SECTION-F

Accounting Standards

Accounting Standards 9

This Module Includes

Accounting Standards

SLOB Mapped against the Module

To gain application-oriented knowledge on identifying the impact of various standards on treatment of certain transactions to ensure appropriate reporting. (CMLO 4a, c)

Module Learning Objectives:

After studying this module, the students will be able to:

- Understand the basic concept of Accounting Standards;
- Get an overview of certain specified accounting standards (namely AS 1, AS 3, AS 10, AS 11, AS 12, AS 16 and AS 22) along withtheir comparative provisions with Indian Accounting Standards (Ind AS).

Introduction to Accounting Standards

9.1

Accountancy is often referred to as an art of recording, classifying and summarizing financial information, which involves the use of accountant's creative skills. However, if full independence is provided to the accountants regarding the accounting system and practices to be followed, it is bound to result in lack of uniformity, and in some cases may end up in manipulation of accounts. Thus, there arises a need for an accounting framework on the basis of which the financial transactions should be recorded in the books of accounts and ultimately make the resulting financial statements comparable. This need led to the framing of the Generally Accepted Accounting Principles (GAAP).

9.1.1 Generally Accepted Accounting Principles (GAAP)

The main objective of accounting is to provide financial information to the stakeholders, thus helping them in taking informed decisions. This financial information is normally communicated via the financial statements, which happen to be the interface between an organisation and its stakeholders. The financial statements are prepared from the information contained in the books of accounts, which are based on certain Generally Accepted Accounting Principles (GAAP).

In simple terms, Generally Accepted Accounting Principles (GAAP) is a collection of commonly followed accounting rules and standards meant for accounting of transactions and ultimately their reporting. It is an embodiment of rules and standards which are accepted and practiced by the accountants. GAAP contains a set of accounting standards, principles, and procedures that accountants must follow. These are basic accounting principles and guidelines which provide the framework for more detailed and comprehensive accounting rules, standards and other industry-specific accounting practices.

9.1.2 Accounting Standards (AS)

Accounting Standards are written policy documents which discuss the aspects of recognition, measurement and treatment of specific accounting transactions, along with the presentation and disclosure thereof in the financial statements of an entity. These are usually issued by specified professional accounting bodies, or by the government, or other regulatory bodies. In India, accounting standards are governed by The Institute of Chartered Accountants of India (ICAI). In the US, the American Institute of Certified Public Accountants (AICPA) is responsible to lay down the standards. The Financial Accounting Standards Board (FASB) is the body that sets up the International Accounting Standards. These standards basically deal with accounting treatment of business transactions and disclosing the same in financial statements.

In India, the Accounting Standards for non-corporate entities including Small and Medium sized Enterprises, are issued by the Accounting Standards Board (ASB) of Institute of Chartered Accountants of India (ICAI), to establish uniform standards for preparation of financial statements, in accordance with the Indian GAAP (Generally Accepted Accounting Practices), for better understanding of the users. However, in the case of corporate entities, the Accounting Standards notified by the MCA are applicable. These standards are mandatory on and from the dates specified either in the respective document or as may be notified by the ICAI/ MCA.

It may be noted that MCA also issues the Accounting Standards for companies, based on recommendations made by the ICAI. Accordingly MCA notifies such Accounting Standards vide Companies (Accounting Standards) Rules and amendments thereto, applicable for companies including Small and Medium Sized Companies to whom Indian Accounting Standards (Ind AS) are not applicable.

9.1.3 Convergence to Indian Accounting Standards (Ind AS) – Applicability and Scope

In the context of financial accounting and reporting, convergence refers to the process of harmonising the accounting standards issued by various regulatory bodies of different countries of the world. It refers to the goal of establishing a single set of high quality accounting standard that will be used internationally , and in particular the effort to reduce differences between the local generally accepted accounting practice and International Financial Reporting Standards (IFRS). IFRS are a set of accounting standards developed by the International Accounting Standards Board (IASB). These are the global standards for the preparation of public company financial statements

The objective of the convergence exercise is to produce a common set of high quality accounting standards to enhance the consistency, comparability and efficiency of financial statements.

There are two aspects to the concept of convergence of accounting standards:

- **International-level Convergence:** It is the process within which the International Accounting Standards Board (IASB) and National Standard-Setters (NSS) converge their respective accounting standards into one global set of accounting regulations. This concept of a single global comprehensive set of accounting standards is a conceptual ideal. It would help to ensure the comparability of financial statements. Further, it would allow companies to enjoy a lower cost of capital as a result of their financial statements being more readily comprehended and understood. A single set of accounting standards would also ensure lower barriers to the free movement of accountants in business across jurisdictions.
- **National-level Convergence:** This involves the adoption of the international accounting standards as national GAAP. For example, the Institute of Chartered Accountants of India (ICAI) has converged its accounting standards with those of the IASB. The two aspects are clearly intertwined, the IASB works with the national standard setting body in one country to converge IFRS and local generally accepted accounting practices, which has implications for the convergence of local GAAP in another country with IAS.

In the Indian context, convergence means that the Indian Accounting Standards and the International Financial Reporting Standards would, over time, continue working together to develop high quality, compatible accounting standards. It would be worth noting here that conceptually 'convergence of accounting standards' is different from that of 'adoption of accounting standards' which means full-fledged use of IFRS as issued by the IASB by the Indian public companies.

The Indian Accounting Standards (Ind AS), as notified under section 133 of the Companies Act 2013, have been formulated keeping the Indian economic & legal environment in view and with a view to converge with IFRS Standards as issued by the IFRS Foundation.

Applicability and Scope of Ind AS

Ind AS are the Indian version of IFRS which are global standards governing the accounting aspects. These are basically standards that have been harmonised with the IFRS to make reporting by Indian companies more globally accessible. The Ministry of Corporate Affairs (MCA), in 2015, had notified the Companies (Indian Accounting Standards) Rules 2015, which stipulated the adoption and applicability of IND AS in a phased manner beginning from the Accounting period 2016-17. The MCA has since issued seven Amendment Rules, one each in year 2016, 2017, 2018, 2019, 2020, 2021 and 2022 to amend the original 2015 rules.

Following is the timeline of applicability of Ind AS:

A. For Companies other than the Banks, Non-banking Financial Companies, and Insurance Companies

Phase-I

1. 1st April 2015 and onwards: Application on a voluntary basis for all the companies along with comparatives.
2. 1st April 2016: Mandatory for the following companies:
   - Companies listed or in the process of listing in India or outside India with a net worth equal to or more than ₹ 500 crores
   - Unlisted companies having a net worth equal to or more than ₹ 500 crores
   - Holding, subsidiary, joint venture, and associate of the above companies

Phase-II: From 1st April 2017

- All the companies that are listed or in the process of listing in India or outside India that are not covered in Phase-I
- Unlisted companies with a net worth of ₹ 250 crores or above but less than ₹ 500 crores
- Holding, subsidiary, joint venture, and associate of the above companies

In this respect, the following points are to be noted:

- Companies that are listed on the SME exchange are not required to apply Ind AS on a mandatory basis
- Once the company starts to follow Ind AS, whether voluntarily or mandatorily, then it shall follow Ind AS for all the subsequent financial statements even though any of the criteria does not subsequently apply to it.
- The companies who satisfy the above criteria in an accounting year shall immediately apply the Ind AS in subsequent accounting year with comparatives. The Ind AS shall be applicable on both standalone and consolidated financial statements.
- The remaining companies not covered above shall continue to apply the existing Accounting Standards as notified in the Companies (Accounting Standards) Rules, 2006.

B. For Scheduled Commercial Banks (excluding Regional Rural Banks), Non-Banking Financial Companies, Insurers, and Insurance Companies

(1) Non-Banking Financial Companies (NBFCs)

Phase-I: From 1st April 2018:

- Listed or unlisted NBFCs with a net worth of ₹ 500 crores or more
- Holding, subsidiary, joint venture, and associate companies of the above companies excluding those that are already covered under the corporate roadmap.

