

AS 4* : Contingencies¹ and Events Occurring After the Balance Sheet Date

[This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of the Preface to the Statements of Accounting Standards² and the 'Applicability of Accounting Standards to Various Entities'.]

Introduction

1. This Standard deals with the treatment in financial statements of
 - (a) contingencies, and
 - (b) events occurring after the balance sheet date.
2. The following subjects, which may result in contingencies, are excluded from the scope of this Standard in view of special considerations applicable to them:
 - (a) liabilities of life assurance and general insurance enterprises arising from policies issued;
 - (b) obligations under retirement benefit plans; and
 - (c) commitments arising from long-term lease contracts.

Definitions

3. The following terms are used in this Standard with the meanings specified:

3.1 A contingency is a condition or situation, the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence, or non-occurrence, of one or more uncertain future events.

3.2 Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and, by the corresponding approving authority in the case of any other entity.

Two types of events can be identified:

- (a) those which provide further evidence of conditions that existed at the balance sheet date; and**

* Revised in 1995.

¹All paragraphs of this Standard that deal with contingencies are applicable only to the extent not covered by other Accounting Standards prescribed by the Central Government. For example, the impairment of financial assets such as impairment of receivables (commonly known as provision for bad and doubtful debts) is governed by this Standard.

²Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material.

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(b) those which are indicative of conditions that arose subsequent to the balance sheet date.

Explanation

4. Contingencies

4.1 The term “contingencies” used in this Standard is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur.

4.2 Estimates are required for determining the amounts to be stated in the financial statements for many on-going and recurring activities of an enterprise. One must, however, distinguish between an event which is certain and one which is uncertain. The fact that an estimate is involved does not, of itself, create the type of uncertainty which characterises a contingency. For example, the fact that estimates of useful life are used to determine depreciation, does not make depreciation a contingency; the eventual expiry of the useful life of the asset is not uncertain. Also, amounts owed for services received are not contingencies as defined in paragraph 3.1, even though the amounts may have been estimated, as there is nothing uncertain about the fact that these obligations have been incurred.

4.3 The uncertainty relating to future events can be expressed by a range of outcomes. This range may be presented as quantified probabilities, but in most circumstances, this suggests a level of precision that is not supported by the available information. The possible outcomes can, therefore, usually be generally described except where reasonable quantification is practicable.

4.4 The estimates of the outcome and of the financial effect of contingencies are determined by the judgement of the management of the enterprise. This judgement is based on consideration of information available up to the date on which the financial statements are approved and will include a review of events occurring after the balance sheet date, supplemented by experience of similar transactions and, in some cases, reports from independent experts.

5. Accounting Treatment of Contingent Losses

5.1 The accounting treatment of a contingent loss is determined by the expected outcome of the contingency. If it is likely that a contingency will result in a loss to the enterprise, then it is prudent to provide for that loss in the financial statements.

5.2 The estimation of the amount of a contingent loss to be provided for in the financial statements may be based on information referred to in paragraph 4.4.

5.3 If there is conflicting or insufficient evidence for estimating the amount of a contingent loss, then disclosure is made of the existence and nature of the contingency.

5.4 A potential loss to an enterprise may be reduced or avoided because a contingent liability is matched by a related counter-claim or claim against a third party. In such cases, the amount of the provision is determined after taking into account the probable recovery under the claim if no significant uncertainty as to its measurability or collectability exists.

Suitable disclosure regarding the nature and gross amount of the contingent liability is also made.

5.5 The existence and amount of guarantees, obligations arising from discounted bills of exchange and similar obligations undertaken by an enterprise are generally disclosed in financial statements by way of note, even though the possibility that a loss to the enterprise will occur, is remote.

5.6 Provisions for contingencies are not made in respect of general or unspecified business risks since they do not relate to conditions or situations existing at the balance sheet date.

6. Accounting Treatment of Contingent Gains

Contingent gains are not recognised in financial statements since their recognition may result in the recognition of revenue which may never be realised. However, when the realisation of a gain is virtually certain, then such gain is not a contingency and accounting for the gain is appropriate.

7. Determination of the Amounts at which Contingencies are included in Financial Statements

7.1 The amount at which a contingency is stated in the financial statements is based on the information which is available at the date on which the financial statements are approved. Events occurring after the balance sheet date that indicate that an asset may have been impaired, or that a liability may have existed, at the balance sheet date are, therefore, taken into account in identifying contingencies and in determining the amounts at which such contingencies are included in financial statements.

7.2 In some cases, each contingency can be separately identified, and the special circumstances of each situation considered in the determination of the amount of the contingency. A substantial legal claim against the enterprise may represent such a contingency. Among the factors taken into account by management in evaluating such a contingency are the progress of the claim at the date on which the financial statements are approved, the opinions, wherever necessary, of legal experts or other advisers, the experience of the enterprise in similar cases and the experience of other enterprises in similar situations.

7.3 If the uncertainties which created a contingency in respect of an individual transaction are common to a large number of similar transactions, then the amount of the contingency need not be individually determined, but may be based on the group of similar transactions. An example of such contingencies may be the estimated uncollectable portion of accounts receivable. Another example of such contingencies may be the warranties for products sold. These costs are usually incurred frequently and experience provides a means by which the amount of the liability or loss can be estimated with reasonable precision although the particular transactions that may result in a liability or a loss are not identified. Provision for these costs results in their recognition in the same accounting period in which the related transactions took place.

8. Events Occurring after the Balance Sheet Date

8.1 Events which occur between the balance sheet date and the date on which the financial statements are approved, may indicate the need for adjustments to assets and liabilities as at the balance sheet date or may require disclosure.

8.2 Adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. For example, an adjustment may be made for a loss on a trade receivable account which is confirmed by the insolvency of a customer which occurs after the balance sheet date.

8.3 Adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. An example is the decline in market value of investments between the balance sheet date and the date on which the financial statements are approved. Ordinary fluctuations in market values do not normally relate to the condition of the investments at the balance sheet date, but reflect circumstances which have occurred in the following period.

8.4 Events occurring after the balance sheet date which do not affect the figures stated in the financial statements would not normally require disclosure in the financial statements although they may be of such significance that they may require a disclosure in the report of the approving authority to enable users of financial statements to make proper evaluations and decisions.

8.5 There are events which, although they take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature. For example, if dividends are declared after the balance sheet date but before the financial statements are approved for issue, the dividends are not recognised as a liability at the balance sheet date because no obligation exists at that time unless a statute requires otherwise. Such dividends are disclosed in the notes.

8.6 Events occurring after the balance sheet date may indicate that the enterprise ceases to be a going concern. A deterioration in operating results and financial position, or unusual changes affecting the existence or substratum of the enterprise after the balance sheet date (e.g., destruction of a major production plant by a fire after the balance sheet date) may indicate a need to consider whether it is proper to use the fundamental accounting assumption of going concern in the preparation of the financial statements.

9. Disclosure

9.1 The disclosure requirements herein referred to apply only in respect of those contingencies or events which affect the financial position to a material extent.

9.2 If a contingent loss is not provided for, its nature and an estimate of its financial effect are generally disclosed by way of note unless the possibility of a loss is remote (other than the circumstances mentioned in paragraph 5.5). If a reliable estimate of the financial effect cannot be made, this fact is disclosed.

9.3 When the events occurring after the balance sheet date are disclosed in the report of the approving authority, the information given comprises the nature of the events and an estimate of their financial effects or a statement that such an estimate cannot be made.

Main Principles

Contingencies⁴

10. The amount of a contingent loss should be provided for by a charge in the statement of profit and loss if:

- (a) it is probable that future events will confirm that, after taking into account any related probable recovery, an asset has been impaired or a liability has been incurred as at the balance sheet date, and**
- (b) a reasonable estimate of the amount of the resulting loss can be made.**

11. The existence of a contingent loss should be disclosed in the financial statements if either of the conditions in paragraph 10 is not met, unless the possibility of a loss is remote.

12. Contingent gains should not be recognised in the financial statements.

Events Occurring after the Balance Sheet Date

13. Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern (i.e., the continuance of existence or substratum of the enterprise) is not appropriate.

14. If an enterprise declares dividends to shareholders after the balance sheet date, the enterprise should not recognise those dividends as a liability at the balance sheet date unless a statute requires otherwise. Such dividends should be disclosed in notes.

15. Disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise.

Disclosure

16. If disclosure of contingencies is required by paragraph 11 of this Standard, the following information should be provided:

- (a) the nature of the contingency;**
- (b) the uncertainties which may affect the future outcome;**
- (c) an estimate of the financial effect, or a statement that such an estimate cannot be made.**

⁴See also footnote 1

17. If disclosure of events occurring after the balance sheet date in the report of the approving authority is required by paragraph 15 of this Standard, the following information should be provided:

- (a) the nature of the event;**
- (b) an estimate of the financial effect, or a statement that such an estimate cannot be made.**

AS 5* : Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

*[This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective, the Preface to the Statements of Accounting Standards¹ and the 'Applicability of Accounting Standards to Various Entities']*

Objective

The objective of this Standard is to prescribe the classification and disclosure of certain items in the statement of profit and loss so that all enterprises prepare and present such a statement on a uniform basis. This enhances the comparability of the financial statements of an enterprise over time and with the financial statements of other enterprises. Accordingly, this Standard requires the classification and disclosure of extraordinary and prior period items, and the disclosure of certain items within profit or loss from ordinary activities. It also specifies the accounting treatment for changes in accounting estimates and the disclosures to be made in the financial statements regarding changes in accounting policies.

Scope

1. This Standard should be applied by an enterprise in presenting profit or loss from ordinary activities, extraordinary items and prior period items in the statement of profit and loss, in accounting for changes in accounting estimates, and in disclosure of changes in accounting policies.

2. This Standard deals with, among other matters, the disclosure of certain items of net profit or loss for the period. These disclosures are made in addition to any other disclosures required by other Accounting Standards.

* Revised in 1997. A limited revision was made in 2001, pursuant to which paragraph 33 has been added in this standard (see footnote 2).

¹Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material.

3. This Standard does not deal with the tax implications of extraordinary items, prior period items, changes in accounting estimates, and changes in accounting policies for which appropriate adjustments will have to be made depending on the circumstances.

Definitions

4. The following terms are used in this Standard with the meanings specified:

4.1. Ordinary activities are any activities which are undertaken by an enterprise as part of its business and such related activities in which the enterprise engages in furtherance of, incidental to, or arising from, these activities.

4.2. Extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly.

4.3. Prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods.

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

Net Profit or Loss for the Period

5. All items of income and expense which are recognised in a period should be included in the determination of net profit or loss for the period unless an Accounting Standard requires or permits otherwise.

6. Normally, all items of income and expense which are recognised in a period are included in the determination of the net profit or loss for the period. This includes extraordinary items and the effects of changes in accounting estimates.

7. The net profit or loss for the period comprises the following components, each of which should be disclosed on the face of the statement of profit and loss:

- (a) profit or loss from ordinary activities; and**
- (b) extraordinary items.**

Extraordinary Items

8. Extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

9. Virtually all items of income and expense included in the determination of net profit or loss for the period arise in the course of the ordinary activities of the enterprise. Therefore, only on rare occasions does an event or transaction give rise to an extraordinary item.

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10. Whether an event or transaction is clearly distinct from the ordinary activities of the enterprise is determined by the nature of the event or transaction in relation to the business ordinarily carried on by the enterprise rather than by the frequency with which such events are expected to occur. Therefore, an event or transaction may be extraordinary for one enterprise but not so for another enterprise because of the differences between their respective ordinary activities. For example, losses sustained as a result of an earthquake may qualify as an extraordinary item for many enterprises. However, claims from policyholders arising from an earthquake do not qualify as an extraordinary item for an insurance enterprise that insures against such risks.

11. Examples of events or transactions that generally give rise to extraordinary items for most enterprises are:

- attachment of property of the enterprise; or
- an earthquake.

Profit or Loss from Ordinary Activities

12. *When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.*

13. Although the items of income and expense described in paragraph 12 are not extraordinary items, the nature and amount of such items may be relevant to users of financial statements in understanding the financial position and performance of an enterprise and in making projections about financial position and performance. Disclosure of such information is sometimes made in the notes to the financial statements.

14. Circumstances which may give rise to the separate disclosure of items of income and expense in accordance with paragraph 12 include:

- (a) the write-down of inventories to net realisable value as well as the reversal of such write-downs;
- (b) a restructuring of the activities of an enterprise and the reversal of any provisions for the costs of restructuring;
- (c) disposals of items of fixed assets;
- (d) disposals of long-term investments;
- (e) legislative changes having retrospective application;
- (f) litigation settlements; and
- (g) other reversals of provisions.

Prior Period Items

15. *The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived.*

16. The term 'prior period items', as defined in this Standard, refers only to income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. The term does not include other adjustments necessitated by circumstances, which though related to prior periods, are determined in the current period, e.g., arrears payable to workers as a result of revision of wages with retrospective effect during the current period.

17. Errors in the preparation of the financial statements of one or more prior periods may be discovered in the current period. Errors may occur as a result of mathematical mistakes, mistakes in applying accounting policies, misinterpretation of facts, or oversight.

18. Prior period items are generally infrequent in nature and can be distinguished from changes in accounting estimates. Accounting estimates by their nature are approximations that may need revision as additional information becomes known. For example, income or expense recognised on the outcome of a contingency which previously could not be estimated reliably does not constitute a prior period item.

19. Prior period items are normally included in the determination of net profit or loss for the current period. An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss. In either case, the objective is to indicate the effect of such items on the current profit or loss.

Changes in Accounting Estimates

20. As a result of the uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated. The estimation process involves judgments based on the latest information available. Estimates may be required, for example, of bad debts, inventory obsolescence or the useful lives of depreciable assets. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

21. An estimate may have to be revised if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments. The revision of the estimate, by its nature, does not bring the adjustment within the definitions of an extraordinary item or a prior period item.

22. Sometimes, it is difficult to distinguish between a change in an accounting policy and a change in an accounting estimate. In such cases, the change is treated as a change in an accounting estimate, with appropriate disclosure.

23. The effect of a change in an accounting estimate should be included in the determination of net profit or loss in:

(a) the period of the change, if the change affects the period only; or

(b) the period of the change and future periods, if the change affects both.

24. A change in an accounting estimate may affect the current period only or both the current period and future periods. For example, a change in the estimate of the amount of bad debts is recognised immediately and therefore affects only the current period. However, a change in the estimated useful life of a depreciable asset affects the

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depreciation in the current period and in each period during the remaining useful life of the asset. In both cases, the effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods, is recognised in future periods.

25. The effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate.

26. To ensure the comparability of financial statements of different periods, the effect of a change in an accounting estimate which was previously included in the profit or loss from ordinary activities is included in that component of net profit or loss. The effect of a change in an accounting estimate that was previously included as an extraordinary item is reported as an extraordinary item.

27. The nature and amount of a change in an accounting estimate which has a material effect in the current period, or which is expected to have a material effect in subsequent periods, should be disclosed. If it is impracticable to quantify the amount, this fact should be disclosed.

Changes in Accounting Policies

28. Users need to be able to compare the financial statements of an enterprise over a period of time in order to identify trends in its financial position, performance and cash flows. Therefore, the same accounting policies are normally adopted for similar events or transactions in each period.

29. A change in an accounting policy should be made only if the adoption of a different accounting policy is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate presentation of the financial statements of the enterprise.

30. A more appropriate presentation of events or transactions in the financial statements occurs when the new accounting policy results in more relevant or reliable information about the financial position, performance or cash flows of the enterprise.

31. The following are not changes in accounting policies:

- (a) the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, e.g., introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement; and
- (b) the adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial.

32. Any change in an accounting policy which has a material effect should be disclosed. The impact of, and the adjustments resulting from, such change, if material, should be shown in the financial statements of the period in which such change is made, to reflect the effect of such change. Where the effect of such change 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.

33. A change in accounting policy consequent upon the adoption of an Accounting Standard should be accounted for in accordance with the specific transitional provisions, if any, contained in that Accounting Standard. However, disclosures required by paragraph 32 of this Standard should be made unless the transitional provisions of any other Accounting Standard require alternative disclosures in this regard.²

AS 7*: Construction Contracts

*[This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective, the Preface to the Statements of Accounting Standards¹ and the 'Applicability of Accounting Standards to Various Entities'.]*

Objective

The objective of this Standard is to prescribe the accounting treatment of revenue and costs associated with construction contracts. Because of the nature of the activity undertaken in construction contracts, the date at which the contract activity is entered into and the date when the activity is completed usually fall into different accounting periods. Therefore, the primary issue in accounting for construction contracts is the allocation of contract revenue and contract costs to the accounting periods in which construction work is performed. This Standard uses the recognition criteria established in the Framework for the Preparation and Presentation of Financial Statements to determine when contract revenue and contract costs should be recognised as revenue and expenses in the statement of profit and loss. It also provides practical guidance on the application of these criteria.

Scope

1. This Standard should be applied in accounting for construction contracts in the financial statements of contractors.

²As a limited revision to AS 5, the Council of the Institute decided to add this paragraph in AS 5 in 2001. This revision came into effect in respect of accounting periods commencing on or after 1.4.2001 (see 'The Chartered Accountant', September 2001, pp. 342).

*Revised in 2002 and came into effect in respect of all contracts entered into during accounting periods commencing on or after 1-4-2003 and is mandatory in nature from that date.

¹Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material.

Definitions

2. The following terms are used in this Standard with the meanings specified:

2.1 A construction contract is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.

2.2 A fixed price contract is a construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, which in some cases is subject to cost escalation clauses.

2.3 A cost plus contract is a construction contract in which the contractor is reimbursed for allowable or otherwise defined costs, plus percentage of these costs or a fixed fee.

3. A construction contract may be negotiated for the construction of a single asset such as a bridge, building, dam, pipeline, road, ship or tunnel. A construction contract may also deal with the construction of a number of assets which are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use; examples of such contracts include those for the construction of refineries and other complex pieces of plant or equipment.

4. For the purposes of this Standard, construction contracts include:

- (a) contracts for the rendering of services which are directly related to the construction of the asset, for example, those for the services of project managers and architects; and
- (b) contracts for destruction or restoration of assets, and the restoration of the environment following the demolition of assets.

5. Construction contracts are formulated in a number of ways which, for the purposes of this Standard, are classified as fixed price contracts and cost plus contracts. Some construction contracts may contain characteristics of both a fixed price contract and a cost plus contract, for example, in the case of a cost plus contract with an agreed maximum price. In such circumstances, a contractor needs to consider all the conditions in paragraphs 22 and 23 in order to determine when to recognise contract revenue and expenses.

Combining and Segmenting Construction Contracts

6. The requirements of this Standard are usually applied separately to each construction contract. However, in certain circumstances, it is necessary to apply the Standard to the separately identifiable components of a single contract or to a group of contracts together in order to reflect the substance of a contract or a group of contracts.

7. When a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

- (a) separate proposals have been submitted for each asset;**

(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

8. A group of contracts, whether with a single customer or with several customers, should be treated as a single construction contract when:

(a) the group of contracts is negotiated as a single package;

(b) the contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin; and

(c) the contracts are performed concurrently or in a continuous sequence.

9. A contract may provide for the construction of an additional asset at the option of the customer or may be amended to include the construction of an additional asset. The construction of the additional asset should be treated as a separate construction contract when:

(a) the asset differs significantly in design, technology or function from the asset or assets covered by the original contract; or

(b) the price of the asset is negotiated without regard to the original contract price.

Contract Revenue

10. Contract revenue should comprise:

(a) the initial amount of revenue agreed in the contract; and

(b) variations in contract work, claims and incentive payments:

(i) to the extent that it is probable that they will result in revenue; and

(ii) they are capable of being reliably measured.

11. Contract revenue is measured at the consideration received or receivable. The measurement of contract revenue is affected by a variety of uncertainties that depend on the outcome of future events. The estimates often need to be revised as events occur and uncertainties are resolved. Therefore, the amount of contract revenue may increase or decrease from one period to the next. For example:

(a) a contractor and a customer may agree to variations or claims that increase or decrease contract revenue in a period subsequent to that in which the contract was initially agreed;

(b) the amount of revenue agreed in a fixed price contract may increase as a result of cost escalation clauses;

(c) the amount of contract revenue may decrease as a result of penalties arising from delays caused by the contractor in the completion of the contract; or

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(d) when a fixed price contract involves a fixed price per unit of output, contract revenue increases as the number of units is increased.

12. A variation is an instruction by the customer for a change in the scope of the work to be performed under the contract. A variation may lead to an increase or a decrease in contract revenue. Examples of variations are changes in the specifications or design of the asset and changes in the duration of the contract. A variation is included in contract revenue when:

- (a) it is probable that the customer will approve the variation and the amount of revenue arising from the variation; and
- (b) the amount of revenue can be reliably measured.

13. A claim is an amount that the contractor seeks to collect from the customer or another party as reimbursement for costs not included in the contract price. A claim may arise from, for example, customer caused delays, errors in specifications or design, and disputed variations in contract work. The measurement of the amounts of revenue arising from claims is subject to a high level of uncertainty and often depends on the outcome of negotiations. Therefore, claims are only included in contract revenue when:

- (a) negotiations have reached an advanced stage such that it is probable that the customer will accept the claim; and
- (b) the amount that it is probable will be accepted by the customer can be measured reliably.

14. Incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when:

- (a) the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and
- (b) the amount of the incentive payment can be measured reliably.

Contract Costs

15. Contract costs should comprise:

- (a) costs that relate directly to the specific contract;**
- (b) costs that are attributable to contract activity in general and can be allocated to the contract; and**
- (c) such other costs as are specifically chargeable to the customer under the terms of the contract.**

16. Costs that relate directly to a specific contract include:

- (a) site labour costs, including site supervision;
- (b) costs of materials used in construction;
- (c) depreciation of plant and equipment used on the contract;

- (d) costs of moving plant, equipment and materials to and from the contract site;
- (e) costs of hiring plant and equipment;
- (f) costs of design and technical assistance that is directly related to the contract;
- (g) the estimated costs of rectification and guarantee work, including expected warranty costs; and
- (h) claims from third parties.

These costs may be reduced by any incidental income that is not included in contract revenue, for example income from the sale of surplus materials and the disposal of plant and equipment at the end of the contract.

17. Costs that may be attributable to contract activity in general and can be allocated to specific contracts include:

- (a) insurance;
- (b) costs of design and technical assistance that is not directly related to a specific contract; and
- (c) construction overheads.

Such costs are allocated using methods that are systematic and rational and are applied consistently to all costs having similar characteristics. The allocation is based on the normal level of construction activity. Construction overheads include costs such as the preparation and processing of construction personnel payroll. Costs that may be attributable to contract activity in general and can be allocated to specific contracts also include borrowing costs as per Accounting Standard (AS) 16, Borrowing Costs.

18. Costs that are specifically chargeable to the customer under the terms of the contract may include some general administration costs and development costs for which reimbursement is specified in the terms of the contract.

19. Costs that cannot be attributed to contract activity or cannot be allocated to a contract are excluded from the costs of a construction contract. Such costs include:

- (a) general administration costs for which reimbursement is not specified in the contract;
- (b) selling costs;
- (c) research and development costs for which reimbursement is not specified in the contract; and
- (d) depreciation of idle plant and equipment that is not used on a particular contract.

20. Contract costs include the costs attributable to a contract for the period from the date of securing the contract to the final completion of the contract. However, costs that relate directly to a contract and which are incurred in securing the contract are also included as part of the contract costs if they can be separately identified and measured reliably and it is probable that the contract will be obtained. When costs incurred in securing a contract

are recognised as an expense in the period in which they are incurred, they are not included in contract costs when the contract is obtained in a subsequent period.

Recognition of Contract Revenue and Expenses

21. When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date. An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 35.

22. In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:

- (a) total contract revenue can be measured reliably;**
- (b) it is probable that the economic benefits associated with the contract will flow to the enterprise;**
- (c) both the contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably; and**
- (d) the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.**

23. In the case of a cost plus contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:

- (a) it is probable that the economic benefits associated with the contract will flow to the enterprise; and**
- (b) the contract costs attributable to the contract, whether or not specifically reimbursable, can be clearly identified and measured reliably.**

24. The recognition of revenue and expenses by reference to the stage of completion of a contract is often referred to as the percentage of completion method. Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion of work completed. This method provides useful information on the extent of contract activity and performance during a period.

25. Under the percentage of completion method, contract revenue is recognised as revenue in the statement of profit and loss in the accounting periods in which the work is performed. Contract costs are usually recognised as an expense in the statement of profit and loss in the accounting periods in which the work to which they relate is performed. However, any expected excess of total contract costs over total contract revenue for the contract is recognised as an expense immediately in accordance with paragraph 35.

26. A contractor may have incurred contract costs that relate to future activity on the contract. Such contract costs are recognised as an asset provided it is probable that they

will be recovered. Such costs represent an amount due from the customer and are often classified as contract work in progress.

27. When an uncertainty arises about the collectability of an amount already included in contract revenue, and already recognised in the statement of profit and loss, the uncollectable amount or the amount in respect of which recovery has ceased to be probable is recognised as an expense rather than as an adjustment of the amount of contract revenue.

28. An enterprise is generally able to make reliable estimates after it has agreed to a contract which establishes:

- (a) each party's enforceable rights regarding the asset to be constructed;
- (b) the consideration to be exchanged; and
- (c) the manner and terms of settlement.

It is also usually necessary for the enterprise to have an effective internal financial budgeting and reporting system. The enterprise reviews and, when necessary, revises the estimates of contract revenue and contract costs as the contract progresses. The need for such revisions does not necessarily indicate that the outcome of the contract cannot be estimated reliably.

29. The stage of completion of a contract may be determined in a variety of ways. The enterprise uses the method that measures reliably the work performed. Depending on the nature of the contract, the methods may include:

- (a) the proportion that contract costs incurred for work performed upto the reporting date bear to the estimated total contract costs; or
- (b) surveys of work performed; or
- (c) completion of a physical proportion of the contract work.

Progress payments and advances received from customers may not necessarily reflect the work performed.

30. When the stage of completion is determined by reference to the contract costs incurred upto the reporting date, only those contract costs that reflect work performed are included in costs incurred upto the reporting date. Examples of contract costs which are excluded are:

- (a) contract costs that relate to future activity on the contract, such as costs of materials that have been delivered to a contract site or set aside for use in a contract but not yet installed, used or applied during contract performance, unless the materials have been made specially for the contract; and
- (b) payments made to subcontractors in advance of work performed under the subcontract.

31. When the outcome of a construction contract cannot be estimated reliably:

- (a) revenue should be recognised only to the extent of contract costs incurred of which recovery is probable; and**

- (b) contract costs should be recognised as an expense in the period in which they are incurred.**

An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 35.

32. During the early stages of a contract it is often the case that the outcome of the contract cannot be estimated reliably. Nevertheless, it may be probable that the enterprise will recover the contract costs incurred. Therefore, contract revenue is recognised only to the extent of costs incurred that are expected to be recovered. As the outcome of the contract cannot be estimated reliably, no profit is recognised. However, even though the outcome of the contract cannot be estimated reliably, it may be probable that total contract costs will exceed total contract revenue. In such cases, any expected excess of total contract costs over total contract revenue for the contract is recognised as an expense immediately in accordance with paragraph 35.

33. Contract costs recovery of which is not probable are recognised as an expense immediately. Examples of circumstances in which the recoverability of contract costs incurred may not be probable and in which contract costs may, therefore, need to be recognised as an expense immediately include contracts:

- (a) which are not fully enforceable, that is, their validity is seriously in question;
- (b) the completion of which is subject to the outcome of pending litigation or legislation;
- (c) relating to properties that are likely to be condemned or expropriated;
- (d) where the customer is unable to meet its obligations; or
- (e) where the contractor is unable to complete the contract or otherwise meet its obligations under the contract.

34. When the uncertainties that prevented the outcome of the contract being estimated reliably no longer exist, revenue and expenses associated with the construction contract should be recognised in accordance with paragraph 21 rather than in accordance with paragraph 31.

Recognition of Expected Losses

35. When it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.

36. The amount of such a loss is determined irrespective of:

- (a) whether or not work has commenced on the contract;
- (b) the stage of completion of contract activity; or
- (c) the amount of profits expected to arise on other contracts which are not treated as a single construction contract in accordance with paragraph 8.

Changes in Estimates

37. The percentage of completion method is applied on a cumulative basis in each accounting period to the current estimates of contract revenue and contract costs. Therefore, the effect of a change in the estimate of contract revenue or contract costs, or the effect of a change in the estimate of the outcome of a contract, is accounted for as a change in accounting estimate (see Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies). The changed estimates are used in determination of the amount of revenue and expenses recognised in the statement of profit and loss in the period in which the change is made and in subsequent periods.

Disclosure

38. An enterprise should disclose:

- (a) the amount of contract revenue recognised as revenue in the period;*
- (b) the methods used to determine the contract revenue recognised in the period; and*
- (c) the methods used to determine the stage of completion of contracts in progress.*

39. An enterprise should disclose the following for contracts in progress at the reporting date:

- (a) the aggregate amount of costs incurred and recognised profits (less recognised losses) upto the reporting date;*
- (b) the amount of advances received; and*
- (c) the amount of retentions.*

40. Retentions are amounts of progress billings which are not paid until the satisfaction of conditions specified in the contract for the payment of such amounts or until defects have been rectified. Progress billings are amounts billed for work performed on a contract whether or not they have been paid by the customer. Advances are amounts received by the contractor before the related work is performed.

41. An enterprise should present:

- (a) the gross amount due from customers for contract work as an asset; and*
- (b) the gross amount due to customers for contract work as a liability.*

42. The gross amount due from customers for contract work is the net amount of:

- (a) costs incurred plus recognised profits; less
- (b) the sum of recognised losses and progress billings

for all contracts in progress for which costs incurred plus recognised profits (less recognised losses) exceeds progress billings.

43. The gross amount due to customers for contract work is the net amount of:

- (a) the sum of recognised losses and progress billings; less

(b) costs incurred plus recognised profits

for all contracts in progress for which progress billings exceed costs incurred plus recognised profits (less recognised losses).

44. An enterprise discloses any contingencies in accordance with Accounting Standard (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date². Contingencies may arise from such items as warranty costs, penalties or possible losses.

Illustration

This illustration does not form part of the Accounting Standard. Its purpose is to illustrate the application of the Accounting Standard to assist in clarifying its meaning.

Disclosure of Accounting Policies

The following are illustrations of accounting policy disclosures:

Revenue from fixed price construction contracts is recognised on the percentage of completion method, measured by reference to the percentage of labour hours incurred upto the reporting date to estimated total labour hours for each contract.

Revenue from cost plus contracts is recognised by reference to the recoverable costs incurred during the period plus the fee earned, measured by the proportion that costs incurred upto the reporting date bear to the estimated total costs of the contract.

The Determination of Contract Revenue and Expenses

The following illustration illustrates one method of determining the stage of completion of a contract and the timing of the recognition of contract revenue and expenses (see paragraphs 21 to 34 of the Standard). (Amounts shown hereinbelow are in ₹ lakhs)

A construction contractor has a fixed price contract for ₹ 9,000 to build a bridge. The initial amount of revenue agreed in the contract is ₹ 9,000. The contractor's initial estimate of contract costs is ₹ 8,000. It will take 3 years to build the bridge.

By the end of year 1, the contractor's estimate of contract costs has increased to ₹ 8,050.

In year 2, the customer approves a variation resulting in an increase in contract revenue of ₹ 200 and estimated additional contract costs of ₹ 150. At the end of year 2, costs incurred include ₹ 100 for standard materials stored at the site to be used in year 3 to complete the project.

The contractor determines the stage of completion of the contract by calculating the proportion that contract costs incurred for work performed upto the reporting date bear to the latest estimated total contract costs. A summary of the financial data during the construction period is as follows:

²Pursuant to AS 29, Provisions, Contingent Liabilities and Contingent Assets, becoming mandatory, all paragraphs of AS 4 that deal with contingencies stand withdrawn except to the extent they deal with impairment of assets not covered by other Accounting Standards.

(amount in ₹ lakhs)

	Year 1	Year 2	Year 3
Initial amount of revenue agreed in contract	9,000	9,000	9,000
Variation	<u>—</u>	<u>200</u>	<u>200</u>
Total contract revenue	<u>9,000</u>	<u>9,200</u>	<u>9,200</u>
Contract costs incurred upto the reporting date	2,093	6,168	8,200
Contract costs to complete	<u>5,957</u>	<u>2,032</u>	<u>—</u>
Total estimated contract costs	<u>8,050</u>	<u>8,200</u>	<u>8,200</u>
Estimated Profit	950	1,000	1,000
Stage of completion	26%	74%	100%

The stage of completion for year 2 (74%) is determined by excluding from contract costs incurred for work performed upto the reporting date, ₹ 100 of standard materials stored at the site for use in year 3.

The amounts of revenue, expenses and profit recognised in the statement of profit and loss in the three years are as follows:

	Upto the Reporting Date	Recognised in Prior year	Recognised in current year
Year 1			
Revenue (9,000x .26)	2,340		2,340
Expenses (8,050x .26)	<u>2,093</u>		<u>2,093</u>
Profit	<u>247</u>		<u>247</u>
Year 2			
Revenue (9,200x .74)	6,808	2,340	4,468
Expenses (8,200x .74)	<u>6,068</u>	<u>2,093</u>	<u>3,975</u>
Profit	<u>740</u>	<u>247</u>	<u>493</u>
Year 3			
Revenue (9,200x 1.00)	9,200	6,808	2,392
Expenses	<u>8,200</u>	<u>6,068</u>	<u>2,132</u>
Profit	<u>1,000</u>	<u>740</u>	<u>260</u>

Contract Disclosures

A contractor has reached the end of its first year of operations. All its contract costs incurred have been paid for in cash and all its progress billings and advances have been received in cash. Contract costs incurred for contracts B, C and E include the cost of materials that have been purchased for the contract but which have not been used in contract performance

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upto the reporting date. For contracts B, C and E, the customers have made advances to the contractor for work not yet performed.

The status of its five contracts in progress at the end of year 1 is as follows:

Contract
(amount in ₹ lakhs)

	A	B	C	D	E	Total
Contract Revenue recognised in accordance with paragraph 21	145	520	380	200	55	1,300
Contract Expenses recognised in accordance with paragraph 21	110	450	350	250	55	1,215
Expected Losses recognised in accordance with paragraph 35	=	=	=	<u>40</u>	<u>30</u>	<u>70</u>
Recognised profits less recognised losses	<u>35</u>	<u>70</u>	<u>30</u>	<u>(90)</u>	<u>(30)</u>	<u>15</u>
Contract Costs incurred in the period	110	510	450	250	100	1,420
Contract Costs incurred recognised as contract expenses in the period in accordance with paragraph 21	<u>110</u>	<u>450</u>	<u>350</u>	<u>250</u>	<u>55</u>	<u>1,215</u>
Contract Costs that relate to future activity recognised as an asset in accordance with paragraph 26	=	<u>60</u>	<u>100</u>	=	<u>45</u>	<u>205</u>
Contract Revenue (see above)	145	520	380	200	55	1,300
Progress Billings (paragraph 40)	<u>100</u>	<u>520</u>	<u>380</u>	<u>180</u>	<u>55</u>	<u>1,235</u>
Unbilled Contract Revenue	<u>45</u>	=	=	<u>20</u>	=	<u>65</u>
Advances (paragraph 40)	=	80	20	=	25	125

The amounts to be disclosed in accordance with the Standard are as follows:

Contract revenue recognised as revenue in the period [paragraph 38(a)]	1,300
Contract costs incurred and recognised profits (less recognised losses) upto the reporting date [paragraph 39(a)]	1,435
Advances received [paragraph 39(b)]	125
Gross amount due from customers for contract work — presented as an asset in accordance with paragraph 41(a)	220
Gross amount due to customers for contract work — presented as a liability in accordance with paragraph 41(b)	(20)

The amounts to be disclosed in accordance with paragraphs 39(a), 41(a) and 41(b) are calculated as follows:

	(amount in ₹ lakhs)					
	A	B	C	D	E	Total
Contract Costs incurred	110	510	450	250	100	1,420
Recognised profits less recognised losses	35	70	30	(90)	(30)	15
	145	580	480	160	70	1,435
Progress billings	100	520	380	180	55	1,235
Due from customers	45	60	100	—	15	220
Due to customers	—	—	—	(20)	—	(20)

The amount disclosed in accordance with paragraph 39(a) is the same as the amount for the current period because the disclosures relate to the first year of operation.

AS 9*: Revenue Recognition¹

*[This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of the Preface to the Statements of Accounting Standards² and the 'Applicability of Accounting Standards to Various Entities'.]*

Introduction

1. This Standard deals with the bases for recognition of revenue in the statement of profit and loss of an enterprise. The Standard is concerned with the recognition of revenue arising in the course of the ordinary activities of the enterprise from
 - the sale of goods,
 - the rendering of services, and
 - the use by others of enterprise resources yielding interest, royalties and dividends.
2. This Standard does not deal with the following aspects of revenue recognition to which special considerations apply:
 - (i) Revenue arising from construction contracts³
 - (ii) Revenue arising from hire-purchase, lease agreements;
 - (iii) Revenue arising from government grants and other similar subsidies;

*Issued in 1985

¹It is reiterated that this Accounting Standard (as is the case of other accounting standards) assumes that the three fundamental accounting assumptions i.e., going concern, consistency and accrual have been followed in the preparation and presentation of financial statements.

²Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material.

³Refer to AS 7 on 'Construction Contracts'.

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- (iv) Revenue of insurance companies arising from insurance contracts.
3. Examples of items not included within the definition of “revenue” for the purpose of this Standard are:
- (i) Realised gains resulting from the disposal of, and unrealised gains resulting from the holding of, non-current assets e.g. appreciation in the value of fixed assets;
 - (ii) Unrealised holding gains resulting from the change in value of current assets, and the natural increases in herds and agricultural and forest products;
 - (iii) Realised or unrealised gains resulting from changes in foreign exchange rates and adjustments arising on the translation of foreign currency financial statements;
 - (iv) Realised gains resulting from the discharge of an obligation at less than its carrying amount;
 - (v) Unrealised gains resulting from the restatement of the carrying amount of an obligation.

Definitions

4. The following terms are used in this Standard with the meanings specified:

4.1 Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise⁴ from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends. Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration.

4.2 Completed service contract method is a method of accounting which recognises revenue in the statement of profit and loss only when the rendering of services under a contract is completed or substantially completed.

