AS 1

DISCLOSURE OF ACCOUNTING POLICIES

Talati & Talati Group

Business in Focus

Summary

- Need for disclosure of Accounting policies
- Fundamental Accounting Assumptions
  1. Going concern
  2. Consistency
  3. Accrual
- Principles regarding the accounting policies
  1. Prudence
  2. Substance over form
  3. Materiality

Case 1

- ABC Ltd wants to apply SLM method of depreciation for some of its Plant & Machinery and WDV method for other Plant & Machinery. Can it do so?

- XYZ Ltd wants to apply FIFO for some of its inventories and WAM for others. Can it do so?

Case 2

- What are the principles to be followed if an enterprise is **not going concern?**

Case 3

- ABC Ltd mentions its accounting policies wrt to inventories as: "Inventories are valued at cost and NRV, whichever is lower". Is this appropriate?
  - NRV
  - Cost formula

AS 3

CASH FLOW STATEMENT

Talati & Talati Group

Business in Focus

Summary

- Applicability
  i. Other than SMC (T/o – 50 Crs, B – 10 Crs, not listed)
  ii. Other than OPC, Small Company, Dormant Company (T/o – 2 Crs, SC – 50 lacs, not public company)
- Presentation of cash flow statement
  - Operating activities
    - Methods
      i. Direct method
      ii. Indirect method (mandatory for listed companies)
  - Investing activities
  - Financing activities

Definitions

- ***Cash*** comprises cash on hand and demand deposits with banks.
- ***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.
- ***Operating activities*** are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.
- ***Investing activities*** are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.
- ***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.

Case 1

- Can MF units, that are readily convertible into cash at their NAV, be treated as cash equivalent?

Case 2

- A company has acquired a plant on finance lease and funds are arranged by acquiring a loan. What would be the treatment in cash flow statement?
  - Initial Entry
  - Subsequent Entry
    - Principal
    - Interest

Case 3

- Where should 'Income Taxes Paid' be classified in Cash Flow Statement?
  - What if the taxes are on STCG?

Case 4

- Where should you disclose 'Bank OD'?
  - Cash and cash equivalents
  - Operating
  - Financing

Case 5

- Where should you disclose 'Fixed Deposits with Banks'?
  - Cash and cash equivalents
  - Investing
- What if it is a 12-month FD?

Disclosures of certain items

- Interest / Dividend expense
  - Financing activities
  - Operating activities
- Interest / Dividend income
  - Investing activities
  - Operating activities
- DDT
  - Financing activities
  - Operating activities

Missing areas in AS 3

- Cash flow in case of a foreign subsidiary
- Cash flow between a parent, its subsidiary, associates and joint ventures.