Phase-II: From 1st April 2019

- NBFCs with a net worth of less than ₹ 500 crores whose equity or debt securities are listed or in the process of listing on the stock exchange in India
- Unlisted NBFCs with a net worth of ₹ 250 crores or more but less than ₹ 500 crores
- Holding, subsidiary, joint venture, and associate companies of the above companies excluding those that are already covered under the corporate roadmap.

In this respect, the following points are to be noted:

The Ind AS shall be applied on both standalone and consolidated financial statements. Also, NBFCs with a net worth of less than ₹ 250 crores shall not apply Ind AS on a voluntary basis.

(2) Scheduled Commercial Banks (Excluding Regional Rural Banks)

Ind AS were required to be implemented by Scheduled Commercial Banks (excluding RRBs) from 1st April 2018. However, presently it stands deferred till further notice.

(3) Insurance Companies / Insurers

The insurance companies were required to prepare Ind AS based stand-alone and consolidated financial statements for FY 2018-19 with comparatives of FY 2017-18. The IRDA issued a circular under Section 34 of the Insurance Act, 1938, which mandates insurers to comply with Ind AS and its implementation Roadmap issued by the MCA.

Specified Accounting Standards with Comparative Provisions under Ind AS

9.2

Disclosure of Accounting Policies Accounting Standard (AS) 1

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

Accounting policies refer to specific accounting principles and the method of applying those principles adopted by an enterprise in preparation and presentation of the financial statements.

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. There are various areas where more than one accounting methods or treatments can be applied.

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.

Disclosure of significant accounting policies followed is necessary if the view presented is to be properly appreciated.

Need for disclosure of Accounting Policies

For proper and better understanding of financial statement, it is necessary to follow all the significant account policies in preparation and presentation of financial statements, because assets and liabilities in balance sheet and profit and loss account are significantly affected by accounting policies followed.

All significant accounting policies followed should be disclosed at one place for the benefit of the reader of the financial statement.

Fundamental Accounting Assumptions

Certain fundamental accounting assumptions are followed in preparation and presentation of financial statements. Disclosure is necessary if they are not followed.

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

It means that the financial statement is prepared on mercantile system only. Whenever revenues and costs are accrued, that is, recognised as they are earned or incurred and recorded in the financial statements of the periods to which they relate.

Areas in Which Differing Accounting Policies are Encountered

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.

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

Selection of Accounting Policies

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.

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

- 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.
- Such disclosure should form part of the financial statements.
- 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.
- Examples of matters in respect of which disclosure of accounting policies adopted will be required.
- 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.
- Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item in the accounts.

Illustration 1

Jivandeep Ltd. had made a right issue in 2021. In the offer document to its members, it had projected a surplus of ₹ 40 crores during the accounting year to be ended on 31st March 2023. The draft results for the year prepared on the hitherto followed accounting policies and presented for perusal of the Board of Directors showed a deficit of ₹ 10 crores. The Board, in consultation with the Managing Director, decided on the following:

(i) Value year-end inventory at works cost (₹50 crores) instead of the hitherto method of valuation of inventory at Prime Cost (₹ 30 crores).

(ii) Provide depreciation for the year on straight line basis or account of substantial additions in gross block during the year, instead of on the Reducing Balance Method, which had been hitherto adopted. As a consequence, the charge for depreciation at ₹ 27 crores is lower than the amount of ₹ 45 crones -which would have been provided had the old method been followed-by ₹ 18 crores.

(iii) Not to provide for "after-sales expenses" during the warranty period. Till the last year, provision at 2% on sales used to be made under the concept of "matching of cost against revenue" and actual expenses used to be charged against the provision. The Board now decided to account for expenses as and when actually incurred. Sales during the year total to ₹ 600 crores.

(iv) Provide for permanent fall in the value of investment-which fall had taken place over the past 5 years-the provision being ₹ 10 crores. As chief accountant of the company, you are asked by the Managing Director to draft the Notes on Accounts for inclusion in the annual report for 2022-2023.

Solution:

According to AS 1: "in the case of a change in accounting policies which has a material effect in the current period should be disclosd, 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." Naturally, the **Notes on Accounts** must disclose the change.

Notes on Accounts

(i) Till last year, it was the practice of valuing inventory at prime cost but during the year the same was valued at works cost. Due to this change the closing inventory was valued at ₹ 50 crores and, accordingly, profit was increased by ₹ 20 crores (i.e. ₹ 50 crores - ₹ 30 crores) due to the change of the method of valuation.

(ii) During the year the company decided to change the method of providing for depreciation from reducing balance method to straight line method. Due to this change, the amount of depreciation was undercharged i.e., instead of charging ₹ 45 crores it was charged by ₹ 27 crores and, as a consequence, the profit was increased by ₹ 18 crores (i.e., ₹ 45 crores minus ₹ 27 crores).

(iii) It was the practice of the company to make provision of @ 2% on sales for 'After-Sales expenses' during the warranty period. It may be assumed that as a result of improved techniques and methods in production the possibility of defects became very rare. Consequently, the company took decision not to make any provision for after -sales expense' during warranty period. As a result of this change, the profit would be increased by ₹ 12 crores.

(iv) As a result of permanent fall in the value of investments which took place over the last 5 years the company decided to make provision to the extent of ₹ 10 crores. Due to this effect the profit would be reduced by ₹ 10 crores.

Illustration 2

Which one is the correct one? Fundamental accounting assumptions as per AS 1 are:

(a) Going Concern, Matching and Consistency;

(b) Money Measurement, Going Concern and Prudence;

(c) Accounting Period, Going Concern and Entity Concept; and

(d) Going Concern, Consistency and Accruals.

Solution:

As per As 1, the fundamental accounting assumptions are: Going Concern, Consistency and Accruals.

Illustration 3

Explain, in short, the relevant Disclosures of Accounting Policies as per AS 1.

Solution:

As per AS 1, the Disclosures of Accounting Policies are: All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.

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.

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.

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

Illustration 4

Explain the methods/criteria for the selection and application of Accounting Policies.

Solution:

The major considerations governing the selection and application of accounting policies are:

Prudence – Generally maker of financial statement has to face uncertainties at the time of preparation of financial statement. These uncertainties may be regarding collectability of recoverable, number of warranty claims that may occur. Prudence means making of estimates that are required under conditions of uncertainty.

Substance over form – It means that transaction should be accounted for in accordance with actual happening and economic reality of the transactions not by its legal form.

Materiality – Financial Statement should disclose all the items and facts which are sufficient enough to influence the decisions of reader or/ user of financial statement.

Property Plant and Equipment (AS 10)

Objective:

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 / Applicability:

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

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) also.

Other Accounting Standards may require recognition of an item of property, plant and equipment based on an approach which is different from this Standard.

However, in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed by this Standard.

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.

Important Terminology:

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 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 accumulated impairment 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:

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:

- 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.

- 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.

- This Standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgment is required in applying the recognition criteria to specific circumstances of an enterprise.

- 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:

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:

- Under the recognition principle (as mentioned above), an enterprise does not recognise in the carrying amount of an item of property, plant and equipment the costs of the day-today 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.

- Parts of some items of property, plant and equipment may require replacement at regular intervals or it may require replacement several times. Items of property, plant and equipment may also be acquired to make a less frequently recurring replacement or to make a non-recurring replacement. Under the recognition principle (as discussed above), 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.

- A condition of continuing to operate an item of property, plant and equipment 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 is derecognised.
- The derecognition of the carrying amount 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:

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

Elements of Cost:

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.

Measurement of Cost:

- 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.
- 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.

- 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.

- 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.

- 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.