4.3 Proportionate completion method is a method of accounting which recognises revenue in the statement of profit and loss proportionately with the degree of completion of services under a contract.

Explanation

5. Revenue recognition is mainly concerned with the timing of recognition of revenue in the statement of profit and loss of an enterprise. The amount of revenue arising on a transaction is usually determined by agreement between the parties involved in the transaction. When uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

⁴The Institute has issued an Announcement in 2005 titled ‘Treatment of Inter-divisional Transfers’. As per the Announcement, the recognition of inter-divisional transfers as sales is an inappropriate accounting treatment and is inconsistent with Accounting Standard 9.

6. Sale of Goods

6.1 A key criterion for determining when to recognise revenue from a transaction involving the sale of goods is that the seller has transferred the property in the goods to the buyer for a consideration. The transfer of property in goods, in most cases, results in or coincides with the transfer of significant risks and rewards of ownership to the buyer. However, there may be situations where transfer of property in goods does not coincide with the transfer of significant risks and rewards of ownership. Revenue in such situations is recognised at the time of transfer of significant risks and rewards of ownership to the buyer. Such cases may arise where delivery has been delayed through the fault of either the buyer or the seller and the goods are at the risk of the party at fault as regards any loss which might not have occurred but for such fault. Further, sometimes the parties may agree that the risk will pass at a time different from the time when ownership passes.

6.2 At certain stages in specific industries, such as when agricultural crops have been harvested or mineral ores have been extracted, performance may be substantially complete prior to the execution of the transaction generating revenue. In such cases when sale is assured under a forward contract or a government guarantee or where market exists and there is a negligible risk of failure to sell, the goods involved are often valued at net realisable value. Such amounts, while not revenue as defined in this Standard, are sometimes recognised in the statement of profit and loss and appropriately described.

7. Rendering of Services

7.1 Revenue from service transactions is usually recognised as the service is performed, either by the proportionate completion method or by the completed service contract method.

- (i) **Proportionate completion method**—Performance consists of the execution of more than one act. Revenue is recognised proportionately by reference to the performance of each act. The revenue recognised under this method would be determined on the basis of contract value, associated costs, number of acts or other suitable basis. For practical purposes, when services are provided by an indeterminate number of acts over a specific period of time, revenue is recognised on a straight line basis over the specific period unless there is evidence that some other method better represents the pattern of performance.
- (ii) **Completed service contract method**—Performance consists of the execution of a single act. Alternatively, services are performed in more than a single act, and the services yet to be performed are so significant in relation to the transaction taken as a whole that performance cannot be deemed to have been completed until the execution of those acts. The completed service contract method is relevant to these patterns of performance and accordingly revenue is recognised when the sole or final act takes place and the service becomes chargeable.

8. The Use by Others of Enterprise Resources Yielding Interest, Royalties and Dividends

8.1 The use by others of such enterprise resources gives rise to:

- (i) interest—charges for the use of cash resources or amounts due to the enterprise;
- (ii) royalties—charges for the use of such assets as know-how, patents, trademarks and copyrights;
- (iii) dividends—rewards from the holding of investments in shares.

8.2 Interest accrues, in most circumstances, on the time basis determined by the amount outstanding and the rate applicable. Usually, discount or premium on debt securities held is treated as though it were accruing over the period to maturity.

8.3 Royalties accrue in accordance with the terms of the relevant agreement and are usually recognised on that basis unless, having regard to the substance of the transactions, it is more appropriate to recognise revenue on some other systematic and rational basis.

8.4 Dividends from investments in shares are not recognised in the statement of profit and loss until a right to receive payment is established.

8.5 When interest, royalties and dividends from foreign countries require exchange permission and uncertainty in remittance is anticipated, revenue recognition may need to be postponed.

9. Effect of Uncertainties on Revenue Recognition

9.1 Recognition of revenue requires that revenue is measurable and that at the time of sale or the rendering of the service it would not be unreasonable to expect ultimate collection.

9.2 Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g., for escalation of price, export incentives, interest etc., revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, revenue is recognised at the time of sale or rendering of service even though payments are made by instalments.

9.3 When the uncertainty relating to collectability arises subsequent to the time of sale or the rendering of the service, it is more appropriate to make a separate provision to reflect the uncertainty rather than to adjust the amount of revenue originally recorded.

9.4 An essential criterion for the recognition of revenue is that the consideration receivable for the sale of goods, the rendering of services or from the use by others of enterprise resources is reasonably determinable. When such consideration is not determinable within reasonable limits, the recognition of revenue is postponed.

9.5 When recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is properly recognised.

Main Principles

10. Revenue from sales or service transactions should be recognised when the requirements as to performance set out in paragraphs 11 and 12 are satisfied, provided that at the time of performance it is not unreasonable to expect ultimate collection. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

Explanation:

The amount of revenue from sales transactions (turnover) should be disclosed in the following manner on the face of the statement of profit or loss :

Turnover (Gross)	XX	
Less: Excise Duty	<u>XX</u>	
Turnover (Net)		XX

The amount of excise duty to be deducted from the turnover should be the total excise duty for the year except the excise duty related to the difference between the closing start and opening stock. The excise duty related to the difference between the closing stock and opening stock should be recognised separately in the statement of profit or loss, with an explanatory note in the notes to accounts to explain the nature of the two amounts of excise duty.

11. In a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

- (i) the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and**
- (ii) no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.**

12. In a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished. Such performance should be regarded as being achieved when no significant uncertainty exists regarding the amount of the consideration that will be derived from rendering the service.

13. Revenue arising from the use by others of enterprise resources yielding interest, royalties and dividends should only be recognised when no significant uncertainty as to measurability or collectability exists. These revenues are recognised on the following bases:

- (i) Interest : on time proportion basis taking into account the amount outstanding and the rate applicable.**

(ii) *Royalties* : *on an accrual basis in accordance with the terms of the relevant agreement.*

(iii) *Dividends from* : *when the owner's right to receive payment is investments in shares established.*

Disclosure

14. In addition to the disclosures required by Accounting Standard 1 on 'Disclosure of Accounting Policies' (AS 1), an enterprise should also disclose the circumstances in which revenue recognition has been postponed pending the resolution of significant uncertainties.

Illustrations

These illustrations do not form part of the Accounting Standard. Their purpose is to illustrate the application of the Standard to a number of commercial situations in an endeavour to assist in clarifying application of the Standard.

A. Sale of Goods

1. *Delivery is delayed at buyer's request and buyer takes title and accepts billing*

Revenue should be recognised notwithstanding that physical delivery has not been completed so long as there is every expectation that delivery will be made. However, the item must be on hand, identified and ready for delivery to the buyer at the time the sale is recognised rather than there being simply an intention to acquire or manufacture the goods in time for delivery.

2. *Delivered subject to conditions*

(a) installation and inspection i.e. goods are sold subject to installation, inspection etc.

Revenue should normally not be recognised until the customer accepts delivery and installation and inspection are complete. In some cases, however, the installation process may be so simple in nature that it may be appropriate to recognise the sale notwithstanding that installation is not yet completed (e.g. installation of a factory-tested television receiver normally only requires unpacking and connecting of power and antennae).

(b) on approval

Revenue should not be recognised until the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has elapsed or where no time has been fixed, a reasonable time has elapsed.

(c) guaranteed sales i.e. delivery is made giving the buyer an unlimited right of return

Recognition of revenue in such circumstances will depend on the substance of the agreement. In the case of retail sales offering a guarantee of "money back if not completely satisfied" it may be appropriate to recognise the sale but to make a suitable

provision for returns based on previous experience. In other cases, the substance of the agreement may amount to a sale on consignment, in which case it should be treated as indicated below.

(d) consignment sales i.e. a delivery is made whereby the recipient undertakes to sell the goods on behalf of the consignor.

Revenue should not be recognised until the goods are sold to a third party.

(e) cash on delivery sales

Revenue should not be recognised until cash is received by the seller or his agent.

3. *Sales where the purchaser makes a series of instalment payments to the seller, and the seller delivers the goods only when the final payment is received*

Revenue from such sales should not be recognised until goods are delivered. However, when experience indicates that most such sales have been consummated, revenue may be recognised when a significant deposit is received.

4. *Special order and shipments i.e. where payment (or partial payment) is received for goods not presently held in stock e.g. the stock is still to be manufactured or is to be delivered directly to the customer from a third party*

Revenue from such sales should not be recognised until goods are manufactured, identified and ready for delivery to the buyer by the third party.

5. *Sale/repurchase agreements i.e. where seller concurrently agrees to repurchase the same goods at a later date*

For such transactions that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognised as revenue.

6. *Sales to intermediate parties i.e. where goods are sold to distributors, dealers or others for resale*

Revenue from such sales can generally be recognised if significant risks of ownership have passed; however, in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.

7. *Subscriptions for publications*

Revenue received or billed should be deferred and recognised either on a straight line basis over time or, where the items delivered vary in value from period to period, revenue should be based on the sales value of the item delivered in relation to the total sales value of all items covered by the subscription.

8. *Instalment sales*

When the consideration is receivable in instalments, revenue attributable to the sales price exclusive of interest should be recognised at the date of sale. The interest element should be recognised as revenue, proportionately to the unpaid balance due to the seller.

9. *Trade discounts and volume rebates*

Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.

B. Rendering of Services

1. *Installation Fees*

In cases where installation fees are other than incidental to the sale of a product, they should be recognised as revenue only when the equipment is installed and accepted by the customer.

2. *Advertising and insurance agency commissions*

Revenue should be recognised when the service is completed. For advertising agencies, media commissions will normally be recognised when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency, as opposed to production commission, which will be recognised when the project is completed. Insurance agency commissions should be recognised on the effective commencement or renewal dates of the related policies.

3. *Financial service commissions*

A financial service may be rendered as a single act or may be provided over a period of time. Similarly, charges for such services may be made as a single amount or in stages over the period of the service or the life of the transaction to which it relates. Such charges may be settled in full when made or added to a loan or other account and settled in stages. The recognition of such revenue should therefore have regard to:

- (a) whether the service has been provided "once and for all" or is on a "continuing" basis;
- (b) the incidence of the costs relating to the service;
- (c) when the payment for the service will be received. In general, commissions charged for arranging or granting loan or other facilities should be recognised when a binding obligation has been entered into. Commitment, facility or loan management fees which relate to continuing obligations or services should normally be recognised over the life of the loan or facility having regard to the amount of the obligation outstanding, the nature of the services provided and the timing of the costs relating thereto.

4. *Admission fees*

Revenue from artistic performances, banquets and other special events should be recognised when the event takes place. When a subscription to a number of events is sold, the fee should be allocated to each event on a systematic and rational basis.

5. *Tuition fees*

Revenue should be recognised over the period of instruction.

6. *Entrance and membership fees*

Revenue recognition from these sources will depend on the nature of the services being provided. Entrance fee received is generally capitalised. If the membership fee permits only membership and all other services or products are paid for separately, or if there is a separate annual subscription, the fee should be recognised when received. If the membership fee entitles the member to services or publications to be provided during the year, it should be recognised on a systematic and rational basis having regard to the timing and nature of all services provided.

AS 14*: Accounting for Amalgamations

*[This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of the Preface to the Statements of Accounting Standards¹ and the 'Applicability of Accounting Standards to Various Entities'.]*

Introduction

1. This standard deals with accounting for amalgamations and the treatment of any resultant goodwill or reserves. This Standard is directed principally to companies although some of its requirements also apply to financial statements of other enterprises.
2. This standard does not deal with cases of acquisitions which arise when there is a purchase by one company (referred to as the acquiring company) of the whole or part of the shares, or the whole or part of the assets, of another company (referred to as the acquired company) in consideration for payment in cash or by issue of shares or other securities in the acquiring company or partly in one form and partly in the other. The distinguishing feature of an acquisition is that the acquired company is not dissolved and its separate entity continues to exist.

Definitions

3. ***The following terms are used in this standard with the meanings specified:***
 - (a) ***Amalgamation means an amalgamation pursuant to the provisions of the Companies Act, 2013 or any other statute which may be applicable to companies and includes 'merger'.***
 - (b) ***Transferor company means the company which is amalgamated into another company.***

*Issued in 1994. A limited revision to this Standard was made in 2004, pursuant to which paragraphs 23 and 42 of this Standard were revised.

¹Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material.

- (c) Transferee company means the company into which a transferor company is amalgamated.**
- (d) Reserve means the portion of earnings, receipts or other surplus of an enterprise (whether capital or revenue) appropriated by the management for a general or a specific purpose other than a provision for depreciation or diminution in the value of assets or for a known liability.**
- (e) Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions.**

 - (i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.**
 - (ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.**
 - (iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.**
 - (iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.**
 - (v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.**
- (f) Amalgamation in the nature of purchase is an amalgamation which does not satisfy any one or more of the conditions specified in sub-paragraph (e) above.**
- (g) Consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.**
- (h) Fair value is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.**
- (i) Pooling of interests is a method of accounting for amalgamations the object of which is to account for the amalgamation as if the separate businesses of the amalgamating companies were intended to be continued by the transferee company. Accordingly, only minimal changes are made in**

aggregating the individual financial statements of the amalgamating companies.

Explanation

Types of Amalgamations

4. Generally speaking, amalgamations fall into two broad categories. In the first category are those amalgamations where there is a genuine pooling not merely of the assets and liabilities of the amalgamating companies but also of the shareholders' interests and of the businesses of these companies. Such amalgamations are amalgamations which are in the nature of 'merger' and the accounting treatment of such amalgamations should ensure that the resultant figures of assets, liabilities, capital and reserves more or less represent the sum of the relevant figures of the amalgamating companies. In the second category are those amalgamations which are in effect a mode by which one company acquires another company and, as a consequence, the shareholders of the company which is acquired normally do not continue to have a proportionate share in the equity of the combined company, or the business of the company which is acquired is not intended to be continued. Such amalgamations are amalgamations in the nature of 'purchase'.

5. An amalgamation is classified as an 'amalgamation in the nature of merger' when all the conditions listed in paragraph 3(e) are satisfied. There are, however, differing views regarding the nature of any further conditions that may apply. Some believe that, in addition to an exchange of equity shares, it is necessary that the shareholders of the transferor company obtain a substantial share in the transferee company even to the extent that it should not be possible to identify any one party as dominant therein. This belief is based in part on the view that the exchange of control of one company for an insignificant share in a larger company does not amount to a mutual sharing of risks and benefits.

6. Others believe that the substance of an amalgamation in the nature of merger is evidenced by meeting certain criteria regarding the relationship of the parties, such as the former independence of the amalgamating companies, the manner of their amalgamation, the absence of planned transactions that would undermine the effect of the amalgamation, and the continuing participation by the management of the transferor company in the management of the transferee company after the amalgamation.

Methods of Accounting for Amalgamations

7. There are two main methods of accounting for amalgamations:

- (a) the pooling of interests method; and
- (b) the purchase method.

8. The use of the pooling of interests method is confined to circumstances which meet the criteria referred to in paragraph 3(e) for an amalgamation in the nature of merger.

9. The object of the purchase method is to account for the amalgamation by applying the same principles as are applied in the normal purchase of assets. This method is used in accounting for amalgamations in the nature of purchase.

The Pooling of Interests Method

10. Under the pooling of interests method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts (after making the adjustments required in paragraph 11).

11. If, at the time of the amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies is adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies are reported in accordance with Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

The Purchase Method

12. Under the purchase method, the transferee company accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company.

13. Where assets and liabilities are restated on the basis of their fair values, the determination of fair values may be influenced by the intentions of the transferee company. For example, the transferee company may have a specialised use for an asset, which is not available to other potential buyers. The transferee company may intend to effect changes in the activities of the transferor company which necessitate the creation of specific provisions for the expected costs, e.g. planned employee termination and plant relocation costs.

Consideration

14. The consideration for the amalgamation may consist of securities, cash or other assets. In determining the value of the consideration, an assessment is made of the fair value of its elements. A variety of techniques is applied in arriving at fair value. For example, when the consideration includes securities, the value fixed by the statutory authorities may be taken to be the fair value. In case of other assets, the fair value may be determined by reference to the market value of the assets given up. Where the market value of the assets given up cannot be reliably assessed, such assets may be valued at their respective net book values.

15. Many amalgamations recognise that adjustments may have to be made to the consideration in the light of one or more future events. When the additional payment is probable and can reasonably be estimated at the date of amalgamation, it is included in the calculation of the consideration. In all other cases, the adjustment is recognised as soon as the amount is determinable [see Accounting Standard (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date].

Treatment of Reserves on Amalgamation

16. If the amalgamation is an 'amalgamation in the nature of merger', the identity of the reserves is preserved and they appear in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company. Thus, for example, the General Reserve of the transferor company becomes the General Reserve of the transferee company, the Capital Reserve of the transferor company becomes the Capital Reserve of the transferee company and the Revaluation Reserve of the transferor company becomes the Revaluation Reserve of the transferee company. As a result of preserving the identity, reserves which are available for distribution as dividend before the amalgamation would also be available for distribution as dividend after the amalgamation. The difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company is adjusted in reserves in the financial statements of the transferee company.

17. If the amalgamation is an 'amalgamation in the nature of purchase', the identity of the reserves, other than the statutory reserves dealt with in paragraph 18, is not preserved. The amount of the consideration is deducted from the value of the net assets of the transferor company acquired by the transferee company. If the result of the computation is negative, the difference is debited to goodwill arising on amalgamation and dealt with in the manner stated in paragraphs 19-20. If the result of the computation is positive, the difference is credited to Capital Reserve.

18. Certain reserves may have been created by the transferor company pursuant to the requirements of, or to avail of the benefits under, the Income-tax Act, 1961; for example, Development Allowance Reserve, or Investment Allowance Reserve. The Act requires that the identity of the reserves should be preserved for a specified period. Likewise, certain other reserves may have been created in the financial statements of the transferor company in terms of the requirements of other statutes. Though, normally, in an amalgamation in the nature of purchase, the identity of reserves is not preserved, an exception is made in respect of reserves of the aforesaid nature (referred to hereinafter as 'statutory reserves') and such reserves retain their identity in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company, so long as their identity is required to be maintained to comply with the relevant statute. This exception is made only in those amalgamations where the requirements of the relevant statute for recording the statutory reserves in the books of the transferee company are complied with. In such cases the statutory reserves are recorded in the financial statements of the transferee company by a corresponding debit to a suitable account head (e.g., 'Amalgamation Adjustment Reserve') which is presented as a separate line item. When the identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account are reversed.

Treatment of Goodwill Arising on Amalgamation

19. Goodwill arising on amalgamation represents a payment made in anticipation of future income and it is appropriate to treat it as an asset to be amortised to income on a systematic basis over its useful life. Due to the nature of goodwill, it is frequently difficult to estimate its useful life with reasonable certainty. Such estimation is, therefore, made on a prudent basis. Accordingly, it is considered appropriate to amortise goodwill over a period not exceeding five years unless a somewhat longer period can be justified.

20. Factors which may be considered in estimating the useful life of goodwill arising on amalgamation include:

- (a) the foreseeable life of the business or industry;
- (b) the effects of product obsolescence, changes in demand and other economic factors;
- (c) the service life expectancies of key individuals or groups of employees;
- (d) expected actions by competitors or potential competitors; and
- (e) legal, regulatory or contractual provisions affecting the useful life.

Balance of Profit and Loss Account

21. In the case of an 'amalgamation in the nature of merger', the balance of the Profit and Loss Account appearing in the financial statements of the transferor company is aggregated with the corresponding balance appearing in the financial statements of the transferee company. Alternatively, it is transferred to the General Reserve, if any.

22. In the case of an 'amalgamation in the nature of purchase', the balance of the Profit and Loss Account appearing in the financial statements of the transferor company, whether debit or credit, loses its identity.

Treatment of Reserves Specified in a Scheme of Amalgamation

23. The scheme of amalgamation sanctioned under the provisions of the Companies Act, 1956 or any other statute may prescribe the treatment to be given to the reserves of the transferor company after its amalgamation. Where the treatment is so prescribed, the same is followed. In some cases, the scheme of amalgamation sanctioned under a statute may prescribe a different treatment to be given to the reserves of the transferor company after amalgamation as compared to the requirements of this Standard that would have been followed had no treatment been prescribed by the scheme. In such cases, the following disclosures are made in the first financial statements following the amalgamation:

- (a) A description of the accounting treatment given to the reserves and the reasons for following the treatment different from that prescribed in this Standard.
- (b) Deviations in the accounting treatment given to the reserves as prescribed by the scheme of amalgamation sanctioned under the statute as compared to the requirements of this Standard that would have been followed had no treatment been prescribed by the scheme.

- (c) The financial effect, if any, arising due to such deviation.

Disclosure

24. For all amalgamations, the following disclosures are considered appropriate in the first financial statements following the amalgamation:

- (a) names and general nature of business of the amalgamating companies;
- (b) effective date of amalgamation for accounting purposes;
- (c) the method of accounting used to reflect the amalgamation; and
- (d) particulars of the scheme sanctioned under a statute.

25. For amalgamations accounted for under the pooling of interests method, the following additional disclosures are considered appropriate in the first financial statements following the amalgamation:

- (a) description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation;
- (b) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.

26. For amalgamations accounted for under the purchase method, the following additional disclosures are considered appropriate in the first financial statements following the amalgamation:

- (a) consideration for the amalgamation and a description of the consideration paid or contingently payable; and
- (b) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof including the period of amortisation of any goodwill arising on amalgamation.

Amalgamation after the Balance Sheet Date

27. When an amalgamation is effected after the balance sheet date but before the issuance of the financial statements of either party to the amalgamation, disclosure is made in accordance with AS 4, 'Contingencies and Events Occurring After the Balance Sheet Date', but the amalgamation is not incorporated in the financial statements. In certain circumstances, the amalgamation may also provide additional information affecting the financial statements themselves, for instance, by allowing the going concern assumption to be maintained.

Main Principles

28. An amalgamation may be either –

- (a) an amalgamation in the nature of merger, or**
- (b) an amalgamation in the nature of purchase.**

29. An amalgamation should be considered to be an amalgamation in the nature of merger when all the following conditions are satisfied:

- (i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.*
- (ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.*
- (iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.*
- (iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.*
- (v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.*

30. An amalgamation should be considered to be an amalgamation in the nature of purchase, when any one or more of the conditions specified in paragraph 29 is not satisfied.

31. When an amalgamation is considered to be an amalgamation in the nature of merger, it should be accounted for under the pooling of interests method described in paragraphs 33–35.

32. When an amalgamation is considered to be an amalgamation in the nature of purchase, it should be accounted for under the purchase method described in paragraphs 36–39.

The Pooling of Interests Method

33. In preparing the transferee company's financial statements, the assets, liabilities and reserves (whether capital or revenue or arising on revaluation) of the transferor company should be recorded at their existing carrying amounts and in the same form as at the date of the amalgamation. The balance of the Profit and Loss Account of the transferor company should be aggregated with the corresponding balance of the transferee company or transferred to the General Reserve, if any.

34. If, at the time of the amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies should be adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies should be reported in accordance with Accounting Standard (AS) 5 Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

35. The difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company should be adjusted in reserves.

The Purchase Method

36. In preparing the transferee company's financial statements, the assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or, alternatively, the consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation. The reserves (whether capital or revenue or arising on revaluation) of the transferor company, other than the statutory reserves, should not be included in the financial statements of the transferee company except as stated in paragraph 39.

37. Any excess of the amount of the consideration over the value of the net assets of the transferor company acquired by the transferee company should be recognised in the transferee company's financial statements as goodwill arising on amalgamation. If the amount of the consideration is lower than the value of the net assets acquired, the difference should be treated as Capital Reserve.

38. The goodwill arising on amalgamation should be amortised to income on a systematic basis over its useful life. The amortisation period should not exceed five years unless a somewhat longer period can be justified.

39. Where the requirements of the relevant statute for recording the statutory reserves in the books of the transferee company are complied with, statutory reserves of the transferor company should be recorded in the financial statements of the transferee company. The corresponding debit should be given to a suitable account head (e.g., 'Amalgamation Adjustment Reserve') which should be presented as a separate line item. When the identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account should be reversed.

Common Procedures

40. The consideration for the amalgamation should include any non-cash element at fair value. In case of issue of securities, the value fixed by the statutory authorities may be taken to be the fair value. In case of other assets, the fair value may be determined by reference to the market value of the assets given up. Where the market value of the assets given up cannot be reliably assessed, such assets may be valued at their respective net book values.

41. Where the scheme of amalgamation provides for an adjustment to the consideration contingent on one or more future events, the amount of the additional payment should be included in the consideration if payment is probable and a reasonable estimate of the amount can be made. In all other cases, the adjustment should be recognised as soon as the amount is determinable [see Accounting Standard (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date].

Treatment of Reserves Specified in a Scheme of Amalgamation

42. Where the scheme of amalgamation sanctioned under a statute prescribes the treatment to be given to the reserves of the transferor company after amalgamation, the same should be followed. Where the scheme of amalgamation sanctioned under a statute prescribes a different treatment to be given to the reserves of the transferor company after amalgamation as compared to the requirements of this Standard that would have been followed had no treatment been prescribed by the scheme, the following disclosures should be made in the first financial statements following the amalgamation:

- (a) A description of the accounting treatment given to the reserves and reasons for following the treatment different from that prescribed in this Standard.**
- (b) Deviations in the accounting treatment given to the reserves as prescribed by the scheme of amalgamation sanctioned under the statute as compared to the requirements of this Standard that would have been followed had no treatment been prescribed by the scheme.**
- (c) The financial effect, if any, arising due to such deviation.**

Disclosure

43. For all amalgamations, the following disclosures should be made in the first financial statements following the amalgamation:

- (a) names and general nature of business of the amalgamating companies;**
- (b) effective date of amalgamation for accounting purposes;**
- (c) the method of accounting used to reflect the amalgamation; and**
- (d) particulars of the scheme sanctioned under a statute.**

44. For amalgamations accounted for under the pooling of interests method, the following additional disclosures should be made in the first financial statements following the amalgamation:

- (a) description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation;**
- (b) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.**

45. For amalgamations accounted for under the purchase method, the following additional disclosures should be made in the first financial statements following the amalgamation:

- (a) consideration for the amalgamation and a description of the consideration paid or contingently payable; and**
- (b) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof including the period of amortisation of any goodwill arising on amalgamation.**

Amalgamation after the Balance Sheet Date

46. When an amalgamation is effected after the balance sheet date but before the issuance of the financial statements of either party to the amalgamation, disclosure should be made in accordance with AS 4, 'Contingencies and Events Occurring After the Balance Sheet Date', but the amalgamation should not be incorporated in the financial statements. In certain circumstances, the amalgamation may also provide additional information affecting the financial statements themselves, for instance, by allowing the going concern assumption to be maintained.

AS 17: Segment Reporting

*[This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective, the Preface to the Statements of Accounting Standards¹ and the 'Applicability of Accounting Standards to Various Entities'.]*

This Accounting Standard is not mandatory for Small and Medium Sized Companies and Small and Medium Sized non-corporate entities falling in Level II and Level III 'Applicability of Accounting Standards to Various Entities'. Such Entities are however encouraged to comply with this Standard.

Objective

The objective of this Standard is to establish principles for reporting financial information, about the different types of products and services an enterprise produces and the different geographical areas in which it operates. Such information helps users of financial statements:

- (a) better understand the performance of the enterprise;
- (b) better assess the risks and returns of the enterprise; and
- (c) make more informed judgements about the enterprise as a whole. Many enterprises provide groups of products and services or operate in geographical areas that are subject to differing rates of profitability, opportunities for growth, future prospects, and risks. Information about different types of products and services of an enterprise and its operations in different geographical areas - often called segment information - is relevant to assessing the risks and returns of a diversified or multi-locational enterprise but may not be determinable from the aggregated data. Therefore, reporting of segment information is widely regarded as necessary for meeting the needs of users of financial statements.

¹Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material.

Scope

1. ***This Standard should be applied in presenting general purpose financial statements.***
2. The requirements of this Standard are also applicable in case of consolidated financial statements.
3. ***An enterprise should comply with the requirements of this Standard fully and not selectively.***
4. ***If a single financial report contains both consolidated financial statements and the separate financial statements of the parent, segment information need be presented only on the basis of the consolidated financial statements. In the context of reporting of segment information in consolidated financial statements, the references in this Standard to any financial statement items should construed to be the relevant item as appearing in the consolidated financial statements.***

Definitions

5. ***The following terms are used in this Standard with the meanings specified:***

5.1 A ***business segment*** is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments. Factors that should be considered in determining whether products or services are related include:

- (a) ***the nature of the products or services; (b) the nature of the production processes;***
- (c) ***the type or class of customers for the products or services;***
- (d) ***the methods used to distribute the products or provide the services; and***
- (e) ***if applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities.***

5.2 A ***geographical segment*** is a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic environments. Factors that should be considered in identifying geographical segments include:

- (a) ***similarity of economic and political conditions;***
- (b) ***relationships between operations in different geographical areas;***
- (c) ***proximity of operations;***
- (d) ***special risks associated with operations in a particular area;***
- (e) ***exchange control regulations; and***
- (f) ***the underlying currency risks.***

5.3 A reportable segment is a business segment or a geographical segment identified on the basis of foregoing definitions for which segment information is required to be disclosed by this Standard.

5.4 Enterprise revenue is revenue from sales to external customers as reported in the statement of profit and loss.

5.5 Segment revenue is the aggregate of

- (i) the portion of enterprise revenue that is directly attributable to a segment,**
- (ii) the relevant portion of enterprise revenue that can be allocated on a reasonable basis to a segment, and**
- (iii) revenue from transactions with other segments of the enterprise.**

Segment revenue does not include:

- (a) extraordinary items as defined in AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies;**
- (b) interest or dividend income, including interest earned on advances or loans to other segments unless the operations of the segment are primarily of a financial nature; and**
- (c) gains on sales of investments or on extinguishment of debt unless the operations of the segment are primarily of a financial nature.**

5.6 Segment expense is the aggregate of

- (i) the expense resulting from the operating activities of a segment that is directly attributable to the segment, and**
- (ii) the relevant portion of enterprise expense that can be allocated on a reasonable basis to the segment, including expense relating to transactions with other segments of the enterprise.**

Segment expense does not include:

- (a) extraordinary items as defined in AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies;**
- (b) interest expense, including interest incurred on advances or loans from other segments, unless the operations of the segment are primarily of a financial nature;**

Explanation:

The interest expense relating to overdrafts and other operating liabilities identified to a particular segment are not included as a part of the segment expense unless the operations of the segment are primarily of a financial nature or unless the interest is included as a part of the cost of inventories. In case interest is included as a part of the cost of inventories where it is so required as per AS 16, Borrowing Costs, read with AS 2, Valuation of Inventories, and those inventories are part of segment assets of a particular

segment, such interest is considered as a segment expense. In this case, the amount of such interest and the fact that the segment result has been arrived at after considering such interest is disclosed by way of a note to the segment result.

- (c) losses on sales of investments or losses on extinguishment of debt unless the operations of the segment are primarily of a financial nature;*
- (d) income tax expense; and*
- (e) general administrative expenses, head-office expenses, and other expenses that arise at the enterprise level and relate to the enterprise as a whole. However, costs are sometimes incurred at the enterprise level on behalf of a segment. Such costs are part of segment expense if they relate to the operating activities of the segment and if they can be directly attributed or allocated to the segment on a reasonable basis.*

5.7 Segment result is segment revenue less segment expense.

5.8 Segment assets are those operating assets that are employed by a segment in its operating activities and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.

If the segment result of a segment includes interest or dividend income, its segment assets include the related receivables, loans, investments, or other interest or dividend generating assets.

Segment assets do not include income tax assets.

Segment assets are determined after deducting related allowances/ provisions that are reported as direct offsets in the balance sheet of the enterprise.

5.9 Segment liabilities are those operating liabilities that result from the operating activities of a segment and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.

If the segment result of a segment includes interest expense, its segment liabilities include the related interest-bearing liabilities.

Segment liabilities do not include income tax liabilities.

5.10 Segment accounting policies are the accounting policies adopted for preparing and presenting the financial statements of the enterprise as well as those accounting policies that relate specifically to segment reporting.

6. The factors in paragraph 5 for identifying business segments and geographical segments are not listed in any particular order.

7. A single business segment does not include products and services with significantly differing risks and returns. While there may be dissimilarities with respect to one or several of the factors listed in the definition of business segment, the products and services included in a single business segment are expected to be similar with respect to a majority of the factors.

8. Similarly, a single geographical segment does not include operations in economic environments with significantly differing risks and returns. A geographical segment may be a single country, a group of two or more countries, or a region within a country.

9. The risks and returns of an enterprise are influenced both by the geographical location of its operations (where its products are produced or where its service rendering activities are based) and also by the location of its customers (where its products are sold or services are rendered). The definition allows geographical segments to be based on either:

(a) the location of production or service facilities and other assets of an enterprise;
or

(b) the location of its customers.

10. The organisational and internal reporting structure of an enterprise will normally provide evidence of whether its dominant source of geographical risks results from the location of its assets (the origin of its sales) or the location of its customers (the destination of its sales). Accordingly, an enterprise looks to this structure to determine whether its geographical segments should be based on the location of its assets or on the location of its customers.

11. Determining the composition of a business or geographical segment involves a certain amount of judgement. In making that judgement, enterprise management takes into account the objective of reporting financial information by segment as set forth in this Standard and the qualitative characteristics of financial statements as identified in the Framework for the Preparation and Presentation of Financial Statements issued by the Institute of Chartered Accountants of India. The qualitative characteristics include the relevance, reliability, and comparability over time of financial information that is reported about the different groups of products and services of an enterprise and about its operations in particular geographical areas, and the usefulness of that information for assessing the risks and returns of the enterprise as a whole.

12. The predominant sources of risks affect how most enterprises are organised and managed. Therefore, the organisational structure of an enterprise and its internal financial reporting system are normally the basis for identifying its segments.

13. The definitions of segment revenue, segment expense, segment assets and segment liabilities include amounts of such items that are directly attributable to a segment and amounts of such items that can be allocated to a segment on a reasonable basis. An enterprise looks to its internal financial reporting system as the starting point for identifying those items that can be directly attributed, or reasonably allocated, to segments. There is thus a presumption that amounts that have been identified with segments for internal financial reporting purposes are directly attributable or reasonably allocable to segments for the purpose of measuring the segment revenue, segment expense, segment assets, and segment liabilities of reportable segments.

14. In some cases, however, a revenue, expense, asset or liability may have been allocated to segments for internal financial reporting purposes on a basis that is understood by enterprise management but that could be deemed arbitrary in the perception of external

users of financial statements. Such an allocation would not constitute a reasonable basis under the definitions of segment revenue, segment expense, segment assets, and segment liabilities in this Statement. Conversely, an enterprise may choose not to allocate some item of revenue, expense, asset or liability for internal financial reporting purposes, even though a reasonable basis for doing so exists. Such an item is allocated pursuant to the definitions of segment revenue, segment expense, segment assets, and segment liabilities in this Standard.

15. Examples of segment assets include current assets that are used in the operating activities of the segment and tangible and intangible fixed assets. If a particular item of depreciation or amortisation is included in segment expense, the related asset is also included in segment assets. Segment assets do not include assets used for general enterprise or head-office purposes. Segment assets include operating assets shared by two or more segments if a reasonable basis for allocation exists. Segment assets include goodwill that is directly attributable to a segment or that can be allocated to a segment on a reasonable basis, and segment expense includes related amortisation of goodwill. If segment assets have been revalued subsequent to acquisition, then the measurement of segment assets reflects those revaluations.

16. Examples of segment liabilities include trade and other payables, accrued liabilities, customer advances, product warranty provisions, and other claims relating to the provision of goods and services. Segment liabilities do not include borrowings and other liabilities that are incurred for financing rather than operating purposes. The liabilities of segments whose operations are not primarily of a financial nature do not include borrowings and similar liabilities because segment result represents an operating, rather than a net-of-financing, profit or loss. Further, because debt is often issued at the head-office level on an enterprise-wide basis, it is often not possible to directly attribute, or reasonably allocate, the interest-bearing liabilities to segments.

17. Segment revenue, segment expense, segment assets and segment liabilities are determined before intra-enterprise balances and intra-enterprise transactions are eliminated as part of the process of preparation of enterprise financial statements, except to the extent that such intra-enterprise balances and transactions are within a single segment.

18. While the accounting policies used in preparing and presenting the financial statements of the enterprise as a whole are also the fundamental segment accounting policies, segment accounting policies include, in addition, policies that relate specifically to segment reporting, such as identification of segments, method of pricing inter-segment transfers, and basis for allocating revenues and expenses to segments.

Identifying Reportable Segments

Primary and Secondary Segment Reporting Formats

19. The dominant source and nature of risks and returns of an enterprise should govern whether its primary segment reporting format will be business segments or geographical segments. If the risks and returns of an enterprise are affected

predominantly by differences in the products and services it produces, its primary format for reporting segment information should be business segments, with secondary information reported geographically. Similarly, if the risks and returns of the enterprise are affected predominantly by the fact that it operates in different countries or other geographical areas, its primary format for reporting segment information should be geographical segments, with secondary information reported for groups of related products and services.

20. Internal organisation and management structure of an enterprise and its system of internal financial reporting to the board of directors and the chief executive officer should normally be the basis for identifying the predominant source and nature of risks and differing rates of return facing the enterprise and, therefore, for determining which reporting format is primary and which is secondary, except as provided in subparagraphs (a) and (b) below:

- (a) if risks and returns of an enterprise are strongly affected both by differences in the products and services it produces and by differences in the geographical areas in which it operates, as evidenced by a 'matrix approach' to managing the company and to reporting internally to the board of directors and the chief executive officer, then the enterprise should use business segments as its primary segment reporting format and geographical segments as its secondary reporting format; and**
- (b) if internal organisational and management structure of an enterprise and its system of internal financial reporting to the board of directors and the chief executive officer are based neither on individual products or services or groups of related products/services nor on geographical areas, the directors and management of the enterprise should determine whether the risks and returns of the enterprise are related more to the products and services it produces or to the geographical areas in which it operates and should, accordingly, choose business segments or geographical segments as the primary segment reporting format of the enterprise, with the other as its secondary reporting format.**

21. For most enterprises, the predominant source of risks and returns determines how the enterprise is organised and managed. Organisational and management structure of an enterprise and its internal financial reporting system normally provide the best evidence of the predominant source of risks and returns of the enterprise for the purpose of its segment reporting. Therefore, except in rare circumstances, an enterprise will report segment information in its financial statements on the same basis as it reports internally to top management. Its predominant source of risks and returns becomes its primary segment reporting format. Its secondary source of risks and returns becomes its secondary segment reporting format.

