Presentation on AS-14 AS-22/ AS-24

WIRC of ICAI

Amit A. Purohit

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AS-14
Accounting for Amalgamations

Key Terms	*Types of Amalgamations*	*Methods for accounting for Amalgamations*	Considerations
Disclosures in FS	*Scope Exclusions*	*FRRB Observations*	*EAC Opinion*

AS-14
Coverage & Exclusions

This standard deals with accounting for amalgamations and the treatment of any resultant goodwill or reserves.

This standard does not deal with cases of acquisitions which arise when there is a purchase by one company (referred to as the acquiring company) of the whole or part of the shares, or the whole or part of the assets, of another company (referred to as the acquired company) in consideration for payment in cash or by issue of shares or other securities in the acquiring company or partly in one form and partly in the other and where the acquired company is not dissolved, and it continues to exist.

Modes of M & A Structuring

- *Share acquisition*
- *Asset acquisition or group of assets*
- *Acquisition of the entire business*
- *Merger*
- *Demerger*

AS-14: Q & A on Certain concepts

Q. What is the meaning of Amalgamation under this standard?

A. Amalgamation means an amalgamation pursuant to the provisions of the Companies Act, 2013 or any other statute which may be applicable to companies and includes 'merger'.

Q. Please explain the meaning of Transferor Company under this standard?

A. Transferor company means the company which is amalgamated into another company.

Q. Please explain the meaning of Transferee Company under this standard?

A. Transferee company means the company into which a transferor company is amalgamated.

AS-14: Q & A on Certain concepts

Q. What is the meaning of Consideration under this standard?

A. Consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.

Q. What are the types of Amalgamations which are covered under the Standard?

A. There are two types of Amalgamations covered under the Standard viz.

Amalgamation in the nature of Merger

Amalgamation in the nature of Purchase

AS-14: Q & A on Certain concepts

Q. Please explain when the Amalgamation would be treated as Amalgamation in the nature of Merger?

A. Amalgamation in the nature of merger is an amalgamation which satisfies all the following conditions:

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Share holders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.*

iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

AS-14: Q & A on Amalgamations

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

Note: These are cumulative conditions and not alternative conditions. All the conditions need to be satisfied in order for Amalgamation to be treated as Merger.

AS-14: Q & A on Amalgamations

What is Amalgamation in the nature of purchase?

Amalgamation in the nature of purchase is an amalgamation which does not satisfy any one or more of the conditions specified in relation to Amalgamation in the nature of merger.

Possible scenarios for Amalgamations

- A Ltd. (transferee company) takes over the entire business of B Ltd. (transferor company) and B Ltd. is wound up.

- A Ltd. (transferor company) and B Ltd. (transferor company) decides to amalgamate and incorporate new entity C Ltd. (transferee company) [as a result, A Ltd. and B Ltd. would be wound up].

- Thus amalgamation can involve two or more entities.

- Demerger / spin off of a Division / business line of Company into a separate subsidiary or selling of a division of a company to another company not covered under AS-14. For accounting treatment, relevant accounting standards to be applied (e.g. AS-10, AS-2, AS-13 etc.).

Example: Purchase consideration

Pursuant to amalgamation, B Ltd. (transferor company) is taken over by A Ltd. (transferee company). The purchase consideration to be paid by A Ltd. to B Ltd. is as follows:

- *Issue of 1,00,000 [9%] Preference shares of Rs. 10/- each of A Ltd. against 1,50,000 [10%] Preference shares of Rs. 10/- each of B Ltd.*
- *Issue of 50,000 [8%] Debentures of Rs. 100/- each of A Ltd. against 75,000 [10%] Debentures of Rs. 100/- each of B Ltd.*
- *Issue of 1,00,000 Equity Shares of Rs. 10/- of A Ltd. against 1,50,000 Equity Shares of B Ltd.*
- *Cash Payment of Rs. 20/- per Equity share to the Equity shareholders of B Ltd.*

How the Purchase Consideration will be calculated? What are the components of Purchase Consideration?

Examples

Q. Considering the previous example, whether the Amalgamation would be Amalgamation in the nature of Merger or Amalgamation in the nature of Purchase?