Measurement after Recognition:

An enterprise should choose either the cost model or the revaluation model as its accounting policy and should apply that policy to an entire class of property, plant and equipment. It is discussed hereunder:

(a) Cost Model:

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.

(b) Revaluation Model:

- 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.
- 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.
- 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.

- 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.
- 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; or
  b. the accumulated depreciation is eliminated against the gross carrying amount of the asset.
- 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.
- 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.
- 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 recognized in the statement of profit and loss.
- 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.
- 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 issued 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:

- 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.
- 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.
- 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.

- 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.
- 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.
- 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.
- 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:

- The depreciable amount of an asset should be allocated on a systematic basis over its useful life.
- 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.
- 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.
- The depreciable amount of an asset is determined after deducting its residual value.
- 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.
- 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.
- 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.

- 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 as pecified 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 judgment based on the experience of the enterprise with similar assets.

- 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.

- 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:

- 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.

- 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.

- 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.

- 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:

- 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. Such changes in cost should be accounted for as under:

If the related asset is measured using the cost model:

- Changes in the liability should be added to, or deducted from, the cost of the related asset in the current period.
- 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.
- 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.

If the related asset is measured using the revaluation model:

- Changes in the liability alter the revaluation surplus or deficit previously recognised on that asset, so that:
  - a decrease in the liability should 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;

  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.
- 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.
- 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. If are valuation is necessary, all assets of that class should be revalued.

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:

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:

- 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.

- 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:
    - Impairments of items of property, plant and equipment are recognized in accordance with AS 28;
    - Derecognition of items of property, plant and equipment retired or disposed of is determined in accordance with this Standard;
    - 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
    - The cost of items of property, plant and equipment restored, purchased or constructed as replacements is determined in accordance with this Standard.

Retirements:

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 realizable value. Any write-down in this regard should be recognised immediately in the statement of profit and loss.

Derecognition:

- The carrying amount of an item of property, plant and equipment should be derecognised
    - on disposal; or
    - when no future economic benefits are expected from its use or disposal.
- 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.
- 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.
- 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 19 for recognizing revenue from the sale of goods. AS 19, Leases, applies to disposal by a sale and lease back.
- If, under the recognition principle, 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.
- 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.
- 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:

- 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: additions; assets retired from active use and held for disposal; acquisitions through business combinations; increases or decreases resulting from revaluations and from impairment losses; recognised or reversed directly in revaluation surplus in accordance with AS 28;impairment losses recognised in the statement of profit and loss in accordance with AS 28;impairment losses reversed in the statement of profit and loss in accordance with AS 28;depreciation;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 other changes.
- The financial statements should also disclose: the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities; the amount of expenditure recognised in the carrying amount of an item of property, plant and equipment in the course of its construction; the amount of contractual commitments for the acquisition of property, plant and equipment; 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 the amount of assets retired from active use and held for disposal.
- 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: depreciation, whether recognised in the statement of profit and loss or as a part of the cost of other assets, during a period; and accumulated depreciation at the end of the period.
- 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: residual values; the estimated costs of dismantling, removing or restoring items of property, plant and equipment; useful lives; and depreciation methods.
- If items of property, plant and equipment are stated at revalued amounts, the following should be disclosed: the effective date of the revaluation; whether an independent valuer was involved; the methods and significant assumptions applied in estimating fair values of the items; 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 the revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

- An enterprise is encouraged to disclose the following: the carrying amount of temporarily idle property, plant and equipment; the gross carrying amount of any fully depreciated property, plant and equipment that is still in use; 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; the carrying amount of property, plant and equipment retired from active use and not held for disposal.

Comparative Provisions under Ind AS 16 and AS 10

Presently, in India, Indian Accounting Standard (Ind AS) 16 Property, Plant, and Equipment deal with this issue. Ind AS 16 differs from AS 10, with respect to the following points:

Ind AS 16	AS 10
Does not exclude accounting for real estate developers.	Excludes the accounting for real estate developers
Specific recognition criteria for recognition of fixed assets are laid out.	No recognition criteria for fixed assets are laid out.
Components approach is followed.	Does not require adoption of components approach.
Requires organisation to choose Cost model or Revaluation model.	Recognises the revaluation of fixed assets.
Change in method of depreciation is considered as a change in accounting estimate.	No specific guidance provided.
Does not deal with jointly owned assets.	Deals with fixed assets that are owned jointly with others.
Doesn't deal with assets held for sale.	Deals with fixed assets that have been put up for sale and that have been retired from active use.
Additional costs incurred in construction of self-generated asset should not be considered.	No specific guidance provided.
Revaluation Surplus may be transferred to retained earnings on derecognition of asset.	Guidance note provides recycling to income statement in the ratio of additional depreciation.
Gain on derecognition should be considered as Revenue.	No specific guidance provided.
PPE acquired in exchange of non-monetary asset is recognised at fair value.	PPE acquired in exchange is to be recorded at net book value of asset given up.

Illustration 5

Machineries which appeared in the books of Dee Ltd. at ₹ 86,00,000 has been revalued at ₹ 90,00,000. The accumulated depreciation associated was ₹ 28,00,000. The accountant suggested that revaluation should be accounted for by adjusting accumulated depreciation account. You are required to discuss the treatment as per AS 10.

Solution:

The suggestion of the accountant of Dee Ltd. is incorrect. As per AS 10, when fixed assets are revalued upwards, the increase on account of revaluation should be credited to Revaluation Surplus Account.

Illustration 6

Jay Ltd., a chemical producing company changed a semi-automatic component in an existing machine with a fully-automatic component incurring ₹ 85,000. This new component would result in increasing the output by 150%. The component changing exercise required the company to dismantle a part of the machine and also re-erect the same for which the company incurred ₹ 38,000. How should the costs be treated as per AS 10?

Solution:

Cost of new component: As the new component results in increased output, it would result in increasing the future benefits from the machine. So, the cost incurred ₹ 85,000 should be capitalised.

Cost of dismantling and re-erection: ₹ 38,000 incurred towards dismantling and re-erection should be charged to the Statement of Profit and Loss.

The Effects of Changes in Foreign Exchange Rate (AS 11)

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.

This Standard should be applied:

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

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

(c) This Standard also deals with accounting for foreign currency transactions in the nature of forward exchange contracts.

(d) 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.

(e) 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.

(f) 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).

(g) 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 AS 16, Borrowing Costs).

What are foreign currency transactions?

Transaction which are denominated in a foreign currency or that require settlement in a foreign currency are called foreign currency transaction, examples of foreign currency transactions are—

- Buying or selling of goods or services priced in foreign currency.

- Acquisition or disposal of fixed assets denominated in foreign currency.
- Incurs or settles liabilities denominated in foreign currency.
- Lending or borrowings when the amounts are denominated in a foreign currency.
- Un-performed forward exchange contract.

Definition

- Reporting Currency: Currency of country where financial state¬ments are reported, is called reporting currency. Reporting cur¬rency of the enterprise operating in India is Indian rupees.
- Foreign Currency: Currency other than reporting currency is called foreign currency.
- Exchange Rate: Rate at which foreign currency is converted into reporting currency or vice versa.
- Average Rate: It is the mean of exchange rate in force during the period. Period may be week, fortnight, months etc.
- Forward Rate: Agreed exchange rate between two parties for exchange of two currencies at a specified future date.
- Closing Rate: Exchange rate at the balance sheet date.
- Monetary items: Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amount of money. For example - cash, receivable and payable.
- Non-Monetary items: Non-monetary items are assets and liabilities other than monetary items. For example - fixed assets, inventories, and investment in equity shares.
- Foreign operations: Operational activities conducted in a country other than the country of the reporting enterprises by the reporting enterprises. These activities may be in the form of a subsidiary, associate, joint ventures or a branch of the reporting enterprises.