22. A 'matrix presentation' — both business segments and geographical segments as primary segment reporting formats with full segment disclosures on each basis -- will often provide useful information if risks and returns of an enterprise are strongly affected both

by differences in the products and services it produces and by differences in the geographical areas in which it operates. This Standard does not require, but does not prohibit, a 'matrix presentation'.

23. In some cases, organisation and internal reporting of an enterprise may have developed along lines unrelated to both the types of products and services it produces, and the geographical areas in which it operates. In such cases, the internally reported segment data will not meet the objective of this Standard. Accordingly, paragraph 20(b) requires the directors and management of the enterprise to determine whether the risks and returns of the enterprise are more product/service driven or geographically driven and to accordingly choose business segments or geographical segments as the primary basis of segment reporting. The objective is to achieve a reasonable degree of comparability with other enterprises, enhance understandability of the resulting information, and meet the needs of investors, creditors, and others for information about product/service-related and geographically-related risks and returns.

Business and Geographical Segments

24. Business and geographical segments of an enterprise for external reporting purposes should be those organisational units for which information is reported to the board of directors and to the chief executive officer for the purpose of evaluating the unit's performance and for making decisions about future allocations of resources, except as provided in paragraph 25.

25. If internal organisational and management structure of an enterprise and its system of internal financial reporting to the board of directors and the chief executive officer are based neither on individual products or services or groups of related products/services nor on geographical areas, paragraph 20(b) requires that the directors and management of the enterprise should choose either business segments or geographical segments as the primary segment reporting format of the enterprise based on their assessment of which reflects the primary source of the risks and returns of the enterprise, with the other as its secondary reporting format. In that case, the directors and management of the enterprise should determine its business segments and geographical segments for external reporting purposes based on the factors in the definitions in paragraph 5 of this Standard, rather than on the basis of its system of internal financial reporting to the board of directors and chief executive officer, consistent with the following:

- (a) if one or more of the segments reported internally to the directors and management is a business segment or a geographical segment based on the factors in the definitions in paragraph 5 but others are not, sub-paragraph (b) below should be applied only to those internal segments that do not meet the definitions in paragraph 5 (that is, an internally reported segment that meets the definition should not be further segmented);***
- (b) for those segments reported internally to the directors and management that do not satisfy the definitions in paragraph 5, management of the enterprise***

should look to the next lower level of internal segmentation that reports information along product and service lines or geographical lines, as appropriate under the definitions in paragraph 5; and

- (c) if such an internally reported lower-level segment meets the definition of business segment or geographical segment based on the factors in paragraph 5, the criteria in paragraph 27 for identifying reportable segments should be applied to that segment.*

26. Under this Standard, most enterprises will identify their business and geographical segments as the organisational units for which information is reported to the board of the directors (particularly the non-executive directors, if any) and to the chief executive officer (the senior operating decision maker, which in some cases may be a group of several people) for the purpose of evaluating each unit's performance and for making decisions about future allocations of resources. Even if an enterprise must apply paragraph 25 because its internal segments are not along product/service or geographical lines, it will consider the next lower level of internal segmentation that reports information along product and service lines or geographical lines rather than construct segments solely for external reporting purposes. This approach of looking to organisational and management structure of an enterprise and its internal financial reporting system to identify the business and geographical segments of the enterprise for external reporting purposes is sometimes called the 'management approach', and the organisational components for which information is reported internally are sometimes called 'operating segments'.

Reportable Segments

27. A business segment or geographical segment should be identified as a reportable segment if:

- (a) its revenue from sales to external customers and from transactions with other segments is 10 per cent or more of the total revenue, external and internal, of all segments; or*
- (b) its segment result, whether profit or loss, is 10 per cent or more of -*
- (i) the combined result of all segments in profit, or*
- (ii) the combined result of all segments in loss, whichever is greater in absolute amount; or*
- (c) its segment assets are 10 per cent or more of the total assets of all segments.*

28. A business segment or a geographical segment which is not a reportable segment as per paragraph 27, may be designated as a reportable segment despite its size at the discretion of the management of the enterprise. If that segment is not designated as a reportable segment, it should be included as an unallocated reconciling item.

29. If total external revenue attributable to reportable segments constitutes less than 75 per cent of the total enterprise revenue, additional segments should be identified as reportable segments, even if they do not meet the 10 per cent thresholds in

paragraph 27, until at least 75 per cent of total enterprise revenue is included in reportable segments.

30. The 10 per cent thresholds in this Standard are not intended to be a guide for determining materiality for any aspect of financial reporting other than identifying reportable business and geographical segments.

Illustration II attached to this Standard presents an illustration of the determination of reportable segments as per paragraphs 27-29.

31. A segment identified as a reportable segment in the immediately preceding period because it satisfied the relevant 10 per cent thresholds should continue to be a reportable segment for the current period notwithstanding that its revenue, result, and assets all no longer meet the 10 per cent thresholds.

32. If a segment is identified as a reportable segment in the current period because it satisfies the relevant 10 per cent thresholds, preceding-period segment data that is presented for comparative purposes should, unless it is impracticable to do so, be restated to reflect the newly reportable segment as a separate segment, even if that segment did not satisfy the 10 per cent thresholds in the preceding period.

Segment Accounting Policies

33. Segment information should be prepared in conformity with the accounting policies adopted for preparing and presenting the financial statements of the enterprise as a whole.

34. There is a presumption that the accounting policies that the directors and management of an enterprise have chosen to use in preparing the financial statements of the enterprise as a whole are those that the directors and management believe are the most appropriate for external reporting purposes. Since the purpose of segment information is to help users of financial statements better understand and make more informed judgements about the enterprise as a whole, this Standard requires the use, in preparing segment information, of the accounting policies adopted for preparing and presenting the financial statements of the enterprise as a whole. That does not mean, however, that the enterprise accounting policies are to be applied to reportable segments as if the segments were separate stand-alone reporting entities. A detailed calculation done in applying a particular accounting policy at the enterprise-wide level may be allocated to segments if there is a reasonable basis for doing so. Pension calculations, for example, often are done for an enterprise as a whole, but the enterprise-wide figures may be allocated to segments based on salary and demographic data for the segments.

35. This Standard does not prohibit the disclosure of additional segment information that is prepared on a basis other than the accounting policies adopted for the enterprise financial statements provided that (a) the information is reported internally to the board of directors and the chief executive officer for purposes of making decisions about allocating resources to the segment and assessing its performance and (b) the basis of measurement for this additional information is clearly described.

36. Assets and liabilities that relate jointly to two or more segments should be allocated to segments if, and only if, their related revenues and expenses also are allocated to those segments.

37. The way in which asset, liability, revenue, and expense items are allocated to segments depends on such factors as the nature of those items, the activities conducted by the segment, and the relative autonomy of that segment. It is not possible or appropriate to specify a single basis of allocation that should be adopted by all enterprises; nor is it appropriate to force allocation of enterprise asset, liability, revenue, and expense items that relate jointly to two or more segments, if the only basis for making those allocations is arbitrary. At the same time, the definitions of segment revenue, segment expense, segment assets, and segment liabilities are interrelated, and the resulting allocations should be consistent. Therefore, jointly used assets and liabilities are allocated to segments if, and only if, their related revenues and expenses also are allocated to those segments. For example, an asset is included in segment assets if, and only if, the related depreciation or amortisation is included in segment expense.

Disclosure

38. Paragraphs 39-46 specify the disclosures required for reportable segments for primary segment reporting format of an enterprise. Paragraphs 47-51 identify the disclosures required for secondary reporting format of an enterprise. Enterprises are encouraged to make all of the primary-segment disclosures identified in paragraphs 39-46 for each reportable secondary segment although paragraphs 47-51 require considerably less disclosure on the secondary basis. Paragraphs 53-59 address several other segment disclosure matters. Illustration III attached to this Standard illustrates the application of these disclosure standards.

Explanation:

In case, by applying the definitions of 'business segment' and 'geographical segment', it is concluded that there is neither more than one business segment nor more than one geographical segment, segment information as per this Standard is not required to be disclosed. However, the fact that there is only one 'business segment' and 'geographical segment' is disclosed by way of a note.

Primary Reporting Format

39. The disclosure requirements in paragraphs 40-46 should be applied to each reportable segment based on primary reporting format of an enterprise.

40. An enterprise should disclose the following for each reportable segment:

- (a) segment revenue, classified into segment revenue from sales to external customers and segment revenue from transactions with other segments;**
- (b) segment result;**
- (c) total carrying amount of segment assets;**
- (d) total amount of segment liabilities;**

- (e) total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets);**
- (f) total amount of expense included in the segment result for depreciation and amortisation in respect of segment assets for the period; and**
- (g) total amount of significant non-cash expenses, other than depreciation and amortisation in respect of segment assets, that were included in segment expense and, therefore, deducted in measuring segment result.**

41. Paragraph 40 (b) requires an enterprise to report segment result. If an enterprise can compute segment net profit or loss or some other measure of segment profitability other than segment result, without arbitrary allocations, reporting of such amount(s) in addition to segment result is encouraged. If that measure is prepared on a basis other than the accounting policies adopted for the financial statements of the enterprise, the enterprise will include in its financial statements a clear description of the basis of measurement.

42. An example of a measure of segment performance above segment result in the statement of profit and loss is gross margin on sales. Examples of measures of segment performance below segment result in the statement of profit and loss are profit or loss from ordinary activities (either before or after income taxes) and net profit or loss.

43. Accounting Standard 5, 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies' requires that "when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately". Examples of such items include write-downs of inventories, provisions for restructuring, disposals of fixed assets and long-term investments, legislative changes having retrospective application, litigation settlements, and reversal of provisions. An enterprise is encouraged, but not required, to disclose the nature and amount of any items of segment revenue and segment expense that are of such size, nature, or incidence that their disclosure is relevant to explain the performance of the segment for the period. Such disclosure is not intended to change the classification of any such items of revenue or expense from ordinary to extraordinary or to change the measurement of such items. The disclosure, however, does change the level at which the significance of such items is evaluated for disclosure purposes from the enterprise level to the segment level.

44. An enterprise that reports the amount of cash flows arising from operating, investing and financing activities of a segment need not disclose depreciation and amortisation expense and non-cash expenses of such segment pursuant to subparagraphs (f) and (g) of paragraph 40.

45. AS 3, Cash Flow Statements, recommends that an enterprise present a cash flow statement that separately reports cash flows from operating, investing and financing activities. Disclosure of information regarding operating, investing and financing cash flows of each reportable segment is relevant to understanding the enterprise's overall financial

position, liquidity, and cash flows. Disclosure of segment cash flow is, therefore, encouraged, though not required. An enterprise that provides segment cash flow disclosures need not disclose depreciation and amortisation expense and non-cash expenses pursuant to sub-paragraphs (f) and (g) of paragraph 40.

46. An enterprise should present a reconciliation between the information disclosed for reportable segments and the aggregated information in the enterprise financial statements. In presenting the reconciliation, segment revenue should be reconciled to enterprise revenue; segment result should be reconciled to enterprise net profit or loss; segment assets should be reconciled to enterprise assets; and segment liabilities should be reconciled to enterprise liabilities.

Secondary Segment Information

47. Paragraphs 39-46 identify the disclosure requirements to be applied to each reportable segment based on primary reporting format of an enterprise. Paragraphs 48-51 identify the disclosure requirements to be applied to each reportable segment based on secondary reporting format of an enterprise, as follows:

- (a) if primary format of an enterprise is business segments, the required secondary-format disclosures are identified in paragraph 48;
- (b) if primary format of an enterprise is geographical segments based on location of assets (where the products of the enterprise are produced or where its service rendering operations are based), the required secondary-format disclosures are identified in paragraphs 49 and 50;
- (c) if primary format of an enterprise is geographical segments based on the location of its customers (where its products are sold or services are rendered), the required secondary-format disclosures are identified in paragraphs 49 and 51.

48. If primary format of an enterprise for reporting segment information is business segments, it should also report the following information:

- (a) **segment revenue from external customers by geographical area based on the geographical location of its customers, for each geographical segment whose revenue from sales to external customers is 10 per cent or more of enterprise revenue;**
- (b) **the total carrying amount of segment assets by geographical location of assets, for each geographical segment whose segment assets are 10 per cent or more of the total assets of all geographical segments; and**
- (c) **the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets) by geographical location of assets, for each geographical segment whose segment assets are 10 per cent or more of the total assets of all geographical segments.**

49. If primary format of an enterprise for reporting segment information is geographical segments (whether based on location of assets or location of customers),

it should also report the following segment information for each business segment whose revenue from sales to external customers is 10 per cent or more of enterprise revenue or whose segment assets are 10 per cent or more of the total assets of all business segments:

- (a) segment revenue from external customers;*
- (b) the total carrying amount of segment assets; and*
- (c) the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets).*

50. If primary format of an enterprise for reporting segment information is geographical segments that are based on location of assets, and if the location of its customers is different from the location of its assets, then the enterprise should also report revenue from sales to external customers for each customer-based geographical segment whose revenue from sales to external customers is 10 per cent or more of enterprise revenue.

51. If primary format of an enterprise for reporting segment information is geographical segments that are based on location of customers, and if the assets of the enterprise are located in different geographical areas from its customers, then the enterprise should also report the following segment information for each asset-based geographical segment whose revenue from sales to external customers or segment assets are 10 per cent or more of total enterprise amounts:

- (a) the total carrying amount of segment assets by geographical location of the assets; and*
- (b) the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets) by location of the assets.*

Illustrative Segment Disclosures

52. Illustration III attached to this Standard illustrates the disclosures for primary and secondary formats that are required by this Standard.

Other Disclosures

53. In measuring and reporting segment revenue from transactions with other segments, inter-segment transfers should be measured on the basis that the enterprise actually used to price those transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements.

54. Changes in accounting policies adopted for segment reporting that have a material effect on segment information should be disclosed. Such disclosure should include a description of the nature of the change, and the financial effect of the change if it is reasonably determinable.

55. AS 5 requires that changes in accounting policies adopted by the enterprise should be made only if required by statute, or for compliance with an accounting standard, or if it is considered that the change would result in a more appropriate presentation of events or transactions in the financial statements of the enterprise.

56. Changes in accounting policies adopted at the enterprise level that affect segment information are dealt with in accordance with AS 5. AS 5 requires that any change in an accounting policy which has a material effect should be disclosed. The impact of, and the adjustments resulting from, such change, if material, should be shown in the financial statements of the period in which such change is made, to reflect the effect of such change. Where the effect of such change 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.

57. Some changes in accounting policies relate specifically to segment reporting. Examples include changes in identification of segments and changes in the basis for allocating revenues and expenses to segments. Such changes can have a significant impact on the segment information reported but will not change aggregate financial information reported for the enterprise. To enable users to understand the impact of such changes, this Standard requires the disclosure of the nature of the change and the financial effect of the change, if reasonably determinable.

58. An enterprise should indicate the types of products and services included in each reported business segment and indicate the composition of each reported geographical segment, both primary and secondary, if not otherwise disclosed in the financial statements.

59. To assess the impact of such matters as shifts in demand, changes in the prices of inputs or other factors of production, and the development of alternative products and processes on a business segment, it is necessary to know the activities encompassed by that segment. Similarly, to assess the impact of changes in the economic and political environment on the risks and returns of a geographical segment, it is important to know the composition of that geographical segment.

Illustration I

Segment Definition Decision Tree

The purpose of this illustration is to illustrate the application of paragraphs 24-32 of the Accounting Standard.

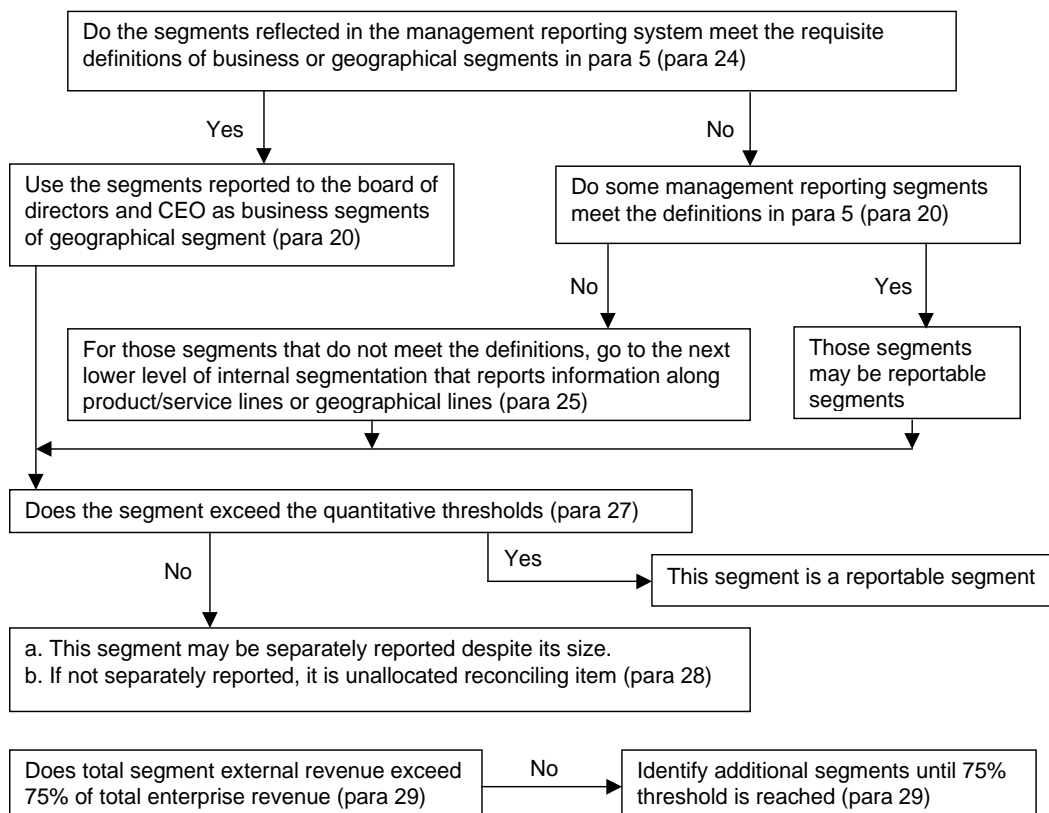


Illustration II

Illustration on Determination of Reportable Segments [Paragraphs 27-29]

This illustration does not form part of the Accounting Standard. Its purpose is to illustrate the application of paragraphs 27-29 of the Accounting Standard.

An enterprise operates through eight segments, namely, A, B, C, D, E, F, G and H. The relevant information about these segments is given in the following table (amounts in ₹'000):

	A	B	C	D	E	F	G	H	Total (Segments)	Total (Enterprise)
1. SEGMENT REVENUE										
(a) External Sales	-	255	15	10	15	50	20	35	400	
(b) Inter-segment Sales	100	60	30	5	-	-	5	-	200	
(c) Total Revenue	100	315	45	15	15	50	25	35	600	400
2. Total Revenue of each segment as a percentage of total revenue of all	16.7	52.5	7.5	2.5	2.5	8.3	4.2	5.8		

segments									
3.SEGMENT RESULT	5	(90)	15	(5)	8	(5)	5	7	
[Profit/(Loss)]									
4. Combined Result of all Segments in profits	5		15		8		5	7	40
5. Combined Result of all Segments in loss		(90)		(5)		(5)			(100)
6. Segment Result as a percentage of the greater of the totals arrived at 4 and 5 above in absolute amount (i.e., 100)	5	90	15	5	8	5	5	7	
7.SEGMENT ASSETS	15	47	5	11	3	5	5	9	100
8. Segment assets as a percentage of total assets of all segments	15	47	5	11	3	5	5	9	

The reportable segments of the enterprise will be identified as below:

(a) In accordance with paragraph 27(a), segments whose total revenue from external sales and inter-segment sales is 10% or more of the total revenue of all segments, external and internal, should be identified as reportable segments. Therefore, Segments A and B are reportable segments.

(b) As per the requirements of paragraph 27(b), it is to be first identified whether the combined result of all segments in profit or the combined result of all segments in loss is greater in absolute amount. From the table, it is evident that combined result in loss (i.e., ₹100,000) is greater. Therefore, the individual segment result as a percentage of ₹ 100,000 needs to be examined. In accordance with paragraph 27(b), Segments B and C are reportable segments as their segment result is more than the threshold limit of 10%.

(c) Segments A, B and D are reportable segments as per paragraph 27(c), as their segment assets are more than 10% of the total segment assets. Thus, Segments A, B, C and D are reportable segments in terms of the criteria laid down in paragraph 27.

Paragraph 28 of the Standard gives an option to the management of the enterprise to designate any segment as a reportable segment. In the given case, it is presumed that the management decides to designate Segment E as a reportable segment.

Paragraph 29 requires that if total external revenue attributable to reportable segments identified as aforesaid constitutes less than 75% of the total enterprise revenue, additional segments should be identified as reportable segments even if they do not meet the 10% thresholds in paragraph 27, until at least 75% of total enterprise revenue is included in reportable segments.

58 Accounting Pronouncements

The total external revenue of Segments A, B, C, D and E, identified above as reportable segments, is ₹ 295,000. This is less than 75% of total enterprise revenue of ₹ 400,000. The management of the enterprise is required to designate any one or more of the remaining segments as reportable segment(s) so that the external revenue of reportable segments is at least 75% of the total enterprise revenue. Suppose, the management designates Segment H for this purpose. Now the external revenue of reportable segments is more than 75% of the total enterprise revenue.

Segments A, B, C, D, E and H are reportable segments. Segments F and G will be shown as reconciling items.

Illustration III

Illustrative Segment Disclosures

This illustration does not form part of the Accounting Standard. Its purpose is to illustrate the application of paragraphs 38-59 of the Accounting Standard.

This illustration illustrates the segment disclosures that this Standard would require for a diversified multi-locational business enterprise. This example is intentionally complex to illustrate most of the provisions of this Standard.

INFORMATION ABOUT BUSINESS SEGMENTS (NOTE XX)

(ALL AMOUNTS IN ₹ LAKHS)

	Paper Products		Office Products		Publishing		Other Operations		Eliminations		Consolidated Total	
	Current Year	Previous Year	Current Year	Previous Year	Current Year	Previous Year	Current Year	Previous Year	Current Year	Previous Year	Current Year	Previous Year
REVENUE												
External sales	55	50	20	17	19	16	7	7				
Inter-segment sales	15	10	10	14	2	4	2	2	(29)	(30)		
Total Revenue	70	60	30	31	21	20	9	9	(29)	(30)	101	90
RESULT												
Segment result	20	17	9	7	2	1	0	0	(1)	(1)	30	24
Unallocated corporate expenses											(7)	(9)
Operating profit											23	15
Interest expense											(4)	(4)
Interest income											2	3
Income taxes											(7)	(4)
Profit from ordinary activities											14	10
Extraordinary loss:												(3)
uninsured earthquake damage to factory			(3)									(3)

Net profit									14	7
OTHER INFORMATION										
Segment assets	54	50	34	30	10	10	10	9	108	99
Unallocated Corporate assets									35	30
Total assets									143	129
Segment liabilities	25	15	8	11	8	8	1	1	42	35
Unallocated liabilities									40	55
Total liabilities									82	90
Capital expenditure	12	10	3	5	5		4	3		
Depreciation	9	7	9	7	5	3	3	4		
Non-cash expenses other than	8	2	7	3	2	2	2	1		

Note xx-Business and Geographical Segments (amounts in ₹ lakhs)

Business segments: For management purposes, the Company is organised on a worldwide basis into three major operating divisions—paper products, office products and publishing — each headed by a senior vice president. The divisions are the basis on which the company reports its primary segment information. The paper products segment produces a broad range of writing and publishing papers and newsprint. The office products segment manufactures labels, binders, pens, and markers and also distributes office products made by others. The publishing segment develops and sells books in the fields of taxation, law and accounting. Other operations include development of computer software for standard and specialised business applications. Financial information about business segments is presented in the above table (from page 314 to page 317).

Geographical segments: Although the Company's major operating divisions are managed on a worldwide basis, they operate in four principal geographical areas of the world. In India, its home country, the Company produces and sells a broad range of papers and office products. Additionally, all of the Company's publishing and computer software development operations are conducted in India. In the European Union, the Company operates paper and office products manufacturing facilities and sales offices in the following countries: France, Belgium, Germany and the U.K. Operations in Canada and the United States are essentially similar and consist of manufacturing papers and newsprint that are sold entirely within those two countries. Operations in Indonesia include the production of paper pulp and the manufacture of writing and publishing papers and office products, almost all of which is sold outside Indonesia, both to other segments of the company and to external customers.

60 Accounting Pronouncements

Sales by market: The following table shows the distribution of the Company's consolidated sales by geographical market, regardless of where the goods were produced:

	Sales Revenue by Geographical Market	
	<i>Current Year</i>	<i>Previous Year</i>
India	19	22
European Union	30	31
Canada and the United States	28	21
Mexico and South America	6	2
Southeast Asia (principally Japan and Taiwan)	<u>18</u>	<u>14</u>
	<u>101</u>	<u>90</u>

Assets and additions to tangible and intangible fixed assets by geographical area: The following table shows the carrying amount of segment assets and additions to tangible and intangible fixed assets by geographical area in which the assets are located:

	Carrying Amount of Segment Assets		Additions to Fixed Assets and Intangible Assets	
	Current Year	Previous Year	Current Year	Previous Year
India	72	78	8	5
European Union	47	37	5	4
Canada and the United States	34	20	4	3
Indonesia	22	20	7	6
	175	155	24	18

Segment revenue and expense: In India, paper and office products are manufactured in combined facilities and are sold by a combined sales force. Joint revenues and expenses are allocated to the two business segments on a reasonable basis. All other segment revenue and expense are directly attributable to the segments.

Segment assets and liabilities: Segment assets include all operating assets used by a segment and consist principally of operating cash, debtors, inventories and fixed assets, net of allowances and provisions which are reported as direct offsets in the balance sheet. While most such assets can be directly attributed to individual segments, the carrying amount of certain assets used jointly by two or more segments is allocated to the segments on a reasonable basis. Segment liabilities include all operating liabilities and consist principally of creditors and accrued liabilities. Segment assets and liabilities do not include deferred income taxes.

Inter-segment transfers: Segment revenue, segment expenses and segment result include transfers between business segments and between geographical segments. Such transfers

are accounted for at competitive market prices charged to unaffiliated customers for similar goods. Those transfers are eliminated in consolidation.

Unusual item: Sales of office products to external customers in the current year were adversely affected by a lengthy strike of transportation workers in India, which interrupted product shipments for approximately four months. The Company estimates that sales of office products during the four-month period were approximately half of what they would otherwise have been.

Extraordinary loss: As more fully discussed in Note x, the Company incurred an uninsured loss of ₹ 3,00,000 caused by earthquake damage to a paper mill in India during the previous year.

Illustration IV

Summary of Required Disclosure

This illustration does not form part of the Accounting Standard. Its purpose is to summarise the disclosures required by paragraphs 38-59 for each of the three possible primary segment reporting formats.

Figures in parentheses refer to paragraph numbers of the relevant paragraphs in the text.

PRIMARY FORMAT IS BUSINESS SEGMENTS	PRIMARY FORMAT IS GEOGRAPHICAL SEGMENTS BY LOCATION OF ASSETS	PRIMARY FORMAT IS GEOGRAPHICAL SEGMENTS BY LOCATION OF CUSTOMERS
<i>Required Primary Disclosures</i>	<i>Required Primary Disclosures</i>	<i>Required Primary Disclosures</i>
Revenue from external customers by business segment [40(a)]	Revenue from external customers by location of assets [40(a)]	Revenue from external customers by location of customers [40(a)]
Revenue from transactions with other segments by business segment [40(a)]	Revenue from transactions with other segments by location of assets [40(a)]	Revenue from transactions with other segments by location of customers [40(a)]
Segment result by business segment [40(b)]	Segment result by location of assets [40(b)]	Segment result by location of customers [40(b)]
Carrying amount of segment assets by business segment [40(c)]	Carrying amount of segment assets by location of assets [40(c)]	Carrying amount of segment assets by location of customers [40(c)]
Segment liabilities by business segment [40(d)]	Segment liabilities by location of assets [40(d)]	Segment liabilities by location of customers [40(d)]

Cost to acquire tangible and intangible fixed assets by business segment [40(e)]	Cost to acquire tangible and intangible fixed assets by location of assets [40(e)]	Cost to acquire tangible and intangible fixed assets by location of customers [40(e)]
Required Primary Disclosures	Required Primary Disclosures	Required Primary Disclosures
Depreciation and amortisation expense by business segment [40(f)]	Depreciation and amortisation expense by location of assets [40(f)]	Depreciation and amortisation expense by location of customers [40(f)]
Non-cash expenses other than depreciation and amortisation by business segment [40(g)]	Non-cash expenses other than depreciation and amortisation by location of assets [40(g)]	Non-cash expenses other than depreciation and amortisation by location of customers [40(g)]
Reconciliation of revenue, result, assets, and liabilities by business segment [46]	Reconciliation of revenue, result, assets, and liabilities [46]	Reconciliation of revenue, result, assets, and liabilities [46]
Required Secondary Disclosures	Required Secondary Disclosures	Required Secondary Disclosures
Revenue from external customers by location of customers [48]	Revenue from external customers by business segment [49]	Revenue from external customers by business segment [49]
Carrying amount of segment assets by location of assets [48]	Carrying amount of segment assets by business segment [49]	Carrying amount of segment assets by business segment [49]
Cost to acquire tangible and intangible fixed assets by location of assets [48]	Cost to acquire tangible and intangible fixed assets by business segment [49]	Cost to acquire tangible and intangible fixed assets by business segment [49]
	Revenue from external customers by geographical customers if different from location of assets [50]	
PRIMARY FORMAT IS BUSINESS SEGMENTS	PRIMARY FORMAT IS GEOGRAPHICAL SEGMENTS BY LOCATION OF ASSETS	PRIMARY FORMAT IS GEOGRAPHICAL SEGMENTS BY

		LOCATION OF CUSTOMERS
<i>Required Secondary Disclosures</i>	<i>Required Secondary Disclosures</i>	<i>Required Secondary Disclosures</i>
		Carrying amount of segment assets by location of assets if different from location of customers [51]
		Cost to acquire tangible and intangible fixed assets by location of assets if different from location of customers [51]
<i>Other Required Disclosures</i>	<i>Other Required Disclosures</i>	<i>Other Required Disclosures</i>
Basis of pricing inter-segment transfers and any change therein [53]	Basis of pricing inter-segment transfers and any change therein [53]	Basis of pricing inter-segment transfers and any change therein [53]
Changes in segment accounting policies [54]	Changes in segment accounting policies [54]	Changes in segment accounting policies [54]
Types of products and services in each business segment [58]	Types of products and services in each business segment [58]	Types of products and services in each business segment [58]
Composition of each geographical segment [58]	Composition of each geographical segment [58]	Composition of each geographical segment [58]

AS 18* (issued 2000) - Related Party Disclosures

*[This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective, the Preface to the*

*A limited revision to this Standard was made in 2003, pursuant to which paragraph 26 of this Standard was revised and paragraph 27 was added to this Standard.

Statements of Accounting Standards¹ and the 'Applicability of Accounting Standards to Various Entities']

This Accounting Standard is not Mandatory for non-corporate entities falling in Level III.

Objective

The objective of this Standard is to establish requirements for disclosure of:

- (a) related party relationships; and
- (b) transactions between a reporting enterprise and its related parties.

Scope

1. This Standard should be applied in reporting related party relationships and transactions between a reporting enterprise and its related parties. The requirements of this Standard apply to the financial statements of each reporting enterprise as also to consolidated financial statements presented by a holding company.

2. This Standard applies only to related party relationships described in paragraph 3.

3. This Standard deals only with related party relationships described in (a) to (e) below:

- (a) enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise (this includes holding companies, subsidiaries and fellow subsidiaries);
- (b) associates and joint ventures of the reporting enterprise and the investing party or venturer in respect of which the reporting enterprise is an associate or a joint venture;
- (c) individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual;
- (d) key management personnel and relatives of such personnel; and
- (e) enterprises over which any person described in (c) or (d) is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.

4. In the context of this Standard, the following are deemed not to be related parties:

- (a) two companies simply because they have a director in common, notwithstanding paragraph 3(d) or (e) above (unless the director is able to affect the policies of both companies in their mutual dealings);

¹Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material.

- (b) a single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence; and
- (c) the parties listed below, in the course of their normal dealings with an enterprise by virtue only of those dealings (although they may circumscribe the freedom of action of the enterprise or participate in its decision-making process):
 - (i) providers of finance;
 - (ii) trade unions;
 - (iii) public utilities;
 - (iv) government departments and government agencies including government sponsored bodies.

5. Related party disclosure requirements as laid down in this Standard do not apply in circumstances where providing such disclosures would conflict with the reporting enterprise's duties of confidentiality as specifically required in terms of a statute or by any regulator or similar competent authority.

6. In case a statute or a regulator or a similar competent authority governing an enterprise prohibit the enterprise to disclose certain information which is required to be disclosed as per this Standard, disclosure of such information is not warranted. For example, banks are obliged by law to maintain confidentiality in respect of their customers' transactions and this Standard would not override the obligation to preserve the confidentiality of customers' dealings.

7. No disclosure is required in consolidated financial statements in respect of intra-group transactions.

8. Disclosure of transactions between members of a group is unnecessary in consolidated financial statements because consolidated financial statements present information about the holding and its subsidiaries as a single reporting enterprise.

9. No disclosure is required in the financial statements of state-controlled enterprises as regards related party relationships with other state-controlled enterprises and transactions with such enterprises.

Definitions

10. For the purpose of this Standard, the following terms are used with the meanings specified:

10.1 Related party - parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

10.2 Related party transaction - a transfer of resources or obligations between related parties, regardless of whether or not a price is charged.

10.3 Control –

- (a) ownership, directly or indirectly, of more than one half of the voting power of an enterprise, or**
- (b) control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise, or**
- (c) a substantial interest in voting power and the power to direct, by statute or agreement, the financial and/or operating policies of the enterprise.**

10.4 Significant influence - participation in the financial and/or operating policy decisions of an enterprise, but not control of those policies.

10.5 An Associate - an enterprise in which an investing reporting party has significant influence and which is neither a subsidiary nor a joint venture of that party.

10.6 A Joint venture - a contractual arrangement whereby two or more parties undertake an economic activity which is subject to joint control.

10.7 Joint control - the contractually agreed sharing of power to govern the financial and operating policies of an economic activity so as to obtain benefits from it.

10.8 Key management personnel - those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise.

10.9 Relative – in relation to an individual, means the spouse, son, daughter, brother, sister, father and mother who may be expected to influence, or be influenced by, that individual in his/her dealings with the reporting enterprise.

10.10 Holding company - a company having one or more subsidiaries.

10.11 Subsidiary - a company:

- (a) in which another company (the holding company) holds, either by itself and/or through one or more subsidiaries, more than one-half in nominal value of its equity share capital; or**
- (b) of which another company (the holding company) controls, either by itself and/or through one or more subsidiaries, the composition of its board of directors.**

10.12 Fellow subsidiary - a company is considered to be a fellow subsidiary of another company if both are subsidiaries of the same holding company.

10.13 State-controlled enterprise - an enterprise which is under the control of the Central Government and/or any State Government(s).

11. For the purpose of this Standard, an enterprise is considered to control the composition of

- (i) the board of directors of a company, if it has the power, without the consent or concurrence of any other person, to appoint or remove all or a majority of

directors of that company. An enterprise is deemed to have the power to appoint a director if any of the following conditions is satisfied:

- (a) a person cannot be appointed as director without the exercise in his favour by that enterprise of such a power as aforesaid; or
 - (b) a person's appointment as director follows necessarily from his appointment to a position held by him in that enterprise; or
 - (c) the director is nominated by that enterprise; in case that enterprise is a company, the director is nominated by that company/subsidiary thereof.
- (ii) the governing body of an enterprise that is not a company, if it has the power, without the consent or the concurrence of any other person, to appoint or remove all or a majority of members of the governing body of that other enterprise. An enterprise is deemed to have the power to appoint a member if any of the following conditions is satisfied:
- (a) a person cannot be appointed as member of the governing body without the exercise in his favour by that other enterprise of such a power as aforesaid; or
 - (b) a person's appointment as member of the governing body follows necessarily from his appointment to a position held by him in that other enterprise; or
 - (c) the member of the governing body is nominated by that other enterprise.

12. An enterprise is considered to have a substantial interest in another enterprise if that enterprise owns, directly or indirectly, 20 per cent or more interest in the voting power of the other enterprise. Similarly, an individual is considered to have a substantial interest in an enterprise, if that individual owns, directly or indirectly, 20 per cent or more interest in the voting power of the enterprise.

13. Significant influence may be exercised in several ways, for example, by representation on the board of directors, participation in the policy making process, material inter-company transactions, interchange of managerial personnel, or dependence on technical information. Significant influence may be gained by share ownership, statute or agreement. As regards share ownership, if an investing party holds, directly or indirectly through intermediaries, 20 per cent or more of the voting power of the enterprise, it is presumed that the investing party does have significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investing party holds, directly or indirectly through intermediaries, less than 20 per cent of the voting power of the enterprise, it is presumed that the investing party does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investing party does not necessarily preclude an investing party from having significant influence.

Explanation

An intermediary means a subsidiary as defined in AS 21, Consolidated Financial Statements.

14. Key management personnel are those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. For example, in the case of a company, the managing director(s), whole time director(s), manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered key management personnel.

Explanation

A non-executive director of a company is not considered as a key management person under this Standard by virtue of merely his being a director unless he has the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. The requirements of this Standard are not applied in respect of a non-executive director even enterprise, unless he falls in any of the categories in paragraph 3 of this Standard.

The Related Party Issue

15. Related party relationships are a normal feature of commerce and business. For example, enterprises frequently carry on separate parts of their activities through subsidiaries or associates and acquire interests in other enterprises - for investment purposes or for trading reasons - that are of sufficient proportions for the investing enterprise to be able to control or exercise significant influence on the financial and/or operating decisions of its investee.

