Chapter 3

Provisions under accounting standards for items appearing in financial statements

1. Revenue Recognition (Ind AS 18)
2. Valuation of inventory (Ind AS 2)
3. Property plant and equipment (Ind AS 16)
4. Borrowing Cost (Ind AS 23)
5. Intangible assets (Ind AS 38)
6. Provisions, Contingent Liabilities and Contingent Assets (Ind AS 37)
7. Earnings Per Share (Ind AS 33)

1) Revenue Recognition (IndAS18)

Meaning of revenue: Ind AS 18, defines revenue as the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when these inflows results in increase in equity, other than increases relating to contributions from equity participants.
This, Revenue is nothing but the inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise.
Scope: This standard shall be applied in accounting for revenue arising from the following transactions and events:

1. From sale of goods,
2. From rendering of services,
3. From the use by others of entity assets yielding interests, royalties and dividends
4. When goods are sold or services are rendered in exchange for dissimilar goods and services, the exchange is regarded as a transaction which generates revenue.

This standard does not deal with revenue arising from:

1. Lease agreements
2. Dividends arising from investments which are accounted under equity method
3. Insurance contracts within the scope of Ind AS 104, Insurance contracts
4. Changes in the fair value of other current assets
5. Initial recognition and from changes in the fair value of biological assets relating to agricultural activity
6. Initial recognition of agricultural produce and
7. The extraction of mineral ores.

Measurement of Revenue

Measurement of revenue means the value at which revenue should be recognised. This standard prescribes that revenue shall be measured at the fair value of the consideration received or receivable taking into account the amount of any trade discounts and volume of rebates allowed by the entity.
Disclosure

1. The accounting policies adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transaction involving the rendering of services.
2. The amount of each significant category of revenue recognized during the year, including revenue arising from, sale of goods, rendering of services, interest, royalties and dividends.
3. The amount of revenue arising from exchange of goods or services included in each significant category of revenue.

ALWAYS CK

2) Ind AS 2 - Valuation of Inventory

Definition: Inventories are defined as assets-

1. held for sale in the ordinary course of business (finished goods)
2. in the process of production of such sale (raw material and work-in-progress)
3. in the form of materials or supplies to be consumed in production process or in the rendering of services (stores, spares, raw materials etc)
4. inventories do not include machinery

Objectives:

1. formulate the method of computation of cost of inventories
2. Determine the value of closing stock for recognition in the financial statement.

Scope: This standard deals with all inventories except the following:

1. Work In Progress arising under construction contract including directly related to service contract.
2. Work In Progress arising in ordinary course of business for service providers.
3. Financial instruments
4. Livestock, agricultural, mineral oils, forest products, ores and gases (these inventories are valued at net realisable value)

Measurement of Inventories: Inventories should be valued at the lower of cost and net realisable value.

Cost of purchase consist of purchase price including duties, taxes, freight inwards and other expenditure directly attributable to the purchase, trade discounts, rebates, duty drawback and other similar items are deducted in determining the cost of purchase.

Net realisable value means the estimated selling price in ordinary course of business, less estimated cost of completion and estimated cost necessary to make the sale. It is estimated based on most realisable evidence at the time of valuation. It considers the purpose of inventory and it is calculated at each balance sheet date.

Methods of determination of cost:

1. Specific identification method.
2. FIFO (First in first out) method.
3. Weighted average cost method.

Disclosure:

1. Accounting policy adopted in measuring inventories.
2. Formula used
3. Total carrying amount of inventories together.
4. Classifications of inventories are:
   i. Raw materials and components
   ii. Work in progress
   iii. Finished goods
   iv. Stock in trade
   v. Stores and spares
   vi. Loose tools etc.

ALWAYS CK

3) IAS 38 Intangible Assets

IAS 38 sets out the criteria for recognising and measuring intangible assets and requires disclosures about them. An intangible asset is an identifiable non-monetary asset without physical substance. Such an asset is identifiable when it is separable, or when it arises from contractual or other legal rights. Separable assets can be sold, transferred, licensed, etc. Examples of intangible assets include computer software, licences, trademarks, patents, films, copyrights and import quotas. Goodwill acquired in a business combination is accounted for in accordance with IFRS 3 and is outside the scope of IAS 38. Internally generated goodwill is within the scope of IAS 38 but is not recognised as an asset because it is not an identifiable resource.

Expenditure for an intangible item is recognised as an expense, unless the item meets the definition of an intangible asset, and:

1. it is probable that there will be future economic benefits from the asset; and
2. The cost of the asset can be reliably measured.

Recognition:

- Acquisition
- Exchange of assets
- Part of a business combination
- Government grants
- Internally generated intangible assets

The cost of generating an intangible asset internally is often difficult to distinguish from the cost of maintaining or enhancing the entity's operations or goodwill. For this reason, internally generated brands, mastheads, publishing titles, customer lists and similar items are not recognised as intangible assets. The costs of generating other internally generated intangible assets are classified into whether they arise in a research phase or a development phase. Research expenditure is recognised as an expense. Development expenditure that meets specified criteria is recognised as the cost of an intangible asset.