Classification for accounting treatment

For the purpose of accounting treatment for the effect of change in foreign exchange rates, the transaction can be classified into following categories—

Category-1 - Foreign currency transactions:

- Buying or selling the goods or services
- Lending and borrowing in foreign currency
- Acquisition and disposition of assets denominated in foreign currency.

Category-2 - Foreign operations:

- Foreign branch
- An associate
- Joint venture
- Foreign subsidiary

For the purpose of accounting these will be further classified in two types—

- Integral operation

- Non-integral operation

Category-3 - Forward exchange contracts

These contracts may be of two types—

- For managing risk/hedging.
- For trading and speculation.

Accounting treatment of foreign currency transactions (Category-1)

The accounting standard prescribes the accounting treatment for the following issues—

- Initial recognition of foreign transaction.
- Valuation at the balance sheet date.
- Contingent liabilities.
- Treatment of exchange difference.

Initial recognition of foreign currency transactions - Initially foreign currency transactions should be recorded by applying an exchange rate between the reporting currency and the foreign currency at the date of the transaction.

Alternatively average rate for a week or a month can be used if there is no significant fluctuation in the exchange rate.

Valuation at the Balance Sheet date - For the purpose of the valuation at the balance sheet date the foreign currency denominated transaction are divided into two categories—

- Monetary Items
- Non-monetary Items

Monetary Items - Monetary items is to be converted at closing rate and reported as such. Closing rate is the exchange rate on the balance sheet date. Examples of monetary items are debtors, creditors etc.

In case 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 conversion should be done at the rate likely to be realized.

As a result the balance sheet date exchange fluctuations gain or loss will arise, which is the difference of the closing exchange rate and exchange rate used for initial recognition.

Non-monetary Item - For the purpose of conversion and reporting on the balance sheet date non-monetary items are further categorized into two categories—

- Items carried at historical cost
- Items carried at fair value.

Non-monetary items carried at historical cost- Examples of such non-monetary items are fixed assets, long-term investment. These items should be continued to be reported at the actual rate used for initial recognition, thereafter in this case no exchange fluctuation gain or loss will arise out of such foreign currency denominated non-monetary items.

Non-monetary items carried at fair value - Examples of such non-monetary items are inventory, current investment which are carried at fair value, these are converted and reported using the exchange rate when such fair value are determined. Fair value is determined at the balance sheet date.

Conversion should be made using exchange rate of the balance sheet date.

Contingent liabilities - These liabilities are reported at the exchange rate of the balance sheet date.

Treatment of exchange difference - Exchange difference arises because of—

- A transaction being reported at a rate different from the rate at which it was initially recorded.
- A transaction in monetary or non-monetary items being settled at a rate different from the rate at which it was initially recorded.
- A transaction being settled at a rate different from the one taken for the reporting in the last financial statement.

Translation of financial statement of foreign operation (Category-2)

For the purpose of the translation of financial statement of foreign operation, AS-11 classifies the foreign operation into two types:

- Integral foreign operation
- Non-integral foreign operation.

Integral Foreign Operation - A foreign operation which is carried as if it were extensions of the reporting enterprise activities like dependent branches, sales depot, foreign arm which produces raw material and transfer it to head office (reporting enterprise) or foreign operation only raises finance to help the reporting enterprise.

Translation of Financial Statements of integral foreign operation - The individual items in the financial statements of the foreign operation are translated as if all these transactions had been entered into by the reporting enterprises. In that case the financial statements should be translated by using the principles as prescribed for foreign currency transactions of the reporting entity. It means—

- Individual items in the financial statements of the foreign operation are translated at the actual rate on the date of the transaction; alternatively, average rate can also be applied.
- The cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost.
- If tangible fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation.
- The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realisable value is translated applying exchange rate when realisable value is determined which is generally closing rate.
- Exchange difference arising on the translation of the financial statement of integral foreign operation should be charged to profit and loss account.
- Exchange difference arising on the translation of the financial statement of foreign operation may have tax effect which should be dealt with as per AS-22 “Accounting for taxes on income”.

Non-integral foreign operation

Accounting Standard -11 does not define the non-integral foreign operation, however it describes the same. As per the accounting standard following are the indications of non-integral foreign operation—

- Control by reporting enterprises - While the reporting enterprise may control the foreign operation; the activities of foreign operation are carried independently without much dependence in reporting enterprise.
- Transactions with the reporting enterprises are not a high proportion of the foreign operation's activities.
- Activities of foreign operation are mainly financed by its operations or from local borrowings. In other words, it raises its finance independently and is in no way dependent on reporting enterprises.
- Foreign operation sales are mainly in currencies other than reporting currency.
- All the expenses by foreign operations are primarily paid in local currency not in the reporting currency.
- Day to day cash flows of the reporting enterprises is independent of the foreign enterprises cash flows.
- Sales prices of the foreign enterprises are not affected by the day to day changes in exchange rate of the reporting currency of the foreign operation.
- There is an active sales market for the foreign operation product.

These are only indicators and not decisive/conclusive factors to classify the foreign operations as non-integral, much will depend on factual information, situations of the particular case and therefore, proper judgment is necessary to be applied to determine the appropriate classification.

In case of branches classified as independent for the purpose of accounting are generally classified as non-integral foreign operations.

Translations of accounts of non-integral foreign operation –

Accounts of non-integral foreign operation are translated using the following principles :

- Balance sheet items i.e. Assets and Liabilities both monetary and non-monetary - apply closing rate.
- Items of income and expenses - at actual exchange rates on the date of transactions. However, accounting standard allows average rate subject to materiality.
- Resulting exchange rate difference should be accumulated in a "foreign currency translation reserve" until the disposal of "net investment in non-integral foreign operation".
- Net investment in a non-integral foreign operation- An item for which settlement is neither planned nor likely to occur in foreseeable future which is in substance a net investment in non-integral foreign operation, which may be calculated as - all assets exclude trade receivable less outside liabilities excluding trade payable.
- Contingent liability - at closing rate.
- Tax effects, if any may be accounted for as per AS-22.

When a non-integral foreign subsidiary, foreign jointly controlled entity (JV) is consolidated with the reporting enterprise, the reporting enterprises follow normal consolidation procedure such as—

- Goodwill/capital reserve arising on the acquisition, as a result of consolidation is translated using closing rate.
- Intra-group transactions are eliminated as per AS-21 and AS-27.
- Exchange difference arising on intra-group monetary items whether short-term or long-term cannot be set-off against a corresponding amount arising on other intra-group balances because the monetary items represents commitments to convert one currency into another and expose the reporting enterprises to gain or loss through currency fluctuation. This difference is to be recognized as income or expense in consolidated financial statements.

If exchange difference arising on monetary items that in substance form part of net investment in non-integral foreign operation, should be accumulated in currency translation reserve.

- Procedure for different reporting date/policies shall be followed as mentioned in AS-21.

Disposal of non-integral foreign operations - When non-integral foreign operation is disposed fully or partially the corresponding exchange difference lying in the exchange translation reserve is recognized as income or expense.

- What is disposal - Disposal of a non-integral foreign operation includes—
  - Sales
  - Liquidation
  - Repayment of its share capital by non-integral foreign opera¬tion
  - Abandonment of all or part of the foreign operation by reporting enterprises
  - Payment of dividend by the non-integral foreign operation if it is treated as return on investment by the reporting enterprises (partial disposal).
- Disposal does not include - Write down of the carrying amount of non-integral foreign operation asset. For example - write down due to impairment of asset (AS-28).
- Treatment of foreign currency translation reserve - On the disposal of non-integral foreign operation the translation reserve is treated as under—
  - On partial disposal proportionate foreign currency translation reserve is recognized as income or expense.
  - On full disposal, whole foreign currency translation reserve is recognized income or expense.

The above treatment of foreign currency translation is done in the period in which gain or loss on disposal is recognized.

When there is a change in classification from—

- Integral to non-integral
- Non-integral to integral.

