

- ***The discount rate used should be determined by reference to market yields at the balance sheet date on government bonds as per paragraph 78 of the Standard.***

Presentation

Offset

117. An enterprise should offset an asset relating to one plan against a liability relating to another plan when, and only when, the enterprise:

(a) has a legally enforceable right to use a surplus in one plan to settle obligations under the other plan; and

(b) intends either to settle the obligations on a net basis, or to realise the surplus in one plan and settle its obligation under the other plan simultaneously.

Financial Components of Post-employment Benefit Costs

118. This Standard does not specify whether an enterprise should present current service cost, interest cost and the expected return on plan assets as components of a single item of income or expense on the face of the statement of profit and loss.

Provided that a Small and Medium-sized company, as defined in the Notification, may not apply the presentation requirements laid down in paragraphs 117 to 118 of the Standard in respect of accounting for defined benefit plans.

Disclosure

119. An enterprise should disclose information that enables users of financial statements to evaluate the nature of its defined benefit plans and the financial effects of changes in those plans during the period.

120. An enterprise should disclose the following information about defined benefit plans:

(a) the enterprise's accounting policy for recognising actuarial gains and losses.

(b) a general description of the type of plan.

(c) a reconciliation of opening and closing balances of the present value of the defined benefit obligation showing separately, if applicable, the effects during the period attributable to each of the following:

(i) current service cost,

(ii) interest cost,

(iii) contributions by plan participants,

(iv) actuarial gains and losses,

(v) foreign currency exchange rate changes on plans measured in a currency different from the enterprise's reporting currency,

(vi) benefits paid,

(vii) past service cost,

(viii) amalgamations,

(ix) curtailments, and

(x) settlements.

(d) an analysis of the defined benefit obligation into amounts arising from plans that are wholly unfunded and amounts arising from plans that are wholly or partly funded.

(e) a reconciliation of the opening and closing balances of the fair value of plan assets and of the opening and closing balances of any reimbursement right recognised as an asset in accordance with paragraph 103 showing separately, if applicable, the effects during the period attributable to each of the following:

(i) expected return on plan assets,

(ii) actuarial gains and losses,

(iii) foreign currency exchange rate changes on plans measured in a currency different from the enterprise's reporting currency,

(iv) contributions by the employer,

(v) contributions by plan participants,

(vi) benefits paid,

(vii) amalgamations, and

(viii) settlements.

(f) a reconciliation of the present value of the defined benefit obligation in (c) and the fair value of the plan assets in (e) to the assets and liabilities recognised in the balance sheet, showing at least:

(i) the past service cost not yet recognised in the balance sheet (see paragraph 94);

(ii) any amount not recognised as an asset, because of the limit in paragraph 59(b);

(iii) the fair value at the balance sheet date of any reimbursement right recognised as an asset in accordance with paragraph 103 (with a brief description of the link between the reimbursement right and the related obligation); and

(iv) the other amounts recognised in the balance sheet.

(g) the total expense recognised in the statement of profit and loss for each of the following, and the line item(s) of the statement of profit and loss in which they are included:

(i) current service cost;

(ii) interest cost;

(iii) expected return on plan assets;

(iv) expected return on any reimbursement right recognised as an asset in accordance with paragraph 103;

(v) actuarial gains and losses;

(vi) past service cost;

(vii) the effect of any curtailment or settlement; and

(viii) the effect of the limit in paragraph 59 (b), i.e., the extent to which the amount determined in accordance with paragraph 55 (if negative) exceeds the amount determined in accordance with paragraph 59 (b).

(h) for each major category of plan assets, which should include, but is not limited to, equity instruments, debt instruments, property, and all other assets, the percentage or amount that each major category constitutes of the fair value of the total plan assets.

(i) the amounts included in the fair value of plan assets for:

(i) each category of the enterprise's own financial instruments; and

(ii) any property occupied by, or other assets used by, the enterprise.

(j) a narrative description of the basis used to determine the overall expected rate of return on assets, including the effect of the major categories of plan assets.

(k) the actual return on plan assets, as well as the actual return on any reimbursement right recognised as an asset in accordance with paragraph 103.

(l) the principal actuarial assumptions used as at the balance sheet date, including, where applicable:

(i) the discount rates;

(ii) the expected rates of return on any plan assets for the periods presented in the financial statements;

(iii) the expected rates of return for the periods presented in the financial statements on any reimbursement right recognised as an asset in accordance with paragraph 103;

(iv) medical cost trend rates; and

(v) any other material actuarial assumptions used.

An enterprise should disclose each actuarial assumption in absolute terms (for example, as an absolute percentage) and not just as a margin between different percentages or other variables.

Apart from the above actuarial assumptions, an enterprise should include an assertion under the actuarial assumptions to the effect that estimates of future salary increases, considered in actuarial valuation, take account of inflation, seniority, promotion and other relevant factors, such as supply and demand in the employment market.

(m) the effect of an increase of one percentage point and the effect of a decrease of one percentage point in the assumed medical cost trend rates on:

(i) the aggregate of the current service cost and interest cost components of net periodic post-employment medical costs; and

(ii) the accumulated post-employment benefit obligation for medical costs.

For the purposes of this disclosure, all other assumptions should be held constant. For plans operating in a high inflation environment, the disclosure should be the effect of a percentage increase or decrease in the assumed medical cost trend rate of a significance similar to one percentage point in a low inflation environment.

(n) the amounts for the current annual period and previous four annual periods of:

(i) the present value of the defined benefit obligation, the fair value of the plan assets and the surplus or deficit in the plan; and

(ii) the experience adjustments arising on:

(A) the plan liabilities expressed either as (1) an amount or (2) a percentage of the plan liabilities at the balance sheet date, and

(B) the plan assets expressed either as (1) an amount or (2) a percentage of the plan assets at the balance sheet date.

(o) the employer's best estimate, as soon as it can reasonably be determined, of contributions expected to be paid to the plan during the annual period beginning after the balance sheet date.

121. Paragraph 120(b) requires a general description of the type of plan. Such a description distinguishes, for example, flat salary pension plans from final salary pension plans and from post-employment medical plans. The description of the plan should include informal practices that give rise to other obligations included in the measurement of the defined benefit obligation in accordance with paragraph 53. Further detail is not required.

122. When an enterprise has more than one defined benefit plan, disclosures may be made in total, separately for each plan, or in such groupings as are considered to be the most useful. It may be useful to distinguish groupings by criteria such as the following:

(a) the geographical location of the plans, for example, by distinguishing domestic plans from foreign plans; or

(b) whether plans are subject to materially different risks, for example, by distinguishing flat salary pension plans from final salary pension plans and from post-employment medical plans.

When an enterprise provides disclosures in total for a grouping of plans, such disclosures are provided in the form of weighted averages or of relatively narrow ranges.

123. Paragraph 30 requires additional disclosures about multi-employer defined benefit plans that are treated as if they were defined contribution plans.

124. Where required by AS 18, *Related Party Disclosures,* an enterprise discloses information about:

(a) related party transactions with post-employment benefit plans; and

(b) post-employment benefits for key management personnel.

125. Where required by AS 29, *Provisions, Contingent Liabilities and Contingent Assets* an enterprise discloses information about contingent liabilities arising from post-employment benefit obligations.

Illustrative Disclosures

126. Illustration II attached to the Standard contains illustrative disclosures.

Provided that a Small and Medium-sized Company, as defined in the Notification, may not apply the disclosure requirements laid down in paragraphs 119 to 123 of the Standard in respect of accounting for defined benefit plans. However, such company should disclose actuarial assumptions as per paragraph 120(l) of the Standard.

Other Long-term Employee Benefits

127. Other long-term employee benefits include, for example:

(a) long-term compensated absences such as long-service or sabbatical leave;

(b) jubilee or other long-service benefits;

(c) long-term disability benefits;

(d) profit-sharing and bonuses payable twelve months or more after the end of the period in which the employees render the related service; and

(e) deferred compensation paid twelve months or more after the end of the period in which it is earned.

128. In case of other long-term employee benefits, the introduction of, or changes to, other long-term employee benefits rarely causes a material amount of past service cost. For this reason, this Standard requires a simplified method of accounting for other long-term employee benefits. This method differs from the accounting required for post-employment benefits insofar as that all past service cost is recognised immediately.

Recognition and Measurement

129. The amount recognised as a liability for other long-term employee benefits should be the net total of the following amounts:

(a) the present value of the defined benefit obligation at the balance sheet date (see paragraph 65);

(b) minus the fair value at the balance sheet date of plan assets (if any) out of which the obligations are to be settled directly (see paragraphs 100-102).

In measuring the liability, an enterprise should apply paragraphs 49-91, excluding paragraphs 55 and 61. An enterprise should apply paragraph 103 in recognising and measuring any reimbursement right.

130. For other long-term employee benefits, an enterprise should recognise the net total of the following amounts as expense or (subject to paragraph 59) income, except to the extent that another Accounting Standard requires or permits their inclusion in the cost of an asset:

(a) current service cost (see paragraphs 64-91);

(b) interest cost (see paragraph 82);

(c) the expected return on any plan assets (see paragraphs 107-109) and on any reimbursement right recognised as an asset (see paragraph 103);

(d) actuarial gains and losses, which should all be recognised immediately;

(e) past service cost, which should all be recognised immediately; and

(f) the effect of any curtailments or settlements (see paragraphs 110 and 111).

131. One form of other long-term employee benefit is long- term disability benefit. If the level of benefit depends on the length of service, an obligation arises when the service is rendered. Measurement of that obligation reflects the probability that payment will be required and the length of time for which payment is expected to be made. If the level of benefit is the same for any disabled employee regardless of years of service, the expected cost of those benefits is recognised when an event occurs that causes a long-term disability.

Provided that a Small and Medium-sized Company, as defined in the Notification, may not apply the recognition and measurement principles laid down in paragraphs 129 to 131 of the Standard in respect of accounting for other long-term employee benefits. However, such a company should actuarially determine and provide for the accrued liability in respect of other long-term employee benefits as follows:

• The method used for actuarial valuation should be the Projected Unit Credit Method ; and

• The discount rate used should be determined by reference to market yields at the balance sheet date on government bonds as per paragraph 78 of the Standard.

Disclosure

132. Although this Standard does not require specific disclosures about other long-term employee benefits, other Accounting Standards may require disclosures, for example, where the expense resulting from such benefits is of such size, nature or incidence that its disclosure is relevant to explain the performance of the enterprise for the period (see AS 5, *Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies*). Where required by AS 18 *Related Party Disclosures* an enterprise discloses information about other long-term employee benefits for key management personnel.

Termination Benefits

133. This Standard deals with termination benefits separately from other employee benefits because the event which gives rise to an obligation is the termination rather than employee service.

Recognition

134. An enterprise should recognise termination benefits as a liability and an expense when, and only when:

(a) the enterprise has a present obligation as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation.

135. An enterprise may be committed, by legislation, by contractual or other agreements with employees or their representatives or by an obligation based on business practice, custom or a desire to act equitably, to make payments (or provide other benefits) to employees when it terminates their employment. Such payments are termination benefits. Termination benefits are typically lump-sum payments, but sometimes also include:

(a) enhancement of retirement benefits or of other post-employment benefits, either indirectly through an employee benefit plan or directly; and

(b) salary until the end of a specified notice period if the employee renders no further service that provides economic benefits to the enterprise.

136. Some employee benefits are payable regardless of the reason for the employee's departure. The payment of such benefits is certain (subject to any vesting or minimum service requirements) but the timing of their payment is uncertain. Although such benefits may be described as termination indemnities, or termination gratuities, they are post-employment benefits, rather than termination benefits and an enterprise accounts for them as post-employment benefits. Some enterprises provide a lower level of benefit for voluntary termination at the request of the employee (in substance, a post-employment benefit) than for involuntary termination at the request of the enterprise. The additional benefit payable on involuntary termination is a termination benefit.

137. Termination benefits are recognised as an expense immediately.

138. Where an enterprise recognises termination benefits, the enterprise
may also have to account for a curtailment of retirement benefits or other employee benefits (see paragraph 110).

Measurement

139. Where termination benefits fall due more than 12 months after the balance sheet date, they should be discounted using the discount rate specified in paragraph 78.

Provided that a Small and Medium-sized Company, as defined in the Notification , may not discount amounts that fall due more than 12 months after the balance sheet date.

Disclosure

140. Where there is uncertainty about the number of employees who will accept an offer of termination benefits, a contingent liability exists. As required by AS 29, *Provisions, Contingent Liabilities and Contingent Assets* an enterprise discloses information about the contingent liability unless the possibility of an outflow in settlement is remote.

141. As required by AS 5, *Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies* an enterprise discloses the nature and amount of an expense if it is of such size, nature or incidence that its disclosure is relevant to explain the performance of the enterprise for the period. Termination benefits may result in an expense needing disclosure in order to comply with this requirement.

142. Where required by AS 18, *Related Party Disclosures* an enterprise discloses information about termination benefits for key management personnel.

Transitional Provisions[18]

142A. An enterprise may disclose the amounts required by paragraph 120(n) as the amounts are determined for each accounting period prospectively from the date the enterprise first adopts this Standard.

Employee Benefits other than Defined Benefit Plans and Termination Benefits

143. Where an enterprise first adopts this Standard for employee benefits, the difference (as adjusted by any related tax expense) between the liability in respect of employee benefits other than defined benefit plans and termination benefits, as per this Standard, existing on the date of adopting this Standard and the liability that would have been recognised at the same date, as per the pre-revised AS 15 issued by the ICAI in 1995, should be adjusted against opening balance of revenue reserves and surplus.

Defined Benefit Plans

144. On first adopting this Standard, an enterprise should determine its transitional liability for defined benefit plans at that date as:

(a) the present value of the obligation (see paragraph 65) at the date of adoption;

(b) minus the fair value, at the date of adoption, of plan assets (if any) out of which the obligations are to be settled directly (see paragraphs 100-102);

[18] Transitional Provisions given in Paragraphs 142A-146 are relevant only for standards notified under Companies (Accounting Standards) Rules, 2006, as amended from time to time.

(c) minus any past service cost that, under paragraph 94, should be recognised in later periods.

145. If the transitional liability is more than the liability that would have been recognised at the same date as per the pre-revised AS 15, the enterprise should make an irrevocable choice to recognise that increase as part of its defined benefit liability under paragraph 55:

(a) immediately as an adjustment against the opening balance of revenue reserves and surplus (as adjusted by any related tax expense), or

(b) as an expense on a straight-line basis over up to five years from the date of adoption.

If an enterprise chooses (b), the enterprise should:

(i) apply the limit described in paragraph 59(b) in measuring any asset recognised in the balance sheet;

(ii) disclose at each balance sheet date (1) the amount of the increase that remains unrecognised; and (2) the amount recognised in the current period;

(iii) limit the recognition of subsequent actuarial gains (but not negative past service cost) only to the extent that the net cumulative unrecognised actuarial gains (before recognition of that actuarial gain) exceed the unrecognised part of the transitional liability; and

(iv) include the related part of the unrecognised transitional liability in determining any subsequent gain or loss on settlement or curtailment.

If the transitional liability is less than the liability that would have been recognised at the same date as per the pre-revised AS 15, the enterprise should recognise that decrease immediately as an adjustment against the opening balance of revenue reserves and surplus.

Example Illustrating Paragraphs 144 and 145

At 31st March 20X7, an enterprise's balance sheet includes a pension liability of Rs. 100, recognised as per the pre-revised AS 15 issued by the ICAI in 1995. The enterprise adopts the Standard as of 1st April 20X7, when the present value of the obligation under the Standard is Rs. 1,300 and the fair value of plan assets is Rs. 1,000. On 1st April 20X1, the enterprise had improved pensions (cost for non-vested benefits: Rs. 160; and average remaining period at that date until vesting: 10 years).

	(Amount in Rs.)
The transitional effect is as follows:	
Present value of the obligation	*1,300*
Fair value of plan assets	*(1,000)*
Less: past service cost to be recognised in later periods (160 x 4/10)	*(64)*
Transitional liability	*236*
Liability already recognised	*100*
Increase in liability	*136*

An enterprise may choose to recognise the increase in liability (as adjusted by any related tax expense) either immediately as an adjustment against the opening balance of revenue reserves and surplus as on 1 April 20X7 or as an expense on straight line basis over up to five years from that date. The choice is irrevocable.

At 31 March 20X8, the present value of the obligation under the Standard is Rs. 1,400 and the fair value of plan assets is Rs. 1,050. Net cumulative unrecognised actuarial gains since the date of adopting the Standard are Rs. 120. The enterprise is required, as per paragraph 92, to recognise all actuarial gains and losses immediately.

(Amount in Rs.)

The effect of the limit in paragraph 145 (b) (iii) is as follows:	
Net unrecognised actuarial gain	*120*
Unrecognised part of the transitional liability (136 × 4/5)	*109*
(If the enterprise adopts the policy of recognising it over 5 years)	
Maximum gain to be recognised	*11*

Termination Benefits

146. This Standard requires immediate expensing of expenditure on termination benefits (including expenditure incurred on voluntary retirement scheme (VRS)). However, where an enterprise incurs expenditure on termination benefits on or before 31st March, 2009, the enterprise may choose to follow the accounting policy of deferring such expenditure for amortisation over its pay-back period. However, the expenditure so deferred cannot be carried forward to accounting periods commencing on or after 1st April, 2010.

Illustration I

Illustration

This illustration is illustrative only and does not form part of the Standard. The purpose of this illustration is to illustrate the application of the Standard to assist in clarifying its meaning. Extracts from statements of profit and loss and balance sheets are provided to show the effects of the transactions described below. These extracts do not necessarily conform with all the disclosure and presentation requirements of other Accounting Standards.

Background Information

The following information is given about a funded defined benefit plan. To keep interest computations simple, all transactions are assumed to occur at the year end. The present value of the obligation and the fair value of the plan assets were both Rs. 1,000 at 1 April, 20X4.

(Amount in Rs.)

	20X4-X5	20X5-X6	20X6-X7
Discount rate at start of year	10.0%	9.0%	8.0%
Expected rate of return on plan assets at start of year	12.0%	11.1%	10.3%
Current service cost	130	140	150
Benefits paid	150	180	190
Contributions paid	90	100	110

Present value of obligation at 31 March	1,141	1,197	1,295
Fair value of plan assets at 31 March	1,092	1,109	1,093
Expected average remaining working lives of employees (years)	10	10	10

In 20X5-X6, the plan was amended to provide additional benefits with effect from 1 April 20X5. The present value as at 1 April 20X5 of additional benefits for employee service before 1 April 20X5 was Rs. 50 for vested benefits and Rs. 30 for non-vested benefits. As at 1 April 20X5, the enterprise estimated that the average period until the non-vested benefits would become vested was three years; the past service cost arising from additional non-vested benefits is therefore recognised on a straight-line basis over three years. The past service cost arising from additional vested benefits is recognised immediately (paragraph 94 of the Standard).

Changes in the Present Value of the Obligation and in the Fair Value of the Plan Assets

The first step is to summarise the changes in the present value of the obligation and in the fair value of the plan assets and use this to determine the amount of the actuarial gains or losses for the period. These are as follows:

(Amount in Rs.)

	20X4-X5	20X5-X6	20X6-X7
Present value of obligation, 1 April	1,000	1,141	1,197
Interest cost	100	103	96
Current service cost	130	140	150
Past service cost – (non vested benefits)	-	30	-
Past service cost – (vested benefits)	-	50	-
Benefits paid	(150)	(180)	(190)
Actuarial (gain) loss on obligation (balancing figure)	61	(87)	42
Present value of obligation, 31 March	1,141	1,197	1,295
Fair value of plan assets, 1 April	1,000	1,092	1,109
Expected return on plan assets	120	121	114
Contributions	90	100	110
Benefits paid	(150)	(180)	(190)
Actuarial gain (loss) on plan assets (balancing figure)	32	(24)	(50)
Fair value of plan assets, 31 March	1,092	1,109	1,093
Total actuarial gain (loss) to be recognised immediately as per the Standard	(29)	63	(92)

Amounts Recognised in the Balance Sheet and Statements of Profit and Loss, and Related Analyses

The final step is to determine the amounts to be recognised in the balance sheet and statement of profit and loss, and the related analyses to be disclosed in accordance with paragraphs 120 (f), (g) and (j) of the Standard (the analyses required to be disclosed in accordance with paragraph 120(c) and (e) are given in the section of this Illustration 'Changes in the Present Value of the Obligation and in the Fair Value of the Plan Assets'). These are as follows:

(Amount in Rs.)

	20X4-X5	20X5-X6	20X6-X7
Present value of the obligation	1,141	1,197	1,295
Fair value of plan assets	(1,092)	(1,109)	(1,093)
	49	88	202
Unrecognised past service cost – non vested benefits	**-**	(20)	(10)
Liability recognised in balance sheet	**49**	**68**	**192**
Current service cost	130	140	150
Interest cost	100	103	96
Expected return on plan assets	(120)	(121)	(114)
Net actuarial (gain) loss recognised in year	29	(63)	92
Past service cost - non-vested benefits	-	10	10
Past service cost - vested benefits	-	50	-
Expense recognised in the statement of profit and loss	**139**	**119**	**234**
Actual return on plan assets:			
Expected return on plan assets	120	121	114
Actuarial gain (loss) on plan assets	32	(24)	(50)
Actual return on plan assets	152	97	64

Note: see example illustrating paragraphs 103-105 for presentation of reimbursements.

Illustration II

Illustrative Disclosures

This illustration is illustrative only and does not form part of the Standard. The purpose of this illustration is to illustrate the application of the Standard to assist in clarifying its meaning. Extracts from notes to the financial statements show how the required disclosures may be aggregated in the case of a large multi-national group that provides a variety of employee benefits. These extracts do not necessarily provide all the information required under the disclosure and presentation requirements of AS 15 and other Accounting Standards. In particular, they do not illustrate the disclosure of:

(a) accounting policies for employee benefits (see AS 1 Disclosure of Accounting Policies). Paragraph 120(a) of the Standard requires this disclosure to include the enterprise's accounting policy for recognising actuarial gains and losses.

(b) a general description of the type of plan (paragraph 120(b)).

(c) a narrative description of the basis used to determine the overall expected rate of return on assets (paragraph 120(j)).

(d) employee benefits granted to directors and key management personnel (see AS 18 Related Party Disclosures).

Employee Benefit Obligations

The amounts (in Rs.) recognised in the balance sheet are as follows:

	Defined benefit pension plans		Post-employment medical benefits	
	20X5-X6	20X4-X5	20X5-X6	20X4-X5
Present value of funded obligations	20,300	17,400	-	-
Fair value of plan assets	18,420	17,280	-	-
	1,880	120	-	-
Present value of unfunded obligations	2000	1000	7,337	6,405
Unrecognised past service cost	(450)	(650)	-	-
Net liability	3,430	470	7,337	6,405
Amounts in the balance sheet:				
Liabilities	3,430	560	7,337	6,405
Assets	-	(90)	-	-
Net liability	3,430	470	7,337	6,405

The pension plan assets include equity shares issued by [name of reporting enterprise] with a fair value of Rs. 317 (20X4-X5: Rs. 281). Plan assets also include property occupied by [name of reporting enterprise] with a fair value of Rs. 200 (20X4-X5: Rs. 185).

The amounts (in Rs.) recognised in the statement of profit and loss are as follows:

	Defined benefit plans		Post-employment pension medical benefits	
	20X5-X6	20X4-X5	20X5-X6	20X4-X5
Current service cost	850	750	479	411
Interest on obligation	950	1,000	803	705
Expected return on plan assets	(900)	(650)		
Net actuarial losses (gains) recognised in year	2,650	(650)	250	400
Past service cost	200	200	-	-
Losses (gains) on curtailments and settlements	175	(390)	-	-
Total, included in 'employee benefit expense'	3,925	260	1,532	1,516
Actual return on plan assets	600	2,250	-	-

Changes in the present value of the defined benefit obligation representing reconciliation of opening and closing balances thereof are as follows:

	Defined benefit pension plans		Post-employment medical benefits	
	20X5-X6	20X4-X5	20X5-X6	20X4-X5
Opening defined benefit obligation	18,400	11,600	6,405	5,439
Service cost	850	750	479	411
Interest cost	950	1,000	803	705
Actuarial losses (gains)	2,350	950	250	400
Losses (gains) on curtailments	(500)	-		
Liabilities extinguished on settlements	-	(350)		
Liabilities assumed in an amalgamation in the nature of purchase	-	5,000		
Exchange differences on foreign plans	900	(150)		
Benefits paid	(650)	(400)	(600)	(550)
Closing defined benefit obligation	22,300	18,400	7,337	6,405

Changes in the fair value of plan assets representing reconciliation of the opening and closing balances thereof are as follows:

	Defined benefit pension plans	
	20X5-X6	20X4-X5
Opening fair value of plan assets	17,280	9,200
Expected return	900	650
Actuarial gains and (losses)	(300)	1,600
Assets distributed on settlements	(400)	-
Contributions by employer	700	350
Assets acquired in an amalgamation in the nature of purchase	-	6,000
Exchange differences on foreign plans	890	(120)
Benefits paid	(650)	(400)
	18,420	17,280

The Group expects to contribute Rs. 900 to its defined benefit pension plans in 20X6-X7.

The major categories of plan assets as a percentage of total plan assets are as follows:

	Defined benefit plans		Post-employment pension medical benefits	
	20X5-X6	20X4-X5	20X5-X6	20X4-X5
Government of India Securities	80%	82%	78%	81%
High quality corporate bonds	11%	10%	12%	12%
Equity shares of listed companies	4%	3%	10%	7%
Property	5%	5%	-	-

Principal actuarial assumptions at the balance sheet date (expressed as weighted averages):

	20X5-X6	20X4-X5
Discount rate at 31 March	5.0%	6.5%
Expected return on plan assets at 31 March	5.4%	7.0%
Proportion of employees opting for early retirement	30%	30%
Annual increase in healthcare costs	8%	8%
Future changes in maximum state health care benefits	3%	2%

The estimates of future salary increases, considered in actuarial valuation, take account of inflation, seniority, promotion and other relevant factors, such as supply and demand in the employment market.

Assumed healthcare cost trend rates have a significant effect on the amounts recognised in the statement of profit and loss. At present, healthcare costs, as indicated in the principal actuarial assumption given above, are expected to increase at 8% p.a. A one percentage point change in assumed healthcare cost trend rates would have the following effects on the aggregate of the service cost and interest cost and defined benefit obligation:

	one percentage point increase	one percentage point decrease
Effect on the aggregate of the service cost and interest cost	190	(150)
Effect on defined benefit obligation	1,000	(900)

Amounts for the current and previous four periods are as follows:

	20X5-X6	20X4-X5	20X3-X4	20X2-X3	20X1-X2
Defined benefit pension plans					
Defined benefit obligation	(22,300)	(18,400)	(11,600)	(10,582)	(9,144)
Plan assets	18,420	17,280	9,200	8,502	10,000
Surplus/(deficit)	(3,880)	(1,120)	(2,400)	(2,080)	856
Experience adjustments on plan liabilities	(1,111)	(768)	(69)	543	(642)
Experience adjustments on plan assets	(300)	1,600	(1,078)	(2,890)	2,777
Post-employment medical benefits					—

	20X5-X6	20X4-X5	20X3-X4	20X2-X3	20X1-X2
Defined benefit obligation	7,337	6,405	5,439	4,923	4,221
Experience adjustments on plan liabilities	(232)	829	490	(174)	(103)

The group also participates in an industry-wide defined benefit plan which provides pensions linked to final salaries and is funded in a manner such that contributions are set at a level that is expected to be sufficient to pay the benefits falling due in the same period. It is not practicable to determine the present value of the group's obligation or the related current service cost as the plan computes its obligations on a basis that differs materially from the basis used in [name of reporting enterprise]'s financial statements. [describe basis] On that basis, the plan's financial statements to 30 September 20X3 show an unfunded liability of Rs. 27,525. The unfunded liability will result in future payments by participating employers. The plan has approximately 75,000 members, of whom approximately 5,000 are current or former employees of [name of reporting enterprise] or their dependants. The expense recognised in the statement of profit and loss, which is equal to contributions due for the year, and is not included in the above amounts, was Rs. 230 (20X4-X5: Rs. 215). The group's future contributions may be increased substantially if other enterprises withdraw from the plan.

Accounting Standard (AS) 16

Borrowing Costs

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the General Instructions contained in part A of the Annexure to the Notification.)*

Objective

The objective of this Standard is to prescribe the accounting treatment for borrowing costs.

Scope

1. This Standard should be applied in accounting for borrowing costs.

2. This Standard does not deal with the actual or imputed cost of owners' equity, including preference share capital not classified as a liability.

Definitions

3. The following terms are used in this Standard with the meanings specified:

3.1 Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds.

3.2 A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Explanation:

What constitutes a substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of facts and circumstances of the case. In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale is considered.

4. Borrowing costs may include:

(a) interest and commitment charges on bank borrowings and other short-term and long-term borrowings;

(b) amortisation of discounts or premiums relating to borrowings;

(c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;

(d) finance charges in respect of assets acquired under finance leases or under other similar arrangements; and

(e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

Explanation:

Exchange differences arising from foreign currency borrowing and considered as borrowing costs are those exchange differences which arise on the amount of principal of the foreign currency borrowings to the extent of the difference between interest on local currency borrowings and interest on foreign currency borrowings. Thus, the amount of exchange difference not exceeding the difference between interest on local currency borrowings and interest on foreign currency borrowings is considered as borrowings cost to be accounted for under this Standard and the remaining exchange difference, if any, is accounted for under AS 11, *The Effect of Changes in Foreign Exchange Rates*. For this purpose, the interest rate for the local currency borrowings is considered as that rate at which the enterprise would have raised the borrowings locally had the enterprise not decided to raise the foreign currency borrowings.

The application of this explanation is illustrated in the Illustration attached to the Standard.

5. Examples of qualifying assets are manufacturing plants, power generation facilities, inventories that require a substantial period of time to bring them to a saleable condition, and investment properties. Other investments, and those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired also are not qualifying assets.

Recognition

6. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

7. Borrowing costs are capitalised as part of the cost of a qualifying asset when it is probable that they will result in future economic benefits to the enterprise and the costs can be measured reliably. Other borrowing costs are recognised as an expense in the period in which they are incurred.

Borrowing Costs Eligible for Capitalisation

8. The borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made. When an enterprise borrows funds specifically for the purpose of obtaining a particular qualifying asset, the borrowing costs that directly relate to that qualifying asset can be readily identified.

9. It may be difficult to identify a direct relationship between particular borrowings and a qualifying asset and to determine the borrowings that could otherwise have been avoided. Such a difficulty occurs, for example, when the financing activity of an enterprise is co-ordinated centrally or when a range of debt instruments are used to borrow funds at varying rates of interest and such borrowings are not readily identifiable with a specific qualifying asset. As a

result, the determination of the amount of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset is often difficult and the exercise of judgement is required.

10. To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

11. The financing arrangements for a qualifying asset may result in an enterprise obtaining borrowed funds and incurring associated borrowing costs before some or all of the funds are used for expenditure on the qualifying asset. In such circumstances, the funds are often temporarily invested pending their expenditure on the qualifying asset. In determining the amount of borrowing costs eligible for capitalisation during a period, any income earned on the temporary investment of those borrowings is deducted from the borrowing costs incurred.

12. To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation should be determined by applying a capitalisation rate to the expenditure on that asset. The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalised during a period should not exceed the amount of borrowing costs incurred during that period.

Excess of the Carrying Amount of the Qualifying Asset over Recoverable Amount

13. When the carrying amount or the expected ultimate cost of the qualifying asset exceeds its recoverable amount or net realisable value, the carrying amount is written down or written off in accordance with the requirements of other Accounting Standards. In certain circumstances, the amount of the write-down or write-off is written back in accordance with those other Accounting Standards.

Commencement of Capitalisation

14. The capitalisation of borrowing costs as part of the cost of a qualifying asset should commence when all the following conditions are satisfied:

- ***(a) expenditure for the acquisition, construction or production of a qualifying asset is being incurred;***
- ***(b) borrowing costs are being incurred; and***
- ***(c) activities that are necessary to prepare the asset for its intended use or sale are in progress.***

15. Expenditure on a qualifying asset includes only such expenditure that has resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities. Expenditure is reduced by any progress payments received and grants received in connection with the asset (see Accounting Standard 12, *Accounting for Government Grants*). The average carrying amount of the asset during a period, including borrowing costs previously capitalised, is normally a reasonable approximation of the expenditure to

which the capitalisation rate is applied in that period.

16. The activities necessary to prepare the asset for its intended use or sale encompass more than the physical construction of the asset. They include technical and administrative work prior to the commencement of physical construction, such as the activities associated with obtaining permits prior to the commencement of the physical construction. However, such activities exclude the holding of an asset when no production or development that changes the asset's condition is taking place. For example, borrowing costs incurred while land is under development are capitalised during the period in which activities related to the development are being undertaken. However, borrowing costs incurred while land acquired for building purposes is held without any associated development activity do not qualify for capitalisation.

Suspension of Capitalisation

17. Capitalisation of borrowing costs should be suspended during extended periods in which active development is interrupted.

18. Borrowing costs may be incurred during an extended period in which the activities necessary to prepare an asset for its intended use or sale are interrupted. Such costs are costs of holding partially completed assets and do not qualify for capitalisation. However, capitalisation of borrowing costs is not normally suspended during a period when substantial technical and administrative work is being carried out. Capitalisation of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale. For example, capitalisation continues during the extended period needed for inventories to mature or the extended period during which high water levels delay construction of a bridge, if such high water levels are common during the construction period in the geographic region involved.

Cessation of Capitalisation

19. Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

20. An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications, such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete.

21. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

22. A business park comprising several buildings, each of which can be used individually, is an example of a qualifying asset for which each part is capable of being used while construction continues for the other parts. An example of a qualifying asset that needs to be complete before any part can be used is an industrial plant involving several processes which are carried out in sequence at different parts of the plant within the same site, such as a steel mill.

Disclosure

23. The financial statements should disclose:

(a) the accounting policy adopted for borrowing costs; and

(b) the amount of borrowing costs capitalised during the period.

Illustration

Note: This illustration does not form part of the Accounting Standard. Its purpose is to assist in clarifying the meaning of paragraph 4(e) of the Standard.

Facts:

XYZ Ltd. has taken a loan of USD 10,000 on April 1, 20X3, for a specific project at an interest rate of 5% p.a., payable annually. On April 1, 20X3, the exchange rate between the currencies was Rs. 45 per USD. The exchange rate, as at March 31, 20X4, is Rs. 48 per USD. The corresponding amount could have been borrowed by XYZ Ltd. in local currency at an interest rate of 11 per cent annum as on April 1, 20X3.

The following computation would be made to determine the amount of borrowing costs for the purposes of paragraph 4(e) of AS 16:

(i) Interest for the period = USD 10,000 × 5% × Rs. 48/USD = Rs. 24,000.

(ii) Increase in the liability towards the principal amount = USD 10,000 × (48–45) = Rs. 30,000.

(iii) Interest that would have resulted if the loan was taken in Indian currency = USD 10,000 × 45 × 11% = Rs. 49,500.

(iv) Difference between interest on local currency borrowing and foreign currency borrowing = Rs. 49,500 – Rs. 24,000 = Rs. 25,500.

Therefore, out of Rs. 30,000 increase in the liability towards principal amount, only Rs. 25,500 will be considered as the borrowing cost. Thus, total borrowing cost would be Rs. 49,500 being the aggregate of interest of Rs. 24,000 on foreign currency borrowings [covered by paragraph 4(a) of AS 16] plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of Rs. 25,500. Thus, Rs. 49,500 would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining Rs. 4,500 would be considered as the exchange difference to be accounted for as per Accounting Standard (AS) 11, *The Effects of Changes in Foreign Exchange Rates.*

In the above example, if the interest rate on local currency borrowings is assumed to be 13% instead of 11%, the entire exchange difference of Rs. 30,000 would be considered as borrowing costs, since in that case the difference between the interest on local currency borrowings and foreign currency borrowings [i.e. Rs. 34,500 (Rs. 58,500 – Rs. 24,000)] is more than the exchange difference of Rs. 30,000. Therefore, in such a case, the total borrowing cost would be Rs. 54,000 (Rs. 24,000 + Rs. 30,000) which would be accounted for under AS 16 and there would be no exchange difference to be accounted for under AS 11, *The Effects of Changes in Foreign Exchange Rates.*

Accounting Standard (AS) 17

Segment Reporting

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the General Instructions contained in part A of the Annexure to the Notification.)*

This Accounting Standard is not mandatory for Small and Medium Sized Companies, as defined in the Notification. Such Companies are however encouraged to comply with the Standard.

Objective

The objective of this Standard is to establish principles for reporting financial information, about the different types of products and services an enterprise produces and the different geographical areas in which it operates. Such information helps users of financial statements:

(a) better understand the performance of the enterprise;

(b) better assess the risks and returns of the enterprise; and

(c) make more informed judgements about the enterprise as a whole.

Many enterprises provide groups of products and services or operate in geographical areas that are subject to differing rates of profitability, opportunities for growth, future prospects, and risks. Information about different types of products and services of an enterprise and its operations in different geographical areas - often called segment information - is relevant to assessing the risks and returns of a diversified or multi-locational enterprise but may not be determinable from the aggregated data. Therefore, reporting of segment information is widely regarded as necessary for meeting the needs of users of financial statements.

Scope

1. This Standard should be applied in presenting general purpose financial statements.

2. The requirements of this Standard are also applicable in case of consolidated financial statements.

3. An enterprise should comply with the requirements of this Standard fully and not selectively.

4. If a single financial report contains both consolidated financial statements and the separate financial statements of the parent, segment information need be presented only on the basis of the consolidated financial statements. In the context of reporting of segment information in consolidated financial statements, the references in this Standard to any financial statement items should construed to be the relevant item as appearing in the consolidated financial statements.

Definitions

5. The following terms are used in this Standard with the meanings specified:

5.1 A <u>business segment</u> is a distinguishable component of an enterprise that is engaged in

providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments. Factors that should be considered in determining whether products or services are related include:

(a) the nature of the products or services;

(b) the nature of the production processes;

(c) the type or class of customers for the products or services;

(d) the methods used to distribute the products or provide the services; and

(e) if applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities.

5.2 A <u>geographical segment</u> is a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic environments. Factors that should be considered in identifying geographical segments include:

(a) similarity of economic and political conditions;

(b) relationships between operations in different geographical areas;

(c) proximity of operations;

(d) special risks associated with operations in a particular area;

(e) exchange control regulations; and

(f) the underlying currency risks.

5.3 A <u>reportable segment</u> is a business segment or a geographical segment identified on the basis of foregoing definitions for which segment information is required to be disclosed by this Standard.

5.4 <u>Enterprise revenue</u> is revenue from sales to external customers as reported in the statement of profit and loss.

5.5 <u>Segment revenue</u> is the aggregate of

(i) the portion of enterprise revenue that is directly attributable to a segment,

(ii) the relevant portion of enterprise revenue that can be allocated on a reasonable basis to a segment, and

(iii) revenue from transactions with other segments of the enterprise.

Segment revenue does not include:

(a) extraordinary items as defined in AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies;

(b) interest or dividend income, including interest earned on advances or loans to other segments unless the operations of the segment are primarily of a financial

nature; and

(c) gains on sales of investments or on extinguishment of debt unless the operations of the segment are primarily of a financial nature.

5.6 <u>Segment expense</u> is the aggregate of

(i) the expense resulting from the operating activities of a segment that is directly attributable to the segment, and

(ii) the relevant portion of enterprise expense that can be allocated on a reasonable basis to the segment, including expense relating to transactions with other segments of the enterprise.

Segment expense does not include:

(a) extraordinary items as defined in AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies;

(b) interest expense, including interest incurred on advances or loans from other segments, unless the operations of the segment are primarily of a financial nature;

Explanation:

The interest expense relating to overdrafts and other operating liabilities identified to a particular segment are not included as a part of the segment expense unless the operations of the segment are primarily of a financial nature or unless the interest is included as a part of the cost of inventories. In case interest is included as a part of the cost of inventories where it is so required as per AS 16, Borrowing Costs, read with AS 2, Valuation of Inventories, and those inventories are part of segment assets of a particular segment, such interest is considered as a segment expense. In this case, the amount of such interest and the fact that the segment result has been arrived at after considering such interest is disclosed by way of a note to the segment result.

(c) losses on sales of investments or losses on extinguishment of debt unless the operations of the segment are primarily of a financial nature;

(d) income tax expense; and

(e) general administrative expenses, head-office expenses, and other expenses that arise at the enterprise level and relate to the enterprise as a whole. However, costs are sometimes incurred at the enterprise level on behalf of a segment. Such costs are part of segment expense if they relate to the operating activities of the segment and if they can be directly attributed or allocated to the segment on a reasonable basis.

5.7 <u>Segment result</u> is segment revenue less segment expense.

5.8 <u>Segment assets</u> are those operating assets that are employed by a segment in its operating activities and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.

If the segment result of a segment includes interest or dividend income, its segment assets include the related receivables, loans, investments, or other interest or dividend generating assets.

Segment assets do not include income tax assets.

Segment assets are determined after deducting related allowances/ provisions that are reported as direct offsets in the balance sheet of the enterprise.

5.9 <u>Segment liabilities</u> are those operating liabilities that result from the operating activities of a segment and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.

If the segment result of a segment includes interest expense, its segment liabilities include the related interest-bearing liabilities.

Segment liabilities do not include income tax liabilities.

5.10 <u>Segment accounting policies</u> are the accounting policies adopted for preparing and presenting the financial statements of the enterprise as well as those accounting policies that relate specifically to segment reporting.

6. The factors in paragraph 5 for identifying business segments and geographical segments are not listed in any particular order.

7. A single business segment does not include products and services with significantly differing risks and returns. While there may be dissimilarities with respect to one or several of the factors listed in the definition of business segment, the products and services included in a single business segment are expected to be similar with respect to a majority of the factors.

8. Similarly, a single geographical segment does not include operations in economic environments with significantly differing risks and returns. A geographical segment may be a single country, a group of two or more countries, or a region within a country.

9. The risks and returns of an enterprise are influenced both by the geographical location of its operations (where its products are produced or where its service rendering activities are based) and also by the location of its customers (where its products are sold or services are rendered). The definition allows geographical segments to be based on either:

(a) the location of production or service facilities and other assets of an enterprise; or

(b) the location of its customers.

10. The organisational and internal reporting structure of an enterprise will normally provide evidence of whether its dominant source of geographical risks results from the location of its assets (the origin of its sales) or the location of its customers (the destination of its sales). Accordingly, an enterprise looks to this structure to determine whether its geographical segments should be based on the location of its assets or on the location of its customers.

11. Determining the composition of a business or geographical segment involves a certain amount of judgement. In making that judgement, enterprise management takes into account the objective of reporting financial information by segment as set forth in this Standard and the qualitative characteristics of financial statements as identified in the Framework for the Preparation and Presentation of Financial Statements issued by the Institute of Chartered Accountants of India. The qualitative characteristics include the relevance, reliability, and comparability over time of financial information that is reported about the different groups of products and services of an enterprise and about its operations in particular geographical areas, and the usefulness of that information for assessing the risks and returns of the enterprise as a whole.

12. The predominant sources of risks affect how most enterprises are organised and managed. Therefore, the organisational structure of an enterprise and its internal financial reporting system are normally the basis for identifying its segments.

13. The definitions of segment revenue, segment expense, segment assets and segment liabilities include amounts of such items that are directly attributable to a segment and amounts of such items that can be allocated to a segment on a reasonable basis. An enterprise looks to its internal financial reporting system as the starting point for identifying those items that can be directly attributed, or reasonably allocated, to segments. There is thus a presumption that amounts that have been identified with segments for internal financial reporting purposes are directly attributable or reasonably allocable to segments for the purpose of measuring the segment revenue, segment expense, segment assets, and segment liabilities of reportable segments.

14. In some cases, however, a revenue, expense, asset or liability may have been allocated to segments for internal financial reporting purposes on a basis that is understood by enterprise management but that could be deemed arbitrary in the perception of external users of financial statements. Such an allocation would not constitute a reasonable basis under the definitions of segment revenue, segment expense, segment assets, and segment liabilities in this Standard. Conversely, an enterprise may choose not to allocate some item of revenue, expense, asset or liability for internal financial reporting purposes, even though a reasonable basis for doing so exists. Such an item is allocated pursuant to the definitions of segment revenue, segment expense, segment assets, and segment liabilities in this Standard.

15. Examples of segment assets include current assets that are used in the operating activities of the segment and tangible and intangible fixed assets. If a particular item of depreciation or amortisation is included in segment expense, the related asset is also included in segment assets. Segment assets do not include assets used for general enterprise or head-office purposes. Segment assets include operating assets shared by two or more segments if a reasonable basis for allocation exists. Segment assets include goodwill that is directly attributable to a segment or that can be allocated to a segment on a reasonable basis, and segment expense includes related amortisation of goodwill. If segment assets have been revalued subsequent to acquisition, then the measurement of segment assets reflects those revaluations.

16. Examples of segment liabilities include trade and other payables, accrued liabilities, customer advances, product warranty provisions, and other claims relating to the provision of goods and services. Segment liabilities do not include borrowings and other liabilities that are incurred for financing rather than operating purposes. The liabilities of segments whose operations are not primarily of a financial nature do not include borrowings and similar liabilities because segment result represents an operating, rather than a net-of-financing, profit or loss. Further, because debt is often issued at the head-office level on an enterprise-wide basis, it is often not possible to directly attribute, or reasonably allocate, the interest- bearing liabilities to segments.

17. Segment revenue, segment expense, segment assets and segment liabilities are determined before intra-enterprise balances and intra-enterprise transactions are eliminated as part of the process of preparation of enterprise financial statements, except to the extent that such intra-enterprise balances and transactions are within a single segment.

18. While the accounting policies used in preparing and presenting the financial statements of the enterprise as a whole are also the fundamental segment accounting policies, segment accounting policies include, in addition, policies that relate specifically to segment reporting, such as identification of segments, method of pricing inter-segment transfers, and basis for allocating revenues and expenses to segments.

Identifying Reportable Segments

Primary and Secondary Segment Reporting Formats

19. The dominant source and nature of risks and returns of an enterprise should govern whether its primary segment reporting format will be business segments or geographical segments. If the risks and returns of an enterprise are affected predominantly by differences in the products and services it produces, its primary format for reporting segment information should be business segments, with secondary information reported geographically. Similarly, if the risks and returns of the enterprise are affected predominantly by the fact that it operates in different countries or other geographical areas, its primary format for reporting segment information should be geographical segments, with secondary information reported for groups of related products and services.

20. Internal organisation and management structure of an enterprise and its system of internal financial reporting to the board of directors and the chief executive officer should normally be the basis for identifying the predominant source and nature of risks and differing rates of return facing the enterprise and, therefore, for determining which reporting format is primary and which is secondary, except as provided in sub-paragraphs (a) and (b) below:

(a) if risks and returns of an enterprise are strongly affected both by differences in the products and services it produces and by differences in the geographical areas in which it operates, as evidenced by a 'matrix approach' to managing the company and to reporting internally to the board of directors and the chief executive officer, then the enterprise should use business segments as its primary segment reporting format and geographical segments as its secondary reporting format; and

(b) if internal organisational and management structure of an enterprise and its system of internal financial reporting to the board of directors and the chief executive officer are based neither on individual products or services or groups of related products/services nor on geographical areas, the directors and management of the enterprise should determine whether the risks and returns of the enterprise are related more to the products and services it produces or to the geographical areas in which it operates and should, accordingly, choose business segments or geographical segments as the primary segment reporting format of the enterprise, with the other as its secondary reporting format.

21. For most enterprises, the predominant source of risks and returns determines how the enterprise is organised and managed. Organisational and management structure of an enterprise and its internal financial reporting system normally provide the best evidence of the predominant source of risks and returns of the enterprise for the purpose of its segment reporting. Therefore, except in rare circumstances, an enterprise will report segment information in its financial statements on the same basis as it reports internally to top management. Its predominant source of risks and returns becomes its primary segment reporting format. Its secondary source of risks and returns becomes its secondary segment reporting format.

22. A 'matrix presentation' — both business segments and geographical segments as primary segment reporting formats with full segment disclosures on each basis — will often provide useful information if risks and returns of an enterprise are strongly affected both by differences in the products and services it produces and by differences in the geographical areas in which it operates. This Standard does not require, but does not prohibit, a 'matrix presentation'.

23. In some cases, organisation and internal reporting of an enterprise may have developed along lines unrelated to both the types of products and services it produces, and the geographical areas in which it operates. In such cases, the internally reported segment data will not meet the objective of this Standard. Accordingly, paragraph 20(b) requires the directors and management of the enterprise to determine whether the risks and returns of the enterprise are more product/service driven or geographically driven and to accordingly choose business segments or geographical segments as the primary basis of segment reporting. The objective is to achieve a reasonable degree of comparability with other enterprises, enhance understandability of the resulting information, and meet the needs of investors, creditors, and others for information about product/service-related and geographically- related risks and returns.

Business and Geographical Segments

24. Business and geographical segments of an enterprise for external reporting purposes should be those organisational units for which information is reported to the board of directors and to the chief executive officer for the purpose of evaluating the unit's performance and for making decisions about future allocations of resources, except as provided in paragraph 25.

25. If internal organisational and management structure of an enterprise and its system of internal financial reporting to the board of directors and the chief executive officer are based neither on individual products or services or groups of related products/services nor on geographical areas, paragraph 20(b) requires that the directors and management of the enterprise should choose either business segments or geographical segments as the primary segment reporting format of the enterprise based on their assessment of which reflects the primary source of the risks and returns of the enterprise, with the other as its secondary reporting format. In that case, the directors and management of the enterprise should determine its business segments and geographical segments for external reporting purposes based on the factors in the definitions in paragraph 5 of this Standard, rather than on the basis of its system of internal financial reporting to the board of directors and chief executive officer, consistent with the following:

(a) if one or more of the segments reported internally to the directors and management is a business segment or a geographical segment based on the factors in the definitions in paragraph 5 but others are not, sub-paragraph (b) below should be applied only to those internal segments that do not meet the definitions in paragraph 5 (that is, an internally reported segment that meets the definition should not be further segmented);

(b) for those segments reported internally to the directors and management that do not satisfy the definitions in paragraph 5, management of the enterprise should look to the next lower level of internal segmentation that reports information along product and service lines or geographical lines, as appropriate under the definitions in paragraph 5; and

(c) if such an internally reported lower-level segment meets the definition of business segment or geographical segment based on the factors in paragraph 5, the criteria in paragraph 27 for identifying reportable segments should be applied to that segment.

26. Under this Standard, most enterprises will identify their business and geographical segments as the organisational units for which information is reported to the board of the directors (particularly the non-executive directors, if any) and to the chief executive officer (the senior operating decision maker, which in some cases may be a group of several people) for the purpose of evaluating each unit's performance and for making decisions about future

allocations of resources. Even if an enterprise must apply paragraph 25 because its internal segments are not along product/service or geographical lines, it will consider the next lower level of internal segmentation that reports information along product and service lines or geographical lines rather than construct segments solely for external reporting purposes. This approach of looking to organisational and management structure of an enterprise and its internal financial reporting system to identify the business and geographical segments of the enterprise for external reporting purposes is sometimes called the 'management approach', and the organisational components for which information is reported internally are sometimes called 'operating segments'.

Reportable Segments

27. A business segment or geographical segment should be identified as a reportable segment if:

(a) its revenue from sales to external customers and from transactions with other segments is 10 per cent or more of the total revenue, external and internal, of all segments; or

(b) its segment result, whether profit or loss, is 10 per cent or more of -

(i) the combined result of all segments in profit, or

(ii) the combined result of all segments in loss,

whichever is greater in absolute amount; or

(c) its segment assets are 10 per cent or more of the total assets of all segments.

28. A business segment or a geographical segment which is not a reportable segment as per paragraph 27, may be designated as a reportable segment despite its size at the discretion of the management of the enterprise. If that segment is not designated as a reportable segment, it should be included as an unallocated reconciling item.

29. If total external revenue attributable to reportable segments constitutes less than 75 per cent of the total enterprise revenue, additional segments should be identified as reportable segments, even if they do not meet the 10 per cent thresholds in paragraph 27, until at least 75 per cent of total enterprise revenue is included in reportable segments.

30. The 10 per cent thresholds in this Standard are not intended to be a guide for determining materiality for any aspect of financial reporting other than identifying reportable business and geographical segments.

Illustration II attached to this Standard presents an illustration of the determination of reportable segments as per paragraphs 27-29.

31. A segment identified as a reportable segment in the immediately preceding period because it satisfied the relevant 10 per cent thresholds should continue to be a reportable segment for the current period notwithstanding that its revenue, result, and assets all no longer meet the 10 per cent thresholds.

32. If a segment is identified as a reportable segment in the current period because it satisfies the relevant 10 per cent thresholds, preceding-period segment data that is presented for comparative purposes should, unless it is impracticable to do so, be restated to reflect the newly reportable segment as a separate segment, even if that segment did not satisfy the 10 per cent thresholds in the preceding period.

Segment Accounting Policies

33. Segment information should be prepared in conformity with the accounting policies adopted for preparing and presenting the financial statements of the enterprise as a whole.

34. There is a presumption that the accounting policies that the directors and management of an enterprise have chosen to use in preparing the financial statements of the enterprise as a whole are those that the directors and management believe are the most appropriate for external reporting purposes. Since the purpose of segment information is to help users of financial statements better understand and make more informed judgements about the enterprise as a whole, this Standard requires the use, in preparing segment information, of the accounting policies adopted for preparing and presenting the financial statements of the enterprise as a whole. That does not mean, however, that the enterprise accounting policies are to be applied to reportable segments as if the segments were separate stand-alone reporting entities. A detailed calculation done in applying a particular accounting policy at the enterprise-wide level may be allocated to segments if there is a reasonable basis for doing so. Pension calculations, for example, often are done for an enterprise as a whole, but the enterprise-wide figures may be allocated to segments based on salary and demographic data for the segments.

35. This Standard does not prohibit the disclosure of additional segment information that is prepared on a basis other than the accounting policies adopted for the enterprise financial statements provided that (a) the information is reported internally to the board of directors and the chief executive officer for purposes of making decisions about allocating resources to the segment and assessing its performance and (b) the basis of measurement for this additional information is clearly described.

36. Assets and liabilities that relate jointly to two or more segments should be allocated to segments if, and only if, their related revenues and expenses also are allocated to those segments.

37. The way in which asset, liability, revenue, and expense items are allocated to segments depends on such factors as the nature of those items, the activities conducted by the segment, and the relative autonomy of that segment. It is not possible or appropriate to specify a single basis of allocation that should be adopted by all enterprises; nor is it appropriate to force allocation of enterprise asset, liability, revenue and expense items that relate jointly to two or more segments, if the only basis for making those allocations is arbitrary. At the same time, the definitions of segment revenue, segment expense, segment assets and segment liabilities are interrelated, and the resulting allocations should be consistent. Therefore, jointly used assets and liabilities are allocated to segments if, and only if, their related revenues and expenses also are allocated to those segments. For example, an asset is included in segment assets if, and only if, the related depreciation or amortisation is included in segment expense.