AS 4

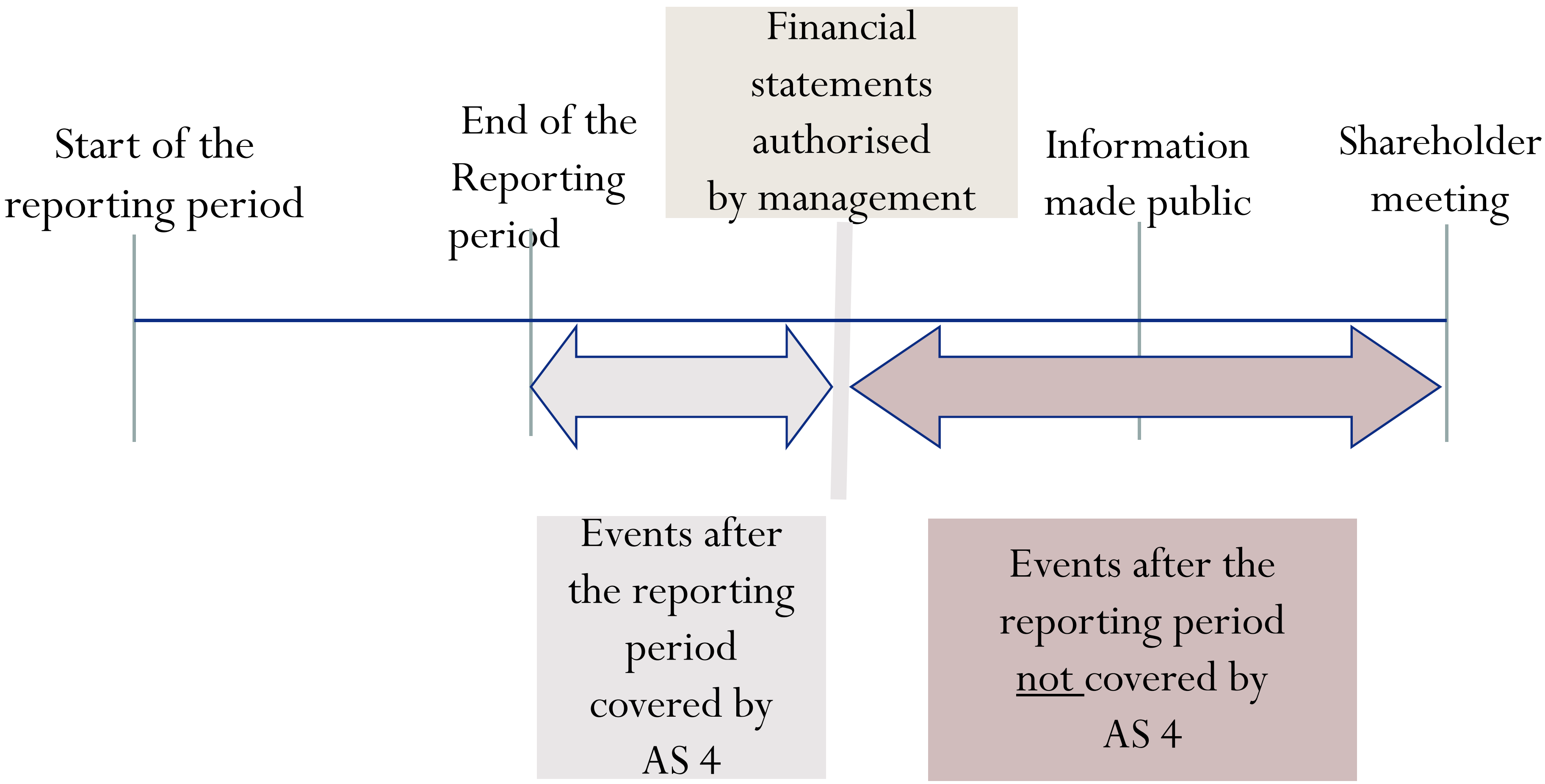
CONTINGENCIES & EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

Summary

- Contingencies
    - AS 29
    - Bad debts?

- Events occurring after the Balance Sheet date
    - Adjusting
    - Non-adjusting

Events to be considered



Definitions

- **Events occurring after the balance sheet date** are those significant events,
- both favorable and unfavorable,
- 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.

Case 1

- A company had announced a voluntary retirement for its employees on January 1, 2015. The scheme was scheduled to be closed on June 30, 2015. The scheme envisages an initial lump-sum of Rs. 2 lakhs and monthly payments over the balance period of service of employees coming under the plan. 200 employees opted with the scheme as on March 31, 2015. The total lump-sum payment for these employees would be Rs. 250 lakhs and the aggregate of future payments to them would amount to Rs. 1500 lakhs. However no payment is payment on March 31, 2015. Is company is required to make the provision for the same?

Case 2

- Accounting for proposed dividend?
  - Is provision required?
  - Disclosures?

Case 3

- On 30/4/2015, due to destruction of the factory by fire, X, one of the company's debtors, declared himself insolvent. What treatment should the company consider for the year ended 31/3/2015?

Case 4

- After the close of accounting year of ABC Co. Ltd. there was an earthquake. As a result of which, a portion of the building and few machineries were destroyed. The extent of the damage was beyond repair. Also, the company's resources were inadequate to fund the replacement of the assets so destroyed. What should the company do in such case?

AS 5

PRIOR PERIOD ITEMS AND CHANGES IN ACCOUNTING POLICIES

Talati & Talati Group
Business in Focus

Summary

- Net profit or loss for the period
  1. Extraordinary items
  2. Profit or loss from ordinary items
  3. Prior period items
  4. Changes in accounting estimates
  5. Changes in accounting policies

Definitions

- **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.

- **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.

- **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.

- **Accounting policies** are the specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements.