The accounting treatment is as under—

- Integral to non-integral
  - Translation procedure applicable to non-integral shall be followed from the date of change.
  - Exchange difference arising on the translation of non-monetary assets at the date of re-classification is accumulated in foreign currency translation reserve.
- From non-integral to integral
  - Translation procedure as applicable to integral should be applied from the date of change.
  - Translated amount of non-monetary items at the date of change are treated as historical cost.
  - Exchange difference lying in foreign currency translation reserve is not to be recognized as income or expense till the disposal of the operation even if the foreign operation becomes integral.

Forward Contract - A forward contract is an agreement between two parties whereby one party agrees to buy from or sell to the other party an asset at future date for an agreed price, in case of forward exchange contract the asset is “foreign currency”]

Purposes of accounting treatment of forward exchange contract has been classified in two types—

- Forward exchange contract entered for managing risk (hedging).
- Forward exchange contract entered for trading or speculation.

Disclosures

An enterprise should disclose—

- Amount of exchange difference included in the net profit or loss.
- Amount accumulated in foreign exchange translation reserve.
- Reconciliation of opening and closing balance of foreign exchange translation reserve.
- If the reporting currency is different from the currency of the country in which entity is domiciled, the reason for such difference.
- A change in classification of significant foreign operation needs following disclosures—

- Nature of change in classification
- The reason for the change
- Effect of such change on shareholders fund
- Impact of change on net profit or loss for each prior period presented
- The disclosure is also encouraged of an enterprise's foreign currency risk management policy.

Comparative Provisions between AS 11 and Ind AS 21

Presently, in India, Indian Accounting Standard (Ind AS) 21 The effect of changes in foreign exchange rates deal with the same issue. Ind AS 11 differs from AS 21, with respect to the following points:

Ind AS 21	AS 11
Forward exchange contracts are not covered.	Forward exchange contracts are included within its scope.
Accounting of foreign operations is based on functional currency approach.	Accounting of foreign operations is based on integral and non-integral approach.
No specific guidance provided.	Option to recognise exchange difference arising on translation of certain long-term monetary items over the period is available.
Presentation currency could be different from the local currency.	No such specification provided.

Illustration 7

During the financial year 2022-23, Zeds Ltd., an e-commerce firm entered into a foreign currency transaction relating to fees for technical services paid to a Lucas Ltd., an Atlanta based organisation in the USA. The transaction was for $24,000, which was entered into on 07.12.2022. The payment for the same was made on 20.05.2023. Given that the exchange rates are: on 07.12.2022: $1 = ₹ 73.80; on 01.01.2023: $1 = ₹ 73.95; on 31.03.2023: $1 = ₹ 75.45; on 20.05.2023: $1 = ₹ 76.50.

You are required to:

(a) ascertain the amount at which the transaction would get recognised in the books; and

(b) calculate amount of foreign exchange gain/ loss to be recorded in the financial statement for the years 2022-23 and 2023-24.

Solution:

(a) As per AS 11, 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.

∴ Fees for technical services \$24,000 would be recorded on 07.12.2022 applying the exchange rate existing on that date = 24,000 × ₹ 73.80 = ₹ 17,71,200.

(b) For 2022-23:

On 31.03.2023, Outstanding fess for technical services should be reflected in the balance sheet using the closing rate (\$1 = ₹ 75.45) i.e. 24,000 × ₹ 75.45 = ₹ 18,10,800.

∴ Exchange loss to be charged to the Statement of Profit and Loss = ₹ (18,10,800 – 17,71,200) = ₹ 39,600.
For 2023-24:

On 20.05.2023, Outstanding fess for technical services paid should be recognised using the existing rate (\$1 = ₹ 76.50) i.e. 24,000 × ₹ 76.50 = ₹ 18,36,000.

∴ Exchange loss on settlement to be charged to the Statement of Profit and Loss = ₹ (18,36,000 – 18,10,800) = ₹ 25,200.

Illustration 8

Subhash Ltd. purchased a machine costing ₹ 224 lakhs on 1.4.2022 and the same was fully financed by foreign currency loan (US \$) payable in three annual equal instalments. Exchange rates were \$1 = ₹ 70.00 and ₹ 72.95 as on 1.4.2022 and 31.03.2023 respectively. First instalment was paid on 31.03.2023. The entire difference in foreign exchange has been capitalized. Advice how the exchange gain/ loss should be accounted for by the company.

Solution:

Cost of machine (in US\$) = ₹ 224,00,000/ 70.00 = \$3,20,000.

∴ Exchange loss on payment of first instalment = 3,20,000 × ₹ (72.95 – 70.00) = ₹ 9,44,000.

This entire loss due to exchange differences amounting ₹ 9,44,000 should be charged to the Statement of Profit and Loss.

Illustration 9

Particulars	Exchange Rate
Goods purchased on 24.02.2022 of US\$ 10000	₹76.60
Exchange rate on 31.03.2022	₹77.00
Date of actual payment 5.06.2023	₹77.50

Calculate the loss / gain for the financial years 2021-22 and 2023-24.

Solutions:

As per AS-11 all foreign currency transactions should be recorded by applying the exchange rate at the date of transaction. Therefore goods purchased on 24.02.2022 and corresponding creditor would be recorded at ₹76.60 = US\$1, i.e. 10,000 x 76.60 = ₹7,66,000

As per AS-11 at the balance sheet date all monetary items should be reported using the closing rate therefore creditors of US$10000 outstanding on 31.3.2023 will reported.

10,000 x ₹77.00 = ₹7,70,000

Exchange loss ₹(7,70,000 – 7,66,000) i.e. ₹4,000 should be debited in profit and loss account for 2021-22.

As per As-11 exchange difference on settlement on monetary items should be transferred to profit and loss account as gain or loss therefore 10000 x ₹77.50 = ₹7,75,000 – ₹7,70,000 = ₹5000 will be be debited to profit or loss for the year 2023-24.

Illustration: 10

MM Ltd. purchased fixed assets for US$50 lakhs costing ₹3,825 lakhs on 01.04.2022 and the same was fully financed by the foreign currency loan [i.e. US Dollars] repayment in five equal instalments annually. [Exchange rate at the time of purchase was 1 US Dollar = ₹76.50]. as on 31.03.2023 the first instalment was paid when 1 US Dollar fetched ₹81.50. The entire loss on exchange was included in cost of goods sold etc. MM Ltd. normally provided depreciation on fixed assets at 20% on WDV basis.

Solutions:

In this case AS-11 will be applicable on Accounting for effects of changes in Foreign Exchange rates, as the transaction in foreign currency has been entered into by the reporting enterprises before 01.04.2023. Exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets, should be adjusted in the carrying amount of the respectively fixed assets. The carrying amount of such fixed assets to the extent not already so adjusted or otherwise accounted for, also to be adjusted to account for any increase or decrease in the liability of the enterprise, as expressed in the reporting currency by applying the closing rate, for making payments towards the whole or a part of the cost of the assets or for repayment of the whole or a part of the monies borrowed by the enterprise from any person directly or indirectly, in foreign currency specifically for the purpose of acquiring those assets.

Thus the entire exchange loss due to variation of ₹50 lakhs on 31.03.2023 on payment of US$ 10 lakhs should be added to the carrying amount of fixed assets and not to the cost of goods sold.

Further, depreciation on the unamortised depreciable amount should also be provided, in accordance with AS-10.

Calculate Exchange loss:

Foreign currency loan = $\dfrac{\text{₹ 3,825 lakhs}}{\text{₹ 76.50 lakhs}}$ = 50 lakhs US Dollars

Exchange loss on outstanding loan on 31.03.2023 = 40 lakhs US$ x ₹(81.50 – 76.50) = ₹200 lakhs should also be added to cost of fixed asset with corresponding credit to outstanding loan.

