PRESENTATION
ON
AS 2 – Valuation of Inventories

BY

JAYESH GANDHI

AT WIRC ON 27 JUNE 2015

APPLICABILTY

- This standard is mandatory for the financial statements of the period commencing on or after 01.04.1999.
- Inventories are assets:
  - Held for sale in the ordinary course of business;
  - In the process of production for such sale;
  - In the form of materials or supplies to be consumed in the production process or in the rendering services;
  - It also includes maintenance supplies, consumables and loose tools;
  - But does not include machinery spares which can be used only in connection with an item of fixed asset.
  - Such machinery spares are accounted for in accordance with AS 10, Accounting for Fixed Assets.

APPLICABILTY (contd.)

- This standard is not applicable to the following types of inventories:
  - WIP arising under construction contracts or of a service provider
  - Shares, debentures held as stock-in-trade,
  - Inventories of livestock, agricultural and forest products, mineral oils, ores and gases to the extent they are measured at net realisable value.

APPLICABILTY (contd.)

Case Study:

Is following items are covered by AS 2?

Sr.	Particulars	Yes/ No
1	Computer software held for resale	
2	Debentures held for resale	
3	Land and other property held for resale	
4	Machinery produced by the manufacturer	
5	Work in progress in the course of service provider (CA, Lawyers etc.)	
6	Consumable / Loose tools	

MEASUREMENT

- Inventories should be valued at the lower of cost or net realisable value (NRV)
- **Cost of goods is the summation of**
  - Cost of purchase
  - Cost of conversion
  - Other cost
- Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated selling cost.

HOW TO DETERMINE COST?

- **Inclusion of cost of inventories**
  - **Cost of purchases** consist of purchase price including duties (other than recoverable set off claims), freight inwards and other expenditure directly attributable to the acquisition.
  - **Cost of conversion** inventories include cost directly related to the unit production, such as direct labour.
  - **Other cost** to be included only to the extent that they are incurred in bringing the inventory to their present location and condition.
- **Exclusion from cost of inventories:**
  - Abnormal cost; such as wasted material etc.
  - Storage cost, unless it is during production process;
  - Common administrative overheads that do not contribute in bringing the goods to the present condition and location;
  - Selling and distribution costs.

HOW TO DETERMINE COST?

- **Interest and other borrowing costs** are not usually considered as part of cost of inventories, unless it is **qualifying assets** as per AS 16

HOW TO DETERMINE COST?

- All trade discounts/rebates including duty drawback to be excluded.
- Fixed production overheads absorption to be considered based on normal capacity in case of lower production.
- Normal capacity is the production expected to be achieved on an average over a number of periods or seasons under normal circumstances.
- Installed capacity not necessarily normal capacity
- In case of by-products or waste material, generally the sale price of such products is reduced from the total cost incurred to ascertain cost of the main products. for e.g. glycerin and steric acid in case of soap manufacturing.

COST FORMULAS

Following are various cost formulas suggested by AS 2

- Specific Identification Method
- FIFO / Weighted Average Price (Different from AS 13)
- Standard Cost Method / Adjusted Selling Price Method or Retail Method

COST FORMULAS

- Specific cost to be assigned if inventories are meant for specific contracts/projects in case such items are not interchangeable.
- The FIFO formula assumes that the items of inventory which were purchased or produced first are consumed or sold first. Under the weighted average cost formula, the cost of each item is determined from 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.

TECHNIQUES OF MEASUREMENT

- Standard cost method can be used for convenience if the results approximate the actual cost. Standard costs are regularly reviewed and revised in the light of current conditions.
- The retail method is often used for measuring large numbers of rapidly changing items that have similar margins. Cost is determined by reducing from sales value appropriate percentage gross margin.

HOW TO ASCERTAIN NRV?