A. Amalgamation in the nature of Purchase

Q. A Ltd. takes over the Textile business unit of B Ltd. for a PC of Rs. 10 Crores. B Ltd. has separate verticals in Textiles, Retail and IT sector. The PC to be discharged by issue of equity shares of A Ltd. for the equivalent amount. Please advise whether the same amounts to Amalgamation as envisaged under AS-14.

A. Not Amalgamation (its business acquisition but not treated Amalgamation as B Ltd. continues to exist).

Q. A Ltd. acquires 70 % Equity stake in B Ltd. Please advise whether the same can be treated as an Amalgamation? If not, then how would the same be accounted?

A. Not Amalgamation (Its an investment in subsidiary) [covered under AS-13 and AS-21]

Examples

Q. A Ltd. takes over B Ltd. by taking over all assets and liabilities as a going concern for Rs. 50 Crores. Pursuant to amalgamation, B Ltd. would be dissolved. A Ltd. obtains valuation report from the independent valuer and accounts for identifiable assets and liabilities of B Ltd. in its books as per the values assigned in the valuation report (at respective fair value). Entire PC is discharged by issue of Equity shares of A Ltd. Please advise whether the amalgamation is in the nature of Merger or purchase?

A. Amalgamation in the nature of Purchase (as assets and liabilities taken over at fair value)

Q. A Ltd. has a wholly owned subsidiary named B Ltd. For better synergies of business operations, A Ltd. decides to merge B Ltd. with itself. All assets, liabilities, and reserves of B Ltd. would be taken over at book value. The entire capital of B Ltd, would be knocked off against Investments in the books of A Ltd. Please advise whether the amalgamation would be in the nature of merger or purchase?

A. Amalgamation in the nature of Merger (condition relating to issue of equity shares as consideration is not possible in case of Holding-Subsidiary scenario).

AS-14
Methods for Accounting Amalgamations

Q. What are the methods which are prescribed under AS-14 for accounting amalgamations?

A. There are two methods of accounting for amalgamations:

(a) the pooling of interests method; and

(b) the purchase method

AS-14
Methods for Accounting Amalgamations

Q. *What is Pooling of interest method and when it can be used?*

A. *Pooling of interests is a method of accounting for amalgamations, the object of which is to account for the amalgamation as if the separate businesses of the amalgamating companies were intended to be continued by the transferee company.*

Under the pooling of interests method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts.

Accordingly, only minimal changes are made in aggregating the individual financial statements of the amalgamating companies.

The use of the pooling of interests method is to be applied for an amalgamation in the nature of merger.

AS-14
Pooling of Interests Method

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

Example- change in accounting policy

Q. A Ltd. (transferee) merges B Ltd. (transferor) with itself. Both the Companies are in similar business. The amalgamation is Amalgamation in the nature of merger. All assets, liabilities, and reserves of B Ltd. would be taken over at book value. B Ltd. follows W.D.V. method for depreciation in respect of its fixed assets (PPE). While A Ltd. follows S.L.M. for depreciation. Further, B Ltd. follows Weighted average method of stock valuation whereas A Ltd. follows FIFO method. In order to align the accounting policies, A Ltd. wants to change the accounting policies of B Ltd. and arrive at new book values at the time of amalgamation. Please guide A Ltd.

A. Hint:

Whether change in the method of depreciation is change in accounting policy in view of revised AS-10 "Property, Plant and Equipment". If its only an estimate, can the book values be changed?

Purchase Method

Q. What is Purchase method of accounting Amalgamations and when it can be used?

A. The object of the purchase method is to account for the amalgamation by applying the same principles as are applied in the normal purchase of assets. Under the purchase method, the transferee company accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company.

This method is used in accounting for amalgamations in the nature of purchase.