Disclosure

38. Paragraphs 39-46 specify the disclosures required for reportable segments for primary segment reporting format of an enterprise. Paragraphs 47-51 identify the disclosures required for secondary reporting format of an enterprise. Enterprises are encouraged to make all of the primary-segment disclosures identified in paragraphs 39-46 for each reportable secondary segment although paragraphs 47-51 require considerably less disclosure on the secondary basis. Paragraphs 53-59 address several other segment disclosure matters. Illustration III attached to this Standard illustrates the application of these disclosure standards.

Explanation:

In case, by applying the definitions of 'business segment' and 'geographical segment', it is concluded that there is neither more than one business segment nor more than one geographical segment, segment information as per this Standard is not required to be disclosed. However, the fact that there is only one 'business segment' and 'geographical segment' is disclosed by way of a note.

Primary Reporting Format

39. The disclosure requirements in paragraphs 40-46 should be applied to each reportable segment based on primary reporting format of an enterprise.

40. An enterprise should disclose the following for each reportable segment:

(a) segment revenue, classified into segment revenue from sales to external customers and segment revenue from transactions with other segments;

(b) segment result;

(c) total carrying amount of segment assets;

(d) total amount of segment liabilities;

(e) total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets);

(f) total amount of expense included in the segment result for depreciation and amortisation in respect of segment assets for the period; and

(g) total amount of significant non-cash expenses, other than depreciation and amortisation in respect of segment assets, that were included in segment expense and, therefore, deducted in measuring segment result.

41. Paragraph 40 (b) requires an enterprise to report segment result. If an enterprise can compute segment net profit or loss or some other measure of segment profitability other than segment result, without arbitrary allocations, reporting of such amount(s) in addition to segment result is encouraged. If that measure is prepared on a basis other than the accounting policies adopted for the financial statements of the enterprise, the enterprise will include in its financial statements a clear description of the basis of measurement.

42. An example of a measure of segment performance above segment result in the statement of profit and loss is gross margin on sales. Examples of measures of segment performance below segment result in the statement of profit and loss are profit or loss from ordinary activities (either before or after income taxes) and net profit or loss.

43. Accounting Standard 5, *Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies* requires that "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". Examples of such items include write- downs of inventories, provisions for restructuring, disposals of fixed assets and long-term investments, legislative changes having retrospective application, litigation settlements, and reversal of provisions. An enterprise is encouraged, but not required, to disclose the nature and amount of any items of segment revenue and segment expense that are of such size, nature, or incidence that their disclosure is relevant to explain the performance of the segment for the period. Such

disclosure is not intended to change the classification of any such items of revenue or expense from ordinary to extraordinary or to change the measurement of such items. The disclosure, however, does change the level at which the significance of such items is evaluated for disclosure purposes from the enterprise level to the segment level.

44. An enterprise that reports the amount of cash flows arising from operating, investing and financing activities of a segment need not disclose depreciation and amortisation expense and non-cash expenses of such segment pursuant to sub-paragraphs (f) and (g) of paragraph 40.

45. AS 3 *Cash Flow Statements* recommends that an enterprise present a cash flow statement that separately reports cash flows from operating, investing and financing activities. Disclosure of information regarding operating, investing and financing cash flows of each reportable segment is relevant to understanding the enterprise's overall financial position, liquidity, and cash flows. Disclosure of segment cash flow is, therefore, encouraged, though not required. An enterprise that provides segment cash flow disclosures need not disclose depreciation and amortisation expense and non-cash expenses pursuant to sub-paragraphs (f) and (g) of paragraph 40.

46. An enterprise should present a reconciliation between the information disclosed for reportable segments and the aggregated information in the enterprise financial statements. In presenting the reconciliation, segment revenue should be reconciled to enterprise revenue; segment result should be reconciled to enterprise net profit or loss; segment assets should be reconciled to enterprise assets; and segment liabilities should be reconciled to enterprise liabilities.

Secondary Segment Information

47. Paragraphs 39-46 identify the disclosure requirements to be applied to each reportable segment based on primary reporting format of an enterprise. Paragraphs 48-51 identify the disclosure requirements to be applied to each reportable segment based on secondary reporting format of an enterprise, as follows:

(a) if primary format of an enterprise is business segments, the required secondary-format disclosures are identified in paragraph 48;

(b) if primary format of an enterprise is geographical segments based on location of assets (where the products of the enterprise are produced or where its service rendering operations are based), the required secondary-format disclosures are identified in paragraphs 49 and 50;

(c) if primary format of an enterprise is geographical segments based on the location of its customers (where its products are sold or services are rendered), the required secondary-format disclosures are identified in paragraphs 49 and 51.

48. If primary format of an enterprise for reporting segment information is business segments, it should also report the following information:

(a) segment revenue from external customers by geographical area based on the geographical location of its customers, for each geographical segment whose revenue from sales to external customers is 10 per cent or more of enterprise revenue;

(b) the total carrying amount of segment assets by geographical location of assets, for each geographical segment whose segment assets are 10 per cent or more of the

total assets of all geographical segments; and

(c) the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets) by geographical location of assets, for each geographical segment whose segment assets are 10 per cent or more of the total assets of all geographical segments.

49. If primary format of an enterprise for reporting segment information is geographical segments (whether based on location of assets or location of customers), it should also report the following segment information for each business segment whose revenue from sales to external customers is 10 per cent or more of enterprise revenue or whose segment assets are 10 per cent or more of the total assets of all business segments:

(a) segment revenue from external customers;

(b) the total carrying amount of segment assets; and

(c) the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets).

50. If primary format of an enterprise for reporting segment information is geographical segments that are based on location of assets, and if the location of its customers is different from the location of its assets, then the enterprise should also report revenue from sales to external customers for each customer-based geographical segment whose revenue from sales to external customers is 10 per cent or more of enterprise revenue.

51. If primary format of an enterprise for reporting segment information is geographical segments that are based on location of customers, and if the assets of the enterprise are located in different geographical areas from its customers, then the enterprise should also report the following segment information for each asset-based geographical segment whose revenue from sales to external customers or segment assets are 10 per cent or more of total enterprise amounts:

(a) the total carrying amount of segment assets by geographical location of the assets; and

(b) the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets) by location of the assets.

Illustrative Segment Disclosures

52. Illustration III attached to this Standard Illustrates the disclosures for primary and secondary formats that are required by this Standard.

Other Disclosures

53. In measuring and reporting segment revenue from transactions with other segments, inter-segment transfers should be measured on the basis that the enterprise actually used to price those transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements.

54. Changes in accounting policies adopted for segment reporting that have a material effect on segment information should be disclosed. Such disclosure should include a description of the nature of the change, and the financial effect of the change if it is

reasonably determinable.

55. AS 5 requires that changes in accounting policies adopted by the enterprise should be made only if required by statute, or for compliance with an accounting standard, or if it is considered that the change would result in a more appropriate presentation of events or transactions in the financial statements of the enterprise.

56. Changes in accounting policies adopted at the enterprise level that affect segment information are dealt with in accordance with AS 5. AS 5 requires that 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.

57. Some changes in accounting policies relate specifically to segment reporting. Examples include changes in identification of segments and changes in the basis for allocating revenues and expenses to segments. Such changes can have a significant impact on the segment information reported but will not change aggregate financial information reported for the enterprise. To enable users to understand the impact of such changes, this Standard requires the disclosure of the nature of the change and the financial effect of the change, if reasonably determinable.

58. An enterprise should indicate the types of products and services included in each reported business segment and indicate the composition of each reported geographical segment, both primary and secondary, if not otherwise disclosed in the financial statements.

59. To assess the impact of such matters as shifts in demand, changes in the prices of inputs or other factors of production, and the development of alternative products and processes on a business segment, it is necessary to know the activities encompassed by that segment. Similarly, to assess the impact of changes in the economic and political environment on the risks and returns of a geographical segment, it is important to know the composition of that geographical segment.

Illustration I

Segment Definition Decision Tree

The purpose of this illustration is to illustrate the application of paragraphs 24-32 of the Accounting Standard.

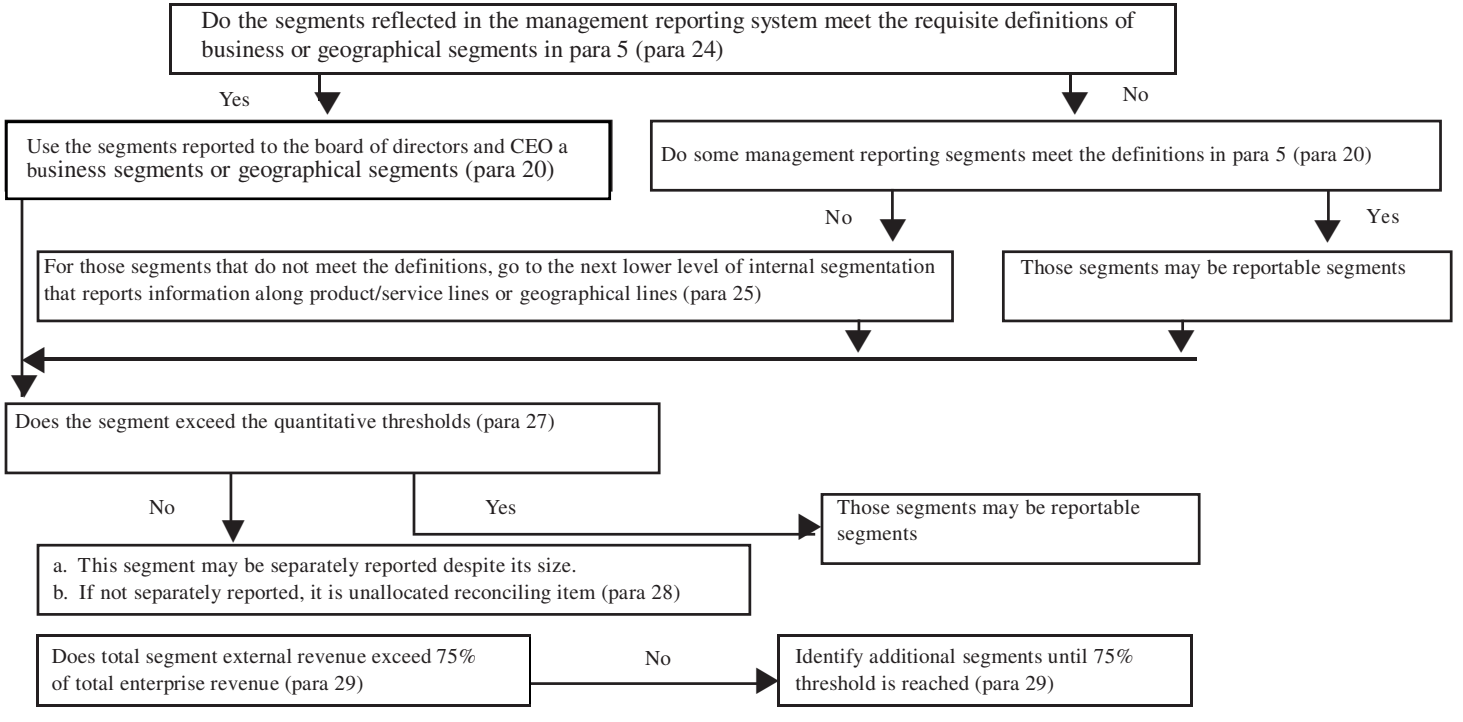

Illustration II

Illustration on Determination of Reportable Segments [Paragraphs 27-29]

This illustration does not form part of the Accounting Standard. Its purpose is to illustrate the application of paragraphs 27-29 of the Accounting Standard.

An enterprise operates through eight segments, namely, A, B, C, D, E, F, G and H. The relevant information about these segments is given in the following table (amounts in Rs.'000):

	A	B	C	D	E	F	G	H	Total (Segments)	Total (Enterprise)
1. SEGMENT REVENUE										
(a) External Sales	-	255	15	10	15	50	20	35	400	
(b) Inter-segment Sales	100	60	30	5	-	-	5	-	200	
(c) Total Revenue	100	315	45	15	15	50	25	35	600	400
2. Total Revenue of each segment as a percentage of total revenue of all segments	16.7	52.5	7.5	2.5	2.5	8.3	4.2	5.8		

	A	B	C	D	E	F	G	H	Total (Segments)	Total (Enterprise)
3. SEGMENT RESULT [Profit/(Loss)]	5	(90)	15	(5)	8	(5)	5	7		
4. Combined Result of all Segments in profits	5		15		8		5	7	40	
5. Combined Result of all Segments in loss		(90)		(5)		(5)			(100)	
6. Segment Result as a percentage of the greater of the totals arrived at 4 and 5 above in absolute amount(i.e., 100)	5	90	15	5	8	5	5	7		
7. SEGMENT ASSETS	15	47	5	11	3	5	5	9	100	
8. Segment assets as a percentage of total assets of all segments	15	47	5	11	3	5	5	9		

The reportable segments of the enterprise will be identified as below:

(a) In accordance with paragraph 27(a), segments whose total revenue from external sales and inter-segment sales is 10% or more of the total revenue of all segments, external and internal, should be identified as reportable segments. Therefore, Segments A and B are reportable segments.

(b) As per the requirements of paragraph 27(b), it is to be first identified whether the combined result of all segments in profit or the combined result of all segments in loss is greater in absolute amount. From the table, it is evident that combined result in loss (i.e., Rs.1,00,000) is greater. Therefore, the individual segment result as a percentage of Rs.1,00,000 needs to be examined. In accordance with paragraph 27(b), Segments B and C are reportable segments as their segment result is more than the threshold limit of 10%.

(c) Segments A, B and D are reportable segments as per paragraph 27(c), as their segment assets are more than 10% of the total segment assets.

Thus, Segments A, B, C and D are reportable segments in terms of the criteria laid down in paragraph 27.

Paragraph 28 of the Standard gives an option to the management of the enterprise to designate any segment as a reportable segment. In the given case, it is presumed that the management decides to designate Segment E as a reportable segment.

Paragraph 29 requires that if total external revenue attributable to reportable segments identified as aforesaid constitutes less than 75% of the total enterprise revenue, additional segments should be identified as reportable segments even if they do not meet the 10% thresholds in paragraph 27, until at least 75% of total enterprise revenue is included in reportable segments.

The total external revenue of Segments A, B, C, D and E, identified above as reportable segments, is Rs.2,95,000. This is less than 75% of total enterprise revenue of Rs.4,00,000. The management of the enterprise is required to designate any one or more of the remaining segments as reportable segment(s) so that the external revenue of reportable segments is at least 75% of the total enterprise revenue. Suppose, the management designates Segment H for this purpose. Now the external revenue of reportable segments is more than 75% of the total enterprise revenue.

Segments A, B, C, D, E and H are reportable segments. Segments F and G will be shown as reconciling items.

Illustration III

Illustrative Segment Disclosures

This illustration does not form part of the Accounting Standard. Its purpose is to illustrate the application of paragraphs 38-59 of the Accounting Standard.

This illustration illustrates the segment disclosures that this Standard would require for a diversified multi-locational business enterprise. This example is intentionally complex to illustrate most of the provisions of this Standard.

INFORMATION ABOUT BUSINESS SEGMENTS (NOTE xx)

(All amounts in Rs. lakhs)

	Paper Products		**Office Products**		**Publishing**		**Other Operations**		**Eliminations**		**Consolidated Total**	
	Current Year	*Previous Year*	*Current Year*	*Previous Year*	*Current Year*	*Previous Year*	*Current Year*	*Previous Year*	*Current Year*	*Previous Year*	*Current Year*	*Previous Year*
REVENUE												
External sales	55	50	20	17	19	16	7	7				
Inter- segment sales	15	10	10	14	2	4	2	2	(29)	(30)		
Total Revenue	70	60	30	31	21	20	9	9	(29)	(30)	101	90

	Paper Products		Office Products		Publishing		Other Operations		Eliminations		Consolidated Total	
	Current Year	*Previous Year*	*Current Year*	*Previous Year*	*Current Year*	*Previous Year*	*Current Year*	*Previous Year*	*Current Year*	*Previous Year*	*Current Year*	*Previous Year*
RESULT												
Segment result	20	17	9	7	2	1	0	0	(1)	(1)	30	24
Unallocated corporate expenses											(7)	(9)
Operating profit											23	15
Interest expense											(4)	(4)
Interest income											2	3
Income taxes											(7)	(4)
Profit from ordinary activities											14	10

	Paper Products		Office Products		Publishing		Other Operations		Eliminations		Consolidated Total	
	Current Year	*Previous Year*	*Current Year*	*Previous Year*	*Current Year*	*Previous Year*	*Current Year*	*Previous Year*	*Current Year*	*Previous Year*	*Current Year*	*Previous Year*
Extraordinary loss: uninsured earthquake damage to factory		(3)										(3)
Net profit											14	7
OTHER INFORMATION												
Segment assets	54	50	34	30	10	10	10	9			108	99
Unallocated corporate assets											67	56
Total assets											175	155
Segment liabilities	25	15	8	11	8	8	1	1			42	35

	Paper Products		Office Products		Publishing		Other Operations		Eliminations		Consolidated Total	
	Current Year	*Previous Year*	*Current Year*	*Previous Year*	*Current Year*	*Previous Year*	*Current Year*	*Previous Year*	*Current Year*	*Previous Year*	*Current Year*	*Previous Year*
Unallocated corporate liabilities											40	55
Total liabilities											82	90
Capital expenditure	12	10	3	5	5		4	3				
Depreciation	9	7	9	7	5	3	3	4				
Non-cash expenses other than depreciation	8	2	7	3	2	2	2	1				

Note xx-Business and Geographical Segments (amounts in Rs. lakhs)

Business segments: For management purposes, the Company is organised on a worldwide basis into three major operating divisions-paper products, office products and publishing — each headed by a senior vice president. The divisions are the basis on which the company reports its primary segment information. The paper products segment produces a broad range of writing and publishing papers and newsprint. The office products segment manufactures labels, binders, pens, and markers and also distributes office products made by others. The publishing segment develops and sells books in the fields of taxation, law and accounting. Other operations include development of computer software for standard and specialised business applications. Financial information about business segments is presented in the above table.

Geographical segments: Although the Company's major operating divisions are managed on a worldwide basis, they operate in

four principal geographical areas of the world. In India, its home country, the Company produces and sells a broad range of papers and office products. Additionally, all of the Company's publishing and computer software development operations are conducted in India. In the European Union, the Company operates paper and office products manufacturing facilities and sales offices in the following countries: France, Belgium, Germany and the U.K. Operations in Canada and the United States are essentially similar and consist of manufacturing papers and newsprint that are sold entirely within those two countries. Operations in Indonesia include the production of paper pulp and the manufacture of writing and publishing papers and office products, almost all of which is sold outside Indonesia, both to other segments of the company and to external customers.

Sales by market: The following table shows the distribution of the Company's consolidated sales by geographical market, regardless of where the goods were produced:

	Sales Revenue by *Geographical Market*	
	Current Year	Previous Year
India	19	22
European Union	30	31
Canada and the United States	28	21
Mexico and South America	6	2
Southeast Asia (principally Japan and Taiwan)	18	14
	101	90

Assets and additions to tangible and intangible fixed assets by geographical area: The following table shows the carrying amount of segment assets and additions to tangible and intangible fixed assets by geographical area in which the assets are located:

	Carrying Amount of Segment Assets		**Additions to Fixed Assets and Intangible Assets**	
	Current Year	**Previous Year**	**Current Year**	**Previous Year**
India	72	78	8	5
European Union	47	37	5	4
Canada and the United States	34	20	4	3

Indonesia	22	20	7	6
	175	155	24	18

Segment revenue and expense: In India, paper and office products are manufactured in combined facilities and are sold by a combined sales force. Joint revenues and expenses are allocated to the two business segments on a reasonable basis. All other segment revenue and expense are directly attributable to the segments.

Segment assets and liabilities: Segment assets include all operating assets used by a segment and consist principally of operating cash, debtors, inventories and fixed assets, net of allowances and provisions which are reported as direct offsets in the balance sheet. While most such assets can be directly attributed to individual segments, the carrying amount of certain assets used jointly by two or more segments is allocated to the segments on a reasonable basis. Segment liabilities include all operating liabilities and consist principally of creditors and accrued liabilities. Segment assets and liabilities do not include deferred income taxes.

Inter-segment transfers: Segment revenue, segment expenses and segment result include transfers between business segments and between geographical segments. Such transfers are accounted for at competitive market prices charged to unaffiliated customers for similar goods. Those transfers are eliminated in consolidation.

Unusual item: Sales of office products to external customers in the current year were adversely affected by a lengthy strike of transportation workers in India, which interrupted product shipments for approximately four months. The Company estimates that sales of office products during the four-month period were approximately half of what they would otherwise have been.

Extraordinary loss: As more fully discussed in Note x, the Company incurred an uninsured loss of Rs.3,00,000 caused by earthquake damage to a paper mill in India during the previous year.

Illustration IV

Summary of Required Disclosure

This illustration does not form part of the Accounting Standard. Its purpose is to summarise the disclosures required by paragraphs 38-59 for each of the three possible primary segment reporting formats.

Figures in parentheses refer to paragraph numbers of the relevant paragraphs in the text.

PRIMARY FORMAT IS BUSINESS SEGMENTS	**PRIMARY FORMAT IS GEOGRAPHICAL SEGMENTS BY LOCATION OF ASSETS**	**PRIMARY FORMAT IS GEOGRAPHICAL SEGMENTS BY LOCATION OF CUSTOMERS**
Required Primary Disclosures	***Required Primary Disclosures***	***Required Primary Disclosures***
Revenue from external customers by business segment [40(a)]	Revenue from external customers by location of assets [40(a)]	Revenue from external customers by location of customers [40(a)]
Revenue from transactions with other segments by business segment [40(a)]	Revenue from transactions with other segments by location of assets [40(a)]	Revenue from transactions with other segments by location of customers [40(a)]
Segment result by business segment [40(b)]	Segment result by location of assets [40(b)]	Segment result by location of customers [40(b)]
Carrying amount of segment assets by business segment [40(c)]	Carrying amount of segment assets by location of assets [40(c)]	Carrying amount of segment assets by location of customers [40(c)]
Segment liabilities by business segment [40(d)]	Segment liabilities by location of assets [40(d)]	Segment liabilities by location of customers [40(d)]
Cost to acquire tangible and intangible fixed assets by business segment [40(e)]	Cost to acquire tangible and intangible fixed assets by location of assets [40(e)]	Cost to acquire tangible and intangible fixed assets by location of customers [40(e)]
Depreciation and amortisation expense by business segment [40(f)]	Depreciation and amortisation expense by location of assets[40(f)]	Depreciation and amortisation expense by location of customers[40(f)]
Non-cash expenses other than depreciation and amortisation by business segment [40(g)]	Non-cash expenses other than depreciation and amortisation by location of assets [40(g)]	Non-cash expenses other than depreciation and amortisation by location of customers [40(g)]
Reconciliation of revenue, result, assets, and liabilities by business segment [46]	Reconciliation of revenue, result, assets, and liabilities [46]	Reconciliation of revenue, result, assets, and liabilities [46]

PRIMARY FORMAT IS BUSINESS SEGMENTS	**PRIMARY FORMAT IS GEOGRAPHICAL SEGMENTS BY LOCATION OF ASSETS**	**PRIMARY FORMAT IS GEOGRAPHICAL SEGMENTS BY LOCATION OF CUSTOMERS**
Required Secondary Disclosures	***Required Secondary Disclosures***	***Required Secondary Disclosures***
Revenue from external customers by location of customers [48]	Revenue from external customers by business segment [49]	Revenue from external customers by business segment [49]
Carrying amount of segment assets by location of assets [48]	Carrying amount of segment assets by business segment [49]	Carrying amount of segment assets by business segment [49]
Cost to acquire tangible and intangible fixed assets by location of assets [48]	Cost to acquire tangible and intangible fixed assets by business segment [49]	Cost to acquire tangible and intangible fixed assets by business segment [49]
	Revenue from external customers by geographical customers if different from location of assets [50]	
		Carrying amount of segment assets by location of assets if different from location of customers [51]
		Cost to acquire tangible and intangible fixed assets by location of assets if different from location of customers [51]
Other Required Disclosures	***Other Required Disclosures***	***Other Required Disclosures***
Basis of pricing inter-segment transfers and any change therein [53]	Basis of pricing inter-segment transfers and any change therein [53]	Basis of pricing inter- segment transfers and any change therein [53]
Changes in segment accounting policies [54]	Changes in segment accounting policies [54]	Changes in segment accounting policies [54]
Types of products and services in each business segment [58]	Types of products and services in each business segment [58]	Types of products and services in each business segment [58]
Composition of each geographical segment [58]	Composition of each geographical segment [58]	Composition of each geographical segment [58]

Accounting Standard (AS) 18

Related Party Disclosures

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the General Instructions contained in part A of the Annexure to the Notification.)*

Objective

The objective of this Standard is to establish requirements for disclosure of:

(a) related party relationships; and

(b) transactions between a reporting enterprise and its related parties.

Scope

1. This Standard should be applied in reporting related party relationships and transactions between a reporting enterprise and its related parties. The requirements of this Standard apply to the financial statements of each reporting enterprise as also to consolidated financial statements presented by a holding company.

2. This Standard applies only to related party relationships described in paragraph 3.

3. This Standard deals only with related party relationships described in (a) to (e) below:

(a) enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise (this includes holding companies, subsidiaries and fellow subsidiaries);

(b) associates and joint ventures of the reporting enterprise and the investing party or venturer in respect of which the reporting enterprise is an associate or a joint venture;

(c) individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual;

(d) key management personnel and relatives of such personnel; and

(e) enterprises over which any person described in (c) or (d) is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.

4. In the context of this Standard, the following are deemed not to be related parties:

(a) two companies simply because they have a director in common, notwithstanding paragraph 3(d) or (e) above (unless the director is able to affect the policies of both companies in their mutual dealings);

(b) a single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting

economic dependence; and

(c) the parties listed below, in the course of their normal dealings with an enterprise by virtue only of those dealings (although they may circumscribe the freedom of action of the enterprise or participate in its decision-making process):
(i) providers of finance;
(ii) trade unions;
(iii) public utilities;
(iv) government departments and government agencies including government sponsored bodies.

5. Related party disclosure requirements as laid down in this Standard do not apply in circumstances where providing such disclosures would conflict with the reporting enterprise's duties of confidentiality as specifically required in terms of a statute or by any regulator or similar competent authority.

6. In case a statute or a regulator or a similar competent authority governing an enterprise prohibit the enterprise to disclose certain information which is required to be disclosed as per this Standard, disclosure of such information is not warranted. For example, banks are obliged by law to maintain confidentiality in respect of their customers' transactions and this Standard would not override the obligation to preserve the confidentiality of customers' dealings.

7. No disclosure is required in consolidated financial statements in respect of intra-group transactions.

8. Disclosure of transactions between members of a group is unnecessary in consolidated financial statements because consolidated financial statements present information about the holding and its subsidiaries as a single reporting enterprise.

9. No disclosure is required in the financial statements of state-controlled enterprises as regards related party relationships with other state-controlled enterprises and transactions with such enterprises.

Definitions

10. For the purpose of this Standard, the following terms are used with the meanings specified:

10.1 <u>Related party</u> - parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

10.2 <u>Related party transaction</u> - a transfer of resources or obligations between related parties, regardless of whether or not a price is charged.

10.3 <u>Control</u> – (a) ownership, directly or indirectly, of more than one half of the voting power of an enterprise, or

(b) control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise, or

(c) a substantial interest in voting power and the power to direct, by statute or agreement, the financial and/or operating policies of the enterprise.

10.4 <u>Significant influence</u> - participation in the financial and/or operating policy decisions of an enterprise, but not control of those policies.

10.5 An <u>Associate</u> - an enterprise in which an investing reporting party has significant influence and which is neither a subsidiary nor a joint venture of that party.

10.6 A <u>Joint venture</u> - a contractual arrangement whereby two or more parties undertake an economic activity which is subject to joint control.

10.7 <u>Joint control</u> - the contractually agreed sharing of power to govern the financial and operating policies of an economic activity so as to obtain benefits from it.

10.8 <u>Key management personnel</u> - those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise.

10.9 <u>Relative</u> – in relation to an individual, means the spouse, son, daughter, brother, sister, father and mother who may be expected to influence, or be influenced by, that individual in his/her dealings with the reporting enterprise.

10.10 <u>Holding company</u> - a company having one or more subsidiaries.

10.11 <u>Subsidiary</u> - a company:

(a) in which another company (the holding company) holds, either by itself and/or through one or more subsidiaries, more than one-half in nominal value of its equity share capital; or

(b) of which another company (the holding company) controls, either by itself and/or through one or more subsidiaries, the composition of its board of directors.

10.12 <u>Fellow subsidiary</u> - a company is considered to be a fellow subsidiary of another company if both are subsidiaries of the same holding company.

10.13 <u>State-controlled enterprise -</u> an enterprise which is under the control of the Central Government and/or any State Government(s).

11. For the purpose of this Standard, an enterprise is considered to control the composition of

(i) the board of directors of a company, if it has the power, without the consent or concurrence of any other person, to appoint or remove all or a majority of directors of that company. An enterprise is deemed to have the power to appoint a director if any of the following conditions is satisfied:

(a) a person cannot be appointed as director without the exercise in his favour by that enterprise of such a power as aforesaid; or

(b) a person's appointment as director follows necessarily from his appointment to a position held by him in that enterprise; or

(c) the director is nominated by that enterprise; in case that enterprise is a company, the director is nominated by that company/subsidiary thereof.

(ii) the governing body of an enterprise that is not a company, if it has the power, without the consent or the concurrence of any other person, to appoint or remove all or a majority of members of the governing body of that other enterprise. An enterprise is deemed to have the power to appoint a member if any of the following conditions is

satisfied:

(a) a person cannot be appointed as member of the governing body without the exercise in his favour by that other enterprise of such a power as aforesaid; or

(b) a person's appointment as member of the governing body follows necessarily from his appointment to a position held by him in that other enterprise; or

(c) the member of the governing body is nominated by that other enterprise.

12. An enterprise is considered to have a substantial interest in another enterprise if that enterprise owns, directly or indirectly, 20 per cent or more interest in the voting power of the other enterprise. Similarly, an individual is considered to have a substantial interest in an enterprise, if that individual owns, directly or indirectly, 20 per cent or more interest in the voting power of the enterprise.

13. Significant influence may be exercised in several ways, for example, by representation on the board of directors, participation in the policy making process, material inter-company transactions, interchange of managerial personnel, or dependence on technical information. Significant influence may be gained by share ownership, statute or agreement. As regards share ownership, if an investing party holds, directly or indirectly through intermediaries, 20 per cent or more of the voting power of the enterprise, it is presumed that the investing party does have significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investing party holds, directly or indirectly through intermediaries, less than 20 per cent of the voting power of the enterprise, it is presumed that the investing party does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investing party does not necessarily preclude an investing party from having significant influence.

Explanation

An intermediary means a subsidiary as defined in AS 21, *Consolidated Financial Statements.*

14. Key management personnel are those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. For example, in the case of a company, the managing director(s), whole time director(s), manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered key management personnel.

Explanation

A non-executive director of a company is not considered as a key management person under this Standard by virtue of merely his being a director unless he has the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. The requirements of this Standard are not applied in respect of a non-executive director even enterprise, unless he falls in any of the categories in paragraph 3 of this Standard.

The Related Party Issue

15. Related party relationships are a normal feature of commerce and business. For example, enterprises frequently carry on separate parts of their activities through subsidiaries or associates and acquire interests in other enterprises - for investment purposes or for trading reasons - that are of sufficient proportions for the investing enterprise to be able to control or exercise significant influence on the financial and/or operating decisions of its investee.

16. Without related party disclosures, there is a general presumption that transactions reflected

in financial statements are consummated on an arm's-length basis between independent parties. However, that presumption may not be valid when related party relationships exist because related parties may enter into transactions which unrelated parties would not enter into. Also, transactions between related parties may not be effected at the same terms and conditions as between unrelated parties. Sometimes, no price is charged in related party transactions, for example, free provision of management services and the extension of free credit on a debt. In view of the aforesaid, the resulting accounting measures may not represent what they usually would be expected to represent. Thus, a related party relationship could have an effect on the financial position and operating results of the reporting enterprise.

17. The operating results and financial position of an enterprise may be affected by a related party relationship even if related party transactions do not occur. The mere existence of the relationship may be sufficient to affect the transactions of the reporting enterprise with other parties. For example, a subsidiary may terminate relations with a trading partner on acquisition by the holding company of a fellow subsidiary engaged in the same trade as the former partner. Alternatively, one party may refrain from acting because of the control or significant influence of another - for example, a subsidiary may be instructed by its holding company not to engage in research and development.

18. Because there is an inherent difficulty for management to determine the effect of influences which do not lead to transactions, disclosure of such effects is not required by this Standard.

19. Sometimes, transactions would not have taken place if the related party relationship had not existed. For example, a company that sold a large proportion of its production to its holding company at cost might not have found an alternative customer if the holding company had not purchased the goods.

Disclosure

20. The statutes governing an enterprise often require disclosure in financial statements of transactions with certain categories of related parties. In particular, attention is focussed on transactions with the directors or similar key management personnel of an enterprise, especially their remuneration and borrowings, because of the fiduciary nature of their relationship with the enterprise.

21. Name of the related party and nature of the related party relationship where control exists should be disclosed irrespective of whether or not there have been transactions between the related parties.

22. Where the reporting enterprise controls, or is controlled by, another party, this information is relevant to the users of financial statements irrespective of whether or not transactions have taken place with that party. This is because the existence of control relationship may prevent the reporting enterprise from being independent in making its financial and/or operating decisions. The disclosure of the name of the related party and the nature of the related party relationship where control exists may sometimes be at least as relevant in appraising an enterprise's prospects as are the operating results and the financial position presented in its financial statements. Such a related party may establish the enterprise's credit standing, determine the source and price of its raw materials, and determine to whom and at what price the product is sold.

23. If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following:

(i) the name of the transacting related party;

(ii) a description of the relationship between the parties;

(iii) a description of the nature of transactions;

(iv) volume of the transactions either as an amount or as an appropriate proportion;

(v) any other elements of the related party transactions necessary for an understanding of the financial statements;

(vi) the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date; and

(vii)amounts written off or written back in the period in respect of debts due from or to related parties.

24. The following are examples of the related party transactions in respect of which disclosures may be made by a reporting enterprise:

(a) purchases or sales of goods (finished or unfinished);

(b) purchases or sales of fixed assets;

(c) rendering or receiving of services;

(d) agency arrangements;

(e) leasing or hire purchase arrangements;

(f) transfer of research and development;

(g) licence agreements;

(h) finance (including loans and equity contributions in cash or in kind);

(i) guarantees and collaterals; and

(j) management contracts including for deputation of employees.

25. Paragraph 23 (v) requires disclosure of 'any other elements of the related party transactions necessary for an understanding of the financial statements'. An example of such a disclosure would be an indication that the transfer of a major asset had taken place at an amount materially different from that obtainable on normal commercial terms.

26. Items of a similar nature may be disclosed in aggregate by type of related party except when seperate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the reporting enterprise.

Explanation:

Type of related party means each related party relationship described in paragraph 3 above.

27. Disclosure of details of particular transactions with individual related parties would frequently be too voluminous to be easily understood. Accordingly, items of a similar nature may be disclosed in aggregate by type of related party. However, this is not done in such a way as to obscure the importance of significant transactions. Hence, purchases or sales of goods are not aggregated with purchases or sales of fixed assets. Nor a material related party transaction with an individual party is clubbed in an aggregated disclosure.

Explanation:

(a) Materiality primarily depends on the facts and circumstances of each case. In deciding whether an item or an aggregate of items is material, the nature and the size of the item(s) are evaluated together. Depending on the circumstances, either the nature or the size of the item could be the determining factor. As regards size, for the purpose of applying the test of materiality as per this paragraph, ordinarily a related party transaction, the amount of which is in excess of 10% of the total related party transactions of the same type (such as purchase of goods), is considered material, unless on the basis of facts and circumstances of the case it can be concluded that even a transaction of less than 10% is material. As regards nature, ordinarily the related party transactions which are not entered into in the normal course of the business of the reporting enterprise are considered material subject to the facts and circumstances of the case.

(b) The manner of disclosure required by paragraph 23, read with paragraph 26, is illustrated in the Illustration attached to the Standard.

Illustration

Note: This illustration does not form part of the Accounting Standard. Its purpose is to assist in clarifying the meaning of the Accounting Standard.

The manner or disclosures required by paragraphs 23 and 26 of AS 18 is illustrated as below. It may be noted that the format given below is merely illustrative in nature and is not exhaustive.

	Holding Company	Subsi-diaries	Fellow Subsi-diaries	Associates	Key Manage-ment Personnel	Relatives of Key Manage-ment Personnel	Total
Purchases of goods							
Sale of goods							
Purchase of fixed assets							
Sale of fixed assets							
Rendering of services							
Receiving of services							
Agency arrangements							
Leasing or hire purchase arrangements							
Transfer of research and development							
Licence agreements Finance (including loans and equity contributions in cash or in kind)							
Guarantees and collaterals							
Management contracts including for deputation of employees							

Note:

Name of related parties and description of relationship:

1.	Holding Company	A Ltd.
2.	Subsidiaries	B Ltd. and C (P) Ltd.
3.	Fellow Subsidiaries	D Ltd. and Q Ltd.
4.	Associates	X Ltd., Y Ltd. and Z (P) Ltd.
5.	Key Management Personnel	Mr. Y and Mr. Z
6.	Relatives of Key Management Personnel	Mrs. Y (wife of Mr. Y), Mr. F (father of Mr. Z)

Accounting Standard (AS) 19

Leases‡‡‡‡‡

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the General Instructions contained in part A of the Annexure to the Notification.)*

Objective

The objective of this Standard is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosures in relation to finance leases and operating leases.

Scope

1. This Standard should be applied in accounting for all leases other than:

(a) lease agreements to explore for or use natural resources, such as oil, gas, timber, metals and other mineral rights; and

(b) licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights; and

(c) lease agreements to use lands.

2. This Standard applies to agreements that transfer the right to use assets even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets. On the other hand, this Standard does not apply to agreements that are contracts for services that do not transfer the right to use assets from one contracting party to the other.

Definitions

3. The following terms are used in this Standard with the meanings specified:

3.1 A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

3.2 A finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset.

3.3 An operating lease is a lease other than a finance lease.

3.4 A non-cancellable lease is a lease that is cancellable only:

(a) upon the occurrence of some remote contingency; or

‡‡‡‡‡ In respect of assets leased prior to the effective date of the notification prescribing Accounting Standard (AS) 19 as part of Companies (Accounting Standards) Rules, 2006, the applicability of this Standard would be determined on the basis of the Accounting Standard (AS) 19, issued by the ICAI in 2001.

(b) with the permission of the lessor; or

(c) if the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or

(d) upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain.

3.5 The inception of the lease is the earlier of the date of the lease agreement and the date of a commitment by the parties to the principal provisions of the lease.

3.6 The lease term is the non-cancellable period for which the lessee has agreed to take on lease the asset together with any further periods for which the lessee has the option to continue the lease of the asset, with or without further payment, which option at the inception of the lease it is reasonably certain that the lessee will exercise.

3.7 Minimum lease payments are the payments over the lease term that the lessee is, or can be required, to make excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor, together with:

(a) in the case of the lessee, any residual value guaranteed by or on behalf of the lessee; or

(b) in the case of the lessor, any residual value guaranteed to the lessor:

(i) by or on behalf of the lessee; or

(ii) by an independent third party financially capable of meeting this guarantee.

However, if the lessee has an option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable that, at the inception of the lease, is reasonably certain to be exercised, the minimum lease payments comprise minimum payments payable over the lease term and the payment required to exercise this purchase option.

3.8 Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction.

3.9 Economic life is either:

(a) the period over which an asset is expected to be economically usable by one or more users; or

(b) the number of production or similar units expected to be obtained from the asset by one or more users.

3.10 Useful life of a leased asset is either:

(a) the period over which the leased asset is expected to be used by the lessee; or

(b) the number of production or similar units expected to be obtained from the use of the asset by the lessee.

3.11 Residual value of a leased asset is the estimated fair value of the asset at the end of the lease term.

3.12 Guaranteed residual value is:

- ***(a) in the case of the lessee, that part of the residual value which is guaranteed by the lessee or by a party on behalf of the lessee (the amount of the guarantee being the maximum amount that could, in any event, become payable); and***

- ***(b) in the case of the lessor, that part of the residual value which is guaranteed by or on behalf of the lessee, or by an independent third party who is financially capable of discharging the obligations under the guarantee.***

3.13 Unguaranteed residual value of a leased asset is the amount by which the residual value of the asset exceeds its guaranteed residual value.

3.14 Gross investment in the lease is the aggregate of the minimum lease payments under a finance lease from the standpoint of the lessor and any unguaranteed residual value accruing to the lessor.

3.15 Unearned finance income is the difference between:

- ***(a) the gross investment in the lease; and***

- ***(b) the present value of***

  - ***(i) the minimum lease payments under a finance lease from the standpoint of the lessor; and***

  - ***(ii) any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.***

3.16 Net investment in the lease is the gross investment in the lease less unearned finance income.

3.17 The interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of

- ***(a) the minimum lease payments under a finance lease from the standpoint of the lessor; and***

- ***(b) any unguaranteed residual value accruing to the lessor, to be equal to the fair value of the leased asset.***

3.18 The lessee's incremental borrowing rate of interest is the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.

3.19 Contingent rent is that portion of the lease payments that is not fixed in amount but is based on a factor other than just the passage of time (e.g., percentage of sales, amount of usage, price indices, market rates of interest).

4. The definition of a lease includes agreements for the hire of an asset which contain a provision giving the hirer an option to acquire title to the asset upon the fulfillment of agreed conditions. These agreements are commonly known as hire purchase agreements. Hire

purchase agreements include agreements under which the property in the asset is to pass to the hirer on the payment of the last instalment and the hirer has a right to terminate the agreement at any time before the property so passes.

Classification of Leases

5. The classification of leases adopted in this Standard is based on the extent to which risks and rewards incident to ownership of a leased asset lie with the lessor or the lessee. Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return due to changing economic conditions. Rewards may be represented by the expectation of profitable operation over the economic life of the asset and of gain from appreciation in value or realisation of residual value.

6. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. Title may or may not eventually be transferred. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incident to ownership.

7. Since the transaction between a lessor and a lessee is based on a lease agreement common to both parties, it is appropriate to use consistent definitions. The application of these definitions to the differing circumstances of the two parties may sometimes result in the same lease being classified differently by the lessor and the lessee.

8. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than its form. Examples of situations which would normally lead to a lease being classified as a finance lease are:

(a) the lease transfers ownership of the asset to the lessee by the end of the lease term;

(b) the lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised;

(c) the lease term is for the major part of the economic life of the asset even if title is not transferred;

(d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and

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

9. Indicators of situations which individually or in combination could also lead to a lease being classified as a finance lease are:

(a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;

(b) gains or losses from the fluctuation in the fair value of the residual fall to the lessee (for example in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and

(c) the lessee can continue the lease for a secondary period at a rent which is substantially lower than market rent.

10. Lease classification is made at the inception of the lease. If at any time the lessee and the lessor agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification of the lease under the criteria in paragraphs 5 to 9 had the changed terms been in effect at the inception of the lease, the revised agreement is considered as a new agreement over its revised term. Changes in estimates (for example, changes in estimates of the economic life or of the residual value of the leased asset) or changes in circumstances (for example, default by the lessee), however, do not give rise to a new classification of a lease for accounting purposes.

Leases in the Financial Statements of Lessees

Finance Leases

11. At the inception of a finance lease, the lessee should recognise the lease as an asset and a liability. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of the lease. However, if the fair value of the leased asset exceeds the present value of the minimum lease payments from the standpoint of the lessee, the amount recorded as an asset and a liability should be the present value of the minimum lease payments from the standpoint of the lessee. In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease, if this is practicable to determine; if not, the lessee's incremental borrowing rate should be used.

Example

(a) An enterprise (the lessee) acquires a machinery on lease from a leasing company (the lessor) on January 1, 20X0. The lease term covers the entire economic life of the machinery, i.e., 3 years. The fair value of the machinery on January 1, 20X0 is Rs.2,35,500. The lease agreement requires the lessee to pay an amount of Rs.1,00,000 per year beginning December 31, 20X0. The lessee has guaranteed a residual value of Rs.17,000 on December 31, 20X2 to the lessor. The lessor, however, estimates that the machinery would have a salvage value of only Rs.3,500 on December 31, 20X2.

The interest rate implicit in the lease is 16 per cent (approx.). This is calculated using the following formula:

$$\text{Fair value} = \frac{\text{ALR}}{(1+r)^1} + \frac{\text{ALR}}{(1+r)^2} + \ldots + \frac{\text{ALR}}{(1+r)^n} + \frac{\text{RV}}{(1+r)^n}$$

The lessee would record the machinery as an asset at Rs. 2,35,500 with a corresponding liability representing the present value of lease payments over the lease term (including the guaranteed residual value).

(b) In the above example, suppose the lessor estimates that the machinery would have a salvage value of Rs. 17,000 on December 31, 20X2. The lessee, however, guarantees a residual value of Rs. 5,000 only.

The interest rate implicit in the lease in this case would remain unchanged at 16% (approx.). The present value of the minimum lease payments from the standpoint of the lessee, using this interest rate implicit in the lease, would be Rs.2,27,805. As this amount is lower than the fair value of the leased asset (Rs.2,35,500), the lessee would recognise the asset and

the liability arising from the lease at Rs. 2,27,805.

In case the interest rate implicit in the lease is not known to the lessee, the present value of the minimum lease payments from the standpoint of the lessee would be computed using the lessee's incremental borrowing rate.

12. Transactions and other events are accounted for and presented in accordance with their substance and financial reality and not merely with their legal form. While the legal form of a lease agreement is that the lessee may acquire no legal title to the leased asset, in the case of finance leases the substance and financial reality are that the lessee acquires the economic benefits of the use of the leased asset for the major part of its economic life in return for entering into an obligation to pay for that right an amount approximating to the fair value of the asset and the related finance charge.

13. If such lease transactions are not reflected in the lessee's balance sheet, the economic resources and the level of obligations of an enterprise are understated thereby distorting financial ratios. It is therefore appropriate that a finance lease be recognised in the lessee's balance sheet both as an asset and as an obligation to pay future lease payments. At the inception of the lease, the asset and the liability for the future lease payments are recognised in the balance sheet at the same amounts.

14. It is not appropriate to present the liability for a leased asset as a deduction from the leased asset in the financial statements. The liability for a leased asset should be presented separately in the balance sheet as a current liability or a long-term liability as the case may be.

15. Initial direct costs are often incurred in connection with specific leasing activities, as in negotiating and securing leasing arrangements. The costs identified as directly attributable to activities performed by the lessee for a finance lease are included as part of the amount recognised as an asset under the lease.

16. Lease payments should be apportioned between the finance charge and the reduction of the outstanding liability. The finance charge should be allocated to periods during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

Example

In the example (a) illustrating paragraph 11, the lease payments would be apportioned by the lessee between the finance charge and the reduction of the outstanding liability as follows:

Year		*Finance charge (Rs.)*	*Payment (Rs.)*	*Reduction in outstanding liability (Rs.)*	*Outstanding liability (Rs.)*
Year 1	(January 1)				2,35,500
	(December 31)	37,680	1,00,000	62,320	1,73,180
Year 2	(December 31)	27,709	1,00,000	72,291	1,00,889
Year 3	(December 31)	16,142	1,00,000	83,858	17,031*

* The difference between this figure and guaranteed residual value (Rs.17,000) is due to approximation in computing the interest rate implicit in the lease.

17. In practice, in allocating the finance charge to periods during the lease term, some form of approximation may be used to simplify the calculation.

18. A finance lease gives rise to a depreciation expense for the asset as well as a finance expense for each accounting period. The depreciation policy for a leased asset should be consistent with that for depreciable assets which are owned, and the depreciation recognised should be calculated on the basis set out in Accounting Standard (AS) 10, Property, Plant and Equipment. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset should be fully depreciated over the lease term or its useful life, whichever is shorter.

19. The depreciable amount of a leased asset is allocated to each accounting period during the period of expected use on a systematic basis consistent with the depreciation policy the lessee adopts for depreciable assets that are owned. If there is reasonable certainty that the lessee will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset; otherwise the asset is depreciated over the lease term or its useful life, whichever is shorter.

20. The sum of the depreciation expense for the asset and the finance expense for the period is rarely the same as the lease payments payable for the period, and it is, therefore, inappropriate simply to recognise the lease payments payable as an expense in the statement of profit and loss. Accordingly, the asset and the related liability are unlikely to be equal in amount after the inception of the lease.

21. To determine whether a leased asset has become impaired, an enterprise applies the Accounting Standard (AS) 28, *Impairment of Assets*, that sets out the requirements as to how an enterprise should perform the review of the carrying amount of an asset, how it should determine the recoverable amount of an asset and when it should recognise, or reverse, an impairment loss.

22. The lessee should, in addition to the requirements of AS 10, Property, Plant and Equipment, and the governing statute, make the following disclosures for finance leases:

(a) assets acquired under finance lease as segregated from the assets owned;

(b) for each class of assets, the net carrying amount at the balance sheet date;

(c) a reconciliation between the total of minimum lease payments at the balance sheet date and their present value. In addition, an enterprise should disclose the total of minimum lease payments at the balance sheet date, and their present value, for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years;

(iii) later than five years;

(d) contingent rents recognised as expense in the statement of profit and loss for the period;

(e) the total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date; and

(f) a general description of the lessee's significant leasing arrangements including, but not limited to, the following:

(i) the basis on which contingent rent payments are determined;

(ii) the existence and terms of renewal or purchase options and escalation clauses;
(iii) restrictions imposed by lease arrangements, such as those and concerning dividends, additional debt, and further leasing.

Provided that a Small and Medium Sized Company, as defined in the Notification, may not comply with sub-paragraphs (c), (e) and (f).

Operating Leases

23. Lease payments under an operating lease should be recognised as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

24. For operating leases, lease payments (excluding costs for services such as insurance and maintenance) are recognised as an expense in the statement of profit and loss on a straight line basis unless another systematic basis is more representative of the time pattern of the user's benefit, even if the payments are not on that basis.

25. The lessee should make the following disclosures for operating leases:

(a) the total of future minimum lease payments under non-cancellable operating leases for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years;

(iii) later than five years;

(b) the total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date;

(c) lease payments recognised in the statement of profit and loss for the period, with separate amounts for minimum lease payments and contingent rents;

(d) sub-lease payments received (or receivable) recognised in the statement of profit and loss for the period;

(e) a general description of the lessee's significant leasing arrangements including, but not limited to, the following:

(i) the basis on which contingent rent payments are determined;

(ii) the existence and terms of renewal or purchase options and escalation clauses; and

(iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

Provided that a Small and Medium Sized Company, as defined in the Notification, may not comply with sub-paragraphs (a), (b) and (e).

Leases in the Financial Statements of Lessors

Finance Leases

26. The lessor should recognise assets given under a finance lease in its balance sheet as a receivable at an amount equal to the net investment in the lease.

27. Under a finance lease substantially all the risks and rewards incident to legal ownership are transferred by the lessor, and thus the lease payment receivable is treated by the lessor as repayment of principal, i.e., net investment in the lease, and finance income to reimburse and reward the lessor for its investment and services.

28. The recognition of finance income should be based on a pattern reflecting a constant periodic rate of return on the net investment of the lessor outstanding in respect of the finance lease.

29. A lessor aims to allocate finance income over the lease term on a systematic and rational basis. This income allocation is based on a pattern reflecting a constant periodic return on the net investment of the lessor outstanding in respect of the finance lease. Lease payments relating to the accounting period, excluding costs for services, are reduced from both the principal and the unearned finance income.

30. Estimated unguaranteed residual values used in computing the lessor's gross investment in a lease are reviewed regularly. If there has been a reduction in the estimated unguaranteed residual value, the income allocation over the remaining lease term is revised and any reduction in respect of amounts already accrued is recognised immediately. An upward adjustment of the estimated residual value is not made.

31. Initial direct costs, such as commissions and legal fees, are often incurred by lessors in negotiating and arranging a lease. For finance leases, these initial direct costs are incurred to produce finance income and are either recognised immediately in the statement of profit and loss or allocated against the finance income over the lease term.

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

33. Manufacturers or dealers may offer to customers the choice of either buying or leasing an asset. A finance lease of an asset by a manufacturer or dealer lessor gives rise to two types of income:

(a) the profit or loss equivalent to the profit or loss resulting from an outright sale of the asset being leased, at normal selling prices, reflecting any applicable volume or trade discounts; and

(b) the finance income over the lease term.

34. The sales revenue recorded at the commencement of a finance lease term by a

manufacturer or dealer lessor is the fair value of the asset. However, if the present value of the minimum lease payments accruing to the lessor computed at a commercial rate of interest is lower than the fair value, the amount recorded as sales revenue is the present value so computed. The cost of sale recognised at the commencement of the lease term is the cost, or carrying amount if different, of the leased asset less the present value of the unguaranteed residual value. The difference between the sales revenue and the cost of sale is the selling profit, which is recognised in accordance with the policy followed by the enterprise for sales.

35. Manufacturer or dealer lessors sometimes quote artificially low rates of interest in order to attract customers. The use of such a rate would result in an excessive portion of the total income from the transaction being recognised at the time of sale. If artificially low rates of interest are quoted, selling profit would be restricted to that which would apply if a commercial rate of interest were charged.

36. Initial direct costs are recognised as an expense at the commencement of the lease term because they are mainly related to earning the manufacturer's or dealer's selling profit.

37. The lessor should make the following disclosures for finance leases:

(a) a reconciliation between the total gross investment in the lease at the balance sheet date, and the present value of minimum lease payments receivable at the balance sheet date. In addition, an enterprise should disclose the total gross investment in the lease and the present value of minimum lease payments receivable at the balance sheet date, for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years;

(iii) later than five years;

(b) unearned finance income;

(c) the unguaranteed residual values accruing to the benefit of the lessor;

(d) the accumulated provision for uncollectible minimum lease payments receivable;

(e) contingent rents recognised in the statement of profit and loss for the period;

(f) a general description of the significant leasing arrangements of the lessor; and

(g) accounting policy adopted in respect of initial direct costs.

Provided that a Small and Medium Sized Company, as defined in the Notification, may not comply with sub-paragraphs (a) and (f).

38. As an indicator of growth it is often useful to also disclose the gross investment less unearned income in new business added during the accounting period, after deducting the relevant amounts for cancelled leases.

