INTRODUCTION TO ACCOUNTING STANDARDS

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OBJECTIVES

- Standardize diverse accounting practices and policies.
- Make accounting statements comparable.
- Help implement necessary disclosure requirements.
- Increase reliability of financial statements.
- Promote better understanding of financial statements.

DISADVANTAGES

- May bring rigidity in accounting.
- May not harmonize with global accounting practices.
- May not agree with law.

APPLICABILITY

- Applicable to all Commercial, Business & Industrial Enterprises.
- **Level I Enterprise :**
  - Listed or in process of listing
  - Turnover exceeds Rs. 50 Crores or Borrowings exceed Rs. 10 Crores.
  - Carrying Banking or Insurance business.
- **Level II Enterprise :**
  - Turnover between Rs.40 Lakhs & Rs.50 Crores
  - Borrowings between Rs.1 Crore & Rs.10 Crores
- **Level III Enterprise :**
  - Enterprise not falling in Level I or Level II

AS-1 DISCLOSURE OF ACCOUNTING POLICIES

- All significant accounting policies to be disclosed.
- Enterprises should follow fundamental accounting assumptions:
  – Going Concern
  – Consistency
  – Accrual

- Accounting policies should be selected keeping in mind:
  - Prudence
  - Materiality
  - Substance over form

- If fundamental accounting assumptions i.e. Going Concern, Consistency & Accrual are not followed, the fact to be disclosed.

DISCLOSURE REQUIREMENTS

- Accounting Policies followed by the Enterprise to be disclosed.
- Any change in accounting policy to be disclosed.
- Effect of any material change in financial statements due to change in accounting policy to be quantified.

AS-2 VALUATION OF INVENTORIES

- **Inventories are Assets held**
  - For sale in ordinary course of business
  - In production for sale
  - In the form of materials or supplies to be consumed in the production process or rendering of services.
- Machinery spares used regularly and not related to any particular item of Fixed Asset to be treated as inventory.
- Machinery spares used irregularly & directly related to a particular item of Fixed Asset to be capitalized.

Inventories to be valued at lower of Cost or Net Realizable Value.

Cost of Inventories = Cost of Purchase + Cost of Conversion

- **Cost of Purchase includes :**
  - Purchase Price
  - Duties & Taxes
  - Freight Inward
  - Other Expenses directly attributable to acquisition
- **Does not Include :**
  - Duties & Taxes which are recoverable from tax authorities
  - Trade Discount
  - Rebate or drawback
- **Cost of Conversion includes :**
  - Direct Material, Direct Labour, Direct Expenses and Fixed & Variable Production Overheads

- **If specific identification of Inventory possible :**
  - Link cost with specific item of inventory
- **If specific identification not possible :**
  - FIFO method
  - Weighted Average method
- Damaged goods where cost may not be recoverable, value at Net Realizable Value.
- Materials & supplies held for production should not be written down if final product is expected to be sold above cost.

- **Disclosure Requirements :**
  - Accounting policies followed in measuring and valuing inventories.
  - Classification of Inventory.
  - Total carrying cost.

AS-6 DEPRECIATION ACCOUNTING

- Depreciation is a measure of wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time, or obsolescence through technology and market changes.
- **Applicable to all depreciable assets except :**
  - Forest Plantations
  - Wasting assets, Minerals & Natural Gas
  - Expenditure on Research & Development
  - Goodwill
  - Livestock
  - Land, unless it has limited useful life to the enterprise.

- **Depreciable assets :**
  - Expected to be used for more than one accounting period
  - Have a limited useful life
  - Held for use in the production & supply of goods and services, for rental, or for administrative purposes, and not for purpose of sale in the ordinary course of business
- **Useful Life :**
  - Period over which depreciable asset is expected to be used.
  - Useful life is shorter than the physical life of the asset.
- **Methods of Depreciation :**
  - Straight Line Method
  - Written Down Value Method

- **Change in method of depreciation – Why?**
  - For compliance with statute or accounting standard
  - For better presentation of financial statements
- **Effect of change in method :**
  - Depreciation to be computed with retrospective effect
  - Surplus / Deficiency on change of method to be charged to Profit & Loss A/c
- When there is revision of estimated life of asset, unamortized amount will be depreciated over the revised remaining life.

- **Addition or Extension to Asset :**
  - If integral to existing asset, to be depreciated over the remaining life of the asset.
  - If it creates a new identity, and is capable of being used after the existing asset is disposed off, depreciation to be provided on its own useful life.
- **Revaluation of Assets :**
  - Depreciation to be provided on revalued amount on the estimated remaining life of the asset.