Treatment of Reserves on Amalgamation

Q. What is the treatment to be given in respect of the reserves of Transferor Company?

- *If the amalgamation is an ‘amalgamation in the nature of merger’, the identity of the reserves is preserved, and they appear in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company. Thus, for example, the General Reserve of the transferor company becomes the General Reserve of the transferee company, the Capital Reserve of the transferor company becomes the Capital Reserve of the transferee company and the Revaluation Reserve of the transferor company becomes the Revaluation Reserve of the transferee company.*

- *If the amalgamation is an ‘amalgamation in the nature of purchase’, the identity of the reserves, other than the statutory reserves is not preserved. The amount of the consideration is deducted from the value of the net assets of the transferor company acquired by the transferee company.*

Treatment of Statutory Reserves

Q. ***What is the treatment of Statutory reserves as envisaged under the Standard?***

A. ***Certain reserves may have been created by the transferor company pursuant to the requirements of, or to avail of the benefits under, the Income-tax Act, 1961; for example, Development Allowance Reserve, or Investment Allowance Reserve. The Act requires that the identity of the reserves should be preserved for a specified period.***

Though, normally, in an amalgamation in the nature of purchase, the identity of reserves is not preserved, an exception is made in respect of reserves of the aforesaid nature (referred to hereinafter as 'statutory reserves') and such reserves retain their identity in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company, so long as their identity is required to be maintained to comply with the relevant statute. In such cases the statutory reserves are recorded in the financial statements of the transferee company by a corresponding debit to a suitable account head (e.g., 'Amalgamation Adjustment Reserve') which is presented as a separate line item in the Reserves & Surplus. When the identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account are reversed.

Treatment of Difference between PC and Share Capital / Net Assets of the Transferor Company

Q. Since all the assets, liabilities and reserves are taken over by the Transferee Company exactly as they appear in the books of Transferor Company under the Pooling of Interest method, how the difference between Purchase Consideration given and the Share capital of the Transferor Company is accounted in the books of the Transferee Company?

A. The difference between the amount recorded as share capital issued and the amount of share capital of the transferor company is adjusted is reserves in the financial statements of the transferee company.

Q. How the difference between the Net Assets taken over and Purchase Consideration given is accounted under the Purchase method?

A. If the result of the computation is negative (i.e. if the PC is more), the difference is debited to goodwill arising on amalgamation. If the result of the computation is positive (if PC is less), the difference is credited to Capital Reserve.

Treatment of Reserves Specified in A Scheme of Amalgamation

Q. What if the scheme of amalgamation as sanctioned by the Court provides for different treatment of reserves as compared to the Standard?

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

(a) A description of the accounting treatment given to the reserves and the reasons for following the treatment different from that prescribed in this Standard.

(b) Deviations in the accounting treatment given to the reserves as prescribed by the scheme of amalgamation sanctioned under the statute as compared to the requirements of this Standard that would have been followed had no treatment been prescribed by the scheme.

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

- *Footnote: This shall not apply to any scheme of amalgamation approved under the Companies Act, 2013.*

Contingent Consideration

Q. What is the treatment of Contingent Consideration?

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

Treatment of Goodwill Arising on Amalgamation

Q. What is the treatment given to the Goodwill which arises on Amalgamation in the nature of purchase?

A. Goodwill arising on amalgamation represents a payment made in anticipation of future income and it is appropriate to treat it as an asset to be amortised on a systematic basis over its useful life.

Due to the nature of goodwill, it is frequently difficult to estimate its useful life with reasonable certainty. Such estimation is, therefore, made on a prudent basis. Accordingly, it is considered appropriate to amortise goodwill over a period not exceeding five years unless a somewhat longer period can be justified.

Treatment of Goodwill Arising on Amalgamation

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

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

Appointed date & Effective date

- ***Meaning of Appointed date:***

The appointed date is generally understood as the date from which the scheme of amalgamation comes into force (and is usually specified in the scheme of amalgamation). It also denotes the date on which the amalgamation takes place or, in other words, the property, assets, and liabilities of the Transferor-Company vest in and are transferred to the Transferee Company.

- ***Meaning of Effective date:***

The effective date is the date when the amalgamation/merger is completed in all respects after having gone through the formalities involved and the transferor company having been liquidated by the Registrar of Companies, based on the approval of the NCLT and filing the necessary documents thereof with the Registrar of Companies.

Footnote: Clarifications issued by MCA vide its General Circular No. 09/2019 on 21st August 2019 under Section 232(6) of the Companies Act,2013.

