FRSA
Module 1:- Accounting Standards

Generally Accepted Accounting Principles

Generally accepted accounting principles (GAAP) refer to a common set of accepted accounting principles, standards, and procedures that business reporting entity must follow when it prepares and present its financial statements. GAAP is a combination of authoritative standards (set by policy boards) and the commonly accepted ways of recording and reporting accounting information. At international level such authoritative standards are known as International Financial Reporting Standards (IFRS) and in India we have authoritative standards named as AS and IND-AS. Accounting Standards (ASs) are written policy documents issued by the Government with the support of other regulatory bodies (e.g., Ministry of Corporate Affairs (MCA) issuing Accounting Standards for corporates in consultation with National Financial Reporting Authority (NFRA) covering the following aspects of accounting transaction in financial statements.

• measurement,

• presentation,

• disclosure

The ostensible purpose of the standard setting bodies is to promote the dissemination of timely and useful financial information to investors and certain other stakeholders, having an interest in the company's economic performance. Accounting Standards reduce the accounting alternatives in the preparation of financial statements within the bounds of rationality, thereby, ensuring comparability of financial statements of different enterprises.

<u>Accounting Standards deal with the following:</u>

(i) recognition of events and transactions in the financial statements,

(ii) measurement of these transactions and events,

(iii) presentation of these transactions and events in the financial statements in a manner that is meaningful and understandable to the reader, and

(iv) the disclosure relating to these transactions and events to enable the public at large and the stakeholders and the potential investors in particular, to get an insight into what these financial statements are trying to reflect and thereby facilitating them to take prudent and informed business decisions.

The following are the benefits of Accounting Standards:

(i) Standardisation of alternative accounting treatments: Accounting Standards reduce to a reasonable extent or eliminate altogether confusing variations in the accounting treatment followed for the purpose of preparation of financial statements. The standard policies are intended to reflect a consensus on accounting policies to be used in different identified area.

(ii) Requirements for additional disclosures: There are certain areas where important is not statutorily required to be disclosed. Standards may call for disclosure beyond that required by law.

(iii) Comparability of financial statements: In addition to improving credibility of accounting data, standardisation of accounting procedures improves comparability of financial statements, both intra-enterprise and interenterprise.

STANDARDS SETTING PROCESS:-

The Institute of Chartered Accountants of India (ICAI), being a premier accounting body in the country, took upon itself the leadership role by constituting the Accounting Standards Board (ASB) in 1977. The ICAI has taken significant initiatives in the issuing of Accounting Standards to ensure that the standard-setting process is fully consultative and transparent. The ASB considered the International Accounting Standards (IASs)/International Financial Reporting Standards (IFRSs) while framing Indian Accounting Standards (ASs) and tried to integrate them, in the light of the applicable laws, customs, usages and business environment in the country. The composition of ASB includes representatives of industries (namely, ASSOCHAM, CII, FICCI), regulators, academicians, government departments, etc. Although ASB is a body constituted by the Council of the ICAI, it (ASB) is independent in the formulation of accounting standards and Council of the ICAI is not empowered to make any modifications in the draft accounting standards formulated by ASB without consulting with the ASB. It may be noted that ASB is a committee under Institute of Chartered Accountants of India (ICAI) which consists of representatives from government department, academicians, other professional bodies viz. ICSI, ICAI, representatives from ASSOCHAM, CII, FICCI, etc. NFRA recommend these standards to the Ministry of Corporate Affairs (MCA). MCA has to spell out the accounting standards applicable for companies in India.

The standard-setting procedure of Accounting Standards Board (ASB) can be briefly outlined as follows:

♦Identification of broad areas by ASB for formulation of AS.

♦Constitution of study groups by ASB to consider specific projects and to prepare preliminary drafts of the proposed accounting standards. The draft normally includes objective and scope of the standard, definitions of the terms used in the standard, recognition and measurement principles wherever applicable and presentation and disclosure requirements.

♦Consideration of the preliminary draft prepared by the study group of ASB and revision, if any, of the draft on the basis of deliberations.

♦Circulation of draft of accounting standard (after revision by ASB) to the Council members of the ICAI and specified outside bodies such as Ministry of Corporate Affairs (MCA), Securities and Exchange Board of India (SEBI), Comptroller and Auditor General of India (C&AG), Central Board of Direct Taxes (CBDT), Standing Conference of Public Enterprises (SCOPE), etc. for comments.

♦ Meeting with the representatives of the specified outside bodies to ascertain their views on the draft of the proposed accounting standard.

♦ Finalisation of the exposure draft of the proposed accounting standard and its issuance inviting public comments.

