Capsule on Accounting Standards

Conducted by

Young Members Empowerment Committee
jointly with Accounting Standards Board

Presented by

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Standards in this module

- AS 1 – Disclosure of Accounting Policies
- AS 3 – Cash Flow Statements
- AS 4 – Contingencies and Events occurring after the Balance Sheet Date
- AS 5 – Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
- AS 20 – Earnings per Share
- AS 24 – Discontinuing Operations
- AS 2 – Valuation of Inventories

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Accounting Standard (AS) 3
Cash Flow Statements
(Not Applicable to SMCs)

Discussion Points

- Definitions
- Presentation of Cash Flows
- Disclosures

Definitions

- Cash
  - Cash on hand and demand deposits
- Cash Equivalents
  - Short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value

Definitions

- Operating Activities
  - Principal revenue-producing activities of the entity and other activities that are not investing or financing activities
- Investing Activities
  - Acquisition and disposal of long-term assets and other investments not included in cash equivalents
- Financing Activities
  - Activities that result in changes in the size and composition of the contributed equity and borrowing of the entity

Classification of Cash Flows

- Operating Activities
  - Direct Method
  - Indirect Method
- Investing Activities
  - On gross basis
- Financing Activities
  - On gross basis

Reporting Cash Flows on Net basis

- Cash flows arising from operating, investing and financing activities that may be reported on a net basis:
  - Cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the entity; and
  - Cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short

Reporting Cash Flows on Net basis

- Cash flows of a financial institution that may be reported on a net basis
  - Cash receipt and payments for the acceptance and repayment of deposits with a fixed maturity date
  - The placement of deposits with and withdrawal of deposits from other financial institutions
  - Cash advances and loans made to customers and the repayment of those advances and loans

Presentation of Cash Flows

- Foreign currency cash flows
  - Exchange rate for translation
  - Foreign subsidiary cash flows
  - Unrealised gains and losses due to restatement
- Interest & Dividends
  - Classification of Interest paid and Interest & Dividends received for financial institution
  - Classification of Interest paid and interest & dividends received for other entities
  - Classification of Dividends paid

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Presentation of Cash Flows

- Taxes on Income
  - Classification
- Non-cash Transactions

Acquisition and Disposals of business

- Classification as investing activities
- Aggregate cash flows arising from obtaining or losing control of subsidiaries or other business
- Disclosures
  - Total consideration paid or received
  - Portion of the consideration consisting of cash and cash equivalents
- Required by IAS 7
  - Amount of cash or cash equivalents in the subsidiaries or other businesses over which control is obtained or lost
  - Amount of assets and liabilities other than C&CE in the subsidiaries or other businesses over which control is obtained or lost

Disclosures

- Components of Cash and Cash Equivalents
- Reconciliation of amounts reported in Cash Flow Statement with the equivalent items reported in the Balance Sheet
- Restriction on use of cash and cash equivalents held

Recommended Disclosures

- Amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities
- Aggregate amount of cash flows that represent increases in operating capacity separately from those cash flows that are required to maintain operating capacity
- Cash flows for each segment

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Case Studies

1. Is a time deposit with a bank cash equivalent?
2. Are investments in equity shares cash equivalents?
3. Are balances in Cash Credit Account part of Operating Activities?
4. How should changes in ownership interest in a subsidiary that do not result in a loss of control be classified?
5. How should a change in classification of financial instruments would be effected in Cash flow Statements?

Case Studies

- Revised Schedule VI requires presentation of line items, either on face or in the notes, which are different vis-à-vis those required under Old Schedule VI. Is it mandatory for a company to present revised line items in the cash flow statements also?
- As part of working capital movement, is it mandatory to present a separate movement for current and non-current components? For example, a company has segregated trade receivables into current and non-current based on Revised Schedule VI criteria. Is it mandatory for the company to disclose movement in current and non-current trade receivables separately?

Case Studies

- Whether long-term loans and advances are to be presented as investing activities? If yes, whether the amounts are to be reported on gross basis?

Case Studies

- ABCD Ltd. has adjusted ₹10 lac as interest expense and ₹5 lac as interest income to derive Cash Flow from Operating Activities and has shown the same amount under Financing activities and Investing Activities respectively. Comment.

Case Studies

- ABCD Ltd. has reported ₹20 lacs as Cash flows due to repayment of borrowings in the current year and ₹30 lacs as Current portion of long term borrowings in the previous year. Comment.