Case 1

- XYZ Ltd. is planning to change the method valuing the inventories from FIFO to WAM. Will this be considered as change in accounting policy?

Case 2

- ABC Ltd. is planning to change its depreciation method from SLM to WDV. Will this amount to change in accounting estimate or change in accounting policy?

Case 3

- Will the following errors indicate prior period item?

1. XYZ Ltd had re-valued a machinery at Rs. 11,000 as on 31/3/2012 and had been charging depreciation accordingly. Later in the year 2014-15, the management realized that the machinery was overvalued by Rs. 1000 and is planning to correct the value and depreciation charged in earlier years.
2. The management of ABC Ltd. made a wrong accounting estimate in financials of 2011-12 and is planning to correct the same.
3. A company made a wrong disclosure in financial statement of 2013-14. The management is planning to correct the same in FY 2014-15.

Prior Period Item disclosures

- Sch III - disclose by way notes
- AS 5 - 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.***
  - Prior period items are normally included in the determination of net profit or loss for the current period (i.e. before PAT)
  - An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss (i.e. after PAT)
  - In either case, the objective is to indicate the effect of such items on the current profit or loss.

AS 16

Borrowing Costs

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Business in Focus

Definitions

- **Borrowing costs** are interest and other costs incurred by an enterprise in connection with the borrowing of funds.
- **Qualifying asset** is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Summary

- Recognition
  - Borrowing Costs Eligible for Capitalization
    - Specific borrowing
    - General borrowing
  - Excess of the Carrying Amount of the Qualifying Asset over Recoverable Amount
  - Cessation of Capitalization

Case 1

- A company taken a foreign loan of USD 100,000 on 1st Jan 2014. Rate of interest is 5% and exchange rate on that date was Rs. 50/USD.
- The same loan could have been borrowed by the company @ 15%. The exchange rate on 31st December, 2014 was Rs. 60
- Interest in INR = 7,50,000
- Interest in USD = $5,000

Case 2

- ABC Ltd. has taken a loan of USD 10,000 on 1/4/2014 for a specific project at 5% p.a. The due date of the interest to be paid is 31/3/2015. However the interest was actually paid on 14/4/2015. The exchange rate on 31/3/2015 was Rs. 46, and on 14/4/2015 was Rs. 50. At what rate should the interest be considered?

Case 3

- A company has purchased a machinery on a bank loan and the bank has charged processing fees for Rs. 10000. Should the company capitalize these fees?

Case 4

- XYZ Ltd. had taken a loan of Rs. 150 crores for the construction purpose on 1/7/2009. It has already spent Rs. 100 crores. However, the management will not be in need of additional funds for some time and is planning to invest the surplus money of Rs. 50 crores. What shall be the treatment of the interest that is to be earned on the investment? Should it be treated as income or should be adjusted with the interest that is to be paid on the loan?

Case Study 5

- Loan taken = April 25, 2010
- Contractors hired (advance paid) = May 1, 2010
- Asset construction start date = May 10, 2010

Case Study 6

- Loan taken
- Land purchased for construction of building
- Construction not started

Case Study 7

- Bridge being constructed
- Suspended due to high water levels
- Such high water levels normal