Calculation of additional depreciation on account of increase in the depreciable amount of fixed assets: 20% of ₹250 lakhs = ₹50lakhs.

Accounting for Government Grants (AS 12)

This Standard deals with accounting for Government grants. Government grants are sometimes called by other names such as subsidies, cash incentives, duty drawbacks, etc.

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

Government refers to government, government agencies and similar bodies whether local, national or international.

Government grants 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.

Accounting Treatment of Government Grants

Capital Approach versus Income Approach

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.

Capital approach:

- 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.
- 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.

Income approach:

- 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.
- 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.
- 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.

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.

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.

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.

Recognition of Government Grants

Government grants available to the enterprise are considered for inclusion in accounts:

- where there is reasonable assurance that the enterprise will comply with the conditions attached to them; and
- 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.

Non-monetary Government Grants

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.

Presentation of Grants Related to Specific Fixed Assets

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.

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.

Method 1: 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 whole, or virtually the whole, of the cost of the asset is shown in the balance sheet at a nominal value.

Method 2: Grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement 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.

Presentation of Grants Related to Revenue

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.

Presentation of Grants of the nature of Promoters' contribution

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 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.

Refund of Government Grants

Government grants sometimes become refundable because certain conditions are not fulfilled. A government grant that becomes refundable is treated as an extraordinary item as per AS 5.

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.

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.

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.

Disclosure

(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.

Comparative Provisions under Ind AS 20 and AS 12

Presently, in India, Indian Accounting Standard (Ind AS) 20 Accounting for Government Grants and Disclosure of Government Assistance deal with the issue of government grants. Ind AS 20 differs from AS 12, with respect to the following points:

Ind AS 20	AS 12
Disclosure required in financial statements with indication on other forms of government assistance received	No specific guidance as does not deal with other forms of government assistance
Government grants in the nature of capital contribution are not recognized	Government grants as capital contribution are specifically recognized
Prohibition of recognition of grants directly to the shareholder's fund	Grants for non-depreciable assets are required to be shown as a capital reserve under shareholder's funds
Recognition of non-monetary grants at fair value	Recognition of non-monetary grants at acquisition cost or nominal value
No option to deduct the amount of grant from the book value of the asset.	Optional to deduct the amount of grant from the book value of the asset.

Illustration 11

Dee Ltd. received ₹80,00,000 from the Central Government as subsidy for setting up a factory in a backward area. How would you treat the transaction in the financial statement of the company?

Solution:

When 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 are credited directly to shareholders' funds. So, Dee Ltd. should credit the amount of ₹80,00,000 to capital reserve and the same would get reflected in the Balance Sheet.

Illustration 12

Big Box Ltd., a start-up purchased on April 1, 2020, a machine worth ₹44,85,000 in relation to which it received ₹7,35,000 as grant from Government of India. The company decided to treat this grant as a capital receipt. It is estimated that the realizable value of the machine at the end of its useful life of 4 years will be ₹15,36,000. During the financial year 2022-23, the grant became refundable as the start-up company failed to comply with the necessary terms and conditions of the grant.

You are required to calculate the amount of depreciation that is to be charged to the statement of profit and loss for the years 2022-23 and 2023-24 given that the company follows straight line method of charging depreciation.

Solution:

As per AS 12, the amount refundable in respect of government grant is related to 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 case the book value of the asset is increased, depreciation is provided on the revised book value.

Calculation of Depreciation for the years 2022-23 and 2023-24 **₹ '000**

Cost of machine on 01.01.2020	4,485
Less: Grant from Government of India	735
Net cost of machine	3,750
Estimated useful life	4 years
Depreciation p.a. under straight line method [$\frac{3,750 - 1,536}{4}$]	553.5
Depreciation charged during 2020-21 and 2021-22 [553.5 × 2]	1,107
Book value of machine on 01.04.2022 [3,750 – 1,107]	2,643
Add: Refund of government grant during 2022-23	735
Revised Book value of machine	3,378
Remaining useful life of machine	2 years
Revised depreciation p.a. [$\frac{3,378 - 1,536}{2}$]	921

Illustration 13

Z Ltd. has set up its business in designated backward area which entitles it to receive as per a public scheme announced by the Government of India, a subsidy of 25% of the cost of investment. Having fulfilled the conditions laid down under the scheme, the company on its investment of ₹100 lakhs in capital assets during its accounting year ending on 31st March,2023, received a subsidy of ₹ 25 lakhs in January, 2023 from the Government of India. The Accountant of the company would like to record the receipt as an item of revenue and to reduce the losses on the Profit and Loss Account for the year ended 31st March, 2023. Is his action justified?

Solution:

As per AS-12, the Government grants related to depreciable fixed assets to be treated as deferred income which should be recognized in the Profit and Loss Account on a systematic and rational basis over the useful life of the asset. Such grants should be allocated to income over the periods and in proportions in which depreciation on those assets is charged.

The company has received ₹ 25 lakhs subsidy for investment in capital assets which are depreciable in nature. In view of the provisions under AS-12, the subsidy amount ₹ 25 lakhs received should not be credited to the Profit and Loss Account for the year ended 31st March, 2023. the subsidy should be recognized and credited to the Profit and Loss Account in the proportion of depreciation charge over the life of the subsidized assets.

Illustration 14

Explain the treatment of the following:

(i) A firm acquired a fixed asset for ₹550 lakhs on which the Government grant received was 40%.

(ii) Capital subsidy received from the Central Government for setting up a plant in the notified backward region. Cost of the plant ₹600 lakhs, subsidy received ₹150 lakhs.

(iii) ₹125 lakhs received from the local authority for providing medical facilities to the employees.

Solution:

(i) The total cost of the fixed asset is ₹550 lakhs and the grant is 40% i.e., ₹220 lakhs. In the balance sheet, the asset will be shown at the net amount (₹550 lakhs – ₹220 lakhs) i.e., ₹330 lakhs only. This will be depreciated over the life of the asset.

(ii) In this case, the subsidy received for setting up a plant in the notified region, should be treated as a capital subsidy. The amount of subsidy i.e., ₹150 lakhs be added to the Capital Reserves and the plant should be shown at ₹600 lakhs.

(iii) It is a case of revenue grant and should be shown in the profit and loss account. However, if the medical facilities are to be provided over a period of more than one year, it may be treated as deferred income and then taken to Profit and Loss Account on a systematic basis.

Borrowing Costs (AS 16)

Objective

The objective of this Standard is to prescribe the accounting treatment for borrowing costs.

Scope

This Standard is applicable in accounting for borrowing costs.

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.

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.

Examples of Qualifying Assets: 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

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.

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

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.

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.

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.

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.

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.

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.

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. 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.

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

Capitalisation of borrowing costs should be suspended during extended periods in which active development is interrupted.

Cessation of Capitalisation

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.

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.

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

(a) the accounting policy adopted for borrowing costs; and

(b) the amount of borrowing costs capitalised during the period.

Comparative Provisions under Ind AS 23 and AS 16

Presently, in India, Indian Accounting Standard (Ind AS) 23 Borrowing Costs deal with this issue. Ind AS 23 differs from AS 16, with respect to the following points:

Ind AS 23	AS 16
Qualifying Assets will never Include Biological Assets.	Qualifying Assets may Include Biological Assets.
No specific definition and explanation on the understanding of substantial period of time has been provided; rather, it is a matter of judgement.	Specific definition and explanation on the understanding of substantial period of time is provided.
Inventories which are produced in large quantities should not be considered as Qualifying Assets. It implies that Inventories which are produced in lower quantity only can be considered as Qualifying assets.	Inventories may be considered as Qualifying assets if condition of substantial period is satisfied.
interest expense which is capitalized or not capitalized during the period should be disclosed separately	Disclosure is required to be made only if capitalization of borrowing cost has been made during the period.
Borrowing costs in hyper-inflationary situation is addressed. If interest cost increase due to hyper inflationary situation then the increase in Interest cost should be written off in income statement.	Inflation in interest rate is not addressed.
Weighted Average capitalisation rate on borrowings should be disclosed in Notes to accounts.	No specific guidance provided.
In consolidated financial statements, weighted average capitalisation rate on total borrowing of Holding & subsidiaries is to be considered.	No specific guidance provided.