16. Without related party disclosures, there is a general presumption that transactions reflected in financial statements are consummated on an arm's- length basis between independent parties. However, that presumption may not be valid when related party relationships exist because related parties may enter into transactions which unrelated parties would not enter into. Also, transactions between related parties may not be effected at the same terms and conditions as between unrelated parties. Sometimes, no price is charged in related party transactions, for example, free provision of management services and the extension of free credit on a debt. In view of the aforesaid, the resulting accounting measures may not represent what they usually would be expected to represent. Thus, a related party relationship could have an effect on the financial position and operating results of the reporting enterprise.

17. The operating results and financial position of an enterprise may be affected by a related party relationship even if related party transactions do not occur. The mere existence of the relationship may be sufficient to affect the transactions of the reporting enterprise with other parties. For example, a subsidiary may terminate relations with a trading partner on acquisition by the holding company of a fellow subsidiary engaged in the same trade as the former partner. Alternatively, one party may refrain from acting because of the control or significant influence of another - for example, a subsidiary may be instructed by its holding company not to engage in research and development.

18. Because there is an inherent difficulty for management to determine the effect of influences which do not lead to transactions, disclosure of such effects is not required by this Standard.

19. Sometimes, transactions would not have taken place if the related party relationship had not existed. For example, a company that sold a large proportion of its production to its holding company at cost might not have found an alternative customer if the holding company had not purchased the goods.

Disclosure

20. The statutes governing an enterprise often require disclosure in financial statements of transactions with certain categories of related parties. In particular, attention is focussed on transactions with the directors or similar key management personnel of an enterprise, especially their remuneration and borrowings, because of the fiduciary nature of their relationship with the enterprise.

21. Name of the related party and nature of the related party relationship where control exists should be disclosed irrespective of whether or not there have been transactions between the related parties.

22. Where the reporting enterprise controls, or is controlled by, another party, this information is relevant to the users of financial statements irrespective of whether or not transactions have taken place with that party. This is because the existence of control relationship may prevent the reporting enterprise from being independent in making its financial and/or operating decisions. The disclosure of the name of the related party and the nature of the related party relationship where control exists may sometimes be at least as relevant in appraising an enterprise's prospects as are the operating results and the financial position presented in its financial statements. Such a related party may establish the enterprise's credit standing, determine the source and price of its raw materials, and determine to whom and at what price the product is sold.

23. If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following:

- (i) the name of the transacting related party;**
- (ii) a description of the relationship between the parties;**
- (iii) a description of the nature of transactions;**
- (iv) volume of the transactions either as an amount or as an appropriate proportion;**
- (v) any other elements of the related party transactions necessary for an understanding of the financial statements;**
- (vi) the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date; and**

(vii) amounts written off or written back in the period in respect of debts due from or to related parties.

24. The following are examples of the related party transactions in respect of which disclosures may be made by a reporting enterprise:

- (a) purchases or sales of goods (finished or unfinished);
- (b) purchases or sales of fixed assets;
- (c) rendering or receiving of services;
- (d) agency arrangements;
- (e) leasing or hire purchase arrangements;
- (f) transfer of research and development;
- (g) license agreements;
- (h) finance (including loans and equity contributions in cash or in kind);
- (i) guarantees and collaterals; and
- (j) management contracts including for deputation of employees.

25. Paragraph 23 (v) requires disclosure of 'any other elements of the related party transactions necessary for an understanding of the financial statements'. An example of such a disclosure would be an indication that the transfer of a major asset had taken place at an amount materially different from that obtainable on normal commercial terms.

26. Items of a similar nature may be disclosed in aggregate by type of related party except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the reporting enterprise.

Explanation:

Type of related party means each related party relationship described in paragraph 3 above.

27. Disclosure of details of particular transactions with individual related parties would frequently be too voluminous to be easily understood. Accordingly, items of a similar nature may be disclosed in aggregate by type of related party. However, this is not done in such a way as to obscure the importance of significant transactions. Hence, purchases or sales of goods are not aggregated with purchases or sales of fixed assets. Nor a material related party transaction with an individual party is clubbed in an aggregated disclosure.

Explanation:

(a) Materiality primarily depends on the facts and circumstances of each case. In deciding whether an item or an aggregate of items is material, the nature and the size of the item(s) are evaluated together. Depending on the circumstances, either the nature or the size of the item could be the determining factor. As regards size, for the purpose of applying the test of materiality as per this paragraph, ordinarily a related party transaction, the amount of which is in excess of 10% of the total related party transactions of the same type (such as purchase of goods), is considered material, unless on the basis of facts and circumstances of the case it can be concluded that even a transaction of less than 10% is

material. As regards nature, ordinarily the related party transactions which are not entered into in the normal course of the business of the reporting enterprise are considered material subject to the facts and circumstances of the case.

(b) The manner of disclosure required by paragraph 23, read with paragraph 26, is illustrated in the Illustration attached to the Standard.

Illustration

Note: This illustration does not form part of the Accounting Standard. Its purpose is to assist in clarifying the meaning of the Accounting Standard.

The manner or disclosures required by paragraphs 23 and 26 of AS 18 is illustrated as below. It may be noted that the format given below is merely illustrative in nature and is not exhaustive.

	<i>Holding Company</i>	<i>Subsidiaries</i>	<i>Fellow Subsidiaries</i>	<i>Associates</i>	<i>Key Management Personnel</i>	<i>Relatives Total of Key Management Personnel</i>
Purchases of goods						
Sale of goods						
Purchase of fixed assets						
Sale of fixed assets						
Rendering of services						
Receiving of services						
Agency arrangements						
Leasing or hire purchase arrangements						
Transfer of research and development						
License agreements						
Finance (including loans and equity contributions in cash or in kind)						
Guarantees and collaterals						
Management contracts including for deputation of employees						

Note:**Name of related parties and description of relationship:**

1.	Holding Company	A Ltd.
2.	Subsidiaries	B Ltd. and C (P) Ltd.
3.	Fellow Subsidiaries	D Ltd. and Q Ltd.
4.	Associates	X Ltd., Y Ltd. and Z (P) Ltd.
5.	Key Management Personnel	Mr. Y and Mr. Z
6.	Relatives of Key Management Personnel	Mrs. Y (wife of Mr. Y), Mr. F (father of Mr. Z)

AS 19¹: Leases

*[This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective, the Preface to the Statements of Accounting Standards¹ and the 'Applicability of Accounting Standards to Various Entities'.]*

Objective

The objective of this Standard is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosures in relation to finance leases and operating leases.

Scope

1. ***This Standard should be applied in accounting for all leases other than:***
 - (a) ***lease agreements to explore for or use natural resources, such as oil, gas, timber, metals and other mineral rights; and***
 - (b) ***licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights; and***
 - (c) ***lease agreements to use lands.***
2. This Standard applies to agreements that transfer the right to use assets even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets. On the other hand, this Standard does not apply to agreements that are contracts for services that do not transfer the right to use assets from one contracting party to the other.

¹Issued in 2001

¹Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material.

Definitions

3. The following terms are used in this Standard with the meanings specified:

3.1 A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

3.2 A finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset.

3.3 An operating lease is a lease other than a finance lease.

3.4 A non-cancellable lease is a lease that is cancellable only:

(a) upon the occurrence of some remote contingency; or

(b) with the permission of the lessor; or

(c) if the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or

(d) upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain.

3.5 The inception of the lease is the earlier of the date of the lease agreement and the date of a commitment by the parties to the principal provisions of the lease.

3.6 The lease term is the non-cancellable period for which the lessee has agreed to take on lease the asset together with any further periods for which the lessee has the option to continue the lease of the asset, with or without further payment, which option at the inception of the lease it is reasonably certain that the lessee will exercise.

3.7 Minimum lease payments are the payments over the lease term that the lessee is, or can be required, to make excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor, together with:

(a) in the case of the lessee, any residual value guaranteed by or on behalf of the lessee; or

(b) in the case of the lessor, any residual value guaranteed to the lessor:

(i) by or on behalf of the lessee; or

(ii) by an independent third party financially capable of meeting this guarantee.

However, if the lessee has an option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable that, at the inception of the lease, is reasonably certain to be exercised, the minimum lease payments comprise minimum payments payable over the lease term and the payment required to exercise this purchase option.

3.8 Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction.

3.9 Economic life is either:

- (a) the period over which an asset is expected to be economically usable by one or more users; or**
- (b) the number of production or similar units expected to be obtained from the asset by one or more users.**

3.10 Useful life of a leased asset is either:

- (a) the period over which the leased asset is expected to be used by the lessee; or**
- (b) the number of production or similar units expected to be obtained from the use of the asset by the lessee.**

3.11 Residual value of a leased asset is the estimated fair value of the asset at the end of the lease term.

3.12 Guaranteed residual value is:

- (a) in the case of the lessee, that part of the residual value which is guaranteed by the lessee or by a party on behalf of the lessee (the amount of the guarantee being the maximum amount that could, in any event, become payable); and**
- (b) in the case of the lessor, that part of the residual value which is guaranteed by or on behalf of the lessee, or by an independent third party who is financially capable of discharging the obligations under the guarantee.**

3.13 Unguaranteed residual value of a leased asset is the amount by which the residual value of the asset exceeds its guaranteed residual value.

3.14 Gross investment in the lease is the aggregate of the minimum lease payments under a finance lease from the standpoint of the lessor and any unguaranteed residual value accruing to the lessor.

3.15 Unearned finance income is the difference between:

- (a) the gross investment in the lease; and**
- (b) the present value of
 - (i) the minimum lease payments under a finance lease from the standpoint of the lessor; and**
 - (ii) any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.****

3.16 Net investment in the lease is the gross investment in the lease less unearned finance income.

3.17 The interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of

- (a) the minimum lease payments under a finance lease from the standpoint of the lessor; and**

(b) any unguaranteed residual value accruing to the lessor, to be equal to the fair value of the leased asset.

3.18 The lessee's incremental borrowing rate of interest is the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.

3.19 Contingent rent is that portion of the lease payments that is not fixed in amount but is based on a factor other than just the passage of time (e.g., percentage of sales, amount of usage, price indices, market rates of interest).

4. The definition of a lease includes agreements for the hire of an asset which contain a provision giving the hirer an option to acquire title to the asset upon the fulfillment of agreed conditions. These agreements are commonly known as hire purchase agreements. Hire purchase agreements include agreements under which the property in the asset is to pass to the hirer on the payment of the last instalment and the hirer has a right to terminate the agreement at any time before the property so passes.

Classification of Leases

5. The classification of leases adopted in this Standard is based on the extent to which risks and rewards incident to ownership of a leased asset lie with the lessor or the lessee. Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return due to changing economic conditions. Rewards may be represented by the expectation of profitable operation over the economic life of the asset and of gain from appreciation in value or realisation of residual value.

6. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. Title may or may not eventually be transferred. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incident to ownership.

7. Since the transaction between a lessor and a lessee is based on a lease agreement common to both parties, it is appropriate to use consistent definitions. The application of these definitions to the differing circumstances of the two parties may sometimes result in the same lease being classified differently by the lessor and the lessee.

8. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than its form. Examples of situations which would normally lead to a lease being classified as a finance lease are:

- (a) the lease transfers ownership of the asset to the lessee by the end of the lease term;
- (b) the lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised;

- (c) the lease term is for the major part of the economic life of the asset even if title is not transferred;
 - (d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and
 - (e) the leased asset is of a specialised nature such that only the lessee can use it without major modifications being made.
9. Indicators of situations which individually or in combination could also lead to a lease being classified as a finance lease are:
- (a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;
 - (b) gains or losses from the fluctuation in the fair value of the residual fall to the lessee (for example in the form of a rent rebate equaling most of the sales proceeds at the end of the lease); and
 - (c) the lessee can continue the lease for a secondary period at a rent which is substantially lower than market rent.
10. Lease classification is made at the inception of the lease. If at any time the lessee and the lessor agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification of the lease under the criteria in paragraphs 5 to 9 had the changed terms been in effect at the inception of the lease, the revised agreement is considered as a new agreement over its revised term. Changes in estimates (for example, changes in estimates of the economic life or of the residual value of the leased asset) or changes in circumstances (for example, default by the lessee), however, do not give rise to a new classification of a lease for accounting purposes.

Leases in the Financial Statements of Lessees

Finance Leases

11. At the inception of a finance lease, the lessee should recognise the lease as an asset and a liability. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of the lease. However, if the fair value of the leased asset exceeds the present value of the minimum lease payments from the standpoint of the lessee, the amount recorded as an asset and a liability should be the present value of the minimum lease payments from the standpoint of the lessee. In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease, if this is practicable to determine; if not, the lessee's incremental borrowing rate should be used.

Example

- (a) An enterprise (the lessee) acquires a machinery on lease from a leasing company (the lessor) on January 1, 20X0. The lease term covers the entire economic life of the machinery, i.e., 3 years. The fair value of the machinery on January 1, 20X0 is ₹ 2,35,500. The lease agreement requires the lessee to pay an amount of

₹ 1,00,000 per year beginning December 31, 20X0. The lessee has guaranteed a residual value of ₹ 17,000 on December 31, 20X2 to the lessor. The lessor, however, estimates that the machinery would have a salvage value of only ₹ 3,500 on December 31, 20X2.

The interest rate implicit in the lease is 16 per cent (approx.). This is calculated using the following formula:

$$\text{Fair value} = \frac{\text{ALR}}{(1+r)^1} + \frac{\text{ALR}}{(1+r)^2} + \dots + \frac{\text{ALR}}{(1+r)^n} + \frac{\text{RV}}{(1+r)^n}$$

where ALR is annual lease rental,

RV is residual value (both guaranteed and unguaranteed),

n is the lease term,

r is interest rate implicit in the lease.

The present value of minimum lease payments from the stand point of the lessee is ₹ 2,35,500.

The lessee would record the machinery as an asset at ₹ 2,35,500 with a corresponding liability representing the present value of lease payments over the lease term (including the guaranteed residual value).

- (b) In the above example, suppose the lessor estimates that the machinery would have a salvage value of ₹ 17,000 on December 31, 20X2. The lessee, however, guarantees a residual value of ₹ 5,000 only.

The interest rate implicit in the lease in this case would remain unchanged at 16% (approx.). The present value of the minimum lease payments from the standpoint of the lessee, using this interest rate implicit in the lease, would be ₹ 2,27,805. As this amount is lower than the fair value of the leased asset (₹ 2,35,500), the lessee would recognise the asset and the liability arising from the lease at ₹ 2,27,805.

In case the interest rate implicit in the lease is not known to the lessee, the present value of the minimum lease payments from the standpoint of the lessee would be computed using the lessee's incremental borrowing rate.

12. Transactions and other events are accounted for and presented in accordance with their substance and financial reality and not merely with their legal form. While the legal form of a lease agreement is that the lessee may acquire no legal title to the leased asset, in the case of finance leases the substance and financial reality are that the lessee acquires the economic benefits of the use of the leased asset for the major part of its economic life in return for entering into an obligation to pay for that right an amount approximating to the fair value of the asset and the related finance charge.

13. If such lease transactions are not reflected in the lessee's balance sheet, the economic resources and the level of obligations of an enterprise are understated thereby distorting financial ratios. It is therefore appropriate that a finance lease be recognised in the lessee's

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balance sheet both as an asset and as an obligation to pay future lease payments. At the inception of the lease, the asset and the liability for the future lease payments are recognised in the balance sheet at the same amounts.

14. It is not appropriate to present the liability for a leased asset as a deduction from the leased asset in the financial statements. The liability for a leased asset should be presented separately in the balance sheet as a current liability or a long-term liability as the case may be.

15. Initial direct costs are often incurred in connection with specific leasing activities, as in negotiating and securing leasing arrangements. The costs identified as directly attributable to activities performed by the lessee for a finance lease are included as part of the amount recognised as an asset under the lease.

16. Lease payments should be apportioned between the finance charge and the reduction of the outstanding liability. The finance charge should be allocated to periods during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

Example

In the example (a) illustrating paragraph 11, the lease payments would be apportioned by the lessee between the finance charge and the reduction of the outstanding liability as follows:

	Year	Finance charge (₹)	Payment (₹)	Reduction in outstanding liability (₹)	Outstanding liability (₹)
Year 1	(January 1)				2,35,500
	(December 31)	37,680	1,00,000	62,320	1,73,180
Year 2	(December 31)	27,709	1,00,000	72,291	1,00,889
Year 3	(December 31)	16,142	1,00,000	83,858	17,031*

17. In practice, in allocating the finance charge to periods during the lease term, some form of approximation may be used to simplify the calculation.

18. A finance lease gives rise to a depreciation expense for the asset as well as a finance expense for each accounting period. The depreciation policy for a leased asset should be consistent with that for depreciable assets which are owned, and the depreciation recognised should be calculated on the basis set out in Accounting Standard (AS) 6, Depreciation Accounting. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset should be fully depreciated over the lease term or its useful life, whichever is shorter.

*The difference between this figure and guaranteed residual value (₹17,000) is due to approximation in computing the interest rate implicit in the lease.

19. The depreciable amount of a leased asset is allocated to each accounting period during the period of expected use on a systematic basis consistent with the depreciation policy the lessee adopts for depreciable assets that are owned. If there is reasonable certainty that the lessee will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset; otherwise the asset is depreciated over the lease term or its useful life, whichever is shorter.

20. The sum of the depreciation expense for the asset and the finance expense for the period is rarely the same as the lease payments payable for the period, and it is, therefore, inappropriate simply to recognise the lease payments payable as an expense in the statement of profit and loss. Accordingly, the asset and the related liability are unlikely to be equal in amount after the inception of the lease.

21. To determine whether a leased asset has become impaired, an enterprise applies the Accounting Standard dealing with impairment of assets⁴, that sets out the requirements as to how an enterprise should perform the review of the carrying amount of an asset, how it should determine the recoverable amount of an asset and when it should recognise, or reverse, an impairment loss.

22. The lessee should, in addition to the requirements of AS 10, Accounting for Fixed Assets, AS 6, Depreciation Accounting, and the governing statute, make the following disclosures for finance leases:

- (a) assets acquired under finance lease as segregated from the assets owned;**
- (b) for each class of assets, the net carrying amount at the balance sheet date;**
- (c) a reconciliation between the total of minimum lease payments at the balance sheet date and their present value. In addition, an enterprise should disclose the total of minimum lease payments at the balance sheet date, and their present value, for each of the following periods:**
 - (i) not later than one year;**
 - (ii) later than one year and not later than five years; (iii) later than five years;**
- (d) contingent rents recognised as expense in the statement of profit and loss for the period;**
- (e) the total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date; and**
- (f) a general description of the lessee's significant leasing arrangements including, but not limited to, the following:**
 - (i) the basis on which contingent rent payments are determined;**

⁴Accounting Standard (AS) 28, 'Impairment of Assets,' specifies the requirements relating to impairment of assets.

- (ii) the existence and terms of renewal or purchase options and escalation clauses; and*
- (iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.*

Provided that a Small and Medium Sized Company and a Small and Medium Sized Enterprise (Levels II and III non-corporate entities), may not comply with subparagraphs (c), (e) and (f).

Operating Leases

23. Lease payments under an operating lease should be recognised as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

24. For operating leases, lease payments (excluding costs for services such as insurance and maintenance) are recognised as an expense in the statement of profit and loss on a straight line basis unless another systematic basis is more representative of the time pattern of the user's benefit, even if the payments are not on that basis.

25. The lessee should make the following disclosures for operating leases:

(a) the total of future minimum lease payments under non-cancellable operating leases for each of the following periods:

- (i) not later than one year;*
- (ii) later than one year and not later than five years;*
- (iii) later than five years;*

(b) the total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date;

(c) lease payments recognised in the statement of profit and loss for the period, with separate amounts for minimum lease payments and contingent rents;

(d) sub-lease payments received (or receivable) recognised in the statement of profit and loss for the period;

(e) a general description of the lessee's significant leasing arrangements including, but not limited to, the following:

- (i) the basis on which contingent rent payments are determined;*
- (ii) the existence and terms of renewal or purchase options and escalation clauses; and*
- (iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.*

Provided that a Small and Medium Sized Company and a Small and Medium Sized Enterprise (Levels II and III non-corporate entities), may not comply with subparagraphs (a), (b) and (e).

Leases in the Financial Statements of Lessors

Finance Leases

26. The lessor should recognise assets given under a finance lease in its balance sheet as a receivable at an amount equal to the net investment in the lease.

27. Under a finance lease substantially all the risks and rewards incident to legal ownership are transferred by the lessor, and thus the lease payment receivable is treated by the lessor as repayment of principal, i.e., net investment in the lease, and finance income to reimburse and reward the lessor for its investment and services.

28. The recognition of finance income should be based on a pattern reflecting a constant periodic rate of return on the net investment of the lessor outstanding in respect of the finance lease.

29. A lessor aims to allocate finance income over the lease term on a systematic and rational basis. This income allocation is based on a pattern reflecting a constant periodic return on the net investment of the lessor outstanding in respect of the finance lease. Lease payments relating to the accounting period, excluding costs for services, are reduced from both the principal and the unearned finance income.

30. Estimated unguaranteed residual values used in computing the lessor's gross investment in a lease are reviewed regularly. If there has been a reduction in the estimated unguaranteed residual value, the income allocation over the remaining lease term is revised and any reduction in respect of amounts already accrued is recognised immediately. An upward adjustment of the estimated residual value is not made.

31. Initial direct costs, such as commissions and legal fees, are often incurred by lessors in negotiating and arranging a lease. For finance leases, these initial direct costs are incurred to produce finance income and are either recognised immediately in the statement of profit and loss or allocated against the finance income over the lease term.

32. The manufacturer or dealer lessor should recognise the transaction of sale in the statement of profit and loss for the period, in accordance with the policy followed by the enterprise for outright sales. If artificially low rates of interest are quoted, profit on sale should be restricted to that which would apply if a commercial rate of interest were charged. Initial direct costs should be recognised as an expense in the statement of profit and loss at the inception of the lease.

33. Manufacturers or dealers may offer to customers the choice of either buying or leasing an asset. A finance lease of an asset by a manufacturer or dealer lessor gives rise to two types of income:

- (a) the profit or loss equivalent to the profit or loss resulting from an outright sale of the asset being leased, at normal selling prices, reflecting any applicable volume or trade discounts; and
- (b) the finance income over the lease term.

34. The sales revenue recorded at the commencement of a finance lease term by a manufacturer or dealer lessor is the fair value of the asset. However, if the present value of the minimum lease payments accruing to the lessor computed at a commercial rate of interest is lower than the fair value, the amount recorded as sales revenue is the present value so computed. The cost of sale recognised at the commencement of the lease term is the cost, or carrying amount if different, of the leased asset less the present value of the unguaranteed residual value. The difference between the sales revenue and the cost of sale is the selling profit, which is recognised in accordance with the policy followed by the enterprise for sales.

35. Manufacturer or dealer lessors sometimes quote artificially low rates of interest in order to attract customers. The use of such a rate would result in an excessive portion of the total income from the transaction being recognised at the time of sale. If artificially low rates of interest are quoted, selling profit would be restricted to that which would apply if a commercial rate of interest were charged.

36. Initial direct costs are recognised as an expense at the commencement of the lease term because they are mainly related to earning the manufacturer's or dealer's selling profit.

37. The lessor should make the following disclosures for finance leases:

- (a) a reconciliation between the total gross investment in the lease at the balance sheet date, and the present value of minimum lease payments receivable at the balance sheet date. In addition, an enterprise should disclose the total gross investment in the lease and the present value of minimum lease payments receivable at the balance sheet date, for each of the following periods:**
 - (i) not later than one year;**
 - (ii) later than one year and not later than five years;**
 - (iii) later than five years;**
- (b) unearned finance income;**
- (c) the unguaranteed residual values accruing to the benefit of the lessor;**
- (d) the accumulated provision for uncollectible minimum lease payments receivable;**
- (e) contingent rents recognised in the statement of profit and loss for the period;**
- (f) a general description of the significant leasing arrangements of the lessor; and**
- (g) accounting policy adopted in respect of initial direct costs.**

Provided that a Small and Medium Sized Company and a non-corporate Small and Medium Sized Enterprise falling in Level II and Level III may not comply with sub-paragraphs (a) and (f). Further, a non-corporate Small and Medium Sized Enterprise falling in Level III, may not comply with sub-paragraph (g) also.

38. As an indicator of growth it is often useful to also disclose the gross investment less unearned income in new business added during the accounting period, after deducting the relevant amounts for cancelled leases.

Operating Leases

39. The lessor should present an asset given under operating lease in its balance sheet under fixed assets.

40. Lease income from operating leases should be recognised in the statement of profit and loss on a straight line basis over the lease term, unless another systematic basis is more representative of the time pattern in which benefit derived from the use of the leased asset is diminished.

41. Costs, including depreciation, incurred in earning the lease income are recognised as an expense. Lease income (excluding receipts for services provided such as insurance and maintenance) is recognised in the statement of profit and loss on a straight line basis over the lease term even if the receipts are not on such a basis, unless another systematic basis is more representative of the time pattern in which benefit derived from the use of the leased asset is diminished.

42. Initial direct costs incurred specifically to earn revenues from an operating lease are either deferred and allocated to income over the lease term in proportion to the recognition of rent income, or are recognised as an expense in the statement of profit and loss in the period in which they are incurred.

43. The depreciation of leased assets should be on a basis consistent with the normal depreciation policy of the lessor for similar assets, and the depreciation charge should be calculated on the basis set out in AS 6, Depreciation Accounting.

44. To determine whether a leased asset has become impaired, an enterprise applies the Accounting Standard dealing with impairment of assets⁵ that sets out the requirements for how an enterprise should perform the review of the carrying amount of an asset, how it should determine the recoverable amount of an asset and when it should recognise, or reverse, an impairment loss.

45. A manufacturer or dealer lessor does not recognise any selling profit on entering into an operating lease because it is not the equivalent of a sale.

46. The lessor should, in addition to the requirements of AS 6, Depreciation Accounting and AS 10, Accounting for Fixed Assets, and the governing statute, make the following disclosures for operating leases:

- (a) for each class of assets, the gross carrying amount, the accumulated depreciation and accumulated impairment losses at the balance sheet date; and**

⁵Accounting Standard (AS) 28, 'Impairment of Assets', specifies the requirements relating to impairment of assets.

- (i) the depreciation recognised in the statement of profit and loss for the period;*
- (ii) impairment losses recognised in the statement of profit and loss for the period;*
- (iii) impairment losses reversed in the statement of profit and loss for the period;*
- (b) the future minimum lease payments under non-cancellable operating leases in the aggregate and for each of the following periods:*
 - (i) not later than one year;*
 - (ii) later than one year and not later than five years;*
 - (iii) later than five years;*
- (c) total contingent rents recognised as income in the statement of profit and loss for the period;*
- (d) a general description of the lessor 's significant leasing arrangements; and*
- (e) accounting policy adopted in respect of initial direct costs.*

Provided that a Small and Medium Sized Company and a non-corporate Small and Medium Sized Enterprise falling in Level II and Level III, may not comply with sub-paragraphs (b) and (d). Further, a non-corporate Small and Medium Sized Enterprise falling in Level III, may not comply with sub-paragraph (e) also.

Sale and Leaseback Transactions

47. A sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the same asset back to the vendor. The lease payments and the sale price are usually interdependent as they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends upon the type of lease involved.

48. If a sale and leaseback transaction results in a finance lease, any excess or deficiency of sales proceeds over the carrying amount should not be immediately recognised as income or loss in the financial statements of a seller-lessee. Instead, it should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

49. If the leaseback is a finance lease, it is not appropriate to regard an excess of sales proceeds over the carrying amount as income. Such excess is deferred and amortised over the lease term in proportion to the depreciation of the leased asset. Similarly, it is not appropriate to regard a deficiency as loss. Such deficiency is deferred and amortised over the lease term.

50. If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately. If the sale price is below fair value, any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to

the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

51. If the leaseback is an operating lease, and the lease payments and the sale price are established at fair value, there has in effect been a normal sale transaction and any profit or loss is recognised immediately.

52. For operating leases, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value should be recognised immediately.

53. For finance leases, no such adjustment is necessary unless there has been an impairment in value, in which case the carrying amount is reduced to recoverable amount in accordance with the Accounting Standard dealing with impairment of assets.

54. Disclosure requirements for lessees and lessors apply equally to sale and leaseback transactions. The required description of the significant leasing arrangements leads to disclosure of unique or unusual provisions of the agreement or terms of the sale and leaseback transactions.

55. Sale and leaseback transactions may meet the separate disclosure criteria set out in paragraph 12 of Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

Illustration

Sale and Leaseback Transactions that Result in Operating Leases

The illustration does not form part of the accounting standard. Its purpose is to illustrate the application of the accounting standard.

A sale and leaseback transaction that results in an operating lease may give rise to profit or a loss, the determination and treatment of which depends on the leased asset's carrying amount, fair value and selling price. The following table shows the requirements of the accounting standard in various circumstances.

Sale price established at fair value (paragraph 50)	Carrying amount equal to fair value	Carrying amount less than fair value	Carrying amount above fairvalue
Profit	No profit	Recognise profit immediately	Not applicable
Loss	No loss	Not applicable	Recognise loss immediately
Sale price below fair value (paragraph 50)			

Profit	No profit	Recognise profit immediately	No profit (note 1)
Loss not compensated by future lease payments at below market price	Recognise loss immediately	Recognise loss immediately	(note 1)
Loss compensated by future lease payments at below market price	Defer and amortise loss	Defer and amortise loss	(note 1)
Sale price above fair value (paragraph 50)			
Profit	Defer and amortise profit	Defer and amortise profit	Defer and amortise profit (note 2)
Loss	No loss	No loss	(note 1)

Note 1 These parts of the table represent circumstances that would have been dealt with under paragraph 52 of the Standard. Paragraph 52 requires the carrying amount of an asset to be written down to fair value where it is subject to a sale and leaseback.

Note 2 The profit would be the difference between fair value and sale price as the carrying amount would have been written down to fair value in accordance with paragraph 52.

AS 20* - Earnings Per Share

*[This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective, the Preface to the Statements of Accounting Standards¹ and the 'Applicability of Accounting Standards to Various Entities'.]*

Objective

The objective of this Standard is to prescribe principles for the determination and presentation of earnings per share which will improve comparison of performance among different enterprises for the same period and among different accounting periods for the same enterprise. The focus of this Standard is on the denominator of the earnings per share calculation. Even though earnings per share data has limitations because of different

*Issued in 2001. A limited revision to this Standard was made in 2004, pursuant to which paragraphs 48 and 51 of this Standard were revised.

¹Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material.

accounting policies used for determining 'earnings', a consistently determined denominator enhances the quality of financial reporting.

Scope

1. This Standard should be applied by all the entities. However, a Small and Medium Sized Company and a Small and Medium Sized non-corporate entity falling in Level II or Level III 'Applicability of Accounting Standards to Various Entities', may not disclose diluted earnings per share (both including and excluding extraordinary items). Further, a non-corporate Small and Medium Sized Entity falling in level III, may not disclose the information required by paragraph 48(ii) of the standard.

2. In consolidated financial statements, the information required by this Standard should be presented on the basis of consolidated information.²

3. In the case of a parent (holding enterprise), users of financial statements are usually concerned with, and need to be informed about, the results of operations of both the enterprise itself as well as of the group as a whole. Accordingly, in the case of such enterprises, this Standard requires the presentation of earnings per share information on the basis of consolidated financial statements as well as individual financial statements of the parent. In consolidated financial statements, such information is presented on the basis of consolidated information.

Definitions

4. For the purpose of this Standard, the following terms are used with the meanings specified:

4.1 An equity share is a share other than a preference share.

4.2 A preference share is a share carrying preferential rights to dividends and repayment of capital.

4.3 A financial instrument is any contract that gives rise to both a financial asset of one enterprise and a financial liability or equity shares of another enterprise.

4.4 A potential equity share is a financial instrument or other contract that entitles, or may entitle, its holder to equity shares.

4.5 Share warrants or options are financial instruments that give the holder the right to acquire equity shares.

4.6 Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

²Accounting Standard (AS) 21, 'Consolidated Financial Statements', specifies the requirements relating to consolidated financial statements.

5. Equity shares participate in the net profit for the period only after preference shares. An enterprise may have more than one class of equity shares. Equity shares of the same class have the same rights to receive dividends.

6. A financial instrument is any contract that gives rise to both a financial asset of one enterprise and a financial liability or equity shares of another enterprise. For this purpose, a financial asset is any asset that is

- (a) cash;
- (b) a contractual right to receive cash or another financial asset from another enterprise;
- (c) a contractual right to exchange financial instruments with another enterprise under conditions that are potentially favourable; or
- (d) an equity share of another enterprise.

A financial liability is any liability that is a contractual obligation to deliver cash or another financial asset to another enterprise or to exchange financial instruments with another enterprise under conditions that are potentially unfavourable.

7. Examples of potential equity shares are:

- (a) debt instruments or preference shares, that are convertible into equity shares;
- (b) share warrants;
- (c) options including employee stock option plans under which employees of an enterprise are entitled to receive equity shares as part of their remuneration and other similar plans; and
- (d) shares which would be issued upon the satisfaction of certain conditions resulting from contractual arrangements (contingently issuable shares), such as the acquisition of a business or other assets, or shares issuable under a loan contract upon default of payment of principal or interest, if the contract so provides.

Presentation

8. *An enterprise should present basic and diluted earnings per share on the face of the statement of profit and loss for each class of equity shares that has a different right to share in the net profit for the period. An enterprise should present basic and diluted earnings per share with equal prominence for all periods presented.*

9. *This Standard requires an enterprise to present basic and diluted earnings per share, even if the amounts disclosed are negative (a loss per share).*

Measurement

Basic Earnings Per Share

10. *Basic earnings per share should be calculated by dividing the net profit or loss for the period attributable to equity shareholders by the weighted average number of equity shares outstanding during the period.*

Earnings - Basic

11. For the purpose of calculating basic earnings per share, the net profit or loss for the period attributable to equity shareholders should be the net profit or loss for the period after deducting preference dividends and any attributable tax thereto for the period.

12. All items of income and expense which are recognised in a period, including tax expense and extraordinary items, are included in the determination of the net profit or loss for the period unless an Accounting Standard requires or permits otherwise (see *Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies*). The amount of preference dividends and any attributable tax thereto for the period is deducted from the net profit for the period (or added to the net loss for the period) in order to calculate the net profit or loss for the period attributable to equity shareholders.

13. The amount of preference dividends for the period that is deducted from the net profit for the period is:

- (a) the amount of any preference dividends on non-cumulative preference shares provided for in respect of the period; and
- (b) the full amount of the required preference dividends for cumulative preference shares for the period, whether or not the dividends have been provided for. The amount of preference dividends for the period does not include the amount of any preference dividends for cumulative preference shares paid or declared during the current period in respect of previous periods.

14. If an enterprise has more than one class of equity shares, net profit or loss for the period is apportioned over the different classes of shares in accordance with their dividend rights.

Per Share - Basic

15. For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

16. The weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or lesser number of shares outstanding at any time. It is the number of equity shares outstanding at the beginning of the period, adjusted by the number of equity shares bought back or issued during the period multiplied by the time-weighting factor. The time-weighting factor is the number of days for which the specific shares are outstanding as a proportion of the total number of days in the period; a reasonable approximation of the weighted average is adequate in many circumstances.

Illustration I attached to the Standard illustrates the computation of weighted average number of shares.

17. In most cases, shares are included in the weighted average number of shares from the date the consideration is receivable, for example:

- (a) equity shares issued in exchange for cash are included when cash is receivable;
- (b) equity shares issued as a result of the conversion of a debt instrument to equity shares are included as of the date of conversion;
- (c) equity shares issued in lieu of interest or principal on other financial instruments are included as of the date interest ceases to accrue;
- (d) equity shares issued in exchange for the settlement of a liability of the enterprise are included as of the date the settlement becomes effective;
- (e) equity shares issued as consideration for the acquisition of an asset other than cash are included as of the date on which the acquisition is recognised; and
- (f) equity shares issued for the rendering of services to the enterprise are included as the services are rendered.

In these and other cases, the timing of the inclusion of equity shares is determined by the specific terms and conditions attaching to their issue. Due consideration should be given to the substance of any contract associated with the issue.

18. Equity shares issued as part of the consideration in an amalgamation in the nature of purchase are included in the weighted average number of shares as of the date of the acquisition because the transferee incorporates the results of the operations of the transferor into its statement of profit and loss as from the date of acquisition. Equity shares issued during the reporting period as part of the consideration in an amalgamation in the nature of merger are included in the calculation of the weighted average number of shares from the beginning of the reporting period because the financial statements of the combined enterprise for the reporting period are prepared as if the combined entity had existed from the beginning of the reporting period. Therefore, the number of equity shares used for the calculation of basic earnings per share in an amalgamation in the nature of merger is the aggregate of the weighted average number of shares of the combined enterprises, adjusted to equivalent shares of the enterprise whose shares are outstanding after the amalgamation.

19. Partly paid equity shares are treated as a fraction of an equity share to the extent that they were entitled to participate in dividends relative to a fully paid equity share during the reporting period.

Illustration II attached to the Standard illustrates the computations in respect of partly paid equity shares.

20. Where an enterprise has equity shares of different nominal values but with the same dividend rights, the number of equity shares is calculated by converting all such equity shares into equivalent number of shares of the same nominal value.

21. Equity shares which are issuable upon the satisfaction of certain conditions resulting from contractual arrangements (contingently issuable shares) are considered outstanding,

and included in the computation of basic earnings per share from the date when all necessary conditions under the contract have been satisfied.

22. *The weighted average number of equity shares outstanding during the period and for all periods presented should be adjusted for events, other than the conversion of potential equity shares, that have changed the number of equity shares outstanding, without a corresponding change in resources.*

23. Equity shares may be issued, or the number of shares outstanding may be reduced, without a corresponding change in resources. Examples include:

- (a) a bonus issue;
- (b) a bonus element in any other issue, for example a bonus element in a rights issue to existing shareholders;
- (c) a share split; and
- (d) a reverse share split (consolidation of shares).

24. In case of a bonus issue or a share split, equity shares are issued to existing shareholders for no additional consideration. Therefore, the number of equity shares outstanding is increased without an increase in resources. The number of equity shares outstanding before the event is adjusted for the proportionate change in the number of equity shares outstanding as if the event had occurred at the beginning of the earliest period reported. For example, upon a two-for-one bonus issue, the number of shares outstanding prior to the issue is multiplied by a factor of three to obtain the new total number of shares, or by a factor of two to obtain the number of additional shares.