Operating Leases

39. The lessor should present an asset given under operating lease in its balance sheet under fixed assets.

40. Lease income from operating leases should be recognised in the statement of profit and loss on a straight line basis over the lease term, unless another systematic basis is more representative of the time pattern in which benefit derived from the use of the leased asset is diminished.

41. Costs, including depreciation, incurred in earning the lease income are recognised as an expense. Lease income (excluding receipts for services provided such as insurance and maintenance) is recognised in the statement of profit and loss on a straight line basis over the lease term even if the receipts are not on such a basis, unless another systematic basis is more representative of the time pattern in which benefit derived from the use of the leased asset is diminished.

42. Initial direct costs incurred specifically to earn revenues from an operating lease are either deferred and allocated to income over the lease term in proportion to the recognition of rent income, or are recognised as an expense in the statement of profit and loss in the period in which they are incurred.

43. The depreciation of leased assets should be on a basis consistent with the normal depreciation policy of the lessor for similar assets, and the depreciation charge should be calculated on the basis set out in AS 10, Property, Plant and Equipment.

44. To determine whether a leased asset has become impaired, an enterprise applies AS 28, *Impairment of Assets,* that sets out the requirements for how an enterprise should perform the review of the carrying amount of an asset, how it should determine the recoverable amount of an asset and when it should recognise, or reverse, an impairment loss.

45. A manufacturer or dealer lessor does not recognise any selling profit on entering into an operating lease because it is not the equivalent of a sale.

46. The lessor should, in addition to the requirements of AS 10, Property, Plant and Equipment, and the governing statute, make the following disclosures for operating leases:

(a) for each class of assets, the gross carrying amount, the accumulated depreciation and accumulated impairment losses at the balance sheet date; and

(i) the depreciation recognised in the statement of profit and loss for the period;

(ii) impairment losses recognised in the statement of profit and loss for the period;

(iii) impairment losses reversed in the statement of profit and loss for the period;

(b) the future minimum lease payments under non-cancellable operating leases in the aggregate and for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years; (iii) later than five years;

(c) total contingent rents recognised as income in the statement of profit and loss for the period;

(d) a general description of the lessor 's significant leasing arrangements; and

(e) accounting policy adopted in respect of initial direct costs.

Provided that a Small and Medium Sized Company, as defined in the Notification, may not comply with sub-paragraphs (b) and (d).

Sale and Leaseback Transactions

47. A sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the same asset back to the vendor. The lease payments and the sale price are usually interdependent as they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends upon the type of lease involved.

48. If a sale and leaseback transaction results in a finance lease, any excess or deficiency of sales proceeds over the carrying amount should not be immediately recognised as income or loss in the financial statements of a seller-lessee. Instead, it should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

49. If the leaseback is a finance lease, it is not appropriate to regard an excess of sales proceeds over the carrying amount as income. Such excess is deferred and amortised over the lease term in proportion to the depreciation of the leased asset. Similarly, it is not appropriate to regard a deficiency as loss. Such deficiency is deferred and amortised over the lease term.

50. If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately. If the sale price is below fair value, any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

51. If the leaseback is an operating lease, and the lease payments and the sale price are established at fair value, there has in effect been a normal sale transaction and any profit or loss is recognised immediately.

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

53. For finance leases, no such adjustment is necessary unless there has been an impairment in value, in which case the carrying amount is reduced to recoverable amount in accordance with the Accounting Standard dealing with impairment of assets.

54. Disclosure requirements for lessees and lessors apply equally to sale and leaseback transactions. The required description of the significant leasing arrangements leads to disclosure of unique or unusual provisions of the agreement or terms of the sale and leaseback transactions.

55. Sale and leaseback transactions may meet the separate disclosure criteria set out in paragraph 12 of Accounting Standard (AS) 5, *Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.*

Illustration

Sale and Leaseback Transactions that Result in Operating Leases

The illustration does not form part of the accounting standard. Its purpose is to illustrate the application of the accounting standard.

A sale and leaseback transaction that results in an operating lease may give rise to profit or a loss, the determination and treatment of which depends on the leased asset's carrying amount, fair value and selling price. The following table shows the requirements of the accounting standard in various circumstances.

Sale price established at fair value (paragraph 50)	**Carrying amount equal to fair value**	**Carrying amount less than fair value**	**Carrying amount above fair value**
Profit	No profit	Recognise profit immediately	Not applicable
Loss	No loss	Not applicable	Recognise loss immediately
Sale price below fair value (paragraph 50)			
Profit	No profit	Recognise profit immediately	No profit (note 1)
Loss not compensated by future lease payments at below market price	Recognise loss immediately	Recognise loss immediately	(note 1)
Loss compensated by future lease payments at below market price	Defer and amortise loss	Defer and amortise loss	(note 1)
Sale price above fair value (paragraph 50)			
Profit	Defer and amortise profit	Defer and amortise profit	Defer and amortise profit (note 2)
Loss	No loss	No loss	(note 1)

Note 1. These parts of the table represent circumstances that would have been dealt with under paragraph 52 of the Standard. Paragraph 52 requires the carrying amount of an asset to be written down to fair value where it is subject to a sale and leaseback.

Note 2. The profit would be the difference between fair value and sale price as the carrying amount would have been written down to fair value in accordance with paragraph 52.

Accounting Standard (AS) 20

Earnings Per Share

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the General Instructions contained in part A of the Annexure to the Notification.)*

This Accounting Standard is mandatory for all companies. However, disclosure of diluted earnings per share (both including and excluding extra- ordinary items) is not mandatory for Small and Medium Sized Companies, as defined in the Notification. Such companies are however encouraged to make these disclosures.

Objective

The objective of this Standard is to prescribe principles for the determination and presentation of earnings per share which will improve comparison of performance among different enterprises for the same period and among different accounting periods for the same enterprise. The focus of this Standard is on the denominator of the earnings per share calculation. Even though earnings per share data has limitations because of different accounting policies used for determining 'earnings', a consistently determined denominator enhances the quality of financial reporting.

Scope

1. ***This Standard should be applied by all Companies. However, a Small and Medium Sized Company, as defined in the Notification, may not disclose diluted earnings per share (both including and excluding extraordinary items).***

2. In consolidated financial statements, the information required by this Standardshould be presented on the basis of consolidated information.[20]

3. In the case of a parent (holding enterprise), users of financial statements are usually concerned with, and need to be informed about, the results of operations of both the enterprise itself as well as of the group as a whole. Accordingly, in the case of such enterprises, this Standard requires the presentation of earnings per share information on the basis of consolidated financial statements as well as individual financial statements of the parent. In consolidated financial statements, such information is presented on the basis of consolidated information.

Definitions

4. For the purpose of this Standard, the following terms are used with the meanings specified:

4.1 An equity share is a share other than a preference share.

4.2 A preference share is a share carrying preferential rights to dividends and repayment of

[20] Accounting Standard (AS) 21, *Consolidated Financial Statements*, specifies the requirements relating to consolidated financial statements.

capital.

4.3 A financial instrument is any contract that gives rise to both a financial asset of one enterprise and a financial liability or equity shares of another enterprise.

4.4 A potential equity share is a financial instrument or other contract that entitles, or may entitle, its holder to equity shares.

4.5 Share warrants or options are financial instruments that give the holder the right to acquire equity shares.

4.6 Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

5. Equity shares participate in the net profit for the period only after preference shares. An enterprise may have more than one class of equity shares. Equity shares of the same class have the same rights to receive dividends.

6. A financial instrument is any contract that gives rise to both a financial asset of one enterprise and a financial liability or equity shares of another enterprise. For this purpose, a financial asset is any asset that is

(a) cash;

(b) a contractual right to receive cash or another financial asset from another enterprise;

(c) a contractual right to exchange financial instruments with another enterprise under conditions that are potentially favourable; or

(d) an equity share of another enterprise.

A financial liability is any liability that is a contractual obligation to deliver cash or another financial asset to another enterprise or to exchange financial instruments with another enterprise under conditions that are potentially unfavourable.

7. Examples of potential equity shares are:

(a) debt instruments or preference shares, that are convertible into equity shares;

(b) share warrants;

(c) options including employee stock option plans under which employees of an enterprise are entitled to receive equity shares as part of their remuneration and other similar plans; and

(d) shares which would be issued upon the satisfaction of certain conditions resulting from contractual arrangements (contingently issuable shares), such as the acquisition of a business or other assets, or shares issuable under a loan contract upon default of payment of principal or interest, if the contract so provides.

Presentation

8. An enterprise should present basic and diluted earnings per share on the face of the statement of profit and loss for each class of equity shares that has a different right to share in the net profit for the period. An enterprise should present basic and diluted

earnings per share with equal prominence for all periods presented.

9. This Standard requires an enterprise to present basic and diluted earnings per share, even if the amounts disclosed are negative (a loss per share).

Measurement

Basic Earnings Per Share

10. Basic earnings per share should be calculated by dividing the net profit or loss for the period attributable to equity shareholders by the weighted average number of equity shares outstanding during the period.

Earnings - Basic

11. For the purpose of calculating basic earnings per share, the net profit or loss for the period attributable to equity shareholders should be the net profit or loss for the period after deducting preference dividends and any attributable tax thereto for the period.

12. All items of income and expense which are recognised in a period, including tax expense and extraordinary items, are included in the determination of the net profit or loss for the period unless an Accounting Standard requires or permits otherwise *(see Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies)*. The amount of preference dividends and any attributable tax thereto for the period is deducted from the net profit for the period (or added to the net loss for the period) in order to calculate the net profit or loss for the period attributable to equity shareholders.

13. The amount of preference dividends for the period that is deducted from the net profit for the period is:

(a) the amount of any preference dividends on non-cumulative preference shares provided for in respect of the period; and

(b) the full amount of the required preference dividends for cumulative preference shares for the period, whether or not the dividends have been provided for. The amount of preference dividends for the period does not include the amount of any preference dividends for cumulative preference shares paid or declared during the current period in respect of previous periods.

14. If an enterprise has more than one class of equity shares, net profit or loss for the period is apportioned over the different classes of shares in accordance with their dividend rights.

Per Share - Basic

15. For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

16. The weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or lesser number of shares outstanding at any time. It is the number of equity shares outstanding at the beginning of the period, adjusted by the number of equity shares bought back or issued during the period multiplied by the time-weighting factor. The time-weighting factor is the number of days for which the specific shares are outstanding as a proportion of

the total number of days in the period; a reasonable approximation of the weighted average is adequate in many circumstances.

Illustration I attached to the Standard illustrates the computation of weighted average number of shares.

17. In most cases, shares are included in the weighted average number of shares from the date the consideration is receivable, for example:

(a) equity shares issued in exchange for cash are included when cash is receivable;

(b) equity shares issued as a result of the conversion of a debt instrument to equity shares are included as of the date of conversion;

(c) equity shares issued in lieu of interest or principal on other financial instruments are included as of the date interest ceases to accrue;

(d) equity shares issued in exchange for the settlement of a liability of the enterprise are included as of the date the settlement becomes effective;

(e) equity shares issued as consideration for the acquisition of an asset other than cash are included as of the date on which the acquisition is recognised; and

(f) equity shares issued for the rendering of services to the enterprise are included as the services are rendered.

In these and other cases, the timing of the inclusion of equity shares is determined by the specific terms and conditions attaching to their issue. Due consideration should be given to the substance of any contract associated with the issue.

18. Equity shares issued as part of the consideration in an amalgamation in the nature of purchase are included in the weighted average number of shares as of the date of the acquisition because the transferee incorporates the results of the operations of the transferor into its statement of profit and loss as from the date of acquisition. Equity shares issued during the reporting period as part of the consideration in an amalgamation in the nature of merger are included in the calculation of the weighted average number of shares from the beginning of the reporting period because the financial statements of the combined enterprise for the reporting period are prepared as if the combined entity had existed from the beginning of the reporting period. Therefore, the number of equity shares used for the calculation of basic earnings per share in an amalgamation in the nature of merger is the aggregate of the weighted average number of shares of the combined enterprises, adjusted to equivalent shares of the enterprise whose shares are outstanding after the amalgamation.

19. Partly paid equity shares are treated as a fraction of an equity share to the extent that they were entitled to participate in dividends relative to a fully paid equity share during the reporting period.

Illustration II attached to the Standard illustrates the computations in respect of partly paid equity shares.

20. Where an enterprise has equity shares of different nominal values but with the same dividend rights, the number of equity shares is calculated by converting all such equity shares into equivalent number of shares of the same nominal value.

21. Equity shares which are issuable upon the satisfaction of certain conditions resulting

from contractual arrangements (contingently issuable shares) are considered outstanding, and included in the computation of basic earnings per share from the date when all necessary conditions under the contract have been satisfied.

22. The weighted average number of equity shares outstanding during the period and for all periods presented should be adjusted for events, other than the conversion of potential equity shares, that have changed the number of equity shares outstanding, without a corresponding change in resources.

23. Equity shares may be issued, or the number of shares outstanding may be reduced, without a corresponding change in resources. Examples include:

(a) a bonus issue;

(b) a bonus element in any other issue, for example a bonus element in a rights issue to existing shareholders;

(c) a share split; and

(d) a reverse share split (consolidation of shares).

24. In case of a bonus issue or a share split, equity shares are issued to existing shareholders for no additional consideration. Therefore, the number of equity shares outstanding is increased without an increase in resources. The number of equity shares outstanding before the event is adjusted for the proportionate change in the number of equity shares outstanding as if the event had occurred at the beginning of the earliest period reported. For example, upon a two-for-one bonus issue, the number of shares outstanding prior to the issue is multiplied by a factor of three to obtain the new total number of shares, or by a factor of two to obtain the number of additional shares.

Illustration III attached to the Standard illustrates the computation of weighted average number of equity shares in case of a bonus issue during the period.

25. The issue of equity shares at the time of exercise or conversion of potential equity shares will not usually give rise to a bonus element, since the potential equity shares will usually have been issued for full value, resulting in a proportionate change in the resources available to the enterprise. In a rights issue, on the other hand, the exercise price is often less than the fair value of the shares. Therefore, a rights issue usually includes a bonus element. The number of equity shares to be used in calculating basic earnings per share for all periods prior to the rights issue is the number of equity shares outstanding prior to the issue, multiplied by the following factor:

$$\frac{\text{Fair value per share immediately prior to the exercise of rights}}{\text{Theoretical ex-rights fair value per share}}$$

The theoretical ex-rights fair value per share is calculated by adding the aggregate fair value of the shares immediately prior to the exercise of the rights to the proceeds from the exercise of the rights, and dividing by the number of shares outstanding after the exercise of the rights. Where the rights themselves are to be publicly traded separately from the shares prior to the exercise date, fair value for the purposes of this calculation is established at the close of the last day on which the shares are traded together with the rights.

Illustration IV attached to the Standard illustrates the computation of weighted average number of equity shares in case of a rights issue during the period.

Diluted Earnings Per Share

26. For the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares.

27. In calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period, that is:

(a) the net profit for the period attributable to equity shares is:

(i) increased by the amount of dividends recognised in the period in respect of the dilutive potential equity shares as adjusted for any attributable change in tax expense for the period;

(ii) increased by the amount of interest recognised in the period in respect of the dilutive potential equity shares as adjusted for any attributable change in tax expense for the period; and

(iii) adjusted for the after-tax amount of any other changes in expenses or income that would result from the conversion of the dilutive potential equity shares.

(b) the weighted average number of equity shares outstanding during the period is increased by the weighted average number of additional equity shares which would have been outstanding assuming the conversion of all dilutive potential equity shares.

28. For the purpose of this Standard, share application money pending allotment or any advance share application money as at the balance sheet date, which is not statutorily required to be kept separately and is being utilised in the business of the enterprise, is treated in the same manner as dilutive potential equity shares for the purpose of calculation of diluted earnings per share.

Earnings - Diluted

29. For the purpose of calculating diluted earnings per share, the amount of net profit or loss for the period attributable to equity shareholders, as calculated in accordance with paragraph 11, should be adjusted by the following, after taking into account any attributable change in tax expense for the period:

(a) any dividends on dilutive potential equity shares which have been deducted in arriving at the net profit attributable to equity shareholders as calculated in accordance with paragraph 11;

(b) interest recognised in the period for the dilutive potential equity shares; and

(c) any other changes in expenses or income that would result from the conversion of the dilutive potential equity shares.

30. After the potential equity shares are converted into equity shares, the dividends, interest and other expenses or income associated with those potential equity shares will no longer be incurred (or earned). Instead, the new equity shares will be entitled to participate in the net profit attributable to equity shareholders. Therefore, the net profit for the period attributable to equity shareholders calculated in accordance with paragraph 11 is increased by the amount of

dividends, interest and other expenses that will be saved, and reduced by the amount of income that will cease to accrue, on the conversion of the dilutive potential equity shares into equity shares. The amounts of dividends, interest and other expenses or income are adjusted for any attributable taxes.

Illustration V attached to the standard illustrates the computation of diluted earnings in case of convertible debentures.

31. The conversion of some potential equity shares may lead to consequential changes in other items of income or expense. For example, the reduction of interest expense related to potential equity shares and the resulting increase in net profit for the period may lead to an increase in the expense relating to a non-discretionary employee profit sharing plan. For the purpose of calculating diluted earnings per share, the net profit or loss for the period is adjusted for any such consequential changes in income or expenses.

Per Share – Diluted

32. For the purpose of calculating diluted earnings per share, the number of equity shares should be the aggregate of the weighted average number of equity shares calculated in accordance with paragraphs 15 and 22, and the weighted average number of equity shares which would be issued on the conversion of all the dilutive potential equity shares into equity shares. Dilutive potential equity shares should be deemed to have been converted into equity shares at the beginning of the period or, if issued later, the date of the issue of the potential equity shares.

33. The number of equity shares which would be issued on the conversion of dilutive potential equity shares is determined from the terms of the potential equity shares. The computation assumes the most advantageous conversion rate or exercise price from the standpoint of the holder of the potential equity shares.

34. Equity shares which are issuable upon the satisfaction of certain conditions resulting from contractual arrangements (contingently issuable shares) are considered outstanding and included in the computation of both the basic earnings per share and diluted earnings per share from the date when the conditions under a contract are met. If the conditions have not been met, for computing the diluted earnings per share, contingently issuable shares are included as of the beginning of the period (or as of the date of the contingent share agreement, if later). The number of contingently issuable shares included in this case in computing the diluted earnings per share is based on the number of shares that would be issuable if the end of the reporting period was the end of the contingency period. Restatement is not permitted if the conditions are not met when the contingency period actually expires subsequent to the end of the reporting period. The provisions of this paragraph apply equally to potential equity shares that are issuable upon the satisfaction of certain conditions (contingently issuable potential equity shares).

35. For the purpose of calculating diluted earnings per share, an enterprise should assume the exercise of dilutive options and other dilutive potential equity shares of the enterprise. The assumed proceeds from these issues should be considered to have been received from the issue of shares at fair value. The difference between the number of shares issuable and the number of shares that would have been issued at fair value should be treated as an issue of equity shares for no consideration.

36. Fair value for this purpose is the average price of the equity shares during the period. Theoretically, every market transaction for an enterprise's equity shares could be included in determining the average price. As a practical matter, however, a simple average of last six

months weekly closing prices are usually adequate for use in computing the average price.

37. Options and other share purchase arrangements are dilutive when they would result in the issue of equity shares for less than fair value. The amount of the dilution is fair value less the issue price. Therefore, in order to calculate diluted earnings per share, each such arrangement is treated as consisting of:

(a) a contract to issue a certain number of equity shares at their average fair value during the period. The shares to be so issued are fairly priced and are assumed to be neither dilutive nor anti- dilutive. They are ignored in the computation of diluted earnings per share; and

(b) a contract to issue the remaining equity shares for no consideration. Such equity shares generate no proceeds and have no effect on the net profit attributable to equity shares outstanding. Therefore, such shares are dilutive and are added to the number of equity shares outstanding in the computation of diluted earnings per share.

Illustration VI attached to the Standard illustrates the effects of share options on diluted earnings per share.

38. To the extent that partly paid shares are not entitled to participate in dividends during the reporting period they are considered the equivalent of warrants or options.

Dilutive Potential Equity Shares

39. Potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations.

40. An enterprise uses net profit from continuing ordinary activities as "the control figure" that is used to establish whether potential equity shares are dilutive or anti-dilutive. The net profit from continuing ordinary activities is the net profit from ordinary activities (as defined in AS 5) after deducting preference dividends and any attributable tax thereto and after excluding items relating to discontinued operations[21].

41. Potential equity shares are anti-dilutive when their conversion to equity shares would increase earnings per share from continuing ordinary activities or decrease loss per share from continuing ordinary activities. The effects of anti-dilutive potential equity shares are ignored in calculating diluted earnings per share.

42. In considering whether potential equity shares are dilutive or anti- dilutive, each issue or series of potential equity shares is considered separately rather than in aggregate. The sequence in which potential equity shares are considered may affect whether or not they are dilutive. Therefore, in order to maximise the dilution of basic earnings per share, each issue or series of potential equity shares is considered in sequence from the most dilutive to the least dilutive. For the purpose of determining the sequence from most dilutive to least dilutive potential equity shares, the earnings per incremental potential equity share is calculated. Where the earnings per incremental share is the least, the potential equity share is considered most dilutive and vice-versa.

Illustration VII attached to the Standard illustrates the manner of determining the order in

[21] Accounting Standard (AS) 24, *Discontinuing Operations*, specifies the requirements in respect of discontinued operations

which dilutive securities should be included in the computation of weighted average number of shares.

43. Potential equity shares are weighted for the period they were outstanding. Potential equity shares that were cancelled or allowed to lapse during the reporting period are included in the computation of diluted earnings per share only for the portion of the period during which they were outstanding. Potential equity shares that have been converted into equity shares during the reporting period are included in the calculation of diluted earnings per share from the beginning of the period to the date of conversion; from the date of conversion, the resulting equity shares are included in computing both basic and diluted earnings per share.

Restatement

44. If the number of equity or potential equity shares outstanding increases as a result of a bonus issue or share split or decreases as a result of a reverse share split (consolidation of shares), the calculation of basic and diluted earnings per share should be adjusted for all the periods presented. If these changes occur after the balance sheet date but before the date on which the financial statements are approved by the board of directors, the per share calculations for those financial statements and any prior period financial statements presented should be based on the new number of shares. When per share calculations reflect such changes in the number of shares, that fact should be disclosed.

45. An enterprise does not restate diluted earnings per share of any prior period presented for changes in the assumptions used or for the conversion of potential equity shares into equity shares outstanding.

46. An enterprise is encouraged to provide a description of equity share transactions or potential equity share transactions, other than bonus issues, share splits and reverse share splits (consolidation of shares) which occur after the balance sheet date when they are of such importance that non- disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions. Examples of such transactions include:

(a) the issue of shares for cash;

(b) the issue of shares when the proceeds are used to repay debt or preference shares outstanding at the balance sheet date;

(c) the cancellation of equity shares outstanding at the balance sheet date;

(d) the conversion or exercise of potential equity shares, outstanding at the balance sheet date, into equity shares;

(e) the issue of warrants, options or convertible securities; and

(f) the satisfaction of conditions that would result in the issue of contingently issuable shares.

47. Earnings per share amounts are not adjusted for such transactions occurring after the balance sheet date because such transactions do not affect the amount of capital used to produce the net profit or loss for the period.

Disclosure

48. In addition to disclosures as required by paragraphs 8, 9 and 44 of this Standard, an enterprise should disclose the following:

(i) where the statement of profit and loss includes extraordinary items (within the meaning of AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies), the enterprise should disclose basic and diluted earnings per share computed on the basis of earnings excluding extraordinary items (net of tax expense); and

(ii) (a) the amounts used as the numerators in calculating basic and diluted earnings per share, and a reconciliation of those amounts to the net profit or loss for the period;

(b) the weighted average number of equity shares used as the denominator in calculating basic and diluted earnings per share, and a reconciliation of these denominators to each other; and

(c) the nominal value of shares along with the earnings per share figures.

49. Contracts generating potential equity shares may incorporate terms and conditions which affect the measurement of basic and diluted earnings per share. These terms and conditions may determine whether or not any potential equity shares are dilutive and, if so, the effect on the weighted average number of shares outstanding and any consequent adjustments to the net profit attributable to equity shareholders. Disclosure of the terms and conditions of such contracts is encouraged by this Standard.

50. If an enterprise discloses, in addition to basic and diluted earnings per share, per share amounts using a reported component of net profit other than net profit or loss for the period attributable to equity shareholders, such amounts should be calculated using the weighted average number of equity shares determined in accordance with this Standard. If a component of net profit is used which is not reported as a line item in the statement of profit and loss, a reconciliation should be provided between the component used and a line item which is reported in the statement of profit and loss. Basic and diluted per share amounts should be disclosed with equal prominence.

51. An enterprise may wish to disclose more information than this Standard requires. Such information may help the users to evaluate the performance of the enterprise and may take the form of per share amounts for various components of net profit. Such disclosures are encouraged. However, when such amounts are disclosed, the denominators need to be calculated in accordance with this Standard in order to ensure the comparability of the per share amounts disclosed.

Illustrations

Note: These illustrations do not form part of the Accounting Standard. Their purpose is to illustrate the application of the Accounting Standard.

Illustration I

Example - Weighted Average Number of Shares
(Accounting year 01-01-20X1 to 31-12-20X1)

		No. of Shares Issued	*No. of Shares Bought Back*	*No. of Shares Outstanding*
1st January, 20X1	Balance at beginning of year	*1,800*	-	*1,800*
31st May, 20X1	Issue of shares for cash	*600*	-	*2,400*
1st Nov., 20X1	Buy Back of shares	-	*300*	*2,100*
31st Dec., 20X1	Balance at end of year	*2,400*	*300*	*2,100*

Computation of Weighted Average:
(1,800 x 5/12) + (2,400 x 5/12) + (2,100 x 2/12) = 2,100 shares.

The weighted average number of shares can alternatively be computed as follows:
(1,800 x12/12) + (600 x 7/12) - (300 x 2/12) = 2,100 shares

Illustration II

Example – Partly paid shares
(Accounting year 01-01-20X1 to 31-12-20X1)

		No. of shares issued	*Nominal value of shares*	*Amount paid*
1st January, 20X1	Balance at beginning of year	1,800	Rs. 10	Rs. 10
31st October, 20X1	Issue of Shares	600	Rs. 10	Rs. 5

Assuming that partly paid shares are entitled to participate in the dividend to the extent of amount paid, number of partly paid equity shares would be taken as 300 for the purpose of calculation of earnings per share.

Computation of weighted average would be as follows:

(1,800x12/12) + (300x2/12) = 1,850 shares.

Illustration III

Example - Bonus Issue

(Accounting year 01-01-20XX to 31-12-20XX)

Net profit for the year 20X0	Rs. 18,00,000
Net profit for the year 20X1	Rs. 60,00,000
No. of equity shares outstanding until 30th September 20X1	20,00,000
Bonus issue 1st October 20X1	2 equity shares for each equity share outstanding at 30th September, 20X1 20,00,000 x 2 = 40,00,000
Earnings per share for the year 20X1	Rs. 60,00,000 / (20,00,000 + 40,00,000) = Re. 1.00
Adjusted earnings per share for the year 20X0	Rs. 18,00,000 / (20,00,000 + 40,00,000) = Re. 0.30
Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred prior to the beginning of the year 20X0, the earliest period reported.	

Illustration IV

Example - Rights Issue

(Accounting year 01-01-20XX to 31-12-20XX)

Net profit	Year	20X0 :	Rs. 11,00,000
	Year	20X1 :	Rs. 15,00,000
No. of shares outstanding prior to rights issue	5,00,000 shares		
Rights issue	One new share for each five outstanding (i.e. 1,00,000 new shares) Rights issue price : Rs. 15.00 Last date to exercise rights: 1st March 20X1		
Fair value of one equity share immediately prior to exercise of rights on 1st March 20X1	Rs. 21.00		

Computation of theoretical ex-rights fair value per share

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights+total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + number of shares issued in the exercise}}$$

$$= \frac{\text{(Rs. 21.00 x 5,00,000 shares) + (Rs. 15.00 x 1,00,000 shares)}}{\text{5,00,000 shares + 1,00,000 shares}}$$

Theoretical ex-rights fair value per share = Rs. 20.00

Computation of adjustment factor

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-rights value per share}} = \frac{\text{Rs. (21.00)}}{\text{Rs. (20.00)}} = 1.05$$

Computation of earnings per share

	Year 20X0	**Year 20X1**
EPS for the year 20X0 as originally reported: Rs.11,00,000/5,00,000 shares	Rs. 2.20	
EPS for the year 20X0 restated for rights issue: Rs.11,00,000/ (5,00,000 shares x 1.05)	Rs. 2.10	
EPS for the year 20X1 including effects of rights issue $\frac{\text{Rs. 15,00,000}}{\text{(5,00,000 x 1.05 x 2/12)+ (6,00,000 x 10/12)}}$		Rs. 2.55

Illustration V

Example - Convertible Debentures

(Accounting year 01-01-20XX to 31-12-20XX)

Net profit for the current year	Rs. 1,00,00,000
No. of equity shares outstanding	50,00,000
Basic earnings per share	Rs. 2.00
No. of 12% convertible debentures of Rs. 100 each Each debenture is convertible into 10 equity shares	1,00,000
Interest expense for the current year	Rs. 12,00,000
Tax relating to interest expense (30%)	Rs. 3,60,000
Adjusted net profit for the current year	Rs. (1,00,00,000 + 12,00,000 - 3,60,000) = Rs. 1,08,40,000
No. of equity shares resulting from conversion of debentures	10,00,000
No. of equity shares used to compute diluted earnings per share	50,00,000 + 10,00,000 = 60,00,000

Diluted earnings per share	1,08,40,000/60,00,000 = Re. 1.81

Illustration VI

Example - Effects of Share Options on Diluted Earnings Per Share
(Accounting year 01-01-20XX to 31-12-20XX)

Net profit for the year 20X1	Rs. 12,00,000
Weighted average number of equity shares outstanding during the year 20X1	5,00,000 shares
Average fair value of one equity share during the year 20X1	Rs. 20.00
Weighted average number of shares under option during the year 20X1	1,00,000 shares
Exercise price for shares under option during the year 20X1	Rs. 15.00

Computation of earnings per share

	Earnings	***Shares***	***Earnings per share***
Net profit for the year 20X1	Rs. 12,00,000		
Weighted average number of shares outstanding during year 20X1		5,00,000	
Basic earnings per share			Rs. 2.40
Number of shares under option		1,00,000	
Number of shares that would have been issued at fair value: (100,000 x 15.00)/20.00	*	(75,000)	
Diluted earnings per share	Rs. 12,00,000	5,25,000	Rs. 2.29

**The earnings have not been increased as the total number of shares has been increased only by the number of shares (25,000) deemed for the purpose of the computation to have been issued for no consideration {see para 37(b)}*

Illustration VII

Example - Determining the Order in Which to Include Dilutive Securities in the Computation of Weighted Average Number of Shares

(Accounting year 01-01-20XX to 31-12-20XX)

Earnings, i.e., Net profit attributable to equity shareholders	Rs. 1,00,00,000
No. of equity shares outstanding	20,00,000
Average fair value of one equity share during the year	Rs. 75.00
Potential Equity Shares	
Options	1,00,000 with exercise price of Rs. 60
Convertible Preference Shares Attributable tax, e.g., corporate dividend tax	8,00,000 shares entitled to a cumulative dividend of Rs. 8 per share. Each preference share is convertible into 2 equity shares. 10%
12% Convertible Debentures of Rs. 100 each	Nominal amount Rs. 10,00,00,000. Each debenture is convertible into 4 equity shares.
Tax rate	30%

Increase in Earnings Attributable to Equity Shareholders on Conversion of Potential Equity Shares

	Increase in Earnings	*Increase in no. of Equity Shares*	*Earnings per Incremental Share*
Options			
Increase in earnings	Nil		
No. of incremental shares issued for no consideration {1,00,000 x (75 - 60) / 75}		20,000	Nil
Convertible Preference Shares			
Increase in net profit attributable to equity shareholders as adjusted by attributable tax [(Rs.8 x 8,00,000)+ 10%(8 x 8,00,000)]	Rs. 70,40,000		
No. of incremental shares {2 x 8,00,000}		16,00,000	Rs. 4.40
12% Convertible Debentures			
Increase in net profit {Rs. 10,00,00,000 x 0.12 x (1 - 0.30)}	Rs. 84,00,000		
No. of incremental shares {10,00,000 x 4}		40,00,000	Rs. 2.10

It may be noted from the above that options are most dilutive as their earnings per

incremental share is nil. Hence, for the purpose of computation of diluted earnings per share, options will be considered first. 12% convertible debentures being second most dilutive will be considered next and thereafter convertible preference shares will be considered (see para 42).

	Net Profit Attributable (Rs.)	*No. of Equity Shares*	*Net profit attributable Per Share (Rs.)*	
As reported	1,00,00,000	20,00,000	5.00	
Options		20,000		
	1,00,00,000	20,20,000	4.95	Dilutive
12% Convertible Debentures	84,00,000	40,00,000		
		60,20,000	3.06	Dilutive
Convertible Preference Shares	70,40,000	16,00,000		
	2,54,40,000	76,20,000	3.34	Anti-Dilutive

Computation of Diluted Earnings Per Share

Since diluted earnings per share is increased when taking the convertible preference shares into account (from Rs. 3.06 to Rs 3.34), the convertible preference shares are anti-dilutive and are ignored in the calculation of diluted earnings per share. Therefore, diluted earnings per share is Rs. 3.06.

Accounting Standard (AS) 21

Consolidated Financial Statements[22]

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the General Instructions contained in part A of the Annexure to the Notification.)*

Objective

The objective of this Standard is to lay down principles and procedures for preparation and presentation of consolidated financial statements. Consolidated financial statements are presented by a parent (also known as holding enterprise) to provide financial information about the economic activities of its group. These statements are intended to present financial information about a parent and its subsidiary(ies) as a single economic entity to show the economic resources controlled by the group, the obligations of the group and results the group achieves with its resources.

Scope

1. This Standard should be applied in the preparation and presentation of consolidated financial statements for a group of enterprises under the control of a parent.

2. This Standard should also be applied in accounting for investments in subsidiaries in the separate financial statements of a parent.

3. In the preparation of consolidated financial statements, other Accounting Standards also apply in the same manner as they apply to the separate financial statements.

4. This Standard does not deal with:

(a) methods of accounting for amalgamations and their effects on consolidation, including goodwill arising on amalgamation (see AS 14, *Accounting for Amalgamations*);

(b) accounting for investments in associates (at present governed by AS 13, *Accounting for Investments*[23]); and

(c) accounting for investments in joint ventures (at present governed by AS 13, *Accounting for Investments*[24]).

Definitions

5. For the purpose of this Standard, the following terms are used with the meanings specified:

5.1 Control:

(a) the ownership, directly or indirectly through subsidiary(ies), of more than one-half of the voting power of an enterprise; or

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[22] It is clarified that AS 21 is mandatory if an enterprise presents consolidated financial statements. In other words, the accounting standard does not mandate an enterprise to present consolidated financial statements but, if the enterprise presents consolidated financial statements for complying with the requirements of any statute or otherwise, it should prepare and present consolidated financial statements in accordance with AS 21.

[23] Accounting Standard (AS) 23, *Accounting for Investments in Associates in Consolidated Financial Statements*, specifies the requirements relating to accounting for investments in associates in Consolidated Financial Statements.

[24] Accounting Standard (AS) 27, *Financial Reporting of Interests in Joint Ventures*, specifies the requirements relating to accounting for investments in joint ventures.

(b) control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise so as to obtain economic benefits from its activities.

5.2 A subsidiary is an enterprise that is controlled by another enterprise (known as the parent).

5.3 A parent is an enterprise that has one or more subsidiaries.

5.4 A group is a parent and all its subsidiaries.

5.5 Consolidated financial statements are the financial statements of a group presented as those of a single enterprise.

5.6 Equity is the residual interest in the assets of an enterprise after deducting all its liabilities.

5.7 Minority interest is that part of the net results of operations and of the net assets of a subsidiary attributable to interests which are not owned, directly or indirectly through subsidiary(ies), by the parent.

6. Consolidated financial statements normally include consolidated balance sheet, consolidated statement of profit and loss, and notes, other statements and explanatory material that form an integral part thereof. Consolidated cash flow statement is presented in case a parent presents its own cash flow statement. The consolidated financial statements are presented, to the extent possible, in the same format as that adopted by the parent for its separate financial statements.

Explanation:

All the notes appearing in the separate financial statements of the parent enterprise and its subsidiaries need not be included in the notes to the consolidated financial statement. For preparing consolidated financial statements, the following principles may be observed in respect of notes and other explanatory material that form an integral part thereof:

(a) Notes which are necessary for presenting a true and fair view of the consolidated financial statements are included in the consolidated financial statements as an integral part thereof.

(b) Only the notes involving items which are material need to be disclosed. Materiality for this purpose is assessed in relation to the information contained in consolidated financial statements. In view of this, it is possible that certain notes which are disclosed in separate financial statements of a parent or a subsidiary would not be required to be disclosed in the consolidated financial statements when the test of materiality is applied in the context of consolidated financial statements.

(c) Additional statutory information disclosed in separate financial statements of the subsidiary and/or a parent having no bearing on the true and fair view of the consolidated financial statements need not be disclosed in the consolidated financial statements.

Presentation of Consolidated Financial Statements

7. A parent which presents consolidated financial statements should present these statements in addition to its separate financial statements.

8. Users of the financial statements of a parent are usually concerned with, and need to be informed about, the financial position and results of operations of not only the enterprise itself but also of the group as a whole. This need is served by providing the users -

(a) separate financial statements of the parent; and

(b) consolidated financial statements, which present financial information about the group as that of a single enterprise without regard to the legal boundaries of the separate legal entities.

Scope of Consolidated Financial Statements

9. A parent which presents consolidated financial statements should consolidate all subsidiaries, domestic as well as foreign, other than those referred to in paragraph 11. Where an enterprise does not have a subsidiary but has an associate and/or a joint venture such an enterprise should also prepare consolidated financial statements in accordance with Accounting Standard (AS) 23, Accounting for Associates in Consolidated Financial Statements, and Accounting Standard (AS) 27, Financial Reporting of Interests in Joint Ventures respectively.

10. The consolidated financial statements are prepared on the basis of financial statements of parent and all enterprises that are controlled by the parent, other than those subsidiaries excluded for the reasons set out in paragraph 11. Control exists when the parent owns, directly or indirectly through subsidiary(ies), more than one-half of the voting power of an enterprise. Control also exists when an enterprise controls the composition of the board of directors (in the case of a company) or of the corresponding governing body (in case of an enterprise not being a company) so as to obtain economic benefits from its activities. An enterprise may control the composition of the governing bodies of entities such as gratuity trust, provident fund trust etc. Since the objective of control over such entities is not to obtain economic benefits from their activities, these are not considered for the purpose of preparation of consolidated financial statements. For the purpose of this Standard, an enterprise is considered to control the composition of:

(i) the board of directors of a company, if it has the power, without the consent or concurrence of any other person, to appoint or remove all or a majority of directors of that company. An enterprise is deemed to have the power to appoint a director, if any of the following conditions is satisfied:

(a) a person cannot be appointed as director without the exercise in his favour by that enterprise of such a power as aforesaid; or

(b) a person's appointment as director follows necessarily from his appointment to a position held by him in that enterprise; or

(c) the director is nominated by that enterprise or a subsidiary thereof.

(ii) the governing body of an enterprise that is not a company, if it has the power, without the consent or the concurrence of any other person, to appoint or remove all or a majority of members of the governing body of that other enterprise. An enterprise is deemed to have the power to appoint a member, if any of the following conditions is satisfied:

(a) a person cannot be appointed as member of the governing body without the exercise in his favour by that other enterprise of such a power as aforesaid; or

(b) a person's appointment as member of the governing body follows necessarily

from his appointment to a position held by him in that other enterprise; or

(c) the member of the governing body is nominated by that other enterprise.

Explanation:

It is possible that an enterprise is controlled by two enterprises — one controls by virtue of ownership of majority of the voting power of that enterprise and other controls, by virtue of an agreement or otherwise, the composition of the board of directors so as to obtain economic benefit from its activities. In such a rare situation, when an enterprise is controlled by two enterprises as per the definition of 'control', the first mentioned enterprise will be considered as subsidiary of both the controlling enterprises within the meaning of this Standard and, therefore, both the enterprises need to consolidate the financial statements of that enterprise as per the requirements of this Standard.

11. A subsidiary should be excluded from consolidation when:

(a) control is intended to be temporary because the subsidiary is acquired and held exclusively with a view to its subsequent disposal in the near future; or

(b) it operates under severe long-term restrictions which significantly impair its ability to transfer funds to the parent.

In consolidated financial statements, investments in such subsidiaries should be accounted for in accordance with Accounting Standard (AS) 13, Accounting for Investments. The reasons for not consolidating a subsidiary should be disclosed in the consolidated financial statements.

Explanation:

(a) Where an enterprise owns majority of voting power by virtue of ownership of the shares of another enterprise and all the shares are held as 'stock-in-trade' and are acquired and held exclusively with a view to their subsequent disposal in the near future, the control by the first mentioned enterprise is considered to be temporary within the meaning of paragraph 11(a).

(b) The period of time, which is considered as near future for the purposes of this Standard primarily depends on the facts and circumstances of each case. However, ordinarily, the meaning of the words 'near future' is considered as not more than twelve months from acquisition of relevant investments unless a longer period can be justified on the basis of facts and circumstances of the case. The intention with regard to disposal of the relevant investment is considered at the time of acquisition of the investment. Accordingly, if the relevant investment is acquired without an intention to its subsequent disposal in near future, and subsequently, it is decided to dispose off the investments, such an in- vestment is not excluded from consolidation, until the investment is actually disposed off. Conversely, if the relevant investment is acquired with an intention to its subsequent disposal in near future, but, due to some valid reasons, it could not be disposed off within that period, the same will continue to be excluded from consolidation, provided there is no change in the intention.

12. Exclusion of a subsidiary from consolidation on the ground that its business activities are dissimilar from those of the other enterprises within the group is not justified because better information is provided by consolidating such subsidiaries and disclosing additional information in the consolidated financial statements about the different business activities of subsidiaries. For example, the disclosures required by Accounting Standard (AS) 17, *Segment Reporting,* help to explain the significance of different business activities within the group.

Consolidation Procedures

13. In preparing consolidated financial statements, the financial statements of the parent and its subsidiaries should be combined on a line by line basis by adding together like items of assets, liabilities, income and expenses. In order that the consolidated financial statements present financial information about the group as that of a single enterprise, the following steps should be taken:

(a) the cost to the parent of its investment in each subsidiary and the parent's portion of equity of each subsidiary, at the date on which investment in each subsidiary is made, should be eliminated;

(b) any excess of the cost to the parent of its investment in a subsidiary over the parent's portion of equity of the subsidiary, at the date on which investment in the subsidiary is made, should be described as goodwill to be recognised as an asset in the consolidated financial statements;

(c) when the cost to the parent of its investment in a subsidiary is less than the parent's portion of equity of the subsidiary, at the date on which investment in the subsidiary is made, the difference should be treated as a capital reserve in the consolidated financial statements;

(d) minority interests in the net income of consolidated subsidiaries for the reporting period should be identified and adjusted against the income of the group in order to arrive at the net income attributable to the owners of the parent; and

(e) minority interests in the net assets of consolidated subsidiaries should be identified and presented in the consolidated balance sheet separately from liabilities and the equity of the parent's shareholders. Minority interests in the net assets consist of:

(i) the amount of equity attributable to minorities at the date on which investment in a subsidiary is made; and

(ii) the minorities' share of movements in equity since the date the parent-subsidiary relationship came in existence.

Where the carrying amount of the investment in the subsidiary is different from its cost, the carrying amount is considered for the purpose of above computations.

Explanation:

(a) The tax expense (comprising current tax and deferred tax) to be shown in the consolidated financial statements should be the aggregate of the amounts of tax expense appearing in the separate financial statements of the parent and its subsidiaries.

(b) The parent's share in the post-acquisition reserves of a subsidiary, forming part of the corresponding reserves in the consolidated balance sheet, is not required to be disclosed separately in the consolidated balance sheet keeping in view the objective of consolidated financial statements to present financial information of the group as a whole. In view of this, the consolidated reserves disclosed in the consolidated balance sheet are inclusive of the parent's share in the post-acquisition reserves of a subsidiary.

14. The parent's portion of equity in a subsidiary, at the date on which investment is made, is determined on the basis of information contained in the financial statements of the subsidiary as on the date of investment. However, if the financial statements of a subsidiary, as on the date of investment, are not available and if it is impracticable to draw

the financial statements of the subsidiary as on that date, financial statements of the subsidiary for the immediately preceding period are used as a basis for consolidation. Adjustments are made to these financial statements for the effects of significant transactions or other events that occur between the date of such financial statements and the date of investment in the subsidiary.

15. If an enterprise makes two or more investments in another enterprise at different dates and eventually obtains control of the other enterprise, the consolidated financial statements are presented only from the date on which holding-subsidiary relationship comes in existence. If two or more investments are made over a period of time, the equity of the subsidiary at the date of investment, for the purposes of paragraph 13 above, is generally determined on a step-by-step basis; however, if small investments are made over a period of time and then an investment is made that results in control, the date of the latest investment, as a practicable measure, may be considered as the date of investment.

16. Intragroup balances and intragroup transactions and resulting unrealised profits should be eliminated in full. Unrealised losses resulting from intragroup transactions should also be eliminated unless cost cannot be recovered.

17. Intragroup balances and intragroup transactions, including sales, expenses and dividends, are eliminated in full. Unrealised profits resulting from intragroup transactions that are included in the carrying amount of assets, such as inventory and fixed assets, are eliminated in full. Unrealised losses resulting from intragroup transactions that are deducted in arriving at the carrying amount of assets are also eliminated unless cost cannot be recovered.

18. The financial statements used in the consolidation should be drawn up to the same reporting date. If it is not practicable to draw up the financial statements of one or more subsidiaries to such date and, accordingly, those financial statements are drawn up to different reporting dates, adjustments should be made for the effects of significant transactions or other events that occur between those dates and the date of the parent's financial statements. In any case, the difference between reporting dates should not be more than six months.

19. The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements are usually drawn up to the same date. When the reporting dates are different, the subsidiary often prepares, for consolidation purposes, statements as at the same date as that of the parent. When it is impracticable to do this, financial statements drawn up to different reporting dates may be used provided the difference in reporting dates is not more than six months. The consistency principle requires that the length of the reporting periods and any difference in the reporting dates should be the same from period to period.

20. Consolidated financial statements should be prepared using uniform accounting policies for like transactions and other events in similar circumstances. If it is not practicable to use uniform accounting policies in preparing the consolidated financial statements, that fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.

21. If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements when they are used in preparing the consolidated financial statements.

22. The results of operations of a subsidiary are included in the consolidated financial statements as from the date on which parent-subsidiary relationship came in existence. The results of operations of a subsidiary with which parent-subsidiary relationship ceases to exist

are included in the consolidated statement of profit and loss until the date of cessation of the relationship. The difference between the proceeds from the disposal of investment in a subsidiary and the carrying amount of its assets less liabilities as of the date of disposal is recognised in the consolidated statement of profit and loss as the profit or loss on the disposal of the investment in the subsidiary. In order to ensure the comparability of the financial statements from one accounting period to the next, supplementary information is often provided about the effect of the acquisition and disposal of subsidiaries on the financial position at the reporting date and the results for the reporting period and on the corresponding amounts for the preceding period.

23. An investment in an enterprise should be accounted for in accordance with Accounting Standard (AS) 13, Accounting for Investments, from the date that the enterprise ceases to be a subsidiary and does not become an associate[25].

24. The carrying amount of the investment at the date that it ceases to be a subsidiary is regarded as cost thereafter.

25. Minority interests should be presented in the consolidated balance sheet separately from liabilities and the equity of the parent's shareholders. Minority interests in the income of the group should also be separately presented.

26. The losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity of the subsidiary. The excess, and any further losses applicable to the minority, are adjusted against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. If the subsidiary subsequently reports profits, all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered.

27. If a subsidiary has outstanding cumulative preference shares which are held outside the group, the parent computes its share of profits or losses after adjusting for the subsidiary's preference dividends, whether or not dividends have been declared.

Accounting for Investments in Subsidiaries in a Parent's Separate Financial Statements

28. In a parent's separate financial statements, investments in subsidiaries should be accounted for in accordance with Accounting Standard (AS) 13, Accounting for Investments.

Disclosure

29. In addition to disclosures required by paragraph 11 and 20, following disclosures should be made:

(a) in consolidated financial statements a list of all subsidiaries including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held;

(b) in consolidated financial statements, where applicable:

(i) the nature of the relationship between the parent and a subsidiary, if the parent does not own, directly or indirectly through subsidiaries, more than one-half of

[25] Accounting Standard (AS) 23, *Accounting for Investments in Associates in Consolidated Financial Statements*, defines the term 'associate' and specifies the requirements relating to accounting for investments in associates in Consolidated Financial Statements.

the voting power of the subsidiary;

(ii) the effect of the acquisition and disposal of subsidiaries on the financial position at the reporting date, the results for the reporting period and on the corresponding amounts for the preceding period; and

(iii) the names of the subsidiary(ies) of which reporting date(s) is/are different from that of the parent and the difference in reporting dates.

Transitional Provisions[26]

30. On the first occasion that consolidated financial statements are presented, comparative figures for the previous period need not be presented. In all subsequent years full comparative figures for the previous period should be presented in the consolidated financial statements.

[26] Transitional Provisions given in Paragraph 30 are relevant for standards notified under Companies (Accounting Standards) Rules, 2006 (as amended from time to time) as well as Companies (Accounting Standards) Rules, 2021.

Accounting Standard (AS) 22

Accounting for Taxes on Income

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the General Instructions contained in part A of the Annexure to the Notification.)*

Objective

The objective of this Standard is to prescribe accounting treatment for taxes on income. Taxes on income is one of the significant items in the statement of profit and loss of an enterprise. In accordance with the matching concept, taxes on income are accrued in the same period as the revenue and expenses to which they relate. Matching of such taxes against revenue for a period poses special problems arising from the fact that in a number of cases, taxable income may be significantly different from the accounting income. This divergence between taxable income and accounting income arises due to two main reasons. Firstly, there are differences between items of revenue and expenses as appearing in the statement of profit and loss and the items which are considered as revenue, expenses or deductions for tax purposes. Secondly, there are differences between the amount in respect of a particular item of revenue or expense as recognised in the statement of profit and loss and the corresponding amount which is recognised for the computation of taxable income.

Scope

1. This Standard should be applied in accounting for taxes on income. This includes the determination of the amount of the expense or saving related to taxes on income in respect of an accounting period and the disclosure of such an amount in the financial statements.

2. For the purposes of this Standard, taxes on income include all domestic and foreign taxes which are based on taxable income.

3. This Standard does not specify when, or how, an enterprise should account for taxes that are payable on distribution of dividends and other distributions made by the enterprise.

Definitions

4. For the purpose of this Standard, the following terms are used with the meanings specified:

4.1 Accounting income (loss) is the net profit or loss for a period, as reported in the statement of profit and loss, before deducting income tax expense or adding income tax saving.

4.2 Taxable income (tax loss) is the amount of the income (loss) for a period, determined in accordance with the tax laws, based upon which income tax payable (recoverable) is determined.

4.3 Tax expense (tax saving) is the aggregate of current tax and deferred tax charged or credited to the statement of profit and loss for the period.

4.4 Current tax is the amount of income tax determined to be payable (recoverable) in respect of the taxable income (tax loss) for a period.

4.5 Deferred tax is the tax effect of timing differences.

4.6 Timing differences are the differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods.

4.7 Permanent differences are the differences between taxable income and accounting income for a period that originate in one period and do not reverse subsequently.

5. Taxable income is calculated in accordance with tax laws. In some circumstances, the requirements of these laws to compute taxable income differ from the accounting policies applied to determine accounting income. The effect of this difference is that the taxable income and accounting income may not be the same.

6. The differences between taxable income and accounting income can be classified into permanent differences and timing differences. Permanent differences are those differences between taxable income and accounting income which originate in one period and do not reverse subsequently. For instance, if for the purpose of computing taxable income, the tax laws allow only a part of an item of expenditure, the disallowed amount would result in a permanent difference.

7. Timing differences are those differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods. Timing differences arise because the period in which some items of revenue and expenses are included in taxable income do not coincide with the period in which such items of revenue and expenses are included or considered in arriving at accounting income. For example, machinery purchased for scientific research related to business is fully allowed as deduction in the first year for tax purposes whereas the same would be charged to the statement of profit and loss as depreciation over its useful life. The total depreciation charged on the machinery for accounting purposes and the amount allowed as deduction for tax purposes will ultimately be the same, but periods over which the depreciation is charged and the deduction is allowed will differ. Another example of timing difference is a situation where, for the purpose of computing taxable income, tax laws allow depreciation on the basis of the written down value method, whereas for accounting purposes, straight line method is used. Some other examples of timing differences arising under the Indian tax laws are given in Illustration 1.

8. Unabsorbed depreciation and carry forward of losses which can be set- off against future taxable income are also considered as timing differences and result in deferred tax assets, subject to consideration of prudence (see paragraphs 15-18).

Recognition

9. Tax expense for the period, comprising current tax and deferred tax, should be included in the determination of the net profit or loss for the period.

10. Taxes on income are considered to be an expense incurred by the enterprise in earning income and are accrued in the same period as the revenue and expenses to which they relate. Such matching may result into timing differences. The tax effects of timing differences are included in the tax expense in the statement of profit and loss and as deferred tax assets (subject to the consideration of prudence as set out in paragraphs 15-18) or as deferred tax liabilities, in the balance sheet.

11. An example of tax effect of a timing difference that results in a deferred tax asset is an expense provided in the statement of profit and loss but not allowed as a deduction under Section 43B of the Income-tax Act, 1961. This timing difference will reverse when the

deduction of that expense is allowed under Section 43B in subsequent year(s). An example of tax effect of a timing difference resulting in a deferred tax liability is the higher charge of depreciation allowable under the Income-tax Act, 1961, compared to the depreciation provided in the statement of profit and loss. In subsequent years, the differential will reverse when comparatively lower depreciation will be allowed for tax purposes.

12. Permanent differences do not result in deferred tax assets or deferred tax liabilities.

13. Deferred tax should be recognised for all the timing differences, subject to the consideration of prudence in respect of deferred tax assets as set out in paragraphs 15-18.

Explanation:

(a) The deferred tax in respect of timing differences which reverse during the tax holiday period is not recognised to the extent the enterprise's gross total income is subject to the deduction during the tax holiday period as per the requirements of sections 80-IA/80IB of the Income-tax Act, 1961. In case of sections 10A/10B of the Income-tax Act, 1961 (covered under Chapter III of the Income-tax Act, 1961 dealing with incomes which do not form part of total income), the deferred tax in respect of timing differences which reverse during the tax holiday period is not recognised to the extent deduction from the total income of an enterprise is allowed during the tax holiday period as per the provisions of the said sections.