- **Disclosure Requirements :**
  - Method of Depreciation
  - Depreciation rates, if they are different from principal rates
  - Historical cost of assets
  - Total depreciation for each class of assets
  - Accumulated depreciation

AS-10 ACCOUNTING FOR FIXED ASSETS

- Fixed Assets to be shown at historical cost or revalued price.
- **Historical Cost includes :**
  - Purchase Price
  - Non refundable taxes & duties
  - Attributable costs of bringing the assets to working condition
- **Deductions from Cost :**
  - Refundable taxes & duties
  - Amount of Government Grants received / receivable against Fixed Assets
- **Historical Cost of Self Constructed Assets :**
  - All costs directly related to the specific asset
  - All costs attributable to construction activity

- **Revaluation of Assets :**
  - Selection of Assets for revaluation on systematic basis.
  - Revaluation done by a competent valuer through appraisal.
  - Basis of Revaluation to be disclosed.
  - Revaluation restricted to the recoverable amount of Fixed Assets.
  - Increase in net book value to be credited to Revaluation Reserve.
  - Decrease in net book value to be charged to Profit & Loss Account.
- **Treatment of cost of improvement & repair :**
  - If future benefits are expected to accrue, expenditure to be capitalized, else should be charged to Profit & Loss Account.

- **Addition / Extension to existing Capital Asset :**
  - If integral part of existing asset, add to cost of existing asset.
  - If separate identity created, which is capable of use after disposal of existing asset, to be accounted separately.
- **Disposal of Asset :**
  - Profit / Loss on sale to be disclosed separately in Profit &Loss Account.
- **Disposal of Revalued Asset :**
  - Profit to be credited to Profit & Loss Account.
  - Loss to be adjusted against Revaluation Reserve, the balance to be charged to Profit & Loss Account.

- **Disclosure Requirements :**
  - Gross & Net book value of the fixed assets at the beginning and end of the Accounting period.
  - Additions, disposal and other movement.
  - Expenses incurred on construction or acquisition.
  - Revalued amount to be substituted for historical cost.
  - Method adopted for revaluation.

AS-9 REVENUE RECOGNITION

- **Deals with :**
  - When revenue should be recognized.
  - When revenue recognition should be postponed.
- **Applicable to revenue arising in ordinary course of business from :**
  - Sale of goods
  - Rendering of services
  - Use of enterprise resources, yielding interest, royalty and dividend.
- **Not applicable to revenue from :**
  - Construction Contracts
  - Hire Purchase & Lease agreements
  - Government Grants & subsidies
  - Revenue of Insurance Companies from insurance contracts

- **Sale of Goods :**
  - Seller has transferred ownership of goods to buyer for a price.
  - Seller does not retain effective control of ownership of the transferred goods.
  - No significant uncertainty in collection of the consideration.
- **Rendering of services :**
  - Completed service contract
  - Proportionate completion method

- **Interest :**
  - on time proportion basis.
- **Royalties :**
  - On accrual basis as per the terms of the agreement.
- **Dividend :**
  - When Company declares dividend.
- **Subsequent uncertainty in collection :**
  - Make provision for uncertainty in collection.
  - No adjustment in already recognized revenue.

- **Disclosure Requirements :**
  - Basis of recognition revenue as required by AS -1.
  - Circumstances in which revenue recognition is postponed.

AS-12 ACCOUNTING FOR GOVERNMENT GRANTS

- Government grants are assistance given by Government in cash or kind to an enterprise for past or future compliance with certain conditions.
- **AS not applicable to :**
  - Government assistance other than in the form of Grants.
  - Government participation in the ownership of enterprise.
- **Conditions for recognition of Grants :**
  - Reasonable certainty about the receipt of the Grants.
  - Enterprise will comply with the conditions attached.

- **Non-monetary Grants (in form of Assets) :**
  - At concessional rates, assets are accounted for at cost of acquisition.
  - Free of cost, assets are recorded at nominal value.
- **Monetary Grants (Depreciable Assets) :**
  - Shown as deduction from gross value of assets.
  - Treated as deferred income and recognized in Profit & Loss Account over the life of the asset.
- **Monetary Grants (Non-Depreciable Assets) :**
  - Shown as deduction from gross value of assets.
  - If conditions fulfilled, Grant credited to Capital Reserve Account.
  - If conditions not fulfilled, credited as income over the period of meeting the conditions.
  - Unapportioned Grant shown as Deferred Government Grant on Liability side of Balance Sheet.
  - Grant in nature of Promoter's Contribution credited to Capital Reserve Account.