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Case Study

- White Ltd. acquired an equipment through finance lease from Black Ltd. The present value of minimum lease payments was Rs.5 lac whereas fair value of the equipment at the inception of the lease was Rs.5.25 lac. White Ltd. would be repaying Rs.1.10 lac each year for 5 years. The life of the equipment is 5 years. Show the Journal entries to be passed in White Ltd.'s books for finance lease during the year and answer the questions in next slides:

Multiple choice Question

- The purchase of the equipment through the finance lease will be classified as
  - Operating activities
  - Investing activities
  - Financing activities
  - Cash and Cash Equivalents
  - None of the above

Multiple Choice Question

- The liability incurred at the acquisition of the asset is classified as
  - Operating activities
  - Investing activities
  - Financing activities
  - Cash and Cash Equivalents
  - None of the above

Multiple Choice Question

- The payments made to the lessor during the year including interest is classified as
  - Operating activities
  - Investing activities
  - Financing activities
  - Cash and Cash Equivalents
  - None of the above

Multiple Choice Question

- The movement in bank balance due to lease transaction is classified as
  - Operating activities
  - Investing activities
  - Financing activities
  - Cash and Cash Equivalents
  - None of the above

Multiple choice Question

- Depreciation on Lease Equipment is classified as
  - Operating activities
  - Investing activities
  - Financing activities
  - Cash and Cash Equivalents
  - None of the above

Multiple Choice Questions

- X Ltd. purchase a building and the seller accepts payment partly in equity shares and partly in debenture of the entity. The transaction should be treated in the cash flow statement as:
  1. Operating
  2. Investing
  3. Financing
  4. None of the Above

Multiple Choice Question

- Select the statements that are correct with respect to disclosure of non-cash transactions
  1. Such transactions should be disclosed in the financial statements, providing all the relevant information
  2. Such transaction should be excluded from a statement of cash flows
  3. The acquisition of an entity by means of an equity issue is an example of a non-cash transaction
  4. A foreign exchange contract close out is an example of a non-cash transaction
  5. The conversion of debt to equity is an example of a non-cash transaction

Multiple Choice Question

- Which of the following items would be classified under operating activities
  - Cash payment to purchase PPE
  - Cash payment related to income taxes
  - Cash receipts from royalties
  - Cash proceeds from issuing shares
  - Cash payment to invest in a subsidiary
  - Cash payments for futures contracts that are held for trading purposes

Multiple Choice Question

- Under the indirect method, the net cash from operating activities is determined by adjusting net profit or loss for the effects of which of the following
  - Changes during the period in inventories and operating receivables and payables
  - Cash receipts from royalties, fees commission and other revenue
  - Non-cash items such as depreciation, provisions and deferred taxes
  - All other items included in profit or loss for which the cash effects are investing or financing cash flows
  - Cash receipts and from sales of PPE
  - Cash payments to acquire equity or debt instruments of other entities and interests in joint ventures

Multiple Choice Question

- Which of the following could an entity classify under financing activities
  - Cash receipts from the sale of intangible assets
  - Interest payments on day to day transactions
  - Proceeds from issuing of shares
  - Cash receipts from the repayment of an advance made to a party other than a financial institution

Multiple Choice Question

- Which of the cash flows would be classified under investing activities
  – Cash payment to acquire a debt instrument of another entity
  – Cash payments to owners to redeem the entity's shares
  – Cash receipt from the repayment of advance made to a party other than a financial institution
  – Amortisation of intangible asset
  – Cash payments to suppliers of goods

QUESTIONS

Accounting Standard (AS) 4

Contingencies and Events occurring after the Balance Sheet Date

EABSD

Date of end of Reporting Period

Date of authorisation of FS

Relating to Conditions existing at the end of the Reporting Period

Not Relating to Conditions existing at the end of the Reporting Period

Adjusting Events

Non-Adjusting Events

Adjust Financials

Disclose in Notes if Material

IFRS vis-à-vis Indian GAAP

Proposed Dividend

Going Concern

Case Studies

- Whether settlement of a court case that confirms that the entity had a present obligation at the BS Date is a non-adjusting event?
- Whether bankruptcy of a customer that occurs after the BS Date due to fire at his place after the BS Date is a non-adjusting event?
- Whether the sale of inventories after the BS Date at below cost is a non-adjusting event?
- Whether the determination after the BS Date of the cost of assets purchased or the proceeds from assets sold is a non-adjusting event?

Case Studies

- Whether the determination of the amount of profit-sharing or bonus payments for which the entity has a present obligation at the BS Date as per AS 15 is an adjusting event?
- Whether discovery of fraud or errors after the BS Date that show that the FS are incorrect is an adjusting event?
- Whether a major business combination after the BS Date is an adjusting event?
- Whether announcement of a plan to discontinue an operation after the BS Date is an adjusting event?