(b) Deferred tax in respect of timing differences which reverse after the tax holiday period is recognised in the year in which the timing differences originate. However, recognition of deferred tax assets is subject to the consideration of prudence as laid down in paragraphs 15 to 18.

(c) For the above purposes, the timing differences which originate first are considered to reverse first.

The application of the above explanation is illustrated in the Illustration attached to the Standard.

14. This Standard requires recognition of deferred tax for all the timing differences. This is based on the principle that the financial statements for a period should recognise the tax effect, whether current or deferred, of all the transactions occurring in that period.

15. Except in the situations stated in paragraph 17, deferred tax assets should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised.

16. While recognising the tax effect of timing differences, consideration of prudence cannot be ignored. Therefore, deferred tax assets are recognised and carried forward only to the extent that there is a reasonable certainty of their realisation. This reasonable level of certainty would normally be achieved by examining the past record of the enterprise and by making realistic estimates of profits for the future.

17. Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognised only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised.

Explanation:

1. ***Determination of virtual certainty that sufficient future taxable income will be available is a matter of judgement based on convincing evidence and will have to be evaluated on a case to case basis. Virtual certainty refers to the extent of certainty, which, for all practical purposes, can be considered certain. Virtual certainty cannot be based merely on forecasts of performance such as business plans. Virtual certainty is not a matter of perception and is to be supported by convincing evidence. Evidence is a matter of fact. To be convincing, the evidence should be available at the reporting date in a concrete form, for example, a profitable binding export order, cancellation of which will result in payment of heavy damages by the defaulting party. On the other hand, a projection of the future profits made by an enterprise based on the future capital expenditures or future restructuring etc., submitted even to an outside agency, e.g., to a credit agency for obtaining loans and accepted by that agency cannot, in isolation, be considered as convincing evidence.***

2 ***(a) As per the relevant provisions of the Income-tax Act, 1961 , the 'loss' arising under the head 'Capital gains' can be carried forward and set-off in future years, only against the income arising under that head as per the requirements of the Income-tax Act, 1961.***

(b) Where an enterprise's statement of profit and loss includes an item of 'loss' which can be set-off in future for taxation purposes, only against the income arising under the head 'Capital gains' as per the requirements of the Income-tax Act, 1961, that item is a timing difference to the extent it is not set-off in the current year and is allowed to be set-off against the income arising under the head 'Capital gains' in subsequent years subject to the provisions of the Income-tax Act, 1961. In respect of such 'loss', deferred tax asset is recognised and carried forward subject to the consideration of prudence. Accordingly, in respect of such 'loss', deferred tax asset is recognised and carried forward only to the extent that there is a virtual certainty, supported by convincing evidence, that sufficient future taxable income will be available under the head 'Capital gains' against which the loss can be set-off as per the provisions of the Income-tax Act, 1961. Whether the test of virtual certainty is fulfilled or not would depend on the facts and circumstances of each case. The examples of situations in which the test of virtual certainty, supported by convincing evidence, for the purposes of the recognition of deferred tax asset in respect of loss arising under the head 'Capital gains' is normally fulfilled, are sale of an asset giving rise to capital gain (eligible to set-off the capital loss as per the provisions of the Income-tax Act, 1961) after the balance sheet date but before the financial statements are approved, and binding sale agreement which will give rise to capital gain (eligible to set-off the capital loss as per the provisions of the Income-tax Act, 1961).

(c) In cases where there is a difference between the amounts of 'loss' recognised for accounting purposes and tax purposes because of cost indexation under the Income-tax Act, 1961 in respect of long-term capital assets, the deferred tax asset is recognised and carried forward (subject to the consideration of prudence) on the amount which can be carried forward and set-off in future years as per the provisions of the Income-tax Act, 1961.

18. The existence of unabsorbed depreciation or carry forward of losses under tax laws is strong evidence that future taxable income may not be available. Therefore, when an enterprise has a history of recent losses, the enterprise recognises deferred tax assets only to the extent that it has timing differences the reversal of which will result in sufficient income or there is other convincing evidence that sufficient taxable income will be available against which such deferred tax assets can be realised. In such circumstances, the nature of the evidence supporting its recognition is disclosed.

Re-assessment of Unrecognised Deferred Tax Assets

19. At each balance sheet date, an enterprise re-assesses unrecognised deferred tax assets. The enterprise recognises previously unrecognised deferred tax assets to the extent that it has become reasonably certain or virtually certain, as the case may be (see paragraphs 15 to 18), that sufficient future taxable income will be available against which such deferred tax assets can be realised. For example, an improvement in trading conditions may make it reasonably certain that the enterprise will be able to generate sufficient taxable income in the future.

Measurement

20. Current tax should be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the applicable tax rates and tax laws.

21. Deferred tax assets and liabilities should be measured using the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.

Explanation:

(a) The payment of tax under section 115JB of the Income-tax Act, 1961 is a current tax for the period.

(b) In a period in which a company pays tax under section 115JB of the Income-tax Act, 1961, the deferred tax assets and liabilities in respect of timing differences arising during the period, tax effect of which is required to be recognised under this Standard, is measured using the regular tax rates and not the tax rate under section 115JB of the Income-tax Act, 1961.

(c) In case an enterprise expects that the timing differences arising in the current period would reverse in a period in which it may pay tax under section 115JB of the Income-tax Act, 1961, the deferred tax assets and liabilities in respect of timing differences arising during the current period, tax effect of which is required to be recognised under AS 22, is measured using the regular tax rates and not the tax rate under section 115JB of the Income-tax Act, 1961.

22. Deferred tax assets and liabilities are usually measured using the tax rates and tax laws that have been enacted. However, certain announcements of tax rates and tax laws by the government may have the substantive effect of actual enactment. In these circumstances, deferred tax assets and liabilities are measured using such announced tax rate and tax laws.

23. When different tax rates apply to different levels of taxable income, deferred tax assets and liabilities are measured using average rates.

24. Deferred tax assets and liabilities should not be discounted to their present value.

25. The reliable determination of deferred tax assets and liabilities on a discounted basis requires detailed scheduling of the timing of the reversal of each timing difference. In a number of cases such scheduling is impracticable or highly complex. Therefore, it is inappropriate to require discounting of deferred tax assets and liabilities. To permit, but not to require, discounting would result in deferred tax assets and liabilities which would not be comparable between enterprises. Therefore, this Standard does not require or permit the discounting of deferred tax assets and liabilities.

Review of Deferred Tax Assets

26. The carrying amount of deferred tax assets should be reviewed at each balance sheet

date. An enterprise should write-down the carrying amount of a deferred tax asset to the extent that it is no longer reasonably certain or virtually certain, as the case may be (see paragraphs 15 to 18), that sufficient future taxable income will be available against which deferred tax asset can be realised. Any such write-down may be reversed to the extent that it becomes reasonably certain or virtually certain, as the case may be (see paragraphs 15 to 18), that sufficient future taxable income will be available.

Presentation and Disclosure

27. An enterprise should offset assets and liabilities representing current tax if the enterprise:

(a) has a legally enforceable right to set off the recognised amounts; and

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

28. An enterprise will normally have a legally enforceable right to set off an asset and liability representing current tax when they relate to income taxes levied under the same governing taxation laws and the taxation laws permit the enterprise to make or receive a single net payment.

29. An enterprise should offset deferred tax assets and deferred tax liabilities if:

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

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

30. Deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities.

31. The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balances should be disclosed in the notes to accounts.

32. The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.

Transitional Provisions[27]

33. On the first occasion that the taxes on income are accounted for in accordance with this Standard, the enterprise should recognise, in the financial statements, the deferred tax balance that has accumulated prior to the adoption of this Standard as deferred tax asset/liability with a corresponding credit/charge to the revenue reserves, subject to the consideration of prudence in case of deferred tax assets (see paragraphs 15-18). The amount so credited/charged to the revenue reserves should be the same as that which would have resulted if this Standard had been in effect from the beginning.

34. For the purpose of determining accumulated deferred tax in the period in which this

[27] Transitional Provisions given in Paragraphs 33-34 are relevant only for standards notified under Companies (Accounting Standards) Rules, 2006, as amended from time to time.

Standard is applied for the first time, the opening balances of assets and liabilities for accounting purposes and for tax purposes are compared and the differences, if any, are determined. The tax effects of these differences, if any, should be recognised as deferred tax assets or liabilities, if these differences are timing differences. For example, in the year in which an enterprise adopts this Standard, the opening balance of a fixed asset is Rs. 100 for accounting purposes and Rs. 60 for tax purposes. The difference is because the enterprise applies written down value method of depreciation for calculating taxable income whereas for accounting purposes straight line method is used. This difference will reverse in future when depreciation for tax purposes will be lower as compared to the depreciation for accounting purposes. In the above case, assuming that enacted tax rate for the year is 40% and that there are no other timing differences, deferred tax liability of Rs. 16 [(Rs. 100 - Rs. 60) x 40%] would be recognised. Another example is an expenditure that has already been written off for accounting purposes in the year of its incurrence but is allowable for tax purposes over a period of time. In this case, the asset representing that expenditure would have a balance only for tax purposes but not for accounting purposes. The difference between balance of the asset for tax purposes and the balance (which is nil) for accounting purposes would be a timing difference which will reverse in future when this expenditure would be allowed for tax purposes. Therefore, a deferred tax asset would be recognised in respect of this difference subject to the consideration of prudence (see paragraphs 15 - 18).

Illustration I

Examples of Timing Differences

Note: This illustration does not form part of the Accounting Standard. The purpose of this illustration is to assist in clarifying the meaning of the Accounting Standard. The sections mentioned hereunder are references to sections in the Income-tax Act, 1961, as amended by the Finance Act, 2001.

1. Expenses debited in the statement of profit and loss for accounting purposes but allowed for tax purposes in subsequent years, e.g.

a) Expenditure of the nature mentioned in section 43B (e.g. taxes, duty, cess, fees, etc.) accrued in the statement of profit and loss on mercantile basis but allowed for tax purposes in subsequent years on payment basis.

b) Payments to non-residents accrued in the statement of profit and loss on mercantile basis, but disallowed for tax purposes under section 40(a)(i) and allowed for tax purposes in subsequent years when relevant tax is deducted or paid.

c) Provisions made in the statement of profit and loss in anticipation of liabilities where the relevant liabilities are allowed in subsequent years when they crystallize.

2. Expenses amortized in the books over a period of years but are allowed for tax purposes wholly in the first year (e.g. substantial advertisement expenses to introduce a product, etc. treated as deferred revenue expenditure in the books) or if amortization for tax purposes is over a longer or shorter period (e.g. preliminary expenses under section 35D, expenses incurred for amalgamation under section 35DD, prospecting expenses under section 35E).

3. Where book and tax depreciation differ. This could arise due to:

a) Differences in depreciation rates.

b) Differences in method of depreciation e.g. SLM or WDV.

c) Differences in method of calculation e.g. calculation of depreciation with reference to individual assets in the books but on block basis for tax purposes and calculation with reference to time in the books but on the basis of full or half depreciation under the block basis for tax purposes.

d) Differences in composition of actual cost of assets.

4. Where a deduction is allowed in one year for tax purposes on the basis of a deposit made under a permitted deposit scheme (e.g. tea development account scheme under section 33AB or site restoration fund scheme under section 33ABA) and expenditure out of withdrawal from such deposit is debited in the statement of profit and loss in subsequent years.

5. Income credited to the statement of profit and loss but taxed only in subsequent years e.g. conversion of capital assets into stock in trade.

6. If for any reason the recognition of income is spread over a number of years in the accounts but the income is fully taxed in the year of receipt.

Illustration II

Note: This illustration does not form part of the Accounting Standard. Its purpose is to illustrate the application of the Accounting Standard. Extracts from statement of profit and loss are provided to show the effects of the transactions described below.

Illustration 1

A company, ABC Ltd., prepares its accounts annually on 31st March. On 1st April, 20x1, it purchases a machine at a cost of Rs. 1,50,000. The machine has a useful life of three years and an expected scrap value of zero. Although it is eligible for a 100% first year depreciation allowance for tax purposes, the straight-line method is considered appropriate for accounting purposes. ABC Ltd. has profits before depreciation and taxes of Rs. 2,00,000 each year and the corporate tax rate is 40 per cent each year.

The purchase of machine at a cost of Rs. 1,50,000 in 20x1 gives rise to a tax saving of Rs. 60,000. If the cost of the machine is spread over three years of its life for accounting purposes, the amount of the tax saving should also be spread over the same period as shown below:

Statement of Profit and Loss
(for the three years ending 31st March, 20x1, 20x2, 20x3)

(Rupees in thousands)

	20x1	20x2	20x3
Profit before depreciation and taxes	200	200	200
Less: Depreciation for accounting purposes	50	50	50
Profit before taxes	150	150	150
Less: Tax expense			
Current tax			
0.40 (200 – 150)	20		
0.40 (200)		80	80
Deferred tax			
Tax effect of timing differences originating during the year			
0.40 (150 – 50)	40		
Tax effect of timing differences reversing during the year			
0.40 (0 – 50)		(20)	(20)
Tax expense	60	60	60
after tax	90	90	90
Net timing differences	100	50	0
Deferred tax liability	40	20	0

In 20x1, the amount of depreciation allowed for tax purposes exceeds the amount of depreciation charged for accounting purposes by Rs. 1,00,000 and, therefore, taxable income is lower than the accounting income. This gives rise to a deferred tax liability of Rs. 40,000. In 20x2 and 20x3, accounting income is lower than taxable income because the

amount of depreciation charged for accounting purposes exceeds the amount of depreciation allowed for tax purposes by Rs. 50,000 each year. Accordingly, deferred tax liability is reduced by Rs. 20,000 each in both the years. As may be seen, tax expense is based on the accounting income of each period.

In 20x1, the profit and loss account is debited and deferred tax liability account is credited with the amount of tax on the originating timing difference of Rs. 1,00,000 while in each of the following two years, deferred tax liability account is debited and profit and loss account is credited with the amount of tax on the reversing timing difference of Rs. 50,000.

The following Journal entries will be passed:

Year 20x1

Profit and Loss A/c	Dr.	20,000	
To Current tax A/c			20,000
(Being the amount of taxes payable for the year 20x1 provided for)			
Profit and Loss A/c	Dr.	40,000	
To Deferred tax A/c			40,000
(Being the deferred tax liability created for originating timing difference of Rs. 1,00,000)			

Year 20x2

Profit and Loss A/c	Dr.	80,000	
To Current tax A/c			80,000
(Being the amount of taxes payable for the year 20x2 provided for)			
Deferred tax A/c	Dr.	20,000	
To Profit and Loss A/c			20,000
(Being the deferred tax liability adjusted for reversing timing difference of Rs. 50,000)			

Year 20x3

Profit and Loss A/c	Dr.	80,000	
To Current tax A/c			80,000
(Being the amount of taxes payable for the year 20x3 provided for)			
Deferred tax A/c	Dr.	20,000	
To Profit and Loss A/c			20,000
(Being the deferred tax liability adjusted for reversing timing difference of Rs. 50,000)			

In year 20x1, the balance of deferred tax account i.e., Rs. 40,000 would be shown separately from the current tax payable for the year in terms of paragraph 30 of the Standard. In Year 20x2, the balance of deferred tax account would be Rs. 20,000 and be shown separately from the current tax payable for the year as in year 20x1. In Year 20x3, the balance of deferred tax liability account would be nil.

Illustration 2

In the above illustration, the corporate tax rate has been assumed to be same in each of the three years. If the rate of tax changes, it would be necessary for the enterprise to adjust the amount of deferred tax liability carried forward by applying the tax rate that has been enacted or substantively enacted by the balance sheet date on accumulated timing differences at the end of the accounting year (see paragraphs 21 and 22). For example, if in Illustration 1, the

substantively enacted tax rates for 20x1, 20x2 and 20x3 are 40%, 35% and 38% respectively, the amount of deferred tax liability would be computed as follows:

The deferred tax liability carried forward each year would appear in the balance sheet as under:

31st March, 20x1 = 0.40 (1,00,000)= Rs. 40,000

31st March, 20x2 = 0.35 (50,000) = Rs. 17,500

31st March, 20x3 = 0.38 (Zero) = Rs. Zero

Accordingly, the amount debited/(credited) to the profit and loss account (with corresponding credit or debit to deferred tax liability) for each year would be as under:

31st March, 20x1 Debit = Rs. 40,000

31st March, 20x2 (Credit) = Rs. (22,500)

31st March, 20x3 (Credit) = Rs. (17,500)

Illustration 3

A company, ABC Ltd., prepares its accounts annually on 31st March. The company has incurred a loss of Rs. 1,00,000 in the year 20x1 and made profits of Rs. 50,000 and 60,000 in year 20x2 and year 20x3 respectively. It is assumed that under the tax laws, loss can be carried forward for 8 years and tax rate is 40% and at the end of year 20x1, it was virtually certain, supported by convincing evidence, that the company would have sufficient taxable income in the future years against which unabsorbed depreciation and carry forward of losses can be set-off. It is also assumed that there is no difference between taxable income and accounting income except that set- off of loss is allowed in years 20x2 and 20x3 for tax purposes.

Statement of Profit and Loss
(for the three years ending 31st March, 20x1, 20x2, 20x3)

(Rupees in thousands)

	20x1	20x2	20x3
Profit (loss)	(100)	50	60
Less: Current tax	—	—	(4)
Deferred tax:			
Tax effect of timing differences originating during the year	40		
Tax effect of timing differences reversing during the year	___	(20)	(20)
Profit (loss) after tax effect	(60)	30	36

Illustration 4

Note: The purpose of this illustration is to assist in clarifying the meaning of the explanation to paragraph 13 of the Standard.

Facts:

1. The income before depreciation and tax of an enterprise for 15 years is Rs. 1000 lakhs per year, both as per the books of account and for income-tax purposes.

2. The enterprise is subject to 100 percent tax-holiday for the first 10 years under section 80-IA. Tax rate is assumed to be 30 percent.

3. At the beginning of year 1, the enterprise has purchased one machine for Rs. 1500 lakhs. Residual value is assumed to be nil.

4. For accounting purposes, the enterprise follows an accounting policy to provide depreciation on the machine over 15 years on straight-line basis.

5. For tax purposes, the depreciation rate relevant to the machine is 25% on written down value basis.

The following computations will be made, ignoring the provisions of section 115JB (MAT), in this regard:

Table 1
Computation of depreciation on the machine for accounting purposes and tax purposes
(Amounts in Rs. lakhs)

Year	Depreciation for accounting purposes	Depreciation for tax purposes
1	100	375
2	100	281
3	100	211
4	100	158
5	100	119
6	100	89
7	100	67
8	100	50
9	100	38
10	100	28
11	100	21
12	100	16
13	100	12
14	100	9
15	100	7

At the end of the 15th year, the carrying amount of the machinery for accounting purposes would be nil whereas for tax purposes, the carrying amount is Rs. 19 lakhs which is eligible to be allowed in subsequent years.

Table 2
Computation of Timing differences

(Amounts in Rs. lakhs)

1	2	3	4	5	6	7	8	9
Year	Income before Depreciation and tax (both for accounting purposes and tax purposes)	Accounting Income after depreciation	Gross Total Income (after deducting depreciation under tax laws)	Deduction under section 80-IA	Taxable Income (4-5)	Total Difference between accounting income and taxable income (3-6)	Permanent Difference (deduction pursuant to section 80-IA)	Timing Difference(due to different amounts of depreciation for accounting purposes and tax purposes) (O= Originating and R=Reversing)
1	1000	900	625	625	Nil	900	625	275 (O)
2	1000	900	719	719	Nil	900	719	181 (O)
3	1000	900	789	789	Nil	900	789	111 (O)
4	1000	900	842	842	Nil	900	842	58 (O)
5	1000	900	881	881	Nil	900	881	19(O)
6	1000	900	911	911	Nil	900	911	11 (R)
7	1000	900	933	933	Nil	900	933	33 (R)
8	1000	900	950	950	Nil	900	950	50 (R)
9	1000	900	962	962	Nil	900	962	62 (R)
10	1000	900	972	972	Nil	900	972	72 (R)
11	1000	900	979	Nil	979	-79	Nil	79 (R)
12	1000	900	984	Nil	984	-84	Nil	84 (R)
13	1000	900	988	Nil	988	-88	Nil	88 (R)
14	1000	900	991	Nil	991	-91	Nil	91 (R)
15	1000	900	993	Nil	993	-93	Nil	74 (R) 19 (O)

Notes:

1. Timing differences originating during the tax holiday period are Rs.644 lakhs, out of which Rs. 228 lakhs are reversing during the tax holiday period and Rs. 416 lakhs are reversing after the tax holiday period. Timing difference of Rs. 19 lakhs is originating in the 15th year which would reverse in subsequent years when for accounting purposes depreciation would be nil but for tax purposes the written down value of the machinery of Rs. 19 lakhs would be eligible to be allowed as depreciation.

2. As per the Standard, deferred tax on timing differences which reverse during the tax holiday period should not be recognised. For this purpose, timing differences which originate first are considered to reverse first. Therefore, the reversal of timing difference of Rs. 228 lakhs during the tax holiday period, would be considered to be out of the timing difference which originated in year 1. The rest of the timing difference originating in year 1 and timing differences originating in years 2 to 5 would be considered to be reversing after the tax holiday period. Therefore, in year 1, deferred tax would be recognised on the timing difference of Rs. 47 lakhs (Rs. 275 lakhs - Rs. 228 lakhs) which would reverse after the tax holiday period. Similar computations would be made for the subsequent years. The deferred tax assets/liabilities to be recognised during different years would be computed as per the following Table.

Table 3
Computation of current tax and deferred tax

(Amounts in Rs. lakhs)

Year	Current tax (Taxable Income x 30%)	Deferred tax (Timing difference x 30%)	Accumulated Deferred tax (L= Liability and A = Asset)	Tax expense
1	Nil	47 × 30%= 14 (see note 2 above)	14 (L)	14
2	Nil	181 × 30%=54	68 (L)	54
3	Nil	111× 30%=33	101 (L)	33
4	Nil	58 × 30%= 17	118 (L)	17
5	Nil	19 × 30%=6	124 (L)	6
6	Nil	Nil[1]	124 (L)	Nil
7	Nil	Nil[1]	124 (L)	Nil
8	Nil	Nil[1]	124 (L)	Nil
9	Nil	Nil[1]	124 (L)	Nil
10	Nil	Nil[1]	124 (L)	Nil
11	294	–79 × 30%= -24	100 (L)	270
12	295	–84 × 30%= -25	75 (L)	270
13	296	–88 × 30%= -26	49 (L)	270
14	297	–91 × 30%= -27	22 (L)	270
15	298	–74 × 30%= -22	Nil	270
		–19 × 30%= -6	6(A)[2]	

[1.] No deferred tax is recognised since in respect of timing differences reversing during the tax holiday period, no deferred tax was recognised at their origination.

[2.] Deferred tax asset of Rs. 6 lakhs would be recognised at the end of year 15 subject to consideration of prudence as per AS 22. If it is so recognised, the said deferred tax asset would be realized in subsequent periods when for tax purposes depreciation would be allowed but for accounting purposes no depreciation would be recognised.

Accounting Standard (AS) 23

Accounting for Investments in Associates in Consolidated Financial Statements[28]

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the General Instructions contained in part A of the Annexure to the Notification.)*

Objective

The objective of this Standard is to set out principles and procedures for recognising, in the consolidated financial statements, the effects of the investments in associates on the financial position and operating results of a group.

Scope

1. This Standard should be applied in accounting for investments in associates in the preparation and presentation of consolidated financial statements by an investor.

2. This Standard does not deal with accounting for investments in associates in the preparation and presentation of separate financial statements by an investor.[29]

Definitions

3. For the purpose of this Standard, the following terms are used with the meanings specified:

3.1 An associate is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture[30] of the investor.

3.2 Significant influence is the power to participate in the financial and/ or operating policy decisions of the investee but not control over those policies.

3.3 Control:

(a) the ownership, directly or indirectly through subsidiary(ies), of more than one-half of the voting power of an enterprise; or

(b) control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise so as to obtain economic benefits from its activities.

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[28] It is clarified that AS 23 is mandatory if an enterprise presents consolidated financial statements. In other words, if an enterprise presents consolidated financial statements, it should account for investments in associates in the consolidated financial statements in accordance with AS 23.

[29] Accounting Standard (AS) 13, *Accounting for Investments*, is applicable for accounting for investments in associates in the separate financial statements of an investor.

[30] Accounting Standard (AS) 27, *Financial Reporting of Interests in Joint Ventures*, defines the term 'joint venture' and specifies the requirements relating to accounting for investments in joint ventures.

3.4 A <u>subsidiary</u> is an enterprise that is controlled by another enterprise (known as the parent).

3.5 A <u>parent</u> is an enterprise that has one or more subsidiaries.

3.6 A <u>group</u> is a parent and all its subsidiaries.

3.7 <u>Consolidated financial statements</u> are the financial statements of a group presented as those of a single enterprise.

3.8 <u>The equity method</u> is a method of accounting whereby the investment is initially recorded at cost, identifying any goodwill/capital reserve arising at the time of acquisition. The carrying amount of the investment is adjusted thereafter for the post acquisition change in the investor's share of net assets of the investee. The consolidated statement of profit and loss reflects the investor's share of the results of operations of the investee.

3.9 <u>Equity</u> is the residual interest in the assets of an enterprise after deducting all its liabilities.

4. For the purpose of this Standard significant influence does not extend to power to govern the financial and/or operating policies of an enterprise. Significant influence may be gained by share ownership, statute or agreement. As regards share ownership, if an investor holds, directly or indirectly through subsidiary(ies), 20% or more of the voting power of the investee, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly through subsidiary(ies), less than 20% of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.

Explanation:

In considering the share ownership, the potential equity shares of the investees held by the investor are not taken into account for determining the voting power of the investor.

5. The existence of significant influence by an investor is usually evidenced in one or more of the following ways:

(a) Representation on the board of directors or corresponding governing body of the investee;

(b) participation in policy making processes;

(c) material transactions between the investor and the investee;

(d) interchange of managerial personnel; or

(e) provision of essential technical information.

6. Under the equity method, the investment is initially recorded at cost, identifying any goodwill/capital reserve arising at the time of acquisition and the carrying amount is increased or decreased to recognise the investor's share of the profits or losses of the investee after the date of acquisition. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for alterations in the investor's proportionate interest in the investee arising from changes in the investee's equity that have not been included in the statement of profit and loss. Such changes include those

arising from the revaluation of fixed assets and investments, from foreign exchange translation differences and from the adjustment of differences arising on amalgamations.

Explanations:

(a) Adjustments to the carrying amount of investment in an investee arising from changes in the investee's equity that have not been included in the statement of profit and loss of the investee are directly made in the carrying amount of investment without routing it through the consolidated statement of profit and loss. The corresponding debit/ credit is made in the relevant head of the equity interest in the consolidated balance sheet. For example, in case the adjustment arises because of revaluation of fixed assets by the investee, apart from adjusting the carrying amount of investment to the extent of proportionate share of the investor in the revalued amount, the corresponding amount of revaluation reserve is shown in the consolidated balance sheet.

(b) In case an associate has made a provision for proposed dividend in its financial statements, the investor's share of the results of operations of the associate is computed without taking in to consideration the proposed dividend.

Accounting for Investments – Equity Method

7. An investment in an associate should be accounted for in consolidated financial statements under the equity method except when:

(a) the investment is acquired and held exclusively with a view to its subsequent disposal in the near future; or

(b) the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.

Investments in such associates should be accounted for in accordance with Accounting Standard (AS) 13, Accounting for Investments. The reasons for not applying the equity method in accounting for investments in an associate should be disclosed in the consolidated financial statements.

Explanation:

The period of time, which is considered as near future for the purposes of this Standard, primarily depends on the facts and circumstances of each case. However, ordinarily, the meaning of the words 'near future' is considered as not more than twelve months from acquisition of relevant investments unless a longer period can be justified on the basis of facts and circumstances of the case. The intention with regard to disposal of the relevant investment is considered at the time of acquisition of the investment. Accordingly, if the relevant investment is acquired without an intention to its subsequent disposal in near future, and subsequently, it is decided to dispose off the investment, such an investment is not excluded from application of the equity method, until the investment is actually disposed off. Conversely, if the relevant investment is acquired with an intention to its subsequent disposal in near future, however, due to some valid reasons, it could not be disposed off within that period, the same will continue to be excluded from application of the equity method, provided there is no change in the intention.

8. Recognition of income on the basis of distributions received may not be an adequate measure of the income earned by an investor on an investment in an associate because the distributions received may bear little relationship to the performance of the associate. As

the investor has significant influence over the associate, the investor has a measure of responsibility for the associate's performance and, as a result, the return on its investment. The investor accounts for this stewardship by extending the scope of its consolidated financial statements to include its share of results of such an associate and so provides an analysis of earnings and investment from which more useful ratios can be calculated. As a result, application of the equity method in consolidated financial statements provides more informative reporting of the net assets and net income of the investor.

9. An investor should discontinue the use of the equity method from the date that:

(a) it ceases to have significant influence in an associate but retains, either in whole or in part, its investment; or

(b) the use of the equity method is no longer appropriate because the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.

From the date of discontinuing the use of the equity method, investments in such associates should be accounted for in accordance with Accounting Standard (AS) 13, Accounting for Investments. For this purpose, the carrying amount of the investment at that date should be regarded as cost thereafter.

Application of the Equity Method

10. Many of the procedures appropriate for the application of the equity method are similar to the consolidation procedures set out in Accounting Standard (AS) 21, Consolidated Financial Statements. Furthermore, the broad concepts underlying the consolidation procedures used in the acquisition of a subsidiary are adopted on the acquisition of an investment in an associate.

11. An investment in an associate is accounted for under the equity method from the date on which it falls within the definition of an associate. On acquisition of the investment any difference between the cost of acquisition and the investor's share of the equity of the associate is described as goodwill or capital reserve, as the case may be.

12. Goodwill/capital reserve arising on the acquisition of an associate by an investor should be included in the carrying amount of investment in the associate but should be disclosed separately.

13. In using equity method for accounting for investment in an associate, unrealised profits and losses resulting from transactions between the investor (or its consolidated subsidiaries) and the associate should be eliminated to the extent of the investor's interest in the associate. Unrealised losses should not be eliminated if and to the extent the cost of the transferred asset cannot be recovered.

14. The most recent available financial statements of the associate are used by the investor in applying the equity method; they are usually drawn up to the same date as the financial statements of the investor. When the reporting dates of the investor and the associate are different, the associate often prepares, for the use of the investor, statements as at the same date as the financial statements of the investor. When it is impracticable to do this, financial statements drawn up to a different reporting date may be used. The consistency principle requires that the length of the reporting periods, and any difference in the reporting dates, are consistent from period to period.

15. When financial statements with a different reporting date are used, adjustments are made for the effects of any significant events or transactions between the investor (or its consolidated subsidiaries) and the associate that occur between the date of the associate's financial statements and the date of the investor's consolidated financial statements.

16. The investor usually prepares consolidated financial statements using uniform accounting policies for the like transactions and events in similar circumstances. In case an associate uses accounting policies other than those adopted for the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to the associate's financial statements when they are used by the investor in applying the equity method. If it is not practicable to do so, that fact is disclosed along with a brief description of the differences between the accounting policies.

17. If an associate has outstanding cumulative preference shares held outside the group, the investor computes its share of profits or losses after adjusting for the preference dividends whether or not the dividends have been declared.

18. If, under the equity method, an investor's share of losses of an associate equals or exceeds the carrying amount of the investment, the investor ordinarily discontinues recognising its share of further losses and the investment is reported at nil value. Additional losses are provided for to the extent that the investor has incurred obligations or made payments on behalf of the associate to satisfy obligations of the associate that the investor has guaranteed or to which the investor is otherwise committed. If the associate subsequently reports profits, the investor resumes including its share of those profits only after its share of the profits equals the share of net losses that have not been recognised.

19. Where an associate presents consolidated financial statements, the results and net assets to be taken into account are those reported in that associate's consolidated financial statements.

20. The carrying amount of investment in an associate should be reduced to recognise a decline, other than temporary, in the value of the investment, such reduction being determined and made for each investment individually.

Contingencies

21. In accordance with Accounting Standard (AS) 4, *Contingencies and Events Occurring After the Balance Sheet Date*[31], the investor discloses in the consolidated financial statements:

(a) its share of the contingencies and capital commitments of an associate for which it is also contingently liable; and

(b) those contingencies that arise because the investor is severally liable for the liabilities of the associate.

Disclosure

22. In addition to the disclosures required by paragraphs 7 and 12, an appropriate listing and description of associates including the proportion of ownership interest and, if different, the proportion of voting power held should be disclosed in the consolidated financial

[31] All paragraphs of AS 4 that deal with contingencies are applicable only to the extent not covered by other Accounting Standards prescribed by the Central Government. For example, the impairment of financial assets such as impairment of receivables (commonly known as provision for bad and doubtful debts) is governed by AS 4.

statements.

23. Investments in associates accounted for using the equity method should be classified as long-term investments and disclosed separately in the consolidated balance sheet. The investor's share of the profits or losses of such investments should be disclosed separately in the consolidated statement of profit and loss. The investor's share of any extraordinary or prior period items should also be separately disclosed.

24. The name(s) of the associate(s) of which reporting date(s) is/are different from that of the financial statements of an investor and the differences in reporting dates should be disclosed in the consolidated financial statements.

25. In case an associate uses accounting policies other than those adopted for the consolidated financial statements for like transactions and events in similar circumstances and it is not practicable to make appropriate adjustments to the associate's financial statements, the fact should be disclosed along with a brief description of the differences in the accounting policies.

Transitional Provisions[32]

26. On the first occasion when investment in an associate is accounted for in consolidated financial statements in accordance with this Standard the carrying amount of investment in the associate should be brought to the amount that would have resulted had the equity method of accounting been followed as per this Standard since the acquisition of the associate. The corresponding adjustment in this regard should be made in the retained earnings in the consolidated financial statements.

[32] Transitional Provisions given in Paragraph 26 are relevant for standards notified under Companies (Accounting Standards) Rules, 2006 (as amended from time to time) as well as Companies (Accounting Standards) Rules, 2021.

Accounting Standard (AS) 24

Discontinuing Operations

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the General Instructions contained in part A of the Annexure to the Notification.)*

Objective

The objective of this Standard is to establish principles for reporting information about discontinuing operations, thereby enhancing the ability of users of financial statements to make projections of an enterprise's cash flows, earnings-generating capacity, and financial position by segregating information about discontinuing operations from information about continuing operations.

Scope

1. This Standard applies to all discontinuing operations of an enterprise.

2. The requirements related to cash flow statement contained in this Standard are applicable where an enterprise prepares and presents a cash flow statement.

Definitions

Discontinuing Operation

3. A discontinuing operation is a component of an enterprise:

(a) that the enterprise, pursuant to a single plan, is:

(i) disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders; or

(ii) disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or

(iii) terminating through abandonment; and

(b) that represents a separate major line of business or geographical area of operations; and

(c) that can be distinguished operationally and for financial reporting purposes.

4. Under criterion (a) of the definition (paragraph 3 (a)), a discontinuing operation may be disposed of in its entirety or piecemeal, but always pursuant to an overall plan to discontinue the entire component.

5. If an enterprise sells a component substantially in its entirety, the result can be a net gain or net loss. For such a discontinuance, a binding sale agreement is entered into on a

specific date, although the actual transfer of possession and control of the discontinuing operation may occur at a later date. Also, payments to the seller may occur at the time of the agreement, at the time of the transfer, or over an extended future period.

6. Instead of disposing of a component substantially in its entirety, an enterprise may discontinue and dispose of the component by selling its assets and settling its liabilities piecemeal (individually or in small groups). For piecemeal disposals, while the overall result may be a net gain or a net loss, the sale of an individual asset or settlement of an individual liability may have the opposite effect. Moreover, there is no specific date at which an overall binding sale agreement is entered into. Rather, the sales of assets and settlements of liabilities may occur over a period of months or perhaps even longer. Thus, disposal of a component may be in progress at the end of a financial reporting period. To qualify as a discontinuing operation, the disposal must be pursuant to a single co-ordinated plan.

7. An enterprise may terminate an operation by abandonment without substantial sales of assets. An abandoned operation would be a discontinuing operation if it satisfies the criteria in the definition. However, changing the scope of an operation or the manner in which it is conducted is not an abandonment because that operation, although changed, is continuing.

8. Business enterprises frequently close facilities, abandon products or even product lines, and change the size of their work force in response to market forces. While those kinds of terminations generally are not, in themselves, discontinuing operations as that term is defined in paragraph 3 of this Standard, they can occur in connection with a discontinuing operation.

9. Examples of activities that do not necessarily satisfy criterion (a) of paragraph 3, but that might do so in combination with othercircumstances, include:

(a) gradual or evolutionary phasing out of a product line or class of service;

(b) discontinuing, even if relatively abruptly, several products within an ongoing line of business;

(c) shifting of some production or marketing activities for a particular line of business from one location to another; and

(d) closing of a facility to achieve productivity improvements or other cost savings.

An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.

10. A reportable business segment or geographical segment as defined in Accounting Standard (AS) 17, *Segment Reporting*, would normally satisfy criterion (b) of the definition of a discontinuing operation (paragraph 3), that is, it would represent a separate major line of business or geographical area of operations. A part of such a segment may also satisfy criterion (b) of the definition. For an enterprise that operates in a single business or geographical segment and therefore does not report segment information, a major product or service line may also satisfy the criteria of the definition.

11. A component can be distinguished operationally and for financial reporting purposes - criterion (c) of the definition of a discontinuing operation (paragraph 3) - if all the following conditions are met:

(a) the operating assets and liabilities of the component can be directly attributed to

it;

(b) its revenue can be directly attributed to it;

(c) at least a majority of its operating expenses can be directly attributed to it.

12. Assets, liabilities, revenue, and expenses are directly attributable to a component if they would be eliminated when the component is sold, abandoned or otherwise disposed of. If debt is attributable to a component, the related interest and other financing costs are similarly attributed to it.

13. Discontinuing operations, as defined in this Standard are expected to occur relatively infrequently. All infrequently occurring events do not necessarily qualify as discontinuing operations. Infrequently occurring events that do not qualify as discontinuing operations may result in items of income or expense that require separate disclosure pursuant to Accounting Standard (AS) 5, *Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies,* because their size, nature, or incidence make them relevant to explain the performance of the enterprise for the period.

14. The fact that a disposal of a component of an enterprise is classified as a discontinuing operation under this Standard does not, in itself, bring into question the enterprise's ability to continue as a going concern.

Initial Disclosure Event

15. With respect to a discontinuing operation, the initial disclosure event is the occurrence of one of the following, whichever occurs earlier:

(a) the enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or

(b) the enterprise's board of directors or similar governing body has both (i) approved a detailed, formal plan for the discontinuance and (ii) made an announcement of the plan.

16. A detailed, formal plan for the discontinuance normally includes:

(a) identification of the major assets to be disposed of;

(b) the expected method of disposal;

(c) the period expected to be required for completion of the disposal;

(d) the principal locations affected;

(e) the location, function, and approximate number of employees who will be compensated for terminating their services; and

(f) the estimated proceeds or salvage to be realised by disposal.

17. An enterprise's board of directors or similar governing body is considered to have made the announcement of a detailed, formal plan for discontinuance, if it has announced the main features of the plan to those affected by it, such as, lenders, stock exchanges, creditors, trade unions, etc., in a sufficiently specific manner so as to make the enterprise demonstrably committed to the discontinuance.

Recognition and Measurement

18. An enterprise should apply the principles of recognition and measurement that are set out in other Accounting Standards for the purpose of deciding as to when and how to recognise and measure the changes in assets and liabilities and the revenue, expenses, gains, losses and cash flows relating to a discontinuing operation.

19. This Standard does not establish any recognition and measurement principles. Rather, it requires that an enterprise follow recognition and measurement principles established in other Accounting Standards, e.g., Accounting Standard (AS) 4, *Contingencies and Events Occurring After the Balance Sheet Date*[33] and Accounting Standard (AS) 28, *Impairment of Assets*.

Presentation and Disclosure

Initial Disclosure

20. An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event (as defined in paragraph 15) occurs:

(a) a description of the discontinuing operation(s);

(b) the business or geographical segment(s) in which it is reported as per AS 17, Segment Reporting;

(c) the date and nature of the initial disclosure event;

(d) the date or period in which the discontinuance is expected to be completed if known or determinable;

(e) the carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;

(f) the amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;

(g) the amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense[34] related thereto; and

(h) the amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

21. For the purpose of presentation and disclosures required by this Standard, the items of assets, liabilities, revenues, expenses, gains, losses, and cash flows can be attributed to a

[33] All paragraphs of AS 4 that deal with contingencies are applicable only to the extent not covered by other Accounting Standards prescribed by the Central Government. For example, the impairment of financial assets such as impairment of receivables (commonly known as provision for bad and doubtful debts) is governed by AS 4.

[34] As defined in Accounting Standard (AS) 22, *Accounting for Taxes on Income*.

discontinuing operation only if they will be disposed of, settled, reduced, or eliminated when the discontinuance is completed. To the extent that such items continue after completion of the discontinuance, they are not allocated to the discontinuing operation. For example, salary of the continuing staff of a discontinuing operation.

22. If an initial disclosure event occurs between the balance sheet date and the date on which the financial statements for that period are approved by the board of directors in the case of a company or by the corresponding approving authority in the case of any other enterprise, disclosures as required by Accounting Standard (AS) 4, *Contingencies and Events Occurring After the Balance Sheet Date*, are made.

Other Disclosures

23. When an enterprise disposes of assets or settles liabilities attributable to a discontinuing operation or enters into binding agreements for the sale of such assets or the settlement of such liabilities, it should include, in its financial statements, the following information when the events occur:

(a) for any gain or loss that is recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation, (i) the amount of the pre-tax gain or loss and (ii) income tax expense relating to the gain or loss; and

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

24. The asset disposals, liability settlements, and binding sale agreements referred to in the preceding paragraph may occur concurrently with the initial disclosure event, or in the period in which the initial disclosure event occurs, or in a later period.

25. If some of the assets attributable to a discontinuing operation have actually been sold or are the subject of one or more binding sale agreements entered into between the balance sheet date and the date on which the financial statements are approved by the board of directors in case of a company or by the corresponding approving authority in the case of any other enterprise, the disclosures required by Accounting Standard (AS) 4, *Contingencies and Events Occurring After the Balance Sheet Date* are made.

Updating the Disclosures

26. In addition to the disclosures in paragraphs 20 and 23, an enterprise should include, in its financial statements, for periods subsequent to the one in which the initial disclosure event occurs, a description of any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled and the events causing those changes.

27. Examples of events and activities that would be disclosed include the nature and terms of binding sale agreements for the assets, a demerger or spin-off by issuing equity shares of the new company to the enterprise's shareholders, and legal or regulatory approvals.

28. The disclosures required by paragraphs 20, 23 and 26 should continue in financial statements for periods up to and including the period in which the discontinuance is completed. A discontinuance is completed when the plan is substantially completed or abandoned, though full payments from the buyer(s) may not yet have been received.

29. If an enterprise abandons or withdraws from a plan that was previously reported as a discontinuing operation, that fact, reasons therefor and its effect should be disclosed.

30. For the purpose of applying paragraph 29, disclosure of the effect includes reversal of any prior impairment loss (see AS 28 *Impairment of Assets*), or provision that was recognised with respect to the discontinuing operation.

Separate Disclosure for Each Discontinuing Operation

31. Any disclosures required by this Standard should be presented separately for each discontinuing operation.

Presentation of the Required Disclosures

32. The disclosures required by paragraphs 20, 23, 26, 28, 29 and 31 should be presented in the notes to the financial statements except the following which should be shown on the face of the statement of profit and loss:

(a) the amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto (paragraph 20 (g)); and

(b) the amount of the pre-tax gain or loss recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation (paragraph 23 (a)).

Illustrative Presentation and Disclosures

33. Illustration 1 attached to the Standard illustrates the presentation and disclosures required by this Standard.

Restatement of Prior Periods

34. Comparative information for prior periods that is presented in financial statements prepared after the initial disclosure event should be restated to segregate assets, liabilities, revenue, expenses, and cash flows of continuing and discontinuing operations in a manner similar to that required by paragraphs 20, 23, 26, 28, 29, 31 and 32.

35. Illustration 2 attached to this Standard illustrates application of paragraph 34.

Disclosure in Interim Financial Reports

36. Disclosures in an interim financial report in respect of a discontinuing operation should be made in accordance with AS 25, Interim Financial Reporting, including:

(a) any significant activities or events since the end of the most recent annual reporting period relating to a discontinuing operation; and

(b) any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled.

Illustration 1

Illustrative Disclosures

This illustration does not form part of the Accounting Standard. Its purpose is to illustrate the application of the Accounting Standard to assist in clarifying its meaning.

Facts

- Delta Company has three segments, Food Division, Beverage Division and Clothing Division.
- Clothing Division, is deemed inconsistent with the long-term strategy of the Company. Management has decided, therefore, to dispose of the Clothing Division.
- On 15 November 20X1, the Board of Directors of Delta Company approved a detailed, formal plan for disposal of Clothing Division, and an announcement was made. On that date, the carrying amount of lakhs minus liabilities of Rs. 15 lakhs).
- The recoverable amount of the assets carried at Rs. 105 lakhs was estimated to be Rs. 85 lakhs and the Company had concluded that a pre-tax impairment loss of Rs. 20 lakhs should be recognised.
- At 31 December 20Xl, the carrying amount of the Clothing Division's net assets was Rs. 70 lakhs (assets of Rs. 85 lakhs minus liabilities of Rs. 15 lakhs). There was no further impairment of assets between 15 November 20X1 and 31 December 20X1 when the financial statements were prepared.
- On 30 September 20X2, the carrying amount of the net assets of the Clothing Division continued to be Rs. 70 lakhs. On that day, Delta Company signed a legally binding contract to sell the Clothing Division.
- The sale is expected to be completed by 31 January 20X3. The recoverable amount of the net assets is Rs. 60 lakhs. Based on that amount, an additional impairment loss of Rs. 10 lakhs is recognised.
- In addition, prior to 31 January 20X3, the sale contract obliges Delta Company to terminate employment of certain employees of the Clothing Division, which would result in termination cost of Rs. 30 lakhs, to be paid by 30 June 20X3. A liability and related expense in this regard is also recognised.
- The Company continued to operate the Clothing Division throughout 20X2.
- At 31 December 20X2, the carrying amount of the Clothing Division's net assets is Rs. 45 lakhs, consisting of assets of Rs. 80 lakhs minus liabilities of Rs. 35 lakhs (including provision for expected termination cost of Rs. 30 lakhs).
- Delta Company prepares its financial statements annually as of 31 December. It does not prepare a cash flow statement.
- Other figures in the following financial statements are assumed to illustrate the presentation and disclosures required by the Standard.

1. Financial Statements for 20X1

1.1 Statement of Profit and Loss for 20X1

The Statement of Profit and Loss of Delta Company for the year 20X1 can be presented as follows:

(Amount in Rs. lakhs)

		20X1		20X0
Turnover		140		150
Operating expenses		(92)		(105)
Impairment loss		(20)		(---)
Pre-tax profit from operating activities		28		45
Interest expense		(15)		(20)
Profit before tax		13		25
Profit from continuing operations before tax (see Note 5)	15		12	
Income tax expense	(7)		(6)	
Profit from continuing operations after tax		8		6
Profit (loss) from discontinuing operations before tax (see Note 5)	(2)		13	
Income tax expense	1		(7)	
Profit (loss) from discontinuing operations after tax		(1)		6
Profit from operating activities after tax		**7**		**12**

1.2 Note to Financial Statements for 20X1

The following is Note 5 to Delta Company's financial statements:

On 15 November 20Xl, the Board of Directors announced a plan to dispose of Company's Clothing Division, which is also a separate segment as per AS 17, *Segment Reporting*. The disposal is consistent with the Company's long-term strategy to focus its activities in the areas of food and beverage manufacture and distribution, and to divest unrelated activities. The Company is actively seeking a buyer for the Clothing Division and hopes to complete the sale by the end of 20X2. At 31 December 20Xl, the carrying amount of the assets of the Clothing Division was Rs. 85 lakhs (previous year Rs. 120 lakhs) and its liabilities were Rs. 15 lakhs (previous year Rs. 20 lakhs). The following statement shows the revenue and expenses of continuing and discontinuing operations:

(Amount in Rs. Lakhs)

	Continuing Operations (Food and Beverage Divisions)		Discontinuing Operation (Clothing Division)		Total	
	20X1	20X0	20X1	20X0	20X1	20X0
Turnover	90	80	50	70	140	150
Operating Expenses	(65)	(60)	(27)	(45)	(92)	(105)
Impairment Loss	(---)	(---)	(20)	(---)	(20)	(---)
Pre-tax profit from operating activities	25	20	3	25	28	45
Interest expense	(10)	(8)	(5)	(12)	(15)	(20)
Profit (loss) before tax	15	12	(2)	13	13	25
Income tax expense	(7)	(6)	1	(7)	(6)	(13)

Profit (loss) from operating activities after tax	8	6	(1)	6	7	12

2. Financial Statements for 20X2

2.1 Statement of Profit and Loss for 20X2

The Statement of Profit and Loss of Delta Company for the year 20X2 can be presented as follows:

(Amount in Rs. lakhs)

		20X2		20X1
Turnover		140		140
Operating expenses		(90)		(92)
Impairment loss		(10)		(20)
Provision for employee termination benefits		(30)		--
Pre-tax profit from operating activities		10		28
Interest expense		(25)		(15)
Profit (loss) before tax		(15)		13
Profit from continuing operations before tax (see Note 5)	20		15	
Income tax expense	(6)		(7)	
Profit from continuing operations after tax		14		8
Loss from discontinuing operations before tax (see Note 5)	(35)		(2)	
Income tax expense	10		1	
Loss from discontinuing operations after tax		(25)		(1)
Profit (loss) from operating activities after tax		**(11)**		7

2.2 Note to Financial Statements for 20X2

The following is Note 5 to Delta Company's financial statements:

On 15 November 20Xl, the Board of Directors had announced a plan to dispose of Company's Clothing Division, which is also a separate segment as per AS 17, *Segment Reporting*. The disposal is consistent with the Company's long-term strategy to focus its activities in the areas of food and beverage manufacture and distribution, and to divest unrelated activities. On 30 September 20X2, the Company signed a contract to sell the Clothing Division to Z Corporation for Rs. 60 lakhs.

Clothing Division's assets are written down by Rs. 10 lakhs (previous year Rs. 20 lakhs) before income tax saving of Rs. 3 lakhs (previous year Rs. 6 lakhs) to their recoverable amount.

The Company has recognised provision for termination benefits of Rs. 30 lakhs (previous year Rs. nil) before income tax saving of Rs. 9 lakhs (previous year Rs. nil) to be paid by 30 June 20X3 to certain employees of the Clothing Division whose jobs will be terminated as a result of the sale.

At 31 December 20X2, the carrying amount of assets of the Clothing Division was Rs. 80

lakhs (previous year Rs. 85 lakhs) and its liabilities were Rs. 35 lakhs (previous year Rs. 15 lakhs), including the provision for expected termination cost of Rs. 30 lakhs (previous year Rs. nil). The process of selling the Clothing Division is likely to be completed by 31 January 20X3.

The following statement shows the revenue and expenses of continuing and discontinuing operations:

	Continuing Operations (Food and Beverage Divisions)		**Discontinuing Operation (Clothing Division)**		**Total**	
	20X2	**20X1**	**20X2**	**20X1**	**20X2**	**20X1**
Turnover	100	90	40	50	140	140
Operating Expenses	(60)	(65)	(30)	(27)	(90)	(92)
Impairment Loss	....	....	(10)	(20)	(10)	(20)
Provision for employee termination	....	....	(30)	....	(30)	....
Pre-tax profit (loss) from operating activities	40	25	(30)	3	10	28
Interest expense	(20)	(10)	(5)	(5)	(25)	(15)
Profit (loss) before tax	20	15	(35)	(2)	(15)	13
Income tax expense	(6)	(7)	10	1	4	(6)
Profit (loss) from operating activities after tax	14	8	(25)	(1)	(11)	7

3. Financial Statements for 20X3

The financial statements for 20X3, would disclose information related to discontinued operations in a manner similar to that for 20X2 including the fact of completion of discontinuance.

Illustration 2

Classification of Prior Period Operations

This illustration does not form part of the Accounting Standard. Its purpose is to illustrate the application of the Accounting Standard to assist in clarifying its meaning.

Facts

1. Paragraph 34 requires that comparative information for prior periods that is presented in financial statements prepared after the initial disclosure event be restated to segregate assets, liabilities, revenue, expenses, and cash flows of continuing and discontinuing operations in a manner similar to that required by paragraphs 20, 23, 26, 28, 29, 31 and 32.

2. Consider following facts:

   (a) Operations A, B, C, and D were all continuing in years 1 and 2;

   (b) Operation D is approved and announced for disposal in year 3 but actually disposed of in year 4;

   (c) Operation B is discontinued in year 4 (approved and announced for disposal and actually disposed of) and operation E is acquired; and

   (d) Operation F is acquired in year 5.

3. The following table illustrates the classification of continuing and discontinuing operations in years 3 to 5:

FINANCIAL STATEMENTS FOR YEAR 3 (Approved and Published early in Year 4)			
Year 2 Comparatives		**Year 3**	
Continuing	Discontinuing	Continuing	Discontinuing
A		A	
B		B	
C		C	
	D		D

FINANCIAL STATEMENTS FOR YEAR 4 (Approved and Published early in Year 5)			
Year 3 Comparatives		**Year 4**	
Continuing	Discontinuing	Continuing	Discontinuing
A		A	
	B		B
C		C	
	D		D
		E	

FINANCIAL STATEMENTS FOR YEAR 5 (Approved and Published early in Year 6)			
Year 4 Comparatives		**Year 5**	
Continuing	Discontinuing	Continuing	Discontinuing
A		A	
	B		
C		C	
	D		
E		E	
		F	

4. If, for whatever reason, five-year comparative financial statements were prepared in year 5, the classification of continuing and discontinuing operations would be as follows:

FINANCIAL STATEMENTS FOR YEAR 5									
Year 1 Comparatives		**Year 2 Comparatives**		**Year 3 Comparatives**		**Year 4 Comparatives**		**Year 5**	
Cont.	Disc.	Cont.	Disc.	Cont.	Disc.	Cont.	Disc.	Cont.	Disc.
A		A		A		A		A	
	B		B		B		B		
C		C		C		C		C	
	D		D		D		D		
						E		E	
								F	

Accounting Standard (AS) 25

Interim Financial Reporting

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the General Instructions contained in part A of the Annexure to the Notification.)*

Objective

The objective of this Standard is to prescribe the minimum content of an interim financial report and to prescribe the principles for recognition and measurement in a complete or condensed financial statements for an interim period. Timely and reliable interim financial reporting improves the ability of investors, creditors, and others to understand an enterprise's capacity to generate earnings and cash flows, its financial condition and liquidity.