- In case of obsolete or damaged items, generally NRV is lower than the cost.
- For each item of inventory, NRV is separately worked out.
- For WIP one needs to estimate cost to convert into finished goods and the amount arrived should be reduced from NRV of finished goods.
- NRV can be applied on a global basis if items pertain to the same product line, have similar purposes and are produced and marketed in the same geographical area and cannot be practicably evaluated separately.

HOW TO ASCERTAIN NRV? (contd.)

- NRV is based on the most reliable evidence available at the time of making the estimates. Post balance sheet events can be considered to the extent such events confirm the conditions existing at the Balance Sheet date.
- Raw materials and other supplies are not written below cost unless:
  - There is a decline in the price
  - And the cost of the finished goods in which they are incorporated are expected to exceed the net realizable value.
- Last purchase price may be used to work out decline in the price for raw materials.
- An assessment of net realizable value to be made at each balance sheet date.

DISCLOSURES

- Accounting policies adopted in measuring inventories, including cost formula used
- Total carrying amount of inventories for each classification of inventory.
- **Question**

Change in method is it change in Accounting Policy?

ACCOUNTING FOR MACHINERY SPARES

- Machinery spares not specific to a particular item of fixed asset should be treated as inventory. such machinery to be charged to P&L a/c as and when issued for consumption
- Machinery spares which are specific to a particular item of fixed asset and their use is irregular should be capitalised.
- Insurance/capital spares should be capitalised
- Total cost of these assets to be allocated over the useful life of the fixed asset to which they relate.
- When related fixed asset is discarded or sold, the W.D.V. of the related capital/insurance spares should be written off.
- A standby equipment is a separate fixed asset and should be depreciated like any other fixed asset e.g. a generator.

PRACTICAL ISSUES

- A company is a basic service provider of telephone services. It uses cables for laying down the lines and also for connection of new telephone lines. It generally carries huge stock of cables. what is the correct way to value such cables ?
- Company “w” is producing wine as its final product after processing raw grapes and converting it into juice, the company is required to keep such juice in special containers for a minimum period of 2 years for converting it into saleable wine. Depending upon the quality of wine, the minimum period of maturity may go up to 5 to 6 years. “w” incurs certain direct expenses including interest cost during the period of maturing, can such cost be considered for inventory valuation ?
- Whether coffee manufacturing company need to follow this standard ?

PRACTICAL ISSUES (contd.)

- The company has 3 manufacturing units for the same product the company has various sales depots and the final product is usually transferred from the nearest factory.

  However, in case of emergency, it may be transferred from other factories. In addition to that, there are lot of inter-depot transfers to take care of urgent demands.

  Identification of the factory in which the finished product is produced is difficult.

  In such circumstances, how to value the year-end finished products lying at various sales depots?

CERTAIN ISSUES

- Valuation of scrap at net realisable value whether possible?
- Inventory used for scientific research activities whether to be treated separately?
- Treatment given for exchange difference on imports?
- Plant running at lower capacity how to use in valuation?
- Provision based on period of holding – whether possible ?
- Whether provision shown on a liability side or as a reduction of inventory value?
- Whether disputed amount relating to transportation of raw material with the transporter already provided in books of accounts be considered in valuation of raw material?

PRESENTATION
ON
ACCOUNTING STANDARD - 20

EARNINGS PER SHARE

BY

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AT WIRC ON 27 JUNE 2015

EARNINGS PER SHARE - AS 20

SCOPE AND APPLICABILTY

- This Accounting Standard is mandatory for all companies. However, a Small and Medium Sized Companies may not disclose diluted earnings per share (both including and excluding extraordinary items).
- In consolidated financial statements, the information required by this Statement should be presented on the basis of consolidated information.
- Para 48 of guidance note on ESOP requires a disclosure to be made in financial statement at fair value measurement. (SEBI has also prescribed such disclosure as a part of Directors Report)

PRESENTATION

- 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 net profit for period. An enterprise to present basic and diluted earnings per share with equal prominence for all periods presented.
- This Standard requires an enterprise to present basic and diluted earnings per share, even if amount disclosed are negative (a loss per share).
- For shares having differential voting rights, for each class of such shares EPS is required to be given in accordance with their voting right.