Other aspects of Amalgamation

Q. A Ltd (transferee company) incurs Rs. 50 Lakhs towards expenses on amalgamation. Please advise the CFO of the Company as regards treatment of Amalgamation expenses.

A. No specific guidance, varied practices of debiting to reserves / goodwill / P&L

Q. A Ltd (transferee company) amalgamated with B Ltd. (transferor company). There are certain inter-co balances between these two companies on the date of amalgamation. Please advise the CFO of the Company as regards Accounting treatment of Inter company balances (e.g. receivable / payable/ stocks etc.)

A. Interco balances to be elimited. Profit element in stocks to be removed

Q. How the Goodwill arising on Amalgamation will be disclosed in the Financial Statements?

A. No specific guidance unlike Goodwill arising on Consolidation.

Amalgamation after the Balance Sheet Date

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

Amalgamation after the Balance Sheet Date

Scenario I:

- *A Ltd. (a transferee Company) is amalgamated with B Ltd. (a transferor Company). As per the scheme of amalgamation, the appointed date is 1st April 2019. The Amalgamation was approved by the shareholders on 30th April 2019 and the scheme was filed with NCLT for its approval on 5th May 2019. The scheme was later approved by the NCLT on 1st July 2020 and the same was immediately filed with ROC on the same day (effective date). The Accounts of A Ltd. for F.Y. 19-20 were approved by the Board on 24th July 2020.*

- *A. Since the event is covered under guidance given under AS-4 and effective date is before the approval date of financial statements, hence the amalgamation can be incorporated.*

Amalgamation after the Balance Sheet Date

Scenario- II:

- *A Ltd. (a transferee company) is amalgamated with B Ltd. (a transferor Company). As per the scheme of amalgamation, the appointed date is 1st April 2019. The Amalgamation was approved by the shareholders on 30th April 2019 and the scheme was filed with NCLT for its approval on 5th May 2019. The scheme was later approved by the NCLT on 1st July 2020 and the same was immediately filed with ROC on the same day (effective date). The Accounts of A Ltd. were approved by the Board on 1st June 2020. The AGM of the Company for adoption of accounts was held on 30 September 2020.*

- *A. Possible view:*

  The Financial statements can be revised since the AGM has not approved and adopted the Financial statements. The revision will be limited to incorporate the effect of the amalgamation. Auditors' report can also refer to the limited revision in financial statements.

Disclosures

- *General Disclosures:*
  - *Names and general nature of business of the amalgamating companies;*
  - *Effective date of amalgamation for accounting purposes;*
  - *The method of accounting used to reflect the amalgamation; and*
  - *Particulars of the scheme sanctioned under a statute.*

- *Specific Disclosures for amalgamations accounted for under the pooling of interests method :*
  - *The following additional disclosures are considered appropriate in the first financial statements following the amalgamation:*

    (a) description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation;

    (b) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.

Disclosures

- *For amalgamations accounted for under the purchase method:*

(a) consideration for the amalgamation and a description of the consideration paid or contingently payable; and

(b) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof including the period of amortisation of any goodwill arising on amalgamation

Few Observations of FRRB

- *Proper disclosure of equity shares exchanged not made.*
- *Accounting treatment for difference between the consideration and net assets acquired not disclosed.*
- *Different treatment given to reserves as per Court order, however the details of deviation as compared to the requirements of standard not disclosed.*
- *Non -disclosure of accounting policy for amortising of Goodwill.*

EAC Opinions on Amalgamations

- ***Treatment of reserves arising out of amalgamations in the nature of merger. Whether reserves created out of amalgamations available for distribution as dividend / issue of Bonus shares? (ICAI journal April 2004, page no. 1042]***

- ***Accounting treatment for amalgamation of wholly owned subsidiary (Compendium of Opinions Vol. no. XXXV Q-6].***

AS-22 Accounting for Taxes on Income

- *Objective*
- *Scope*
- *Scope exclusions*
- *Important concepts*
- *Recognition*
- *Measurement*
- *Presentation and Disclosures*
- *EAC Opinions*
- *FRRB Observations*