Scope

1. This Standard does not mandate which enterprises should be required to present interim financial reports, how frequently, or how soon after the end of an interim period. If an enterprise is required or elects to prepare and present an interim financial report, it should comply with this Standard.

2. A statute governing an enterprise or a regulator may require an enterprise to prepare and present certain information at an interim date which may be different in form and/or content as required by this Standard. In such a case, the recognition and measurement principles as laid down in this Standard are applied in respect of such information, unless otherwise specified in the statute or by the regulator.

3. The requirements related to cash flow statement, complete or condensed, contained in this Standard are applicable where an enterprise prepares and presents a cash flow statement for the purpose of its annual financial report.

Definitions

4. The following terms are used in this Standard with the meanings specified:

4.1 Interim period is a financial reporting period shorter than a full financial year.

4.2 Interim financial report means a financial report containing either a complete set of financial statements or a set of condensed financial statements (as described in this Standard) for an interim period.

5. During the first year of operations of an enterprise, its annual financial reporting period may be shorter than a financial year. In such a case, that shorter period is not considered as an

interim period.

Content of an Interim Financial Report

6. A complete set of financial statements normally includes:

(a) balance sheet;

(b) statement of profit and loss;

(c) cash flow statement; and

(d) notes including those relating to accounting policies and other statements and explanatory material that are an integral part of the financial statements.

7. In the interest of timeliness and cost considerations and to avoid repetition of information previously reported, an enterprise may be required to or may elect to present less information at interim dates as compared with its annual financial statements. The benefit of timeliness of presentation may be partially offset by a reduction in detail in the information provided. Therefore, this Standard requires preparation and presentation of an interim financial report containing, as a minimum, a set of condensed financial statements. The interim financial report containing condensed financial statements is intended to provide an update on the latest annual financial statements. Accordingly, it focuses on new activities, events, and circumstances and does not duplicate information previously reported.

8. This Standard does not prohibit or discourage an enterprise from presenting a complete set of financial statements in its interim financial report, rather than a set of condensed financial statements. This Standard also does not prohibit or discourage an enterprise from including, in condensed interim financial statements, more than the minimum line items or selected explanatory notes as set out in this Standard. The recognition and measurement principles set out in this Standard apply also to complete financial statements for an interim period, and such statements would include all disclosures required by this Standard (particularly the selected disclosures in paragraph 16) as well as those required by other Accounting Standards.

Minimum Components of an Interim Financial Report

9. An interim financial report should include, at a minimum, the following components:

(a) condensed balance sheet;

(b) condensed statement of profit and loss;

(c) condensed cash flow statement; and

(d) selected explanatory notes.

Form and Content of Interim Financial Statements

10. If an enterprise prepares and presents a complete set of financial statements in its interim financial report, the form and content of those statements should conform to the requirements as applicable to annual complete set of financial statements.

11. If an enterprise prepares and presents a set of condensed financial statements in its interim financial report, those condensed statements should include, at a minimum, each of the headings and sub-headings that were included in its most recent annual financial statements and the selected explanatory notes as required by this Standard. Additional line items or notes should be included if their omission would make the condensed interim financial statements misleading.

12. If an enterprise presents basic and diluted earnings per share in its annual financial statements in accordance with Accounting Standard (AS) 20, Earnings Per Share, basic and diluted earnings per share should be presented in accordance with AS 20 on the face of the statement of profit and loss, complete or condensed, for an interim period.

13. If an enterprise's annual financial report included the consolidated financial statements in addition to the parent's separate financial statements, the interim financial report includes both the consolidated financial statements and separate financial statements, complete or condensed.

14. Illustration I attached to the Standard provides illustrative formats of condensed financial statements.

Selected Explanatory Notes

15. A user of an enterprise's interim financial report will ordinarily have access to the most recent annual financial report of that enterprise. It is, therefore, not necessary for the notes to an interim financial report to provide relatively insignificant updates to the information that was already reported in the notes in the most recent annual financial report. At an interim date, an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the enterprise since the last annual reporting date is more useful.

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

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

(c) the nature and amount of items affecting assets, liabilities, equity, net income, or cash flows that are unusual because of their nature, size, or incidence (see paragraphs 12 to 14 of Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies);

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

(e) issuances, buy-backs, repayments and restructuring of debt, equity and potential equity shares;

(f) dividends, aggregate or per share (in absolute or percentage terms), separately for equity shares and other shares;

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

(h) material events subsequent to the end of the interim period that have not been reflected in the financial statements for the interim period;

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

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

The above information should normally be reported on a financial year- to-date basis. However, the enterprise should also disclose any events or transactions that are material to an understanding of the current interim period.

17. Other Accounting Standards specify disclosures that should be made in financial statements. In that context, financial statements mean complete set of financial statements normally included in an annual financial report and sometimes included in other reports. The disclosures required by those other Accounting Standards are not required if an enterprise's interim financial report includes only condensed financial statements and selected explanatory notes rather than a complete set of financial statements.

Periods for which Interim Financial Statements are required to be presented

18. Interim reports should include interim financial statements (condensed or complete) for periods as follows:

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

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

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

19. For an enterprise whose business is highly seasonal, financial information for the twelve months ending on the interim reporting date and comparative information for the prior twelve-month period may be useful. Accordingly, enterprises whose business is highly seasonal are encouraged to consider reporting such information in addition to the information called for in the preceding paragraph.

20. Illustration 2 attached to the Standard illustrates the periods required to be presented by an enterprise that reports half-yearly and an enterprise that reports quarterly.

Materiality

21. In deciding how to recognise, measure, classify, or disclose an item for interim financial reporting purposes, materiality should be assessed in relation to the interim period financial data. In making assessments of materiality, it should be recognised that interim measurements may rely on estimates to a greater extent than measurements of annual financial data.

22. The Preface to the Statements of Accounting Standards states that "The Accounting Standards are intended to apply only to items which are material". The Framework for the Preparation and Presentation of Financial Statements, issued by the Institute of Chartered Accountants of India, states that "information is material if its misstatement (i.e., omission or erroneous statement) could influence the economic decisions of users taken on the basis of the financial information".

23. Judgement is always required in assessing materiality for financial reporting purposes. For reasons of understandability of the interim figures, materiality for making recognition and disclosure decision is assessed in relation to the interim period financial data. Thus, for example, unusual or extraordinary items, changes in accounting policies or estimates, and prior period items are recognised and disclosed based on materiality in relation to interim period data. The overriding objective is to ensure that an interim financial report includes all information that is relevant to understanding an enterprise's financial position and performance during the interim period.

Disclosure in Annual Financial Statements

24. An enterprise may not prepare and present a separate financial report for the final interim period because the annual financial statements are presented. In such a case, paragraph 25 requires certain disclosures to be made in the annual financial statements for that financial year.

25. If an estimate of an amount reported in an interim period is changed significantly during the final interim period of the financial year but a separate financial report is not prepared and presented for that final interim period, the nature and amount of that change in estimate should be disclosed in a note to the annual financial statements for that financial year.

26. Accounting Standard (AS) 5, *Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies,* requires disclosure, in financial statements, of the nature and (if practicable) the 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. Paragraph 16(d) of this Standard requires similar disclosure in an interim financial report. Examples include changes in estimate in the final interim period relating to inventory write-downs, restructurings, or impairment losses that were reported in an earlier interim period of the financial year. The disclosure required by the preceding paragraph is consistent with AS 5 requirements and is intended to be restricted in scope so as to relate only to the change in estimates. An enterprise is not required to include additional interim period financial information in its annual financial statements.

Recognition and Measurement

Same Accounting Policies as Annual

27. An enterprise should apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements. However, the frequency of an enterprise's reporting (annual, half-yearly, or quarterly) should not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes should be made on a year-to-date basis.

28. Requiring that an enterprise apply the same accounting policies in its interim financial statements as in its annual financial statements may seem to suggest that interim period measurements are made as if each interim period stands alone as an independent reporting period. However, by providing that the frequency of an enterprise's reporting should not affect the measurement of its annual results, paragraph 27 acknowledges that an interim period is a part of a financial year. Year-to-date measurements may involve changes in estimates of amounts reported in prior interim periods of the current financial year. But the principles for recognising assets, liabilities, income, and expenses for interim periods are the same as in annual financial statements.

29. To illustrate:

(a) the principles for recognising and measuring losses from inventory write-downs, restructurings, or impairments in an interim period are the same as those that an enterprise would follow if it prepared only annual financial statements. However, if such items are recognised and measured in one interim period and the estimate changes in a subsequent interim period of that financial year, the original estimate is changed in the subsequent interim period either by accrual of an additional amount of loss or by reversal of the previously recognised amount;

(b) a cost that does not meet the definition of an asset at the end of an interim period is not deferred on the balance sheet date either to await future information as to whether it has met the definition of an asset or to smooth earnings over interim periods within a financial year; and

(c) income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year. Amounts accrued for income tax expense in one interim period may have to be adjusted in a subsequent interim period of that financial year if the estimate of the annual income tax rate changes.

30. Under the Framework for the Preparation and Presentation of Financial Statements, recognition is the "process of incorporating in the balance sheet or statement of profit and loss an item that meets the definition of an element and satisfies the criteria for recognition". The definitions of assets, liabilities, income, and expenses are fundamental to recognition, both at annual and interim financial reporting dates.

31. For assets, the same tests of future economic benefits apply at interim dates as they apply at the end of an enterprise's financial year. Costs that, by their nature, would not qualify as assets at financial year end would not qualify at interim dates as well. Similarly, a liability at an interim reporting date must represent an existing obligation at that date, just as it must at an annual reporting date.

32. Income is recognised in the statement of profit and loss when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably. Expenses are recognised in the statement of profit and loss when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably. The recognition of items in the balance sheet which do not meet the definition of assets or liabilities is not allowed.

33. In measuring assets, liabilities, income, expenses, and cash flows reported in its financial statements, an enterprise that reports only annually is able to take into account information that becomes available throughout the financial year. Its measurements are, in effect, on a year-to-date basis.

34. An enterprise that reports half-yearly, uses information available by mid-year or shortly thereafter in making the measurements in its financial statements for the first six-month period and information available by year- end or shortly thereafter for the twelve-month period. The twelve-month measurements will reflect any changes in estimates of amounts reported for the

first six-month period. The amounts reported in the interim financial report for the first six-month period are not retrospectively adjusted. Paragraphs 16(d) and 25 require, however, that the nature and amount of any significant changes in estimates be disclosed.

35. An enterprise that reports more frequently than half-yearly, measures income and expenses on a year-to-date basis for each interim period using information available when each set of financial statements is being prepared. Amounts of income and expenses reported in the current interim period will reflect any changes in estimates of amounts reported in prior interim periods of the financial year. The amounts reported in prior interim periods are not retrospectively adjusted. Paragraphs 16(d) and 25 require, however, that the nature and amount of any significant changes in estimates be disclosed.

Revenues Received Seasonally or Occasionally

36. Revenues that are received seasonally or occasionally within a financial year should not be anticipated or deferred as of an interim date if anticipation or deferral would not be appropriate at the end of the enterprise's financial year.

37. Examples include dividend revenue, royalties, and government grants. Additionally, some enterprises consistently earn more revenues in certain interim periods of a financial year than in other interim periods, for example, seasonal revenues of retailers. Such revenues are recognised when they occur.

Costs Incurred Unevenly During the Financial Year

38. Costs that are incurred unevenly during an enterprise's financial year should be anticipated or deferred for interim reporting purposes if, and only if, it is also appropriate to anticipate or defer that type of cost at the end of the financial year.

Applying the Recognition and Measurement principles

39. Illustration 3 attached to the Standard illustrates application of the general recognition and measurement principles set out in paragraphs 27 to 38.

Use of Estimates

40. The measurement procedures to be followed in an interim financial report should be designed to ensure that the resulting information is reliable and that all material financial information that is relevant to an understanding of the financial position or performance of the enterprise is appropriately disclosed. While measurements in both annual and interim financial reports are often based on reasonable estimates, the preparation of interim financial reports generally will require a greater use of estimation methods than annual financial reports.

41. Illustration 4 attached to the Standard illustrates the use of estimates in interim periods.

Restatement of Previously Reported Interim Periods

42. A change in accounting policy, other than one for which the transition is specified by an Accounting Standard, should be reflected by restating the financial statements of prior interim periods of the current financial year.

43. One objective of the preceding principle is to ensure that a single accounting policy is applied to a particular class of transactions throughout an entire financial year. The effect of the principle in paragraph 42 is to require that within the current financial year any change in accounting policy be applied retrospectively to the beginning of the financial year.

Transitional Provision[35]

44. On the first occasion that an interim financial report is presented in accordance with this Standard, the following need not be presented in respect of all the interim periods of the current financial year:

(a) comparative statements of profit and loss for the comparable interim periods (current and year-to-date) of the immediately preceding financial year; and

(b) comparative cash flow statement for the comparable year-to-date period of the immediately preceding financial year.

Illustration 1

Illustrative Format of Condensed Financial Statements

This illustration which does not form part of the Accounting Standard, provides illustrative format of condensed financial statements. Its purpose is to illustrate the application of the Accounting Standard to assist in clarifying its meaning.

Paragraph 11 of the Accounting Standard provides that if an enterprise prepares and presents a set of condensed financial statements in its interim financial report, those condensed statements should include, at a minimum, each of the headings and sub-headings that were included in its most recent annual financial statements and the selected explanatory notes as required by the Standard. Additional line items or notes should be included if their omission would make the condensed interim financial statements misleading.

The purpose of the following illustrative format is primarily to illustrate the requirements of paragraph 11 of the Standard. It may be noted that these illustrative formats are subject to the requirements laid down in the Standard including those of paragraph 11.

[35] Transitional Provisions given in Paragraph 44 are relevant for standards notified under Companies (Accounting Standards) Rules, 2006 (as amended from time to time) as well as Companies (Accounting Standards) Rules, 2021.

Illustrative Format of Condensed Financial Statements for an enterprise other than a bank

(A) Condensed Balance Sheet

Particulars	Figures at the end of the current interim period (in Rs.) (DD/MM/YYYY)	Figures at the end of the previous accounting year (in Rs.) (DD/MM/YYYY)
I. EQUITY AND LIABILITIES		
(1) Shareholders' funds		
(a) Share capital		
(b) Reserves and surplus		
(c) Money received against share warrants		
(2) Share application money pending allotment		
(3) Minority interests (in case of consolidate financial statements)		
(4)Non-current liabilities (a) Long-term borrowings		
(b) Deferred tax liabilities (Net)		
(c) Other Long term liabilities		
(d) Long-term provisions		
(5) Current liabilities		
(a) Short-term borrowings		
(b) Trade Payables (A) total outstanding dues of micro enterprises and small enterprises; and (B) total outstanding dues of creditors other than micro enterprises and small enterprises.		
(c) Other current liabilities		
(d) Short-term provisions		
TOTAL		
II. ASSETS		
(1) Non-current assets		

(a) Property, Plant and Equipment		
(i) Tangible assets		
(ii) Intangible assets		
(iii) Capital work-in-progress		
(iv) Intangible assets under development		
(b) Non-current investments		
(c) Deferred tax assets (net)		
(d) Long-term loans and advances		
(e) Other non-current assets		
(2) Current assets		
(a) Current investments		
(b) Inventories		
(c) Trade receivables		
(d) Cash and cash equivalents		
(e) Short-term loans and advances		
(f) Other current assets		
TOTAL		

See accompanying notes to the condensed financial statements

(B) Condensed Statement of Profit and Loss

Particulars	**Three months ended (in Rs.) From (DD/MM/YYYY) To (DD/MM/YYYY)**	**Corresponding three months of the previous accounting year (in Rs.) From (DD/MM/YYYY) To (DD/MM/YYYY)**	**Year-to-date figures for current period (in Rs.) From (DD/MM/YYYY) To (DD/MM/YYYY)**	**Year-to-date figures for the previous year (in Rs.) From (DD/MM/YYYY) To (DD/MM/YYYY)**
I. Revenue from operations				
II. Other income				
III. Total Revenue (I + II)				
IV. Expenses:				
Cost of materials consumed				

Purchases of Stock-in-Trade				
Changes in inventories of finished goods				
work-in-progress and Stock-in-Trade				
Employee benefits expense				
Finance costs				
Depreciation and amortisation expense				
Other expenses				
Total expenses				
V. Profit before exceptional and extraordinary items and tax (III - IV)				
VI. Exceptional items				
VII. Profit before extraordinary items and tax (V - VI)				
VIII. Extraordinary items				
IX. Profit before tax (VII- VIII)				
X. Tax expense:				
(1) Current tax				
(2) Deferred tax				
XI. Profit (Loss) for the period from continuing operations (VII-VIII)				
XII. Profit/(loss) from discontinuing operations				
XIII. Tax expense of discontinuing operations				
XIV. Profit/(loss) from Discontinuing operations (after tax) (XII-XIII)				
XV. Profit (Loss) (XI + XIV) XVI Minority Interests (in case of consolidated financial statements)				
XVII. Net Profit (Loss) for the period available to equity shareholders				
XVIII Earnings per equity share:				

(1) Basic				
(2) Diluted				

See accompanying notes to the condensed financial statements

(C) Condensed Cash Flow Statement

	Year-to-date figures for the current period (in Rs.) From (DD/MM/YYYY) To (DD/MM/YYYY)	**Year-to-date figures for the previous year (in Rs.) From (DD/MM/YYYY) To (DD/MM/YYYY)**
1. Cash flows from operating activities		
2. Cash flows from investing activities		
3. Cash flows from financing activities		
4. Net increase/(decrease) in cash and cash equivalents		
5. Cash and cash equivalents at beginning of period		
6. Cash and cash equivalents at end of period		

(D) Selected Explanatory Notes

This part should contain selected explanatory notes as required by paragraph 16 of this Standard.

Illustrative Format of Condensed Financial Statements for a Bank

(A) Condensed Balance Sheet

	Figures at the end of the current interim period (in Rs.) (DD/MM/YYYY)	**Figures at the end of the previous accounting year (in Rs.) (DD/MM/YYYY)**
I. Capital and Liabilities		
1. Capital		
2. Reserve and surplus		

3. Minority interests (in case of consolidated financial statements)		
4. Deposits		
5. Borrowings		
6. Other liabilities and provisions		
Total		
II. Assets		
1. Cash and balances with Reserve Bank of India		
2. Balances with banks and money at call and short notice		
3. Investments		
4. Advances		
5. Fixed assets (a) Tangible fixed assets (b) Intangible fixed assets		
6. Other Assets		
Total		

See accompanying notes to the condensed financial statements

(B) Condensed Statement of Profit and Loss

	Three months ended (in Rs.) From (DD/MM/YYYY) To _ (DD/MM/YYYY)	Corresponding three months of the previous accounting year **(in Rs.)** From (DD/MM/YYYY) To _ (DD/MM/YYYY)	Year-to-date figures for current period **(in Rs.)** From (DD/MM/YYYY) To _ (DD/MM/YYYY)	Year-to-date figures for the previous year **(in Rs.)** From (DD/MM/YYYY) To _ (DD/MM/YYYY)
INCOME				
1. Interest earned (a) Interest/discount on advances/bills (b) Interest on Investments (c) Interest on balances with Reserve Bank of India and other inter banks funds (d) Others				
2. Other Income				
Total Income				
EXPENDITURE				
1. Interest expended				
2. Operating expenses (a) Payments to and provisions for employees (b) Other operating expenses				
3. Provisions and contingencies				
4. Total expenses				
5. Profit or loss from ordinary activities before tax				
6. Extraordinary items				
7. Profit or loss before tax				
8. Tax expense				

(B) Condensed Statement of Profit and Loss *(Contd.)*

	Three months ended (in Rs.) From (DD/MM/YYYY) To _ (DD/MM/YYY	Corresponding three months of the previous accounting year **(in Rs.)** From (DD/MM/YYYY) To _ (DD/MM/YYYY)	Year-to-date figures for current period **(in Rs.)** From (DD/MM/YYY) To _ (DD/MM/YYY)	Year-to-date figures for the previous year **(in Rs.)** From (DD/MM/YYYY) To _ (DD/MM/YYYY)
9. Profit or loss after tax				
10. Minority Interests (in case of consolidated financial statements)				
11. Net profit or loss for the period available to equity shareholders				
Earnings Per Share 1. Basic Earnings Per Share 2. Diluted Earnings Per Share				

See accompanying notes to the condensed financial statements

(C) Condensed Cash Flow Statement

	Year-to-date figures for the current period (in Rs.) From _____ (DD/MM/YYYY) To _____ (DD/MM/YYYY)	**Year-to-date figures for the previous year (in Rs.)** From _____ (DD/MM/YYYY) To _____ (DD/MM/YYYY)
1. Cash flows from operating activities		
2. Cash flows from investing activities		
3. Cash flows from financing activities		
4. Net increase/(decrease) in cash and cash equivalents		

5. Cash and cash equivalents at beginning of period		
6. Cash and cash equivalents at end of period		

(D) Selected Explanatory Notes

This part should contain selected explanatory notes as required by paragraph 16 of this Standard.

Illustration 2

Illustration of Periods Required to Be Presented

This illustration which does not form part of the Accounting Standard, Illustrates application of the principles in paragraphs 18 and 19. Its purpose is to illustrate the application of the Accounting Standard to assist in clarifying its meaning.

Enterprise Preparing and Presenting Interim Financial Reports Half- Yearly

1. An enterprise whose financial year ends on 31 March, presents financial statements (condensed or complete) for following periods in its half-yearly interim financial report as of 30 September 2001:

Balance Sheet:		
As at	30 September 2001	31 March 2001
Statement of Profit and Loss:		
6 months ending	30 September 2001	30 September 2000
Cash Flow Statement[36]:		
6 months ending	30 September 2001	30 September 2000

Enterprise Preparing and Presenting Interim Financial Reports Quarterly

2. An enterprise whose financial year ends on 31 March, presents financial statements (condensed or complete) for following periods in its interim financial report for the second quarter ending 30 September 2001:

Balance Sheet:		
As at	30 September 2001	31 March 2001
Statement of Profit and Loss:		

[36] It is assumed that the enterprise prepares a cash flow statement for the purpose of its Annual Report.

6 months ending	30 September 2001	30 September 2000
3 months ending	30 September 2001	30 September 2000
Cash Flow Statement:		
6 months ending	30 September 2001	30 September 2000

Enterprise whose business is highly seasonal Preparing and Presenting Interim Financial Reports Quarterly

3. An enterprise whose financial year ends on 31 March, may present financial statements (condensed or complete) for the following periods in its interim financial report for the second quarter ending 30 September 2001:

Balance Sheet:		
As at	30 September 2001	31 March 2001 30 September 2000
Statement of Profit and Loss:		
6 months ending	30 September 2001	30 September 2000
3 months ending	30 September 2001	30 September 2000
12 months ending	30 September 2001	30 September 2000
Cash Flow Statement:		
6 months ending	30 September 2001	30 September 2000
12 months ending	30 September 2001	30 September 2000

Illustration 3

Illustration of Applying the Recognition and Measurement Principles

This illustration, which does not form part of the Accounting Standard, illustrates application of the general recognition and measurement principles set out in paragraphs 27-38 of this Standard. Its purpose is to illustrate the application of the Accounting Standard to assist in clarifying its meaning.

Gratuity and Other Defined Benefit Schemes

1. Provisions in respect of gratuity and other defined benefit schemes for an interim period are calculated on a year-to-date basis by using the actuarially determined rates at the end of the prior financial year, adjusted for significant market fluctuations since that time and for significant curtailments, settlements, or other significant one-time events.

Major Planned Periodic Maintenance or Overhaul

2. The cost of a major planned periodic maintenance or overhaul or other seasonal expenditure that is expected to occur late in the year is not anticipated for interim reporting purposes unless an event has caused the enterprise to have a present obligation. The mere intention or necessity to incur expenditure related to the future is not sufficient to give rise to an obligation.

Provisions

3. This Standard requires that an enterprise apply the same criteria for recognising and measuring a provision at an interim date as it would at the end of its financial year. The existence or non-existence of an obligation to transfer economic benefits is not a function of the length of the reporting period. It is a question of fact subsisting on the reporting date.

Year-End Bonuses

4. The nature of year-end bonuses varies widely. Some are earned simply by continued employment during a time period. Some bonuses are earned based on monthly, quarterly, or annual measure of operating result. They may be purely discretionary, contractual, or based on years of historical precedent.

5. A bonus is anticipated for interim reporting purposes if, and only if, (a) the bonus is a legal obligation or an obligation arising from past practice for which the enterprise has no realistic alternative but to make the payments, and (b) a reliable estimate of the obligation can be made.

Intangible Assets

6. An enterprise will apply the definition and recognition criteria for an intangible asset in the same way in an interim period as in an annual period. Costs incurred before the recognition criteria for an intangible asset are met are recognised as an expense. Costs incurred after the specific point in time at which the criteria are met are recognised as part of the cost of an intangible asset. "Deferring" costs as assets in an interim balance sheet in the hope that the recognition criteria will be met later in the financial year is not justified.

Other Planned but Irregularly Occurring Costs

7. An enterprise's budget may include certain costs expected to be incurred irregularly during the financial year, such as employee training costs. These costs generally are discretionary even though they are planned and tend to recur from year to year. Recognising an obligation at an interim financial reporting date for such costs that have not yet been incurred generally is not consistent with the definition of a liability.

Measuring Income Tax Expense for Interim Period

8. Interim period income tax expense is accrued using the tax rate that would be applicable to expected total annual earnings, that is, the estimated average annual effective income tax rate applied to the pre-tax income of the interim period.

9. This is consistent with the basic concept set out in paragraph 27 that the same accounting recognition and measurement principles should be applied in an interim financial report as are applied in annual financial statements. Income taxes are assessed on an annual basis. Therefore, interim period income tax expense is calculated by applying, to an interim period's pre-tax income, the tax rate that would be applicable to expected total annual earnings, that is, the estimated average effective annual income tax rate. That estimated average annual income tax rate would reflect the tax rate structure expected to be applicable to the full year's earnings including enacted or substantively enacted changes in the income tax rates scheduled to take effect later in the financial year. The estimated average annual income tax rate would be re-estimated on a year-to-date basis, consistent with paragraph 27 of this Standard. Paragraph 16(d) requires disclosure of a significant change in estimate.

10. To the extent practicable, a separate estimated average annual effective income tax rate is determined for each governing taxation law and applied individually to the interim period pre-tax income under such laws. Similarly, if different income tax rates apply to different categories of income (such as capital gains or income earned in particular industries), to the extent practicable a separate rate is applied to each individual category of interim period pre-tax income. While that degree of precision is desirable, it may not be achievable in all cases, and a weighted average of rates across such governing taxation laws or across categories of income is used if it is a reasonable approximation of the effect of using more specific rates.

11. As illustration, an enterprise reports quarterly, earns Rs. 150 lakhs pre- tax profit in the first quarter but expects to incur losses of Rs 50 lakhs in each of the three remaining quarters (thus having zero income for the year), and is governed by taxation laws according to which its estimated average annual income tax rate is expected to be 35 per cent. The following table shows the amount of income tax expense that is reported in each quarter:

(Amount in Rs. lakhs)

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Annual
Tax Expense	52.5	(17.5)	(17.5)	(17.5)	0

Difference in Financial Reporting Year and Tax Year

12. If the financial reporting year and the income tax year differ, income tax expense for the interim periods of that financial reporting year is measured using separate weighted average estimated effective tax rates for each of the income tax years applied to the portion of pre-tax income earned in each of those income tax years.

13. To illustrate, an enterprise's financial reporting year ends 30 September and it reports quarterly. Its year as per taxation laws ends 31 March. For the financial year that begins 1 October, Year 1 ends 30 September of Year 2, the enterprise earns Rs 100 lakhs pre-tax each quarter. The estimated weighted average annual income tax rate is 30 per cent in Year 1 and 40 per cent in Year 2.

(Amount in Rs. lakhs)

	Quarter Ending 31 Dec. Year 1	Quarter Ending 31 Mar. Year 1	Quarter Ending 30 June Year 2	Quarter Ending 30 Sep. Year 2	Year Ending 30 Sep. Year 2
Tax Expense	30	30	40	40	140

Tax Deductions/Exemptions

14. Tax statutes may provide deductions/exemptions in computation of income for determining tax payable. Anticipated tax benefits of this type for the full year are generally reflected in computing the estimated annual effective income tax rate, because these deductions/exemptions are calculated on an annual basis under the usual provisions of tax statutes. On the other hand, tax benefits that relate to a one-time event are recognised in computing income tax expense in that interim period, in the same way that special tax rates applicable to particular categories of income are not blended into a single effective annual tax rate.

Tax Loss Carryforwards

15. A deferred tax asset should be recognised in respect of carryforward tax losses to the extent that it is virtually certain, supported by convincing evidence, that future taxable income will be available against which the deferred tax assets can be realised. The criteria are to be applied at the end of each interim period and, if they are met, the effect of the tax loss carryforward is reflected in the computation of the estimated average annual effective income tax rate.

16. To illustrate, an enterprise that reports quarterly has an operating loss carryforward of Rs 100 lakhs for income tax purposes at the start of the current financial year for which a deferred tax asset has not been recognised. The enterprise earns Rs. 100 lakhs in the first quarter of the current year and expects to earn Rs. 100 lakhs in each of the three remaining quarters. Excluding the loss carryforward, the estimated average annual income tax rate is expected to be 40 per cent. The estimated payment of the annual tax on Rs. 400 lakhs of earnings for the current year would be Rs. 120 lakhs {(Rs. 400 lakhs - Rs. 100 lakhs) x 40%}. Considering the loss carryforward, the estimated average annual effective income tax rate would be 30% {(Rs. 120 lakhs/Rs. 400 lakhs) x 100}. This average annual effective income tax rate would be applied to earnings of each quarter. Accordingly, tax expense would be as follows:

(Amount in Rs. lakhs)

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Annual
Tax Expense	30.00	30.00	30.00	30.00	120.00

Contractual or Anticipated Purchase Price Changes

17. Volume rebates or discounts and other contractual changes in the prices of goods and services are anticipated in interim periods, if it is probable that they will take effect. Thus, contractual rebates and discounts are anticipated but discretionary rebates and discounts are not anticipated because the resulting liability would not satisfy the conditions of recognition, viz., that a liability must be a present obligation whose settlement is expected to result in an outflow of resources.

Depreciation and Amortisation

18. Depreciation and amortisation for an interim period is based only on assets owned during that interim period. It does not take into account asset acquisitions or disposals planned for later in the financial year.

Inventories

19. Inventories are measured for interim financial reporting by the same principles as at financial year end. AS 2 on *Valuation of Inventories*, establishes standards for recognising and measuring inventories. Inventories pose particular problems at any financial reporting date because of the need to determine inventory quantities, costs, and net realisable values. Nonetheless, the same measurement principles are applied for interim inventories. To save cost and time, enterprises often use estimates to measure inventories at interim dates to a greater extent than at annual reporting dates. Paragraph 20 below provides an example of how to apply the net realisable value test at an interim date.

Net Realisable Value of Inventories

20. The net realisable value of inventories is determined by reference to selling prices and related costs to complete and sell the inventories. An enterprise will reverse a write-down to net realisable value in a subsequent interim period as it would at the end of its financial year.

Foreign Currency Translation Gains and Losses

21. Foreign currency translation gains and losses are measured for interim financial reporting by the same principles as at financial year end in accordance with the principles as stipulated in AS 11 on *The Effects of Changes in Foreign Exchange Rates.*

Impairment of Assets

22. Accounting Standard (AS) 28, *Impairment of Assets* requires that an impairment loss be recognised if the recoverable amount has declined below carrying amount.

23. An enterprise applies the same impairment tests, recognition, and reversal criteria at an interim date as it would at the end of its financial year. That does not mean, however, that an enterprise must necessarily make a detailed impairment calculation at the end of each interim period. Rather, an enterprise will assess the indications of significant impairment since the end of the most recent financial year to determine whether such a calculation is needed.

Illustration 4

Examples of the Use of Estimates

This illustration which does not form part of the Accounting Standard, illustrates application of the principles in this Standard. Its purpose is to illustrate the application of the Accounting Standard to assist in clarifying its meaning.

1. **Provisions:** Determination of the appropriate amount of a provision (such as a provision for warranties, restructuring costs, gratuity, etc.) may be complex and often costly and time-consuming. Enterprises sometimes engage outside experts to assist in annual calculations. Making similar estimates at interim dates often involves updating the provision made in the preceding annual financial statements rather than engaging outside experts to do a new calculation.

2. **Contingencies:** Measurement of contingencies may involve obtaining opinions of legal experts or other advisers. Formal reports from independent experts are sometimes obtained with respect to contingencies. Such opinions about litigation, claims, assessments, and other contingencies and uncertainties may or may not be needed at interim dates.

3. **Specialised industries:** Because of complexity, costliness, and time involvement, interim period measurements in specialised industries might be less precise than at financial year end. An example is calculation of insurance reserves by insurance companies.

Accounting Standard (AS) 26

Intangible Assets

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the General Instructions contained in part A of the Annexure to the Notification.)*

Objective

The objective of this Standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Accounting Standard. This Standard requires an enterprise to recognise an intangible asset if, and only if, certain criteria are met. The Standard also specifies how to measure the carrying amount of intangible assets and requires certain disclosures about intangible assets.

Scope

1. This Standard should be applied by all enterprises in accounting for intangible assets, except:

(a) intangible assets that are covered by another Accounting Standard;

(b) financial assets[37];

(c) mineral rights and expenditure on the exploration for, or development and extraction of, minerals, oil, natural gas and similar non-regenerative resources; and

(d) intangible assets arising in insurance enterprises from contracts with policyholders.

This Standard should not be applied to expenditure in respect of termination benefits[38] also.

2. If another Accounting Standard deals with a specific type of intangible asset, an enterprise applies that Accounting Standard instead of this Standard. For example, this Standard does not apply to:

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[37] A financial asset is any asset that is:

(a) cash;
(b) a contractual right to receive cash or another financial asset from another enterprise;
(c) a contractual right to exchange financial instruments with another enterprise under conditions that are potentially favourable; or
(d) an ownership interest in another enterprise.

[38] Termination benefits are employee benefits payable as a result of either:

(a) an enterprise's decision to terminate an employee's employment before the normal retirement date; or
(b) an employee's decision to accept voluntary redundancy in exchange for those benefits (voluntary retirement).

(a) intangible assets held by an enterprise for sale in the ordinary course of business (see AS 2, *Valuation of Inventories*, and AS 7, *Construction Contracts*);

(b) deferred tax assets (see AS 22, *Accounting for Taxes on Income*);

(c) leases that fall within the scope of AS 19, *Leases*; and

(d) goodwill arising on an amalgamation (see AS 14, *Accounting for Amalgamations*) and goodwill arising on consolidation (see AS 21, *Consolidated Financial Statements*).

3. This Standard applies to, among other things, expenditure on advertising, training, start-up, research and development activities. Research and development activities are directed to the development of knowledge. Therefore, although these activities may result in an asset with physical substance (for example, a prototype), the physical element of the asset is secondary to its intangible component, that is the knowledge embodied in it. This Standard also applies to rights under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights. These items are excluded from the scope of AS 19.

4. In the case of a finance lease, the underlying asset may be either tangible or intangible. After initial recognition, a lessee deals with an intangible asset held under a finance lease under this Standard.

5. Exclusions from the scope of an Accounting Standard may occur if certain activities or transactions are so specialised that they give rise to accounting issues that may need to be dealt with in a different way. Such issues arise in the expenditure on the exploration for, or development and extraction of, oil, gas and mineral deposits in extractive industries and in the case of contracts between insurance enterprises and their policyholders. Therefore, this Standard does not apply to expenditure on such activities. However, this Standard applies to other intangible assets used (such as computer software), and other expenditure (such as start-up costs), in extractive industries or by insurance enterprises. Accounting issues of specialised nature also arise in respect of accounting for discount or premium relating to borrowings and ancillary costs incurred in connection with the arrangement of borrowings, share issue expenses and discount allowed on the issue of shares. Accordingly, this Standard does not apply to such items also.

Definitions

6. The following terms are used in this Standard with the meanings specified:

6.1 An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

6.2 An asset is a resource:

(a) controlled by an enterprise as a result of past events; and

(b) from which future economic benefits are expected to flow to the enterprise.

6.3 Monetary assets are money held and assets to be received in fixed or determinable amounts of money.

6.4 Non-monetary assets are assets other than monetary assets.

6.5 Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

6.6 Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

6.7 Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

6.8 Depreciable amount is the cost of an asset less its residual value.

6.9 Useful life is either:

(a) the period of time over which an asset is expected to be used by the enterprise; or

(b) the number of production or similar units expected to be obtained from the asset by the enterprise.

6.10. Residual value is the amount which an enterprise expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.

6.11. Fair value of an asset is the amount for which that asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

6.12. An active market is a market where all the following conditions exist:

(a) the items traded within the market are homogeneous;

(b) willing buyers and sellers can normally be found at any time; and

(c) prices are available to the public.

6.13. An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount (see AS 28, Impairment of Assets).

6.14. Carrying amount is the amount at which an asset is recognised in the balance sheet, net of any accumulated amortisation and accumulated impairment losses thereon.

Intangible Assets

7. Enterprises frequently expend resources, or incur liabilities, on the acquisition, development, maintenance or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new processes or systems, licences, intellectual property, market knowledge and trademarks (including brand names and publishing titles). Common examples of items encompassed by these broad headings are computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, fishing licences, import quotas, franchises, customer or supplier relationships, customer loyalty, market share and marketing rights. Goodwill is another example of an item of intangible nature which either arises on acquisition or is internally generated.

8. Not all the items described in paragraph 7 will meet the definition of an intangible asset, that is, identifiability, control over a resource and expectation of future economic benefits flowing to the enterprise. If an item covered by this Standard does not meet the definition of

an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. However, if the item is acquired in an amalgamation in the nature of purchase, it forms part of the goodwill recognised at the date of the amalgamation (see paragraph 55).

9. Some intangible assets may be contained in or on a physical substance such as a compact disk (in the case of computer software), legal documentation (in the case of a licence or patent) or film (in the case of motion pictures). The cost of the physical substance containing the intangible assets is usually not significant. Accordingly, the physical substance containing an intangible asset, though tangible in nature, is commonly treated as a part of the intangible asset contained in or on it.

10. In some cases, an asset may incorporate both intangible and tangible elements that are, in practice, inseparable. In determining whether such an asset should be treated under AS 10, *Property, Plant and Equipment*, or as an intangible asset under this Standard, judgement is required to assess as to which element is predominant. For example, computer software for a computer controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as a fixed asset. The same applies to the operating system of a computer. Where the software is not an integral part of the related hardware, computer software is treated as an intangible asset.

Identifiability

11. The definition of an intangible asset requires that an intangible asset be identifiable. To be identifiable, it is necessary that the intangible asset is clearly distinguished from goodwill. Goodwill arising on an amalgamation in the nature of purchase represents a payment made by the acquirer in anticipation of future economic benefits. The future economic benefits may result from synergy between the identifiable assets acquired or from assets which, individually, do not qualify for recognition in the financial statements but for which the acquirer is prepared to make a payment in the amalgamation.

12. An intangible asset can be clearly distinguished from goodwill if the asset is separable. An asset is separable if the enterprise could rent, sell, exchange or distribute the specific future economic benefits attributable to the asset without also disposing of future economic benefits that flow from other assets used in the same revenue earning activity.

13. Separability is not a necessary condition for identifiability since an enterprise may be able to identify an asset in some other way. For example, if an intangible asset is acquired with a group of assets, the transaction may involve the transfer of legal rights that enable an enterprise to identify the intangible asset. Similarly, if an internal project aims to create legal rights for the enterprise, the nature of these rights may assist the enterprise in identifying an underlying internally generated intangible asset. Also, even if an asset generates future economic benefits only in combination with other assets, the asset is identifiable if the enterprise can identify the future economic benefits that will flow from the asset.

Control

14. An enterprise controls an asset if the enterprise has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits. The capacity of an enterprise to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control since an enterprise may be able to control the future economic benefits in some other way.

15. Market and technical knowledge may give rise to future economic benefits. An

enterprise controls those benefits if, for example, the knowledge is protected by legal rights such as copyrights, a restraint of trade agreement (where permitted) or by a legal duty on employees to maintain confidentiality.

16. An enterprise may have a team of skilled staff and may be able to identify incremental staff skills leading to future economic benefits from training. The enterprise may also expect that the staff will continue to make their skills available to the enterprise. However, usually an enterprise has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training to consider that these items meet the definition of an intangible asset. For a similar reason, specific management or technical talent is unlikely to meet the definition of an intangible asset, unless it is protected by legal rights to use it and to obtain the future economic benefits expected from it, and it also meets the other parts of the definition.

17. An enterprise may have a portfolio of customers or a market share and expect that, due to its efforts in building customer relationships and loyalty, the customers will continue to trade with the enterprise. However, in the absence of legal rights to protect, or other ways to control, the relationships with customers or the loyalty of the customers to the enterprise, the enterprise usually has insufficient control over the economic benefits from customer relationships and loyalty to consider that such items (portfolio of customers, market shares, customer relationships, customer loyalty) meet the definition of intangible assets.

Future Economic Benefits

18. The future economic benefits flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the enterprise. For example, the use of intellectual property in a production process may reduce future production costs rather than increase future revenues.

Recognition and Initial Measurement of an Intangible Asset

19. The recognition of an item as an intangible asset requires an enterprise to demonstrate that the item meets the:

(a) definition of an intangible asset (see paragraphs 6-18); and

(b) recognition criteria set out in this Standard (see paragraphs 20-54).

20. An intangible asset should be recognised if, and only if:

(a) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and

(b) the cost of the asset can be measured reliably.

21. An enterprise should assess the probability of future economic benefits using reasonable and supportable assumptions that represent best estimate of the set of economic conditions that will exist over the useful life of the asset.

22. An enterprise uses judgement to assess the degree of certainty attached to the flow of future economic benefits that are attributable to the use of the asset on the basis of the evidence available at the time of initial recognition, giving greater weight to external evidence.

23. An intangible asset should be measured initially at cost.

Separate Acquisition

24. If an intangible asset is acquired separately, the cost of the intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

25. The cost of an intangible asset comprises its purchase price, including any import duties and other taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), and any directly attributable expenditure on making the asset ready for its intended use. Directly attributable expenditure includes, for example, professional fees for legal services. Any trade discounts and rebates are deducted in arriving at the cost.

26. If an intangible asset is acquired in exchange for shares or other securities of the reporting enterprise, the asset is recorded at its fair value, or the fair value of the securities issued, whichever is more clearly evident.

Acquisition as Part of an Amalgamation

27. An intangible asset acquired in an amalgamation in the nature of purchase is accounted for in accordance with Accounting Standard (AS) 14, *Accounting for Amalgamations*. Where in preparing the financial statements of the transferee company, the consideration is allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation, paragraphs 28 to 32 of this Standard need to be considered.

28. Judgement is required to determine whether the cost (i.e. fair value) of an intangible asset acquired in an amalgamation can be measured with sufficient reliability for the purpose of separate recognition. Quoted market prices in an active market provide the most reliable measurement of fair value. The appropriate market price is usually the current bid price. If current bid prices are unavailable, the price of the most recent similar transaction may provide a basis from which to estimate fair value, provided that there has not been a significant change in economic circumstances between the transaction date and the date at which the asset's fair value is estimated.

29. If no active market exists for an asset, its cost reflects the amount that the enterprise would have paid, at the date of the acquisition, for the asset in an arm's length transaction between knowledgeable and willing parties, based on the best information available. In determining this amount, an enterprise considers the outcome of recent transactions for similar assets.

30. Certain enterprises that are regularly involved in the purchase and sale of unique intangible assets have developed techniques for estimating their fair values indirectly. These techniques may be used for initial measurement of an intangible asset acquired in an amalgamation in the nature of purchase if their objective is to estimate fair value as defined in this Standard and if they reflect current transactions and practices in the industry to which the asset belongs. These techniques include, where appropriate, applying multiples reflecting current market transactions to certain indicators driving the profitability of the asset (such as revenue, market shares, operating profit, etc.) or discounting estimated future net cash flows from the asset.

31. In accordance with this Standard:

(a) a transferee recognises an intangible asset that meets the recognition criteria in paragraphs 20 and 21, even if that intangible asset had not been recognised in the financial statements of the transferor; and

(b) if the cost (i.e. fair value) of an intangible asset acquired as part of an amalgamation in the nature of purchase cannot be measured reliably, that asset is not recognised as a separate intangible asset but is included in goodwill (see paragraph 55).

32. Unless there is an active market for an intangible asset acquired in an amalgamation in the nature of purchase, the cost initially recognised for the intangible asset is restricted to an amount that does not create or increase any capital reserve arising at the date of the amalgamation.

Acquisition by way of a Government Grant

33. In some cases, an intangible asset may be acquired free of charge, or for nominal consideration, by way of a government grant. This may occur when a government transfers or allocates to an enterprise intangible assets such as airport landing rights, licences to operate radio or television stations, import licences or quotas or rights to access other restricted resources. AS 12, *Accounting for Government Grants*, requires that government grants in the form of non-monetary assets, given at a concessional rate should be accounted for on the basis of their acquisition cost. AS 12 also requires that in case a non-monetary asset is given free of cost, it should be recorded at a nominal value. Accordingly, intangible asset acquired free of charge, or for nominal consideration, by way of government grant is recognised at a nominal value or at the acquisition cost, as appropriate; any expenditure that is directly attributable to making the asset ready for its intended use is also included in the cost of the asset.

Exchanges of Assets

34. An intangible asset may be acquired in exchange or part exchange for another asset. In such a case, the cost of the asset acquired is determined in accordance with the principles laid down in this regard in AS 10, *Property, Plant and Equipment*.

Internally Generated Goodwill

35. Internally generated goodwill should not be recognised as an asset.

36. In some cases, expenditure is incurred to generate future economic benefits, but it does not result in the creation of an intangible asset that meets the recognition criteria in this Standard. Such expenditure is often described as contributing to internally generated goodwill. Internally generated goodwill is not recognised as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost.

37. Differences between the market value of an enterprise and the carrying amount of its identifiable net assets at any point in time may be due to a range of factors that affect the value of the enterprise. However, such differences cannot be considered to represent the cost of intangible assets controlled by the enterprise.

Internally Generated Intangible Assets

38. It is sometimes difficult to assess whether an internally generated intangible asset qualifies for recognition. It is often difficult to:

(a) identify whether, and the point of time when, there is an identifiable asset that will generate probable future economic benefits; and

(b) determine the cost of the asset reliably. In some cases, the cost of

generating an intangible asset internally cannot be distinguished from the cost of maintaining or enhancing the enterprise's internally generated goodwill or of running day-to- day operations.

Therefore, in addition to complying with the general requirements for the recognition and initial measurement of an intangible asset, an enterprise applies the requirements and guidance in paragraphs 39-54 below to all internally generated intangible assets.

39. To assess whether an internally generated intangible asset meets the criteria for recognition, an enterprise classifies the generation of the asset into:

(a) a research phase; and

(b) a development phase.

Although the terms 'research' and 'development' are defined, the terms 'research phase' and 'development phase' have a broader meaning for the purpose of this Standard.

40. If an enterprise cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the enterprise treats the expenditure on that project as if it were incurred in the research phase only.

Research Phase

41. No intangible asset arising from research (or from the research phase of an internal project) should be recognised. Expenditure on research (or on the research phase of an internal project) should be recognised as an expense when it is incurred.

42. This Standard takes the view that, in the research phase of a project, an enterprise cannot demonstrate that an intangible asset exists from which future economic benefits are probable. Therefore, this expenditure is recognised as an expense when it is incurred.

43. Examples of research activities are:

(a) activities aimed at obtaining new knowledge;

(b) the search for, evaluation and final selection of, applications of research findings or other knowledge;

(c) the search for alternatives for materials, devices, products, processes, systems or services; and

(d) the formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.

Development Phase

44. An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an enterprise can demonstrate all of the following:

(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale;

(b) its intention to complete the intangible asset and use or sell it;

(c) its ability to use or sell the intangible asset;

(d) how the intangible asset will generate probable future economic benefits.

Among other things, the enterprise should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;

(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and

(f) its ability to measure the expenditure attributable to the intangible asset during its development reliably.

45. In the development phase of a project, an enterprise can, in some instances, identify an intangible asset and demonstrate that future economic benefits from the asset are probable. This is because the development phase of a project is further advanced than the research phase.

46. Examples of development activities are:

(a) the design, construction and testing of pre-production or pre-use prototypes and models;

(b) the design of tools, jigs, moulds and dies involving new technology;

(c) the design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production; and

(d) the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.

47. To demonstrate how an intangible asset will generate probable future economic benefits, an enterprise assesses the future economic benefits to be received from the asset using the principles in Accounting Standard (AS) 28, *Impairment of Assets*. If the asset will generate economic benefits only in combination with other assets, the enterprise applies the concept of cash- generating units as set out in (AS) 28.

48. Availability of resources to complete, use and obtain the benefits from an intangible asset can be demonstrated by, for example, a business plan showing the technical, financial and other resources needed and the enterprise's ability to secure those resources. In certain cases, an enterprise demonstrates the availability of external finance by obtaining a lender's indication of its willingness to fund the plan.

49. An enterprise's costing systems can often measure reliably the cost of generating an intangible asset internally, such as salary and other expenditure incurred in securing copyrights or licences or developing computer software.

50. Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognised as intangible assets.

51. This Standard takes the view that expenditure on internally generated brands, mastheads, publishing titles, customer lists and items similar in substance cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognised as intangible assets.

Cost of an Internally Generated Intangible Asset

52. The cost of an internally generated intangible asset for the purpose of paragraph 23 is the sum of expenditure incurred from the time when the intangible asset first meets the recognition criteria in paragraphs 20-21 and 44. Paragraph 58 prohibits reinstatement of expenditure recognised as an expense in previous annual financial statements or interim financial reports.

53. The cost of an internally generated intangible asset comprises all expenditure that can be directly attributed, or allocated on a reasonable and consistent basis, to creating, producing and making the asset ready for its intended use. The cost includes, if applicable:

(a) expenditure on materials and services used or consumed in generating the intangible asset;

(b) the salaries, wages and other employment related costs of personnel directly engaged in generating the asset;

(c) any expenditure that is directly attributable to generating the asset, such as fees to register a legal right and the amortisation of patents and licences that are used to generate the asset; and

(d) overheads that are necessary to generate the asset and that can be allocated on a reasonable and consistent basis to the asset (for example, an allocation of the depreciation of fixed assets, insurance premium and rent). Allocations of overheads are made on bases similar to those used in allocating overheads to inventories (see AS 2, *Valuation of Inventories*). AS 16, *Borrowing Costs*, establishes criteria for the recognition of interest as a component of the cost of a qualifying asset. These criteria are also applied for the recognition of interest as a component of the cost of an internally generated intangible asset.

54. The following are not components of the cost of an internally generated intangible asset:

(a) selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to making the asset ready for use;

(b) clearly identified inefficiencies and initial operating losses incurred before an asset achieves planned performance; and

(c) expenditure on training the staff to operate the asset.

Example Illustrating Paragraph 52

An enterprise is developing a new production process. During the year 20X1, expenditure incurred was Rs. 10 lakhs, of which Rs. 9 lakhs was incurred before 1 December 20X1 and 1 lakh was incurred between 1 December 20X1 and 31 December 20X1. The enterprise is able to demonstrate that, at 1 December 20X1, the production process met the criteria for recognition as an intangible asset. The recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be Rs. 5 lakhs.

At the end of 20X1, the production process is recognised as an intangible asset at a cost of Rs. 1 lakh (expenditure incurred since the date when the recognition criteria were met, that is, 1 December 20X1). Rs. 9 lakhs expenditure incurred before 1 December 20X1 is recognised as an expense because the recognition criteria were not met until 1 December 20X1. This expenditure will never form part of the cost of the production process recognised in the balance sheet.

During the year 20X2, expenditure incurred is Rs. 20 lakhs. At the end of 20X2, the recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be Rs. 19 lakhs.

At the end of the year 20X2, the cost of the production process is Rs. 21 lakhs (Rs. 1 lakh expenditure recognised at the end of 20X1 plus Rs. 20 lakhs expenditure recognised in 20X2). The enterprise recognises an impairment loss of Rs. 2 lakhs to adjust the carrying amount of the process before impairment loss (Rs. 21 lakhs) to its recoverable amount (Rs. 19 lakhs). This impairment loss will be reversed in a subsequent period if the requirements for the reversal of an impairment loss in AS 28 are met.

Recognition of an Expense

55. Expenditure on an intangible item should be recognised as an expense when it is incurred unless:

(a) it forms part of the cost of an intangible asset that meets the recognition criteria (see paragraphs 19-54); or

(b) the item is acquired in an amalgamation in the nature of purchase and cannot be recognised as an intangible asset. If this is the case, this expenditure (included in the cost of acquisition) should form part of the amount attributed to goodwill (capital reserve) at the date of acquisition (see AS 14, Accounting for Amalgamations).

56. In some cases, expenditure is incurred to provide future economic benefits to an enterprise, but no intangible asset or other asset is acquired or created that can be recognised. In these cases, the expenditure is recognised as an expense when it is incurred. For example, expenditure on research is always recognised as an expense when it is incurred (see paragraph 41). Examples of other expenditure that is recognised as an expense when it is incurred include:

(a) expenditure on start-up activities (start-up costs), unless this expenditure is included in the cost of an item of fixed asset under AS 10. Start-up costs may consist of preliminary expenses incurred in establishing a legal entity such as legal and secretarial costs, expenditure to open a new facility or business (pre-opening costs) or expenditures for commencing new operations or launching new products or processes (pre-operating costs);

(b) expenditure on training activities;

(c) expenditure on advertising and promotional activities; and

(d) expenditure on relocating or re-organising part or all of an enterprise.

57. Paragraph 55 does not apply to payments for the delivery of goods or services made in advance of the delivery of goods or the rendering of services. Such prepayments are recognised as assets.

Past Expenses not to be Recognised as an Asset

58. Expenditure on an intangible item that was initially recognised as an expense by a reporting enterprise in previous annual financial statements or interim financial reports should not be recognised as part of the cost of an intangible asset at a later date.

Subsequent Expenditure

59. Subsequent expenditure on an intangible asset after its purchase or its completion should be recognised as an expense when it is incurred unless:

(a) it is probable that the expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and

(b) the expenditure can be measured and attributed to the asset reliably.

If these conditions are met, the subsequent expenditure should be added to the cost of the intangible asset.