Case Studies

- Whether destruction of a major production plant by fire after the BS Date is an adjusting event?
- Whether announcement or commencement of the implementation of a major restructuring is an adjusting event?

QUESTIONS

Accounting Standard (AS) 1

Disclosure of Accounting Policies

Objective and Scope

- To promote better understanding of financial statements by establishing
  - the disclosure of accounting policies
  - Manner in which accounting policies are disclosed
- This is a pervasive Accounting Standard
- Accounting policies refer to the specific accounting principles and the methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements

Selection of Accounting Policies

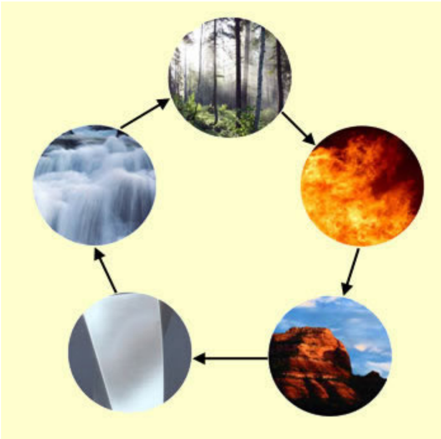
- Major considerations governing selection and application of accounting policies:
  - Prudence
  - Substance over form
  - Materiality

Main Principles

- All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed at one place and form part of the financial statements
- If fundamental accounting assumption is not followed, the fact should be disclosed

Structure of Accounting Policy

- Recognition
- Initial Measurement
- Subsequent Measurement
  - Includes retirements, hedging etc.
- Derecognition



Multiple Choice Question

- Where should the statement of significant accounting policies be disclosed as a best practice measure?
  - After Independent Auditor's Report
  - As a first note to the financial statements
  - As part of Director's Report
  - After all disaggregations of line items

Sample Note

- Note on Basis of Preparation:

The financial statements are prepared on accrual basis under the historical cost convention, modified to include revaluation of certain assets, in accordance with applicable Accounting Standards (“AS”) specified in the Companies (Accounting Standards) Rules, 2006 and presentational requirements of the Companies Act, 1956.

All assets and liabilities have been classified as current or non-current as per the Company’s normal operating cycle and other criteria set out in the Revised Schedule VI to the Companies Act, 1956. Based on the nature of activities and the time between the acquisition of assets for processing and their realisation in cash and cash equivalents, the Company has ascertained its operating cycle as twelve months for the purpose of current/non-current classification of its assets and liabilities.

Sample Note

SAMPLE

- Use of estimates

  The preparation of financial statements in conformity with generally accepted accounting principles in India (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities on the date of the financial statements and the results of operations during the year. Differences between actual results and estimates are recognised in the year in which the results are known or materialise. Examples of such estimates are estimated useful life of assets, provision for doubtful debts, etc. Actual results could differ from those estimates. Any revision to accounting estimates is recognised prospectively in current and future periods.

Multiple Choice Question

- When can an entity be said to be not a going concern?
  - When the entity reports losses continuously for five years
  - When the entity becomes a sick company and is referred to BIFR
  - When the entity intends to liquidate or ceases its operations or has no other alternative but to do so
  - At will of management

QUESTIONS

Accounting Standard (AS) 5

Net Profit or Loss for the Period, Prior Period Items and Disclosure of Accounting Policies

Objective and Scope

- Present Profit or loss from ordinary activities
- Present extraordinary items
- Present prior period items
- Present material items
- Accounting for Changes in Accounting Estimates
- Disclosure of Changes in Accounting Policies

Multiple Choice Question

- Which item of income or expense is credited or debited directly to reserves?
  - Foreign Exchange Gains / Losses
  - Preliminary Expenses
  - Dividend
  - Revaluation of Tangible Assets

Case Studies

- ABCD Ltd. has adjusted preliminary expenses to General Reserves to comply with Revised Schedule VI. Whether the treatment given is in accordance with Accounting Standards?

Case Studies

- Management of ABCD Ltd. wants to create a contingency reserve, so as to meet any eventuality that might arise in future. In this regard, you have been requested to opine on the accounting treatment for amounts to be transferred to and from such reserve.

Case Studies

- ABCD Ltd.'s debenture trust deed requires it to create DRR and invest a part of DRR in specified securities and credit the interest to DRR. The interest on such specified securities has been directly credited to DRR. Comment.