MEASUREMENT

- Basic Earnings Per Share
  - Basic earnings per share to be calculated by dividing net profit or loss for the period attributable to equity shareholders by the weighted average number of equity shares outstanding during period.
- Earnings – Basic
  - For calculating basic earnings per share, net profit or loss to be considered after deducting preference dividend and dividend distribution tax(Cumulative preferences shares dividend to be considered whether dividend declared or not).

MEASUREMENT

- The weighted average number of equity shares outstanding 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
- In most cases, Weightage average number of shares are included from the date of conversion or when the consideration is receivable
- Equity Shares issued as part of consideration in an amalgamation in the nature of purchase are included in weighted average number of shares as of the date of the acquisition.
- Equity Shares issued during the reporting period as part of the consideration in an amalgamation in the nature of merger are included in weighted average number of shares from the effective date.
- Partly paid equity shares are treated proportionately to the extent they are entitled to dividend.

ILLUSTRATION 1

Example – Partly paid Shares
(Accounting Year 01-04-2014 to 31-03-2015)

		No. of Shares Issued	Nominal value of shares	Amount Paid
01/04/2014	Balance at the beginning of year	1,800	Rs. 10	Rs. 10
31/10/2014	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:

(1800 X 12/12) + (300 X 5/12) = 1,925 shares

MEASUREMENT

- In case of bonus issue or a share spilt, 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.
  - Therefore 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.

ILLUSTRATION 2

Example – Bonus Issue
(Accounting Year 01-04-2014 to 31-03-2015)

Net Profit for the year 2013	Rs. 18,00,000
Net Profit for the year 2014	Rs. 60,00,000
No. of equity shares outstanding until 30th September 2014	20,00,000
Bonus issue 1st October 2014	2 equity shares for each equity share outstanding at 30th September, 2014 20,00,000 X 2 = 40,00,000
EPS for the year 2014	$\frac{\text{Rs. } 60,00,000}{(20,00,000 + 40,00,000)}$ = Re. 1.00
Adjusted EPS for the year 2013	$\frac{\text{Rs. } 18,00,000}{(20,00,000 + 40,00,000)}$ = Re. 0.30

MEASUREMENT

- Right issues are generally made at a price lower than fair value of share. Therefore, a right issue usually includes a bonus element.
- As it includes bonus element, the number of equity shares to be used in calculating basic EPS for all periods prior to right issue is the number of equity shares outstanding prior to issue multiplied by ***right factor.***

- $$\text{Right Factor} = \frac{\text{Fair Value per share immediately prior to right issue}}{\text{Theoretical ex-right fair value per share}}$$

- Theoretical Ex-right fair value :-

$$\frac{\text{Aggregate fair value of share immediately prior to the exercise of the rights} + \text{Proceeds from exercise of the rights}}{\text{Number of shares outstanding immediately after the right issue}}$$

ILLUSTRATION 3

Example – Rights Issue
(Accounting Year 01-04-2014 to 31-03-2015)

Particulars	Amount
Net Profit for the year 2013-14	Rs. 11,00,000
Net Profit for the year 2014-15	Rs. 15,00,000
No. of shares outstanding prior to rights issue	5,00,000 shares
Right issue	One new share for each five outstanding (i.e. 1,00,000 new shares) Right issue price : Rs. 15.00 Last date to exercise rights: 1st June 2014
Fair value of one equity share immediately prior to exercise of rights on 1st June 2014	Rs. 21.00

ILLUSTRATION 3 (Cont.…)