60. Subsequent expenditure on a recognised intangible asset is recognised as an expense if this expenditure is required to maintain the asset at its originally assessed standard of performance. The nature of intangible assets is such that, in many cases, it is not possible to determine whether subsequent expenditure is likely to enhance or maintain the economic benefits that will flow to the enterprise from those assets. In addition, it is often difficult to attribute such expenditure directly to a particular intangible asset rather than the business as a whole. Therefore, only rarely will expenditure incurred after the initial recognition of a purchased intangible asset or after completion of an internally generated intangible asset result in additions to the cost of the intangible asset.

61. Consistent with paragraph 50, subsequent expenditure on brands, mastheads, publishing titles, customer lists and items similar in substance (whether externally purchased or internally generated) is always recognised as an expense to avoid the recognition of internally generated goodwill.

Measurement Subsequent to Initial Recognition

62. After initial recognition, an intangible asset should be carried at its cost less any accumulated amortisation and any accumulated impairment losses.

Amortisation

Amortisation Period

63. The depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortisation should commence when the asset is available for use.

64. As the future economic benefits embodied in an intangible asset are consumed over time, the carrying amount of the asset is reduced to reflect that consumption. This is achieved by systematic allocation of the cost of the asset, less any residual value, as an expense over the asset's useful life. Amortisation is recognised whether or not there has been an increase in, for example, the asset's fair value or recoverable amount. Many factors need to be considered in determining the useful life of an intangible asset including:

(a) the expected usage of the asset by the enterprise and whether the asset could be efficiently managed by another management team;

(b) typical product life cycles for the asset and public information on estimates of useful lives of similar types of assets that are used in a similar way;

(c) technical, technological or other types of obsolescence;

(d) the stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;

(e) expected actions by competitors or potential competitors;

(f) the level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the company's ability and intent to reach such a level;

(g) the period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and

(h) whether the useful life of the asset is dependent on the useful life of other assets of the enterprise.

65. Given the history of rapid changes in technology, computer software and many other intangible assets are susceptible to technological obsolescence. Therefore, it is likely that their useful life will be short.

66. Estimates of the useful life of an intangible asset generally become less reliable as the length of the useful life increases. This Standard adopts a presumption that the useful life of intangible assets is unlikely to exceed ten years.

67. In some cases, there may be persuasive evidence that the useful life of an intangible asset will be a specific period longer than ten years. In these cases, the presumption that the useful life generally does not exceed ten years is rebutted and the enterprise:

(a) amortises the intangible asset over the best estimate of its useful life;

(b) estimates the recoverable amount of the intangible asset at least annually in order to identify any impairment loss (see paragraph 83); and

(c) discloses the reasons why the presumption is rebutted and the factor(s) that played a significant role in determining the useful life of the asset (see paragraph 94(a)).

Examples

A. An enterprise has purchased an exclusive right to generate hydro-electric power for sixty years. The costs of generating hydroelectric power are much lower than the costs of obtaining power from alternative sources. It is expected that the geographical area surrounding the power station will demand a significant amount of power from the power station for at least sixty years.

The enterprise amortises the right to generate power over sixty years, unless there is evidence that its useful life is shorter.

B. An enterprise has purchased an exclusive right to operate a toll motorway for thirty years. There is no plan to construct alternative routes in the area served by the motorway. It is expected that this motorway will be in use for at least thirty years.

The enterprise amortises the right to operate the motorway over thirty years, unless there is evidence that its useful life is shorter.

68. The useful life of an intangible asset may be very long but it is always finite. Uncertainty justifies estimating the useful life of an intangible asset on a prudent basis, but it does not justify choosing a life that is unrealistically short.

69. If control over the future economic benefits from an intangible asset is achieved through legal rights that have been granted for a finite period, the useful life of the intangible asset should not exceed the period of the legal rights unless:

(a) the legal rights are renewable; and

(b) renewal is virtually certain.

70. There may be both economic and legal factors influencing the useful life of an intangible asset: economic factors determine the period over which future economic benefits will be generated; legal factors may restrict the period over which the enterprise controls access to these benefits. The useful life is the shorter of the periods determined by these factors.

71. The following factors, among others, indicate that renewal of a legal right is virtually certain:

(a) the fair value of the intangible asset is not expected to reduce as the initial expiry date approaches, or is not expected to reduce by more than the cost of renewing the underlying right;

(b) there is evidence (possibly based on past experience) that the legal rights will be renewed; and

(c) there is evidence that the conditions necessary to obtain the renewal of the legal right (if any) will be satisfied.

Amortisation Method

72. The amortisation method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise. If that pattern cannot be determined reliably, the straight-line method should be used. The amortisation charge for each period should be recognised as an expense unless another Accounting Standard permits or requires it to be included in the carrying amount of another asset.

73. A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the unit of production method. The method used for an asset is selected based on the expected pattern of consumption of economic benefits and is consistently applied from period to period, unless there is a change in the expected pattern of consumption of economic benefits to be derived from that asset. There will rarely, if ever, be persuasive evidence to support an amortisation method for intangible assets that results in a lower amount of accumulated amortisation than under the straight-line method.

74. Amortisation is usually recognised as an expense. However, sometimes, the economic benefits embodied in an asset are absorbed by the enterprise in producing other assets rather than giving rise to an expense. In these cases, the amortisation charge forms part of the cost of the other asset and is included in its carrying amount. For example, the amortisation of intangible assets used in a production process is included in the carrying amount of inventories (see AS 2, *Valuation of Inventories*).

Residual Value

75. The residual value of an intangible asset should be assumed to be zero unless:

(a) there is a commitment by a third party to purchase the asset at the end of its useful

life; or

(b) there is an active market for the asset and:
(i) residual value can be determined by reference to that market; and

(ii) it is probable that such a market will exist at the end of the asset's useful life.

76. A residual value other than zero implies that an enterprise expects to dispose of the intangible asset before the end of its economic life.

77. The residual value is estimated using prices prevailing at the date of acquisition of the asset, for the sale of a similar asset that has reached the end of its estimated useful life and that has operated under conditions similar to those in which the asset will be used. The residual value is not subsequently increased for changes in prices or value.

Review of Amortisation Period and Amortisation Method

78. The amortisation period and the amortisation method should be reviewed at least at each financial year end. If the expected useful life of the asset is significantly different from previous estimates, the amortisation period should be changed accordingly. If there has been a significant change in the expected pattern of economic benefits from the asset, the amortisation method should be changed to reflect the changed pattern. Such changes should be accounted for in accordance with AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

79. During the life of an intangible asset, it may become apparent that the estimate of its useful life is inappropriate. For example, the useful life may be extended by subsequent expenditure that improves the condition of the asset beyond its originally assessed standard of performance. Also, the recognition of an impairment loss may indicate that the amortisation period needs to be changed.

80. Over time, the pattern of future economic benefits expected to flow to an enterprise from an intangible asset may change. For example, it may become apparent that a diminishing balance method of amortisation is appropriate rather than a straight-line method. Another example is if use of the rights represented by a licence is deferred pending action on other components of the business plan. In this case, economic benefits that flow from the asset may not be received until later periods.

Recoverability of the Carrying Amount — Impairment Losses

81. To determine whether an intangible asset is impaired, an enterprise applies AS 28. That Standard explains how an enterprise reviews the carrying amount of its assets, how it determines the recoverable amount of an asset and when it recognises or reverses an impairment loss.

82. If an impairment loss occurs before the end of the first annual accounting period commencing after acquisition for an intangible asset acquired in an amalgamation in the nature of purchase, the impairment loss is recognised as an adjustment to both the amount assigned to the intangible asset and the goodwill (capital reserve) recognised at the date of the amalgamation. However, if the impairment loss relates to specific events or changes in circumstances occurring after the date of acquisition, the impairment loss is recognised under AS 28 and not as an adjustment to the amount assigned to the goodwill (capital reserve) recognised at the date of acquisition.

83. In addition to the requirements of AS 28, an enterprise should estimate the recoverable amount of the following intangible assets at least at each financial year end even if there is no indication that the asset is impaired:

(a) an intangible asset that is not yet available for use; and

(b) an intangible asset that is amortised over a period exceeding ten years from the date when the asset is available for use.

The recoverable amount should be determined under AS 28 and impairment losses recognised accordingly.

84. The ability of an intangible asset to generate sufficient future economic benefits to recover its cost is usually subject to great uncertainty until the asset is available for use. Therefore, this Standard requires an enterprise to test for impairment, at least annually, the carrying amount of an intangible asset that is not yet available for use.

85. It is sometimes difficult to identify whether an intangible asset may be impaired because, among other things, there is not necessarily any obvious evidence of obsolescence. This difficulty arises particularly if the asset has a long useful life. As a consequence, this Standard requires, as a minimum, an annual calculation of the recoverable amount of an intangible asset if its useful life exceeds ten years from the date when it becomes available for use.

86. The requirement for an annual impairment test of an intangible asset applies whenever the current total estimated useful life of the asset exceeds ten years from when it became available for use. Therefore, if the useful life of an intangible asset was estimated to be less than ten years at initial recognition, but the useful life is extended by subsequent expenditure to exceed ten years from when the asset became available for use, an enterprise performs the impairment test required under paragraph 83(b) and also makes the disclosure required under paragraph 94(a).

Retirements and Disposals

87. An intangible asset should be derecognised (eliminated from the balance sheet) on disposal or when no future economic benefits are expected from its use and subsequent disposal.

88. Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the statement of profit and loss.

89. An intangible asset that is retired from active use and held for disposal is carried at its carrying amount at the date when the asset is retired from active use. At least at each financial year end, an enterprise tests the asset for impairment under AS 28, and recognises any impairment loss accordingly.

Disclosure

General

90. The financial statements should disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:

(a) the useful lives or the amortisation rates used;

(b) the amortisation methods used;

(c) the gross carrying amount and the accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period;

(d) a reconciliation of the carrying amount at the beginning and end of the period showing:

(i) additions, indicating separately those from internal development and through amalgamation;

(ii) retirements and disposals;

(iii) impairment losses recognised in the statement of profit and loss during the period (if any);

(iv) impairment losses reversed in the statement of profit and loss during the period (if any);

(v) amortisation recognised during the period; and

(vi) other changes in the carrying amount during the period.

91. A class of intangible assets is a grouping of assets of a similar nature and use in an enterprise's operations. Examples of separate classes may include:

(a) brand names;

(b) mastheads and publishing titles;

(c) computer software;

(d) licences and franchises;

(e) copyrights, and patents and other industrial property rights, service and operating rights;

(f) recipes, formulae, models, designs and prototypes; and

(g) intangible assets under development.

The classes mentioned above are disaggregated (aggregated) into smaller (larger) classes if this results in more relevant information for the users of the financial statements.

92. An enterprise discloses information on impaired intangible assets under AS 28 in addition to the information required by paragraph 90(d)(iii) and (iv).

93. An enterprise discloses the change in an accounting estimate or accounting policy such as that arising from changes in the amortisation method, the amortisation period or estimated residual values, in accordance with AS 5, *Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.*

94. The financial statements should also disclose:

(a) if an intangible asset is amortised over more than ten years, the reasons why it is

presumed that the useful life of an intangible asset will exceed ten years from the date when the asset is available for use. In giving these reasons, the enterprise should describe the factor(s) that played a significant role in determining the useful life of the asset;

(b) a description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the financial statements of the enterprise as a whole;

(c) the existence and carrying amounts of intangible assets whose title is restricted and the carrying amounts of intangible assets pledged as security for liabilities; and

(d) the amount of commitments for the acquisition of intangible assets.

95. When an enterprise describes the factor(s) that played a significant role in determining the useful life of an intangible asset that is amortised over more than ten years, the enterprise considers the list of factors in paragraph 64.

Research and Development Expenditure

96. The financial statements should disclose the aggregate amount of research and development expenditure recognised as an expense during the period.

97. Research and development expenditure comprises all expenditure that is directly attributable to research or development activities or that can be allocated on a reasonable and consistent basis to such activities (see paragraphs 53-54 for guidance on the type of expenditure to be included for the purpose of the disclosure requirement in paragraph 96).

Other Information

98. An enterprise is encouraged, but not required, to give a description of any fully amortised intangible asset that is still in use.

Transitional Provisions[39]

99. Where, on the date of this Standard coming into effect, an enterprise is following an accounting policy of not amortising an intangible item or amortising an intangible item over a period longer than the period determined under paragraph 63 of this Standard and the period determined under paragraph 63 has expired on the date of this Standard coming into effect, the carrying amount appearing in the balance sheet in respect of that item should be eliminated with a corresponding adjustment to the opening balance of revenue reserves.

In the event the period determined under paragraph 63 has not expired on the date of this Standard coming into effect and:

(a) if the enterprise is following an accounting policy of not amortising an intangible item, the carrying amount of the intangible item should be restated, as if the accumulated amortisation had always been determined under this Standard, with the corresponding adjustment to the opening balance of revenue reserves. The restated carrying amount should be amortised over the balance of the period as determined

[39] Transitional Provisions given in Paragraphs 99-100 are relevant only for standards notified under Companies (Accounting Standards) Rules, 2006, as amended from time to time.

in paragraph 63.

(b) if the remaining period as per the accounting policy followed by the enterprise:

(i) is shorter as compared to the balance of the period determined under paragraph 63, the carrying amount of the intangible item should be amortised over the remaining period as per the accounting policy followed by the enterprise,

(ii) is longer as compared to the balance of the period determined under paragraph 63, the carrying amount of the intangible item should be restated, as if the accumulated amortisation had always been determined under this Standard, with the corresponding adjustment to the opening balance of revenue reserves. The restated carrying amount should be amortised over the balance of the period as determined in paragraph 63.

100. Illustration B attached to the Standard illustrates the application of paragraph 99.

Illustration A

This illustration which does not form part of the Accounting Standard, provides illustrative application of the principles laid down in the Standard to internal use software and web-site costs. Its purpose is to illustrate the application of the Accounting Standard to assist in clarifying its meaning.

I. Illustrative Application of the Accounting Standard to Internal Use Computer Software

Computer software for internal use can be internally generated or acquired.

Internally Generated Computer Software

1. Internally generated computer software for internal use is developed or modified internally by the enterprise solely to meet the needs of the enterprise and at no stage it is planned to sell it.

2. The stages of development of internally generated software may be categorised into the following two phases:

- Preliminary project stage, i.e., the research phase
- Development stage

Preliminary project stage

3. At the preliminary project stage the internally generated software should not be recognised as an asset. Expenditure incurred in the preliminary project stage should be recognised as an expense when it is incurred. The reason for such a treatment is that at this stage of the software project an enterprise cannot demonstrate that an asset exists from which future economic benefits are probable.

4. When a computer software project is in the preliminary project stage, enterprises are likely to:

(a) Make strategic decisions to allocate resources between alternative projects at a given point in time. For example, should programmers develop a new payroll system or direct their efforts toward correcting existing problems in an operating system.

(b) Determine the performance requirements (that is, what it is that they need the software to do) and systems requirements for the computer software project it has proposed to undertake.

(c) Explore alternative means of achieving specified performance requirements. For example, should an entity make or buy the software. Should the software run on a mainframe or a client server system.

(d) Determine that the technology needed to achieve performance requirements exists.

(e) Select a consultant to assist in the development and/or installation of the software.

Development Stage

5. An internally generated software arising at the development stage should be

recognised as an asset if, and only if, an enterprise can demonstrate all of the following:

(a) the technical feasibility of completing the internally generated software so that it will be available for internal use;

(b) the intention of the enterprise to complete the internally generated software and use it to perform the functions intended. For example, the intention to complete the internally generated software can be demonstrated if the enterprise commits to the funding of the software project;

(c) the ability of the enterprise to use the software;

(d) how the software will generate probable future economic benefits. Among other things, the enterprise should demonstrate the usefulness of the software;

(e) the availability of adequate technical, financial and other resources to complete the development and to use the software; and

(f) the ability of the enterprise to measure the expenditure attributable to the software during its development reliably.

6. Examples of development activities in respect of internally generated software include:

(a) Design including detailed program design - which is the process of detail design of computer software that takes product function, feature, and technical requirements to their most detailed, logical form and is ready for coding.

(b) Coding which includes generating detailed instructions in a computer language to carry out the requirements described in the detail program design. The coding of computer software may begin prior to, concurrent with, or subsequent to the completion of the detail program design.

At the end of these stages of the development activity, the enterprise has a working model, which is an operative version of the computer software capable of performing all the major planned functions, and is ready for initial testing ("beta" versions).

(c) Testing which is the process of performing the steps necessary to determine whether the coded computer software product meets function, feature, and technical performance requirements set forth in the product design.

At the end of the testing process, the enterprise has a master version of the internal use software, which is a completed version together with the related user documentation and the training materials.

Cost of internally generated software

7. The cost of an internally generated software is the sum of the expenditure incurred from the time when the software first met the recognition criteria for an intangible asset as stated in paragraphs 20 and 21 of this Standard and paragraph 5 above. An expenditure which did not meet the recognition criteria as aforesaid and expensed in an earlier financial statements should not be reinstated if the recognition criteria are met later.

8. The cost of an internally generated software comprises all expenditure that can be directly attributed or allocated on a reasonable and consistent basis to create the software for its intended use. The cost include:

(a) expenditure on materials and services used or consumed in developing the software;

(b) the salaries, wages and other employment related costs of personnel directly engaged in developing the software;

(c) any expenditure that is directly attributable to generating software; and

(d) overheads that are necessary to generate the software and that can be allocated on a reasonable and consistent basis to the software (For example, an allocation of the depreciation of fixed assets, insurance premium and rent). Allocation of overheads are made on basis similar to those used in allocating the overhead to inventories.

9. The following are not components of the cost of an internally generated software:

(a) selling, administration and other general overhead expenditure unless this expenditure can be directly attributable to the development of the software;

(b) clearly identified inefficiencies and initial operating losses incurred before software achieves the planned performance; and

(c) expenditure on training the staff to use the internally generated software.

Software Acquired for Internal Use

10. The cost of a software acquired for internal use should be recognised as an asset if it meets the recognition criteria prescribed in paragraphs 20 and 21 of this Standard.

11. The cost of a software purchased for internal use comprises its purchase price, including any import duties and other taxes (other than those subsequently recoverable by the enterprise from the taxing authorities) and any directly attributable expenditure on making the software ready for its use. Any trade discounts and rebates are deducted in arriving at the cost. In the determination of cost, matters stated in paragraphs 24 to 34 of the Standard need to be considered, as appropriate.

Subsequent expenditure

12. Enterprises may incur considerable cost in modifying existing software systems. Subsequent expenditure on software after its purchase or its completion should be recognised as an expense when it is incurred unless:

(a) it is probable that the expenditure will enable the software to generate future economic benefits in excess of its originally assessed standards of performance; and

(b) the expenditure can be measured and attributed to the software reliably.

If these conditions are met, the subsequent expenditure should be added to the carrying amount of the software. Costs incurred in order to restore or maintain the future economic benefits that an enterprise can expect from the originally assessed standard of performance of existing software systems is recognised as an expense when, and only when, the restoration or maintenance work is carried out.

Amortisation period

13. The depreciable amount of a software should be allocated on a systematic basis over

the best estimate of its useful life. The amortisation should commence when the software is available for use.

14. As per this Standard, there is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. However, given the history of rapid changes in technology, computer software is susceptible to technological obsolescence. Therefore, it is likely that useful life of the software will be much shorter, say 3 to 5 years.

Amortisation method

15. The amortisation method used should reflect the pattern in which the software's economic benefits are consumed by the enterprise. If that pattern can not be determined reliably, the straight-line method should be used. The amortisation charge for each period should be recognised as an expenditure unless another Accounting Standard permits or requires it to be included in the carrying amount of another asset. For example, the amortisation of a software used in a production process is included in the carrying amount of inventories.

II. Illustrative Application of the Accounting Standard to Web-Site Costs

1. An enterprise may incur internal expenditures when developing, enhancing and maintaining its own web site. The web site may be used for various purposes such as promoting and advertising products and services, providing electronic services, and selling products and services.

2. The stages of a web site's development can be described as follows:

(a) Planning - includes undertaking feasibility studies, defining objectives and specifications, evaluating alternatives and selecting preferences;

(b) Application and Infrastructure Development - includes obtaining a domain name, purchasing and developing hardware and operating software, installing developed applications and stress testing; and

(c) Graphical Design and Content Development - includes designing the appearance of web pages and creating, purchasing, preparing and uploading information, either textual or graphical in nature, on the web site prior to the web site becoming available for use. This information may either be stored in separate databases that are integrated into (or accessed from) the web site or coded directly into the web pages.

3. Once development of a web site has been completed and the web site is available for use, the web site commences an operating stage. During this stage, an enterprise maintains and enhances the applications, infrastructure, graphical design and content of the web site.

4. The expenditures for purchasing, developing, maintaining and enhancing hardware (e.g., web servers, staging servers, production servers and Internet connections) related to a web site are not accounted for under this Standard but are accounted for under AS 10, *Property, Plant and Equipment*. Additionally, when an enterprise incurs an expenditure for having an Internet service provider host the enterprise's web site on it's own servers connected to the Internet, the expenditure is recognised as an expense.

5. An intangible asset is defined in paragraph 6 of this Standard as an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. Paragraph 7 of this Standard provides computer software as a common example of an intangible asset. By analogy, a web

site is another example of an intangible asset. Accordingly, a web site developed by an enterprise for its own use is an internally generated intangible asset that is subject to the requirements of this Standard.

6. An enterprise should apply the requirements of this Standard to an internal expenditure for developing, enhancing and maintaining its own web site. Paragraph 55 of this Standard provides expenditure on an intangible item to be recognised as an expense when incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria in paragraphs 19-54 of the Standard. Paragraph 56 of the Standard requires expenditure on start-up activities to be recognised as an expense when incurred. Developing a web site by an enterprise for its own use is not a start-up activity to the extent that an internally generated intangible asset is created. An enterprise applies the requirements and guidance in paragraphs 39-54 of this Standard to an expenditure incurred for developing its own web site in addition to the general requirements for recognition and initial measurement of an intangible asset. The cost of a web site, as described in paragraphs 52-54 of this Standard, comprises all expenditure that can be directly attributed, or allocated on a reasonable and consistent basis, to creating, producing and preparing the asset for its intended use.

The enterprise should evaluate the nature of each activity for which an expenditure is incurred (e.g., training employees and maintaining the web site) and the web site's stage of development or post-development:

(a) Paragraph 41 of this Standard requires an expenditure on research (or on the research phase of an internal project) to be recognised as an expense when incurred. The examples provided in paragraph 43 of this Standard are similar to the activities undertaken in the Planning stage of a web site's development. Consequently, expenditures incurred in the Planning stage of a web site's development are recognised as an expense when incurred.

(b) Paragraph 44 of this Standard requires an intangible asset arising from the development phase of an internal project to be recognised if an enterprise can demonstrate fulfillment of the six criteria specified. Application and Infrastructure Development and Graphical Design and Content Development stages are similar in nature to the development phase. Therefore, expenditures incurred in these stages should be recognised as an intangible asset if, and only if, in addition to complying with the general requirements for recognition and initial measurement of an intangible asset, an enterprise can demonstrate those items described in paragraph 44 of this Standard. In addition,

(i) an enterprise may be able to demonstrate how its web site will generate probable future economic benefits under paragraph 44(d) by using the principles in AS 28. This includes situations where the web site is developed solely or primarily for promoting and advertising an enterprise's own products and services. Demonstrating how a web site will generate probable future economic benefits under paragraph 44(d) by assessing the economic benefits to be received from the web site and using the principles in AS 28, may be particularly difficult for an enterprise that develops a web site solely or primarily for advertising and promoting its own products and services; information is unlikely to be available for reliably estimating the amount obtainable from the sale of the web site in an arm's length transaction, or the future cash inflows and outflows to be derived from its continuing use and ultimate disposal. In this circumstance, an enterprise determines the future economic benefits of the cash-generating unit to which the web site belongs, if it does not belong to one. If the web site is considered a corporate asset (one that does not generate cash inflows independently from other assets and their carrying amount cannot be fully attributed to a cash- generating unit), then an enterprise applies the 'bottom-up' test

and/or the 'top-down' test under AS 28.

(ii) an enterprise may incur an expenditure to enable use of content, which had been purchased or created for another purpose, on its web site (e.g., acquiring a license to reproduce information) or may purchase or create content specifically for use on its web site prior to the web site becoming available for use. In such circumstances, an enterprise should determine whether a separate asset, is identifiable with respect to such content (e.g., copyrights and licenses), and if a separate asset is not identifiable, then the expenditure should be included in the cost of developing the web site when the expenditure meets the conditions in paragraph 44 of this Standard. As per paragraph 20 of this Standard, an intangible asset is recognised if, and only if, it meets specified criteria, including the definition of an intangible asset. Paragraph 52 indicates that the cost of an internally generated intangible asset is the sum of expenditure incurred from the time when the intangible asset first meets the specified recognition criteria. When an enterprise acquires or creates content, it may be possible to identify an intangible asset (e.g., a license or a copyright) separate from a web site. Consequently, an enterprise determines whether an expenditure to enable use of content, which had been created for another purpose, on its web site becoming available for use results in a separate identifiable asset or the expenditure is included in the cost of developing the web site.

(c) the operating stage commences once the web site is available for use, and therefore an expenditure to maintain or enhance the web site after development has been completed should be recognised as an expense when it is incurred unless it meets the criteria in paragraph 59 of the Standard. Paragraph 60 explains that if the expenditure is required to maintain the asset at its originally assessed standard of performance, then the expenditure is recognised as an expense when incurred.

7. An intangible asset is measured subsequent to initial recognition by applying the requirements in paragraph 62 of this Standard. Additionally, since paragraph 68 of the Standard states that an intangible asset always has a finite useful life, a web site that is recognised as an asset is amortised over the best estimate of its useful life. As indicated in paragraph 65 of the Standard, web sites are susceptible to technological obsolescence, and given the history of rapid changes in technology, their useful life will be short.

8. The following table illustrates examples of expenditures that occur within each of the stages described in paragraphs 2 and 3 above and application of paragraphs 5 and 6 above. It is not intended to be a comprehensive checklist of expenditures that might be incurred.

Nature of Expenditure	**Accounting treatment**
Planning • undertaking feasibility studies • defining hardware and software specifications • evaluating alternative products and suppliers • selecting preferences	Expense when incurred
Application and Infrastructure Development • purchasing or developing hardware	Apply the requirements of AS 10

• obtaining a domain name • developing operating software (e.g., operating system and server software) • developing code for the application installing developed applications on the web server • stress testing	Expense when incurred, unless it meets the recognition criteria under paragraphs 20 and 44

Graphical Design and Content Development • designing the appearance (e.g., layout and colour) of web pages • creating, purchasing, preparing (e.g., creating links and identifying tags), and uploading information, either textual or graphical in nature, on the web site prior to the web site becoming available for use. Examples of content include information about an enterprise, products or services offered for sale, and topics that subscribers access	If a separate asset is not identifiable, then expense when incurred, unless it meets the recognition criteria under paragraphs 20 and 44
Operating • updating graphics and revising content • adding new functions, features and content • registering the web site with search engines • backing up data • reviewing security access • analysing usage of the web site	Expense when incurred, unless in rare circumstances it meets the criteria in paragraph 59, in which case the expenditure is included in the cost of the web site
Other • selling, administrative and other general overhead expenditure unless it can be directly attributed to preparing the web site for use • clearly identified inefficiencies and initial operating losses incurred before the web site achieves planned performance (e.g., false start testing) • training employees to operate the web site	Expense when incurred

Illustration B

This Illustration which does not form part of the Accounting Standard, provides illustrative application of the requirements contained in paragraph 99 of this Accounting Standard in respect of transitional provisions.

Illustration 1 - Intangible Item was not amortised and the amortisation period determined under paragraph 63 has expired.

An intangible item is appearing in the balance sheet of A Ltd. at Rs. 10 lakhs as on 1-4-2003. The item was acquired for Rs. 10 lakhs on April 1, 1990 and was available for use from that date. The enterprise has been following an accounting policy of not amortising the item. Applying paragraph 63, the enterprise determines that the item would have been amortised over a period of 10 years from the date when the item was available for use i.e., April 1, 1990.

Since the amortisation period determined by applying paragraph 63 has already expired as on 1-4-2003, the carrying amount of the intangible item of Rs. 10 lakhs would be required to be eliminated with a corresponding adjustment to the opening balance of revenue reserves as on 1-4-2003.

Illustration 2 - Intangible Item is being amortised and the amortisation period determined under paragraph 63 has expired.

An intangible item is appearing in the balance sheet of A Ltd. at Rs. 8 lakhs as on 1-4-2003. The item was acquired for Rs. 20 lakhs on April 1, 1991 and was available for use from that date. The enterprise has been following a policy of amortising the item over a period of 20 years on straight-line basis. Applying paragraph 63, the enterprise determines that the item would have been amortised over a period of 10 years from the date when the item was available for use i.e., April 1, 1991.

Since the amortisation period determined by applying paragraph 63 has already expired as on 1-4-2003, the carrying amount of Rs. 8 lakhs would be required to be eliminated with a corresponding adjustment to the opening balance of revenue reserves as on 1-4-2003.

Illustration 3 - Amortisation period determined under paragraph 63 has not expired and the remaining amortisation period as per the accounting policy followed by the enterprise is shorter.

An intangible item is appearing in the balance sheet of A Ltd. at Rs. 8 lakhs as on 1-4-2003. The item was acquired for Rs. 20 lakhs on April 1, 2000 and was available for use from that date. The enterprise has been following a policy of amortising the intangible item over a period of 5 years on straight line basis. Applying paragraph 63, the enterprise determines the amortisation period to be 8 years, being the best estimate of its useful life, from the date when the item was available for use i.e., April 1, 2000.

On 1-4-2003, the remaining period of amortisation is 2 years as per the accounting policy followed by the enterprise which is shorter as compared to the balance of amortisation period determined by applying paragraph 63, i.e., 5 years. Accordingly, the enterprise would be required to amortise the intangible item over the remaining 2 years as per the accounting policy followed by the enterprise.

Illustration 4 - Amortisation period determined under paragraph 63 has not expired and the remaining amortisation period as per the accounting policy followed by the enterprise is longer.

An intangible item is appearing in the balance sheet of A Ltd. at Rs. 18 lakhs as on 1-4-2003. The item was acquired for Rs. 24 lakhs on April 1, 2000 and was available for use from that date. The enterprise has been following a policy of amortising the intangible item over a period of 12 years on straight-line basis. Applying paragraph 63, the enterprise determines that the item would have been amortised over a period of 10 years on straight line basis from the date when the item was available for use i.e., April 1, 2000.

On 1-4-2003, the remaining period of amortisation is 9 years as per the accounting policy followed by the enterprise which is longer as compared to the balance of period stipulated in paragraph 63, i.e., 7 years. Accordingly, the enterprise would be required to restate the carrying amount of intangible item on 1-4-2003 at Rs. 16.8 lakhs (Rs. 24 lakhs - 3xRs. 2.4 lakhs, i.e., amortisation that would have been charged as per the Standard) and the difference of Rs. 1.2 lakhs (Rs. 18 lakhs-Rs. 16.8 lakhs) would be required to be adjusted against the opening balance of the revenue reserves. The carrying amount of Rs. 16.8 lakhs would be amortised over 7 years which is the balance of the amortisation period as per paragraph 63.

Illustration 5 - Intangible Item is not amortised and amortisation period determined under paragraph 63 has not expired.

An intangible item is appearing in the balance sheet of A Ltd. at Rs. 20 lakhs as on 1-4-2003. The item was acquired for Rs. 20 lakhs on April 1, 2000 and was available for use from that date. The enterprise has been following an accounting policy of not amortising the item. Applying paragraph 63, the enterprise determines that the item would have been amortised over a period of 10 years on straight line basis from the date when the item was available for use i.e., April 1, 2000.

On 1-4-2003, the enterprise would be required to restate the carrying amount of intangible item at Rs. 14 lakhs (Rs. 20 lakhs - 3xRs. 2 lakhs, i.e., amortisation that would have been charged as per the Standard) and the difference of Rs. 6 lakhs (Rs. 20 lakhs-Rs. 14 lakhs) would be required to be adjusted against the opening balance of the revenue reserves. The carrying amount of Rs. 14 lakhs would be amortised over 7 years which is the balance of the amortisation period as per paragraph 63.

Accounting Standard (AS) 27

Financial Reporting of Interests in Joint Ventures

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the General Instructions contained in part A of the Annexure to the Notification.)*

This Standard is mandatory in respect of separate financial statements of an enterprise. In respect of consolidated financial statements of an enterprise, this Standard is mandatory in nature where the enterprise prepares and presents the consolidated financial statements.

Objective

The objective of this Standard is to set out principles and procedures for accounting for interests in joint ventures and reporting of joint venture assets, liabilities, income and expenses in the financial statements of venturers and investors.

Scope

1. This Standard should be applied in accounting for interests in joint ventures and the reporting of joint venture assets, liabilities, income and expenses in the financial statements of venturers and investors, regardless of the structures or forms under which the joint venture activities take place.

2. The requirements relating to accounting for joint ventures in consolidated financial statements, contained in this Standard, are applicable only where consolidated financial statements are prepared and presented by the venturer.

Definitions

3. For the purpose of this Standard, the following terms are used with the meanings specified:

3.1 A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control.

3.2 Joint control is the contractually agreed sharing of control over an economic activity.

3.3 Control is the power to govern the financial and operating policies of an economic activity so as to obtain benefits from it.

3.4 A venturer is a party to a joint venture and has joint control over that joint venture.

3.5 An investor in a joint venture is a party to a joint venture and does not have joint control over that joint venture.

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

Forms of Joint Venture

4. Joint ventures take many different forms and structures. This Standard identifies three broad types - jointly controlled operations, jointly controlled assets and jointly controlled entities - which are commonly described as, and meet the definition of, joint ventures. The following characteristics are common to all joint ventures:

(a) two or more venturers are bound by a contractual arrangement; and

(b) the contractual arrangement establishes joint control.

Contractual Arrangement

5. The existence of a contractual arrangement distinguishes interests which involve joint control from investments in associates in which the investor has significant influence (see Accounting Standard (AS) 23, *Accounting for Investments in Associates in Consolidated Financial Statements*). Activities which have no contractual arrangement to establish joint control are not joint ventures for the purposes of this Standard.

6. In some exceptional cases, an enterprise by a contractual arrangement establishes joint control over an entity which is a subsidiary of that enterprise within the meaning of Accounting Standard (AS) 21, *Consolidated Financial Statements*. In such cases, the entity is consolidated under AS 21 by the said enterprise, and is not treated as a joint venture as per this Standard. The consolidation of such an entity does not necessarily preclude other venturer(s) treating such an entity as a joint venture.

7. The contractual arrangement may be evidenced in a number of ways, for example by a contract between the venturers or minutes of discussions between the venturers. In some cases, the arrangement is incorporated in the articles or other by-laws of the joint venture. Whatever its form, the contractual arrangement is normally in writing and deals with such matters as:

(a) the activity, duration and reporting obligations of the joint venture;

(b) the appointment of the board of directors or equivalent governing body of the joint venture and the voting rights of the venturers;

(c) capital contributions by the venturers; and

(d) the sharing by the venturers of the output, income, expenses or results of the joint venture.

8. The contractual arrangement establishes joint control over the joint venture. Such an arrangement ensures that no single venturer is in a position to unilaterally control the activity. The arrangement identifies those decisions in areas essential to the goals of the joint venture which require the consent of all the venturers and those decisions which may require the consent of a specified majority of the venturers.

9. The contractual arrangement may identify one venturer as the operator or manager of the joint venture. The operator does not control the joint venture but acts within the financial and operating policies which have been agreed to by the venturers in accordance with the contractual arrangement and delegated to the operator.

Jointly Controlled Operations

10. The operation of some joint ventures involves the use of the assets and other resources of the venturers rather than the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves. Each venturer uses its own fixed assets and carries its own inventories. It also incurs its own expenses and liabilities and raises its own finance, which represent its own obligations. The joint venture's activities may be carried out by the venturer's employees alongside the venturer's similar activities. The joint venture agreement usually provides means by which the revenue from the jointly controlled operations and any expenses incurred in common are shared among the venturers.

11. An example of a jointly controlled operation is when two or more venturers combine their operations, resources and expertise in order to manufacture, market and distribute, jointly, a particular product, such as an aircraft. Different parts of the manufacturing process are carried out by each of the venturers. Each venturer bears its own costs and takes a share of the revenue from the sale of the aircraft, such share being determined in accordance with the contractual arrangement.

12. In respect of its interests in jointly controlled operations, a venturer should recognise in its separate financial statements and consequently in its consolidated financial statements:

(a) the assets that it controls and the liabilities that it incurs; and

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

13. Because the assets, liabilities, income and expenses are already recognised in the separate financial statements of the venturer, and consequently in its consolidated financial statements, no adjustments or other consolidation procedures are required in respect of these items when the venturer presents consolidated financial statements.

14. Separate accounting records may not be required for the joint venture itself and financial statements may not be prepared for the joint venture. However, the venturers may prepare accounts for internal management reporting purposes so that they may assess the performance of the joint venture.

Jointly Controlled Assets

15. Some joint ventures involve the joint control, and often the joint ownership, by the venturers of one or more assets contributed to, or acquired for the purpose of, the joint venture and dedicated to the purposes of the joint venture. The assets are used to obtain economic benefits for the venturers. Each venturer may take a share of the output from the assets and each bears an agreed share of the expenses incurred.

16. These joint ventures do not involve the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves. Each venturer has control over its share of future economic benefits through its share in the jointly controlled asset.

17. An example of a jointly controlled asset is an oil pipeline jointly controlled and operated by a number of oil production companies. Each venturer uses the pipeline to transport its own product in return for which it bears an agreed proportion of the expenses of operating the pipeline. Another example of a jointly controlled asset is when two enterprises jointly control a property, each taking a share of the rents received and bearing a share of the expenses.

18. In respect of its interest in jointly controlled assets, a venturer should recognise, in its separate financial statements, and consequently in its consolidated financial statements:

(a) its share of the jointly controlled assets, classified according to the nature of the assets;

(b) any liabilities which it has incurred;

(c) its share of any liabilities incurred jointly with the other venturers in relation to the joint venture;

(d) any income from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and

(e) any expenses which it has incurred in respect of its interest in the joint venture.

19. In respect of its interest in jointly controlled assets, each venturer includes in its accounting records and recognises in its separate financial statements and consequently in its consolidated financial statements:

(a) its share of the jointly controlled assets, classified according to the nature of the assets rather than as an investment, for example, a share of a jointly controlled oil pipeline is classified as a fixed asset;

(b) any liabilities which it has incurred, for example, those incurred in financing its share of the assets;

(c) its share of any liabilities incurred jointly with other venturers in relation to the joint venture;

(d) any income from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and

(e) any expenses which it has incurred in respect of its interest in the joint venture, for example, those related to financing the venturer's interest in the assets and selling its share of the output.

Because the assets, liabilities, income and expenses are already recognised in the separate financial statements of the venturer, and consequently in its consolidated financial statements, no adjustments or other consolidation procedures are required in respect of these items when the venturer presents consolidated financial statements.

20. The treatment of jointly controlled assets reflects the substance and economic reality and, usually, the legal form of the joint venture. Separate accounting records for the joint venture itself may be limited to those expenses incurred in common by the venturers and ultimately borne by the venturers according to their agreed shares. Financial statements may not be prepared for the joint venture, although the venturers may prepare accounts for internal management reporting purposes so that they may assess the performance of the joint venture.

Jointly Controlled Entities

21. A jointly controlled entity is a joint venture which involves the establishment of a

corporation, partnership or other entity in which each venturer has an interest. The entity operates in the same way as other enterprises, except that a contractual arrangement between the venturers establishes joint control over the economic activity of the entity.

22. A jointly controlled entity controls the assets of the joint venture, incurs liabilities and expenses and earns income. It may enter into contracts in its own name and raise finance for the purposes of the joint venture activity. Each venturer is entitled to a share of the results of the jointly controlled entity, although some jointly controlled entities also involve a sharing of the output of the joint venture.

23. An example of a jointly controlled entity is when two enterprises combine their activities in a particular line of business by transferring the relevant assets and liabilities into a jointly controlled entity. Another example is when an enterprise commences a business in a foreign country in conjunction with the government or other agency in that country, by establishing a separate entity which is jointly controlled by the enterprise and the government or agency.

24. Many jointly controlled entities are similar to those joint ventures referred to as jointly controlled operations or jointly controlled assets. For example, the venturers may transfer a jointly controlled asset, such as an oil pipeline, into a jointly controlled entity. Similarly, the venturers may contribute, into a jointly controlled entity, assets which will be operated jointly. Some jointly controlled operations also involve the establishment of a jointly controlled entity to deal with particular aspects of the activity, for example, the design, marketing, distribution or after-sales service of the product.

25. A jointly controlled entity maintains its own accounting records and prepares and presents financial statements in the same way as other enterprises in conformity with the requirements applicable to that jointly controlled entity.

Separate Financial Statements of a Venturer

26. In a venturer's separate financial statements, interest in a jointly controlled entity should be accounted for as an investment in accordance with Accounting Standard (AS) 13, Accounting for Investments.

27. Each venturer usually contributes cash or other resources to the jointly controlled entity. These contributions are included in the accounting records of the venturer and are recognised in its separate financial statements as an investment in the jointly controlled entity.

Consolidated Financial Statements of a Venturer

28. In its consolidated financial statements, a venturer should report its interest in a jointly controlled entity using proportionate consolidation except:

- ***(a) an interest in a jointly controlled entity which is acquired and held exclusively with a view to its subsequent disposal in the near future; and***

- ***(b) an interest in a jointly controlled entity which operates under severe long-term restrictions that significantly impair its ability to transfer funds to the venturer.***

Interest in such a jointly controlled entity should be accounted for as an investment in accordance with Accounting Standard (AS) 13, Accounting for Investments.

Explanation:

The period of time, which is considered as near future for the purposes of this Standard primarily depends on the facts and circumstances of each case. However, ordinarily, the meaning of the words 'near future' is considered as not more than twelve months from acquisition of relevant investments unless a longer period can be justified on the basis of facts and circumstances of the case. The intention with regard to disposal of the relevant investment is considered at the time of acquisition of the investment. Accordingly, if the relevant investment is acquired without an intention to its subsequent disposal in near future, and subsequently, it is decided to dispose off the investment, such an investment is not excluded from application of the proportionate consolidation method, until the investment is actually disposed off. Conversely, if the relevant investment is acquired with an intention to its subsequent disposal in near future, however, due to some valid reasons, it could not be disposed off within that period, the same will continue to be excluded from application of the proportionate consolidation method, provided there is no change in the intention.

29. When reporting an interest in a jointly controlled entity in consolidated financial statements, it is essential that a venturer reflects the substance and economic reality of the arrangement, rather than the joint venture's particular structure or form. In a jointly controlled entity, a venturer has control over its share of future economic benefits through its share of the assets and liabilities of the venture. This substance and economic reality is reflected in the consolidated financial statements of the venturer when the venturer reports its interests in the assets, liabilities, income and expenses of the jointly controlled entity by using proportionate consolidation.

30. The application of proportionate consolidation means that the consolidated balance sheet of the venturer includes its share of the assets that it controls jointly and its share of the liabilities for which it is jointly responsible. The consolidated statement of profit and loss of the venturer includes its share of the income and expenses of the jointly controlled entity. Many of the procedures appropriate for the application of proportionate consolidation are similar to the procedures for the consolidation of investments in subsidiaries, which are set out in Accounting Standard (AS) 21, Consolidated Financial Statements.

31. For the purpose of applying proportionate consolidation, the venturer uses the consolidated financial statements of the jointly controlled entity.

32. Under proportionate consolidation, the venturer includes separate line items for its share of the assets, liabilities, income and expenses of the jointly controlled entity in its consolidated financial statements. For example, it shows its share of the inventory of the jointly controlled entity separately as part of the inventory of the consolidated group; it shows its share of the fixed assets of the jointly controlled entity separately as part of the same items of the consolidated group.

Explanation:

While applying proportionate consolidation method, the venturer's share in the post-acquisition reserves of the jointly controlled entity is shown separately under the relevant reserves in the consolidated financial statements.

33. The financial statements of the jointly controlled entity used in applying proportionate consolidation are usually drawn up to the same date as the financial statements of the venturer. When the reporting dates are different, the jointly controlled entity often prepares, for applying proportionate consolidation, statements as at the same date as that of the venturer.

When it is impracticable to do this, financial statements drawn up to different reporting dates may be used provided the difference in reporting dates is not more than six months. In such a case, adjustments are made for the effects of significant transactions or other events that occur between the date of financial statements of the jointly controlled entity and the date of the venturer's financial statements. The consistency principle requires that the length of the reporting periods, and any difference in the reporting dates, are consistent from period to period.

34. The venturer usually prepares consolidated financial statements using uniform accounting policies for the like transactions and events in similar circumstances. In case a jointly controlled entity uses accounting policies other than those adopted for the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to the financial statements of the jointly controlled entity when they are used by the venturer in applying proportionate consolidation. If it is not practicable to do so, that fact is disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.

35. While giving effect to proportionate consolidation, it is inappropriate to offset any assets or liabilities by the deduction of other liabilities or assets or any income or expenses by the deduction of other expenses or income, unless a legal right of set-off exists and the offsetting represents the expectation as to the realisation of the asset or the settlement of the liability.

36. Any excess of the cost to the venturer of its interest in a jointly controlled entity over its share of net assets of the jointly controlled entity, at the date on which interest in the jointly controlled entity is acquired, is recognised as goodwill, and separately disclosed in the consolidated financial statements. When the cost to the venturer of its interest in a jointly controlled entity is less than its share of the net assets of the jointly controlled entity, at the date on which interest in the jointly controlled entity is acquired, the difference is treated as a capital reserve in the consolidated financial statements. Where the carrying amount of the venturer's interest in a jointly controlled entity is different from its cost, the carrying amount is considered for the purpose of above computations.

37. The losses pertaining to one or more investors in a jointly controlled entity may exceed their interests in the equity[40] of the jointly controlled entity. Such excess, and any further losses applicable to such investors, are recognised by the venturers in the proportion of their shares in the venture, except to the extent that the investors have a binding obligation to, and are able to, make good the losses. If the jointly controlled entity subsequently reports profits, all such profits are allocated to venturers until the investors' share of losses previously absorbed by the venturers has been recovered.

38. A venturer should discontinue the use of proportionate consolidation from the date that:

(a) it ceases to have joint control over a jointly controlled entity but retains, either in whole or in part, its interest in the entity; or

(b) the use of the proportionate consolidation is no longer appropriate because the jointly controlled entity operates under severe long-term restrictions that significantly impair its ability to transfer funds to the venturer.

39. From the date of discontinuing the use of the proportionate consolidation, interest in a jointly controlled entity should be accounted for:

[40] Equity is the residual interest in the assets of an enterprise after deducting all its liabilities.

(a) in accordance with Accounting Standard (AS) 21, Consolidated Financial Statements, if the venturer acquires unilateral control over the entity and becomes parent within the meaning of that Standard; and

(b) in all other cases, as an investment in accordance with Accounting Standard (AS) 13, Accounting for Investments, or in accordance with Accounting Standard (AS) 23, Accounting for Investments in Associates in Consolidated Financial Statements, as appropriate. For this purpose, cost of the investment should be determined as under:

(i) the venturer's share in the net assets of the jointly controlled entity as at the date of discontinuance of proportionate consolidation should be ascertained, and

(ii) the amount of net assets so ascertained should be adjusted with the carrying amount of the relevant goodwill/capital reserve (see paragraph 36) as at the date of discontinuance of proportionate consolidation.

Transactions between a Venturer and Joint Venture

40. When a venturer contributes or sells assets to a joint venture, recognition of any portion of a gain or loss from the transaction should reflect the substance of the transaction. While the assets are retained by the joint venture, and provided the venturer has transferred the significant risks and rewards of ownership, the venturer should recognise only that portion of the gain or loss which is attributable to the interests of the other venturers. The venturer should recognise the full amount of any loss when the contribution or sale provides evidence of a reduction in the net realisable value of current assets or an impairment loss.

41. When a venturer purchases assets from a joint venture, the venturer should not recognise its share of the profits of the joint venture from the transaction until it resells the assets to an independent party. A venturer should recognise its share of the losses resulting from these transactions in the same way as profits except that losses should be recognised immediately when they represent a reduction in the net realisable value of current assets or an impairment loss.

42. To assess whether a transaction between a venturer and a joint venture provides evidence of impairment of an asset, the venturer determines the recoverable amount of the asset as per Accounting Standard (AS) 28, *Impairment of Assets*. In determining value in use, future cash flows from the asset are estimated based on continuing use of the asset and its ultimate disposal by the joint venture.

43. In case of transactions between a venturer and a joint venture in the form of a jointly controlled entity, the requirements of paragraphs 40 and 41 should be applied only in the preparation and presentation of consolidated financial statements and not in the preparation and presentation of separate financial statements of the venturer.

44. In the separate financial statements of the venturer, the full amount of gain or loss on the transactions taking place between the venturer and the jointly controlled entity is recognised. However, while preparing the consolidated financial statements, the venturer's share of the unrealised gain or loss is eliminated. Unrealised losses are not eliminated, if and to the extent they represent a reduction in the net realisable value of current assets or an impairment loss. The venturer, in effect, recognises, in consolidated financial statements, only that portion of gain or loss which is attributable to the interests of other venturers.

Reporting Interests in Joint Ventures in the Financial Statements of an Investor

45. An investor in a joint venture, which does not have joint control, should report its interest in a joint venture in its consolidated financial statements in accordance with Accounting Standard (AS) 13, Accounting for Investments, Accounting Standard (AS) 21, Consolidated Financial Statements or Accounting Standard (AS) 23, Accounting for Investments in Associates in Consolidated Financial Statements, as appropriate.

46. In the separate financial statements of an investor, the interests in joint ventures should be accounted for in accordance with Accounting Standard (AS) 13, Accounting for Investments.

Operators of Joint Ventures

47. Operators or managers of a joint venture should account for any fees in accordance with Accounting Standard (AS) 9, Revenue Recognition.

48. One or more venturers may act as the operator or manager of a joint venture. Operators are usually paid a management fee for such duties. The fees are accounted for by the joint venture as an expense.

Disclosure

49. A venturer should disclose the information required by paragraphs 50, 51, and 52 in its separate financial statements as well as in consolidated financial statements.

50. A venturer should disclose the aggregate amount of the following contingent liabilities, unless the probability of loss is remote, separately from the amount of other contingent liabilities:

- ***(a) any contingent liabilities that the venturer has incurred in relation to its interests in joint ventures and its share in each of the contingent liabilities which have been incurred jointly with other venturers;***
- ***(b) its share of the contingent liabilities of the joint ventures themselves for which it is contingently liable; and***
- ***(c) those contingent liabilities that arise because the venturer is contingently liable for the liabilities of the other venturers of a joint venture.***

51. A venturer should disclose the aggregate amount of the following commitments in respect of its interests in joint ventures separately from other commitments:

- ***(a) any capital commitments of the venturer in relation to its interests in joint ventures and its share in the capital commitments that have been incurred jointly with other venturers; and***
- ***(b) its share of the capital commitments of the joint ventures themselves.***

52. A venturer should disclose a list of all joint ventures and description of interests in significant joint ventures. In respect of jointly controlled entities, the venturer should also disclose the proportion of ownership interest, name and country of incorporation or

residence.

53. A venturer should disclose, in its separate financial statements, the aggregate amounts of each of the assets, liabilities, income and expenses related to its interests in the jointly controlled entities.

Accounting Standard (AS) 28

Impairment of Assets

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the General Instructions contained in part A of the Annexure to the Notification.)*

Objective

The objective of this Standard is to prescribe the procedures that an enterprise applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and this Standard requires the enterprise to recognise an impairment loss. This Standard also specifies when an enterprise should reverse an impairment loss and it prescribes certain disclosures for impaired assets.

Scope

1. This Standard should be applied in accounting for the impairment of all assets, other than:

(a) inventories (see AS 2, Valuation of Inventories);

(b) assets arising from construction contracts (see AS 7, Construction Contracts);

(c) financial assets[1], including investments that are included in the scope of AS 13, Accounting for Investments; and

(d) deferred tax assets (see AS 22, Accounting for Taxes on Income).

2. This Standard does not apply to inventories, assets arising from construction contracts, deferred tax assets or investments because existing Accounting Standards applicable to these assets already contain specific requirements for recognising and measuring the impairment related to these assets.

3. This Standard applies to assets that are carried at cost. It also applies to assets that are carried at revalued amounts in accordance with other applicable Accounting Standards. However, identifying whether a revalued asset may be impaired depends on the basis used to determine the fair value of the asset:

(a) if the fair value of the asset is its market value, the only difference between the fair value of the asset and its net selling price is the direct incremental costs to dispose of the asset:

(i) if the disposal costs are negligible, the recoverable amount of the revalued asset is necessarily close to, or greater than, its revalued amount (fair value). In this case, after the revaluation requirements have been applied, it is unlikely that the

[1] A financial asset is any asset that is:
(a) cash;
(b) a contractual right to receive cash or another financial asset from another enterprise;
(c) a contractual right to exchange financial instruments with another enterprise under conditions that are potentially favourable; or
(d) an ownership interest in another enterprise.

revalued asset is impaired and recoverable amount need not be estimated; and

(ii) if the disposal costs are not negligible, net selling price of the revalued asset is necessarily less than its fair value. Therefore, the revalued asset will be impaired if its value in use is less than its revalued amount (fair value). In this case, after the revaluation requirements have been applied, an enterprise applies this Standard to determine whether the asset may be impaired; and

(b) if the asset's fair value is determined on a basis other than its market value, its revalued amount (fair value) may be greater or lower than its recoverable amount. Hence, after the revaluation requirements have been applied, an enterprise applies this Standard to determine whether the asset may be impaired.

Definitions

4. The following terms are used in this Standard with the meanings specified:

4.1 Recoverable amount is the higher of an asset's net selling price and its value in use.

4.2 Value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

Provided that in the context of Small and Medium-sized Companies, as defined in the Notification, the definition of the term 'value in use' would read as follows:

"Value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life, or a reasonable estimate thereof. "

Explanation:

The definition of the term 'value in use' in the proviso implies that instead of using the present value technique, a reasonable estimate of the 'value in use' can be made. Consequently, if an SMC chooses to measure the 'value in use' by not using the present value technique, the relevant provisions of AS 28, such as discount rate etc., would not be applicable to such an SMC.

4.3 Net selling price is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.

4.4 Costs of disposal are incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense.

4.5 An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount.

4.6 Carrying amount is the amount at which an asset is recognised in the balance sheet after deducting any accumulated depreciation (amortisation) and accumulated impairment losses thereon.

4.7 Depreciation (Amortisation) is a systematic allocation of the depreciable amount of an asset over its useful life.[2]

[2] In the case of an intangible asset or goodwill, the term 'amortisation' is generally used instead of 'depreciation'. Both terms have the same meaning.

4.8 <u>Depreciable amount</u> is the cost of an asset, or other amount substituted for cost in the financial statements, less its residual value.