ALWAYS CK

Intangible assets are measured either cost model or revaluation model. Intangible assets are measured initially at cost. After initial recognition, an entity usually measures an intangible asset at cost less accumulated amortisation. It may choose to measure the asset at fair value in rare cases when fair value can be determined by reference to an active market.

An intangible asset with a finite useful life is amortised and is subject to impairment testing. An intangible asset with an indefinite useful life is not amortised, but is tested annually for impairment. When an intangible asset is disposed of, the gain or loss on disposal is included in profit or loss.

4) IAS 37 Provisions, Contingent Liabilities and Contingent Assets

Accounting for provisions (liabilities of uncertain timing or amount), together with contingent assets (possible assets) and contingent liabilities (possible obligations and present obligations that are not probable or not reliably measurable). Provisions are measured at the best estimate (including risks and uncertainties) of the expenditure required to settle the present obligation, and reflects the present value of expenditures required to settle the obligation where the time value of money is material.

Provision: a liability of uncertain timing or amount.

Liability:

- present obligation as a result of past events
- settlement is expected to result in an outflow of resources (payment)

Contingent liability:

- a possible obligation depending on whether some uncertain future event occurs, or

- a present obligation but payment is not probable or the amount cannot be measured reliably

Contingent asset:

- a possible asset that arises from past events, and
- Whose 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 entity

Objectives: The objective is to ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets. Sufficient informations should be disclosed in the notes to enable users to understand their nature, timing and amount.

Recognition of a provision: An entity must recognise a provision if, and only if:

1. Present obligation (legal or constructive) has arisen as a result of a past event (the obligating event)
2. payment is probable ('more likely than not'), and
3. The amount can be estimated reliably.

An obligating event is an event that creates a legal or constructive obligation and, therefore, results in an entity having no realistic alternative but to settle the obligation.

A constructive obligation arises if past practice creates a valid expectation on the part of a third party, for example, a retail store that has a long-standing policy of allowing customers to return merchandise within, say, a 30-day period.

A possible obligation (a contingent liability) is disclosed but not accrued. However, disclosure is not required if payment is remote.

In rare cases, for example in a lawsuit, it may not be clear whether an entity has a present obligation. In those 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. A provision should be recognised for that present obligation if the other recognition criteria described above are met. If it is more likely than not that no present obligation exists, the entity should disclose a contingent liability, unless the possibility of an outflow of resources is remote.

ALWAYS CK

Measurement of provisions

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, that is, the amount that an entity would rationally pay to settle the obligation at the balance sheet date or to transfer it to a third party. This means:

1. Provisions for one-off events (restructuring, environmental clean-up, settlement of a lawsuit) are measured at the most likely amount.
2. Provisions for large populations of events (warranties, customer refunds) are measured at a probability-weighted expected value.
3. Both measurements are at discounted present value using a pre-tax discount rate that reflects the current market assessments of the time value of money and the risks specific to the liability.

In reaching its best estimate, the entity should take into account the risks and uncertainties that surround the underlying events.

The amount recognised as a provision shall be the best estimate, which has included the risks, uncertainties, present value, future events and expected disposal of assets.

If some or all of the expenditure required settling a provision is expected to be reimbursed by another party, the reimbursement should be recognised as a separate asset, and not as a reduction of the required provision, when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The amount recognised should not exceed the amount of the provision.

In measuring a provision consider future events as follows:

1. forecast reasonable changes in applying existing technology
2. ignore possible gains on sale of assets
3. consider changes in legislation only if virtually certain to be enacted

5) IAS 33 — Earnings per Share

IAS 33 Earnings per Share sets out how to calculate both basic earnings per share (EPS) and diluted EPS. The calculation of Basic EPS is based on the weighted average number of ordinary shares outstanding during the period, whereas diluted EPS also includes dilutive potential ordinary shares (such as options and convertible instruments)

The **objective** of IAS 33 is to prescribe principles for determining and presenting earnings per share (EPS) amounts to improve performance comparisons between different entities in the same reporting period and between different reporting periods for the same entity.

IAS 33 applies to entities whose securities are publicly traded or that are in the process of issuing securities to the public. Other entities that choose to present EPS information must also comply with IAS 33.

If both parent and consolidated statements are presented in a single report, EPS is required only for the consolidated statements.

Ordinary share: also known as a common share or common stock. An equity instrument that is subordinate to all other classes of equity instruments.

Potential ordinary share: a financial instrument or other contract that may entitle its holder to ordinary shares.

Common examples of potential ordinary shares

1. Convertible debt
2. Convertible preferred shares
3. Share warrants
4. Share options
5. Share rights
6. Employee stock purchase plans
7. Contractual rights to purchase shares
8. Contingent issuance contracts or agreements (such as those arising in business combination)

ALWAYS CK

Dilution: a reduction in earnings per share or an increase in loss per share resulting from the assumption that convertible instruments are converted, that options or warrants are exercised, or that ordinary shares are issued upon the satisfaction of specified conditions.