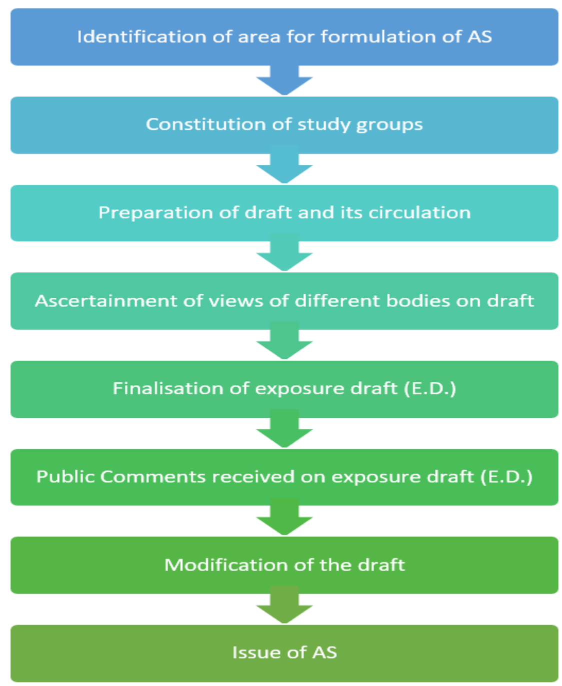
♦ Consideration of comments received on the exposure draft and finalisation of the draft accounting standard by the ASB for submission to the Council of the ICAI for its consideration and approval for issuance.

♦ Consideration of the final draft of the proposed standard and by the Council of the ICAI, and if found necessary, modification of the draft in consultation with the ASB is done.

♦ The accounting standard on the relevant subject (for non-corporate entities) is then issued by the ICAI. For corporate entities the accounting standards are issued by the Central Government of India.

Standard – Setting Process

Earlier, ASB used to issue Accounting Standard Interpretations which address questions that arise in course of application of standard. These were, therefore, issued after issuance of the relevant standard. Authority of the accounting standard interpretation (ASIs) was same as that of the accounting standard (AS) to which it relates. However, after notification of Accounting Standards by the Central Government for the companies, where the consensus portion of ASI was merged as 'Explanation' to the relevant paragraph of the Accounting Standard, the Council of ICAI also decided to merge the consensus portion of ASI as 'Explanation' to the relevant paragraph of the Accounting Standard issued by them. This initiative was taken by the Council of the ICAI to harmonise both the set of standards, i.e., Accounting Standards issued by the ICAI and Accounting Standards notified by the Central



It may be noted that as per Section 133 of the Companies Act, 2013, the Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority (NFRA)

Accounting Standards issues by the Institute Of Chartered Accountants of India:

AS No.	AS Title	Date
1	Disclosure of Accounting Policies	01/04/1993
2	Valuation of Inventories (Revised)	01/04/1999
3	Cash Flow Statement	01/04/2001
4	Contingencies and Events Occurring after the Balance Sheet Date (Revised)	01/04/1998
5	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies	01/04/1996
7	Construction Contracts	01/04/2002
9	Revenue Recognition	01/04/1993
10	Property, Plant and Equipment (Revised)	01/04/2016
11	The Effects of Changes in Foreign Exchange Rates	01/04/2004
12	Accounting for Government Grants	01/04/1994
13	Accounting for Investments (Revised)	01/04/1995
14	Accounting for Amalgamations (Revised)	01/04/1995
15	Employee Benefits	01/04/2006
16	Borrowing Costs	01/04/2000
17	Segment Reporting	01/04/2001
18	Related Party Disclosures	01/04/2001
19	Leases	01/04/2001
20	Earnings Per Share	01/04/2001
21	Consolidated Financial Statements (Revised)	01/04/2001

22	Accounting for Taxes on Income	01/04/2006
23	Accounting for Investments in Associates in Consolidated Financial Statements	01/04/2002
24	Discontinuing Operations	01/04/2004
25	Interim Financial Reporting	01/04/2002
26	Intangible Assets	01/04/2003
27	Financial Reporting of Interests in Joint Ventures	01/04/2002
28	Impairment of Assets	01/04/2008
29	Provisions, Contingent Liabilities and Contingent Assets (Revised)	01/04/2004

ACCOUNTING STANDARDS (AS)2 (VALUATION OF INVENTORIES)

Valuation of Inventories:-
(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 and the General Instructions contained in part A of the Annexure to the Notification.)

Objective:-
A primary issue in accounting for inventories is the determination of the value at which inventories are carried in the financial statements until the related revenues are recognised. This Standard deals with the determination of such value, including the ascertainment of cost of inventories and any write-down thereof to net realisable value.