Computation of theoretical ex-rights fair value per share
$\frac{(\text{Rs. } 21.00 \text{ X } 5{,}00{,}000 \text{ Shares}) + (\text{Rs. } 15.00 \text{ X } 1{,}00{,}000 \text{ shares})}{5{,}00{,}000 \text{ shares} + 1{,}00{,}000 \text{ shares}}$ = 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 2013-14	Year 2014-15
EPS for the year 2013-14 as originally reported Rs. 11,00,000/5,00,000 shares	Rs. 2.20	
EPS for the year 2013-14 restated for right issue : Rs 11,00,000/(5,00,000 shares X 1.05)	Rs. 2.10	
EPS for the year 2014-15 including effects of right issue $\frac{\text{Rs. } 15{,}00{,}000}{(5{,}00{,}000 \text{ X } 1.05 \text{ X } 2/12) + (6{,}00{,}000 \text{ X } 10/12)}$		Rs. 2.55

MEASUREMENT

- Diluted EPS
  - Numerator and denominator are adjusted for the effects of dilutive potential equity shares, assuming conversion into equity.
  - Potential equity shares are treated as dilutive when the conversion into equity would result into reduction of profit per share.
  - Effect will be anti-dilutive if EPS is reduced. In such case, effect on EPS is ignored.
  - Each issue of potential equity share is considered separately and in sequence from the most dilutive to the least dilutive.
  - Most dilutive EPS than will be considered with further disclosure.
- If the number of equity shares or potential equity shares outstanding are increased or decreased on account of bonus / split or consolidation after the balance sheet date but before the approval of financial statements, EPS is calculated after considering effect of the same. The fact should be disclosed.
- If the debentures are converted during the year then it effects the Basic EPS and if it is converted in the future period then it effects the dilutive EPS.

POTENTIAL EQUITY SHARES

- Convertible debenture or preferential shares
- Share Warrants
- Employees’ Stock Option
- Shares issuable on default of loan contract
- Shares to be issued against acquisition of business / assets
- Conversion rights to equity shares in the Loan Agreement, in case of defaults in repayment of interest and principal from Banks

ILLUSTRATION 4

Example – Convertible Debentures
(Accounting Year 01-04-2014 to 31-03-2015)

Particulars	**Amount**
Net Profit for the current year	Rs. 1,00,00,000
No. of Equity shares outstanding	50,00,000
Basic EPS	Rs. 2.00
No. of 12% convertible debentures of Rs. 100 each	1,00,000
Each debenture is convertible into 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

ILLUSTRATION 4 (Cont.…)

Particulars	Amount
No. of equity shares resulting from conversion of debentures	10,00,000
No. of equity shares resulting 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 = Rs. 1.81

DISCLOSURE

- Where the statement of profit and loss includes extraordinary items the enterprise should disclose basic and diluted EPS computed on the basis of earnings excluding extraordinary items (net of tax Expense)
- Amounts used as the numerators in calculating basic and diluted EPS, and a reconciliation of those amounts to the net profit or loss for the period.
- Weightage number of equity shares used in the calculation, in the basic and diluted EPS and reconciliation between the two.
- Nominal value of shares along with EPS figures.

DISCLOSURE (Cont..)

- An enterprise may disclosed more information on a per share basis which may help the users evaluate the performance of the enterprises.
- However, when such amounts are disclosed, the denominators need to be calculated in accordance with AS 20 in order to ensure the comparability of the per share amounts disclosed.

PRESENTATION
ON
AS 24 – Discontinuing Operations

BY

JAYESH GANDHI

AT WIRC ON 27 JUNE 2015

APPLICABILTY

- Mandatory in nature for all companies and all enterprise.

SCOPE

- This standard applies to all discontinuing operations of as enterprises.

Definition:

Discontinuing operation is a component of an enterprise-

- Which is being disposed off or abandoned pursuant to a single co-ordinated plan;
- It represents separate line of business or geographical area of operations;
- Can be distinguished operationally and for financial reporting purposes.

It must be noted that all the above three conditions should be simultaneously satisfied.