Objective & Scope

- *The objective of this Standard is to prescribe accounting treatment for taxes on income (i.e. Income Tax).*
- *In accordance with the matching concept, taxes on income are accrued in the same period as the revenue and expenses to which they relate.*
- *Scope: Determination of the amount of the expense or saving related to taxes on income in respect of an accounting period and the disclosure of such an amount in the financial statements.*
- *Scope exclusion: Does not specify accounting for taxes payable on distribution of dividends (DDT) and other distributions by an enterprise*

Key Terms

Q. What is Tax Expense?

- *Tax expense (tax saving) is the aggregate of current tax and deferred tax charged or credited to the statement of profit and loss for the period. Tax expense for the period, should be included in the determination of the net profit or loss for the period.*

Q. What is Current Tax? How do we measure the same?

- *Current tax is the amount of income tax determined to be payable (recoverable) in respect of the taxable income (tax loss) for a period.*
- *Current tax should be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the applicable tax rates and tax laws.*

Disclosure of Current Tax in Profit & Loss

PARTICULARS	AMOUNT (RS.)
Profit before Tax	**1,00,000/-**
<u>Less: Provision for Taxes</u>	
Current Tax	**(50,000/-)**
Deferred Tax	**(10,000/-)**
Total	**(60,000/-)**
Profit after Tax	**40,000/-**

EAC opinion on AS-22

- ***Query:***

Treatment of income tax paid for earlier years against the uncontested demand received during the current period. The management wants to adjust/debit these tax expenses for earlier years directly to general reserve instead of debiting it to the statement of profit and loss for the current period.

- ***Opinion:***

As per paragraph 9 of Accounting Standard (AS) 22, 'Accounting for Taxes on income', Tax expense for the period, comprising current tax and deferred tax, should be included in the determination of the net profit or loss for the period. Income tax is an expense which is included in the determination of net profit or loss for the period.

As per Paragraph 5 of AS 5, all expenses and incomes should be included in the determination of profit or loss. Accordingly, although income tax in the extant case pertains to earlier periods, it is an expense by nature. in the extant case, income tax has arisen in the current year due to short provision of tax which was recognised in the statement of profit and loss of the relevant earlier period(s). The expense arising due to short provisioning of income tax in the earlier years should also be recognised in the statement of profit and loss.

Presentation and Disclosure of MAT

Q. Whether Tax paid under MAT is a current Tax? How to disclose the same in the Financials?

- *According to paragraph 6 of Accounting Standards Interpretation (ASI) 6, 'Accounting for Taxes on Income in the context of Section 115JB of the Income-tax Act, 1961', issued by the Institute of Chartered Accountants of India, MAT is the current tax. Accordingly, the tax expense arising on account of payment of MAT should be charged at the gross amount, in the normal way, to the profit and loss account in the year of payment of MAT. In the year in which the MAT credit becomes eligible to be recognised as an asset in accordance with the recommendations contained in this Guidance Note, the said asset should be created by way of a credit to the profit and loss account and presented as a separate line item therein."*

Presentation and Disclosure of MAT and MAT Credit

- ***The Disclosure in this regard should be made as under:***

Current tax (MAT)	***XX***
Less : MAT credit entitlement	***(XX)***
Net Current tax	***XX***

Set-off of Current Taxes

- *An enterprise should offset assets and liabilities representing current tax if the enterprise:*

(a) has a legally enforceable right to set off the recognised amounts;

and

(b) intends to settle the asset and the liability on a net basis.

- The Trail balance of A Ltd. shows following items related to Current Income Taxes. Please guide its CFO as

F.Y.	Tax provision (A)	Advance Tax (B)	TDS Receivable (C)	Self Assessment Tax (D)	Net Amount (E)	Remarks
2017-18	1,00,000	75,000	30,000	NIL	5,000 (Dr.)	Excess Tax paid (refund receivable)
2018-19	1,50,000	1,00,000	40,000	5,000	5,000 (Cr.)	Excess Provision
2019-20	NIL	NIL	75,000	NIL	75,000 (Dr.)	Excess Tax paid (Refund receivable)