Scope:-
1. This Standard should be applied in accounting for inventories other than:
(a) work in progress arising under construction contracts, including directly related service contracts (see Accounting Standard (AS) 7, Construction Contracts);
(b) work in progress arising in the ordinary course of business of service providers;
(c) shares, debentures and other financial instruments held as stock-in-trade; and
(d) producers' inventories of livestock, agricultural and forest products, and mineral oils, ores and gases to the extent that they are measured at net realisable value in accordance with well established practices in those industries.

2. The inventories referred to in paragraph 1 (d) are measured at net realisable value at certain stages of production. This occurs, for example, when agricultural crops have been harvested or mineral oils, ores and gases. have been extracted and sale is assured under a forward contract or a government

guarantee, or when a homogenous market exists and there is a negligible risk of failure to sell. These inventories are excluded from the scope of this Standard.

Definitions

The following terms are used in this Standard with the meanings specified:
Inventories are assets:
(a) held for sale in the ordinary course of business;
(b) in the process of production for such sale; or
(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

Inventories encompass goods purchased and held for resale, for example, merchandise purchased by a retailer and held for resale, computer software held for resale, or land and other property held for resale. Inventories also encompass finished goods produced, or work in progress being produced, by the enterprise and include materials, maintenance supplies, consumables and loose tools awaiting use in the production process. Inventories do not include machinery spares which can be used only in connection with an item of fixed asset and whose use is expected to be irregular; such machinery spares are accounted for in accordance with Accounting Standard (AS) 10, Accounting for Fixed Assets.

Measurement of Inventories

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

Cost of Inventories

The cost of inventories should comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Costs of Purchase

The costs of purchase consist of the purchase price including duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates, duty drawbacks

Costs of Conversion

The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials
The allocation of fixed production overheads for the purpose of their inclusion in the costs of conversion is based on the normal capacity of the production facilities. Normal capacity is the production expected

to be achieved on an average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. The amount of fixed production overheads allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognised as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed production overheads allocated to each unit of production is decreased so that inventories are not measured above cost. Variable production overheads are assigned to each unit of production on the basis of the actual use of the production facilities.

A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product. When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production. Most by-products as well as scrap or waste materials, by their nature, are immaterial. When this is the case, they are often measured at net realisable value and this value is deducted from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost.

Other Costs

Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. For example, it may be appropriate to include overheads other than production overheads or the costs of designing products for specific customers in the cost of inventories.

Interest and other borrowing costs are usually considered as not relating to bringing the inventories to their present location and condition and are, therefore, usually not included in the cost of inventories.

Exclusions from the Cost of Inventories

In determining the cost of inventories in accordance with paragraph 6, it is appropriate to exclude certain costs and recognise them as expenses in the period in which they are incurred. Examples of such costs are:

(a) abnormal amounts of wasted materials, labour, or other production costs;

(b) storage costs, unless those costs are necessary in the production process prior to a further production stage;

(c) administrative overheads that do not contribute to bringing the inventories to their present location and condition; and

(d) selling and distribution costs.

Cost Formulas

The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects should be assigned by specific identification of their individual costs. Specific identification of cost means that specific costs are attributed to identified items of inventory. This is an appropriate treatment for items that are segregated for a specific project, regardless of whether they have been purchased or produced. However, when there are large numbers of items of inventory which are ordinarily interchangeable, specific identification of costs is inappropriate since, in such circumstances, an enterprise could obtain predetermined effects on the net profit or loss for the period by selecting

The cost of inventories, other than those dealt with in paragraph 14, should be assigned by using the first-in, first-out (FIFO), or weighted average cost formula. The formula used should reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition.

A variety of cost formulas is used to determine the cost of inventories other than those for which specific identification of individual costs is appropriate. The formula used in determining the cost of an item of inventory needs to be selected with a view to providing the fairest possible approximation to the cost incurred in bringing the item to its present location and condition. The FIFO formula assumes that the items of inventory which were purchased or produced first are consumed or sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced. Under the weighted average cost formula, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the enterprise.

Techniques for the Measurement of Cost

Techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method, may be used for convenience if the results approximate the actual cost. Standard costs take into account normal levels of consumption of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of current conditions.

The retail method is often used in the retail trade for measuring inventories of large numbers of rapidly changing items that have similar margins and for which it is impracticable to use other costing methods. The cost of the inventory is determined by reducing from the sales value of the inventory the appropriate percentage gross margin. The percentage used takes into consideration inventory which has been marked down to below its original selling price. An average percentage for each retail department is often used.