Situation - Not A Discontinuing Operations

- Gradual phasing out of a product line or class of service.
- Discontinuation of certain products
- Shifting or closure of some marketing offices or manufacturing units.
- Closing of a facility for cost savings.

However, in combination with some other circumstances it might be discontinuing operations.

Recognition And Measurement

- This statement does not deal with any recognition and measurement principles.
- For this purpose, provisions of other Accounting Standards should be applied.
- One may look at
  - AS-2 Valuation of Inventories
  - AS-4 Contingencies and Event Occurring after the Balance Sheet Date
  - AS-10 Accounting for fixed assets
  - AS-28 Standard on Impairment of Assets
- This standard deals only with Presentation and Disclosure in the financial statement.
- It will also cover interim financial statements.

PRACTICAL ASPECTS

- For separate line of business or geographical area, to take clue from AS - 17, Segment Reporting.
- If a particular business segment or geographical area is not shown separately for As -17, it will be difficult to consider it as Discontinuing Operation.

PRACTICAL ASPECTS (contd.)

- Infrequently occurring events, which may require separate disclosure as per AS- 5 do not necessarily be on account of Discontinuing Operations.
- Discontinuing Operations on its own shall not affect the going concern assumptions.
- A component can be distinguished operationally and for financial reporting purpose only if its operating assets, liabilities, its revenue and major of its operating expenses can be directly attributed to a component.
- Certain assets commonly used by different segment can not fit into this criteria.

INITIAL DISCLOSURE EVENT

- Initial Disclosure Event is the earliest occurrence of one of the following-

  - Entering into binding sale agreement for substantially all of the assets attributable to the Discontinuing Operation.

  - Enterprise's Governing body has approved a detailed, formal plan for the discontinuance and made an announcement of the plan.

WHAT IS A DETAILED, FORMAL PLAN ?

Normally includes:

- Identification of Major Assets to be disposed off
- Expected method of disposal
- Expected time frame of disposal
- The principal locations affected
- Approx. number of employees to be compensated for termination of service
- Estimated proceeds to be realised by disposal.

WHAT IS A DETAILED, FORMAL PLAN ? (contd.)

- Practically such a plan is difficult to find. Generally you will find discussion in the governing body on different aspects at different point of time. In my opinion, if concrete decision of assets to be disposed off and price band is approved, it may be considered as sufficient indication of a detailed plan.

WHAT IS ANNOUNCEMENT ?

- If the main features for the plan for discontinuance is announced to lenders, stock exchanges, creditors, trade unions, media etc., one need to consider as an announcement.

- For this purpose, one may look at web-site of the company, internal news letters, press conference announcements, correspondence with the stock exchanges etc.

- In case, one does not find such event, one may have to wait upto sale agreement or MOU date for sale of substantial assets of the Discontinuing Operations.

INITIAL DISCLOSURE

An enterprise should give following information in its financial statements beginning with the financial period in which the 'Initial Disclosure Event' occurs:

- A description of discontinuing operation
- Segment in which it is reported as per AS 17
- Date and nature of Initial Disclosure Event
- A time by which the discontinuation is expected to be completed.
- The carrying amounts of the assets to be disposed off.

INITIAL DISCLOSURE (contd..)

- In respect of Discontinuing Operations:
  - Revenue and expenses from ordinary activities.
  - Pre-tax profits or loss and tax expenses relating to such operations (to be disclosed on the face of the profit & loss account)
  - Net cash flows of such operations.
  - Disclosure are only for current period and not for comparative period

- To the extent that any item is expected to be used after completion of discontinuance, such items are not considered for disclosure.
- Important to note that segment reporting disclosures are different than what is required by this standard.

