INTRODUCTION TO ACCOUNTING STANDARDS

C.A. HRISHIKESH A. WANDREKAR
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.
• 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, una amortized 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.
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  
  \[\text{Amount capitalized} = \text{Actual Borrowing cost} - \text{Income on temporary investment of the borrowed funds}\]

• **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 arise 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

WANDREKAR & CO.
C – 20, BLOCK NO. 181
M.I.G. COLONY
GANDHINAGAR, BANDRA (EAST)
MUMBAI 400051
Tel - 2640 0592, 98989 19239
Email - hrishikesh@wandrekarandco.com