- **Grants related to Revenue :**
  - Recognized in Profit & Loss Account to match against the corresponding costs incurred.
  - If Grant received as compensation, for expenses or loss, to be disclosed in Profit & Loss Account as extra-ordinary item.
- **Refund of Grants :**
  - Related to revenue- adjust against Deferred Government Grants and balance against Profit & Loss Account.
  - Grant related to specific assets – Increase value of assets.
  - If Grant credited to Capital Reserve Account, adjust against the same.

- **Disclosure Requirements :**
  - Accounting policies followed in recognizing and treatment of Government Grants.
  - Nature and extent of Government Grants, including non-monetary assets given at a concessional rate or free of cost.

AS-16 BORROWING COSTS

- Borrowing Costs include Interest & other costs incurred in connection with borrowing of funds.
- **Recognition :**
  - Directly attributable to the acquisition, construction or production of a qualifying asset – capitalized as cost of that asset.
  - Other costs – recognized as expenditure
- **Qualifying Asset :**
  - Asset that takes substantial time to get ready for its intended use or sale.

- **Specific Borrowing :**

  Amount capitalized

  = Actual Borrowing cost – Income on temporary investment of the borrowed funds

- **General Borrowing :**
  - Borrowing cost to be capitalized, to be determined by considering average borrowing cost and applying it to the relevant expenditure on the asset.

- **Commencement of Capitalization :**
  - Expenditure for acquisition, construction or production of qualifying asset is incurred.
  - Activity necessary to prepare asset for intended use should be in progress.
  - Borrowing Cost is incurred.
- **Suspension of Capitalization :**
  - Capitalization of Borrowing Costs is suspended when active development is interrupted.
- **Cessation of Capitalization :**
  - All activities to prepare qualifying asset for intended use are completed.

- **Disclosure Requirements :**
  - Accounting policies adopted for recognition of Borrowing Costs
  - Amount of Borrowing Costs capitalized during the period.

AS-18 RELATED PARTY DISCLOSURES

- **Related Party :**
  - Has ability to control the other party or exercise significant influence or control in the financial and/ or operating decisions.
- **Related Party Transactions :**
  - Transfer or resources or obligations between related parties, regardless of whether or not, a price is charged.

- **Related Party Relationships :**
  - Enterprises that through one or more intermediaries, control, or are controlled by the reporting enterprise.
  - Associates & Joint Ventures including Holding & Subsidiary Companies.
  - Individuals owning an interest in the voting power, giving them significant control or influence and relatives of such individual.
  - Key management personnel and relatives of such personnel.

- **Deemed not to be Related Parties :**
  - Two Companies simply because they have a Director in common.
  - Single customer, supplier, franchiser, distributor or agent with whom enterprise transacts large volume of business.
  - **Following parties in the normal course of business :**
    - Providers of finance
    - Trade Unions
    - Public Utilities
    - Government Departments & Agencies

- **Disclosure Requirements :**
  - Name of Related Party
  - Description of relationship
  - Nature of transaction
  - Volume of transaction
  - Any other material element necessary for understanding the transaction
- No disclosure is required in consolidated financial statements in respect of intra-group transactions.

AS-22 ACCOUNTING FOR TAXES ON INCOME

- Income tax expense to be treated on accrual basis, irrespective of the timing of payment of tax.
- Tax expense for the period consists of
  - **Current Tax :** Amount of income tax determined to be payable in respect of the taxable income of a period.
  - **Deferred Tax :** Tax effect on timing difference.

- **Timing Difference :**
  - Differences which a arises in one period and are capable of reversal in one or more subsequent periods.
- **Permanent Difference :**
  - These differences originate in one period and do not reverse subsequently, and is permanent in nature.
- **Deferred Tax Liability :**
  - Recognized for temporary differences that will result in taxable amounts in the future.
- **Deferred Tax Asset :**
  - Recognized for temporary differences that will result in deductible amounts in the future.

- Deferred Tax Asset / Liability to be measured for all timing differences.
- Deferred Tax Asset should be recognized and carried forward, only to the extent it is reasonably certain that there will be sufficient future income to recover the Deferred Tax Asset.

- **Disclosure Requirements :**
  - Amount of Deferred Tax Asset / Liability should be disclosed separately.
  - Deferred Tax Asset to be disclosed after 'Investments' & before 'Current Assets, Loans & Advances'.
  - Deferred Tax Liability to be disclosed on the Liability side, after 'Unsecured Loans'.

Specimen of Significant Accounting Policies

THANK YOU

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