Disclosure requirements under Schedule III

Q. Whether interest on Advance Tax is considered as finance cost or should it be adjusted in Current Taxes?

A. *Any interest on shortfall in payment of advance income-tax is in the nature of finance cost and hence should not be clubbed with the Current tax. The same should be classified as Interest expense under finance costs. However, such amount should be separately disclosed. Similar view can be taken for interest on delayed payment of TDS.*

- *Any penalties levied under Income tax laws should not be classified as Current tax. Penalties which are compensatory in nature should be treated as interest and disclosed in the manner explained above. Other tax penalties should be classified under other expenses.*

- *Excess/Short provision of tax relating to earlier years should be separately disclosed.*

Deferred Taxes -Recognition

- ***The differences between taxable income and accounting income can be classified into permanent differences and timing differences.***

- ***The tax effects of timing differences are included in the tax expense in the statement of profit and loss and as deferred tax assets or as deferred tax liabilities, in the balance sheet.***

Important Concepts

Q. What is timing difference?

- ***Timing differences are those differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods. Timing differences arise because the period in which some items of revenue and expenses are included in taxable income do not coincide with the period in which such items of revenue and expenses are included or considered in arriving at accounting income.***

Q. What is permanent difference?

- ***Permanent differences are those differences between taxable income and accounting income which originate in one period and do not reverse subsequently. For instance, if for the purpose of computing taxable income, the tax laws allow only a part of an item of expenditure, the disallowed amount would result in a permanent difference.***

Q. What is Deferred Tax?

- ***Deferred tax is the tax effect of timing differences.***

Few examples of Timing Differences

- *Difference in Depreciation (due to different rates, different methods, different mode of calculation)*
- *Expenses accrued in the books but allowed on payment basis under Income-Tax Act, 1961 (e.g. items covered under s 43B)*
- *Expenses disallowed on account of non-payment of TDS [s 40a(ia)]*
- *Provision for doubtful debts/ advances*
- *Provision for warranties*
- *Preliminary expenses though written off fully in books but allowed gradually u/s 35D*

Few examples of Permanent Differences

- *Amortisation of Goodwill in the books but considered disallowable under Income-Tax Act*
- *Capital expenditure disallowed (e.g. expenses on issue of shares).*
- *Donations not eligible for deductions under s 80G*
- *Penalties*
- *Personal expenditure disallowed*

Deferred Tax Asset / Deferred Tax Liability

- Timing differences which result in lower Taxable income as compared to book profits resulting in lower Current Taxes give rise to Deferred Tax Liability.

- Timing differences which result in higher Taxable income as compared to book profits resulting in higher Current Taxes give rise to Deferred Tax Asset.

Example

Particulars	Amount (Rs.)	Tax effect (26%)	
Profit before Tax	1,00,000	26,000	(A) Tax on book profit
Add: Book Depreciation	30,000		
Less: IT Depreciation	(40,000)		
Taxable profits	90,000	23,400	(B) Tax on Taxable profits
Tax saving (in current taxes)		2,600	[(A)-(B)]
Deferred Tax charge & Liability (A)		2,600	
Current Tax (B)		23,400	
Total Tax expense (A+B)		26,000	

Example

A Ltd.'s net profit before tax is Rs. 1,00,000/- for the year ended 31/3/2020. Following items are debited to the Profit and Loss. Tax rate applicable 26%.

- Donation amounting to Rs. 20,000/- which is not eligible for deduction under chapter VIA.
- It has paid penalty amounting to Rs. 10,000/-.
- Book depreciation is Rs. 30,000/-. Depreciation allowable under Tax Rs. 40,000/-
- Bonus provision made Rs. 15,000/-
- Expenses on which TDS not paid Rs. 10,000/-.
- Calculate the current Taxes and Deferred Tax