Illustration III attached to the Standard illustrates the computation of weighted average number of equity shares in case of a bonus issue during the period.

25. The issue of equity shares at the time of exercise or conversion of potential equity shares will not usually give rise to a bonus element, since the potential equity shares will usually have been issued for full value, resulting in a proportionate change in the resources available to the enterprise. In a rights issue, on the other hand, the exercise price is often less than the fair value of the shares. Therefore, a rights issue usually includes a bonus element. The number of equity shares to be used in calculating basic earnings per share for all periods prior to the rights issue is the number of equity shares outstanding prior to the issue, multiplied by the following factor:

$$\frac{\text{Fair value per share immediately prior to the exercise of rights}}{\text{Theoretical ex-rights fair value per share}}$$

The theoretical ex-rights fair value per share is calculated by adding the aggregate fair value of the shares immediately prior to the exercise of the rights to the proceeds from the exercise of the rights, and dividing by the number of shares outstanding after the exercise of the rights. Where the rights themselves are to be publicly traded separately from the shares prior to the exercise date, fair value for the purposes of this calculation is established at the close of the last day on which the shares are traded together with the rights.

Illustration IV attached to the Standard illustrates the computation of weighted average number of equity shares in case of a rights issue during the period.

Diluted Earnings Per Share

26. For the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares.

27. In calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period, that is:

- (a) the net profit for the period attributable to equity shares is:
 - (i) increased by the amount of dividends recognised in the period in respect of the dilutive potential equity shares as adjusted for any attributable change in tax expense for the period;
 - (ii) increased by the amount of interest recognised in the period in respect of the dilutive potential equity shares as adjusted for any attributable change in tax expense for the period; and
 - (iii) adjusted for the after-tax amount of any other changes in expenses or income that would result from the conversion of the dilutive potential equity shares.
- (b) the weighted average number of equity shares outstanding during the period is increased by the weighted average number of additional equity shares which would have been outstanding assuming the conversion of all dilutive potential equity shares.

28. For the purpose of this Standard, share application money pending allotment or any advance share application money as at the balance sheet date, which is not statutorily required to be kept separately and is being utilised in the business of the enterprise, is treated in the same manner as dilutive potential equity shares for the purpose of calculation of diluted earnings per share.

Earnings - Diluted

29. For the purpose of calculating diluted earnings per share, the amount of net profit or loss for the period attributable to equity shareholders, as calculated in accordance with paragraph 11, should be adjusted by the following, after taking into account any attributable change in tax expense for the period:

- (a) any dividends on dilutive potential equity shares which have been deducted in arriving at the net profit attributable to equity shareholders as calculated in accordance with paragraph 11;**
- (b) interest recognised in the period for the dilutive potential equity shares; and**
- (c) any other changes in expenses or income that would result from the conversion of the dilutive potential equity shares.**

30. After the potential equity shares are converted into equity shares, the dividends, interest and other expenses or income associated with those potential equity shares will no longer be incurred (or earned). Instead, the new equity shares will be entitled to participate in the net profit attributable to equity shareholders. Therefore, the net profit for the period attributable to equity shareholders calculated in accordance with paragraph 11 is increased by the amount of dividends, interest and other expenses that will be saved, and reduced by the amount of income that will cease to accrue, on the conversion of the dilutive potential equity shares into equity shares. The amounts of dividends, interest and other expenses or income are adjusted for any attributable taxes.

Illustration V attached to the standard illustrates the computation of diluted earnings in case of convertible debentures.

31. The conversion of some potential equity shares may lead to consequential changes in other items of income or expense. For example, the reduction of interest expense related to potential equity shares and the resulting increase in net profit for the period may lead to an increase in the expense relating to a non-discretionary employee profit sharing plan. For the purpose of calculating diluted earnings per share, the net profit or loss for the period is adjusted for any such consequential changes in income or expenses.

Per Share - Diluted

32. For the purpose of calculating diluted earnings per share, the number of equity shares should be the aggregate of the weighted average number of equity shares calculated in accordance with paragraphs 15 and 22, and the weighted average number of equity shares which would be issued on the conversion of all the dilutive potential equity shares into equity shares. Dilutive potential equity shares should be deemed to have been converted into equity shares at the beginning of the period or, if issued later, the date of the issue of the potential equity shares.

33. The number of equity shares which would be issued on the conversion of dilutive potential equity shares is determined from the terms of the potential equity shares. The computation assumes the most advantageous conversion rate or exercise price from the standpoint of the holder of the potential equity shares.

34. Equity shares which are issuable upon the satisfaction of certain conditions resulting from contractual arrangements (contingently issuable shares) are considered outstanding and included in the computation of both the basic earnings per share and diluted earnings per share from the date when the conditions under a contract are met. If the conditions have not been met, for computing the diluted earnings per share, contingently issuable shares are included as of the beginning of the period (or as of the date of the contingent share agreement, if later). The number of contingently issuable shares included in this case in computing the diluted earnings per share is based on the number of shares that would be issuable if the end of the reporting period was the end of the contingency period. Restatement is not permitted if the conditions are not met when the contingency period actually expires subsequent to the end of the reporting period. The provisions of this paragraph apply equally to potential equity shares that are issuable upon the satisfaction of certain conditions (contingently issuable potential equity shares).

35. For the purpose of calculating diluted earnings per share, an enterprise should assume the exercise of dilutive options and other dilutive potential equity shares of the enterprise. The assumed proceeds from these issues should be considered to have been received from the issue of shares at fair value. The difference between the number of shares issuable and the number of shares that would have been issued at fair value should be treated as an issue of equity shares for no consideration.

36. Fair value for this purpose is the average price of the equity shares during the period. Theoretically, every market transaction for an enterprise's equity shares could be included in determining the average price. As a practical matter, however, a simple average of last six months weekly closing prices are usually adequate for use in computing the average price.

37. Options and other share purchase arrangements are dilutive when they would result in the issue of equity shares for less than fair value. The amount of the dilution is fair value less the issue price. Therefore, in order to calculate diluted earnings per share, each such arrangement is treated as consisting of:

- (a) a contract to issue a certain number of equity shares at their average fair value during the period. The shares to be so issued are fairly priced and are assumed to be neither dilutive nor anti-dilutive. They are ignored in the computation of diluted earnings per share; and
- (b) a contract to issue the remaining equity shares for no consideration. Such equity shares generate no proceeds and have no effect on the net profit attributable to equity shares outstanding. Therefore, such shares are dilutive and are added to the number of equity shares outstanding in the computation of diluted earnings per share.

Illustration VI attached to the Standard illustrates the effects of share options on diluted earnings per share.

38. To the extent that partly paid shares are not entitled to participate in dividends during the reporting period they are considered the equivalent of warrants or options.

Dilutive Potential Equity Shares

39. Potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations.

40. An enterprise uses net profit from continuing ordinary activities as "the control figure" that is used to establish whether potential equity shares are dilutive or anti-dilutive. The net profit from continuing ordinary activities is the net profit from ordinary activities (as defined in AS 5) after deducting preference dividends and any attributable tax thereto and after excluding items relating to discontinued operations³.

³Accounting Standard (AS) 24, 'Discontinuing Operations', specifies the requirements in respect of discontinued operations.

41. Potential equity shares are anti-dilutive when their conversion to equity shares would increase earnings per share from continuing ordinary activities or decrease loss per share from continuing ordinary activities. The effects of anti-dilutive potential equity shares are ignored in calculating diluted earnings per share.

42. In considering whether potential equity shares are dilutive or anti-dilutive, each issue or series of potential equity shares is considered separately rather than in aggregate. The sequence in which potential equity shares are considered may affect whether or not they are dilutive. Therefore, in order to maximise the dilution of basic earnings per share, each issue or series of potential equity shares is considered in sequence from the most dilutive to the least dilutive. For the purpose of determining the sequence from most dilutive to least dilutive potential equity shares, the earnings per incremental potential equity share is calculated. Where the earnings per incremental share is the least, the potential equity share is considered most dilutive and vice-versa.

Illustration VII attached to the Standard illustrates the manner of determining the order in which dilutive securities should be included in the computation of weighted average number of shares.

43. Potential equity shares are weighted for the period they were outstanding. Potential equity shares that were cancelled or allowed to lapse during the reporting period are included in the computation of diluted earnings per share only for the portion of the period during which they were outstanding. Potential equity shares that have been converted into equity shares during the reporting period are included in the calculation of diluted earnings per share from the beginning of the period to the date of conversion; from the date of conversion, the resulting equity shares are included in computing both basic and diluted earnings per share.

Restatement

44. *If the number of equity or potential equity shares outstanding increases as a result of a bonus issue or share split or decreases as a result of a reverse share split (consolidation of shares), the calculation of basic and diluted earnings per share should be adjusted for all the periods presented. If these changes occur after the balance sheet date but before the date on which the financial statements are approved by the board of directors, the per share calculations for those financial statements and any prior period financial statements presented should be based on the new number of shares. When per share calculations reflect such changes in the number of shares, that fact should be disclosed.*

45. An enterprise does not restate diluted earnings per share of any prior period presented for changes in the assumptions used or for the conversion of potential equity shares into equity shares outstanding.

46. An enterprise is encouraged to provide a description of equity share transactions or potential equity share transactions, other than bonus issues, share splits and reverse share splits (consolidation of shares) which occur after the balance sheet date when they are of such importance that non-disclosure would affect the ability of the users of the financial

statements to make proper evaluations and decisions. Examples of such transactions include:

- (a) the issue of shares for cash;
- (b) the issue of shares when the proceeds are used to repay debt or preference shares outstanding at the balance sheet date;
- (c) the cancellation of equity shares outstanding at the balance sheet date;
- (d) the conversion or exercise of potential equity shares, outstanding at the balance sheet date, into equity shares;
- (e) the issue of warrants, options or convertible securities; and
- (f) the satisfaction of conditions that would result in the issue of contingently issuable shares.

47. Earnings per share amounts are not adjusted for such transactions occurring after the balance sheet date because such transactions do not affect the amount of capital used to produce the net profit or loss for the period.

Disclosure

48. In addition to disclosures as required by paragraphs 8, 9 and 44 of this Standard, an enterprise should disclose the following:

- (i) **where the statement of profit and loss includes extraordinary items (within the meaning of AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies), the enterprise should disclose basic and diluted earnings per share computed on the basis of earnings excluding extraordinary items (net of tax expense); and**
- (ii) (a) **the amounts used as the numerators in calculating basic and diluted earnings per share, and a reconciliation of those amounts to the net profit or loss for the period;**
(b) the weighted average number of equity shares used as the denominator in calculating basic and diluted earnings per share, and a reconciliation of these denominators to each other; and
(c) the nominal value of shares along with the earnings per share figures.

Provided that a non-corporate Small and Medium Sized Entity Falling in Level III, 'Applicability of Accounting Standards to Various Entities', may not comply with sub-paragraph (ii).

49. Contracts generating potential equity shares may incorporate terms and conditions which affect the measurement of basic and diluted earnings per share. These terms and conditions may determine whether or not any potential equity shares are dilutive and, if so, the effect on the weighted average number of shares outstanding and any consequent adjustments to the net profit attributable to equity shareholders. Disclosure of the terms and conditions of such contracts is encouraged by this Standard.

50. If an enterprise discloses, in addition to basic and diluted earnings per share, per share amounts using a reported component of net profit other than net profit or loss for the period attributable to equity shareholders, such amounts should be calculated using the weighted average number of equity shares determined in accordance with this Standard. If a component of net profit is used which is not reported as a line item in the statement of profit and loss, a reconciliation should be provided between the component used and a line item which is reported in the statement of profit and loss. Basic and diluted per share amounts should be disclosed with equal prominence.

51. An enterprise may wish to disclose more information than this Standard requires. Such information may help the users to evaluate the performance of the enterprise and may take the form of per share amounts for various components of net profit. Such disclosures are encouraged. However, when such amounts are disclosed, the denominators need to be calculated in accordance with this Standard in order to ensure the comparability of the per share amounts disclosed.

Illustrations

Note: These illustrations do not form part of the Accounting Standard. Their purpose is to illustrate the application of the Accounting Standard.

Illustration I

Example - Weighted Average Number of Shares

(Accounting year 01-01-20X1 to 31-12-20X1)

		No. of Shares/Issue	No. of Shares	No. of Shares
1 st Jan., 20X1	Balance at beginning of	1,800	-	1,800
31 st May, 20X1	Issue of shares for cash	600	-	2,400
1 st Nov., 20X1	Buy Back of shares	-	300	2,100
31 st Dec.,	Balance at end of year	2,400	300	2,100

Computation of Weighted Average:

$(1,800 \times 5/12) + (2,400 \times 5/12) + (2,100 \times 2/12) = 2,100$ shares.

The weighted average number of shares can alternatively be computed as follows:

Example – Partly paid shares

(Accounting year 01-01-20X1 to 31-12-20X1)

		No. of shares issued	Nominal value of shares	Amount paid
1 st January, 20X1	Balance at beginning of year	1,800	₹ 10	₹ 10

31 st October, 20X1	Issue of Shares	600	₹ 10	₹ 5
<p>Assuming that partly paid shares are entitled to participate in the dividend to the extent of amount paid, number of partly paid equity shares would be taken as 300 for the purpose of calculation of earnings per share.</p> <p>Computation of weighted average would be as follows: $(1,800 \times 12/12) + (300 \times 2/12) = 1,850$ shares.</p>				

Illustration III

Example - Bonus Issue

(Accounting year 01-01-20XX to 31-12-20XX)

Net profit for the year 20X0	₹ 18,00,000
Net profit for the year 20X1	₹ 60,00,000
No. of equity shares outstanding until 30 th September 20X1	20,00,000
Bonus issue 1 st October 20X1	2 equity shares for each equity share outstanding at 30 th September, 20X1 $20,00,000 \times 2 = 40,00,000$
Earnings per share for the year 20X1	$\frac{60,00,000}{(20,00,000 + 40,00,000)}$ = ₹ 1.00
Adjusted earnings per share for the year 20X0	$\frac{18,00,000}{(20,00,000 + 40,00,000)}$ ₹ 0.30
<p>Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred prior to the beginning of the year 20X0, the earliest period reported.</p>	

Example - Rights Issue

(Accounting year 01-01-20XX to 31-12-20XX)

Net profit	Year 20X0 : ₹ 11,00,000 Year 20X1 : ₹ 15,00,000
No. of shares outstanding prior to rights issue	5,00,000 shares
rights issue	One new share for each five outstanding (i.e. 1,00,000 new shares) Rights issue price : ₹ 15.00

	Last date to exercise rights: 1 st March 20X1	
Fair value of one equity share immediately prior to exercise of rights on 1 st March 20X1	₹ 21.00	
Computation of theoretical ex-rights fair value per share		
Fair value of all outstanding shares immediately prior to exercise of rights + total amount received from exercise		
Number of shares outstanding prior to exercise + number of shares issued in the exercise		
(₹ 21.00 x 5,00,000 shares) + (₹ 15.00 x 1,00,000 shares)		
5,00,000 shares + 1,00,000 shares		
Theoretical ex-rights fair value per share = ₹ 20.00		
Computation of adjustment factor		
Fair value per share prior to exercise of rights = $\frac{₹ (21.00)}{₹ (20.00)} = 1.05$		
Computation of earnings per share		
	Year 20X0	Year 20X1
EPS for the year 20X0 as originally reported: ₹ .11,00,000/5,00,000 shares	₹ 2.20	
EPS for the year 20X0 restated for rights issue: ₹ .11,00,000/ (5,00,000 shares x 1.05)	₹ 2.10	
EPS for the year 20X1 including effects of rights issue ₹ 15,00,000 <u>(5,00,000 x 1.05 x 2/12)+ (6,00,000 x 10/12)</u>		₹ 2.55

Example - Convertible Debentures

(Accounting year 01-01-20XX to 31-12-20XX)

Net profit for the current year	₹ 1,00,00,000
No. of equity shares outstanding	50,00,000
Basic earnings per share	₹ 2.00
No. of 12% convertible debentures of ₹ 100 each Each debenture is convertible into 10 equity shares	1,00,000
Interest expense for the current year	₹ 12,00,000
Tax relating to interest expense (30%)	₹ 3,60,000

Adjusted net profit for the current year	₹ (1,00,00,000 + 12,00,000 - 3,60,000) = ₹ 1,08,40,000
No. of equity shares resulting from conversion of debentures	10,00,000
No. of equity shares used to compute diluted earnings per share	50,00,000 + 10,00,000 = 60,00,000
Diluted earnings per share	1,08,40,000/60,00,000 = ₹ 1.81

Illustration VI

Example - Effects of Share Options on Diluted Earnings Per Share

(Accounting year 01-01-20XX to 31-12-20XX)

Net profit for the year 20X1	₹ 12,00,000
Weighted average number of equity shares outstanding during the year 20X1	5,00,000 shares
Average fair value of one equity share during the year 20X1	₹ 20.00
Weighted average number of shares under option during the	1,00,000
Exercise price for shares under option during the year 20X1	₹ 15.00

Computation of earnings per share

	<i>Earnings</i>	<i>Shares</i>	<i>Earnings per share</i>
Net profit for the year 20X1	₹ 12,00,000		
Weighted average number of shares outstanding during year 20X1		5,00,000	
Basic earnings per share			₹ 2.40
Number of shares under option		1,00,000	
Number of shares that would have been issued at fair value: (100,000 x 15.00)/20.00	*	(75,000)	
Diluted earnings per share	₹ 12,00,000	5,25,000	₹ 2.29

*The earnings have not been increased as the total number of shares has been increased only by the number of shares (25,000) deemed for the purpose of the computation to have been issued for no consideration{see para 37(b)}

Illustration VII

Example - Determining the Order in Which to Include Dilutive Securities in the Computation of Weighted Average Number of Shares (Accounting year 01-01-20XX to 31-12-20XX)

Earnings, i.e., Net profit attributable to equity shareholders	₹ 1,00,00,000
No. of equity shares outstanding	20,00,000
Average fair value of one equity share during the year	₹ 75.00

Potential Equity Shares	
Options	1,00,000 with exercise price of ₹ 60
Convertible Preference Shares	8,00,000 shares entitled to a cumulative dividend of ₹ 8 per share. Each preference share is convertible into 2 equity shares.
Attributable tax, e.g., corporate dividend tax	10%
12% Convertible Debentures of ₹ 100 each	Nominal amount ₹ 10,00,00,000. Each debenture is convertible into 4 equity shares.
Tax rate	30%

**Increase in Earnings Attributable to Equity Shareholders on
Conversion of Potential Equity Shares**

	<i>Increase in Earnings</i>	<i>Increase in no. of Equity Shares</i>	<i>Earnings per Incremental Share</i>
Options			
Increase in earnings	Nil		
No. of incremental shares issued for no consideration {1,00,000 x (75 - 60) / 75}		20,000	Nil
Convertible Preference Shares			
Increase in net profit attributable to equity	₹ 70,40,000		

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shareholders as adjusted by attributable tax [(₹ .8 x 8,00,000) + 10% (8 x 8,00,000)]			
No. of incremental shares {2 x 8,00,000}		16,00,000	₹ 4.40
12% Convertible Debentures			
Increase in net profit {₹ 10,00,00,000 x 0.12 x (1-0.30)}	₹ 84,00,000		
No. of incremental shares {10,00,000 x 4}		40,00,000	₹ .2.10

It may be noted from the above that options are most dilutive as their earnings per incremental share is nil. Hence, for the purpose of computation of diluted earnings per share, options will be considered first. 12% convertible debentures being second most dilutive will be considered next and thereafter convertible preference shares will be considered (see para 42).

Conversion of Diluted Earnings Per Shares

	<i>Net Profit Attributable (₹)</i>	<i>No. of Equity Shares</i>	<i>Net profit attributable Per Share (₹)</i>	
As reported	1,00,00,000	20,00,000	5.00	
Options	<u> </u>	<u>20,000</u>		
	<u>1,00,00,000</u>	<u>20,20,000</u>	4.95	Dilutive
12% Convertible Debentures	<u>84,00,000</u>	<u>40,00,000</u>		
	<u>1,84,00,000</u>	<u>60,20,000</u>	3.06	Dilutive
Convertible Preference Shares	<u>70,40,000</u>	<u>16,00,000</u>		
	<u>2,54,40,000</u>	<u>76,20,000</u>	3.34	Anti-Dilutive

Since diluted earnings per share is increased when taking the convertible preference shares into account (from ₹ 3.06 to ₹ 3.34), the convertible preference shares are anti-dilutive and are ignored in the calculation of diluted earnings per share. Therefore, diluted earnings per share is ₹ 3.06.

AS 22 (issued 2001) – Accounting for Taxes on Income

*[This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective, the Preface to the Statements of Accounting Standards¹ and the 'Applicability of Accounting Standards to Various Entities']*

Objective

The objective of this Standard is to prescribe accounting treatment for taxes on income. Taxes on income is one of the significant items in the statement of profit and loss of an enterprise. In accordance with the matching concept, taxes on income are accrued in the same period as the revenue and expenses to which they relate. Matching of such taxes against revenue for a period poses special problems arising from the fact that in a number of cases, taxable income may be significantly different from the accounting income. This divergence between taxable income and accounting income arises due to two main reasons. Firstly, there are differences between items of revenue and expenses as appearing in the statement of profit and loss and the items which are considered as revenue, expenses or deductions for tax purposes. Secondly, there are differences between the amount in respect of a particular item of revenue or expense as recognised in the statement of profit and loss and the corresponding amount which is recognised for the computation of taxable income.

Scope

1. 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.

2. For the purposes of this Standard, taxes on income include all domestic and foreign taxes which are based on taxable income.

3. 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.

Definitions

4. For the purpose of this Standard, the following terms are used with the meanings specified:

¹Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material

4.1 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.

4.2 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.

4.3 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.

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

4.5 Deferred tax is the tax effect of timing differences.

4.6 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.

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

5. Taxable income is calculated in accordance with tax laws. In some circumstances, the requirements of these laws to compute taxable income differ 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.

6. 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. For instance, if for the purpose of computing taxable income, the tax laws allow only a part of an item of expenditure, the disallowed amount would result in a permanent difference.

7. 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. For example, machinery purchased for scientific research related to business is fully allowed as deduction in the first year for tax purposes whereas the same would be charged to the statement of profit and loss as depreciation over its useful life. The total depreciation charged on the machinery for accounting purposes and the amount allowed as deduction for tax purposes will ultimately be the same, but periods over which the depreciation is charged and the deduction is allowed will differ. Another example of timing difference is a situation where, for the purpose of computing taxable income, tax laws allow depreciation on the basis of the written down value method, whereas for

accounting purposes, straight line method is used. Some other examples of timing differences arising under the Indian tax laws are given in Illustration 1.

8. Unabsorbed depreciation and carry forward of losses which can be set-off against future taxable income are also considered as timing differences and result in deferred tax assets, subject to consideration of prudence (see paragraphs 15-18).

Recognition

9. 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.

10. 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 (subject to the consideration of prudence as set out in paragraphs 15-18) or as deferred tax liabilities, in the balance sheet.

11. An example of tax effect of a timing difference that results in a deferred tax asset is an expense provided in the statement of profit and loss but not allowed as a deduction under Section 43B of the Income-tax Act, 1961. This timing difference will reverse when the deduction of that expense is allowed under Section 43B in subsequent year(s). An example of tax effect of a timing difference resulting in a deferred tax liability is the higher charge of depreciation allowable under the Income-tax Act, 1961, compared to the depreciation provided in the statement of profit and loss. In subsequent years, the differential will reverse when comparatively lower depreciation will be allowed for tax purposes.

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

13. Deferred tax should be recognised for all the timing differences, subject to the consideration of prudence in respect of deferred tax assets as set out in paragraphs 15-18.

Explanation:

- (a) *The deferred tax in respect of timing differences which reverse during the tax holiday period is not recognised to the extent the enterprise's gross total income is subject to the deduction during the tax holiday period as per the requirements of sections 80-IA/80IB of the Income-tax Act, 1961 (hereinafter referred to as the 'Act'). In case of sections 10A/10B of the Act (covered under Chapter III of the Act dealing with incomes which do not form part of total income), the deferred tax in respect of timing differences which reverse during the tax holiday period is not recognised to the extent deduction from the total income of an enterprise is allowed during the tax holiday period as per the provisions of the said sections.*
- (b) *Deferred tax in respect of timing differences which reverse after the tax holiday period is recognised in the year in which the timing differences*

originate. However, recognition of deferred tax assets is subject to the consideration of prudence as laid down in paragraphs 15 to 18.

- (c) For the above purposes, the timing differences which originate first are considered to reverse first.*

The application of the above explanation is illustrated in the Illustration attached to the Standard.

14. 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.

15. Except in the situations stated in paragraph 17, deferred tax assets should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised.

16. 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.

17. 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.

Explanation:

- 1. Determination of virtual certainty that sufficient future taxable income will be available is a matter of judgement based on convincing evidence and will have to be evaluated on a case to case basis. Virtual certainty refers to the extent of certainty, which, for all practical purposes, can be considered certain. Virtual certainty cannot be based merely on forecasts of performance such as business plans. Virtual certainty is not a matter of perception and is to be supported by convincing evidence. Evidence is a matter of fact. To be convincing, the evidence should be available at the reporting date in a concrete form, for example, a profitable binding export order, cancellation of which will result in payment of heavy damages by the defaulting party. On the other hand, a projection of the future profits made by an enterprise based on the future capital expenditures or future restructuring etc. submitted even to an outside agency, e.g., to a credit agency for obtaining loans and accepted by that agency cannot, in isolation, be considered as convincing evidence.***
- 2 (a) As per the relevant provisions of the Income-tax Act, 1961 (here in after referred to as the 'Act'), the 'loss' arising under the head 'Capital gains' can be carried forward and set-off in future years, only against the income arising under that head as per the requirements of the Act.***

- (b) *Where an enterprise's statement of profit and loss includes an item of 'loss' which can be set-off in future for taxation purposes, only against the income arising under the head 'Capital gains' as per the requirements of the Act, that item is a timing difference to the extent it is not set-off in the current year and is allowed to be set-off against the income arising under the head 'Capital gains' in subsequent years subject to the provisions of the Act. In respect of such 'loss', deferred tax asset is recognised and carried forward subject to the consideration of prudence. Accordingly, in respect of such 'loss', deferred tax asset is recognised and carried forward only to the extent that there is a virtual certainty, supported by convincing evidence, that sufficient future taxable income will be available under the head 'Capital gains' against which the loss can be set-off as per the provisions of the Act. Whether the test of virtual certainty is fulfilled or not would depend on the facts and circumstances of each case. The examples of situations in which the test of virtual certainty, supported by convincing evidence, for the purposes of the recognition of deferred tax asset in respect of loss arising under the head 'Capital gains' is normally fulfilled, are sale of an asset giving rise to capital gain (eligible to set-off the capital loss as per the provisions of the Act) after the balance sheet date but before the financial statements are approved, and binding sale agreement which will give rise to capital gain (eligible to set-off the capital loss as per the provisions of the Act).*
- (c) *In cases where there is a difference between the amounts of 'loss' recognised for accounting purposes and tax purposes because of cost indexation under the Act in respect of long- term capital assets, the deferred tax asset is recognised and carried forward (subject to the consideration of prudence) on the amount which can be carried forward and set-off in future years as per the provisions of the Act.*

18. The 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

19. 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 (see paragraphs 15 to 18), that sufficient future taxable income will be available against which such deferred tax assets can be realised. For example, an improvement in trading conditions

may make it reasonably certain that the enterprise will be able to generate sufficient taxable income in the future.

Measurement

20. 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.

21. 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.

Explanation:

(a) The payment of tax under section 115JB of the Income-tax Act, 1961 (hereinafter referred to as the 'Act') is a current tax for the period.

(b) In a period in which a company pays tax under section 115JB of the Act, the deferred tax assets and liabilities in respect of timing differences arising during the period, tax effect of which is required to be recognised under this Standard, is measured using the regular tax rates and not the tax rate under section 115JB of the Act.

(c) In case an enterprise expects that the timing differences arising in the current period would reverse in a period in which it may pay tax under section 115JB of the Act, the deferred tax assets and liabilities in respect of timing differences arising during the current period, tax effect of which is required to be recognised under AS 22, is measured using the regular tax rates and not the tax rate under section 115JB of the Act.

22. Deferred tax assets and liabilities are usually measured using the tax rates and tax laws that have been enacted. However, 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.

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

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

25. The reliable determination of deferred tax assets and liabilities on a discounted basis requires detailed scheduling of the timing of the reversal of each timing difference. In a number of cases such scheduling is impracticable or highly complex. Therefore, it is inappropriate to require discounting of deferred tax assets and liabilities. To permit, but not to require, discounting would result in deferred tax assets and liabilities which would not be comparable between enterprises. Therefore, this Standard does not require or permit the discounting of deferred tax assets and liabilities.

Review of Deferred Tax Assets

26. The carrying amount of deferred tax assets should be reviewed at each balance sheet date. An enterprise should write-down the carrying amount of a deferred tax asset to the extent that it is no longer reasonably certain or virtually certain, as the

case may be (see paragraphs 15 to 18), that sufficient future taxable income will be available against which deferred tax asset can be realised. Any such write-down may be reversed to the extent that it becomes reasonably certain or virtually certain, as the case may be (see paragraphs 15 to 18), that sufficient future taxable income will be available.

Presentation and Disclosure

27. 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.**

28. 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.

29. 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.**

30. 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.

Explanation:

Deferred tax assets (net of the deferred tax liabilities, if any, in accordance with paragraph 29) is disclosed on the face of the balance sheet separately after the head 'Investments' and deferred tax liabilities (net of the deferred tax assets, if any, in accordance with paragraph 29) is disclosed on the face of the balance sheet separately after the head 'Unsecured Loans.'

31. 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.

32. 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.

Transitional Provisions

33. On the first occasion that the taxes on income are accounted for in accordance with this Standard the enterprise should recognise, in the financial statements, the deferred tax balance that has accumulated prior to the adoption of this Standard as deferred tax asset/liability with a corresponding credit/charge to the revenue

reserves, subject to the consideration of prudence in case of deferred tax assets (see paragraphs 15-18). The amount so credited/charged to the revenue reserves should be the same as that which would have resulted if this Standard had been in effect from the beginning.

34. For the purpose of determining accumulated deferred tax in the period in which this Standard is applied for the first time, the opening balances of assets and liabilities for accounting purposes and for tax purposes are compared and the differences, if any, are determined. The tax effects of these differences, if any, should be recognised as deferred tax assets or liabilities, if these differences are timing differences. For example, in the year in which an enterprise adopts this Standard, the opening balance of a fixed asset is ₹ 100 for accounting purposes and ₹ 60 for tax purposes. The difference is because the enterprise applies written down value method of depreciation for calculating taxable income whereas for accounting purposes straight line method is used. This difference will reverse in future when depreciation for tax purposes will be lower as compared to the depreciation for accounting purposes. In the above case, assuming that enacted tax rate for the year is 40% and that there are no other timing differences, deferred tax liability of ₹ 16 [(₹ 100 - ₹ 60) x 40%] would be recognised. Another example is an expenditure that has already been written off for accounting purposes in the year of its incurrence but is allowable for tax purposes over a period of time. In this case, the asset representing that expenditure would have a balance only for tax purposes but not for accounting purposes. The difference between balance of the asset for tax purposes and the balance (which is nil) for accounting purposes would be a timing difference which will reverse in future when this expenditure would be allowed for tax purposes. Therefore, a deferred tax asset would be recognised in respect of this difference subject to the consideration of prudence (see paragraphs 15 - 18).

Illustration I

Examples of Timing Differences

Note: This illustration does not form part of the Accounting Standard. The purpose of this illustration is to assist in clarifying the meaning of the Accounting Standard. The sections mentioned hereunder are references to sections in the Income-tax Act, 1961, as amended by the Finance Act, 2001.

1. Expenses debited in the statement of profit and loss for accounting purposes but allowed for tax purposes in subsequent years, e.g.
 - (a) Expenditure of the nature mentioned in section 43B (e.g. taxes, duty, cess, fees, etc.) accrued in the statement of profit and loss on mercantile basis but allowed for tax purposes in subsequent years on payment basis.
 - (b) Payments to non-residents accrued in the statement of profit and loss on mercantile basis, but disallowed for tax purposes under section 40(a)(i) and allowed for tax purposes in subsequent years when relevant tax is deducted or paid.

- (c) Provisions made in the statement of profit and loss in anticipation of liabilities where the relevant liabilities are allowed in subsequent years when they crystallize.
2. Expenses amortized in the books over a period of years but are allowed for tax purposes wholly in the first year (e.g. substantial advertisement expenses to introduce a product, etc. treated as deferred revenue expenditure in the books) or if amortization for tax purposes is over a longer or shorter period (e.g. preliminary expenses under section 35D, expenses incurred for amalgamation under section 35DD, prospecting expenses under section 35E).
 3. Where book and tax depreciation differ. This could arise due to:
 - (a) Differences in depreciation rates.
 - (b) Differences in method of depreciation e.g. SLM or WDV.
 - (c) Differences in method of calculation e.g. calculation of depreciation with reference to individual assets in the books but on block basis for tax purposes and calculation with reference to time in the books but on the basis of full or half depreciation under the block basis for tax purposes.
 - (d) Differences in composition of actual cost of assets.
 4. Where a deduction is allowed in one year for tax purposes on the basis of a deposit made under a permitted deposit scheme (e.g. tea development account scheme under section 33AB or site restoration fund scheme under section 33ABA) and expenditure out of withdrawal from such deposit is debited in the statement of profit and loss in subsequent years.
 5. Income credited to the statement of profit and loss but taxed only in subsequent years e.g. conversion of capital assets into stock in trade.
 6. If for any reason the recognition of income is spread over a number of years in the accounts but the income is fully taxed in the year of receipt.

Illustration II

Note: This illustration does not form part of the Accounting Standard. Its purpose is to illustrate the application of the Accounting Standard. Extracts from statement of profit and loss are provided to show the effects of the transactions described below.

Illustration 1

A company, ABC Ltd., prepares its accounts annually on 31st March. On 1st April, 20x1, it purchases a machine at a cost of ₹ 1,50,000. The machine has a useful life of three years and an expected scrap value of zero. Although it is eligible for a 100% first year depreciation allowance for tax purposes, the straight-line method is considered appropriate for accounting purposes. ABC Ltd. has profits before depreciation and taxes of ₹ 2,00,000 each year and the corporate tax rate is 40 per cent each year.

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The purchase of machine at a cost of ₹ 1,50,000 in 20x1 gives rise to a tax saving of ₹ 60,000. If the cost of the machine is spread over three years of its life for accounting purposes, the amount of the tax saving should also be spread over the same period as shown below:

Statement of Profit and Loss
(for the three years ending 31st March, 20x1, 20x2, 20x3)

(Rupees in thousands)

	20x1	20x2	20x3
Profit before depreciation and taxes	200	200	200
Less: Depreciation for accounting purposes	50	50	50
Profit before taxes	150	150	150
Less: Tax expense			
Current tax			
0.40 (200 – 150)	20		
0.40 (200)		80	80
Deferred tax			
Tax effect of timing differences originating during the year			
0.40 (150 – 50)	40		

Tax effect of timing differences reversing during the year			
0.40 (0 – 50)		(20)	(20)
Tax expense	60	60	60
Profit after tax	90	90	90
Net timing differences	100	50	0
Deferred tax liability	40	20	0

In 20x1, the amount of depreciation allowed for tax purposes exceeds the amount of depreciation charged for accounting purposes by ₹ 1,00,000 and, therefore, taxable income is lower than the accounting income. This gives rise to a deferred tax liability of ₹ 40,000. In 20x2 and 20x3, accounting income is lower than taxable income because the amount of depreciation charged for accounting purposes exceeds the amount of depreciation allowed for tax purposes by ₹ 50,000 each year. Accordingly, deferred tax liability is reduced by ₹ 20,000 each in both the years. As may be seen, tax expense is based on the accounting income of each period.

In 20x1, the profit and loss account is debited and deferred tax liability account is credited with the amount of tax on the originating timing difference of ₹ 1,00,000 while in each of the following two years, deferred tax liability account is debited and profit and loss account

is credited with the amount of tax on the reversing timing difference of ₹ 50,000.

The following Journal entries will be passed:

Year 20x1

Profit and Loss A/c	Dr.	20,000
To Current tax A/c		20,000

(Being the amount of taxes payable for the year 20x1 provided for)

Profit and Loss A/c	Dr.	40,000
To Deferred tax A/c		40,000

(Being the deferred tax liability created for originating timing difference of ₹ 1,00,000)

Year 20x2

Profit and Loss A/c	Dr.	80,000
To Current tax A/c		80,000

(Being the amount of taxes payable for the year 20x2 provided for)

Deferred tax A/c	Dr.	20,000
To Profit and Loss A/c		20,000

(Being the deferred tax liability adjusted for reversing timing difference of ₹ 50,000)

Year 20x3

Profit and Loss A/c	Dr.	80,000
To Current tax A/c		80,000

(Being the amount of taxes payable for the year 20x3 provided for)

Deferred tax A/c	Dr.	20,000
To Profit and Loss A/c		20,000

(Being the deferred tax liability adjusted for reversing timing difference of ₹ 50,000)

In year 20x1, the balance of deferred tax account i.e., ₹ 40,000 would be shown separately from the current tax payable for the year in terms of paragraph 30 of the Statement. In Year 20x2, the balance of deferred tax account would be ₹ 20,000 and be shown separately from the current tax payable for the year as in year 20x1. In Year 20x3, the balance of deferred tax liability account would be nil.

Illustration 2

In the above illustration, the corporate tax rate has been assumed to be same in each of the three years. If the rate of tax changes, it would be necessary for the enterprise to adjust the amount of deferred tax liability carried forward by applying the tax rate that has been enacted or substantively enacted by the balance sheet date on accumulated timing differences at the end of the accounting year (see paragraphs 21 and 22). For example, if in Illustration 1, the substantively enacted tax rates for 20x1, 20x2 and 20x3 are 40%, 35% and 38% respectively, the amount of deferred tax liability would be computed as follows:

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The deferred tax liability carried forward each year would appear in the balance sheet as under:

31st March, 20x1 = 0.40 (1,00,000) = ₹ 40,000

31st March, 20x2 = 0.35 (50,000) = ₹ 17,500

31st March, 20x3 = 0.38 (Zero) = ₹ Zero

Accordingly, the amount debited/(credited) to the profit and loss account (with corresponding credit or debit to deferred tax liability) for each year would be as under:

31st March, 20x1 Debit = ₹ 40,000

31st March, 20x2 (Credit) = ₹ (22,500)

31st March, 20x3 (Credit) = ₹ (17,500)

Illustration 3

A company, ABC Ltd., prepares its accounts annually on 31st March. The company has incurred a loss of ₹ 1,00,000 in the year 20x1 and made profits of ₹ 50,000 and 60,000 in year 20x2 and year 20x3 respectively. It is assumed that under the tax laws, loss can be carried forward for 8 years and tax rate is 40% and at the end of year 20x1, it was virtually certain, supported by convincing evidence, that the company would have sufficient taxable income in the future years against which unabsorbed depreciation and carry forward of losses can be set-off. It is also assumed that there is no difference between taxable income and accounting income except that set-off of loss is allowed in years 20x2 and 20x3 for tax purposes.