OTHER DISCLOSURE

- On disposal of assets or settlement of liabilities or on entering into binding agreement for disposal / settlement, the financial statements of an enterprise should include the following-
  - Gain / loss recognised on the disposal / settlement including amount of pre-tax gain / loss and income-tax thereon (to be disclosed on the face of the profit and loss account).
- In case enterprise has entered into binding sale agreements (when impact is not recognised in financial statements)
  - Net selling price or range of prices (after deducting expected disposable costs)
  - The expected timing of receipt of consideration.
  - The carrying value of such Net assets on the balance sheet date.

Disclosure Updations

- Financial statement for a period subsequent to the one in which initial disclosure event occurs should disclose;
  - Details of significant changes, if any in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled.
  - Event triggering those changes.

- The disclosures should continue for a periods up to and including the period in which discontinuance is completed i.e. plan is substantially completed or abandoned.

- For abandonment and withdrawal of plan;
  - the facts, reasons and effects should be disclosed, including reversal of impairment loss or any provisions

CASE STUDY - I

- C Ltd. has one common unit for manufacturing Computers and Peripherals. It decides to close down manufacturing of Peripheral products on account of competition and substantial reduction in selling price. However, it continues to manufacture computer from that unit

  - whether it can be treated as Discontinuing Operation?

  - would it make any difference, if C Ltd. has a plan to continue sale of Peripheral products by purchasing from the third party?

CASE STUDY - I - ANSWER

- From the facts of the case, it is clear that peripheral segment was not treated as a separate segment.
- Closure of peripheral manufacturing shall not be treated as Discontinuing Operation as computers are continued to be manufactured from the same place.
- It will not make any difference if trading of peripheral products continue, in the present case.
- However, if manufacturing was only of peripherals, the additional facts will make difference, as one may argue that there is no change in the product line and only form is changed.
- However, if factory was considered as separate geographical segment, one may have to consider it as Discontinuing operations.

CASE STUDY - II

- X Ltd. is manufacturing Consumer goods which are sold locally and also outside India in different countries. It has identified certain geographical segment for AS- 17. If the Company decides to stop its operation in Russia. Whether that should be treated as Discontinuing Operations?

CASE STUDY - II - ANSWER

- Answer will depend upon stand taken for AS - 17. If Russia was considered as separate geographical segment, it should be treated as Discontinuing Operations.

  If Russian business was not tracked separately on materiality ground, it may not be Discontinuing Operations.

CASE STUDY - III

- Y Ltd. manufactures cosmetic products amongst other items. It has only one factory in Goa to manufacture cosmetic products.

  While going through board minutes, auditors gathers that during the board meeting in the year 2014-15, there were lot of discussion on closure of manufacturing unit at Goa, on account of frequent labour troubles and unviable operations. CFO of the Company was also given power to negotiate for disposal of the factory at not less than Rs. 100 Mn. However, there was no announcement to the outsiders in this regard.

CASE STUDY - III (contd.)

On 15.5.2015, CFO reports to the Board that no party is coming forward to purchase the unit, but one party is willing to buy at Rs. 85 Mn, subject to adjustment arising out of due diligence exercise. In the same board meeting the board agrees to price reduction and give power to CFO and MD to finalise MOU with the party.

A Company Secretary points out that approval of shareholders is required for this purpose. The Company Secretary is asked to send notice for calling of EGM. Notice is sent to the shareholders on 20.5.2015.

At the time of finalising accounts of the Company on 30.6.2015, whether it can be treated as Discontinuing Operation?

CASE STUDY - III - ANSWER

- Here it must be noted that
  - No announcement of plan was made in the year 2014-15.
  - By sending notice to the shareholders on 20.5.2015, it will be considered as announcement at that point of time.
- As there is no Initial Disclosure Event in the year 2014-15, no disclosure is required as per this standard.
- However, event occurring after the balance sheet date but before finalisation of accounts need to be disclosed by way of a note as per AS - 4.
- Auditor may have to consider possible impairment of assets in the year 2014-15. There is enough indication of impairment of assets on the balance sheet date. Subsequent event should be used for estimation of impairment.

THANK YOU

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