Net Realisable Value:-

The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined. The cost of inventories may also not be recoverable if the estimated costs of completion or the estimated costs necessary to make the sale have increased. The practice of writing down inventories below cost to net realisable value is consistent with the view that assets should not be

Inventories are usually written down to net realisable value on an itemby-item basis. In some circumstances, however, it may be appropriate to group similar or related items. This may be the case with items of inventory relating to the same product line that have similar purposes or end uses and are produced and marketed in the same geographical area and cannot be practicably evaluated separately from other items in that product line. It is not appropriate to write down inventories based on a classification of inventory, for example, finished goods, or all the inventories in a particular business segment.

Estimates of net realisable value are based on the most reliable evidence available at the time the estimates are made as to the amount the inventories are expected to realise. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the balance sheet date to the extent that such events confirm the conditions existing at the balance sheet date.

Estimates of net realisable value also take into consideration the purpose for which the inventory is held. For example, the net realisable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price. If the sales contracts are for less than the inventory quantities held, the net realisable value of the excess inventory is based on general selling prices. Contingent losses on firm sales contracts in excess of inventory quantities held and contingent losses on firm purchase contracts are dealt with in accordance with the principles enunciated in Accounting Standard (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date

Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value.

An assessment is made of net realisable value as at each balance sheet date.

Disclosure

The financial statements should disclose:

(a) the accounting policies adopted in measuring inventories, including the cost formula used; and

(b) the total carrying amount of inventories and its classification appropriate to the enterprise.

Information about the carrying amounts held in different classifications of inventories and the extent of the changes in these assets is useful to financial statement users. Common classifications of inventories are raw materials and components, work in progress, finished goods, stores and spares, and loose tools.

(FIFO) First In First Out:-

This method of pricing the issues is based on the assumptiion that the materials purchased and received first in store are issued first to the job. It means the materials are issued in the order in which they are received. The price of the earliest lot of purchase is taken first and when that is exhausted, the price of the next lot of purchase is adopted and so on. In other words, the materials are issued at the oldest cost price. The closing stock is valued at latest or current price. This method is suitable when prices are falling. It is also useful if transactions are few and prices of material remain stable. In case of perishable materials this method is best applicable.

Advantages :

The following are the advantages of FIFO method.

i) It is simple to understand and easy to operate.

ii) It is based on logical and sound principle that materials are issued in order of purchase.

iii) The closing stock is valued at a more recent price.

iv) Materials are priced at actual cost hence no unrealised profit or loss arises.

v) Deterioration and obsolescence can be avoided by exhausting oldest materials at the time of issue.

Disadvantage :

This method suffers from the following disadvantages.

i) The calculation becomes difficult and complecated when purchases are made very frequently at different prices.

ii) Issue price does not reflect current market price.

iii) Cost of production tends to be high during the period of falling prices.

iv) The pricing of material returns is difficult.

v) Cost comparision between two similar job becomes difficult when issues are priced differently.

Last in First out (LIFO) Method :

This method is exactly opposite of FIFO method. It is based on the assumption that the material purchased and received last in store are issued first to the job. Under this method the cost of last lot of materials purchased is used for pricing the material issues. Thereafter the price of next earlier lot is taken and so on. In other words, the materials are issued at the latest cost price. The closing stock of materials are valued at the oldest cost price. In case of a rising price LIFO method is suitable because material is issued at current price.

Advantages :

The following are the advantages of LIFO method.

i) It is simple to operate and easy to understand.

ii) It is appropriate for matching cost and revenue.

iii) Closing stock will be valued at earlier price and will not, therfore show unrealised profit.

iv) It shows real income in times of rising prices. v) It is good method of avoiding tax.

Disadvantage :

The main disadvantages of LIFO method are as followes.

i) Calculations become complicated when rates of receipts are highly fluctuating.

ii) Closing stock are not valued at current market price. It is valued at unreal and outdated cost.

iii) The stocks require to be adjusted during falling prices.

iv) Due to variation of prices, comparision of cost of similar job is not possible.

v) This method is not useful in case of perishable materials.

Simple Average Method :

Under this method materials are issued at the average price of materials on hand on the date of issue. The simple average price is calculated dividing the total of all rates of material in hand by the number of rates. The lot which is exhausted, based on FIFO method is excluded in computing the average.

Rate of Issue = Total of Different Rates\ No. of Rates

This method is useful when the materials are received in uniform quantities and purchase prices are normally stable.

Weighted Average Method :

This method gives due importance to quantity of material in stock. Under this method issue price of material is calculated by dividing the value of materials in stock by the quantities of material in stock.

Rate of Issue = Value of material in stock \quantities of material in stock

Weighted average rate is calculated each time when a fresh lot is received. It remains the 5 same till the next lot is received. Thus issue price are calculated at the time of receipt of material and not all the times of issue of material. This method is useful, where the purchase price and quantities of material are widely different.