Statement of Profit and Loss

(for the three years ending 31st March, 20x1, 20x2, 20x3)

(Rupees in thousands)

	20x1	20x2	20x3
Profit (loss)	(100)	50	60
Less: Current tax	—	—	(4)
Deferred tax:			
Tax effect of timing differences originating during the year	40		
Tax effect of timing differences reversing during the year		(20)	(20)
Profit (loss) after tax effect	(60)	30	36

Illustration 4

Note: The purpose of this illustration is to assist in clarifying the meaning of the explanation to paragraph 13 of the Standard.

Facts:

1. The income before depreciation and tax of an enterprise for 15 years is ₹ 1000 lakhs per year, both as per the books of account and for income-tax purposes.
2. The enterprise is subject to 100 percent tax-holiday for the first 10 years under section 80-IA. Tax rate is assumed to be 30 percent.
3. At the beginning of year 1, the enterprise has purchased one machine for ₹ 1500 lakhs. Residual value is assumed to be nil.
4. For accounting purposes, the enterprise follows an accounting policy to provide depreciation on the machine over 15 years on straight-line basis.
5. For tax purposes, the depreciation rate relevant to the machine is 25% on written down value basis.

The following computations will be made, ignoring the provisions of section 115JB (MAT), in this regard:

Table 1
Computation of depreciation on the machine for accounting purposes and tax purposes

(Amounts in ₹ lakhs)

<i>Year</i>	<i>Depreciation for accounting purposes</i>	<i>Depreciation for tax purposes</i>
1	100	375
2	100	281
3	100	211
4	100	158
5	100	119
6	100	89
7	100	67
8	100	50
9	100	38
10	100	28
11	100	21
12	100	16
13	100	12
14	100	9
15	100	7

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At the end of the 15th year, the carrying amount of the machinery for accounting purposes would be nil whereas for tax purposes, the carrying amount is ₹ 19 lakhs which is eligible to be allowed in subsequent years.

Table 2

Computation of Timing differences

(Amounts in ₹ lakhs)

1	2	3	4	5	6	7	8	9
Year	Income before depreciation and tax (both for accounting purposes)	Accounting Income after depreciation	Gross Total Income after deducting depreciation under tax laws)	Deduction under section 80-IA	Taxable Income (4-5)	Total Difference between accounting income and taxable	Permanent Difference (deduction pursuant to section 80-IA)	Timing Difference (due to different amounts of depreciation for
1	1000	900	625	625	Nil	900	625	275 (O)
2	1000	900	719	719	Nil	900	719	181 (O)
3	1000	900	789	789	Nil	900	789	111 (O)
4	1000	900	842	842	Nil	900	842	58 (O)
5	1000	900	881	881	Nil	900	881	19(O)
6	1000	900	911	911	Nil	900	911	11 (R)
7	1000	900	933	933	Nil	900	933	33 (R)
8	1000	900	950	950	Nil	900	950	50 (R)
9	1000	900	962	962	Nil	900	962	62 (R)
10	1000	900	972	972	Nil	900	972	72 (R)
11	1000	900	979	Nil	979	-79	Nil	79 (R)
12	1000	900	984	Nil	984	-84	Nil	84 (R)
13	1000	900	988	Nil	988	-88	Nil	88 (R)
14	1000	900	991	Nil	991	-91	Nil	91 (R)
15	1000	900	993	Nil	993	-93	Nil	74 (R)
								19 (O)

Notes:

1. Timing differences originating during the tax holiday period are ₹ 644 lakhs, out of which ₹ 228 lakhs are reversing during the tax holiday period and ₹ 416 lakhs are reversing after the tax holiday period. Timing difference of ₹ 19 lakhs is originating in the 15th year which would reverse in subsequent years when for accounting purposes depreciation would be nil but for tax purposes the written down value of the machinery of ₹ 19 lakhs would be eligible to be allowed as depreciation.

2. As per the Standard, deferred tax on timing differences which reverse during the tax holiday period should not be recognised. For this purpose, timing differences which originate first are considered to reverse first. Therefore, the reversal of timing difference of ₹ 228 lakhs during the tax holiday period, would be considered to be out of the timing difference which originated in year 1. The rest of the timing difference originating in year 1 and timing differences originating in years 2 to 5 would be considered to be reversing after the tax holiday period. Therefore, in year 1, deferred tax would be recognised on the

timing difference of ₹ 47 lakhs (₹ 275 lakhs - ₹ 228 lakhs) which would reverse after the tax holiday period. Similar computations would be made for the subsequent years. The deferred tax assets/liabilities to be recognised during different years would be computed as per the following Table.

Table 3
Computation of current tax and deferred tax

(Amounts in ₹ lakhs)

Year	Current tax (Taxable Income x 30%)	Deferred tax (Timing difference x 30%)	Accumulated Deferred tax (L = Liability and A = Asset)	Tax expense
1	Nil	47 × 30% = 14 (see note 2 above)	14 (L)	14
2	Nil	118 × 30% = 54	68 (L)	54
3	Nil	111 × 30% = 33	101 (L)	33
4	Nil	58 × 30% = 17	118 (L)	17
5	Nil	19 × 30% = 6	124 (L)	6
6	Nil	Nil ¹	124 (L)	Nil
7	Nil	Nil ¹	124 (L)	Nil
8	Nil	Nil ¹	124 (L)	Nil
9	Nil	Nil ¹	124 (L)	Nil
10	Nil	Nil ¹	124 (L)	Nil
11	294	-79 × 30% = -24	100 (L)	270
12	295	-84 × 30% = -25	75 (L)	270
13	296	-88 × 30% = -26	49 (L)	270
14	297	-91 × 30% = -27	22 (L)	270
15	298	-74 × 30% = -22 -19 × 30% = -6	Nil 6(A) ²	270

¹No deferred tax is recognised since in respect of timing differences reversing during the tax holiday period, no deferred tax was recognised at their origination.

²Deferred tax asset of ₹ 6 lakhs would be recognised at the end of year 15 subject to consideration of prudence as per As 22. If it is so recognised, the said deferred tax asset would be realized in subsequent periods when for tax purposes depreciation would be allowed but for accounting purposes no depreciation would be recognised.

AS 24 (issued 2002) - Discontinuing Operations

[This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective, the Preface to the Statements of Accounting Standards¹ and the 'Applicability of Accounting Standards to Various Entities']

This Accounting Standard is not mandatory for non-corporate entities falling in Level III.

Objective

The objective of this Standard is to establish principles for reporting information about discontinuing operations, thereby enhancing the ability of users of financial statements to make projections of an enterprise's cash flows, earnings-generating capacity, and financial position by segregating information about discontinuing operations from information about continuing operations.

Scope

1. ***This Standard applies to all discontinuing operations of an enterprise.***
2. The requirements related to cash flow statement contained in this Standard are applicable where an enterprise prepares and presents a cash flow statement.

Definitions

Discontinuing Operation

3. ***A discontinuing operation is a component of an enterprise:***
 - (a) ***that the enterprise, pursuant to a single plan, is:***
 - (i) ***disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders; or***
 - (ii) ***disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or***
 - (iii) ***terminating through abandonment; and***
 - (b) ***that represents a separate major line of business or geographical area of operations; and***
 - (c) ***that can be distinguished operationally and for financial reporting purposes.***
4. Under criterion (a) of the definition (paragraph 3 (a)), a discontinuing operation may be disposed of in its entirety or piecemeal, but always pursuant to an overall plan to discontinue the entire component.

¹Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material.

5. If an enterprise sells a component substantially in its entirety, the result can be a net gain or net loss. For such a discontinuance, a binding sale agreement is entered into on a specific date, although the actual transfer of possession and control of the discontinuing operation may occur at a later date. Also, payments to the seller may occur at the time of the agreement, at the time of the transfer, or over an extended future period.

6. Instead of disposing of a component substantially in its entirety, an enterprise may discontinue and dispose of the component by selling its assets and settling its liabilities piecemeal (individually or in small groups). For piecemeal disposals, while the overall result may be a net gain or a net loss, the sale of an individual asset or settlement of an individual liability may have the opposite effect. Moreover, there is no specific date at which an overall binding sale agreement is entered into. Rather, the sales of assets and settlements of liabilities may occur over a period of months or perhaps even longer. Thus, disposal of a component may be in progress at the end of a financial reporting period. To qualify as a discontinuing operation, the disposal must be pursuant to a single co-ordinated plan.

7. An enterprise may terminate an operation by abandonment without substantial sales of assets. An abandoned operation would be a discontinuing operation if it satisfies the criteria in the definition. However, changing the scope of an operation or the manner in which it is conducted is not an abandonment because that operation, although changed, is continuing.

8. Business enterprises frequently close facilities, abandon products or even product lines, and change the size of their work force in response to market forces. While those kinds of terminations generally are not, in themselves, discontinuing operations as that term is defined in paragraph 3 of this Standard they can occur in connection with a discontinuing operation.

9. Examples of activities that do not necessarily satisfy criterion (a) of paragraph 3, but that might do so in combination with other circumstances, include:

- (a) gradual or evolutionary phasing out of a product line or class of service;
- (b) discontinuing, even if relatively abruptly, several products within an ongoing line of business;
- (c) shifting of some production or marketing activities for a particular line of business from one location to another; and
- (d) closing of a facility to achieve productivity improvements or other cost savings.

An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.

10. A reportable business segment or geographical segment as defined in Accounting Standard (AS) 17, Segment Reporting, would normally satisfy criterion (b) of the definition of a discontinuing operation (paragraph 3), that is, it would represent a separate major line of business or geographical area of operations. A part of such a segment may also satisfy criterion (b) of the definition. For an enterprise that operates in a single business or

geographical segment and therefore does not report segment information, a major product or service line may also satisfy the criteria of the definition.

11. A component can be distinguished operationally and for financial reporting purposes - criterion (c) of the definition of a discontinuing operation (paragraph 3) - if all the following conditions are met:

- (a) the operating assets and liabilities of the component can be directly attributed to it;
- (b) its revenue can be directly attributed to it;
- (c) at least a majority of its operating expenses can be directly attributed to it.

12. Assets, liabilities, revenue, and expenses are directly attributable to a component if they would be eliminated when the component is sold, abandoned or otherwise disposed of. If debt is attributable to a component, the related interest and other financing costs are similarly attributed to it.

13. Discontinuing operations, as defined in this Standard are expected to occur relatively infrequently. All infrequently occurring events do not necessarily qualify as discontinuing operations. Infrequently occurring events that do not qualify as discontinuing operations may result in items of income or expense that require separate disclosure pursuant to Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, because their size, nature, or incidence make them relevant to explain the performance of the enterprise for the period.

14. The fact that a disposal of a component of an enterprise is classified as a discontinuing operation under this Standard does not, in itself, bring into question the enterprise's ability to continue as a going concern.

Initial Disclosure Event

15. With respect to a discontinuing operation, the initial disclosure event is the occurrence of one of the following, whichever occurs earlier:

- (a) the enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or**
- (b) the enterprise's board of directors or similar governing body has both (i) approved a detailed, formal plan for the discontinuance and (ii) made an announcement of the plan.**

16. A detailed, formal plan for the discontinuance normally includes:

- (a) identification of the major assets to be disposed of;
- (b) the expected method of disposal;
- (c) the period expected to be required for completion of the disposal;
- (d) the principal locations affected;
- (e) the location, function, and approximate number of employees who will be compensated for terminating their services; and

(f) the estimated proceeds or salvage to be realised by disposal.

17. An enterprise's board of directors or similar governing body is considered to have made the announcement of a detailed, formal plan for discontinuance, if it has announced the main features of the plan to those affected by it, such as, lenders, stock exchanges, creditors, trade unions, etc., in a sufficiently specific manner so as to make the enterprise demonstrably committed to the discontinuance.

Recognition and Measurement

18. An enterprise should apply the principles of recognition and measurement that are set out in other Accounting Standards for the purpose of deciding as to when and how to recognise and measure the changes in assets and liabilities and the revenue, expenses, gains, losses and cash flows relating to a discontinuing operation.

19. This Standard does not establish any recognition and measurement principles. Rather, it requires that an enterprise follow recognition and measurement principles established in other Accounting Standards, e.g., Accounting Standard (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date² and Accounting Standard on Impairment of Assets³.

Presentation and Disclosure

Initial Disclosure

20. An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event (as defined in paragraph 15) occurs:

- (a) a description of the discontinuing operation(s);**
- (b) the business or geographical segment(s) in which it is reported as per AS 17, Segment Reporting;**
- (c) the date and nature of the initial disclosure event;**
- (d) the date or period in which the discontinuance is expected to be completed if known or determinable;**
- (e) the carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;**
- (f) the amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;**

²Pursuant to AS 29, Provisions, Contingent Liabilities and Contingent Assets, becoming mandatory, all paragraphs of AS 4 that deal with contingencies stand withdrawn except to the extent they deal with impairment of assets not covered by other Accounting Standards.

³Accounting Standard (AS) 28, 'Impairment of Assets', specifies the requirements relating to impairment of assets.

- (g) the amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense⁴ related thereto; and**
- (h) the amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.**

21. For the purpose of presentation and disclosures required by this Standard, the items of assets, liabilities, revenues, expenses, gains, losses, and cash flows can be attributed to a discontinuing operation only if they will be disposed of, settled, reduced, or eliminated when the discontinuance is completed. To the extent that such items continue after completion of the discontinuance, they are not allocated to the discontinuing operation. For example, salary of the continuing staff of a discontinuing operation.

22. If an initial disclosure event occurs between the balance sheet date and the date on which the financial statements for that period are approved by the board of directors in the case of a company or by the corresponding approving authority in the case of any other enterprise, disclosures as required by Accounting Standard (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date, are made.

Other Disclosures

23. When an enterprise disposes of assets or settles liabilities attributable to a discontinuing operation or enters into binding agreements for the sale of such assets or the settlement of such liabilities, it should include, in its financial statements, the following information when the events occur:

- (a) for any gain or loss that is recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation, (i) the amount of the pre-tax gain or loss and (ii) income tax expense relating to the gain or loss; and**
- (b) the net selling price or range of prices (which is after deducting expected disposal costs) of those net assets for which the enterprise has entered into one or more binding sale agreements, the expected timing of receipt of those cash flows and the carrying amount of those net assets on the balance sheet date.**

24. The asset disposals, liability settlements, and binding sale agreements referred to in the preceding paragraph may occur concurrently with the initial disclosure event, or in the period in which the initial disclosure event occurs, or in a later period.

25. If some of the assets attributable to a discontinuing operation have actually been sold or are the subject of one or more binding sale agreements entered into between the balance sheet date and the date on which the financial statements are approved by the board of directors in case of a company or by the corresponding approving authority in

⁴As defined in Accounting Standard (AS) 22, Accounting for Taxes on Income.

the case of any other enterprise, the disclosures required by Accounting Standard (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date, are made.

Updating the Disclosures

26. In addition to the disclosures in paragraphs 20 and 23, an enterprise should include, in its financial statements, for periods subsequent to the one in which the initial disclosure event occurs, a description of any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled and the events causing those changes.

27. Examples of events and activities that would be disclosed include the nature and terms of binding sale agreements for the assets, a demerger or spin-off by issuing equity shares of the new company to the enterprise's shareholders, and legal or regulatory approvals.

28. The disclosures required by paragraphs 20, 23 and 26 should continue in financial statements for periods up to and including the period in which the discontinuance is completed. A discontinuance is completed when the plan is substantially completed or abandoned, though full payments from the buyer(s) may not yet have been received.

29. If an enterprise abandons or withdraws from a plan that was previously reported as a discontinuing operation, that fact, reasons therefor and its effect should be disclosed.

30. For the purpose of applying paragraph 29, disclosure of the effect includes reversal of any prior impairment loss⁵ or provision that was recognised with respect to the discontinuing operation.

Separate Disclosure for Each Discontinuing Operation

31. Any disclosures required by this Standard should be presented separately for each discontinuing operation.

Presentation of the Required Disclosures

32. The disclosures required by paragraphs 20, 23, 26, 28, 29 and 31 should be presented in the notes to the financial statements except the following which should be shown on the face of the statement of profit and loss:

- (a) the amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto (paragraph 20 (g)); and**
- (b) the amount of the pre-tax gain or loss recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation (paragraph 23 (a)).**

⁵Accounting Standard (AS) 28, 'Impairment of Assets', specifies the requirements relating to reversal of impairment loss.

Illustrative Presentation and Disclosures

33. Illustration 1 attached to the standard illustrates the presentation and disclosures required by this Standard.

Restatement of Prior Periods

34. Comparative information for prior periods that is presented in financial statements prepared after the initial disclosure event should be restated to segregate assets, liabilities, revenue, expenses, and cash flows of continuing and discontinuing operations in a manner similar to that required by paragraphs 20, 23, 26, 28, 29, 31 and 32.

35. Illustration 2 attached to this Standard illustrates application of paragraph 34.

Disclosure in Interim Financial Reports

36. Disclosures in an interim financial report in respect of a discontinuing operation should be made in accordance with AS 25, Interim Financial Reporting, including:

- (a) any significant activities or events since the end of the most recent annual reporting period relating to a discontinuing operation; and**
- (b) any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled.**

Illustration 1

Illustrative Disclosures

This illustration does not form part of the Accounting Standard. Its purpose is to illustrate the application of the Accounting Standard to assist in clarifying its meaning.

Facts

- Delta Company has three segments, Food Division, Beverage Division and Clothing Division.
- Clothing Division, is deemed inconsistent with the long-term strategy of the Company. Management has decided, therefore, to dispose of the Clothing Division.
- On 15 November 20X1, the Board of Directors of Delta Company approved a detailed, formal plan for disposal of Clothing Division, and an announcement was made. On that date the Clothing Division's net assets was ₹ 90 lakhs (assets of ₹ 105 lakhs minus liabilities of ₹ 15 lakhs).
- The recoverable amount of the assets carried at ₹ 105 lakhs was estimated to be ₹ 85 lakhs and the Company had concluded that a pre-tax impairment loss of ₹ 20 lakhs should be recognised.
- At 31 December 20X1, the carrying amount of the Clothing Division's net assets was ₹ 70 lakhs (assets of ₹ 85 lakhs minus liabilities of ₹ 15 lakhs). There was no further impairment of assets between 15 November 20X1 and 31 December 20X1 when the financial statements were prepared.

- On 30 September 20X2, the carrying amount of the net assets of the Clothing Division continued to be ₹ 70 lakhs. On that day, Delta Company signed a legally binding contract to sell the Clothing Division.
- The sale is expected to be completed by 31 January 20X3. The recoverable amount of the net assets is ₹ 60 lakhs. Based on that amount, an additional impairment loss of ₹ 10 lakhs is recognised.
- In addition, prior to 31 January 20X3, the sale contract obliges Delta Company to terminate employment of certain employees of the Clothing Division, which would result in termination cost of ₹ 30 lakhs, to be paid by 30 June 20X3. A liability and related expense in this regard is also recognised.
- The Company continued to operate the Clothing Division throughout 20X2.
- At 31 December 20X2, the carrying amount of the Clothing Division's net assets is ₹ 45 lakhs, consisting of assets of ₹ 80 lakhs minus liabilities of ₹ 35 lakhs (including provision for expected termination cost of ₹ 30 lakhs).
- Delta Company prepares its financial statements annually as of 31 December. It does not prepare a cash flow statement.
- Other figures in the following financial statements are assumed to illustrate the presentation and disclosures required by the Standard.

I. Financial Statements for 20X1

1.1 Statement of Profit and Loss for 20X1

The Statement of Profit and Loss of Delta Company for the year 20X1 can be presented as follows:

(Amount in ₹ lakhs)

		20X1		20X0
Turnover		140		150
Operating expenses		(92)		(105)
Impairment loss		<u>(20)</u>		<u>(---)</u>
Pre-tax profit from operating activities		28		45
Interest expense		(15)		(20)
Profit before tax		13		25
Profit from continuing operations before tax (see Note 5)	15		12	
Income tax expense	(7)		(6)	
Profit from continuing operations after tax		8		6
Profit (loss) from				

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discontinuing operations before tax (see Note 5)	(2)		13	
Income tax expense	1		(7)	
Profit (loss) from discontinuing operations after tax		(1)		6
Profit from operating activities after tax		7		12

1.2 Note to Financial Statements for 20X1

The following is Note 5 to Delta Company's financial statements:

On 15 November 20X1, the Board of Directors announced a plan to dispose of Company's Clothing Division, which is also a separate segment as per AS 17, Segment Reporting. The disposal is consistent with the Company's long-term strategy to focus its activities in the areas of food and beverage manufacture and distribution, and to divest unrelated activities. The Company is actively seeking a buyer for the Clothing Division and hopes to complete the sale by the end of 20X2. At 31 December 20X1, the carrying amount of the assets of the Clothing Division was ₹ 85 lakhs (previous year ₹ 120 lakhs) and its liabilities were ₹ 15 lakhs (previous year ₹ 20 lakhs). The following statement shows the revenue and expenses of continuing and discontinuing operations:

(Amount in ₹ lakhs)

	Continuing Operations (Food and Beverage Divisions)		Discontinuing Operation (Clothing Division)		Total	
	20X1	20X0	20X1	20X0	20X1	20X0
Turnover	90	80	50	70	140	150
Operating Expenses	(65)	(60)	(27)	(45)	(92)	(105)
Impairment Loss	----	----	(20)	(---)	(20)	(---)
Pre-tax profit from operating activities	25	20	3	25	28	45
Interest expense	(10)	(8)	(5)	(12)	(15)	(20)
Profit (loss) before tax	15	12	(2)	13	13	25
Income tax expense	(7)	(6)	1	(7)	(6)	(13)
Profit (loss) from operating activities after tax	8	6	(1)	6	7	12

II. Financial Statements for 20X2

2.1 Statement of Profit and Loss for 20X2

The Statement of Profit and Loss of Delta Company for the year 20X2 can be presented as follows:

(Amount in ₹ lakhs)

	20X2	20X1
Turnover	140	140
Operating expenses	(90)	(92)
Impairment loss	(10)	(20)
Provision for employee termination benefits	<u>(30)</u>	=
Pre-tax profit from operating activities	10	28
Interest expense	<u>(25)</u>	<u>(15)</u>
Profit (loss) before tax	<u>(15)</u>	<u>13</u>
Profit from continuing operations before tax (see Note 5)	20	15
Income tax expense	<u>(6)</u>	<u>(7)</u>
Profit from continuing operations after tax	14	8
Loss from discontinuing operations before tax (see Note 5)	(35)	(2)
Income tax expense	<u>10</u>	<u>1</u>
Loss from discontinuing operations after tax	<u>(25)</u>	<u>(1)</u>
Profit (loss) from operating activities after tax	(11)	7

2.2 Note to Financial Statements for 20X2

The following is Note 5 to Delta Company's financial statements:

On 15 November 20X1, the Board of Directors had announced a plan to dispose of Company's Clothing Division, which is also a separate segment as per AS 17, Segment Reporting. The disposal is consistent with the Company's long-term strategy to focus its activities in the areas of food and beverage manufacture and distribution, and to divest unrelated activities. On 30 September 20X2, the Company signed a contract to sell the Clothing Division to Z Corporation for ₹ 60 lakhs.

Clothing Division's assets are written down by ₹ 10 lakhs (previous year ₹ 20 lakhs) before income tax saving of ₹ 3 lakhs (previous year ₹ 6 lakhs) to their recoverable amount.

The Company has recognised provision for termination benefits of ₹ 30 lakhs (previous year ₹ nil) before income tax saving of ₹ 9 lakhs (previous year ₹ nil) to be paid by 30 June 20X3 to certain employees of the Clothing Division whose jobs will be terminated as a result of the sale.

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At 31 December 20X2, the carrying amount of assets of the Clothing Division was ₹ 80 lakhs (previous year ₹ 85 lakhs) and its liabilities were ₹ 35 lakhs (previous year ₹ 15 lakhs), including the provision for expected termination cost of ₹ 30 lakhs (previous year ₹ nil). The process of selling the Clothing Division is likely to be completed by 31 January 20X3.

The following statement shows the revenue and expenses of continuing and discontinuing operations:

(Amount in ₹ lakhs)

	Continuing Operations (Food and Beverage Divisions)		Discontinuing Operation (Clothing Division)		Total	
	20X2	20X1	20X2	20X1	20X2	20X1
Turnover	100	90	40	50	140	140
Operating Expenses	(60)	(65)	(30)	(27)	(90)	(92)
Impairment Loss	----	----	(10)	(20)	(10)	(20)
Provision for employee termination	----	----	(30)	----	(30)	---
Pre-tax profit (loss) from operating activities	40	25	(30)	3	10	28
Interest expense	(20)	(10)	(5)	(5)	(25)	(15)
Profit (loss) before tax	20	15	(35)	(2)	(15)	13
Income tax expense	(6)	(7)	10	1	4	(6)
Profit (loss) from operating activities after tax	14	8	(25)	(1)	(11)	7

III. Financial Statements for 20X3

The financial statements for 20X3, would disclose information related to discontinued operations in a manner similar to that for 20X2 including the fact of completion of discontinuance.

Illustration 2

Classification of Prior Period Operations

This illustration does not form part of the Accounting Standard. Its purpose is to illustrate the application of the Accounting Standard to assist in clarifying its meaning.

Facts

1. Paragraph 34 requires that comparative information for prior periods that is presented in financial statements prepared after the initial disclosure event be restated to segregate

assets, liabilities, revenue, expenses, and cash flows of continuing and discontinuing operations in a manner similar to that required by paragraphs 20, 23, 26, 28, 29, 31 and 32.

2. Consider following facts:
- (a) Operations A, B, C, and D were all continuing in years 1 and 2;
 - (b) Operation D is approved and announced for disposal in year 3 but actually disposed of in year 4;
 - (c) Operation B is discontinued in year 4 (approved and announced for disposal and actually disposed of) and operation E is acquired; and
 - (d) Operation F is acquired in year 5.
3. The following table illustrates the classification of continuing and discontinuing operations in years 3 to 5:

FINANCIAL STATEMENTS FOR YEAR 3 (Approved and Published early in Year 4)			
Year 2 Comparatives		Year 3	
Continuing	Discontinuing	Continuing	Discontinuing
A		A	
B		B	
C		C	
	D		D

FINANCIAL STATEMENTS FOR YEAR 4 (Approved and Published early in Year 5)			
Year 3 Comparatives		Year 4	
Continuing	Discontinuing	Continuing	Discontinuing
A		A	
	B		B
C		C	
	D		D
		E	

FINANCIAL STATEMENTS FOR YEAR 5 (Approved and Published early in Year 6)			
Year 4 Comparatives		Year 5	
Continuing	Discontinuing	Continuing	Discontinuing
A		A	
	B		
C		C	
	D		
E		E	
		F	

4. If, for whatever reason, five-year comparative financial statements were prepared in year 5, the classification of continuing and discontinuing operations would be as follows:

FINANCIAL STATEMENTS FOR YEAR 5									
Year 1		Year 2		Year 3		Year 4		Year 5	
Comparatives		Comparatives		Comparatives		Comparatives			
Cont.	Disc.	Cont.	Disc.	Cont.	Disc.	Cont.	Disc.	Cont.	Disc.
A		A		A		A		A	
	B		B		B		B		
C		C		C		C		C	
	D		D		D		D		
						E		E	
								F	

AS 26* : Intangible Assets

*[This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective, the Preface to the Statements of Accounting Standards¹ and the 'Applicability of Accounting Standards to Various Entities'.]*

Objective

The objective of this Standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Accounting Standard. This Standard requires an enterprise to recognise an intangible asset if, and only if, certain criteria are met. The Standard also specifies how to measure the carrying amount of intangible assets and requires certain disclosures about intangible assets.

Scope

1. This Standard should be applied by all enterprises in accounting for intangible assets, except:

- (a) intangible assets that are covered by another Accounting Standard;**
- (b) financial assets²;**

* Issued in 2002.

¹Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material.

²A financial asset is any asset that is:

- (a) cash;
- (b) a contractual right to receive cash or another financial asset from another enterprise;

(c) mineral rights and expenditure on the exploration for, or development and extraction of, minerals, oil, natural gas and similar non-regenerative resources; and

(d) intangible assets arising in insurance enterprises from contracts with policyholders.

This Standard should not be applied to expenditure in respect of termination benefits³ also.

2. If another Accounting Standard deals with a specific type of intangible asset, an enterprise applies that Accounting Standard instead of this Standard. For example, this Standard does not apply to:

- (a) intangible assets held by an enterprise for sale in the ordinary course of business (see AS 2, Valuation of Inventories, and AS 7, Construction Contracts);
- (b) deferred tax assets (see AS 22, Accounting for Taxes on Income);
- (c) leases that fall within the scope of AS 19, Leases; and
- (d) goodwill arising on an amalgamation (see AS 14, Accounting for Amalgamations) and goodwill arising on consolidation (see AS 21, Consolidated Financial Statements).

3. This Standard applies to, among other things, expenditure on advertising, training, start-up, research and development activities. Research and development activities are directed to the development of knowledge. Therefore, although these activities may result in an asset with physical substance (for example, a prototype), the physical element of the asset is secondary to its intangible component, that is the knowledge embodied in it. This Standard also applies to rights under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights. These items are excluded from the scope of AS 19.

4. In the case of a finance lease, the underlying asset may be either tangible or intangible. After initial recognition, a lessee deals with an intangible asset held under a finance lease under this Standard.

5. Exclusions from the scope of an Accounting Standard may occur if certain activities or transactions are so specialised that they give rise to accounting issues that may need to be dealt with in a different way. Such issues arise in the expenditure on the exploration for, or development and extraction of, oil, gas and mineral deposits in extractive industries and in the case of contracts between insurance enterprises and their policyholders. Therefore, this Standard does not apply to expenditure on such activities. However, this Standard applies to other intangible assets used (such as computer software), and other expenditure

(c) a contractual right to exchange financial instruments with another enterprise under conditions that are potentially favourable; or

(d) an ownership interest in another enterprise.

³Termination benefits are employee benefits payable as a result of either:

(such as start-up costs), in extractive industries or by insurance enterprises. Accounting issues of specialised nature also arise in respect of accounting for discount or premium relating to borrowings and ancillary costs incurred in connection with the arrangement of borrowings, share issue expenses and discount allowed on the issue of shares. Accordingly, this Standard does not apply to such items also.

Definitions

6. The following terms are used in this Standard with the meanings specified:

6.1 An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

6.2 An asset is a resource:

(a) controlled by an enterprise as a result of past events; and

(b) from which future economic benefits are expected to flow to the enterprise.

6.3 Monetary assets are money held and assets to be received in fixed or determinable amounts of money.

6.4 Non-monetary assets are assets other than monetary assets.

6.5 Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

6.6 Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.

6.7 Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

6.8 Depreciable amount is the cost of an asset less its residual value.

6.9 Useful life is either:

(a) the period of time over which an asset is expected to be used by the enterprise; or

(b) the number of production or similar units expected to be obtained from the asset by the enterprise.

6.10. Residual value is the amount which an enterprise expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.

6.11. Fair value of an asset is the amount for which that asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

6.12. An active market is a market where all the following conditions exist:

(a) the items traded within the market are homogeneous;

(b) willing buyers and sellers can normally be found at any time; and

(c) *prices are available to the public.*

6.13. *An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount⁴.*

6.14. *Carrying amount is the amount at which an asset is recognised in the balance sheet, net of any accumulated amortisation and accumulated impairment losses thereon.*

Intangible Assets

7. Enterprises frequently expend resources, or incur liabilities, on the acquisition, development, maintenance or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new processes or systems, licences, intellectual property, market knowledge and trademarks (including brand names and publishing titles). Common examples of items encompassed by these broad headings are computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, fishing licences, import quotas, franchises, customer or supplier relationships, customer loyalty, market share and marketing rights. Goodwill is another example of an item of intangible nature which either arises on acquisition or is internally generated.

8. Not all the items described in paragraph 7 will meet the definition of an intangible asset, that is, identifiability, control over a resource and expectation of future economic benefits flowing to the enterprise. If an item covered by this Standard does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. However, if the item is acquired in an amalgamation in the nature of purchase, it forms part of the goodwill recognised at the date of the amalgamation (see paragraph 55).

9. Some intangible assets may be contained in or on a physical substance such as a compact disk (in the case of computer software), legal documentation (in the case of a licence or patent) or film (in the case of motion pictures). The cost of the physical substance containing the intangible assets is usually not significant. Accordingly, the physical substance containing an intangible asset, though tangible in nature, is commonly treated as a part of the intangible asset contained in or on it.

10. In some cases, an asset may incorporate both intangible and tangible elements that are, in practice, inseparable. In determining whether such an asset should be treated under AS 10, Accounting for Fixed Assets, or as an intangible asset under this Standard, judgement is required to assess as to which element is predominant. For example, computer software for a computer controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as a fixed

⁴Accounting Standard (AS) 28, 'Impairment of Assets', specifies the requirements relating to impairment of assets.

asset. The same applies to the operating system of a computer. Where the software is not an integral part of the related hardware, computer software is treated as an intangible asset.

Identifiability

11. The definition of an intangible asset requires that an intangible asset be identifiable. To be identifiable, it is necessary that the intangible asset is clearly distinguished from goodwill. Goodwill arising on an amalgamation in the nature of purchase represents a payment made by the acquirer in anticipation of future economic benefits. The future economic benefits may result from synergy between the identifiable assets acquired or from assets which, individually, do not qualify for recognition in the financial statements but for which the acquirer is prepared to make a payment in the amalgamation.

12. An intangible asset can be clearly distinguished from goodwill if the asset is separable. An asset is separable if the enterprise could rent, sell, exchange or distribute the specific future economic benefits attributable to the asset without also disposing of future economic benefits that flow from other assets used in the same revenue earning activity.

13. Separability is not a necessary condition for identifiability since an enterprise may be able to identify an asset in some other way. For example, if an intangible asset is acquired with a group of assets, the transaction may involve the transfer of legal rights that enable an enterprise to identify the intangible asset. Similarly, if an internal project aims to create legal rights for the enterprise, the nature of these rights may assist the enterprise in identifying an underlying internally generated intangible asset. Also, even if an asset generates future economic benefits only in combination with other assets, the asset is identifiable if the enterprise can identify the future economic benefits that will flow from the asset.

Control

14. An enterprise controls an asset if the enterprise has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits. The capacity of an enterprise to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control since an enterprise may be able to control the future economic benefits in some other way.

15. Market and technical knowledge may give rise to future economic benefits. An enterprise controls those benefits if, for example, the knowledge is protected by legal rights such as copyrights, a restraint of trade agreement (where permitted) or by a legal duty on employees to maintain confidentiality.

16. An enterprise may have a team of skilled staff and may be able to identify incremental staff skills leading to future economic benefits from training. The enterprise may also expect that the staff will continue to make their skills available to the enterprise. However, usually an enterprise has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training to consider that these items meet the

definition of an intangible asset. For a similar reason, specific management or technical talent is unlikely to meet the definition of an intangible asset, unless it is protected by legal rights to use it and to obtain the future economic benefits expected from it, and it also meets the other parts of the definition.

17. An enterprise may have a portfolio of customers or a market share and expect that, due to its efforts in building customer relationships and loyalty, the customers will continue to trade with the enterprise. However, in the absence of legal rights to protect, or other ways to control, the relationships with customers or the loyalty of the customers to the enterprise, the enterprise usually has insufficient control over the economic benefits from customer relationships and loyalty to consider that such items (portfolio of customers, market shares, customer relationships, customer loyalty) meet the definition of intangible assets.

Future Economic Benefits

18. The future economic benefits flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the enterprise. For example, the use of intellectual property in a production process may reduce future production costs rather than increase future revenues.

Recognition and Initial Measurement of an Intangible Asset

19. The recognition of an item as an intangible asset requires an enterprise to demonstrate that the item meets the:

- (a) definition of an intangible asset (see paragraphs 6-18); and
- (b) recognition criteria set out in this Standard (see paragraphs 20-54).

20. *An intangible asset should be recognised if, and only if:*

- (a) *it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and***
- (b) *the cost of the asset can be measured reliably.***

21. *An enterprise should assess the probability of future economic benefits using reasonable and supportable assumptions that represent best estimate of the set of economic conditions that will exist over the useful life of the asset.*

22. An enterprise uses judgement to assess the degree of certainty attached to the flow of future economic benefits that are attributable to the use of the asset on the basis of the evidence available at the time of initial recognition, giving greater weight to external evidence.

23. *An intangible asset should be measured initially at cost.*

Separate Acquisition

24. If an intangible asset is acquired separately, the cost of the intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

25. The cost of an intangible asset comprises its purchase price, including any import duties and other taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), and any directly attributable expenditure on making the asset ready for its intended use. Directly attributable expenditure includes, for example, professional fees for legal services. Any trade discounts and rebates are deducted in arriving at the cost.

26. If an intangible asset is acquired in exchange for shares or other securities of the reporting enterprise, the asset is recorded at its fair value, or the fair value of the securities issued, whichever is more clearly evident.

Acquisition as Part of an Amalgamation

27. An intangible asset acquired in an amalgamation in the nature of purchase is accounted for in accordance with Accounting Standard (AS) 14, Accounting for Amalgamations. Where in preparing the financial statements of the transferee company, the consideration is allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation, paragraphs 28 to 32 of this Standard need to be considered.

28. Judgement is required to determine whether the cost (i.e. fair value) of an intangible asset acquired in an amalgamation can be measured with sufficient reliability for the purpose of separate recognition. Quoted market prices in an active market provide the most reliable measurement of fair value. The appropriate market price is usually the current bid price. If current bid prices are unavailable, the price of the most recent similar transaction may provide a basis from which to estimate fair value, provided that there has not been a significant change in economic circumstances between the transaction date and the date at which the asset's fair value is estimated.