Definitions

- Ordinary Activities
  - Activities undertaken as part of business and such related activities in which the enterprise engages in furtherance of, incidental to, or arising from, these activities
- Extraordinary items
  - Incomes or expenses that arise from events or transactions that are clearly distinct from the ordinary activities and therefore, are not expected to recur frequently or regularly
- Exceptional items?
- No such differentiation in Ind AS / IFRS

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Case Studies

- ABCD Ltd. has paid ₹50 crores towards voluntary retirement scheme which has been aggregated with Salaries and Wages? Comment.

Definitions

- Prior Period Items
  - Incomes 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

Case Studies

- ABCD Ltd. has presented a separate line item “Prior Period Items” on the face of the Statement of Profit and Loss after Profit after Tax. Whether the presentation is proper?
- ABCD Power Ltd. bills fuel surcharge at provisional rates. Final bill for fuel surcharge of ₹53 lakhs for the period April 1 to March 31, 2012 has been received and paid in September 2013 by Jack and Jill Ltd. which has been aggregated with Power and Fuel presented under Other Expenses. Comment.

Case Studies

- ABCD Ltd. provided for warranty of ₹10 crores for the year ended 31 March 2012. In the subsequent year, it was determined that there was an excess provision to the extent of ₹7 crores. The auditor has asked the management to present the excess provision written back as prior period item. Comment.

Case Studies

- A major theft of inventory valued at ₹50 lakhs in the previous year was detected in the year ending on 31 March 2013. Management of the company seeks your opinion on presenting the loss.

Case Studies

- ABCD Ltd. sold a machine (Tangible asset) in previous year to be delivered in the current year for ₹10 lacs which included profit of ₹1 lac. In the current year, the buyer has refused to take delivery and make payment for the same. The management has squared off the Receivable account by debiting ₹10 lacs to Machine Account. Comment.

Case Studies

- ABCD Ltd. sells its entire production to its foreign parent XYZ at prices determined by XYZ. The financial year of ABCD ends on 31 March. Subsequent to the financial year ending on 31 March 2013, ABCD received a debit note from XYZ in May 2013 for reduction in sales prices for the period January 2012 to December 2012. The company is not in favour of presenting the reduction as a priod period item. Comment.

Case Studies

- ABCD Ltd. has taken a land on lease from GIDC in the year ending on 31 March 2012. However, the land has been presented as Freehold Land and not Lease-hold land in the Balance Sheet. Management has sought your opinion on rectification of the error.

Case Studies

- ABCD Ltd. had by error not accounted for bills of one of its dealers amounting to ₹10 crores in the year ended on 31 March 2012. The company seeks your opinion on whether the amount of ₹10 crores is to be considered for computation of managerial remuneration.

Accounting Estimates

- Not Defined
- The effect of a change in an accounting estimate should be included in the determination of profit or loss in
  - The period of the change, if the change affects the period only; or
  - The period of the change and future periods, if the change affects both

Case Studies

- ABCD Ltd. creates a provision of 1% of its receivables as a policy. However, for the year ending on 31 March 2013, it has estimated a higher provision of 4% of its receivables. ABCD Ltd. has sought your help in presenting the same in financial statements for the year ended on 31 March 2013.

Case Studies

- ABCD Ltd. had created warranty provision of ₹10 crores in the year ended on 31 March 2012 and presented the same under Other Expenses. However, during the year, it observed that ₹2 crore excess provision was created in the previous year and has presented the same as Other Income. Comment.

Accounting Policy

Required by Statute → NO → Required by Std. or Interpretation → NO → For more appropriate presentation

Required by Statute ↓ As provided in the Statute

Required by Std. or Interpretation ↓ Apply Transitional Provisions

For more appropriate presentation ↓ Not specified. Application of AS 6 provisions by analogy

Case Studies

- ABCD Ltd. has come under the purview of Payment of Gratuity Act from this year and hence makes provision on actuarial basis. Previously, it used to pay on adhoc basis and accounted for the same when the decision to pay was taken. ABCD Ltd. has disclosed the same as change in accounting policy. Comment.

Case Studies

- ABCD Ltd. allocates the initial direct costs on lease over the lease term. It wants to change the same and recognise them as expense as and when incurred. Whether the change would be a change in accounting policy? Whether the change is to be applied to existing leases or only to new leases?

Change in Accounting Policy

- Any change in accounting policy which has material effect should be disclosed
- Impact of, and adjustment resulting should be disclosed
- Where the effect is not ascertainable, the fact should be indicated
- If not material in current period but is material in later periods, the fact of such change should be disclosed in the period in which the change is adopted

QUESTIONS