4.9 <u>Useful life</u> is either:

(a) the period of time over which an asset is expected to be used by the enterprise; or

(b) the number of production or similar units expected to be obtained from the asset by the enterprise.

4.10 A <u>cash generating unit</u> is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets.

4.11 <u>Corporate assets</u> are assets other than goodwill that contribute to the future cash flows of both the cash generating unit under review and other cash generating units.

4.12 An <u>active market</u> is a market where all the following conditions exist :

(a) the items traded within the market are homogeneous;

(b) willing buyers and sellers can normally be found at any time; and

(c) prices are available to the public.

Identifying an Asset that may be Impaired

5. An asset is impaired when the carrying amount of the asset exceeds its recoverable amount. Paragraphs 6 to 13 specify when recoverable amount should be determined. These requirements use the term 'an asset' but apply equally to an individual asset or a cash-generating unit.

6. An enterprise should assess at each balance sheet date whether there is any indication that an asset may be impaired. If any such indication exists, the enterprise should estimate the recoverable amount of the asset.

7. Paragraphs 8 to 10 describe some indications that an impairment loss may have occurred: if any of those indications is present, an enterprise is required to make a formal estimate of recoverable amount. If no indication of a potential impairment loss is present, this Standard does not require an enterprise to make a formal estimate of recoverable amount.

8. In assessing whether there is any indication that an asset may be impaired, an enterprise should consider, as a minimum, the following indications:

<u>External sources of information</u>

(a) during the period, an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use;

(b) significant changes with an adverse effect on the enterprise have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the enterprise operates or in the market to which an asset is dedicated;

(c) market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in

calculating an asset's value in use and decrease the asset's recoverable amount materially;

(d) the carrying amount of the net assets of the reporting enterprise is more than its market capitalisation;

Internal sources of information

(e) evidence is available of obsolescence or physical damage of an asset;

(f) significant changes with an adverse effect on the enterprise have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include plans to discontinue or restructure the operation to which an asset belongs or to dispose of an asset before the previously expected date; and

(g) evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.

9. The list of paragraph 8 is not exhaustive. An enterprise may identify other indications that an asset may be impaired and these would also require the enterprise to determine the asset's recoverable amount.

10. Evidence from internal reporting that indicates that an asset may be impaired includes the existence of:

(a) cash flows for acquiring the asset, or subsequent cash needs for operating or maintaining it, that are significantly higher than those originally budgeted;

(b) actual net cash flows or operating profit or loss flowing from the asset that are significantly worse than those budgeted;

(c) a significant decline in budgeted net cash flows or operating profit, or a significant increase in budgeted loss, flowing from the asset; or

(d) operating losses or net cash outflows for the asset, when current period figures are aggregated with budgeted figures for the future.

11. The concept of materiality applies in identifying whether the recoverable amount of an asset needs to be estimated. For example, if previous calculations show that an asset's recoverable amount is significantly greater than its carrying amount, the enterprise need not re-estimate the asset's recoverable amount if no events have occurred that would eliminate that difference. Similarly, previous analysis may show that an asset's recoverable amount is not sensitive to one (or more) of the indications listed in paragraph 8.

12. As an illustration of paragraph 11, if market interest rates or other market rates of return on investments have increased during the period, an enterprise is not required to make a formal estimate of an asset's recoverable amount in the following cases:

(a) if the discount rate used in calculating the asset's value in use is unlikely to be affected by the increase in these market rates. For example, increases in short-term interest rates may not have a material effect on the discount rate used for an asset that has a long remaining useful life; or

(b) if the discount rate used in calculating the asset's value in use is likely to be affected by the increase in these market rates but previous sensitivity analysis of recoverable amount shows that:

(i) it is unlikely that there will be a material decrease in recoverable amount because future cash flows are also likely to increase. For example, in some cases, an enterprise may be able to demonstrate that it adjusts its revenues to compensate for any increase in market rates; or

(ii) the decrease in recoverable amount is unlikely to result in a material impairment loss.

13. If there is an indication that an asset may be impaired, this may indicate that the remaining useful life, the depreciation (amortisation) method or the residual value for the asset need to be reviewed and adjusted under the Accounting Standard applicable to the asset, such as Accounting Standard (AS) 10, *Property, Plant and Equipment*[3], even if no impairment loss is recognised for the asset.

Measurement of Recoverable Amount

14. This Standard defines recoverable amount as the higher of an asset's net selling price and value in use. Paragraphs 15 to 55 set out the requirements for measuring recoverable amount. These requirements use the term 'an asset' but apply equally to an individual asset or a cash-generating unit.

15. It is not always necessary to determine both an asset's net selling price and its value in use. For example, if either of these amounts exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.

16. It may be possible to determine net selling price, even if an asset is not traded in an active market. However, sometimes it will not be possible to determine net selling price because there is no basis for making a reliable estimate of the amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In this case, the recoverable amount of the asset may be taken to be its value in use.

17. If there is no reason to believe that an asset's value in use materially exceeds its net selling price, the asset's recoverable amount may be taken to be its net selling price. This will often be the case for an asset that is held for disposal. This is because the value in use of an asset held for disposal will consist mainly of the net disposal proceeds, since the future cash flows from continuing use of the asset until its disposal are likely to be negligible.

18. Recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows from continuing use that are largely independent of those from other assets or groups of assets. If this is the case, recoverable amount is determined for the cash-generating unit to which the asset belongs (see paragraphs 63 to 86), unless either:

(a) the asset's net selling price is higher than its carrying amount; or

(b) the asset's value in use can be estimated to be close to its net selling price and net selling price can be determined.

19. In some cases, estimates, averages and simplified computations may provide a reasonable approximation of the detailed computations illustrated in this Standard for determining net selling price or value in use.

Net Selling Price

20. The best evidence of an asset's net selling price is a price in a binding sale agreement in an

[3] Amortisation (depreciation) of intangible assets is dealt with in AS 26, *Intangible Assets*.

arm's length transaction, adjusted for incremental costs that would be directly attributable to the disposal of the asset.

21. If there is no binding sale agreement but an asset is traded in an active market, net selling price is the asset's market price less the costs of disposal. The appropriate market price is usually the current bid price. When current bid prices are unavailable, the price of the most recent transaction may provide a basis from which to estimate net selling price, provided that there has not been a significant change in economic circumstances between the transaction date and the date at which the estimate is made.

22. If there is no binding sale agreement or active market for an asset, net selling price is based on the best information available to reflect the amount that an enterprise could obtain, at the balance sheet date, for the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal. In determining this amount, an enterprise considers the outcome of recent transactions for similar assets within the same industry. Net selling price does not reflect a forced sale, unless management is compelled to sell immediately.

23. Costs of disposal, other than those that have already been recognised as liabilities, are deducted in determining net selling price. Examples of such costs are legal costs, costs of removing the asset, and direct incremental costs to bring an asset into condition for its sale. However, termination benefits and costs associated with reducing or reorganising a business following the disposal of an asset are not direct incremental costs to dispose of the asset.

24. Sometimes, the disposal of an asset would require the buyer to take over a liability and only a single net selling price is available for both the asset and the liability. Paragraph 76 explains how to deal with such cases.

Value in Use

25. Estimating the value in use of an asset involves the following steps:

(a) estimating the future cash inflows and outflows arising from continuing use of the asset and from its ultimate disposal; and

(b) applying the appropriate discount rate to these future cash flows.

Basis for Estimates of Future Cash Flows

26. In measuring value in use:

(a) cash flow projections should be based on reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset. Greater weight should be given to external evidence;

(b) cash flow projections should be based on the most recent financial budgets/forecasts that have been approved by management. Projections based on these budgets/forecasts should cover a maximum period of five years, unless a longer period can be justified; and

(c) cash flow projections beyond the period covered by the most recent budgets/forecasts should be estimated by extrapolating the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified. This growth rate should not exceed the long-term average growth rate for the products, industries, or

country or countries in which the enterprise operates, or for the market in which the asset is used, unless a higher rate can be justified.

27. Detailed, explicit and reliable financial budgets/forecasts of future cash flows for periods longer than five years are generally not available. For this reason, management's estimates of future cash flows are based on the most recent budgets/forecasts for a maximum of five years. Management may use cash flow projections based on financial budgets/forecasts over a period longer than five years if management is confident that these projections are reliable and it can demonstrate its ability, based on past experience, to forecast cash flows accurately over that longer period.

28. Cash flow projections until the end of an asset's useful life are estimated by extrapolating the cash flow projections based on the financial budgets/ forecasts using a growth rate for subsequent years. This rate is steady or declining, unless an increase in the rate matches objective information about patterns over a product or industry lifecycle. If appropriate, the growth rate is zero or negative.

29. Where conditions are very favourable, competitors are likely to enter the market and restrict growth. Therefore, enterprises will have difficulty in exceeding the average historical growth rate over the long term (say, twenty years) for the products, industries, or country or countries in which the enterprise operates, or for the market in which the asset is used.

30. In using information from financial budgets/forecasts, an enterprise considers whether the information reflects reasonable and supportable assumptions and represents management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset.

Composition of Estimates of Future Cash Flows

31. Estimates of future cash flows should include:

(a) projections of cash inflows from the continuing use of the asset;

(b) projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset (including cash outflows to prepare the asset for use) and that can be directly attributed, or allocated on a reasonable and consistent basis, to the asset; and

(c) net cash flows, if any, to be received (or paid) for the disposal of the asset at the end of its useful life.

32. Estimates of future cash flows and the discount rate reflect consistent assumptions about price increases due to general inflation. Therefore, if the discount rate includes the effect of price increases due to general inflation, future cash flows are estimated in nominal terms. If the discount rate excludes the effect of price increases due to general inflation, future cash flows are estimated in real terms but include future specific price increases or decreases.

33. Projections of cash outflows include future overheads that can be attributed directly, or allocated on a reasonable and consistent basis, to the use of the asset.

34. When the carrying amount of an asset does not yet include all the cash outflows to be incurred before it is ready for use or sale, the estimate of future cash outflows includes an estimate of any further cash outflow that is expected to be incurred before the asset is ready for use or sale. For example, this is the case for a building under construction or for a development project that is not yet completed.

35. To avoid double counting, estimates of future cash flows do not include:

(a) cash inflows from assets that generate cash inflows from continuing use that are largely independent of the cash inflows from the asset under review (for example, financial assets such as receivables); and

(b) cash outflows that relate to obligations that have already been recognised as liabilities (for example, payables, pensions or provisions).

36. Future cash flows should be estimated for the asset in its current condition. Estimates of future cash flows should not include estimated future cash inflows or outflows that are expected to arise from:

(a) a future restructuring to which an enterprise is not yet committed; or

(b) future capital expenditure that will improve or enhance the asset in excess of its originally assessed standard of performance.

37. Because future cash flows are estimated for the asset in its current condition, value in use does not reflect:

(a) future cash outflows or related cost savings (for example, reductions in staff costs) or benefits that are expected to arise from a future restructuring to which an enterprise is not yet committed; or

(b) future capital expenditure that will improve or enhance the asset in excess of its originally assessed standard of performance or the related future benefits from this future expenditure.

38. A restructuring is a programme that is planned and controlled by management and that materially changes either the scope of the business undertaken by an enterprise or the manner in which the business is conducted[4].

39. When an enterprise becomes committed to a restructuring, some assets are likely to be affected by this restructuring. Once the enterprise is committed to the restructuring, in determining value in use, estimates of future cash inflows and cash outflows reflect the cost savings and other benefits from the restructuring (based on the most recent financial budgets/forecasts that have been approved by management).

Illustration 5 given in the Illustrations attached to the Standard illustrates the effect of a future restructuring on a value in use calculation.

40. Until an enterprise incurs capital expenditure that improves or enhances an asset in excess of its originally assessed standard of performance, estimates of future cash flows do not include the estimated future cash inflows that are expected to arise from this expenditure (see Illustration 6 given in the Illustrations attached to the Standard).

41. Estimates of future cash flows include future capital expenditure necessary to maintain or sustain an asset at its originally assessed standard of performance.

42. Estimates of future cash flows should not include:

[4] See AS 29, *Provisions, Contingent Liabilities and Contingent Assets,* for further explanations on 'restructuring'.

(a) cash inflows or outflows from financing activities; or

(b) income tax receipts or payments.

43. Estimated future cash flows reflect assumptions that are consistent with the way the discount rate is determined. Otherwise, the effect of some assumptions will be counted twice or ignored. Because the time value of money is considered by discounting the estimated future cash flows, these cash flows exclude cash inflows or outflows from financing activities. Similarly, since the discount rate is determined on a pre-tax basis, future cash flows are also estimated on a pre-tax basis.

44. The estimate of net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life should be the amount that an enterprise expects to obtain from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the estimated costs of disposal.

45. The estimate of net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life is determined in a similar way to an asset's net selling price, except that, in estimating those net cash flows:

(a) an enterprise uses prices prevailing at the date of the estimate for similar assets that have reached the end of their useful life and that have operated under conditions similar to those in which the asset will be used; and

(b) those prices are adjusted for the effect of both future price increases due to general inflation and specific future price increases (decreases). However, if estimates of future cash flows from the asset's continuing use and the discount rate exclude the effect of general inflation, this effect is also excluded from the estimate of net cash flows on disposal.

Foreign Currency Future Cash Flows

46. Future cash flows are estimated in the currency in which they will be generated and then discounted using a discount rate appropriate for that currency. An enterprise translates the present value obtained using the exchange rate at the balance sheet date (described in Accounting Standard (AS) 11, *The Effects of Changes in Foreign Exchange Rates*, as the closing rate).

Discount Rate

47. The discount rate(s) should be a pre tax rate(s) that reflect(s) current market assessments of the time value of money and the risks specific to the asset. The discount rate(s) should not reflect risks for which future cash flow estimates have been adjusted.

48. A rate that reflects current market assessments of the time value of money and the risks specific to the asset is the return that investors would require if they were to choose an investment that would generate cash flows of amounts, timing and risk profile equivalent to those that the enterprise expects to derive from the asset. This rate is estimated from the rate implicit in current market transactions for similar assets or from the weighted average cost of capital of a listed enterprise that has a single asset (or a portfolio of assets) similar in terms of service potential and risks to the asset under review.

49. When an asset-specific rate is not directly available from the market, an enterprise uses other bases to estimate the discount rate. The purpose is to estimate, as far as possible, a market assessment of:

(a) the time value of money for the periods until the end of the asset's useful life; and

(b) the risks that the future cash flows will differ in amount or timing from estimates.

50. As a starting point, the enterprise may take into account the following rates:

(a) the enterprise's weighted average cost of capital determined using techniques such as the Capital Asset Pricing Model;

(b) the enterprise's incremental borrowing rate; and

(c) other market borrowing rates.

51. These rates are adjusted:

(a) to reflect the way that the market would assess the specific risks associated with the projected cash flows; and

(b) to exclude risks that are not relevant to the projected cash flows.

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

52. To avoid double counting, the discount rate does not reflect risks for which future cash flow estimates have been adjusted.

53. The discount rate is independent of the enterprise's capital structure and the way the enterprise financed the purchase of the asset because the future cash flows expected to arise from an asset do not depend on the way in which the enterprise financed the purchase of the asset.

54. When the basis for the rate is post-tax, that basis is adjusted to reflect a pre-tax rate.

55. An enterprise normally uses a single discount rate for the estimate of an asset's value in use. However, an enterprise uses separate discount rates for different future periods where value in use is sensitive to a difference in risks for different periods or to the term structure of interest rates.

Recognition and Measurement of an Impairment Loss

56. Paragraphs 57 to 62 set out the requirements for recognising and measuring impairment losses for an individual asset. Recognition and measurement of impairment losses for a cash-generating unit are dealt with in paragraphs 87 to 92.

57. If the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. That reduction is an impairment loss.

58. An impairment loss should be recognised as an expense in the statement of profit and loss immediately, unless the asset is carried at revalued amount in accordance with another Accounting Standard (see Accounting Standard (AS) 10, Property, Plant and Equipment), in which case any impairment loss of a revalued asset should be treated as a revaluation decrease under that Accounting Standard.

59. An impairment loss on a revalued asset is recognised as an expense in the statement of profit and loss. However, an impairment loss on a revalued asset is recognised directly against

any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset.

60. When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an enterprise should recognise a liability if, and only if, that is required by another Accounting Standard.

61. After the recognition of an impairment loss, the depreciation (amortisation) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

62. If an impairment loss is recognised, any related deferred tax assets or liabilities are determined under Accounting Standard (AS) 22, *Accounting for Taxes on Income* (see Illustration 3 given in the Illustrations attached to the Standard).

Cash-Generating Units

63. Paragraphs 64 to 92 set out the requirements for identifying the cash-generating unit to which an asset belongs and determining the carrying amount of, and recognising impairment losses for, cash-generating units.

Identification of the Cash-Generating Unit to Which an Asset Belongs

64. If there is any indication that an asset may be impaired, the recoverable amount should be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, an enterprise should determine the recoverable amount of the cash-generating unit to which the asset belongs (the asset's cash-generating unit).

65. The recoverable amount of an individual asset cannot be determined if:

(a) the asset's value in use cannot be estimated to be close to its net selling price (for example, when the future cash flows from continuing use of the asset cannot be estimated to be negligible); and

(b) the asset does not generate cash inflows from continuing use that are largely independent of those from other assets. In such cases, value in use and, therefore, recoverable amount, can be determined only for the asset's cash-generating unit.

Example

A mining enterprise owns a private railway to support its mining activities. The private railway could be sold only for scrap value and the private railway does not generate cash inflows from continuing use that are largely independent of the cash inflows from the other assets of the mine.

It is not possible to estimate the recoverable amount of the private railway because the value in use of the private railway cannot be determined and it is probably different from scrap value. Therefore, the enterprise estimates the recoverable amount of the cash-generating unit to which the private railway belongs, that is, the mine as a whole.

66. As defined in paragraph 4, an asset's cash-generating unit is the smallest group of assets that includes the asset and that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets. Identification of an asset's cash-generating unit involves judgement. If recoverable amount cannot be determined for an individual asset, an enterprise identifies the lowest aggregation of assets that generate

largely independent cash inflows from continuing use.

Example

A bus company provides services under contract with a municipality that requires minimum service on each of five separate routes. Assets devoted to each route and the cash flows from each route can be identified separately. One of the routes operates at a significant loss.

Because the enterprise does not have the option to curtail any one bus route, the lowest level of identifiable cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets is the cash inflows generated by the five routes together. The cash-generating unit for each route is the bus company as a whole.

67. Cash inflows from continuing use are inflows of cash and cash equivalents received from parties outside the reporting enterprise. In identifying whether cash inflows from an asset (or group of assets) are largely independent of the cash inflows from other assets (or groups of assets), an enterprise considers various factors including how management monitors the enterprise's operations (such as by-product lines, businesses, individual locations, districts or regional areas or in some other way) or how management makes decisions about continuing or disposing of the enterprise's assets and operations. Illustation 1 in the Illustrations attached to the Standard illustrates identification of a cash-generating unit.

68. If an active market exists for the output produced by an asset or a group of assets, this asset or group of assets should be identified as a separate cash-generating unit, even if some or all of the output is used internally. If this is the case, management's best estimate of future market prices for the output should be used:

(a) in determining the value in use of this cash-generating unit, when estimating the future cash inflows that relate to the internal use of the output; and

(b) in determining the value in use of other cash-generating units of the reporting enterprise, when estimating the future cash outflows that relate to the internal use of the output.

69. Even if part or all of the output produced by an asset or a group of assets is used by other units of the reporting enterprise (for example, products at an intermediate stage of a production process), this asset or group of assets forms a separate cash-generating unit if the enterprise could sell this output in an active market. This is because this asset or group of assets could generate cash inflows from continuing use that would be largely independent of the cash inflows from other assets or groups of assets. In using information based on financial budgets/forecasts that relates to such a cash-generating unit, an enterprise adjusts this information if internal transfer prices do not reflect management's best estimate of future market prices for the cash-generating unit's output.

70. Cash-generating units should be identified consistently from period to period for the same asset or types of assets, unless a change is justified.

71. If an enterprise determines that an asset belongs to a different cash- generating unit than in previous periods, or that the types of assets aggregated for the asset's cash-generating unit have changed, paragraph 121 requires certain disclosures about the cash-generating unit, if an impairment loss is recognised or reversed for the cash-generating unit and is material to the financial statements of the reporting enterprise as a whole.

Recoverable Amount and Carrying Amount of a Cash- Generating Unit

72. The recoverable amount of a cash-generating unit is the higher of the cash-generating unit's net selling price and value in use. For the purpose of determining the recoverable amount of a cash-generating unit, any reference in paragraphs 15 to 55 to 'an asset' is read as a reference to 'a cash-generating unit'.

73. The carrying amount of a cash-generating unit should be determined consistently with the way the recoverable amount of the cash-generating unit is determined.

74. The carrying amount of a cash-generating unit:

(a) includes the carrying amount of only those assets that can be attributed directly, or allocated on a reasonable and consistent basis, to the cash-generating unit and that will generate the future cash inflows estimated in determining the cash-generating unit's value in use; and

(b) does not include the carrying amount of any recognised liability, unless the recoverable amount of the cash-generating unit cannot be determined without consideration of this liability.

This is because net selling price and value in use of a cash-generating unit are determined excluding cash flows that relate to assets that are not part of the cash-generating unit and liabilities that have already been recognised in the financial statements, as set out in paragraphs 23 and 35.

75. Where assets are grouped for recoverability assessments, it is important to include in the cash-generating unit all assets that generate the relevant stream of cash inflows from continuing use. Otherwise, the cash-generating unit may appear to be fully recoverable when in fact an impairment loss has occurred. In some cases, although certain assets contribute to the estimated future cash flows of a cash-generating unit, they cannot be allocated to the cash-generating unit on a reasonable and consistent basis. This might be the case for goodwill or corporate assets such as head office assets. Paragraphs 78 to 86 explain how to deal with these assets in testing a cash-generating unit for impairment.

76. It may be necessary to consider certain recognised liabilities in order to determine the recoverable amount of a cash-generating unit. This may occur if the disposal of a cash-generating unit would require the buyer to take over a liability. In this case, the net selling price (or the estimated cash flow from ultimate disposal) of the cash-generating unit is the estimated selling price for the assets of the cash-generating unit and the liability together, less the costs of disposal. In order to perform a meaningful comparison between the carrying amount of the cash-generating unit and its recoverable amount, the carrying amount of the liability is deducted in determining both the cash-generating unit's value in use and its carrying amount.

Example

A company operates a mine in a country where legislation requires that the owner must restore the site on completion of its mining operations. The cost of restoration includes the replacement of the overburden, which must be removed before mining operations commence. A provision for the costs to replace the overburden was recognised as soon as the overburden was removed. The amount provided was recognised as part of the cost of the mine and is being depreciated over the mine's useful life. The carrying amount of the provision for restoration costs is Rs. 50,00,000, which is equal to the present value of the restoration costs.

The enterprise is testing the mine for impairment. The cash-generating unit for the mine is the mine as a whole. The enterprise has received various offers to buy the mine at a price of around Rs. 80,00,000; this price encompasses the fact that the buyer will take over the

obligation to restore the overburden. Disposal costs for the mine are negligible. The value in use of the mine is approximately Rs. 1,20,00,000 excluding restoration costs. The carrying amount of the mine is Rs. 1,00,00,000.

The net selling price for the cash-generating unit is Rs. 80,00,000. This amount considers restoration costs that have already been provided for. As a consequence, the value in use for the cash-generating unit is determined after consideration of the restoration costs and is estimated to be Rs. 70,00,000 (Rs. 1,20,00,000 less Rs. 50,00,000). The carrying amount of the cash-generating unit is Rs. 50,00,000, which is the carrying amount of the mine (Rs. 1,00,00,000) less the carrying amount of the provision for restoration costs (Rs. 50,00,000).

77. For practical reasons, the recoverable amount of a cash-generating unit is sometimes determined after consideration of assets that are not part of the cash-generating unit (for example, receivables or other financial assets) or liabilities that have already been recognised in the financial statements (for example, payables, pensions and other provisions). In such cases, the carrying amount of the cash-generating unit is increased by the carrying amount of those assets and decreased by the carrying amount of those liabilities.

Goodwill

78. In testing a cash-generating unit for impairment, an enterprise should identify whether goodwill that relates to this cash-generating unit is recognised in the financial statements. If this is the case, an enterprise should:

(a) perform a 'bottom-up' test, that is, the enterprise should:

(i) identify whether the carrying amount of goodwill can be allocated on a reasonable and consistent basis to the cash- generating unit under review; and

(ii) then, compare the recoverable amount of the cash- generating unit under review to its carrying amount (including the carrying amount of allocated goodwill, if any) and recognise any impairment loss in accordance with paragraph 87.

The enterprise should perform the step at (ii) above even if none of the carrying amount of goodwill can be allocated on a reasonable and consistent basis to the cash-generating unit under review; and

(b) if, in performing the 'bottom-up' test, the enterprise could not allocate the carrying amount of goodwill on a reasonable and consistent basis to the cash-generating unit under review, the enterprise should also perform a 'top-down' test, that is, the enterprise should:

(i) identify the smallest cash-generating unit that includes the cash-generating unit under review and to which the carrying amount of goodwill can be allocated on a reasonable and consistent basis (the 'larger ' cash- generating unit); and

(ii) then, compare the recoverable amount of the larger cash- generating unit to its carrying amount (including the carrying amount of allocated goodwill) and recognise any impairment loss in accordance with paragraph 87.

79. Goodwill arising on acquisition represents a payment made by an acquirer in anticipation of future economic benefits. The future economic benefits may result from synergy between the identifiable assets acquired or from assets that individually do not qualify for recognition in the financial statements. Goodwill does not generate cash flows independently from other assets or groups of assets and, therefore, the recoverable amount of goodwill as an individual asset cannot be determined. As a consequence, if there is an indication that goodwill may be

impaired, recoverable amount is determined for the cash-generating unit to which goodwill belongs. This amount is then compared to the carrying amount of this cash-generating unit and any impairment loss is recognised in accordance with paragraph 87.

80. Whenever a cash-generating unit is tested for impairment, an enterprise considers any goodwill that is associated with the future cash flows to be generated by the cash-generating unit. If goodwill can be allocated on a reasonable and consistent basis, an enterprise applies the 'bottom-up' test only. If it is not possible to allocate goodwill on a reasonable and consistent basis, an enterprise applies both the 'bottom-up' test and 'top-down' test (see Illustration 7 given in the Illustrations attached to the Standard).

81. The 'bottom-up' test ensures that an enterprise recognises any impairment loss that exists for a cash-generating unit, including for goodwill that can be allocated on a reasonable and consistent basis. Whenever it is impracticable to allocate goodwill on a reasonable and consistent basis in the 'bottom-up' test, the combination of the 'bottom-up' and the 'top-down' test ensures that an enterprise recognises:

(a) first, any impairment loss that exists for the cash-generating unit excluding any consideration of goodwill; and

(b) then, any impairment loss that exists for goodwill. Because an enterprise applies the 'bottom-up' test first to all assets that may be impaired, any impairment loss identified for the larger cash-generating unit in the 'top-down' test relates only to goodwill allocated to the larger unit.

82. If the 'top-down' test is applied, an enterprise formally determines the recoverable amount of the larger cash-generating unit, unless there is persuasive evidence that there is no risk that the larger cash-generating unit is impaired.

Corporate Assets

83. Corporate assets include group or divisional assets such as the building of a headquarters or a division of the enterprise, EDP equipment or a research centre. The structure of an enterprise determines whether an asset meets the definition of corporate assets (see paragraph 4) for a particular cash- generating unit. Key characteristics of corporate assets are that they do not generate cash inflows independently from other assets or groups of assets and their carrying amount cannot be fully attributed to the cash-generating unit under review.

84. Because corporate assets do not generate separate cash inflows, the recoverable amount of an individual corporate asset cannot be determined unless management has decided to dispose of the asset. As a consequence, if there is an indication that a corporate asset may be impaired, recoverable amount is determined for the cash-generating unit to which the corporate asset belongs, compared to the carrying amount of this cash-generating unit and any impairment loss is recognised in accordance with paragraph 87.

85. In testing a cash-generating unit for impairment, an enterprise should identify all the corporate assets that relate to the cash-generating unit under review. For each identified corporate asset, an enterprise should then apply paragraph 78, that is:

(a) if the carrying amount of the corporate asset can be allocated on a reasonable and consistent basis to the cash-generating unit under review, an enterprise should apply the 'bottom-up' test only; and

(b) if the carrying amount of the corporate asset cannot be allocated on a reasonable and consistent basis to the cash-generating unit under review, an enterprise should apply both the 'bottom- up' and 'top-down' tests.

86. An Illustration of how to deal with corporate assets is given as Illustration 8 in the Illustrations attached to the Standard.

Impairment Loss for a Cash-Generating Unit

87. An impairment loss should be recognised for a cash-generating unit if, and only if, its recoverable amount is less than its carrying amount. The impairment loss should be allocated to reduce the carrying amount of the assets of the unit in the following order:

(a) first, to goodwill allocated to the cash-generating unit (if any); and

(b) then, to the other assets of the unit on a pro-rata basis based on the carrying amount of each asset in the unit.

These reductions in carrying amounts should be treated as impairment losses on individual assets and recognised in accordance with paragraph 58.

88. In allocating an impairment loss under paragraph 87, the carrying amount of an asset should not be reduced below the highest of:

(a) its net selling price (if determinable);

(b) its value in use (if determinable); and

(c) zero.

The amount of the impairment loss that would otherwise have been allocated to the asset should be allocated to the other assets of the unit on a pro-rata basis.

89. The goodwill allocated to a cash-generating unit is reduced before reducing the carrying amount of the other assets of the unit because of its nature.

90. If there is no practical way to estimate the recoverable amount of each individual asset of a cash-generating unit, this Standard requires the allocation of the impairment loss between the assets of that unit other than goodwill on a pro-rata basis, because all assets of a cash-generating unit work together.

91. If the recoverable amount of an individual asset cannot be determined (see paragraph 65):

(a) an impairment loss is recognised for the asset if its carrying amount is greater than the higher of its net selling price and the results of the allocation procedures described in paragraphs 87 and 88; and

(b) no impairment loss is recognised for the asset if the related cash- generating unit is not impaired. This applies even if the asset's net selling price is less than its carrying amount.

Example

A machine has suffered physical damage but is still working, although not as well as it used to. The net selling price of the machine is less than its carrying amount. The machine does not generate independent cash inflows from continuing use. The smallest identifiable group of assets that includes the machine and generates cash inflows from continuing use that are largely independent of the cash inflows from other assets is the production line to which the machine belongs. The recoverable amount of the production line shows that the production line taken as a whole is not impaired.

Assumption 1: Budgets/forecasts approved by management reflect no commitment of

management to replace the machine.

The recoverable amount of the machine alone cannot be estimated since the machine's value in use:

(a) may differ from its net selling price; and

(b) can be determined only for the cash-generating unit to which the machine belongs (the production line).

The production line is not impaired, therefore, no impairment loss is recognised for the machine. Nevertheless, the enterprise may need to reassess the depreciation period or the depreciation method for the machine. Perhaps, a shorter depreciation period or a faster depreciation method is required to reflect the expected remaining useful life of the machine or the pattern in which economic benefits are consumed by the enterprise.

Assumption 2: Budgets/forecasts approved by management reflect a commitment of management to replace the machine and sell it in the near future. Cash flows from continuing use of the machine until its disposal are estimated to be negligible.

The machine's value in use can be estimated to be close to its net selling price. Therefore, the recoverable amount of the machine can be determined and no consideration is given to the cash-generating unit to which the machine belongs (the production line). Since the machine's net selling price is less than its carrying amount, an impairment loss is recognised for the machine.

92. After the requirements in paragraphs 87 and 88 have been applied, a liability should be recognised for any remaining amount of an impairment loss for a cash-generating unit if that is required by another Accounting Standard.

Reversal of an Impairment Loss

93. Paragraphs 94 to 100 set out the requirements for reversing an impairment loss recognised for an asset or a cash-generating unit in prior accounting periods. These requirements use the term 'an asset' but apply equally to an individual asset or a cash-generating unit. Additional requirements are set out for an individual asset in paragraphs 101 to 105, for a cash-generating unit in paragraphs 106 to 107 and for goodwill in paragraphs 108 to 111.

94. An enterprise should assess at each balance sheet date whether there is any indication that an impairment loss recognised for an asset in prior accounting periods may no longer exist or may have decreased. If any such indication exists, the enterprise should estimate the recoverable amount of that asset.

95. In assessing whether there is any indication that an impairment loss recognised for an asset in prior accounting periods may no longer exist or may have decreased, an enterprise should consider, as a minimum, the following indications:

External sources of information

(a) the asset's market value has increased significantly during the period;

(b) significant changes with a favourable effect on the enterprise have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the enterprise operates or in the market to which the asset is dedicated;

(c) market interest rates or other market rates of return on investments have decreased during the period, and those decreases are likely to affect the discount rate used in calculating the asset's value in use and increase the asset's recoverable amount materially;

Internal sources of information

(d) significant changes with a favourable effect on the enterprise have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, the asset is used or is expected to be used. These changes include capital expenditure that has been incurred during the period to improve or enhance an asset in excess of its originally assessed standard of performance or a commitment to discontinue or restructure the operation to which the asset belongs; and

(e) evidence is available from internal reporting that indicates that the economic performance of the asset is, or will be, better than expected.

96. Indications of a potential decrease in an impairment loss in paragraph 95 mainly mirror the indications of a potential impairment loss in paragraph 8. The concept of materiality applies in identifying whether an impairment loss recognised for an asset in prior accounting periods may need to be reversed and the recoverable amount of the asset determined.

97. If there is an indication that an impairment loss recognised for an asset may no longer exist or may have decreased, this may indicate that the remaining useful life, the depreciation (amortisation) method or the residual value may need to be reviewed and adjusted in accordance with the Accounting Standard applicable to the asset, even if no impairment loss is reversed for the asset.

98. An impairment loss recognised for an asset in prior accounting periods should be reversed if there has been a change in the estimates of cash inflows, cash outflows or discount rates used to determine the asset's recoverable amount since the last impairment loss was recognised. If this is the case, the carrying amount of the asset should be increased to its recoverable amount. That increase is a reversal of an impairment loss.

99. A reversal of an impairment loss reflects an increase in the estimated service potential of an asset, either from use or sale, since the date when an enterprise last recognised an impairment loss for that asset. An enterprise is required to identify the change in estimates that causes the increase in estimated service potential. Examples of changes in estimates include:

(a) a change in the basis for recoverable amount (i.e., whether recoverable amount is based on net selling price or value in use);

(b) if recoverable amount was based on value in use: a change in the amount or timing of estimated future cash flows or in the discount rate; or

(c) if recoverable amount was based on net selling price: a change in estimate of the components of net selling price.

100. An asset's value in use may become greater than the asset's carrying amount simply because the present value of future cash inflows increases as they become closer. However, the service potential of the asset has not increased. Therefore, an impairment loss is not reversed just because of the passage of time (sometimes called the 'unwinding' of the discount), even if the recoverable amount of the asset becomes higher than its carrying amount.

Reversal of an Impairment Loss for an Individual Asset

101. The increased carrying amount of an asset due to a reversal of an impairment loss should not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior accounting periods.

102. Any increase in the carrying amount of an asset above the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior accounting periods is a revaluation. In accounting for such a revaluation, an enterprise applies the Accounting Standard applicable to the asset.

103. A reversal of an impairment loss for an asset should be recognised as income immediately in the statement of profit and loss, unless the asset is carried at revalued amount in accordance with another Accounting Standard (see Accounting Standard (AS) 10, Property, Plant and Equipment) in which case any reversal of an impairment loss on a revalued asset should be treated as a revaluation increase under that Accounting Standard.

104. A reversal of an impairment loss on a revalued asset is credited directly to equity under the heading revaluation surplus. However, to the extent that an impairment loss on the same revalued asset was previously recognised as an expense in the statement of profit and loss, a reversal of that impairment loss is recognised as income in the statement of profit and loss.

105. After a reversal of an impairment loss is recognised, the depreciation (amortisation) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

Reversal of an Impairment Loss for a Cash-Generating Unit

106. A reversal of an impairment loss for a cash-generating unit should be allocated to increase the carrying amount of the assets of the unit in the following order:

- ***(a) first, assets other than goodwill on a pro-rata basis based on the carrying amount of each asset in the unit; and***
- ***(b) then, to goodwill allocated to the cash-generating unit (if any), if the requirements in paragraph 108 are met.***

These increases in carrying amounts should be treated as reversals of impairment losses for individual assets and recognised in accordance with paragraph 103.

107. In allocating a reversal of an impairment loss for a cash-generating unit under paragraph 106, the carrying amount of an asset should not be increased above the lower of:

- ***(a) its recoverable amount (if determinable); and***
- ***(b) the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior accounting periods.***

The amount of the reversal of the impairment loss that would otherwise have been allocated to the asset should be allocated to the other assets of the unit on a pro-rata basis.

Reversal of an Impairment Loss for Goodwill

108. As an exception to the requirement in paragraph 98, an impairment loss recognised for

goodwill should not be reversed in a subsequent period unless:

(a) the impairment loss was caused by a specific external event of an exceptional nature that is not expected to recur; and

(b) subsequent external events have occurred that reverse the effect of that event.

109. Accounting Standard (AS) 26, *Intangible Assets*, prohibits the recognition of internally generated goodwill. Any subsequent increase in the recoverable amount of goodwill is likely to be an increase in internally generated goodwill, unless the increase relates clearly to the reversal of the effect of a specific external event of an exceptional nature.

110. This Standard does not permit an impairment loss to be reversed for goodwill because of a change in estimates (for example, a change in the discount rate or in the amount and timing of future cash flows of the cash-generating unit to which goodwill relates).

111. A specific external event is an event that is outside of the control of the enterprise. Examples of external events of an exceptional nature include new regulations that significantly curtail the operating activities, or decrease the profitability, of the business to which the goodwill relates.

Impairment in case of Discontinuing Operations

112. The approval and announcement of a plan for discontinuance[5] is an indication that the assets attributable to the discontinuing operation may be impaired or that an impairment loss previously recognised for those assets should be increased or reversed. Therefore, in accordance with this Standard an enterprise estimates the recoverable amount of each asset of the discontinuing operation and recognises an impairment loss or reversal of a prior impairment loss, if any.

113. In applying this Standard to a discontinuing operation, an enterprise determines whether the recoverable amount of an asset of a discontinuing operation is assessed for the individual asset or for the asset's cash-generating unit. For example:

(a) if the enterprise sells the discontinuing operation substantially in its entirety, none of the assets of the discontinuing operation generate cash inflows independently from other assets within the discontinuing operation. Therefore, recoverable amount is determined for the discontinuing operation as a whole and an impairment loss, if any, is allocated among the assets of the discontinuing operation in accordance with this Standard;

(b) if the enterprise disposes of the discontinuing operation in other ways such as piecemeal sales, the recoverable amount is determined for individual assets, unless the assets are sold in groups; and

(c) if the enterprise abandons the discontinuing operation, the recoverable amount is determined for individual assets as set out in this Standard.

114. After announcement of a plan, negotiations with potential purchasers of the discontinuing operation or actual binding sale agreements may indicate that the assets of the discontinuing operation may be further impaired or that impairment losses recognised for these assets in prior periods may have decreased. As a consequence, when such events occur, an enterprise re-estimates the recoverable amount of the assets of the discontinuing operation and recognises resulting impairment losses or reversals of impairment losses in accordance with this Standard.

[5] See Accounting Standard (AS) 24, *Discontinuing Operations*.

115. A price in a binding sale agreement is the best evidence of an asset's (cash-generating unit's) net selling price or of the estimated cash inflow from ultimate disposal in determining the asset's (cash-generating unit's) value in use.

116. The carrying amount (recoverable amount) of a discontinuing operation includes the carrying amount (recoverable amount) of any goodwill that can be allocated on a reasonable and consistent basis to that discontinuing operation.

Disclosure

117. For each class of assets, the financial statements should disclose:

(a) the amount of impairment losses recognised in the statement of profit and loss during the period and the line item(s) of the statement of profit and loss in which those impairment losses are included;

(b) the amount of reversals of impairment losses recognised in the statement of profit and loss during the period and the line item(s) of the statement of profit and loss in which those impairment losses are reversed;

(c) the amount of impairment losses recognised directly against revaluation surplus during the period; and

(d) the amount of reversals of impairment losses recognised directly in revaluation surplus during the period.

118. A class of assets is a grouping of assets of similar nature and use in an enterprise's operations.

119. The information required in paragraph 117 may be presented with other information disclosed for the class of assets. For example, this information may be included in a reconciliation of the carrying amount of fixed assets, at the beginning and end of the period, as required under AS 10, *Property, Plant and Equipment*.

120. An enterprise that applies AS 17, Segment Reporting, should disclose the following for each reportable segment based on an enterprise's primary format (as defined in AS 17):

(a) the amount of impairment losses recognised in the statement of profit and loss and directly against revaluation surplus during the period; and

(b) the amount of reversals of impairment losses recognised in the statement of profit and loss and directly in revaluation surplus during the period.

121. If an impairment loss for an individual asset or a cash-generating unit is recognised or reversed during the period and is material to the financial statements of the reporting enterprise as a whole, an enterprise should disclose:

(a) the events and circumstances that led to the recognition or reversal of the impairment loss;

(b) the amount of the impairment loss recognised or reversed;

(c) for an individual asset:
(i) the nature of the asset; and

(ii) the reportable segment to which the asset belongs, based on the enterprise's primary format (as defined in AS 17, Segment Reporting);

(d) for a cash-generating unit:

(i) a description of the cash-generating unit (such as whether it is a product line, a plant, a business operation, a geographical area, a reportable segment as defined in AS 17 or other);

(ii) the amount of the impairment loss recognised or reversed by class of assets and by reportable segment based on the enterprise's primary format (as defined in AS 17); and

(iii) if the aggregation of assets for identifying the cash-generating unit has changed since the previous estimate of the cash- generating unit's recoverable amount (if any), the enterprise should describe the current and former way of aggregating assets and the reasons for changing the way the cash- generating unit is identified;

(e) whether the recoverable amount of the asset (cash-generating unit) is its net selling price or its value in use;

(f) if recoverable amount is net selling price, the basis used to determine net selling price (such as whether selling price was determined by reference to an active market or in some other way); and

(g) if recoverable amount is value in use, the discount rate(s) used in the current estimate and previous estimate (if any) of value in use.
Provided that if a Small and Medium-Sized Company, as defined in the Notification, chooses to measure the 'value in use' as per the proviso to paragraph 4.2 of the Standard, such an SMC need not disclose the information required by paragraph 121(g) of the Standard.

122. If impairment losses recognised (reversed) during the period are material in aggregate to the financial statements of the reporting enterprise as a whole, an enterprise should disclose a brief description of the following:

(a) the main classes of assets affected by impairment losses (reversals of impairment losses) for which no information is disclosed under paragraph 121; and

(b) the main events and circumstances that led to the recognition (reversal) of these impairment losses for which no information is disclosed under paragraph 121.

123. An enterprise is encouraged to disclose key assumptions used to determine the recoverable amount of assets (cash-generating units) during the period.

Transitional Provisions[6]

124. On the date of this Standard becoming mandatory, an enterprise should assess whether there is any indication that an asset may be impaired (see paragraphs 5-13). If any such indication exists, the enterprise should determine impairment loss, if any, in accordance with this Standard. The impairment loss, so determined, should be adjusted against opening

[6] Transitional Provisions given in paragraphs 124-125 are relevant only for standards notified under Companies (Accounting Standards) Rules, 2006, as amended from time to time.

balance of revenue reserves being the accumulated impairment loss relating to periods prior to this Standard becoming mandatory unless the impairment loss is on a revalued asset. An impairment loss on a revalued asset should be recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset. If the impairment loss exceeds the amount held in the revaluation surplus for that same asset, the excess should be adjusted against opening balance of revenue reserves.

125. Any impairment loss arising after the date of this Standard becoming mandatory should be recognised in accordance with this Standard (i.e., in the statement of profit and loss unless an asset is carried at revalued amount. An impairment loss on a revalued asset should be treated as a revaluation decrease).

Illustrations

These illustrations do not form part of the Accounting Standard. The purpose of these Illustrations is to illustrate the application of the Accounting Standard to assist in clarifying its meaning.

All these illustrations assume the enterprises concerned have no transactions other than those described.

Illustration 1 - Identification of Cash-Generating Units

The purpose of this Illustration is:

(a) to give an indication of how cash-generating units are identified in various situations; and

(b) to highlight certain factors that an enterprise may consider in identifying the cash-generating unit to which an asset belongs.

A - Retail Store Chain

Background

Al. Store X belongs to a retail store chain M. X makes all its retail purchases through M's purchasing centre. Pricing, marketing, advertising and human resources policies (except for hiring X's cashiers and salesmen) are decided by M. M also owns 5 other stores in the same city as X (although in different neighbourhoods) and 20 other stores in other cities. All stores are managed in the same way as X. X and 4 other stores were purchased 4 years ago and goodwill was recognised.

What is the cash-generating unit for X (X's cash-generating unit)?

Analysis

A2. In identifying X's cash-generating unit, an enterprise considers whether, for example:

(a) internal management reporting is organised to measure performance on a store-by-store basis; and

(b) the business is run on a store-by-store profit basis or on region/city basis.

A3. All M's stores are in different neighbourhoods and probably have different customer bases. So, although X is managed at a corporate level, X generates cash inflows that are largely independent from those of M's other stores. Therefore, it is likely that X is a cash-generating

unit.

A4. If the carrying amount of the goodwill can be allocated on a reasonable and consistent basis to X's cash-generating unit, M applies the 'bottom-up' test described in paragraph 78 of this Standard. If the carrying amount of the goodwill cannot be allocated on a reasonable and consistent basis to X's cash-generating unit, M applies the 'bottom-up' and 'top-down' tests.

B - Plant for an Intermediate Step in a Production Process

Background

A5. A significant raw material used for plant Y's final production is an intermediate product bought from plant X of the same enterprise. X's products are sold to Y at a transfer price that passes all margins to X. 80% of Y's final production is sold to customers outside of the reporting enterprise.
60% of X's final production is sold to Y and the remaining 40% is sold to customers outside of the reporting enterprise.

For each of the following cases, what are the cash-generating units for X and Y?

Case 1: X could sell the products it sells to Y in an active market. Internal transfer prices are higher than market prices.

Case 2: There is no active market for the products X sells to Y.

Analysis

Case 1

A6. X could sell its products on an active market and, so, generate cash inflows from continuing use that would be largely independent of the cash inflows from Y. Therefore, it is likely that X is a separate cash-generating unit, although part of its production is used by Y (see paragraph 68 of this Standard).

A7. It is likely that Y is also a separate cash-generating unit. Y sells 80% of its products to customers outside of the reporting enterprise. Therefore, its cash inflows from continuing use can be considered to be largely independent.

A8. Internal transfer prices do not reflect market prices for X's output. Therefore, in determining value in use of both X and Y, the enterprise adjusts financial budgets/forecasts to reflect management's best estimate of future market prices for those of X's products that are used internally (see paragraph 68 of this Standard).

Case 2

A9. It is likely that the recoverable amount of each plant cannot be assessed independently from the recoverable amount of the other plant because:

(a) the majority of X's production is used internally and could not be sold in an active market. So, cash inflows of X depend on demand for Y's products. Therefore, X cannot be considered to generate cash inflows that are largely independent from those of Y; and

(b) the two plants are managed together.

A10. As a consequence, it is likely that X and Y together is the smallest group of assets that generates cash inflows from continuing use that are largely independent.

C - Single Product Enterprise

Background

A11. Enterprise M produces a single product and owns plants A, B and C. Each plant is located in a different continent. A produces a component that is assembled in either B or C. The combined capacity of B and C is not fully utilised. M's products are sold world-wide from either B or C. For example, B's production can be sold in C's continent if the products can be delivered faster from B than from C. Utilisation levels of B and C depend on the allocation of sales between the two sites.

For each of the following cases, what are the cash-generating units for A, B and C?

Case 1: There is an active market for A's products.

Case 2: There is no active market for A's products.

Analysis

Case 1

A12. It is likely that A is a separate cash-generating unit because there is an active market for its products (see Example B-Plant for an Intermediate Step in a Production Process, Case 1).

A13. Although there is an active market for the products assembled by B and C, cash inflows for B and C depend on the allocation of production across the two sites. It is unlikely that the future cash inflows for B and C can be determined individually. Therefore, it is likely that B and C together is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent.

A14. In determining the value in use of A and B plus C, M adjusts financial budgets/forecasts to reflect its best estimate of future market prices for A's products (see paragraph 68 of this Standard).

Case 2

A15. It is likely that the recoverable amount of each plant cannot be assessed independently because:

(a) there is no active market for A's products. Therefore, A's cash inflows depend on sales of the final product by B and C; and

(b) although there is an active market for the products assembled by B and C, cash inflows for B and C depend on the allocation of production across the two sites. It is unlikely that the future cash inflows for B and C can be determined individually.

A16. As a consequence, it is likely that A, B and C together (i.e., M as a whole) is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent.

D - Magazine Titles

Background

A17. A publisher owns 150 magazine titles of which 70 were purchased and 80 were self-created. The price paid for a purchased magazine title is recognised as an intangible asset. The costs of creating magazine titles and maintaining the existing titles are recognised as an expense when incurred. Cash inflows from direct sales and advertising are identifiable for

each magazine title. Titles are managed by customer segments. The level of advertising income for a magazine title depends on the range of titles in the customer segment to which the magazine title relates. Management has a policy to abandon old titles before the end of their economic lives and replace them immediately with new titles for the same customer segment.

What is the cash-generating unit for an individual magazine title?

Analysis

A18. It is likely that the recoverable amount of an individual magazine title can be assessed. Even though the level of advertising income for a title is influenced, to a certain extent, by the other titles in the customer segment, cash inflows from direct sales and advertising are identifiable for each title. In addition, although titles are managed by customer segments, decisions to abandon titles are made on an individual title basis.

A19. Therefore, it is likely that individual magazine titles generate cash inflows that are largely independent one from another and that each magazine title is a separate cash-generating unit.

E - Building: Half-Rented to Others and Half-Occupied for Own Use

Background

A20. M is a manufacturing company. It owns a headquarter building that used to be fully occupied for internal use. After down-sizing, half of the building is now used internally and half rented to third parties. The lease agreement with the tenant is for five years.

What is the cash-generating unit of the building?

Analysis

A21. The primary purpose of the building is to serve as a corporate asset, supporting M's manufacturing activities. Therefore, the building as a whole cannot be considered to generate cash inflows that are largely independent of the cash inflows from the enterprise as a whole. So, it is likely that the cash-generating unit for the building is M as a whole.

A22. The building is not held as an investment. Therefore, it would not be appropriate to determine the value in use of the building based on projections of future market related rents.

Illustration 2 - Calculation of Value in Use and Recognition of an Impairment Loss

In this illustration, tax effects are ignored.

Background and Calculation of Value in Use

A23. At the end of 20X0, enterprise T acquires enterprise M for Rs. 10,000 lakhs. M has manufacturing plants in 3 countries. The anticipated useful life of the resulting merged activities is 15 years.

Schedule 1. Data at the end of 20X0 (Amount in Rs. lakhs)

End of 20X0	*Allocation of purchase price*	*Fair value of identifiable assets*	*Goodwill*[(1)]
Activities in Country A	3,000	2,000	1,000
Activities in Country B	2,000	1,500	500
Activities in Country C	5,000	3,500	1,500

Total	10,000	7,000	3,000

(1) Activities in each country are the smallest cash-generating units to which goodwill can be allocated on a reasonable and consistent basis (allocation based on the purchase price of the activities in each country, as specified in the purchase agreement).

A24. T uses straight-line depreciation over a 15-year life for the Country A assets and no residual value is anticipated. In respect of goodwill, T uses straight-line amortisation over a 5 year life.

A25. In 20X4, a new government is elected in Country A. It passes legislation significantly restricting exports of T's main product. As a result, and for the foreseeable future, T's production will be cut by 40%.

A26. The significant export restriction and the resulting production decrease require T to estimate the recoverable amount of the goodwill and net assets of the Country A operations. The cash-generating unit for the goodwill and the identifiable assets of the Country A operations is the Country A operations, since no independent cash inflows can be identified for individual assets.

A27. The net selling price of the Country A cash-generating unit is not determinable, as it is unlikely that a ready buyer exists for all the assets of that unit.

A28. To determine the value in use for the Country A cash-generating unit (see Schedule 2), T:

(a) prepares cash flow forecasts derived from the most recent financial budgets/forecasts for the next five years (years 20X5-20X9) approved by management;

(b) estimates subsequent cash flows (years 20X10-20X15) based on declining growth rates. The growth rate for 20X10 is estimated to be 3%. This rate is lower than the average long- term growth rate for the market in Country A; and

(c) selects a 15% discount rate, which represents a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the Country A cash-generating unit.

Recognition and Measurement of Impairment Loss

A29. The recoverable amount of the Country A cash-generating unit is 1,360 lakhs: the higher of the net selling price of the Country A cash- generating unit (not determinable) and its value in use (Rs. 1,360 lakhs).

A30. T compares the recoverable amount of the Country A cash-generating unit to its carrying amount (see Schedule 3).

A31. T recognises an impairment loss of Rs. 307 lakhs immediately in the statement of profit and loss. The carrying amount of the goodwill that relates to the Country A operations is eliminated before reducing the carrying amount of other identifiable assets within the Country A cash-generating unit (see paragraph 87 of this Standard).

A32. Tax effects are accounted for separately in accordance with AS 22, Accounting for Taxes on Income.

Schedule 2. Calculation of the value in use of the Country A cash-generating unit at the end of 20X4 (Amount in Rs. lakhs)

Year	*Long-term*	*Future*	*Present value*	*Discounted*

	growth rates	*cash flows*	*factor at 15% discount rate*[3]	*future cash flows*
20X5 (n=1)		230[1]	0.86957	200
20X6		253[1]	0.75614	191
20X7		273[1]	0.65752	180
20X8		290[1]	0.57175	166
20X9		304[1]	0.49718	151
20X10	3%	313[2]	0.43233	135
20X11	–2%	307[2]	0.37594	115
20X12	–6%	289[2]	0.32690	94
20X13	–15%	245[2]	0.28426	70
20X14	–25%	184[2]	0.24719	45
20X15	–67%	61[2]	0.21494	13
Value in use				1,360

[1] Based on management's best estimate of net cash flow projections (after the 40% cut).
[2] Based on an extrapolation from preceding year cash flow using declining growth rates.
[3] The present value factor is calculated as $k = 1/(1+a)^n$, where a = discount rate and n= period of discount.