29. If no active market exists for an asset, its cost reflects the amount that the enterprise would have paid, at the date of the acquisition, for the asset in an arm's length transaction between knowledgeable and willing parties, based on the best information available. In determining this amount, an enterprise considers the outcome of recent transactions for similar assets.

30. Certain enterprises that are regularly involved in the purchase and sale of unique intangible assets have developed techniques for estimating their fair values indirectly. These techniques may be used for initial measurement of an intangible asset acquired in an amalgamation in the nature of purchase if their objective is to estimate fair value as defined in this Standard and if they reflect current transactions and practices in the industry to which the asset belongs. These techniques include, where appropriate, applying multiples reflecting current market transactions to certain indicators driving the profitability of the asset (such as revenue, market shares, operating profit, etc.) or discounting estimated future net cash flows from the asset.

31. In accordance with this Standard:

- (a) a transferee recognises an intangible asset that meets the recognition criteria in paragraphs 20 and 21, even if that intangible asset had not been recognised in the financial statements of the transferor; and

- (b) if the cost (i.e. fair value) of an intangible asset acquired as part of an amalgamation in the nature of purchase cannot be measured reliably, that asset is not recognised as a separate intangible asset but is included in goodwill (see paragraph 55).

32. Unless there is an active market for an intangible asset acquired in an amalgamation in the nature of purchase, the cost initially recognised for the intangible asset is restricted to an amount that does not create or increase any capital reserve arising at the date of the amalgamation.

Acquisition by way of a Government Grant

33. In some cases, an intangible asset may be acquired free of charge, or for nominal consideration, by way of a government grant. This may occur when a government transfers or allocates to an enterprise intangible assets such as airport landing rights, licences to operate radio or television stations, import licences or quotas or rights to access other restricted resources. AS 12, Accounting for Government Grants, requires that government grants in the form of non-monetary assets, given at a concessional rate should be accounted for on the basis of their acquisition cost. AS 12 also requires that in case a non-monetary asset is given free of cost, it should be recorded at a nominal value. Accordingly, intangible asset acquired free of charge, or for nominal consideration, by way of government grant is recognised at a nominal value or at the acquisition cost, as appropriate; any expenditure that is directly attributable to making the asset ready for its intended use is also included in the cost of the asset.

Exchanges of Assets

34. An intangible asset may be acquired in exchange or part exchange for another asset. In such a case, the cost of the asset acquired is determined in accordance with the principles laid down in this regard in AS 10, Accounting for Fixed Assets.

Internally Generated Goodwill

35. Internally generated goodwill should not be recognised as an asset.

36. In some cases, expenditure is incurred to generate future economic benefits, but it does not result in the creation of an intangible asset that meets the recognition criteria in this Standard. Such expenditure is often described as contributing to internally generated goodwill. Internally generated goodwill is not recognised as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost.

37. Differences between the market value of an enterprise and the carrying amount of its identifiable net assets at any point in time may be due to a range of factors that affect the value of the enterprise. However, such differences cannot be considered to represent the cost of intangible assets controlled by the enterprise.

Internally Generated Intangible Assets

38. It is sometimes difficult to assess whether an internally generated intangible asset qualifies for recognition. It is often difficult to:

- (a) identify whether, and the point of time when, there is an identifiable asset that will generate probable future economic benefits; and
- (b) determine the cost of the asset reliably. In some cases, the cost of generating an intangible asset internally cannot be distinguished from the cost of maintaining or enhancing the enterprise's internally generated goodwill or of running day-to-day operations.

Therefore, in addition to complying with the general requirements for the recognition and initial measurement of an intangible asset, an enterprise applies the requirements and guidance in paragraphs 39-54 below to all internally generated intangible assets.

39. To assess whether an internally generated intangible asset meets the criteria for recognition, an enterprise classifies the generation of the asset into:

- (a) a research phase; and
- (b) a development phase.

Although the terms 'research' and 'development' are defined, the terms 'research phase' and 'development phase' have a broader meaning for the purpose of this Standard.

40. If an enterprise cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the enterprise treats the expenditure on that project as if it were incurred in the research phase only.

Research Phase

41. No intangible asset arising from research (or from the research phase of an internal project) should be recognised. Expenditure on research (or on the research phase of an internal project) should be recognised as an expense when it is incurred.

42. This Standard takes the view that, in the research phase of a project, an enterprise cannot demonstrate that an intangible asset exists from which future economic benefits are probable. Therefore, this expenditure is recognised as an expense when it is incurred.

43. Examples of research activities are:

- (a) activities aimed at obtaining new knowledge;
- (b) the search for, evaluation and final selection of, applications of research findings or other knowledge;
- (c) the search for alternatives for materials, devices, products, processes, systems or services; and
- (d) the formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.

Development Phase

44. An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an enterprise can demonstrate all of the following:

- (a) the technical feasibility of completing the intangible asset so that it will be available for use or sale;**
- (b) its intention to complete the intangible asset and use or sell it;**
- (c) its ability to use or sell the intangible asset;**
- (d) how the intangible asset will generate probable future economic benefits. Among other things, the enterprise should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;**
- (e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and**
- (f) its ability to measure the expenditure attributable to the intangible asset during its development reliably.**

45. In the development phase of a project, an enterprise can, in some instances, identify an intangible asset and demonstrate that future economic benefits from the asset are probable. This is because the development phase of a project is further advanced than the research phase.

46. Examples of development activities are:

- (a) the design, construction and testing of pre-production or pre-use prototypes and models;
- (b) the design of tools, jigs, moulds and dies involving new technology;
- (c) the design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production; and
- (d) the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.

47. To demonstrate how an intangible asset will generate probable future economic benefits, an enterprise assesses the future economic benefits to be received from the asset using the principles in Accounting Standard on Impairment of Assets⁵. If the asset will generate economic benefits only in combination with other assets, the enterprise applies the concept of cash-generating units as set out in Accounting Standard on Impairment of Assets.

48. Availability of resources to complete, use and obtain the benefits from an intangible asset can be demonstrated by, for example, a business plan showing the technical, financial and other resources needed and the enterprise's ability to secure those resources. In certain cases, an enterprise demonstrates the availability of external finance by obtaining a lender's indication of its willingness to fund the plan.

⁵Accounting Standard (AS) 28, 'Impairment of Assets', specifies the requirements relating to impairment of assets.

49. An enterprise's costing systems can often measure reliably the cost of generating an intangible asset internally, such as salary and other expenditure incurred in securing copyrights or licences or developing computer software.

50. Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognised as intangible assets.

51. This Standard takes the view that expenditure on internally generated brands, mastheads, publishing titles, customer lists and items similar in substance cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognised as intangible assets.

Cost of an Internally Generated Intangible Asset

52. The cost of an internally generated intangible asset for the purpose of paragraph 23 is the sum of expenditure incurred from the time when the intangible asset first meets the recognition criteria in paragraphs 20-21 and

44. Paragraph 58 prohibits reinstatement of expenditure recognised as an expense in previous annual financial statements or interim financial reports.

53. The cost of an internally generated intangible asset comprises all expenditure that can be directly attributed, or allocated on a reasonable and consistent basis, to creating, producing and making the asset ready for its intended use. The cost includes, if applicable:

- (a) expenditure on materials and services used or consumed in generating the intangible asset;
- (b) the salaries, wages and other employment related costs of personnel directly engaged in generating the asset;
- (c) any expenditure that is directly attributable to generating the asset, such as fees to register a legal right and the amortisation of patents and licences that are used to generate the asset; and
- (d) overheads that are necessary to generate the asset and that can be allocated on a reasonable and consistent basis to the asset (for example, an allocation of the depreciation of fixed assets, insurance premium and rent). Allocations of overheads are made on bases similar to those used in allocating overheads to inventories (see AS 2, Valuation of Inventories). AS 16, Borrowing Costs, establishes criteria for the recognition of interest as a component of the cost of a qualifying asset. These criteria are also applied for the recognition of interest as a component of the cost of an internally generated intangible asset.

54. The following are not components of the cost of an internally generated intangible asset:

- (a) selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to making the asset ready for use;
- (b) clearly identified inefficiencies and initial operating losses incurred before an asset achieves planned performance; and

- (c) expenditure on training the staff to operate the asset.

Example Illustrating Paragraph 52

An enterprise is developing a new production process. During the year 20X1, expenditure incurred was ₹ 10 lakhs, of which ₹ 9 lakhs was incurred before 1 December 20X1 and 1 lakh was incurred between 1 December 20X1 and 31 December 20X1. The enterprise is able to demonstrate that, at 1 December 20X1, the production process met the criteria for recognition as an intangible asset. The recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be ₹ 5 lakhs.

At the end of 20X1, the production process is recognised as an intangible asset at a cost of ₹ 1 lakh (expenditure incurred since the date when the recognition criteria were met, that is, 1 December 20X1). The ₹ 9 lakhs expenditure incurred before 1 December 20X1 is recognised as an expense because the recognition criteria were not met until 1 December 20X1. This expenditure will never form part of the cost of the production process recognised in the balance sheet.

During the year 20X2, expenditure incurred is ₹ 20 lakhs. At the end of 20X2, the recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be ₹ 19 lakhs.

At the end of the year 20X2, the cost of the production process is ₹ 21 lakhs (₹ 1 lakh expenditure recognised at the end of 20X1 plus ₹ 20 lakhs expenditure recognised in 20X2). The enterprise recognises an impairment loss of ₹ 2 lakhs to adjust the carrying amount of the process before impairment loss (₹ 21 lakhs) to its recoverable amount (₹ 19 lakhs). This impairment loss will be reversed in a subsequent period if the requirements for the reversal of an impairment loss in Accounting Standard on Impairment of Assets⁶, are met.

Recognition of an Expense

55. Expenditure on an intangible item should be recognised as an expense when it is incurred unless:

- (a) it forms part of the cost of an intangible asset that meets the recognition criteria (see paragraphs 19-54); or**
- (b) the item is acquired in an amalgamation in the nature of purchase and cannot be recognised as an intangible asset. If this is the case, this expenditure (included in the cost of acquisition) should form part of the amount attributed to goodwill (capital reserve) at the date of acquisition (see AS 14, Accounting for Amalgamations).**

56. In some cases, expenditure is incurred to provide future economic benefits to an enterprise, but no intangible asset or other asset is acquired or created that can be

⁶Accounting Standard (AS) 28, 'Impairment of Assets', specifies the requirements relating to impairment of assets.

recognised. In these cases, the expenditure is recognised as an expense when it is incurred. For example, expenditure on research is always recognised as an expense when it is incurred (see paragraph 41). Examples of other expenditure that is recognised as an expense when it is incurred include:

- (a) expenditure on start-up activities (start-up costs), unless this expenditure is included in the cost of an item of fixed asset under AS 10. Start-up costs may consist of preliminary expenses incurred in establishing a legal entity such as legal and secretarial costs, expenditure to open a new facility or business (pre-opening costs) or expenditures for commencing new operations or launching new products or processes (pre-operating costs);
- (b) expenditure on training activities;
- (c) expenditure on advertising and promotional activities; and
- (d) expenditure on relocating or re-organising part or all of an enterprise.

57. Paragraph 55 does not apply to payments for the delivery of goods or services made in advance of the delivery of goods or the rendering of services. Such prepayments are recognised as assets.

Past Expenses not to be Recognised as an Asset

58. *Expenditure on an intangible item that was initially recognised as an expense by a reporting enterprise in previous annual financial statements or interim financial reports should not be recognised as part of the cost of an intangible asset at a later date.*

Subsequent Expenditure

59. *Subsequent expenditure on an intangible asset after its purchase or its completion should be recognised as an expense when it is incurred unless:*

- (a) *it is probable that the expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and***
- (b) *the expenditure can be measured and attributed to the asset reliably.***

If these conditions are met, the subsequent expenditure should be added to the cost of the intangible asset.

60. Subsequent expenditure on a recognised intangible asset is recognised as an expense if this expenditure is required to maintain the asset at its originally assessed standard of performance. The nature of intangible assets is such that, in many cases, it is not possible to determine whether subsequent expenditure is likely to enhance or maintain the economic benefits that will flow to the enterprise from those assets. In addition, it is often difficult to attribute such expenditure directly to a particular intangible asset rather than the business as a whole. Therefore, only rarely will expenditure incurred after the initial recognition of a purchased intangible asset or after completion of an internally generated intangible asset result in additions to the cost of the intangible asset.

61. Consistent with paragraph 50, subsequent expenditure on brands, mastheads, publishing titles, customer lists and items similar in substance (whether externally purchased or internally generated) is always recognised as an expense to avoid the recognition of internally generated goodwill.

Measurement Subsequent to Initial Recognition

62. *After initial recognition, an intangible asset should be carried at its cost less any accumulated amortisation and any accumulated impairment losses.*

Amortisation

Amortisation Period

63. *The depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortisation should commence when the asset is available for use.*

64. As the future economic benefits embodied in an intangible asset are consumed over time, the carrying amount of the asset is reduced to reflect that consumption. This is achieved by systematic allocation of the cost of the asset, less any residual value, as an expense over the asset's useful life. Amortisation is recognised whether or not there has been an increase in, for example, the asset's fair value or recoverable amount. Many factors need to be considered in determining the useful life of an intangible asset including:

- (a) the expected usage of the asset by the enterprise and whether the asset could be efficiently managed by another management team;
- (b) typical product life cycles for the asset and public information on estimates of useful lives of similar types of assets that are used in a similar way;
- (c) technical, technological or other types of obsolescence;
- (d) the stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;
- (e) expected actions by competitors or potential competitors;
- (f) the level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the company's ability and intent to reach such a level;
- (g) the period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and
- (h) whether the useful life of the asset is dependent on the useful life of other assets of the enterprise.

65. Given the history of rapid changes in technology, computer software and many other intangible assets are susceptible to technological obsolescence. Therefore, it is likely that their useful life will be short.

66. Estimates of the useful life of an intangible asset generally become less reliable as the length of the useful life increases. This Standard adopts a presumption that the useful life of intangible assets is unlikely to exceed ten years.

67. In some cases, there may be persuasive evidence that the useful life of an intangible asset will be a specific period longer than ten years. In these cases, the presumption that the useful life generally does not exceed ten years is rebutted and the enterprise:

- (a) amortises the intangible asset over the best estimate of its useful life;
- (b) estimates the recoverable amount of the intangible asset at least annually in order to identify any impairment loss (see paragraph 83); and
- (c) discloses the reasons why the presumption is rebutted and the factor(s) that played a significant role in determining the useful life of the asset (see paragraph 94(a)).

Examples

A. An enterprise has purchased an exclusive right to generate hydro-electric power for sixty years. The costs of generating hydro- electric power are much lower than the costs of obtaining power from alternative sources. It is expected that the geographical area surrounding the power station will demand a significant amount of power from the power station for at least sixty years.

The enterprise amortises the right to generate power over sixty years, unless there is evidence that its useful life is shorter.

B. An enterprise has purchased an exclusive right to operate a toll motorway for thirty years. There is no plan to construct alternative routes in the area served by the motorway. It is expected that this motorway will be in use for at least thirty years.

The enterprise amortises the right to operate the motorway over thirty years, unless there is evidence that its useful life is shorter.

68. The useful life of an intangible asset may be very long but it is always finite. Uncertainty justifies estimating the useful life of an intangible asset on a prudent basis, but it does not justify choosing a life that is unrealistically short.

69. If control over the future economic benefits from an intangible asset is achieved through legal rights that have been granted for a finite period, the useful life of the intangible asset should not exceed the period of the legal rights unless:

- (a) the legal rights are renewable; and**
- (b) renewal is virtually certain.**

70. There may be both economic and legal factors influencing the useful life of an intangible asset: economic factors determine the period over which future economic benefits will be generated; legal factors may restrict the period over which the enterprise controls access to these benefits. The useful life is the shorter of the periods determined by these factors.

71. The following factors, among others, indicate that renewal of a legal right is virtually certain:

- (a) the fair value of the intangible asset is not expected to reduce as the initial expiry date approaches, or is not expected to reduce by more than the cost of renewing the underlying right;
- (b) there is evidence (possibly based on past experience) that the legal rights will be renewed; and
- (c) there is evidence that the conditions necessary to obtain the renewal of the legal right (if any) will be satisfied.

Amortisation Method

72. The amortisation method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise. If that pattern cannot be determined reliably, the straight-line method should be used. The amortisation charge for each period should be recognised as an expense unless another Accounting Standard permits or requires it to be included in the carrying amount of another asset.

73. A variety of amortisation 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 unit of production method. The method used for an asset is selected based on the expected pattern of consumption of economic benefits and is consistently applied from period to period, unless there is a change in the expected pattern of consumption of economic benefits to be derived from that asset. There will rarely, if ever, be persuasive evidence to support an amortisation method for intangible assets that results in a lower amount of accumulated amortisation than under the straight-line method.

74. Amortisation is usually recognised as an expense. However, sometimes, the economic benefits embodied in an asset are absorbed by the enterprise in producing other assets rather than giving rise to an expense. In these cases, the amortisation charge forms part of the cost of the other asset and is included in its carrying amount. For example, the amortisation of intangible assets used in a production process is included in the carrying amount of inventories (see AS 2, Valuation of Inventories).

Residual Value

75. The residual value of an intangible asset should be assumed to be zero unless:

- (a) there is a commitment by a third party to purchase the asset at the end of its useful life; or**
- (b) there is an active market for the asset and:**
 - (i) residual value can be determined by reference to that market; and**
 - (ii) it is probable that such a market will exist at the end of the asset's useful life.**

76. A residual value other than zero implies that an enterprise expects to dispose of the intangible asset before the end of its economic life.

77. The residual value is estimated using prices prevailing at the date of acquisition of the asset, for the sale of a similar asset that has reached the end of its estimated useful life and that has operated under conditions similar to those in which the asset will be used. The residual value is not subsequently increased for changes in prices or value.

Review of Amortisation Period and Amortisation Method

78. The amortisation period and the amortisation method should be reviewed at least at each financial year end. If the expected useful life of the asset is significantly different from previous estimates, the amortisation period should be changed accordingly. If there has been a significant change in the expected pattern of economic benefits from the asset, the amortisation method should be changed to reflect the changed pattern. Such changes should be accounted for in accordance with AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

79. During the life of an intangible asset, it may become apparent that the estimate of its useful life is inappropriate. For example, the useful life may be extended by subsequent expenditure that improves the condition of the asset beyond its originally assessed standard of performance. Also, the recognition of an impairment loss may indicate that the amortisation period needs to be changed.

80. Over time, the pattern of future economic benefits expected to flow to an enterprise from an intangible asset may change. For example, it may become apparent that a diminishing balance method of amortisation is appropriate rather than a straight-line method. Another example is if use of the rights represented by a licence is deferred pending action on other components of the business plan. In this case, economic benefits that flow from the asset may not be received until later periods.

Recoverability of the Carrying Amount — Impairment Losses

81. To determine whether an intangible asset is impaired, an enterprise applies Accounting Standard on Impairment of Assets⁷. That Standard 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 an impairment loss.

82. If an impairment loss occurs before the end of the first annual accounting period commencing after acquisition for an intangible asset acquired in an amalgamation in the nature of purchase, the impairment loss is recognised as an adjustment to both the amount assigned to the intangible asset and the goodwill (capital reserve) recognised at the date of the amalgamation. However, if the impairment loss relates to specific events or changes in circumstances occurring after the date of acquisition, the impairment loss is recognised

⁷Accounting Standard (AS) 28, 'Impairment of Assets', specifies the requirements relating to impairment of assets.

under Accounting Standard on Impairment of Assets and not as an adjustment to the amount assigned to the goodwill (capital reserve) recognised at the date of acquisition.

83. In addition to the requirements of Accounting Standard on Impairment of Assets, an enterprise should estimate the recoverable amount of the following intangible assets at least at each financial year end even if there is no indication that the asset is impaired:

- (a) an intangible asset that is not yet available for use; and**
- (b) an intangible asset that is amortised over a period exceeding ten years from the date when the asset is available for use.**

The recoverable amount should be determined under Accounting Standard on Impairment of Assets and impairment losses recognised accordingly.

84. The ability of an intangible asset to generate sufficient future economic benefits to recover its cost is usually subject to great uncertainty until the asset is available for use. Therefore, this Standard requires an enterprise to test for impairment, at least annually, the carrying amount of an intangible asset that is not yet available for use.

85. It is sometimes difficult to identify whether an intangible asset may be impaired because, among other things, there is not necessarily any obvious evidence of obsolescence. This difficulty arises particularly if the asset has a long useful life. As a consequence, this Standard requires, as a minimum, an annual calculation of the recoverable amount of an intangible asset if its useful life exceeds ten years from the date when it becomes available for use.

86. The requirement for an annual impairment test of an intangible asset applies whenever the current total estimated useful life of the asset exceeds ten years from when it became available for use. Therefore, if the useful life of an intangible asset was estimated to be less than ten years at initial recognition, but the useful life is extended by subsequent expenditure to exceed ten years from when the asset became available for use, an enterprise performs the impairment test required under paragraph 83(b) and also makes the disclosure required under paragraph 94(a).

Retirements and Disposals

87. An intangible asset should be derecognised (eliminated from the balance sheet) on disposal or when no future economic benefits are expected from its use and subsequent disposal.

88. Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the statement of profit and loss.

89. An intangible asset that is retired from active use and held for disposal is carried at its carrying amount at the date when the asset is retired from active use. At least at each

financial year end, an enterprise tests the asset for impairment under Accounting Standard on Impairment of Assets⁸, and recognises any impairment loss accordingly.

Disclosure

General

90. The financial statements should disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:

- (a) the useful lives or the amortisation rates used;**
- (b) the amortisation methods used;**
- (c) the gross carrying amount and the accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period;**
- (d) a reconciliation of the carrying amount at the beginning and end of the period showing:**
 - (i) additions, indicating separately those from internal development and through amalgamation;**
 - (ii) retirements and disposals;**
 - (iii) impairment losses recognised in the statement of profit and loss during the period (if any);**
 - (iv) impairment losses reversed in the statement of profit and loss during the period (if any);**
 - (v) amortisation recognised during the period; and**
 - (vi) other changes in the carrying amount during the period.**

91. A class of intangible assets is a grouping of assets of a similar nature and use in an enterprise's operations. Examples of separate classes may include:

- (a) brand names;
- (b) mastheads and publishing titles;
- (c) computer software;
- (d) licences and franchises;
- (e) copyrights, and patents and other industrial property rights, service and operating rights;
- (f) recipes, formulae, models, designs and prototypes; and
- (g) intangible assets under development.

⁸Accounting Standard (AS) 28, 'Impairment of Assets', specifies the requirements relating to impairment of assets.

The classes mentioned above are disaggregated (aggregated) into smaller (larger) classes if this results in more relevant information for the users of the financial statements.

92. An enterprise discloses information on impaired intangible assets under Accounting Standard on Impairment of Assets⁹ in addition to the information required by paragraph 90(d)(iii) and (iv).

93. An enterprise discloses the change in an accounting estimate or accounting policy such as that arising from changes in the amortisation method, the amortisation period or estimated residual values, in accordance with AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

94. The financial statements should also disclose:

- (a) if an intangible asset is amortised over more than ten years, the reasons why it is presumed that the useful life of an intangible asset will exceed ten years from the date when the asset is available for use. In giving these reasons, the enterprise should describe the factor(s) that played a significant role in determining the useful life of the asset;**
- (b) a description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the financial statements of the enterprise as a whole;**
- (c) the existence and carrying amounts of intangible assets whose title is restricted and the carrying amounts of intangible assets pledged as security for liabilities; and**
- (d) the amount of commitments for the acquisition of intangible assets.**

95. When an enterprise describes the factor(s) that played a significant role in determining the useful life of an intangible asset that is amortised over more than ten years, the enterprise considers the list of factors in paragraph 64.

Research and Development Expenditure

96. The financial statements should disclose the aggregate amount of research and development expenditure recognised as an expense during the period.

97. Research and development expenditure comprises all expenditure that is directly attributable to research or development activities or that can be allocated on a reasonable and consistent basis to such activities (see paragraphs 53-54 for guidance on the type of expenditure to be included for the purpose of the disclosure requirement in paragraph 96).

Other Information

98. An enterprise is encouraged, but not required, to give a description of any fully amortised intangible asset that is still in use.

⁹Accounting Standard (AS) 28, 'Impairment of Assets', specifies the requirements relating to impairment of assets.

Transitional Provisions

99. Where, on the date of this Standard coming into effect, an enterprise is following an accounting policy of not amortising an intangible item or amortising an intangible item over a period longer than the period determined under paragraph 63 of this Standard and the period determined under paragraph 63 has expired on the date of this Standard coming into effect, the carrying amount appearing in the balance sheet in respect of that item should be eliminated with a corresponding adjustment to the opening balance of revenue reserves.

In the event the period determined under paragraph 63 has not expired on the date of this Standard coming into effect and:

- (a) if the enterprise is following an accounting policy of not amortising an intangible item, the carrying amount of the intangible item should be restated, as if the accumulated amortisation had always been determined under this Standard, with the corresponding adjustment to the opening balance of revenue reserves. The restated carrying amount should be amortised over the balance of the period as determined in paragraph 63.**
- (b) if the remaining period as per the accounting policy followed by the enterprise:**
 - (i) is shorter as compared to the balance of the period determined under paragraph 63, the carrying amount of the intangible item should be amortised over the remaining period as per the accounting policy followed by the enterprise,**
 - (ii) is longer as compared to the balance of the period determined under paragraph 63, the carrying amount of the intangible item should be restated, as if the accumulated amortisation had always been determined under this Standard, with the corresponding adjustment to the opening balance of revenue reserves. The restated carrying amount should be amortised over the balance of the period as determined in paragraph 63.**

100. Illustration B attached to the Standard illustrates the application of paragraph 99.

Illustration A

This illustration which does not form part of the Accounting Standard, provides illustrative application of the principles laid down in the Standard to internal use software and web-site costs. Its purpose is to illustrate the application of the Accounting Standard to assist in clarifying its meaning.

I. Illustrative Application of the Accounting Standard to Internal Use Computer Software

Computer software for internal use can be internally generated or acquired.

Internally Generated Computer Software

1. Internally generated computer software for internal use is developed or modified internally by the enterprise solely to meet the needs of the enterprise and at no stage it is planned to sell it.
2. The stages of development of internally generated software may be categorised into the following two phases:
 - Preliminary project stage, i.e., the research phase
 - Development stage

Preliminary project stage

3. At the preliminary project stage the internally generated software should not be recognised as an asset. Expenditure incurred in the preliminary project stage should be recognised as an expense when it is incurred. The reason for such a treatment is that at this stage of the software project an enterprise cannot demonstrate that an asset exists from which future economic benefits are probable.
4. When a computer software project is in the preliminary project stage, enterprises are likely to:
 - (a) Make strategic decisions to allocate resources between alternative projects at a given point in time. For example, should programmers develop a new payroll system or direct their efforts toward correcting existing problems in an operating payroll system.
 - (b) Determine the performance requirements (that is, what it is that they need the software to do) and systems requirements for the computer software project it has proposed to undertake.
 - (c) Explore alternative means of achieving specified performance requirements. For example, should an entity make or buy the software. Should the software run on a mainframe or a client server system.
 - (d) Determine that the technology needed to achieve performance requirements exists.
 - (e) Select a consultant to assist in the development and/or installation of the software.

Development Stage

5. An internally generated software arising at the development stage should be recognised as an asset if, and only if, an enterprise can demonstrate all of the following:
 - (a) the technical feasibility of completing the internally generated software so that it will be available for internal use;
 - (b) the intention of the enterprise to complete the internally generated software and use it to perform the functions intended. For example, the intention to complete

the internally generated software can be demonstrated if the enterprise commits to the funding of the software project;

- (c) the ability of the enterprise to use the software;
 - (d) how the software will generate probable future economic benefits. Among other things, the enterprise should demonstrate the usefulness of the software;
 - (e) the availability of adequate technical, financial and other resources to complete the development and to use the software; and
 - (f) the ability of the enterprise to measure the expenditure attributable to the software during its development reliably.
6. Examples of development activities in respect of internally generated software include:
- (a) Design including detailed program design - which is the process of detail design of computer software that takes product function, feature, and technical requirements to their most detailed, logical form and is ready for coding.
 - (b) Coding which includes generating detailed instructions in a computer language to carry out the requirements described in the detail program design. The coding of computer software may begin prior to, concurrent with, or subsequent to the completion of the detail program design.

At the end of these stages of the development activity, the enterprise has a working model, which is an operative version of the computer software capable of performing all the major planned functions, and is ready for initial testing ("beta" versions).

- (c) Testing which is the process of performing the steps necessary to determine whether the coded computer software product meets function, feature, and technical performance requirements set forth in the product design.

At the end of the testing process, the enterprise has a master version of the internal use software, which is a completed version together with the related user documentation and the training materials.

Cost of internally generated software

7. The cost of an internally generated software is the sum of the expenditure incurred from the time when the software first met the recognition criteria for an intangible asset as stated in paragraphs 20 and 21 of this Standard and paragraph 5 above. An expenditure which did not meet the recognition criteria as aforesaid and expensed in an earlier financial statements should not be reinstated if the recognition criteria are met later.

8. The cost of an internally generated software comprises all expenditure that can be directly attributed or allocated on a reasonable and consistent basis to create the software for its intended use. The cost include:

- (a) expenditure on materials and services used or consumed in developing the software;
- (b) the salaries, wages and other employment related costs of personnel directly engaged in developing the software;

- (c) any expenditure that is directly attributable to generating software; and
 - (d) overheads that are necessary to generate the software and that can be allocated on a reasonable and consistent basis to the software (For example, an allocation of the depreciation of fixed assets, insurance premium and rent). Allocation of overheads are made on basis similar to those used in allocating the overhead to inventories.
9. The following are not components of the cost of an internally generated software:
- (a) selling, administration and other general overhead expenditure unless this expenditure can be directly attributable to the development of the software;
 - (b) clearly identified inefficiencies and initial operating losses incurred before software achieves the planned performance; and
 - (c) expenditure on training the staff to use the internally generated software.

Software Acquired for Internal Use

10. The cost of a software acquired for internal use should be recognised as an asset if it meets the recognition criteria prescribed in paragraphs 20 and 21 of this Standard.

11. The cost of a software purchased for internal use comprises its purchase price, including any import duties and other taxes (other than those subsequently recoverable by the enterprise from the taxing authorities) and any directly attributable expenditure on making the software ready for its use. Any trade discounts and rebates are deducted in arriving at the cost. In the determination of cost, matters stated in paragraphs 24 to 34 of the Standard need to be considered, as appropriate.

Subsequent expenditure

12. Enterprises may incur considerable cost in modifying existing software systems. Subsequent expenditure on software after its purchase or its completion should be recognised as an expense when it is incurred unless:

- (a) it is probable that the expenditure will enable the software to generate future economic benefits in excess of its originally assessed standards of performance; and
- (b) the expenditure can be measured and attributed to the software reliably.

If these conditions are met, the subsequent expenditure should be added to the carrying amount of the software. Costs incurred in order to restore or maintain the future economic benefits that an enterprise can expect from the originally assessed standard of performance of existing software systems is recognised as an expense when, and only when, the restoration or maintenance work is carried out.

Amortisation period

13. The depreciable amount of a software should be allocated on a systematic basis over the best estimate of its useful life. The amortisation should commence when the software is available for use.

14. As per this Standard, there is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. However, given the history of rapid changes in technology, computer software is susceptible to technological obsolescence. Therefore, it is likely that useful life of the software will be much shorter, say 3 to 5 years.

Amortisation method

15. The amortisation method used should reflect the pattern in which the software's economic benefits are consumed by the enterprise. If that pattern cannot be determined reliably, the straight-line method should be used. The amortisation charge for each period should be recognised as an expenditure unless another Accounting Standard permits or requires it to be included in the carrying amount of another asset. For example, the amortisation of a software used in a production process is included in the carrying amount of inventories.

II. Illustrative Application of the Accounting Standard to Web-Site Costs

1. An enterprise may incur internal expenditures when developing, enhancing and maintaining its own web site. The web site may be used for various purposes such as promoting and advertising products and services, providing electronic services, and selling products and services.
2. The stages of a web site's development can be described as follows:
 - (a) Planning - includes undertaking feasibility studies, defining objectives and specifications, evaluating alternatives and selecting preferences;
 - (b) Application and Infrastructure Development - includes obtaining a domain name, purchasing and developing hardware and operating software, installing developed applications and stress testing; and
 - (c) Graphical Design and Content Development - includes designing the appearance of web pages and creating, purchasing, preparing and uploading information, either textual or graphical in nature, on the web site prior to the web site becoming available for use. This information may either be stored in separate databases that are integrated into (or accessed from) the web site or coded directly into the web pages.
3. Once development of a web site has been completed and the web site is available for use, the web site commences an operating stage. During this stage, an enterprise maintains and enhances the applications, infrastructure, graphical design and content of the web site.
4. The expenditures for purchasing, developing, maintaining and enhancing hardware (e.g., web servers, staging servers, production servers and Internet connections) related to a web site are not accounted for under this Standard but are accounted for under AS 10, Accounting for Fixed Assets. Additionally, when an enterprise incurs an expenditure for having an Internet service provider host the enterprise's web site on its own servers connected to the Internet, the expenditure is recognised as an expense.

5. An intangible asset is defined in paragraph 6 of this Standard as an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. Paragraph 7 of this Standard provides computer software as a common example of an intangible asset. By analogy, a web site is another example of an intangible asset. Accordingly, a web site developed by an enterprise for its own use is an internally generated intangible asset that is subject to the requirements of this Standard.

6. An enterprise should apply the requirements of this Standard to an internal expenditure for developing, enhancing and maintaining its own web site. Paragraph 55 of this Standard provides expenditure on an intangible item to be recognised as an expense when incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria in paragraphs 19-54 of the Standard. Paragraph 56 of the Standard requires expenditure on start-up activities to be recognised as an expense when incurred. Developing a web site by an enterprise for its own use is not a start-up activity to the extent that an internally generated intangible asset is created. An enterprise applies the requirements and guidance in paragraphs 39-54 of this Standard to an expenditure incurred for developing its own web site in addition to the general requirements for recognition and initial measurement of an intangible asset. The cost of a web site, as described in paragraphs 52-54 of this Standard, comprises all expenditure that can be directly attributed, or allocated on a reasonable and consistent basis, to creating, producing and preparing the asset for its intended use.

The enterprise should evaluate the nature of each activity for which an expenditure is incurred (e.g., training employees and maintaining the web site) and the web site's stage of development or post-development:

- (a) Paragraph 41 of this Standard requires an expenditure on research (or on the research phase of an internal project) to be recognised as an expense when incurred. The examples provided in paragraph 43 of this Standard are similar to the activities undertaken in the Planning stage of a web site's development. Consequently, expenditures incurred in the Planning stage of a web site's development are recognised as an expense when incurred.
- (b) Paragraph 44 of this Standard requires an intangible asset arising from the development phase of an internal project to be recognised if an enterprise can demonstrate fulfillment of the six criteria specified. Application and Infrastructure Development and Graphical Design and Content Development stages are similar in nature to the development phase. Therefore, expenditures incurred in these stages should be recognised as an intangible asset if, and only if, in addition to complying with the general requirements for recognition and initial measurement of an intangible asset, an enterprise can demonstrate those items described in paragraph 44 of this Standard. In addition,
 - (i) an enterprise may be able to demonstrate how its web site will generate probable future economic benefits under paragraph 44(d) by using the

principles in Accounting Standard on Impairment of Assets¹⁰. This includes situations where the web site is developed solely or primarily for promoting and advertising an enterprise's own products and services. Demonstrating how a web site will generate probable future economic benefits under paragraph 44(d) by assessing the economic benefits to be received from the web site and using the principles in Accounting Standard on Impairment of Assets, may be particularly difficult for an enterprise that develops a web site solely or primarily for advertising and promoting its own products and services; information is unlikely to be available for reliably estimating the amount obtainable from the sale of the web site in an arm's length transaction, or the future cash inflows and outflows to be derived from its continuing use and ultimate disposal. In this circumstance, an enterprise determines the future economic benefits of the cash-generating unit to which the web site belongs, if it does not belong to one. If the web site is considered a corporate asset (one that does not generate cash inflows independently from other assets and their carrying amount cannot be fully attributed to a cash-generating unit), then an enterprise applies the 'bottom-up' test and/or the 'top-down' test under Accounting Standard on Impairment of Assets.

- (ii) an enterprise may incur an expenditure to enable use of content, which had been purchased or created for another purpose, on its web site (e.g., acquiring a license to reproduce information) or may purchase or create content specifically for use on its web site prior to the web site becoming available for use. In such circumstances, an enterprise should determine whether a separate asset, is identifiable with respect to such content (e.g., copyrights and licenses), and if a separate asset is not identifiable, then the expenditure should be included in the cost of developing the web site when the expenditure meets the conditions in paragraph 44 of this Standard. As per paragraph 20 of this Standard, an intangible asset is recognised if, and only if, it meets specified criteria, including the definition of an intangible asset. Paragraph 52 indicates that the cost of an internally generated intangible asset is the sum of expenditure incurred from the time when the intangible asset first meets the specified recognition criteria. When an enterprise acquires or creates content, it may be possible to identify an intangible asset (e.g., a license or a copyright) separate from a web site. Consequently, an enterprise determines whether an expenditure to enable use of content, which had been created for another purpose, on its web site becoming available for use results in a separate identifiable asset or the expenditure is included in the cost of developing the web site.

¹⁰Accounting Standard (AS) 28, 'Impairment of Assets', specifies the requirements relating to impairment of assets.

- (c) the operating stage commences once the web site is available for use, and therefore an expenditure to maintain or enhance the web site after development has been completed should be recognised as an expense when it is incurred unless it meets the criteria in paragraph 59 of the Standard. Paragraph 60 explains that if the expenditure is required to maintain the asset at its originally assessed standard of performance, then the expenditure is recognised as an expense when incurred.

7. An intangible asset is measured subsequent to initial recognition by applying the requirements in paragraph 62 of this Standard. Additionally, since paragraph 68 of the Standard states that an intangible asset always has a finite useful life, a web site that is recognised as an asset is amortised over the best estimate of its useful life. As indicated in paragraph 65 of the Standard, web sites are susceptible to technological obsolescence, and given the history of rapid changes in technology, their useful life will be short.