Anti-dilution: an increase in earnings per share or a reduction in loss per share resulting from the assumption that convertible instruments are converted, that options or warrants are exercised, or that ordinary shares are issued upon the satisfaction of specified conditions.

Requirement to present EPS

An entity whose securities are publicly traded (or that is in process of public issuance) must present, on the face of the statement of comprehensive income, basic and diluted EPS for:

- profit or loss from continuing operations attributable to the ordinary equity holders of the parent entity; and
- Profit or loss attributable to the ordinary equity holders of the parent entity for the period for each class of ordinary shares that has a different right to share in profit for the period.

If an entity presents the components of profit or loss in a separate income statement, it presents EPS only in that separate statement.

Basic and diluted EPS must be presented with equal prominence for all periods presented.

Basic and diluted EPS must be presented even if the amounts are negative (that is, a loss per share).

If an entity reports a discontinued operation, basic and diluted amounts per share must be disclosed for the discontinued operation either on the face of the comprehensive income (or separate income statement if presented) or in the notes to the financial statements.

Basic EPS

Basic EPS is calculated by dividing profit or loss attributable to ordinary equity holders of the parent entity (the numerator) by the weighted average number of ordinary shares outstanding (the denominator) during the period.

The earnings numerators (profit or loss from continuing operations and net profit or loss) used for the calculation should be after deducting all expenses including taxes, minority interests, and preference dividends.

The denominator (number of shares) is calculated by adjusting the shares in issue at the beginning of the period by the number of shares bought back or issued during the period, multiplied by a time-weighting factor. IAS 33 includes guidance on appropriate recognition dates for shares issued in various circumstances. Contingently issuable shares are included in the basic EPS denominator when the contingency has been met.

Diluted EPS

Diluted EPS is calculated by adjusting the earnings and number of shares for the effects of dilutive options and other dilutive potential ordinary shares. The effects of anti-dilutive potential ordinary shares are ignored in calculating diluted EPS.

Guidance on calculating dilution

Convertible securities. The numerator should be adjusted for the after-tax effects of dividends and interest charged in relation to dilutive potential ordinary shares and for any other changes in income that would result from the conversion of the potential ordinary shares. The denominator should include shares that would be issued on the conversion.

Options and warrants. In calculating diluted EPS, assume the exercise of outstanding dilutive options and warrants. The assumed proceeds from exercise should be regarded as having been used to repurchase ordinary shares at the average market price during the period. The difference between the number of ordinary shares assumed issued on exercise and the number of ordinary shares assumed repurchased shall be treated as an issue of ordinary shares for no consideration.

Contingently issuable shares. Contingently issuable ordinary shares are treated as outstanding and included in the calculation of both basic and diluted EPS if the conditions have been met. If the conditions have not been met, the number of contingently issuable shares included in the diluted EPS calculation is based on the number of shares that would be issuable if the end of the period were the end of the contingency period. Restatement is not permitted if the conditions are not met when the contingency period expires.

Contracts that may be settled in ordinary shares or cash. Presume that the contract will be settled in ordinary shares, and include the resulting potential ordinary shares in diluted EPS if the effect is dilutive.

Retrospective adjustments

The calculation of basic and diluted EPS for all periods presented is adjusted retrospectively when the number of ordinary or potential ordinary shares outstanding increases as a result of a capitalisation, bonus issue, or share split, or decreases as a result of a reverse share split. If such changes occur after the balance sheet date but before the financial statements are authorised for issue, the EPS calculations for those and any prior period financial statements presented are based on the new number of shares. Disclosure is required.

Basic and diluted EPS are also adjusted for the effects of errors and adjustments resulting from changes in accounting policies, accounted for retrospectively.
Diluted EPS for prior periods should not be adjusted for changes in the assumptions used or for the conversion of potential ordinary shares into ordinary shares outstanding.

Disclosure

If EPS is presented, the following disclosures are required:

1. the amounts used as the numerators in calculating basic and diluted EPS, and a reconciliation of those amounts to profit or loss attributable to the parent entity for the period
2. the weighted average number of ordinary shares used as the denominator in calculating basic and diluted EPS, and a reconciliation of these denominators to each other
3. instruments (including contingently issuable shares) that could potentially dilute basic EPS in the future, but were not included in the calculation of diluted EPS because they are ant dilutive for the period(s) presented
4. a description of those ordinary share transactions or potential ordinary share transactions that occur after the balance sheet date and that would have changed significantly the number of ordinary shares or potential ordinary shares outstanding at the end of the period if those transactions had occurred before the end of the reporting period. Examples include issues and redemptions of ordinary shares issued for cash, warrants and options, conversions, and exercises

An entity is permitted to disclose amounts per share other than profit or loss from continuing operations, discontinued operations, and net profit or loss earnings per share. Guidance for calculating and presenting such amounts is included in IAS.

ALWAYS CK