AS 19

Leases

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Business in Focus

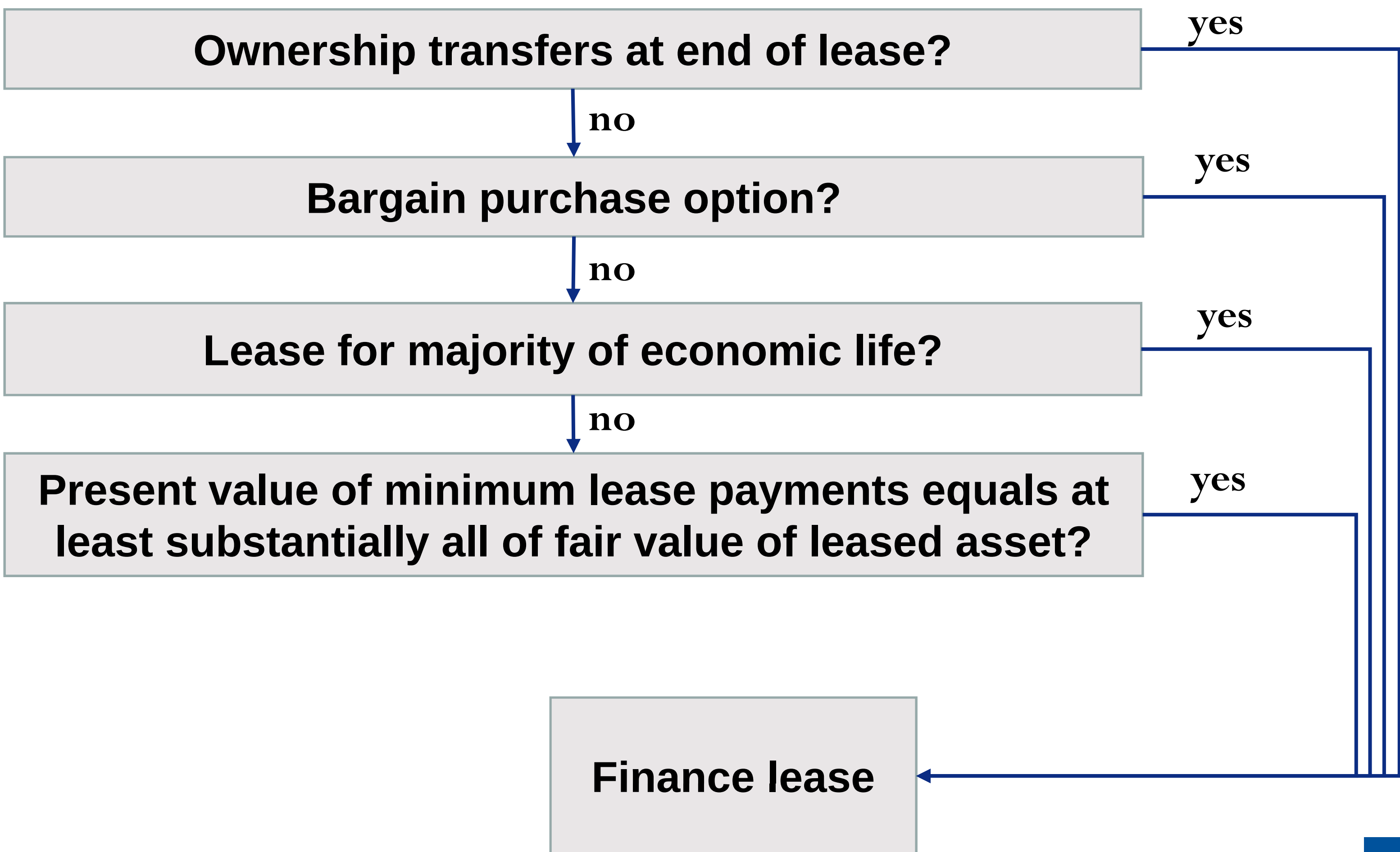
Definitions

- **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.
- **Finance lease** is a lease that transfers substantially all the risks and rewards incident to ownership of an asset.
- **Operating lease** is a lease other than a finance lease.

Summary

- Classification of leases
  - Finance Lease
  - Operating lease
- Treatment of leases in the financial statements of:
  - Lessees
  - Lessors

Indicators of finance lease



Accounting for finance lease

	Lessee	Lessor
Balance Sheet	• Leased asset • Liability (PV of minimum lease payments)	Receivable (PV of gross investment)
Profit or Loss Account	• Depreciation • Finance expense	• Profit on sale? • Finance income • Initial direct expenses

Case Study

- Company A enters into an agreement with Supplier B relating to packaging of bottles into crates for a three year period. The contract specifies the following:
  - The bottling plant is explicitly identified in the arrangement
  - The bottling plant is only used to perform packaging of bottles for Company A and it would neither be economically feasible or practicable for Supplier B to use other assets
  - Each month Company A pays a fixed price amounting to Rs. 10,00,000
  - Company A has the option to change the supplier without losing the control over the bottling plant and hence, it is also able to prevent others from getting physical access to the bottling plant

Case Study

- Additional terms
  - Each month Company A pays a fixed price amounting to Rs. 100,000 for 200,000 bottles (Rs. 0.50 per bottle)
  - Company A will pay that fixed amount even if it does not want any bottles
  - Packaging of bottles more than 200,000 will be at 0.20 per bottle
  - Plant capacity: 220,000 bottles