Example

1. Consider the following information:

- April 01: Inventories on hand are 50 units at the rate of 2 and 100 units at the rate of 4.50
- April 05: Purchased 100 units at 1.80
- April 06: 10 units of inventories purchased on 5 April at 1.80 are returned to supplier
- April 10: 80 units issued to factory
- April 15: 50 units issued to factory
- April 20: 20 units purchased at 1.50
- April 25: 70 units issued to factory
- April 30: 50 units purchased at 1.70
- April 30: 10 units returned to store out of units issued to factory on 25 April

Required: Show the value of the inventory on hand on 30 April using the LIFO method.

	Receipts			Issues			Balance		
Date	Quantity	Unit Cost	Amount	Quantity	Unit Cost	Amount	Quantity	Unit Cost	Amount
2006									
April 01	Balance						50	2.00	100.00
							100	1.50	150.00
April 05	100	1.80	180.00				50	2.00	100.00
							100	1.50	150.00
							100	1.80	180.00
April 06	10	1.80	18.00				50	200	100.00
							100	1.50	150.00
							90	1.80	162.00
April 10				80	1.80	144.00	50	2.00	100.00
							100	1.50	150.00
							10	1.80	18.00
April 15				10	1.80	18.00	50	2.00	100.00
				40	1.50	60.00	60	1.50	90.00
April 20	20	1.50	30.00				50	2.00	100.00
							60	1.50	90.00
							20	1.50	30.00
April 25				20	1.50	30.00	50	2.90	100.00
				50	1.50	75.00	10	1.50	15.00
							50	2.00	100.00
April 30	50	1.70	85.00				10	1.50	15.00
							50	1.70	85.00
				10	1.50	15.00			
April 30							50	2.00	100.00
							10	1.50	15.00
							50	1.70	85.00
							10	1.50	15.00
Value of inventory on hand on 30 April							120		215.00

Example 2

Using the information provided by John Doe, we can compute the value of closing inventory, based on the three inventory valuation methods discussed:

Date	Purchases		Sales				
1-Aug	120	units	$120	20-Aug	30	units	$150
8-Aug	50	units	$125	6-Aug	100	units	$140
16-Aug	20	units	$140	10-Aug	55	units	$145
				25-Aug	40	units	$160

*Note: Only the quantity under the sales column is relevant for inventory valuation. The Sales prices of $140, $145 and $160 are relevant for determining Total Sales

Solution:

FIFO METHOD				
Date	Purchases	Issued	Balance	Total
1-Aug	120 units @ $120		120 units @ $120	14,400.00
6-Aug		100 units @ $120	20 units @ $ 120	2,400.00
8-Aug	50 units @ $125		20 units @ $ 120	2,400.00
			50 units @ $125	6,250.00
				8,650.00
10-Aug		20 units @ $ 120	15 units @ $125	1,875.00
		35 units @ $125		
16-Aug	20 units @ $140		15 units @ $125	1,875.00
			20 units @ $140	2,800.00
				4,675.00
20-Aug	30 units @ $150		15 units @ $125	1,875.00
			20 units @ $140	2,800.00
			30 units @ $150	4,500.00
				9,175.00
25-Aug		15 units @ $125		
		20 units @ $140		
		5 units @ $150	25 units @ $150	**3,750.00**

LIFO METHOD				
Date	Purchases	Issued	Balance	Total
1-Aug	120 units @ $120		120 units @ $120	14,400.00
6-Aug		100 units @ $120	20 units @ $ 120	2,400.00
8-Aug	50 units @ $125		20 units @ $ 120	2,400.00
			50 units @ $125	6,250.00
				8,650.00
10-Aug		50 units @ $125		
		5 units @ $120	15 units @ $ 120	1,800.00
16-Aug	20 units @ $140		15 units @ $ 120	1,800.00
			20 units @ $140	2,800.00
				4,600.00
20-Aug	30 units @ $150		15 units @ $ 120	1,800.00
			20 units @ $140	2,800.00
			30 units @ $150	4,500.00
				9,100.00
25-Aug		30 units @ $150	15 units @ $ 120	1,800.00
		10 units @ $140	10 units @ $140	1,400.00
				3,200.00

Average Cost Method					
Date	**Purchases**	**Issued**	**Average Cost**	**No. of Units**	**Total**
1-Aug	120 units @ $120		120.00	120	14,400.00
6-Aug		100 units @ $120	120.00	20	2,400.00
8-Aug	50 units @ $125		123.57	70	8,650.00
10-Aug		55 units @ $123.57	123.57	15	1,853.57
16-Aug	20 units @ $140		132.96	35	4,653.57
20-Aug	30 units @ $150		140.82	65	9,153.57
25-Aug		40 units @ $140.82	140.82	25	3,520.60

ACCOUNTING STANDARD (AS) 10
ACCOUNTING OF FIXED ASSET

Introduction

Financial statements disclose certain information relating to fixed assets. In many enterprises these assets are grouped into various categories, such as land, buildings, plant and machinery, vehicles, furniture and fittings, goodwill, patents, trade marks and designs. This standard deals with accounting for such fixed assets except as described in paragraphs 2 to 5 below.