Schedule 3. Calculation and allocation of the impairment loss for the Country A cash-generating unit at the end of 20X4 (Amount in Rs. lakhs)

End of 20X4	*Goodwill*	*Identifiable assets*	*Total*
Historical cost	1,000	2,000	3,000
Accumulated depreciation/ amortisation (20X1-20X4)	(800)	(533)	(1,333)
Carrying amount	200	1,467	1,667
Impairment Loss	(200)	(107)	(307)
Carrying amount after impairment loss	0	1,360	1,360

Illustration 3 - Deferred Tax Effects

A33. An enterprise has an asset with a carrying amount of Rs. 1,000 lakhs. Its recoverable amount is Rs. 650 lakhs. The tax rate is 30% and the carrying amount of the asset for tax purposes is Rs. 800 lakhs. Impairment losses are not allowable as deduction for tax purposes. The effect of the impairment loss is as follows:

	Amount in Rs. lakhs
Impairment Loss recognised in the statement of profit and loss	350
Impairment Loss allowed for tax purposes	—
Timing Difference	350
Tax Effect of the above timing difference at 30% (deferred tax asset)	105
Less: Deferred tax liability due to difference in depreciation for accounting purposes and tax purposes [(1,000 – 800) x 30%]	60
Deferred tax asset	45

A34. In accordance with AS 22, *Accounting for Taxes on Income*, the enterprise recognises the deferred tax asset subject to the consideration of prudence as set out in AS 22.

Illustration 4 - Reversal of an Impairment Loss

Use the data for enterprise T as presented in Illustration 2, with supplementary information as provided in this illustration. In this illustration tax effects are ignored.

Background

A35. In 20X6, the government is still in office in Country A, but the business situation is improving. The effects of the export laws on T's production are proving to be less drastic than initially expected by management. As a result, management estimates that production will increase by 30%. This favourable change requires T to re-estimate the recoverable amount of the net assets of the Country A operations (see paragraphs 94-95 of this Standard). The cash-generating unit for the net assets of the Country A operations is still the Country A operations.

A36. Calculations similar to those in Illustration 2 show that the recoverable amount of the Country A cash-generating unit is now Rs. 1,710 lakhs.

Reversal of Impairment Loss

A37. T compares the recoverable amount and the net carrying amount of the Country A cash-generating unit.

Schedule 1. Calculation of the carrying amount of the Country A cash- generating unit at the end of 20X6 (Amount in Rs. lakhs)

	Goodwill	*Identifiable assets*	*Total*
End of 20X4 (Example 2)			
Historical cost	1,000	2,000	3,000
Accumulated depreciation/ amortisation (4 years)	(800)	(533)	(1,333)
Impairment loss	(200)	(107)	(307)
Carrying amount after impairment loss	0	1,360	1,360
End of 20X6			
Additional depreciation (2 years)[(1)]	–	(247)	(247)
Carrying amount	0	1,113	1,113
Recoverable amount			1,710
Excess of recoverable amount over carrying amount			597

[(1)]After recognition of the impairment loss at the end of 20X4, T revised the depreciation charge for the Country A identifiable assets (from Rs. 133.3 lakhs per year to Rs. 123.7 lakhs per year), based on the revised carrying amount and remaining useful life (11 years).

A38. There has been a favourable change in the estimates used to determine the recoverable amount of the Country A net assets since the last impairment loss was recognised. Therefore, in accordance with paragraph 98 of this Standard, T recognises a reversal of the impairment loss recognised in 20X4.

A39. In accordance with paragraphs 106 and 107 of this Standard, T increases the carrying amount of the Country A identifiable assets by Rs. 87 lakhs (see Schedule 3), i.e., up to the lower of recoverable amount (Rs. 1,710 lakhs) and the identifiable assets' depreciated historical cost (Rs. 1,200 lakhs) (see Schedule 2). This increase is recognised in the statement of profit and loss immediately.

Schedule 2. Determination of the depreciated historical cost of the Country A identifiable assets at the end of 20X6 (Amount in Rs. lakhs)

End of 20X6	*Identifiable assets*
Historical cost	2,000
Accumulated depreciation (133.3 * 6 years)	(800)
Depreciated historical cost	1,200
Carrying amount (Schedule 1)	1,113
Difference	87

Schedule 3. Carrying amount of the Country A assets at the end of 20X6 (Amount in Rs. lakhs)

End of 20X6	*Goodwill*	*Identifiable assets*	*Total*
Gross carrying amount	1,000	2,000	3,000
Accumulated depreciation/			

amortisation	(800)	(780)	(1,580)
Accumulated impairment loss	(200)	(107)	(307)
Carrying amount	0	1,113	1,113
Reversal of impairment loss	0	87	87
Carrying amount after reversal of impairment loss	0	1,200	1,200

Illustration 5 - Treatment of a Future Restructuring

In this illustration, tax effects are ignored.

Background

A40. At the end of 20X0, enterprise K tests a plant for impairment. The plant is a cash-generating unit. The plant's assets are carried at depreciated historical cost. The plant has a carrying amount of Rs. 3,000 lakhs and a remaining useful life of 10 years.

A41. The plant is so specialised that it is not possible to determine its net selling price. Therefore, the plant's recoverable amount is its value in use. Value in use is calculated using a pre-tax discount rate of 14%.

A42. Management approved budgets reflect that:

(a) at the end of 20X3, the plant will be restructured at an estimated cost of Rs. 100 lakhs. Since K is not yet committed to the restructuring, a provision has not been recognised for the future restructuring costs; and

(b) there will be future benefits from this restructuring in the form of reduced future cash outflows.

A43. At the end of 20X2, K becomes committed to the restructuring. The costs are still estimated to be Rs. 100 lakhs and a provision is recognised accordingly. The plant's estimated future cash flows reflected in the most recent management approved budgets are given in paragraph A47 and a current discount rate is the same as at the end of 20X0.

A44. At the end of 20X3, restructuring costs of Rs. 100 lakhs are paid. Again, the plant's estimated future cash flows reflected in the most recent management approved budgets and a current discount rate are the same as those estimated at the end of 20X2.

At the End of 20X0

Schedule 1. Calculation of the plant's value in use at the end of 20X0 (Amount in Rs. lakhs)

Year	*Future cash flows*	*Discounted at 14%*
20X1	300	263
20X2	280	215
20X3	420[1]	283
20X4	520[2]	308
20X5	350[2]	182
20X6	420[2]	191
20X7	480[2]	192

20X8	480[2]	168
20X9	460[2]	141
20X10	400[2]	108
Value in use		2,051

[1] Excludes estimated restructuring costs reflected in management budgets.
[2] Excludes estimated benefits expected from the restructuring reflected in management budgets.

A45. The plant's recoverable amount (value in use) is less than its carrying amount. Therefore, K recognises an impairment loss for the plant.

Schedule 2. Calculation of the impairment loss at the end of 20X0 (Amount in Rs. lakhs)

	Plant
Carrying amount before impairment loss	3,000
Recoverable amount (Schedule 1)	2,051
Impairment loss	(949)
Carrying amount after impairment loss	2,051

At the End of 20X1

A46. No event occurs that requires the plant's recoverable amount to be re-estimated. Therefore, no calculation of the recoverable amount is required to be performed.

At the End of 20X2

A47. The enterprise is now committed to the restructuring. Therefore, in determining the plant's value in use, the benefits expected from the restructuring are considered in forecasting cash flows. This results in an increase in the estimated future cash flows used to determine value in use at the end of 20X0. In accordance with paragraphs 94-95 of this Standard, the recoverable amount of the plant is re-determined at the end of 20X2.

Schedule 3. Calculation of the plant's value in use at the end of 20X2 (Amount in Rs. lakhs)

Year	*Future cash flows*	*Discounted at 14%*
20X3	420[1]	368
20X4	570[2]	439
20X5	380[2]	256
20X6	450[2]	266
20X7	510[2]	265
20X8	510[2]	232
20X9	480[2]	192
20X10	410[2]	144
Value in use		2,162

[1] Excludes estimated restructuring costs because a liability has already been recognised.

[2] Includes estimated benefits expected from the restructuring reflected in management budgets.

A48. The plant's recoverable amount (value in use) is higher than its carrying amount (see Schedule 4). Therefore, K reverses the impairment loss recognised for the plant at the end of 20X0.

Schedule 4. Calculation of the reversal of the impairment loss at the end of 20X2 (Amount in Rs. lakhs)

	Plant
Carrying amount at the end of 20X0 (Schedule 2)	2,051
End of 20X2	
Depreciation charge (for 20X1 and 20X2 Schedule 5)	(410)
Carrying amount before reversal	1,641
Recoverable amount (Schedule 3)	2,162
Reversal of the impairment loss	521
Carrying amount after reversal	2,162
Carrying amount: depreciated historical cost (Schedule 5)	2,400[(1)]

[(1)] The reversal does not result in the carrying amount of the plant exceeding what its carrying amount would have been at depreciated historical cost. Therefore, the full reversal of the impairment loss is recognised.

At the End of 20X3

A49. There is a cash outflow of Rs. 100 lakhs when the restructuring costs are paid. Even though a cash outflow has taken place, there is no change in the estimated future cash flows used to determine value in use at the end of 20X2. Therefore, the plant's recoverable amount is not calculated at the end of 20X3.

Schedule 5. Summary of the carrying amount of the plant (Amount in Rs. lakhs)

End of year	*Depreciated historical cost*	*Recoverable amount*	*Adjusted depreciation charge*	*Impairment loss*	*Carrying amount after impairment*
20X0	3,000	2,051	0	(949)	2,051
20X1	2,700	n.c.	(205)	0	1,846
20X2	2,400	2,162	(205)	521	2,162
20X3	2,100	n.c.	(270)	0	1,892

n.c. = not calculated as there is no indication that the impairment loss may have increased/ decreased.

Illustration 6 - Treatment of Future Capital Expenditure

In this illustration, tax effects are ignored.

Background

A50. At the end of 20X0, enterprise F tests a plane for impairment. The plane is a cash-generating unit. It is carried at depreciated historical cost and its carrying amount is Rs. 1,500 lakhs. It has an estimated remaining useful life of 10 years.

A51. For the purpose of this illustration, it is assumed that the plane's net selling price is not determinable. Therefore, the plane's recoverable amount is its value in use. Value in use is calculated using a pre-tax discount rate of 14%.

A52. Management approved budgets reflect that:

(a) in 20X4, capital expenditure of Rs. 250 lakhs will be incurred to renew the engine of the plane; and

(b) this capital expenditure will improve the performance of the plane by decreasing fuel consumption.

A53. At the end of 20X4, renewal costs are incurred. The plane's estimated future cash flows reflected in the most recent management approved budgets are given in paragraph A56 and a current discount rate is the same as at the end of 20X0.

At the End of 20X0

Schedule 1. Calculation of the plane's value in use at the end of 20X0 (Amount in Rs. lakhs)

Year	*Future cash flows*	*Discounted at 14%*
20X1	221.65	194.43
20X2	214.50	165.05
20X3	205.50	138.71
20X4	247.25[(1)]	146.39
20X5	253.25[(2)]	131.53
20X6	248.25[(2)]	113.10
20X7	241.23[(2)]	96.40
20X8	255.33[(2)]	89.51
20X9	242.34[(2)]	74.52
20X10	228.50[(2)]	61.64
Value in use		1,211.28

[(1)] Excludes estimated renewal costs reflected in management budgets.
[(2)] Excludes estimated benefits expected from the renewal of the engine reflected in management budgets.

A54. The plane's carrying amount is less than its recoverable amount (value in use). Therefore, F recognises an impairment loss for the plane.

Schedule 2. Calculation of the impairment loss at the end of 20X0 (Amount in Rs. lakhs)

	Plane
Carrying amount before impairment loss	1,500.00
Recoverable amount (Schedule 1)	1,211.28
Impairment loss	(288.72)
Carrying amount after impairment loss	1,211.28

Years 20X1-20X3

A55. No event occurs that requires the plane's recoverable amount to be re-estimated. Therefore, no calculation of recoverable amount is required to be performed.

At the End of 20X4

A56. The capital expenditure is incurred. Therefore, in determining the plane's value in use, the future benefits expected from the renewal of the engine are considered in forecasting cash flows. This results in an increase in the estimated future cash flows used to determine value in use at the end of 20X0. As a consequence, in accordance with paragraphs 94-95 of this Standard, the recoverable amount of the plane is recalculated at the end of 20X4.

Schedule 3. Calculation of the plane's value in use at the end of 20X4 (Amount in Rs. lakhs)

Year	*Future cash flows*[1]	*Discounted at 14%*
20X5	303.21	265.97
20X6	327.50	252.00
20X7	317.21	214.11
20X8	319.50	189.17
20X9	331.00	171.91
20X10	279.99	127.56
Value in use		1,220.72

[1] Includes estimated benefits expected from the renewal of the engine reflected in management budgets.

A57. The plane's recoverable amount (value in use) is higher than the plane's carrying amount and depreciated historical cost (see Schedule 4). Therefore, K reverses the impairment loss recognised for the plane at the end of 20X0 so that the plane is carried at depreciated historical cost.

Schedule 4. Calculation of the reversal of the impairment loss at the end of 20X4 (Amount in Rs. lakhs)

	Plane
Carrying amount at the end of 20X0 (Schedule 2)	1,211.28
End of 20X4	
Depreciation charge (20X1 to 20X4-Schedule 5)	(484.52)
Renewal expenditure	250.00
Carrying amount before reversal	976.76
Recoverable amount (Schedule 3)	1,220.72
Reversal of the impairment loss	173.24
Carrying amount after reversal	1,150.00
Carrying amount: depreciated historical cost (Schedule 5)	1,150.00[1]

[1] The value in use of the plane exceeds what its carrying amount would have been at depreciated historical cost. Therefore, the reversal is limited to an amount that does not result in the carrying amount of the plane

exceeding depreciated historical cost.

Schedule 5. Summary of the carrying amount of the plane (Amount in Rs. lakhs)

Year	*Depreciated historical cost*	*Recoverable amount*	*Adjusted depreciation charge*	*Impairment loss*	*Carrying amount after impairment*
20X0	1,500.00	1,211.28	0	(288.72)	1,211.28
20X1	1,350.00	n.c.	(121.13)	0	1,090.15
20X2	1,200.00	n.c.	(121.13)	0	969.02
20X3	1,050.00	n.c.	(121.13)	0	847.89
20X4	900.00		(121.13)		
renewal	250.00		–		
	1,150.00	1,220.72	(121.13)	173.24	1,150.00
20X5	958.33	n.c.	(191.67)	0	958.33

n.c. = not calculated as there is no indication that the impairment loss may have increased/ decreased.

Illustration 7 - Application of the 'Bottom-Up' and 'Top-Down' Tests to Goodwill

In this illustration, tax effects are ignored.

A58. At the end of 20X0, enterprise M acquired 100% of enterprise Z for Rs. 3,000 lakhs. Z has 3 cash-generating units A, B and C with net fair values of Rs. 1,200 lakhs, Rs. 800 lakhs and Rs. 400 lakhs respectively. M recognises goodwill of Rs. 600 lakhs (Rs. 3,000 lakhs less Rs. 2,400 lakhs) that relates to Z.

A59. At the end of 20X4, A makes significant losses. Its recoverable amount is estimated to be Rs. 1,350 lakhs. Carrying amounts are detailed below.

Schedule 1. Carrying amounts at the end of 20X4 (Amount in Rs. lakhs)

End of 20X4	*A*	*B*	*C*	*Goodwill*	*Total*
Net carrying amount	1,300	1,200	800	120	3,420

A - Goodwill Can be Allocated on a Reasonable and Consistent Basis

A60. At the date of acquisition of Z, the net fair values of A, B and C are considered a reasonable basis for a pro-rata allocation of the goodwill to A, B and C.

Schedule 2. Allocation of goodwill at the end of 20X4

	A	B	C	Total
End of 20X0				
Net fair values	1,200	800	400	2,400
Pro-rata	50%	33%	17%	100%
End of 20X4				
Net carrying amount	1,300	1,200	800	3,300
Allocation of goodwill (using the pro-rata above)	60	40	20	120
Net carrying amount (after allocation of goodwill)	1,360	1,240	820	3,420

A61. In accordance with the 'bottom-up' test in paragraph 78(a) of this Standard, M compares A's recoverable amount to its carrying amount after the allocation of the carrying amount of goodwill.

Schedule 3. Application of 'bottom-up' test (Amount in Rs. lakhs)

End of 20X4	A
Carrying amount after allocation of goodwill (Schedule 2)	1,360
Recoverable amount	1,350
Impairment loss	10

A62. M recognises an impairment loss of Rs. 10 lakhs for A. The impairment loss is fully allocated to the goodwill in accordance with paragraph 87 of this Standard.

B - Goodwill Cannot Be Allocated on a Reasonable and Consistent Basis

A63. There is no reasonable way to allocate the goodwill that arose on the acquisition of Z to A, B and C. At the end of 20X4, Z's recoverable amount is estimated to be Rs. 3,400 lakhs.

A64. At the end of 20X4, M first applies the 'bottom-up' test in accordance with paragraph 78(a) of this Standard. It compares A's recoverable amount to its carrying amount excluding the goodwill.

Schedule 4. Application of 'bottom-up' test (Amount in Rs. lakhs)

End of 20X4	*A*
Carrying amount	1,300
Recoverable amount	1,350
Impairment loss	0

A65. Therefore, no impairment loss is recognised for A as a result of the 'bottom-up' test.

A66. Since the goodwill could not be allocated on a reasonable and consistent basis to A, M also performs a 'top-down' test in accordance with paragraph 78(b) of this Standard. It compares the carrying amount of Z as a whole to its recoverable amount (Z as a whole is the smallest cash-generating unit that includes A and to which goodwill can be allocated on a reasonable and consistent basis).

Schedule 5. Application of the 'top-down' test (Amount in Rs. lakhs)

End of 20X4	*A*	*B*	*C*	*Goodwill*	*Z*
Carrying amount	1,300	1,200	800	120	3,420
Impairment loss arising from the 'bottom-up' test	0	–	–	–	0
Carrying amount after the 'bottom-up' test	1,300	1,200	800	120	3,420
Recoverable amount					3,400
Impairment loss arising from 'top-down' test					20

A67. Therefore, M recognises an impairment loss of Rs. 20 lakhs that it allocates fully to

goodwill in accordance with paragraph 87 of this Standard.

Illustration 8 - Allocation of Corporate Assets

In this illustration tax effects are ignored.

Background

A68. Enterprise M has three cash-generating units: A, B and C. There are adverse changes in the technological environment in which M operates. Therefore, M conducts impairment tests of each of its cash-generating units. At the end of 20X0, the carrying amounts of A, B and C are Rs. 100 lakhs, Rs. 150 lakhs and Rs. 200 lakhs respectively.

A69. The operations are conducted from a headquarter. The carrying amount of the headquarter assets is Rs. 200 lakhs: a headquarter building of Rs. 150 lakhs and a research centre of Rs. 50 lakhs. The relative carrying amounts of the cash-generating units are a reasonable indication of the proportion of the head-quarter building devoted to each cash-generating unit. The carrying amount of the research centre cannot be allocated on a reasonable basis to the individual cash-generating units.

A70. The remaining estimated useful life of cash-generating unit A is 10 years. The remaining useful lives of B, C and the headquarter assets are 20 years. The headquarter assets are depreciated on a straight-line basis.

A71. There is no basis on which to calculate a net selling price for each cash-generating unit. Therefore, the recoverable amount of each cash- generating unit is based on its value in use. Value in use is calculated using a pre-tax discount rate of 15%.

Identification of Corporate Assets

A72. In accordance with paragraph 85 of this Standard, M first identifies all the corporate assets that relate to the individual cash-generating units under review. The corporate assets are the headquarter building and the research centre.

A73. M then decides how to deal with each of the corporate assets:

(a) the carrying amount of the headquarter building can be allocated on a reasonable and consistent basis to the cash-generating units under review. Therefore, only a 'bottom-up' test is necessary; and

(b) the carrying amount of the research centre cannot be allocated on a reasonable and consistent basis to the individual cash- generating units under review. Therefore, a 'top-down' test will be applied in addition to the 'bottom-up' test.

Allocation of Corporate Assets

A74. The carrying amount of the headquarter building is allocated to the carrying amount of each individual cash-generating unit. A weighted allocation basis is used because the estimated remaining useful life of A's cash-generating unit is 10 years, whereas the estimated remaining useful lives of B and C's cash-generating units are 20 years.

Schedule 1. Calculation of a weighted allocation of the carrying amount of the headquarter building (Amount in Rs. lakhs)

End of 20X0	*A*	*B*	*C*	*Total*
Carrying amount	100	150	200	450

Useful life	10 years	20 years	20 years	
Weighting based on useful life	1	2	2	
Carrying amount after weighting	100	300	400	800
Pro-rata allocation of the building	12.5% (100/800)	37.5% (300/800)	50% (400/800)	100%
Allocation of the carrying amount of the building (based on pro-rata above)	19	56	75	150
Carrying amount (after allocation of the building)	119	206	275	600

Determination of Recoverable Amount

A75. The 'bottom-up' test requires calculation of the recoverable amount of each individual cash-generating unit. The 'top-down' test requires calculation of the recoverable amount of M as a whole (the smallest cash- generating unit that includes the research centre).

Schedule 2. Calculation of A, B, C and M's value in use at the end of 20X0 (Amount in Rs. lakhs)

	A		B		C		M	
Year	*Future cash flows*	*Discount at 15%*	*Future cash flows*	*Discount at 15%*	*Future cash flows*	*Discount at 15%*	*Future cash flows*	*Discount at 15%*
1	2	3	4	5	6	7	8	9
1	18	16	9	8	10	9	39	34
2	31	23	16	12	20	15	72	54
3	37	24	24	16	34	22	105	69
4	42	24	29	17	44	25	128	73
5	47	24	32	16	51	25	143	71
6	52	22	33	14	56	24	155	67
7	55	21	34	13	60	22	162	61
8	55	18	35	11	63	21	166	54
9	53	15	35	10	65	18	167	48
10	48	12	35	9	66	16	169	42
11			36	8	66	14	132	28
12			35	7	66	12	131	25
13			35	6	66	11	131	21
14			33	5	65	9	128	18
15			30	4	62	8	122	15
16			26	3	60	6	115	12
17			22	2	57	5	108	10
18			18	1	51	4	97	8
19			14	1	43	3	85	6

20		10	1	35	2	71	4
Value in use	199		164		271		720[1]

[1] It is assumed that the research centre generates additional future cash flows for the enterprise as a whole. Therefore, the sum of the value in use of each individual cash- generating unit is less than the value in use of the business as a whole. The additional cash flows are not attributable to the headquarter building.

Calculation of Impairment Losses

A76. In accordance with the 'bottom-up' test, M compares the carrying amount of each cash-generating unit (after allocation of the carrying amount of the building) to its recoverable amount.

Schedule 3. Application of 'bottom-up' test (Amount in Rs. lakhs)

End of 20X0	*A*	*B*	*C*
Carrying amount (after allocation of the building) (Schedule 1)	119	206	275
Recoverable amount (Schedule 2)	199	164	271
Impairment loss	0	(42)	(4)

A77. The next step is to allocate the impairment losses between the assets of the cash-generating units and the headquarter building.

Schedule 4. Allocation of the impairment losses for cash-generating units B and C (Amount in Rs. lakhs)

Cash-generating unit	*B*	*C*
To headquarter building	(12) (42*56/206)	(1) (4*75/275)
To assets in cash-generating unit	(30) (42*150/206)	(3) (4*200/275)
	(42)	(4)

A78. In accordance with the 'top-down' test, since the research centre could not be allocated on a reasonable and consistent basis to A, B and C's cash-generating units, M compares the carrying amount of the smallest cash- generating unit to which the carrying amount of the research centre can be allocated (i.e., M as a whole) to its recoverable amount.

Schedule 5. Application of the 'top-down' test (Amount in Rs. lakhs)

End of 20X0	*A*	*B*	*C*	*Building*	*Research centre*	*M*
Carrying amount	100	150	200	150	50	650
Impairment loss arising from the 'bottom-up' test	–	(30)	(3)	(13)	–	(46)
Carrying amount after the 'bottom-up' test	100	120	197	137	50	604
Recoverable amount (Schedule 2)						720
Impairment loss arising from 'top-down' test						0

A79. Therefore, no additional impairment loss results from the application of the 'top-down'

test. Only an impairment loss of Rs. 46 lakhs is recognised as a result of the application of the 'bottom-up' test.

Accounting Standard (AS) 29

Provisions, Contingent Liabilities and Contingent Assets

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the General Instructions contained in part A of the Annexure to the Notification.)*

Pursuant to this Accounting Standard coming into effect, all paragraphs of Accounting Standards (AS) 4, *Contingencies and Events Occuring After the Balance Sheet Date*, that deal with contingencies (viz., paragraphs 1(a), 2, 3.1, 4 (4.1 to 4.4), 5(5.1 to 5.6), 6, 7 (7.1 to 7.3), 9.1 (relevant portion). 9.2, 10, 11, 12 and 16), stand withdrawn except to the extent they deal with impairment of assets not covered by other Indian Accounting Standards.

Objective

The objective of this Standard is to ensure that appropriate recognition criteria and measurement bases are applied to provisions and contingent liabilities and that sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount. The objective of this Standard is also to lay down appropriate accounting for contingent assets.

Scope

1. This Standard should be applied in accounting for provisions and contingent liabilities and in dealing with contingent assets, except:

(a) those resulting from financial instruments[41] that are carried at fair value;

(b) those resulting from executory contracts, except where the contract is onerous;

Explanation:

(i) An 'onerous contract' is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. Thus, for a contract to qualify as an onerous contract, the unavoidable costs of meeting the obligation under the contract should exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it.

(ii) If an enterprise has a contract that is onerous, the present obligation under the contract is recognised and measured as a provision as per this Standard.

The application of the above explanation is illustrated in Illustration 10 of Illustration C attached to the Standard.

[41] For the purpose of this Standard, the term 'financial instruments' shall have the same meaning as in Accounting Standard (AS) 20, *Earnings Per Share.*

(c) those arising in insurance enterprises from contracts with policy-holders; and

(d) those covered by another Accounting Standard.

2. This Standard applies to financial instruments (including guarantees) that are not carried at fair value.

3. Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent. This Standard does not apply to executory contracts unless they are onerous.

4. This Standard applies to provisions, contingent liabilities and contingent assets of insurance enterprises other than those arising from contracts with policy-holders.

5. Where another Accounting Standard deals with a specific type of provision, contingent liability or contingent asset, an enterprise applies that Standard instead of this Standard. For example, certain types of provisions are also addressed in Accounting Standards on:

(a) construction contracts (see AS 7, *Construction Contracts*);

(b) taxes on income (see AS 22, *Accounting for Taxes on Income*);

(c) leases (see AS 19, *Leases*). However, as AS 19 contains no specific requirements to deal with operating leases that have become onerous, this Standard applies to such cases; and

(d) Employee benefits (see AS 15, *Employee Benefits*).

6. Some amounts treated as provisions may relate to the recognition of revenue, for example where an enterprise gives guarantees in exchange for a fee. This Standard does not address the recognition of revenue. AS 9, *Revenue Recognition*, identifies the circumstances in which revenue is recognised and provides practical guidance on the application of the recognition criteria. This Standard does not change the requirements of AS 9.

7. This Standard defines provisions as liabilities which can be measured only by using a substantial degree of estimation. The term 'provision' is also used in the context of items such as depreciation, impairment of assets and doubtful debts: these are adjustments to the carrying amounts of assets and are not addressed in this Standard.

8. Other Accounting Standards specify whether expenditures are treated as assets or as expenses. These issues are not addressed in this Standard. Accordingly, this Standard neither prohibits nor requires capitalisation of the costs recognised when a provision is made.

9. This Standard applies to provisions for restructuring (including discontinuing operations). Where a restructuring meets the definition of a discontinuing operation, additional disclosures are required by AS 24, *Discontinuing Operations.*

Definitions

10. The following terms are used in this Standard with the meanings specified:

10.1 A <u>provision</u> is a liability which can be measured only by using a substantial degree of estimation.

10.2 A <u>liability</u> is a present obligation of the enterprise arising from past events, the

settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

10.3 An <u>obligating event</u> is an event that creates an obligation that results in an enterprise having no realistic alternative to settling that obligation.

10.4 A <u>contingent liability</u> is:

(a) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

(b) a present obligation that arises from past events but is not recognised because:

(i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(ii) a reliable estimate of the amount of the obligation cannot be made.

10.5 A <u>contingent asset</u> is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or non- occurrence of one or more uncertain future events not wholly within the control of the enterprise.

10.6 <u>Present obligation</u> - an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.

10.7 <u>Possible obligation</u> - an obligation is a possible obligation if, based on the evidence available, its existence at the balance sheet date is considered not probable.

10.8 A <u>restructuring</u> is a programme that is planned and controlled by management, and materially changes either:

(a) the scope of a business undertaken by an enterprise; or

(b) the manner in which that business is conducted.

11. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract or statutory requirement. Obligations also arise from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner.

12. Provisions can be distinguished from other liabilities such as trade payables and accruals because in the measurement of provisions substantial degree of estimation is involved with regard to the future expenditure required in settlement. By contrast:

(a) trade payables are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier; and

(b) accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees. Although it is sometimes necessary to estimate the amount of accruals, the degree of estimation is generally much less than that for provisions.

13. In this Standard, the term ‘contingent’ is used for liabilities and assets that are not recognised because their existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise. In

addition, the term ‘contingent liability’ is used for liabilities that do not meet the recognition criteria.

Recognition

Provisions

14. A provision should be recognised when:

(a) an enterprise has a present obligation as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognised.

Present Obligation

15. In almost all cases it will be clear whether a past event has given rise to a present obligation. In rare cases, for example in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such a case, an enterprise determines whether a present obligation exists at the balance sheet date by taking account of all available evidence, including, for example, the opinion of experts. The evidence considered includes any additional evidence provided by events after the balance sheet date. On the basis of such evidence:

(a) where it is more likely than not that a present obligation exists at the balance sheet date, the enterprise recognises a provision (if the recognition criteria are met); and

(b) where it is more likely that no present obligation exists at the balance sheet date, the enterprise discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 68).

Past Event

16. A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the enterprise has no realistic alternative to settling the obligation created by the event.

17. Financial statements deal with the financial position of an enterprise at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognised for costs that need to be incurred to operate in the future. The only liabilities recognised in an enterprise’s balance sheet are those that exist at the balance sheet date.

18. It is only those obligations arising from past events existing independently of an enterprise’s future actions (i.e. the future conduct of its business) that are recognised as provisions. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage, both of which would lead to an outflow of resources embodying economic benefits in settlement regardless of the future actions of the enterprise. Similarly, an enterprise recognises a provision for the decommissioning costs of an oil installation to the extent that the enterprise is obliged to rectify damage already caused. In contrast, because of commercial pressures or legal requirements, an enterprise may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a certain type of factory). Because the enterprise can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised.

19. An obligation always involves another party to whom the obligation is owed. It is not necessary, however, to know the identity of the party to whom the obligation is owed – indeed the obligation may be to the public at large.

20. An event that does not give rise to an obligation immediately may do so at a later date, because of changes in the law. For example, when environmental damage is caused there may be no obligation to remedy the consequences. However, the causing of the damage will become an obligating event when a new law requires the existing damage to be rectified.

21. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted. Differences in circumstances surrounding enactment usually make it impossible to specify a single event that would make the enactment of a law virtually certain. In many cases it will be impossible to be virtually certain of the enactment of a law until it is enacted.

Probable Outflow of Resources Embodying Economic Benefits

22. For a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation. For the purpose of this Standard[42] , an outflow of resources or other event is regarded as probable if the event is more likely than not to occur, i.e., the probability that the event will occur is greater than the probability that it will not. Where it is not probable that a present obligation exists, an enterprise discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 68).

23. Where there are a number of similar obligations (e.g. product warranties or similar contracts) the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole. Although the likelihood of outflow for any one item may be small, it may well be probable that some outflow of resources will be needed to settle the class of obligations as a whole. If that is the case, a provision is recognised (if the other recognition criteria are met).

Reliable Estimate of the Obligation

24. The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability. This is especially true in the case of provisions, which by their nature involve a greater degree of estimation than most other items. Except in extremely rare cases, an enterprise will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is reliable to use in recognising a provision.

25. In the extremely rare case where no reliable estimate can be made, a liability exists that cannot be recognised. That liability is disclosed as a contingent liability (see paragraph 68).

Contingent Liabilities

26. An enterprise should not recognise a contingent liability.

27. A contingent liability is disclosed, as required by paragraph 68, unless the possibility of an outflow of resources embodying economic benefits is remote.

28. Where an enterprise is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability. The enterprise recognises a provision for the part of the obligation for which an outflow of

[42] The interpretation of 'probable' in this Standard as 'more likely than not' does not necessarily apply in other Accounting Standards.

resources embodying economic benefits is probable, except in the extremely rare circumstances where no reliable estimate can be made (see paragraph 14).

29. Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources embodying economic benefits has become probable. If it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in accordance with paragraph 14 in the financial statements of the period in which the change in probability occurs (except in the extremely rare circumstances where no reliable estimate can be made).

Contingent Assets

30. An enterprise should not recognise a contingent asset.

31. Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise. An example is a claim that an enterprise is pursuing through legal processes, where the outcome is uncertain.

32. Contingent assets are not recognised in financial statements since this may result in the recognition of income that may never be realised. However, when the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.

33. A contingent asset is not disclosed in the financial statements. It is usually disclosed in the report of the approving authority (Board of Directors in the case of a company, and, the corresponding approving authority in the case of any other enterprise), where an inflow of economic benefits is probable.

34. Contingent assets are assessed continually and if it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.

Measurement

Best Estimate

35. The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date. The amount of a provision should not be discounted to its present value except in case of decommissioning, restoration and similar liabilities that are recognised as cost of Property, Plant and Equipment. The discount rate (or rates) should be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) should not reflect risks for which future cash flow estimates have been adjusted. Periodic unwinding of discount should be recognised in the statement of profit and loss.

36. The estimates of outcome and financial effect are determined by the judgment of the management of the enterprise, supplemented by experience of similar transactions and, in some cases, reports from independent experts. The evidence considered includes any additional evidence provided by events after the balance sheet date.

37. The provision is measured before tax; the tax consequences of the provision, and changes in it, are dealt with under AS 22, Accounting for Taxes on Income.

Risks and Uncertainties

38. The risks and uncertainties that inevitably surround many events and circumstances should be taken into account in reaching the best estimate of a provision.

39. Risk describes variability of outcome. A risk adjustment may increase the amount at which a liability is measured. Caution is needed in making judgments under conditions of uncertainty, so that income or assets are not overstated and expenses or liabilities are not understated. However, uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities. For example, if the projected costs of a particularly adverse outcome are estimated on a prudent basis, that outcome is not then deliberately treated as more probable than is realistically the case. Care is needed to avoid duplicating adjustments for risk and uncertainty with consequent overstatement of a provision.

40. Disclosure of the uncertainties surrounding the amount of the expenditure is made under paragraph 67(b).

Future Events

41. Future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that they will occur.

42. Expected future events may be particularly important in measuring provisions. For example, an enterprise may believe that the cost of cleaning up a site at the end of its life will be reduced by future changes in technology. The amount recognised reflects a reasonable expectation of technically qualified, objective observers, taking account of all available evidence as to the technology that will be available at the time of the clean-up. Thus, it is appropriate to include, for example, expected cost reductions associated with increased experience in applying existing technology or the expected cost of applying existing technology to a larger or more complex clean-up operation than has previously been carried out. However, an enterprise does not anticipate the development of a completely new technology for cleaning up unless it is supported by sufficient objective evidence.

43. The effect of possible new legislation is taken into consideration in measuring an existing obligation when sufficient objective evidence exists that the legislation is virtually certain to be enacted. The variety of circumstances that arise in practice usually makes it impossible to specify a single event that will provide sufficient, objective evidence in every case. Evidence is required both of what legislation will demand and of whether it is virtually certain to be enacted and implemented in due course. In many cases sufficient objective evidence will not exist until the new legislation is enacted.

Expected Disposal of Assets

44. Gains from the expected disposal of assets should not be taken into account in measuring a provision.

45. Gains on the expected disposal of assets are not taken into account in measuring a provision, even if the expected disposal is closely linked to the event giving rise to the provision. Instead, an enterprise recognises gains on expected disposals of assets at the time specified by the Accounting Standard dealing with the assets concerned.

Reimbursements

46. Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised

for the reimbursement should not exceed the amount of the provision.

47. In the statement of profit and loss, the expense relating to a provision may be presented net of the amount recognised for a reimbursement.

48. Sometimes, an enterprise is able to look to another party to pay part or all of the expenditure required to settle a provision (for example, through insurance contracts, indemnity clauses or suppliers' warranties). The other party may either reimburse amounts paid by the enterprise or pay the amounts directly.

49. In most cases, the enterprise will remain liable for the whole of the amount in question so that the enterprise would have to settle the full amount if the third party failed to pay for any reason. In this situation, a provision is recognised for the full amount of the liability, and a separate asset for the expected reimbursement is recognised when it is virtually certain that reimbursement will be received if the enterprise settles the liability.

50. In some cases, the enterprise will not be liable for the costs in question if the third party fails to pay. In such a case, the enterprise has no liability for those costs and they are not included in the provision.

51. As noted in paragraph 28, an obligation for which an enterprise is jointly and severally liable is a contingent liability to the extent that it is expected that the obligation will be settled by the other parties.

Changes in Provisions

52. Provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed.

Use of Provisions

53. A provision should be used only for expenditures for which the provision was originally recognised.

54. Only expenditures that relate to the original provision are adjusted against it. Adjusting expenditures against a provision that was originally recognised for another purpose would conceal the impact of two different events.

Application of the Recognition and Measurement Rules

Future Operating Losses

55. Provisions should not be recognised for future operating losses.

56. Future operating losses do not meet the definition of a liability in paragraph 10 and the general recognition criteria set out for provisions in paragraph 14.

57. An expectation of future operating losses is an indication that certain assets of the operation may be impaired. An enterprise tests these assets for impairment under Accounting Standard (AS) 28, *Impairment of Assets.*

Restructuring

58. The following are examples of events that may fall under the definition of restructuring:

(a) sale or termination of a line of business;

(b) the closure of business locations in a country or region or the relocation of business activities from one country or region to another;

(c) changes in management structure, for example, eliminating a layer of management; and

(d) fundamental re-organisations that have a material effect on the nature and focus of the enterprise's operations.

59. A provision for restructuring costs is recognised only when the recognition criteria for provisions set out in paragraph 14 are met.

60. No obligation arises for the sale of an operation until the enterprise is committed to the sale, i.e., there is a binding sale agreement.

61. An enterprise cannot be committed to the sale until a purchaser has been identified and there is a binding sale agreement. Until there is a binding sale agreement, the enterprise will be able to change its mind and indeed will have to take another course of action if a purchaser cannot be found on acceptable terms. When the sale of an operation is envisaged as part of a restructuring, the assets of the operation are reviewed for impairment under Accounting Standard (AS) 28, *Impairment of Assets.*

62. A restructuring provision should include only the direct expenditures arising from the restructuring which are those that are both:

(a) necessarily entailed by the restructuring; and

(b) not associated with the ongoing activities of the enterprise.

63. A restructuring provision does not include such costs as:

(a) retraining or relocating continuing staff;

(b) marketing; or

(c) investment in new systems and distribution networks.

These expenditures relate to the future conduct of the business and are not liabilities for restructuring at the balance sheet date. Such expenditures are recognised on the same basis as if they arose independently of a restructuring.

64. Identifiable future operating losses up to the date of a restructuring are not included in a provision.

65. As required by paragraph 44, gains on the expected disposal of assets are not taken into account in measuring a restructuring provision, even if the sale of assets is envisaged as part of the restructuring.

Disclosure

66. For each class of provision, an enterprise should disclose:

(a) the carrying amount at the beginning and end of the period;

(b) additional provisions made in the period, including increases to existing provisions;

(c) amounts used (i.e. incurred and charged against the provision) during the period; and

(d) unused amounts reversed during the period.

Provided that a Small and Medium-sized Company, as defined in the Notification, may not comply with paragraph 66 above.

67. An enterprise should disclose the following for each class of provision:

(a) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;

(b) an indication of the uncertainties about those outflows. Where necessary to provide adequate information, an enterprise should disclose the major assumptions made concerning future events, as addressed in paragraph 41; and

(c) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

Provided that a Small and Medium-sized Company, as defined in in the Notification, may not comply with paragraph 67 above.

68. Unless the possibility of any outflow in settlement is remote, an enterprise should disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, where practicable:

(a) an estimate of its financial effect, measured under paragraphs 35-45;

(b) an indication of the uncertainties relating to any outflow; and

(c) the possibility of any reimbursement.

69. In determining which provisions or contingent liabilities may be aggregated to form a class, it is necessary to consider whether the nature of the items is sufficiently similar for a single statement about them to fulfill the requirements of paragraphs 67 (a) and (b) and 68 (a) and (b). Thus, it may be appropriate to treat as a single class of provision amounts relating to warranties of different products, but it would not be appropriate to treat as a single class amounts relating to normal warranties and amounts that are subject to legal proceedings.

70. Where a provision and a contingent liability arise from the same set of circumstances, an enterprise makes the disclosures required by paragraphs 66-68 in a way that shows the link between the provision and the contingent liability.

71. Where any of the information required by paragraph 68 is not disclosed because it is not practicable to do so, that fact should be stated.

72. In extremely rare cases, disclosure of some or all of the information required by paragraphs 66-70 can be expected to prejudice seriously the position of the enterprise in a dispute with other parties on the subject matter of the provision or contingent liability. In such cases, an enterprise need not disclose the information, but should disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

Transitional Provisions[43]

73. ***All the existing provisions for decommissioning, restoration and similar liabilities (see paragraph 35) should be discounted prospectively, with the corresponding effect to the related item of property, plant and equipment.***

[43] Transitional Provisions given in Paragraph 73 are relevant only for standards notified under Companies (Accounting Standards) Rules, 2006 as amended from time to time.

Illustration A

Tables - Provisions, Contingent Liabilities and Reimbursements

The purpose of this illustration is to summarise the main requirements of the Accounting Standard. It does not form part of the Accounting Standard and should be read in the context of the full text of the Accounting Standard.

Provisions and Contingent Liabilities

Where, as a result of past events, there may be an outflow of resources embodying future economic benefits in settlement of: (a) a present obligation the one whose existence at the balance sheet date is considered probable; or (b) a possible obligation the existence of which at the balance sheet date is considered not probable.		
There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation.	**There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources.**	**There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote.**
A provision is recognised (paragraph 14). Disclosures are required for the provision (paragraphs 66 and 67).	No provision is recognised (paragraph 26). Disclosures are required for the contingent liability (paragraph 68).	No provision is recognised (paragraph 26). No disclosure is required (paragraph 68).

Reimbursements

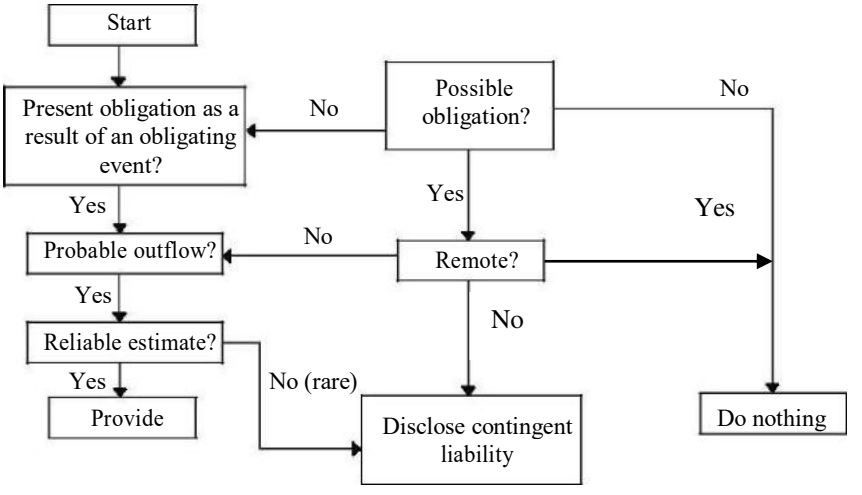
Some or all of the expenditure required to settle a provision is expected to be reimbursed by another party.		
The enterprise has no obligation for the part of the expenditure to be reimbursed by the other party.	**The obligation for the amount expected to be reimbursed remains with the enterprise and it is virtually certain that reimbursement will be received if the enterprise settles the provision.**	**The obligation for the amount expected to be reimbursed remains with the enterprise and the reimbursement is not virtually certain if the enterprise settles the provision.**

The enterprise has no liability for the amount to be reimbursed (paragraph 50).	The reimbursement is recognised as a separate asset in the balance sheet and may be offset against the expense in the statement of profit and loss. The amount recognised for the expected reimbursement does not exceed the liability (paragraphs 46 and 47).	The expected reimbursement is not recognised as an asset (paragraph 46).
No disclosure is required.	The reimbursement is disclosed together with the amount recognised for the reimbursement (paragraph 67(c)).	The expected reimbursement is disclosed (paragraph 67(c)).

Illustration B

Decision Tree

The purpose of the decision tree is to summarise the main recognition requirements of the Accounting Standard for provisions and contingent liabilities. The decision tree does not form part of the Accounting Standard and should be read in the context of the full text of the Accounting Standard.



Note: in rare cases, it is not clear whether there is a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the balance sheet date (paragraph 15 of the Standard)

Illustration C

Illustrations: Recognition

This illustration illustrates the application of the Accounting Standard to assist in clarifying its meaning. It does not form part of the Accounting Standard.

All the enterprises in the Illustration have 31 March year ends. In all cases, it is assumed that a reliable estimate can be made of any outflows expected. In some Illustrations the circumstances described may have resulted in impairment of the assets - this aspect is not dealt with in the Illustrations.

The cross references provided in the Illustrations indicate paragraphs of the Accounting Standard that are particularly relevant. The illustration should be read in the context of the full text of the Accounting Standard.

Illustration 1: Warranties

A manufacturer gives warranties at the time of sale to purchasers of its product. Under the

terms of the contract for sale the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. On past experience, it is probable (i.e. more likely than not) that there will be some claims under the warranties.

Present obligation as a result of a past obligating event - The obligating event is the sale of the product with a warranty, which gives rise to an obligation.

An outflow of resources embodying economic benefits in settlement - Probable for the warranties as a whole (see paragraph 23).

Conclusion - A provision is recognised for the best estimate of the costs of making good under the warranty products sold before the balance sheet date (see paragraphs 14 and 23).

Illustration 2: Contaminated Land - Legislation Virtually Certain to be Enacted

An enterprise in the oil industry causes contamination but does not clean up because there is no legislation requiring cleaning up, and the enterprise has been contaminating land for several years. At 31 March 2005 it is virtually certain that a law requiring a clean-up of land already contaminated will be enacted shortly after the year end.

Present obligation as a result of a past obligating event - The obligating event is the contamination of the land because of the virtual certainty of legislation requiring cleaning up.

An outflow of resources embodying economic benefits in settlement - Probable.

Conclusion - A provision is recognised for the best estimate of the costs of the clean-up (see paragraphs 14 and 21).

Illustration 3: Offshore Oilfield

An enterprise operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Ninety per cent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and ten per cent arise through the extraction of oil. At the balance sheet date, the rig has been constructed but no oil has been extracted.

Present obligation as a result of a past obligating event - The construction of the oil rig creates an obligation under the terms of the licence to remove the rig and restore the seabed and is thus an obligating event. At the balance sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil.

An outflow of resources embodying economic benefits in settlement - Probable.

Conclusion - A provision is recognised for the best estimate of ninety per cent of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it (see paragraph 14). These costs are included as part of the cost of the oil rig. The ten per cent of costs that arise through the extraction of oil are recognised as a liability when the oil is extracted.

Illustration 4: Refunds Policy

A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known.

Present obligation as a result of a past obligating event - The obligating event is the sale of the product, which gives rise to an obligation because obligations also arise from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner.

An outflow of resources embodying economic benefits in settlement - Probable, a proportion of goods are returned for refund (see paragraph 23).

Conclusion - A provision is recognised for the best estimate of the costs of refunds (see paragraphs 11, 14 and 23).

Illustration 5: Legal Requirement to Fit Smoke Filters

Under new legislation, an enterprise is required to fit smoke filters to its factories by 30 September 2005. The enterprise has not fitted the smoke filters.

(a) At the balance sheet date of 31 March 2005

Present obligation as a result of a past obligating event - There is no obligation because there is no obligating event either for the costs of fitting smoke filters or for fines under the legislation.

Conclusion - No provision is recognised for the cost of fitting the smoke filters (see paragraphs 14 and 16-18).

(b) At the balance sheet date of 31 March 2006

Present obligation as a result of a past obligating event - There is still no obligation for the costs of fitting smoke filters because no obligating event has occurred (the fitting of the filters). However, an obligation might arise to pay fines or penalties under the legislation because the obligating event has occurred (the non-compliant operation of the factory).

An outflow of resources embodying economic benefits in settlement - Assessment of probability of incurring fines and penalties by non-compliant operation depends on the details of the legislation and the stringency of the enforcement regime.

Conclusion - No provision is recognised for the costs of fitting smoke filters. However, a provision is recognised for the best estimate of any fines and penalties that are more likely than not to be imposed (see paragraphs 14 and 16-18).

Illustration 6: Staff Retraining as a Result of Changes in the Income Tax System

The government introduces a number of changes to the income tax system. As a result of these changes, an enterprise in the financial services sector will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with financial services regulation. At the balance sheet date, no retraining of staff has taken place.

Present obligation as a result of a past obligating event - There is no obligation because no obligating event (retraining) has taken place.

Conclusion - No provision is recognised (see paragraphs 14 and 16-18).

Illustration 7: A Single Guarantee

During 2004-05, Enterprise A gives a guarantee of certain borrowings of Enterprise B, whose financial condition at that time is sound. During 2005- 06, the financial condition of Enterprise B deteriorates and at 30 September 2005 Enterprise B goes into liquidation.

(a) At 31 March 2005

Present obligation as a result of a past obligating event - The obligating event is the giving of the guarantee, which gives rise to an obligation.

An outflow of resources embodying economic benefits in settlement - No outflow of benefits is probable at 31 March 2005.

Conclusion - No provision is recognised (see paragraphs 14 and 22). The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote (see paragraph 68).

(b) At 31 March 2006

Present obligation as a result of a past obligating event - The obligating event is the giving of the guarantee, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement - At 31 March 2006, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

Conclusion - A provision is recognised for the best estimate of the obligation (see paragraphs 14 and 22).

Note: This example deals with a single guarantee. If an enterprise has a portfolio of similar guarantees, it will assess that portfolio as a whole in determining whether an outflow of resources embodying economic benefit is probable (see paragraph 23). Where an enterprise gives guarantees in exchange for a fee, revenue is recognised under AS 9, *Revenue Recognition.*

Illustration 8 : A Court Case

After a wedding in 2004-05, ten people died, possibly as a result of food poisoning from products sold by the enterprise. Legal proceedings are started seeking damages from the enterprise but it disputes liability. Up to the date of approval of the financial statements for the year 31 March 2005, the enterprise's lawyers advise that it is probable that the enterprise will not be found liable. However, when the enterprise prepares the financial statements for the year 31 March 2006, its lawyers advise that, owing to developments in the case, it is probable that the enterprise will be found liable.

(a) At 31 March 2005

Present obligation as a result of a past obligating event - On the basis of the evidence available when the financial statements were approved, there is no present obligation as a result of past events.

Conclusion - No provision is recognised (see definition of 'present obligation' and paragraph 15). The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote (paragraph 68).

(b) At 31 March 2006

Present obligation as a result of a past obligating event - On the basis of the evidence available, there is a present obligation.

An outflow of resources embodying economic benefits in settlement - Probable.

Conclusion - A provision is recognised for the best estimate of the amount to settle the obligation (paragraphs 14-15).

Illustration 9A: Refurbishment Costs - No Legislative Requirement

A furnace has a lining that needs to be replaced every five years for technical reasons. At the balance sheet date, the lining has been in use for three years.

Present obligation as a result of a past obligating event - There is no present obligation.
Conclusion - No provision is recognised (see paragraphs 14 and 16-18). The cost of replacing the lining is not recognised because, at the balance sheet date, no obligation to replace the lining exists independently of the company's future actions - even the intention to incur the expenditure depends on the company deciding to continue operating the furnace or to replace the lining.

Illustration 9B: Refurbishment Costs – Legislative Requirement

An airline is required by law to overhaul its aircraft once every three years.

Present obligation as a result of a past obligating event - There is no present obligation.
Conclusion - No provision is recognised (see paragraphs 14 and 16-18). The costs of overhauling aircraft are not recognised as a provision for the same reasons as the cost of replacing the lining is not recognised as a provision in illustration 9A. Even a legal requirement to overhaul does not make the costs of overhaul a liability, because no obligation exists to overhaul the aircraft independently of the enterprise's future actions - the enterprise could avoid the future expenditure by its future actions, for example by selling the aircraft.

Illustration 10: An Onerous Contract

An enterprise operates profitably from a factory that it has leased under an operating lease. During December 2005 the enterprise relocates its operations to a new factory. The lease on the old factory continues for the next four years, it cannot be cancelled and the factory cannot be re-let to another user.

Present obligation as a result of a past obligating event-The obligating event occurs when the lease contract becomes binding on the enterprise, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement- When the lease becomes onerous, an outflow of resources embodying economic benefits is probable, (Until the lease becomes onerous, the enterprise accounts for the lease under AS 19, *Leases*).

Conclusion-A provision is recognised for the best estimate of the unavoidable lease payments.

Illustration D

Illustrations: Disclosure

This illustration does not form part of the Accounting Standard. Its purpose is to illustrate the application of the Accounting Standard to assist in clarifying its meaning.

An illustration of the disclosures required by paragraph 67 is provided below.

Illustration 1 Warranties

A manufacturer gives warranties at the time of sale to purchasers of its three product lines. Under the terms of the warranty, the manufacturer undertakes to repair or replace items that fail to perform satisfactorily for two years from the date of sale. At the balance sheet date, a provision of Rs. 60,000 has been recognised. The following information is disclosed:

A provision of Rs. 60,000 has been recognised for expected warranty claims on products sold during the last three financial years. It is expected that the majority of this expenditure will be incurred in the next financial year, and all will be incurred within two years of the balance sheet date.

An illustration is given below of the disclosures required by paragraph 72 where some of the information required is not given because it can be expected to prejudice seriously the position of the enterprise.

Illustration 2 Disclosure Exemption

An enterprise is involved in a dispute with a competitor, who is alleging that the enterprise has infringed patents and is seeking damages of Rs. 1000 lakh. The enterprise recognises a provision for its best estimate of the obligation, but discloses none of the information required by paragraphs 66 and 67 of the Standard. The following information is disclosed:

Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed patents and is seeking damages of Rs. 1000 lakh. The information usually required by AS 29, Provisions, Contingent Liabilities and Contingent Assets is not disclosed on the grounds that it can be expected to prejudice the interests of the company. The directors are of the opinion that the claim can be successfully resisted by the company.