Illustration 15

T&L Ltd. is a large construction company which is presently involved in the construction of a railway bridge over the Ganga river at Patna. The project cost is ₹125 crores, 40% of which is financed by borrowing from Asian Development Bank at an interest of 3%. There has been a delay in the completion of the project, and the project manager of the railway bridge construction site has identified that delay construction of the railway bridge has happened due to high water levels during the monsoon months of July to September. Ms. Sonali Mathur, the accountant of T&L Co. has not suspended the capitalisation of the borrowing cost and reflected the same in the cost of the qualifying asset.

You are required to comment on the treatment

Solution:

In this case, the work got suspended due to temporary delay which is a necessary part of the construction process. Capitalisation of borrowing cost would continue during the extended period during which high water levels delay construction of the railway bridge, as such high water levels are common during the monsoon period in the geographic region involved.

So, the treatment done by Ms. Mathur, the company accountant is correct.

Illustration 16

On 14.08.2022, Pushkar Ltd. obtained a loan from RAR Bank of ₹65 lakhs to be utilised as under:

Purchase of equipment: ₹19,50,000;

Construction of factory shed: ₹26,00,000;

Advance for purchase of delivery vehicle: ₹6,50,000;

Working capital: ₹13,00,000.

In March, 2023 installation of the machinery was completed and also construction of factory shed was completed and the machinery installed. However, the truck was not delivered within 31.03.2023. Total interest charged by the bank for the year ending 31.3.2023 was ₹11.70 lakhs. Discuss how the interest amount would be treated in the financial statements of the company as per AS 16.

Solution:

In this case, only the factory shed is a Qualifying Asset (QA) as per AS 16. The amount of interest on borrowings and its treatment is presented below:

Particulars	Nature of asset	Interest capitalised	Interest charged to Income Statement
Purchase of equipment	Not a QA		3,51,000 [11.7 × 19.5/65]
Construction of factory shed	QA	4,68,000 [11.7 × 26/65]	
Advance for purchase of delivery vehicle	Not a QA		1,17,000 [11.7 × 6.5/65]
Working capital	Not a QA		2,34,000 [11.7 × 13/65]
Total		**4,68,000**	**7,02,000**

Illustration 17

	Amount (₹)
Expenditure incurred till 31.03.2023	5,00,000
Interest cost capitalized for the financial year 2022-23 @ 13%	26,000
Amount borrowed till 31.03.23 is	2,00,000
Assets transferred to construction during 2023-24	1,00,000
Cash payment during 2023-24	75,000
Progress payment received	3,70,000
New borrowing during 2023-24 @ 13%	2,00,000

Calculate the amount of borrowing cost to be capitalized.

Solution:

Total borrowing cost = 4,00,000 x 13/100 = ₹52,000

	Amount (₹)
Expenditure incurred including previously capitalized borrowing cost (5,00,000 + 26,000)	5,26,000
Cash payment during 2023-24	75,000
Asset transferred during 2023-24	1,00,000
	7,01,000
Less: Progress payment received	3,70,000
	3,31,000

Money borrowed including previously capitalized interest cost 4,00,000 + 26,000 = 4,26,000

Borrowing cost to be capitalized $= \frac{3,31,000}{4,26,000} \times 52,000 = 40,404$

Illustration 18

On 30-04-2023 MMLtd. obtained a loan from the bank for ₹200 lakhs to be utilized as under:

Construction of a shed	₹80 lakhs
Purchase of Machinery	₹60 lakhs
Working Capital	₹40 lakhs
Advance for Purchase of truck	₹20 lakhs

In March 2024 construction of shed was completed and machinery installed. Delivery of truck was not received. Total interest charged by the bank for the year ending 31-03-2024 was ₹36 lakhs. Show the treatment of interest under As-16.

Solution:

As per As-16 borrowing cost (interest) should be capitalized if borrowing cost is directly attributable to the acquisition, construction or production of qualifying asset. In other words, asset acquired must be qualifying asset and borrowing cost should be directly attributable to the acquisition, construction or production of qualifying asset.

In the question ₹200 lakhs borrowed from Bank was utilized for –

Construction of a shed	₹80 lakhs
Purchase of Machinery	₹60 lakhs
Purchase of Machinery	₹40 lakhs
Advance for Purchase of truck	₹20 lakhs

Out of the above four payments only construction of a shed of ₹80 lakhs is a qualifying asset as per AS-16, other three payments are not for the qualifying asset. Therefore, borrowing cost attributable to the construction of a shed should only be capitalized which will be equal to ₹36 lakhs x 80/200 = ₹14.40 lakhs

The balance of ₹21.6 lakhs (₹36 lakhs – ₹14.4 lakhs) should be expensed and debited to Profit and Loss Account.

Accounting for Taxes on Income (AS 22)

The objective of this Standard is to prescribe accounting treatment for taxes on income. Taxes on income are one of the significant items in the statement of profit and loss of an enterprise.

Scope

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.

Taxes on income include all domestic and foreign taxes which are based on taxable income.

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.

Important Definitions

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.

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.

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.

Current tax - is the amount of income tax determined to be payable (recoverable) in respect of the taxable income (tax loss) for a period.

Deferred tax is the tax effect of timing differences.

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.

Permanent differences are the differences between taxable income and accounting income for a period that originate in one period and do not reverse subsequently.

Taxable income is calculated in accordance with tax laws. In some circumstances, the computation of taxable income differs 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.

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.

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.

Unabsorbed depreciation and carry forward of losses which can be setoff against future taxable income are also considered as timing differences and result in deferred tax assets, subject to consideration of prudence.

Recognition

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.

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 or as deferred tax liabilities, in the balance sheet.

Permanent differences do not result in deferred tax assets or deferred tax liabilities.

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.

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.

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.

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

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 , that sufficient future taxable income will be available against which such deferred tax assets can be realised.

Measurement

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.

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. 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.

When different tax rates apply to different levels of taxable income, deferred tax assets and liabilities are measured using average rates.

Deferred tax assets and liabilities should not be discounted to their present value.

Carrying amount of deferred tax assets should be reviewed at each balance sheet date.

Disclosure

1. 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.

2. 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.

3. 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.

4. 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. 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.

5. 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.

Comparative Provisions between AS 22 and Ind AS 12

Presently, in India, Indian Accounting Standard (Ind AS) 12 Income Taxes deal with the same issue. Ind AS 12 differs from AS 22, with respect to the following points:

Ind AS 12	AS 22
Based on Balance Sheet approach.	Based on Income Statement approach
Recognition is done based on difference between carrying amounts of assets and liabilities and their tax base.	Recognises the difference between taxable income and accounting income.
Applies to two types of differences - Timing Differences and Permanent Differences.	Applies to two types of differences - Taxable Temporary Differences and Deductible Temporary Differences. This standard does not address Permanent Differences.
Deductible temporary differences are recognised to the extent that future periods are likely to provide taxable earnings.	Deferred taxes are recognised only when and to the degree that there is a reasonable certainty of its realisation.
No concept of virtual certainty.	When a corporation has unabsorbed depreciation or losses carried forward, the deferred tax asset should be to the degree that there is a virtual certainty backed up by convincing evidence.
Current and deferred tax is recognised on income statement, except for tax that arises from transactions done in Other Comprehensive Income or directly in equity.	No specific guidance provided.
The disparity between carrying the amount of a revalued asset and its tax base is dealt with.	The disparity between carrying the amount of a revalued asset and its tax base is not covered.