This standard does not deal with the specialised aspects of accounting for fixed assets that arise under a comprehensive system reflecting the effects of changing prices but applies to financial statements prepared on historical cost basis.

This standard does not deal with accounting for the following items to which special considerations apply:

(i) forests, plantations and similar regenerative natural resources;

(ii) wasting assets including mineral rights, expenditure on the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources;

(iii) expenditure on real estate development; and

(iv) livestock.

Expenditure on individual items of fixed assets used to develop or maintain the activities covered in (i) to (iv) above, but separable from those activities, are to be accounted for in accordance with this Standard.

This standard does not cover the allocation of the depreciable amount of fixed assets to future periods since this subject is dealt with in Accounting Standard 6 on 'Depreciation Accounting'.

5. This standard does not deal with the treatment of government grants and subsidies, and assets under leasing rights. It makes only a brief reference to the capitalisation of borrowing costs and to assets acquired in an amalgamation or merger. These subjects require more extensive consideration than can be given within this Standard.

Definitions

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

1. **Fixed asset** is an asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business.

2.**Fair market value** is the price that would be agreed to in an open and unrestricted market between knowledgeable and willing parties dealing at arm's length who are fully informed and are not under any compulsion to transact.

3.**Gross book value** of a fixed asset is its historical cost or other amount substituted for historical cost in the books of account or financial statements. When this amount is shown net of accumulated depreciation, it is termed as net book value.

Explanation

Fixed assets often comprise a significant portion of the total assets of an enterprise, and therefore are important in the presentation of financial position. Furthermore, the determination of whether an expenditure represents an asset or an expense can have a material effect on an enterprise's reported results of operations.

Identification of Fixed Assets

1. The definition in paragraph 6.1 gives criteria for determining whether items are to be classified as fixed assets. Judgement is required in applying the criteria to specific circumstances or specific types of enterprises. It may be appropriate to aggregate individually insignificant items, and to apply the criteria to the aggregate value. An enterprise may decide to expense an item which could otherwise have been included as fixed asset, because the amount of the expenditure is not material.
2. Stand-by equipment and servicing equipment are normally capitalised. Machinery spares are usually charged to the profit and loss statement as and when consumed. However, if such spares can be used only in connection with an item of fixed asset and their use is expected to be irregular, it may be appropriate to allocate the total cost on a systematic basis over a period not exceeding the useful life of the principal item.
3. In certain circumstances, the accounting for an item of fixed asset may be improved if the total expenditure thereon is allocated to its component parts, provided they are in practice separable, and estimates are made of the useful lives of these components. For example, rather than treat an aircraft and its engines as one unit, it may be better to treat the engines as a separate unit if it is likely that their useful life is shorter than that of the aircraft as a whole.

Components of Cost

The cost of an item of fixed asset comprises its purchase price, including import duties and other non-refundable taxes or levies and any directly attributable cost of bringing the asset to its working condition for its intended use; any trade discounts and rebates are deducted in arriving at the purchase price. Examples of directly attributable costs are:

(i) site preparation;

(ii) initial delivery and handling costs;

(iii) installation cost, such as special foundations for plant; and

(iv) professional fees, for example fees of architects and engineers.

The cost of a fixed asset may undergo changes subsequent to its acquisition or construction on account of exchange fluctuations, price adjustments, changes in duties or similar factors.

Non-monetary Consideration

1. When a fixed asset is acquired in exchange for another asset, its cost is usually determined by reference to the fair market value of the consideration given. It may be appropriate to consider also the fair market value of the asset acquired if this is more clearly evident. An alternative accounting treatment that is sometimes used for an exchange of assets, particularly when the assets exchanged are

similar, is to record the asset acquired at the net book value of the asset given up; in each case an adjustment is made for any balancing receipt or payment of cash or other consideration.

2. When a fixed asset is acquired in exchange forshares or othersecurities in the enterprise, it is usually recorded at its fair market value, or the fair market value of the securities issued, whichever is more clearly evident.