Land lease

- Scope?
- Operating lease/Finance lease

Accounting for lessor

- Derecognise the asset
- Recognise receivable @ Net Investment (NI)

Net Investment = PV of Gross Investment

Net Investment → FV of Asset + incidental costs

PV → Implicit ROI

Gross Investment → Minimum Lease payment + Unguaranteed residual value

Minimum Lease payment →

- Non-cancellable lease payments
- Guaranteed residual value (Lessee + 3rd Party)
- Purchase option if reasonable certainty of exercise
- Lease payments under bargain renewal option

Accounting for lessee

- Recognise the asset @

FV of Asset

Whichever is **Lower**

PV

of

Minimum Lease Payments

Implicit ROI OR Borrowing rate

- Non-cancellable lease payments
- Guaranteed residual value (Only Lessee)
- Purchase option if reasonable certainty of exercise
- Lease payments under bargain renewal option

AS 26

Intangible Assets

Definitions

- 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

What is an intangible asset?

- Software in a CD
- Software of a printer/ scanner
- Legal documentation (patents/ trademarks)
- Movie/ film in a roll
- Customer relationships
- Skilled employees
- Internally generated goodwill

Summary

- Recognition and initial measurement of an intangible asset
  - Separate Acquisition
  - Acquisition as Part of an Amalgamation
  - Acquisition by way of a Government Grant
  - Internally Generated Goodwill
  - Internally Generated Intangible Assets
    - Research Phase
    - Development Phase
    - Cost of an Internally Generated Intangible Asset
- Recognition of expense
  - Past expenses not to be recognized as an asset
- Subsequent expenditure
- Subsequent measurement of an intangible asset
- Amortization
  - Period
  - Method
  - Residual value

Case Study

F Pharmaceuticals is developing a miracle lotion by using extracts from a cactus discovered in the Sahara desert. F claims that, when perfected, the extract will be highly effective against hair loss, and will be used in a revolutionary new product. A team of dedicated scientists has been working on this product for the last three months.

- Research Phase
  - Obtaining of the knowledge
  - Formulation and design of possible alternatives
  - Technical feasibility study
  - Market research
- Proof of development phase
  - Intention to sell the product by starting to advertise
  - Technical feasibility result
  - Market research result

Case Study

- Company A has right to produce product X. That right is for 5 years, renewable at nominal cost. Company X believes that they will be able to renew the right for next 15 years.
- Can they amortise the right over 15 years?

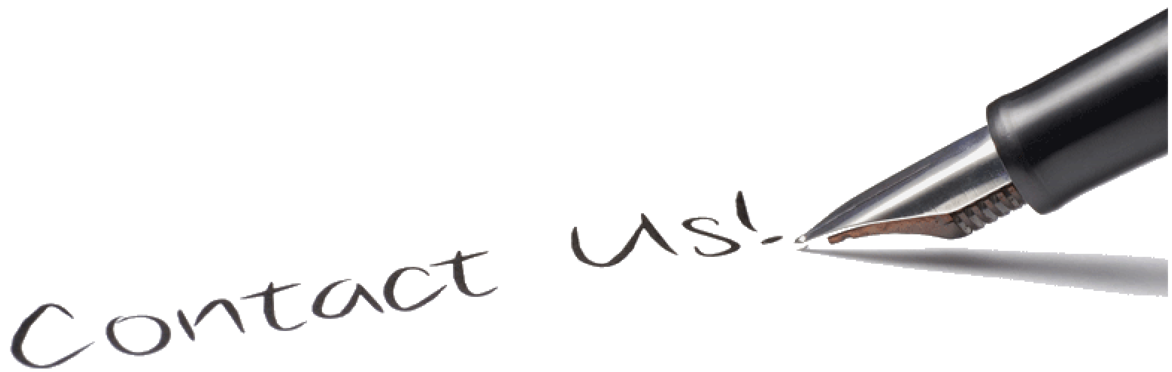
Scope...

- discount or premium relating to borrowings
- ancillary costs incurred in connection with the arrangement of borrowings,
- share issue expenses and discount allowed on the issue of shares
- Miscellaneous Expenses?

Case Study

- Can an intangible assets be revalued?

ThanQ?



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