No specific guidance provided regarding Minimum Alternate Tax u/s 115JB.	Specific guidance provided regarding tax rates for deferred tax assets/ liabilities Minimum Alternate Tax u/s 115JB.
No specific guidance provided on deferred tax for tax holiday situations and capital gain cases.	Specific guidance provided on deferred tax for tax holiday situations and capital gain cases.

Illustration 19

Classify the following as Timing Difference and Permanent Difference and also state whether they would result in Deferred Tax Asset or Deferred Tax Liability:

(a) Unabsorbed depreciation

(b) Income tax penalty

(c) Interest on loan taken from scheduled bank accounted in the books, but not paid till the date of filing Return of Income.

Solution:

Particulars	Nature of difference	DTA/ DTL
Unabsorbed depreciation	Timing Difference	DTA
Income tax penalty	Permanent Difference	Neither DTA nor DTL to be created
Interest on loan taken from scheduled bank accounted in the books, but not paid till the date of filing Return of Income.	Permanent Difference	Neither DTA nor DTL to be created

Illustration 20

Parshuram Ltd., which commenced its operations in 2019-20, provides the following details:

Financial year	Profit before tax (₹)	Timing Difference (₹)	Permanent Difference (₹)	Corporate tax rate	Remarks
2019-20	28,00,000	+ 3,15,000	+ 3,50,000	40%	Reversible in 2022-23
2020-21	31,50,000	+ 2,10,000	+ 2,80,000	38%	Reversible in 2021-22
2021-22	35,00,000	- 70,000	+ 3,15,000	35%	Reversible in 2022-23
2022-23	24,50,000	Nil	+ 4,20,000	30%	--

You are required to calculate the amount of Current Tax for the four financial years.

Solution:

Calculation of Current Tax (in ₹ Lakhs)

Particulars	2019-20	2020 - 21	2021-22	2022-23
Profit before tax	28.00	31.5	35.00	24.50
Timing Differences	3.15	2.10	(0.70)	Nil
Permanent Differences	3.50	2.80	3.15	4.20

Taxable Income	34.65	36.40	37.45	28.70
Corporate tax rate	40%	38%	35%	30%
Current Tax (Taxable Income Tax rate)	13.86	13.832	13.1075	8.61

Illustration 21

The following information is available from the records of Vishnu Ltd.:

Depreciation charged to income statement ₹ 8,00,000; Depreciation u/s 32 of Income Tax Act ₹ 20,00,000; Unamortised preliminary expenditure as per income tax records ₹ 1,50,000.

It is communicated that there is adequate evidence of future profit sufficiency. Given that the corporate tax rate is 40%, you are required to ascertain the amount of deferred tax asset/ deferred tax liability to be created in this situation.

Solution:

Timing Difference = Additional depreciation as per Income Tax Act (-) Preliminary expenditure to be allowed = ₹ (20,00,000 – 8,00,000) - 1,50,000 = ₹ 10,50,000.

Deferred Tax Liability = ₹ 10,50,000 40% = ₹ 4,20,000.

Illustration 22

AB Ltd. has provided depreciation as per accounting records ₹8,00,000 and as per tax records ₹14,00,000. Unamortized preliminary expenses, as per tax record is ₹11,200. There is adequate evidence of future profit sufficiency. How much deferred tax asset / liability should be recognized as transition adjustment. Tax rate is 40%.

Solution:

As per AS-22 deferred tax should be recognized for all the timing differences. In the instant case the timing difference i.e., difference between taxable income and accounting income is –

Excess depreciation as per tax ₹14,00,000 – ₹8,00,000	= ₹6,00,000
Less: Expenses provided in taxable income	₹11,200
	₹5,88,800

As tax expense is more than the current tax due to timing difference of ₹5,88,800, therefore deferred tax liability = 40% of ₹5,88,800 = ₹2,35,520 shall be credited in accounts.

Exercise

A. Theoretical Questions

Multiple Choice Questions

1. In India, Accounting Standards are governed by

   a. The Institute of Cost Accountants of India

   b. Financial Accounting Standards Board

   c. The Institute of Company Secretaries of India

   d. The Institute of Chartered Accountants of India

2. The Full form of GAAP

   a. Generally Accepted Accounting Principles

   b. Generally Accepted Accountancy Principles

   c. Globally Accepted Accounting Principles

   d. Global Accounting Accepted Principles

3. In India, the Accounting Standards for non-corporate entities including Small and Medium sized Enterprises, are issued by the _____________ of Institute of Chartered Accountants of India

   a. Accounting Standards Board

   b. National Standard Setters

   c. Financial Accounting Standards Board

   d. Accounting Standards Committee

4. The IRDA issued a circular under _______ of the Insurance Act, 1938, which mandates insurers to comply with Ind AS and its implementation Roadmap issued by the MCA

   a. Section 35

   b. Section 34

   c. Section 36

   d. Section 40

5. Full form of IFRS

   a. Indian Financial Reporting Standards

   b. International Financial Reporting Standards

   c. International Financials Reporting Standards

   d. Indian Financial Reporting Standard

Answers:

1	d	2	a	3	a	4	b	5	b

B. Numerical Questions

Comprehensive Numerical Problems

1. Alpha Ltd. contracted with a supplier to purchase machinery which is to be installed in its one department in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹1,40,000. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹ 45,000 per month. The machine was purchased at ₹1,58,00,000 and ₹50,000 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of ₹30,000 to supervise machinery installation at the factory site. You are required to ascertain the amount at which the Machinery should be capitalized as per AS 10.

[**Answer:** Total Cost of Machinery ₹1,61,55,000]

2. Mrs. A bought a forward contract for three months of US$ 1,00,000 on 1st December at 1 US$ = ₹ 47.10 when exchange rate was US$ 1 = ₹ 47.02. On 31st December when he closed his books exchange rate was US$ 1 = ₹ 47.15. On 31st January, he decided to sell the contract at ₹ 47.18 per dollar. Show how the profits from contract will be recognised in the books as per AS 11.

[**Answer:** Total Profit (1,00,000 × 0.08) ₹ 8,000]

3.

Particulars	Exchange Rate per $
Goods purchased on 1.1.22 × 1 for US $ 15,000	₹ 75
Exchange rate on 31.3.22 × 1	₹ 74
Date of actual payment 7.7.22 × 1	₹ 73

You are required to ascertain the loss/gain to be recognized for financial years ended 31st March, 2023 and 31st March, 2024 as per AS 11.

[**Answer:** Credited to Profit and Loss Account ₹ 15,000]

4. On 1.4.2022, AS Ltd. received government grant of ₹300 lakhs for acquisition of machinery costing ₹1,500 lakhs. The grant was credited to the cost of the asset. The life of the machinery is 5 years. The machinery is depreciated at 20% on WDV basis. The Company had to refund the grant in May 20 × 4 due to non-fulfilment of certain conditions. How you would deal with the refund of grant in the books of AS Ltd. as per AS 12 assuming that the company did not charge any depreciation for year 20X4?

[**Answer:** Revised book value ₹ 914.40 lakhs]

5. Ashima Ltd. has obtained Institutional Term Loan of ₹580 lakhs for modernisation and renovation of its Plant & Machinery. Plant & Machinery acquired under the modernisation scheme and installation completed on 31st March, 20 × 2 amounted to ₹ 406 lakhs, ₹58 lakhs has been advanced to suppliers for additional assets and the balance loan of ₹116 lakhs has been utilised for working capital purpose. The Accountant is on a dilemma as to how to account for the total interest of ₹ 52.20 lakhs incurred during 20X1-20X2 on the entire Institutional Term Loan of ₹ 580 lakhs. Discuss how the interest amount would be treated in the financial statements of the company as per AS 16.

[**Answer:** Total Interest to be capitalised ₹ 41.76 lakhs; Total Interest to be charged to Profit and Loss Account ₹ 10.44 lakhs]