Improvements and Repairs

Frequently, it is difficult to determine whether subsequent expenditure related to fixed asset represents improvements that ought to be added to the gross book value or repairs that ought to be charged to the profit and loss statement. Only expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance is included in the gross book value, e.g., an increase in capacity.

The cost of an addition or extension to an existing asset which is of a capital nature and which becomes an integral part of the existing asset is usually added to its gross book value. Any addition or extension, which has a separate identity and is capable of being used after the existing asset is disposed of, is accounted for separately.

Amount Substituted for Historical Cost

1. Sometimes financial statements that are otherwise prepared on a historical cost basis include part or all of fixed assets at a valuation in substitution for historical costs and depreciation is calculated accordingly. Such financial statements are to be distinguished from financial statements prepared on a basis intended to reflect comprehensively the effects of

2. A commonly accepted and preferred method of restating fixed assets is by appraisal, normally undertaken by competent valuers. Other methods sometimes used are indexation and reference to current prices which when applied are cross checked periodically by appraisal method.

3. The revalued amounts of fixed assets are presented in financial statements either by restating both the gross book value and accumulated depreciation so as to give a net book value equal to the net revalued amount or by restating the net book value by adding therein the net increase on account of revaluation. An upward revaluation does not provide a basis for crediting to the profit and loss statement the accumulated depreciation existing at the date of revaluation.

4. Different bases of valuation are sometimes used in the same financial statements to determine the book value of the separate items within each of the categories of fixed assets or for the different categories of fixed assets. In such cases, it is necessary to disclose the gross book value included on each basis.

5. Selective revaluation of assets can lead to unrepresentative amounts being reported in financial statements. Accordingly, when revaluations do not cover all the assets of a given class, it is appropriate that the selection of assets to be revalued be made on a systematic basis. For example, an enterprise may revalue a whole class of assets within a unit.

6. It is not appropriate for the revaluation of a class of assets to result in the net book value of that class being greater than the recoverable amount of the assets of that class.

7. An increase in net book value arising on revaluation of fixed assets is normally credited directly to owner's interests under the heading of revaluation reserves and is regarded as not available for distribution. A decrease in net book value arising on revaluation of fixed assets is charged to profit and loss statement except that, to the extent that such a decrease is considered to be related to a previous increase on revaluation that is included in revaluation reserve, it is sometimes charged against that earlier increase. It sometimes happens that an increase to be recorded is a reversal of a previous decrease arising on revaluation which has been charged to profit and loss statement in which case the increase is credited to profit and loss statement to the extent that it offsets the previously recorded decrease.

Retirements and Disposals

1. An item of fixed asset is eliminated from the financial statements on disposal.
2. Items of fixed assets that have been retired from active use and are held for disposal are stated at the lower of their net book value and net realisable value and are shown separately in the financial statements. Any expected loss is recognised immediately in the profit and loss statement.
3. In historical cost financial statements, gains orlosses arising on disposal are generally recognised in the profit and loss statement.
4. On disposal of a previously revalued item of fixed asset, the difference between net disposal proceeds and the net book value is normally charged or credited to the profit and loss statement except that, to the extent such a loss is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilised, it is charged directly to that account. The amount standing in revaluation reserve following the retirement or disposal of an asset which relates to that asset may be transferred to general reserve.

Valuation of Fixed Assets in Special Cases

1. In the case of fixed assets acquired on hire purchase terms, although legal ownership does not vest in the enterprise, such assets are recorded at their cash value, which, if not readily available, is calculated by assuming an appropriate rate of interest. They are shown in the balance sheet with an appropriate narration to indicate that the enterprise does not have full ownership thereof.
2. Where an enterprise owns fixed assets jointly with others (otherwise than as a partner in a firm), the extent of its share in such assets, and the proportion in the original cost, accumulated depreciation and written down value are stated in the balance sheet. Alternatively, the pro rata cost of such jointly owned assets is grouped together with similar fully owned assets. Details of such jointly owned assets are indicated separately in the fixed assets register.
3. Where several assets are purchased for a consolidated price, the consideration is apportioned to the various assets on a fair basis as determined by competent valuers.

Fixed Assets of Special Types

1. Goodwill, in general, is recorded in the books only when some consideration in money or money's worth has been paid for it. Whenever a business is acquired for a price (payable either in cash or in shares or otherwise) which is in excess of the value of the net assets of the business taken over, the excess is termed as 'goodwill'. Goodwill arises from business connections, trade name or reputation of an enterprise or from other intangible benefits enjoyed by an enterprise.
2. As a matter of financial prudence, goodwill iswritten off over a period. However, many enterprises do not write off goodwill and retain it as an asset.