8. The following table illustrates examples of expenditures that occur within each of the stages described in paragraphs 2 and 3 above and application of paragraphs 5 and 6 above. It is not intended to be a comprehensive checklist of expenditures that might be incurred.

Nature of Expenditure	Accounting treatment
<p>Planning</p> <ul style="list-style-type: none"> • undertaking feasibility studies • defining hardware and software specifications • evaluating alternative products and suppliers • selecting preferences 	Expense when incurred
<p>Application and Infrastructure Development</p> <ul style="list-style-type: none"> • purchasing or developing hardware 	Apply the requirements of AS 10
<ul style="list-style-type: none"> • obtaining a domain name • developing operating software (e.g., operating system and server software) • developing code for the application • installing developed applications on the web server • stress testing 	Expense when incurred, unless it meets the recognition criteria under paragraphs 20 and 44

<p>Graphical Design and Content Development</p> <ul style="list-style-type: none"> designing the appearance (e.g., layout and colour) of web pages creating, purchasing, preparing (e.g., creating links and identifying tags), and uploading information, either textual or graphical in nature, on the website prior to the web site becoming available for use. Examples of content include information about an enterprise, products or services offered for sale, and topics that subscribers access 	<p>If a separate asset is not identifiable, then expense when incurred, unless it meets the recognition criteria under paragraphs 20 and 44</p>
<p>Operating</p> <ul style="list-style-type: none"> updating graphics and revising content adding new functions, features and content registering the web site with search engines backing up data reviewing security access analysing usage of the web site 	<p>Expense when incurred, unless in rare circumstances it meets the criteria in paragraph 59, in which case the expenditure is included in the cost of the web site</p>
<p>Other</p> <ul style="list-style-type: none"> selling, administrative and other general overhead expenditure unless it can be directly attributed to preparing the web site for use clearly identified inefficiencies and initial operating losses incurred before the web site achieves planned performance (e.g., false start testing) training employees to operate the web site 	<p>Expense when incurred</p>

Illustration B

This Illustration which does not form part of the Accounting Standard, provides illustrative application of the requirements contained in paragraph 99 of this Accounting Standard in respect of transitional provisions.

Illustration 1 - Intangible Item was not amortised and the amortisation period determined under paragraph 63 has expired.

An intangible item is appearing in the balance sheet of A Ltd. at ₹ 10 lakhs as on 1-4-2003. The item was acquired for ₹ 10 lakhs on April 1, 1990 and was available for use from that date. The enterprise has been following an accounting policy of not amortising the item. Applying paragraph 63, the enterprise determines that the item would have been amortised over a period of 10 years from the date when the item was available for use i.e., April 1, 1990.

Since the amortisation period determined by applying paragraph 63 has already expired as on 1-4-2003, the carrying amount of the intangible item of ₹ 10 lakhs would be required to be eliminated with a corresponding adjustment to the opening balance of revenue reserves as on 1-4-2003.

Illustration 2 - Intangible Item is being amortised and the amortisation period determined under paragraph 63 has expired.

An intangible item is appearing in the balance sheet of A Ltd. at ₹ 8 lakhs as on 1-4-2003. The item was acquired for ₹ 20 lakhs on April 1, 1991 and was available for use from that date. The enterprise has been following a policy of amortising the item over a period of 20 years on straight-line basis. Applying paragraph 63, the enterprise determines that the item would have been amortised over a period of 10 years from the date when the item was available for use i.e., April 1, 1991.

Since the amortisation period determined by applying paragraph 63 has already expired as on 1-4-2003, the carrying amount of ₹ 8 lakhs would be required to be eliminated with a corresponding adjustment to the opening balance of revenue reserves as on 1-4-2003.

Illustration 3 - Amortisation period determined under paragraph 63 has not expired and the remaining amortisation period as per the accounting policy followed by the enterprise is shorter.

An intangible item is appearing in the balance sheet of A Ltd. at ₹ 8 lakhs as on 1-4-2003. The item was acquired for ₹ 20 lakhs on April 1, 2000 and was available for use from that date. The enterprise has been following a policy of amortising the intangible item over a period of 5 years on straight line basis. Applying paragraph 63, the enterprise determines the amortisation period to be 8 years, being the best estimate of its useful life, from the date when the item was available for use i.e., April 1, 2000.

On 1-4-2003, the remaining period of amortisation is 2 years as per the accounting policy followed by the enterprise which is shorter as compared to the balance of amortisation period determined by applying paragraph 63, i.e., 5 years. Accordingly, the enterprise would be required to amortise the intangible item over the remaining 2 years as per the accounting policy followed by the enterprise.

Illustration 4 - Amortisation period determined under paragraph 63 has not expired and the remaining amortisation period as per the accounting policy followed by the enterprise is longer.

An intangible item is appearing in the balance sheet of A Ltd. at ₹ 18 lakhs as on 1-4-2003. The item was acquired for ₹ 24 lakhs on April 1, 2000 and was available for use from that date. The enterprise has been following a policy of amortising the intangible item over a period of 12

years on straight-line basis. Applying paragraph 63, the enterprise determines that the item would have been amortised over a period of 10 years on straight line basis from the date when the item was available for use i.e., April 1, 2000.

On 1-4-2003, the remaining period of amortisation is 9 years as per the accounting policy followed by the enterprise which is longer as compared to the balance of period stipulated in paragraph 63, i.e., 7 years. Accordingly, the enterprise would be required to restate the carrying amount of intangible item on 1-4-2003 at ₹ 16.8 lakhs (₹ 24 lakhs - 3x₹ 2.4 lakhs, i.e., amortisation that would have been charged as per the Standard) and the difference of ₹ 1.2 lakhs (₹ 18 lakhs-₹ 16.8 lakhs) would be required to be adjusted against the opening balance of the revenue reserves. The carrying amount of ₹ 16.8 lakhs would be amortised over 7 years which is the balance of the amortisation period as per paragraph 63.

Illustration 5 - Intangible Item is not amortised and amortisation period determined under paragraph 63 has not expired.

An intangible item is appearing in the balance sheet of A Ltd. at ₹ 20 lakhs as on 1-4-2003. The item was acquired for ₹ 20 lakhs on April 1, 2000 and was available for use from that date. The enterprise has been following an accounting policy of not amortising the item. Applying paragraph 63, the enterprise determines that the item would have been amortised over a period of 10 years on straight line basis from the date when the item was available for use i.e., April 1, 2000.

On 1-4-2003, the enterprise would be required to restate the carrying amount of intangible item at ₹ 14 lakhs (₹ 20 lakhs - 3x₹ 2 lakhs, i.e., amortisation that would have been charged as per the Standard) and the difference of ₹ 6 lakhs (₹ 20 lakhs-₹ 14 lakhs) would be required to be adjusted against the opening balance of the revenue reserves. The carrying amount of ₹ 14 lakhs would be amortised over 7 years which is the balance of the amortisation period as per paragraph 63.

AS 29* : Provisions, Contingent Liabilities and Contingent Assets

*[This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective, the Preface to the Statements of Accounting Standards¹ and the 'Applicability of Accounting Standards to Various Entities'.]*

Pursuant to this Accounting Standard coming into effect, all paragraphs of Accounting Standards (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date, that deal with contingencies (viz., paragraphs 1(a), 2, 3.1, 4 (4.1 to 4.4), 5(5.1 to 5.6), 6, 7 (7.1 to

*Issued in 2003.

¹Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material.

7.3), 9.1 (relevant portion), 9.2, 10, 11, 12 and 16), stand withdrawn except to the extent they deal with impairment of assets not covered by other Accounting Standards.

Objective

The objective of this Standard is to ensure that appropriate recognition criteria and measurement bases are applied to provisions and contingent liabilities and that sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount. The objective of this Standard is also to lay down appropriate accounting for contingent assets.

Scope

1. This Standard should be applied in accounting for provisions and contingent liabilities and in dealing with contingent assets, except:

- (a) those resulting from financial instruments² that are carried at fair value;**
- (b) those resulting from executory contracts, except where the contract is onerous;**

Explanation:

(i) An 'onerous contract' is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. Thus, for a contract to qualify as an onerous contract, the unavoidable costs of meeting the obligation under the contract should exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it.

(ii) If an enterprise has a contract that is onerous, the present obligation under the contract is recognised and measured as a provision as per this Standard.

The application of the above explanation is illustrated in Illustration 10 of Illustration C attached to the Standard.

- (c) those arising in insurance enterprises from contracts with policy-holders; and**
- (d) those covered by another Accounting Standard.**

2. This Standard applies to financial instruments (including guarantees) that are not carried at fair value.

3. Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent. This Standard does not apply to executory contracts unless they are onerous.

²For the purpose of this Standard, the term 'financial instruments' shall have the same meaning as in Accounting Standard (AS) 20, Earnings Per Share.

4. This Standard applies to provisions, contingent liabilities and contingent assets of insurance enterprises other than those arising from contracts with policy-holders.
5. Where another Accounting Standard deals with a specific type of provision, contingent liability or contingent asset, an enterprise applies that Standard instead of this Standard. For example, certain types of provisions are also addressed in Accounting Standards on:
- (a) construction contracts (see AS 7, Construction Contracts);
 - (b) taxes on income (see AS 22, Accounting for Taxes on Income);
 - (c) leases (see AS 19, Leases). However, as AS 19 contains no specific requirements to deal with operating leases that have become onerous, this Standard applies to such cases; and
 - (d) retirement benefits (see AS 15, Accounting for Retirement Benefits in the Financial Statements of Employers).³
6. Some amounts treated as provisions may relate to the recognition of revenue, for example where an enterprise gives guarantees in exchange for a fee. This Standard does not address the recognition of revenue. AS 9, Revenue Recognition, identifies the circumstances in which revenue is recognised and provides practical guidance on the application of the recognition criteria. This Standard does not change the requirements of AS 9.
7. This Standard defines provisions as liabilities which can be measured only by using a substantial degree of estimation. The term 'provision' is also used in the context of items such as depreciation, impairment of assets and doubtful debts: these are adjustments to the carrying amounts of assets and are not addressed in this Standard.
8. Other Accounting Standards specify whether expenditures are treated as assets or as expenses. These issues are not addressed in this Standard. Accordingly, this Standard neither prohibits nor requires capitalisation of the costs recognised when a provision is made.
9. This Standard applies to provisions for restructuring (including discontinuing operations). Where a restructuring meets the definition of a discontinuing operation, additional disclosures are required by AS 24, Discontinuing Operations.

Definitions

10. The following terms are used in this Standard with the meanings specified:

10.1A provision is a liability which can be measured only by using a substantial degree of estimation.

10.2A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

³AS 15 (issued 1995) has since been revised and is now titled as 'Employee Benefits'.

10.3 An **obligating event** is an event that creates an obligation that results in an enterprise having no realistic alternative to settling that obligation.

10.4 A **contingent liability** is:

- (a) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or
- (b) a present obligation that arises from past events but is not recognised because:
 - (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
 - (ii) a reliable estimate of the amount of the obligation cannot be made.

10.5 A **contingent asset** is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

10.6 **Present obligation** - an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.

10.7 **Possible obligation** - an obligation is a possible obligation if, based on the evidence available, its existence at the balance sheet date is considered not probable.

10.8 A **restructuring** is a programme that is planned and controlled by management, and materially changes either:

- (a) the scope of a business undertaken by an enterprise; or
- (b) the manner in which that business is conducted.

11. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract or statutory requirement. Obligations also arise from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner.

12. Provisions can be distinguished from other liabilities such as trade payables and accruals because in the measurement of provisions substantial degree of estimation is involved with regard to the future expenditure required in settlement. By contrast:

- (a) trade payables are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier; and
- (b) accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees. Although it is sometimes necessary to estimate the amount of accruals, the degree of estimation is generally much less than that for provisions.

13. In this Standard, the term 'contingent' is used for liabilities and assets that are not recognised because their existence will be confirmed only by the occurrence or non-

occurrence of one or more uncertain future events not wholly within the control of the enterprise. In addition, the term 'contingent liability' is used for liabilities that do not meet the recognition criteria.

Recognition

Provisions

14. A provision should be recognised when:

- (a) an enterprise has a present obligation as a result of a past event;**
- (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and**
- (c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognised.**

Present Obligation

15. In almost all cases it will be clear whether a past event has given rise to a present obligation. In rare cases, for example in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such a case, an enterprise determines whether a present obligation exists at the balance sheet date by taking account of all available evidence, including, for example, the opinion of experts. The evidence considered includes any additional evidence provided by events after the balance sheet date. On the basis of such evidence:

- (a) where it is more likely than not that a present obligation exists at the balance sheet date, the enterprise recognises a provision (if the recognition criteria are met); and
- (b) where it is more likely that no present obligation exists at the balance sheet date, the enterprise discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 68).

Past Event

16. A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the enterprise has no realistic alternative to settling the obligation created by the event.

17. Financial statements deal with the financial position of an enterprise at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognised for costs that need to be incurred to operate in the future. The only liabilities recognised in an enterprise's balance sheet are those that exist at the balance sheet date.

18. It is only those obligations arising from past events existing independently of an enterprise's future actions (i.e. the future conduct of its business) that are recognised as provisions. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage, both of which would lead to an outflow of resources embodying economic benefits in settlement regardless of the future actions of the enterprise. Similarly, an enterprise recognises a provision for the decommissioning costs of an oil installation to

the extent that the enterprise is obliged to rectify damage already caused. In contrast, because of commercial pressures or legal requirements, an enterprise may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a certain type of factory). Because the enterprise can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised.

19. An obligation always involves another party to whom the obligation is owed. It is not necessary, however, to know the identity of the party to whom the obligation is owed – indeed the obligation may be to the public at large.

20. An event that does not give rise to an obligation immediately may do so at a later date, because of changes in the law. For example, when environmental damage is caused there may be no obligation to remedy the consequences. However, the causing of the damage will become an obligating event when a new law requires the existing damage to be rectified.

21. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted. Differences in circumstances surrounding enactment usually make it impossible to specify a single event that would make the enactment of a law virtually certain. In many cases it will be impossible to be virtually certain of the enactment of a law until it is enacted.

Probable Outflow of Resources Embodying Economic Benefits

22. For a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation. For the purpose of this Standard⁴, an outflow of resources or other event is regarded as probable if the event is more likely than not to occur, i.e., the probability that the event will occur is greater than the probability that it will not. Where it is not probable that a present obligation exists, an enterprise discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 68).

23. Where there are a number of similar obligations (e.g. product warranties or similar contracts) the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole. Although the likelihood of outflow for any one item may be small, it may well be probable that some outflow of resources will be needed to settle the class of obligations as a whole. If that is the case, a provision is recognised (if the other recognition criteria are met).

Reliable Estimate of the Obligation

24. The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability. This is especially true in the case of provisions, which

⁴The interpretation of 'probable' in this Standard as 'more likely than not' does not necessarily apply in other Accounting Standards.

by their nature involve a greater degree of estimation than most other items. Except in extremely rare cases, an enterprise will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is reliable to use in recognising a provision.

25. In the extremely rare case where no reliable estimate can be made, a liability exists that cannot be recognised. That liability is disclosed as a contingent liability (see paragraph 68).

Contingent Liabilities

26. An enterprise should not recognise a contingent liability.

27. A contingent liability is disclosed, as required by paragraph 68, unless the possibility of an outflow of resources embodying economic benefits is remote.

28. Where an enterprise is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability. The enterprise recognises a provision for the part of the obligation for which an outflow of resources embodying economic benefits is probable, except in the extremely rare circumstances where no reliable estimate can be made (see paragraph 14).

29. Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources embodying economic benefits has become probable. If it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in accordance with paragraph 14 in the financial statements of the period in which the change in probability occurs (except in the extremely rare circumstances where no reliable estimate can be made).

Contingent Assets

30. An enterprise should not recognise a contingent asset.

31. Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise. An example is a claim that an enterprise is pursuing through legal processes, where the outcome is uncertain.

32. Contingent assets are not recognised in financial statements since this may result in the recognition of income that may never be realised. However, when the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.

33. A contingent asset is not disclosed in the financial statements. It is usually disclosed in the report of the approving authority (Board of Directors in the case of a company, and, the corresponding approving authority in the case of any other enterprise), where an inflow of economic benefits is probable.

34. Contingent assets are assessed continually and if it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.

Measurement

Best Estimate

35. The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date. The amount of a provision should not be discounted to its present value except in case of decommissioning, restoration and similar liabilities that are recognised as cost of Property, Plant and Equipment. The discount rate (or rates) should be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) should not reflect risks for which future cash flow estimates have been adjusted. Periodic unwinding of discount should be recognised in the statement of profit and loss.

36. The estimates of outcome and financial effect are determined by the judgment of the management of the enterprise, supplemented by experience of similar transactions and, in some cases, reports from independent experts. The evidence considered includes any additional evidence provided by events after the balance sheet date.

37. The provision is measured before tax; the tax consequences of the provision, and changes in it, are dealt with under AS 22, Accounting for Taxes on Income.

Risks and Uncertainties

38. The risks and uncertainties that inevitably surround many events and circumstances should be taken into account in reaching the best estimate of a provision.

39. Risk describes variability of outcome. A risk adjustment may increase the amount at which a liability is measured. Caution is needed in making judgments under conditions of uncertainty, so that income or assets are not overstated and expenses or liabilities are not understated. However, uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities. For example, if the projected costs of a particularly adverse outcome are estimated on a prudent basis, that outcome is not then deliberately treated as more probable than is realistically the case. Care is needed to avoid duplicating adjustments for risk and uncertainty with consequent overstatement of a provision.

40. Disclosure of the uncertainties surrounding the amount of the expenditure is made under paragraph 67(b).

Future Events

41. Future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that they will occur.

42. Expected future events may be particularly important in measuring provisions. For example, an enterprise may believe that the cost of cleaning up a site at the end of its life will be reduced by future changes in technology. The amount recognised reflects a reasonable expectation of technically qualified, objective observers, taking account of all available evidence as to the technology that will be available at the time of the clean-up. Thus, it is appropriate to include, for example, expected cost reductions associated with increased experience in applying existing technology or the expected cost of applying existing technology to a larger or more complex clean-up operation than has previously been carried out. However, an enterprise does not anticipate the development of a completely new technology for cleaning up unless it is supported by sufficient objective evidence.

43. The effect of possible new legislation is taken into consideration in measuring an existing obligation when sufficient objective evidence exists that the legislation is virtually certain to be enacted. The variety of circumstances that arise in practice usually makes it impossible to specify a single event that will provide sufficient, objective evidence in every case. Evidence is required both of what legislation will demand and of whether it is virtually certain to be enacted and implemented in due course. In many cases sufficient objective evidence will not exist until the new legislation is enacted.

Expected Disposal of Assets

44. *Gains from the expected disposal of assets should not be taken into account in measuring a provision.*

45. Gains on the expected disposal of assets are not taken into account in measuring a provision, even if the expected disposal is closely linked to the event giving rise to the provision. Instead, an enterprise recognises gains on expected disposals of assets at the time specified by the Accounting Standard dealing with the assets concerned.

Reimbursements

46. *Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision.*

47. *In the statement of profit and loss, the expense relating to a provision may be presented net of the amount recognised for a reimbursement.*

48. Sometimes, an enterprise is able to look to another party to pay part or all of the expenditure required to settle a provision (for example, through insurance contracts, indemnity clauses or suppliers' warranties). The other party may either reimburse amounts paid by the enterprise or pay the amounts directly.

49. In most cases, the enterprise will remain liable for the whole of the amount in question so that the enterprise would have to settle the full amount if the third party failed to pay

for any reason. In this situation, a provision is recognised for the full amount of the liability, and a separate asset for the expected reimbursement is recognised when it is virtually certain that reimbursement will be received if the enterprise settles the liability.

50. In some cases, the enterprise will not be liable for the costs in question if the third party fails to pay. In such a case, the enterprise has no liability for those costs and they are not included in the provision.

51. As noted in paragraph 28, an obligation for which an enterprise is jointly and severally liable is a contingent liability to the extent that it is expected that the obligation will be settled by the other parties.

Changes in Provisions

52. Provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed.

Use of Provisions

53. A provision should be used only for expenditures for which the provision was originally recognised.

54. Only expenditures that relate to the original provision are adjusted against it. Adjusting expenditures against a provision that was originally recognised for another purpose would conceal the impact of two different events.

Application of the Recognition and Measurement Rules

Future Operating Losses

55. Provisions should not be recognised for future operating losses.

56. Future operating losses do not meet the definition of a liability in paragraph 10 and the general recognition criteria set out for provisions in paragraph 14.

57. An expectation of future operating losses is an indication that certain assets of the operation may be impaired. An enterprise tests these assets for impairment under Accounting Standard (AS) 28, Impairment of Assets.

Restructuring

58. The following are examples of events that may fall under the definition of restructuring:

- (a) sale or termination of a line of business;
- (b) the closure of business locations in a country or region or the relocation of business activities from one country or region to another;
- (c) changes in management structure, for example, eliminating a layer of management; and

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- (d) fundamental re-organisations that have a material effect on the nature and focus of the enterprise's operations.

59. A provision for restructuring costs is recognised only when the recognition criteria for provisions set out in paragraph 14 are met.

60. No obligation arises for the sale of an operation until the enterprise is committed to the sale, i.e., there is a binding sale agreement.

61. An enterprise cannot be committed to the sale until a purchaser has been identified and there is a binding sale agreement. Until there is a binding sale agreement, the enterprise will be able to change its mind and indeed will have to take another course of action if a purchaser cannot be found on acceptable terms. When the sale of an operation is envisaged as part of a restructuring, the assets of the operation are reviewed for impairment under Accounting Standard (AS) 28, Impairment of Assets.

62. A restructuring provision should include only the direct expenditures arising from the restructuring which are those that are both:

- (a) necessarily entailed by the restructuring; and**
- (b) not associated with the ongoing activities of the enterprise.**

63. A restructuring provision does not include such costs as:

- (a) retraining or relocating continuing staff;
- (b) marketing; or
- (c) investment in new systems and distribution networks.

These expenditures relate to the future conduct of the business and are not liabilities for restructuring at the balance sheet date. Such expenditures are recognised on the same basis as if they arose independently of a restructuring.

64. Identifiable future operating losses up to the date of a restructuring are not included in a provision.

65. As required by paragraph 44, gains on the expected disposal of assets are not taken into account in measuring a restructuring provision, even if the sale of assets is envisaged as part of the restructuring.

Disclosure

66. For each class of provision, an enterprise should disclose:

- (a) the carrying amount at the beginning and end of the period; (b) additional provisions made in the period, including increases to existing provisions;**
- (c) amounts used (i.e. incurred and charged against the provision) during the period; and**
- (d) unused amounts reversed during the period.**

Provided that a Small and Medium-sized Company and a Small and Medium-sized Enterprise (Level II and Level III non-corporate entities), may not comply with paragraph 66 above.

67. An enterprise should disclose the following for each class of provision:

- (a) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;**
- (b) an indication of the uncertainties about those outflows. Where necessary to provide adequate information, an enterprise should disclose the major assumptions made concerning future events, as addressed in paragraph 41; and**
- (c) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.**

Provided that a Small and Medium-sized Company and a Small and Medium-sized Enterprise (Level II and Level III non-corporate entities) may not comply with paragraph 67 above.

68. Unless the possibility of any outflow in settlement is remote, an enterprise should disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, where practicable:

- (a) an estimate of its financial effect, measured under paragraphs 35-45;**
- (b) an indication of the uncertainties relating to any outflow; and**
- (c) the possibility of any reimbursement.**

69. In determining which provisions or contingent liabilities may be aggregated to form a class, it is necessary to consider whether the nature of the items is sufficiently similar for a single statement about them to fulfill the requirements of paragraphs 67 (a) and (b) and 68 (a) and (b). Thus, it may be appropriate to treat as a single class of provision amounts relating to warranties of different products, but it would not be appropriate to treat as a single class amounts relating to normal warranties and amounts that are subject to legal proceedings.

70. Where a provision and a contingent liability arise from the same set of circumstances, an enterprise makes the disclosures required by paragraphs 66-68 in a way that shows the link between the provision and the contingent liability.

71. Where any of the information required by paragraph 68 is not disclosed because it is not practicable to do so, that fact should be stated.

72. In extremely rare cases, disclosure of some or all of the information required by paragraphs 66-70 can be expected to prejudice seriously the position of the enterprise in a dispute with other parties on the subject matter of the provision or contingent liability. In such cases, an enterprise need not disclose the information, but should disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

Transitional Provisions

73. All the existing provisions for decommissioning, restoration and similar liabilities (see paragraph 35) should be discounted prospectively, with the corresponding effect to the related item of property, plant and equipment.

Illustration A

Tables - Provisions, Contingent Liabilities and Reimbursements

The purpose of this illustration is to summarise the main requirements of the Accounting Standard. It does not form part of the Accounting Standard and should be read in the context of the full text of the Accounting Standard.

Provisions and Contingent Liabilities

<p>Where, as a result of past events, there may be an outflow of resources embodying future economic benefits in settlement of: (a) a present obligation the one whose existence at the balance sheet date is considered probable; or (b) a possible obligation the existence of which at the balance sheet date is considered not probable.</p>		
<p>There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation.</p>	<p>There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources.</p>	<p>There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote.</p>
<p>A provision is recognised (paragraph 14). Disclosures are required for the provision (paragraphs 66 and 67).</p>	<p>No provision is recognised (para- graph 26). Disclosures are required for the contingent liability (paragraph 68).</p>	<p>No provision is recognised (para- graph 26). No disclosure is required (paragraph 68).</p>

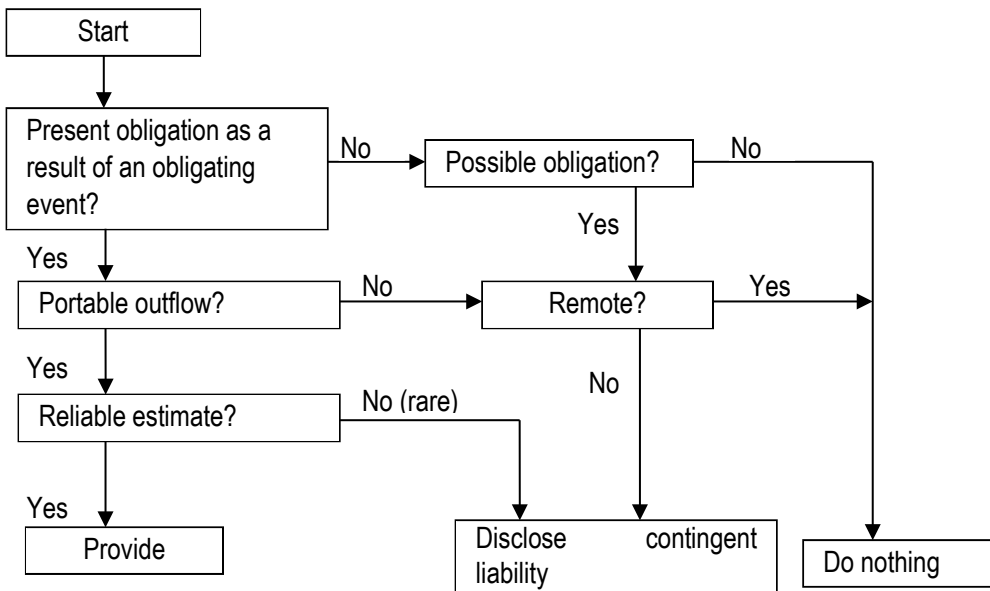
Reimbursements

<p>Some or all of the expenditure required to settle a provision is expected to be reimbursed by another party.</p>		
<p>The enterprise has no obligation for the part of the expenditure to be reimbursed by the other party.</p>	<p>The obligation for the amount expected to be reimbursed remains with the enterprise and it is virtually certain that reimbursement will be</p>	<p>The obligation for the amount expected to be reimbursed remains with the enterprise and the reimbursement is not virtually certain if the</p>

	received if the enterprise settles the provision.	enterprise settles the provision.
The enterprise has no liability for the amount to be reimbursed (paragraph 50).	The reimbursement is recognised as a separate asset in the balance sheet and may be offset against the expense in the statement of profit and loss. The amount recognised for the expected reimbursement does not exceed the liability (paragraphs 46 and 47).	The expected reimbursement is not recognised as an asset (paragraph 46).
No disclosure is required.	The reimbursement is disclosed together with the amount recognised for the reimbursement [paragraph 67(c)].	The expected reimbursement is disclosed [paragraph 67(c)].

Illustration B
Decision Tree

The purpose of the decision tree is to summarise the main recognition requirements of the Accounting Standard for provisions and contingent liabilities. The decision tree does not form part of the Accounting Standard and should be read in the context of the full text of the Accounting Standard.



Note: in rare cases, it is not clear whether there is a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the balance sheet date (paragraph 15 of the Standard).

Illustration C Illustrations: Recognition

This illustration illustrates the application of the Accounting Standard to assist in clarifying its meaning. It does not form part of the Accounting Standard.

All the enterprises in the Illustration have 31 March year ends. In all cases, it is assumed that a reliable estimate can be made of any outflows expected. In some Illustrations the circumstances described may have resulted in impairment of the assets - this aspect is not dealt with in the Illustrations.

The cross references provided in the Illustrations indicate paragraphs of the Accounting Standard that are particularly relevant. The illustration should be read in the context of the full text of the Accounting Standard.

Illustration 1: Warranties

A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. On past experience, it is probable (i.e. more likely than not) that there will be some claims under the warranties.

Present obligation as a result of a past obligating event - The obligating event is the sale of the product with a warranty, which gives rise to an obligation.

An outflow of resources embodying economic benefits in settlement - Probable for the warranties as a whole (see paragraph 23).

Conclusion - A provision is recognised for the best estimate of the costs of making good under the warranty products sold before the balance sheet date (see paragraphs 14 and 23).

Illustration 2: Contaminated Land - Legislation Virtually

Certain to be Enacted

An enterprise in the oil industry causes contamination but does not clean up because there is no legislation requiring cleaning up, and the enterprise has been contaminating land for several years. At 31 March 2005 it is virtually certain that a law requiring a clean-up of land already contaminated will be enacted shortly after the year end.

Present obligation as a result of a past obligating event - The obligating event is the contamination of the land because of the virtual certainty of legislation requiring cleaning up.

An outflow of resources embodying economic benefits in settlement - Probable.

Conclusion - A provision is recognised for the best estimate of the costs of the clean-up (see paragraphs 14 and 21).

Illustration 3: Offshore Oilfield

An enterprise operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Ninety per cent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and ten per cent arise through the extraction of oil. At the balance sheet date, the rig has been constructed but no oil has been extracted.

Present obligation as a result of a past obligating event - The construction of the oil rig creates an obligation under the terms of the licence to remove the rig and restore the seabed and is thus an obligating event. At the balance sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil.

An outflow of resources embodying economic benefits in settlement - Probable.

Conclusion - A provision is recognised for the best estimate of ninety per cent of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it (see paragraph 14). These costs are included as part of the cost of the oil rig. The ten per cent of costs that arise through the extraction of oil are recognised as a liability when the oil is extracted.

Illustration 4: Refunds Policy

A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known.

Present obligation as a result of a past obligating event - The obligating event is the sale of the product, which gives rise to an obligation because obligations also arise from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner.

An outflow of resources embodying economic benefits in settlement -

Probable, a proportion of goods are returned for refund (see paragraph 23).

Conclusion - A provision is recognised for the best estimate of the costs of refunds (see paragraphs 11, 14 and 23).

Illustration 5: Legal Requirement to Fit Smoke Filters

Under new legislation, an enterprise is required to fit smoke filters to its factories by 30 September 2005. The enterprise has not fitted the smoke filters.

(a) At the balance sheet date of 31 March 2005

Present obligation as a result of a past obligating event - There is no obligation because there is no obligating event either for the costs of fitting smoke filters or for fines under the legislation.

Conclusion - No provision is recognised for the cost of fitting the smoke filters (see paragraphs 14 and 16-18).

(b) At the balance sheet date of 31 March 2006

Present obligation as a result of a past obligating event - There is still no obligation for the costs of fitting smoke filters because no obligating event has occurred (the fitting of

the filters). However, an obligation might arise to pay fines or penalties under the legislation because the obligating event has occurred (the non-compliant operation of the factory).

An outflow of resources embodying economic benefits in settlement - Assessment of probability of incurring fines and penalties by non-compliant operation depends on the details of the legislation and the stringency of the enforcement regime.

Conclusion - No provision is recognised for the costs of fitting smoke filters. However, a provision is recognised for the best estimate of any fines and penalties that are more likely than not to be imposed (see paragraphs 14 and 16-18).

Illustration 6: Staff Retraining as a Result of Changes in the Income Tax System

The government introduces a number of changes to the income tax system. As a result of these changes, an enterprise in the financial services sector will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with financial services regulation. At the balance sheet date, no retraining of staff has taken place.

Present obligation as a result of a past obligating event - There is no obligation because no obligating event (retraining) has taken place.

Conclusion - No provision is recognised (see paragraphs 14 and 16-18).

Illustration 7: A Single Guarantee

During 2004-05, Enterprise A gives a guarantee of certain borrowings of Enterprise B, whose financial condition at that time is sound. During 2005-06, the financial condition of Enterprise B deteriorates and at 30 September 2005 Enterprise B goes into liquidation.

(a) At 31 March 2005

Present obligation as a result of a past obligating event - The obligating event is the giving of the guarantee, which gives rise to an obligation.

An outflow of resources embodying economic benefits in settlement -

No outflow of benefits is probable at 31 March 2005.

Conclusion - No provision is recognised (see paragraphs 14 and 22). The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote (see paragraph 68).

(b) At 31 March 2006

Present obligation as a result of a past obligating event - The obligating event is the giving of the guarantee, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement - At 31 March 2006, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

Conclusion - A provision is recognised for the best estimate of the obligation (see paragraphs 14 and 22).

Note: This example deals with a single guarantee. If an enterprise has a portfolio of similar guarantees, it will assess that portfolio as a whole in determining whether an outflow of resources embodying economic benefit is probable (see paragraph 23). Where an enterprise gives guarantees in exchange for a fee, revenue is recognised under AS 9, Revenue Recognition.

Illustration 8 : A Court Case

After a wedding in 2004-05, ten people died, possibly as a result of food poisoning from products sold by the enterprise. Legal proceedings are started seeking damages from the enterprise but it disputes liability. Up to the date of approval of the financial statements for the year 31 March 2005, the enterprise's lawyers advise that it is probable that the enterprise will not be found liable. However, when the enterprise prepares the financial statements for the year 31 March 2006, its lawyers advise that, owing to developments in the case, it is probable that the enterprise will be found liable.

(a) At 31 March 2005

Present obligation as a result of a past obligating event - On the basis of the evidence available when the financial statements were approved, there is no present obligation as a result of past events.

Conclusion - No provision is recognised (see definition of 'present obligation' and paragraph 15). The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote (paragraph 68).

(b) At 31 March 2006

Present obligation as a result of a past obligating event - On the basis of the evidence available, there is a present obligation.

An outflow of resources embodying economic benefits in settlement - Probable.

Conclusion - A provision is recognised for the best estimate of the amount to settle the obligation (paragraphs 14-15).

Illustration 9A: Refurbishment Costs - No Legislative Requirement

A furnace has a lining that needs to be replaced every five years for technical reasons. At the balance sheet date, the lining has been in use for three years.

Present obligation as a result of a past obligating event - There is no present obligation.

Conclusion - No provision is recognised (see paragraphs 14 and 16-18). The cost of replacing the lining is not recognised because, at the balance sheet date, no obligation to replace the lining exists independently of the company's future actions - even the intention to incur the expenditure depends on the company deciding to continue operating the furnace or to replace the lining.

Illustration 9B: Refurbishment Costs – Legislative Requirement

An airline is required by law to overhaul its aircraft once every three years.

Present obligation as a result of a past obligating event - There is no present obligation.

Conclusion - No provision is recognised (see paragraphs 14 and 16-18). The costs of overhauling aircraft are not recognised as a provision for the same reasons as the cost of replacing the lining is not recognised as a provision in illustration 9A. Even a legal requirement to overhaul does not make the costs of overhaul a liability, because no obligation exists to overhaul the aircraft independently of the enterprise's future actions - the enterprise could avoid the future expenditure by its future actions, for example by selling the aircraft.

Illustration 10: An Onerous Contract

An enterprise operates profitably from a factory that it has leased under an operating lease. During December 2005 the enterprise relocates its operations to a new factory. The lease on the old factory continues for the next four years, it cannot be cancelled and the factory cannot be re-let to another user.

Present obligation as a result of a past obligating event-The obligating event occurs when the lease contract becomes binding on the enterprise, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement- When the lease becomes onerous, an outflow of resources embodying economic benefits is probable, (Until the lease becomes onerous, the enterprise accounts for the lease under AS 19, Leases).

Conclusion-A provision is recognised for the best estimate of the unavoidable lease payments.

Illustration D

Illustrations: Disclosure

This illustration does not form part of the Accounting Standard. Its purpose is to illustrate the application of the Accounting Standard to assist in clarifying its meaning.

An illustration of the disclosures required by paragraph 67 is provided below.

Illustration 1 Warranties

A manufacturer gives warranties at the time of sale to purchasers of its three product lines. Under the terms of the warranty, the manufacturer undertakes to repair or replace items that fail to perform satisfactorily for two years from the date of sale. At the balance sheet date, a provision of ₹ 60,000 has been recognised. The following information is disclosed:

A provision of ₹ 60,000 has been recognised for expected warranty claims on products sold during the last three financial years. It is expected that the majority of this expenditure will be incurred in the next financial year, and all will be incurred within two years of the balance sheet date.

An illustration is given below of the disclosures required by paragraph 72 where some of the information required is not given because it can be expected to prejudice seriously the position of the enterprise.

Illustration 2 Disclosure Exemption

An enterprise is involved in a dispute with a competitor, who is alleging that the enterprise has infringed patents and is seeking damages of ₹ 1000 lakh. The enterprise recognises a provision for its best estimate of the obligation, but discloses none of the information required by paragraphs 66 and 67 of the Standard. The following information is disclosed:

Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed patents and is seeking damages of ₹ 1000 lakh. The information usually required by AS 29, Provisions, Contingent Liabilities and Contingent Assets is not disclosed on the grounds that it can be expected to prejudice the interests of the company. The directors are of the opinion that the claim can be successfully resisted by the company.