Disclosure

1. Certain specific disclosures on accounting for fixed assets are already required by Accounting Standard 1 on 'Disclosure of Accounting Policies' and Accounting Standard 6 on 'Depreciation Accounting'.
2. Further disclosures that are sometimes made in financial statements include:

(i) gross and net book values of fixed assets at the beginning and end of an accounting period showing additions, disposals, acquisitions and other movements;
(ii) expenditure incurred on account of fixed assets in the course of construction or acquisition; and
(iii) revalued amounts substituted for historical costs of fixed assets, the method adopted to compute the revalued amounts, the nature of any indices used, the year of any appraisal made, and whether an external valuer was involved, in case where fixed assets are stated at revalued amounts.

Main Principles

1. The items determined in accordance with the definition of this Standard should be included under fixed assets in financial statements.
2. The gross book value of a fixed asset should be either historical cost or a revaluation computed in accordance with this Standard. The method of accounting for fixed assets included at historical cost is set out ,the method of accounting of revalued assets.
3. The cost of a fixed asset should comprise its purchase price and any attributable cost of bringing the asset to its working condition for its intended use.
4. The cost of a self-constructed fixed asset should comprise those costs that relate directly to the specific asset and those that are attributable to the construction activity in general and can be allocated to the specific asset.
5. When a fixed asset is acquired in exchange or in part exchange for another asset, the cost of the asset acquired should be recorded either at fair market value or at the net book value of the asset given up, adjusted for any balancing payment or receipt of cash or other consideration. For these purposes fair market value may be determined by reference either to the asset given up or to the asset acquired, whichever is more clearly evident. Fixed asset acquired in exchange for shares or other securities in the enterprise should be recorded at its fair market value, or the fair market value of the securities issued, whichever is more clearly evident.
6. Subsequent expenditures related to an item of fixed asset should be added to its book value only if they increase the future benefits from the existing asset beyond its previously assessed standard of performance.

7. Material items retired from active use and held for disposal should be stated at the lower of their net book value and net realisable value and shown separately in the financial statements.
8. Fixed asset should be eliminated from the financial statements on disposal or when no further benefit is expected from its use and disposal.
9. Losses arising from the retirement or gains or losses arising from disposal of fixed asset which is carried at cost should be recognised in the profit and loss statement.
10. When a fixed asset is revalued in financial statements, an entire class of assets should be revalued, or the selection of assets for revaluation should be made on a systematic basis. This basis should be disclosed.
11. The revaluation in financial statements of a class of assets should not result in the net book value of that class being greater than the recoverable amount of assets of that class.
12. The revaluation in financial statements of a class of assets should not result in the net book value of that class being greater than the recoverable amount of assets of that class.
13. An increase in net book value arising on revaluation of fixed assets should be credited directly to owners' interests under the head of revaluation reserve, except that, to the extent that such increase is related to and not greater than a decrease arising on revaluation previously recorded as a charge to the profit and loss statement, it may be credited to the profit and loss statement. A decrease in net book value arising on revaluation of fixed asset should be charged directly to the profit and loss statement except that to the extent that such a decrease is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or
14. On disposal of a previously revalued item of fixed asset, the difference between net disposal proceeds and the net book value should be charged or credited to the profit and loss statement except that to the extent that such a loss is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilised, it may be charged directly to that account.
15. Fixed assets acquired on hire purchase terms should be recorded at their cash value, which, if not readily available, should be calculated by assuming an appropriate rate of interest. They should be shown in the balance sheet with an appropriate narration to indicate that the enterprise does not have full ownership thereof.
16. In the case of fixed assets owned by the enterprise jointly with others, the extent of the enterprise's share in such assets, and the proportion of the original cost, accumulated depreciation and written down value should be stated in the balance sheet. Alternatively, the pro rata cost of such jointly owned assets may be grouped together with similar fully owned assets with an appropriate disclosure thereof.
17. Where several fixed assets are purchased for a consolidated price, the consideration should be apportioned to the various assets on a fair basis as determined by competent valuers.
18. Goodwill should be recorded in the books only when some consideration in money or money's worth has been paid for it. Whenever a business is acquired for a price (payable in cash or in shares

or otherwise) which is in excess of the value of the net assets of the business taken over, the excess should be termed as 'goodwill'.

Disclosure.

The following information should be disclosed in the financial statements:

(i) gross and net book values of fixed assets at the beginning and end of an accounting period showing additions, disposals, acquisitions and other movements;

(ii) expenditure incurred on account of fixed assets in the course of construction or acquisition; and

(iii) revalued amounts substituted for historical costs of fixed assets, the method adopted to compute the revalued amounts, the nature of indices used, the year of any appraisal made, and whether an external valuer was involved, in case where fixed assets are stated at revalued amounts.