Examples

- <u>Calculation of Current Tax</u>

Particulars	Amount (Rs)
Net Profit before Tax (book profit)	1,00,000
Add: Donation disallowed	20,000 (permanent difference)
Add: Penalty disallowed	10,000 (permanent difference)
Add: Depreciation as per books	30,000 (timing difference)
Add: Bonus provision made but not paid (43B)	15,000 (timing difference)
Add: Expenses disallowed under 40a(ia)-non deduction of TDS (30% of underlying expense of Rs. 10,000/-)	3,000 (timing difference)
Less: Depreciation allowable under the Tax	40,000 (timing difference)
Taxable Income	1,38,000
Current Tax on the same (@26%) [to be provided in the books of account]	**35,880**

Examples

- <u>Calculation of Deferred Tax</u>

Particulars	Amount (Rs.)	Nature of difference	Deferred Tax	Tax effect of Deferred Tax (@ 26%)
Donation	20,000	Permanent	NIL	NIL
Penalty	10,000	Permanent	NIL	NIL
Depreciation difference (40,000-30,000)	10,000	Timing difference	DTL	2,600
Bonus provision	15,000	Timing difference	DTA	3,900
Expense disallowed under 40a(ia)	3,000	Timing difference	DTA	780
Total DTA (disallowances)				**4,680**
Total DTL (on account of Depreciation)				**2,600**
Net DTA				**2,080**

Tax provision entry

- **Entry for current Tax:**

  Current Taxes (Profit & Loss Account) Dr. 35,880/-

  To Provision for Tax (Short term provision) 35,880/-

  (Being provision for current taxes for F.Y. 19-20)

- **Entry for Deferred Tax:**

  Deferred Tax charge/ Credit (P&L) Dr. 2,600/-

  To Deferred Tax Liability (Non-current Liability) 2,600/-

  (Being Deferred Tax charge on account of depreciation differentials)

  Deferred Tax Asset (Non-current Asset) Dr. 4,680/-

  To Deferred Tax charge / Credit (P&L) 4,680/-

(Being Deferred Tax credit on account of disallowances/ deferrals under Tax)

Tax Reconciliation

Particulars	Amount (Rs)	Tax effect (26%)
Profit as per Profit & Loss Account	100,000	26,000
<u>Add: Items of Permanent Differences</u>		
Donation	20,000	5,200
Penalty	10,000	2,600
Total Tax after Tax effect of Permanent Difference(A)	**1,20,000**	**(A)33,800**
<u>Break up of Total Tax</u>		
Current Tax (Dr. to P&L)		**35,880**
Deferred Tax Credit (Cr. to P&L)		**(2,080)**
Net Tax incidence		**(B)33,800**

Deferred Tax Assets-recognition

Deferred tax assets should be recognised and carried forward only to the extent that there is a <u>reasonable certainty</u> that sufficient future taxable income will be available against which such deferred tax assets can be realised.

This reasonable level of certainty would normally be achieved by examining the past record of the enterprise and by making realistic estimates of profits for the future.

Tax Losses / Unabsorbed Depreciation if eligible for set-off against future income, then the tax effect on the same is treated as Deferred Tax Asset.

Example

Q. A Ltd. as a practice pays bonus during Diwali times (October- November) but before the due date of filing the return. As on 31/3/2020, the Company has provided Bonus liability in its books. CFO of A Ltd. is of the opinion that since as a practice, company normally pays the bonus before the due date of return, it need not create any Deferred Tax Asset as current tax charge already factored in the deduction of bonus? Please guide him.

A. In case, the company does not consider the bonus disallowance in the IT computation for calculating the Current Tax provision, then DTA can not be recognised as there is no timing difference between Taxable income and accounting income as regards bonus deduction. However, another view (which is more technical), can be that since bonus has not been paid till the finalisation of accounts, the addition of the same should be factored in the current taxes by increasing the current tax liability and creating Deferred Tax Asset to the same extent. In either of the scenarios, total tax charge (Current + Deferred) on the Profit & Loss remains the same.

Example

Q. *A Ltd. has business losses and unabsorbed depreciation as per Tax returns. It's CFO would like to recognise these items as Deferred Tax Assets. Based on the future income projections for next 4 years, he is confident that these losses will be set-off against future taxable income resulting in reversal of Deferred Tax Assets? Please advise.*

- *Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognised only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised.*

Virtual Certainty

- *Virtual certainty refers to the extent of certainty, which, for all practical purposes, can be considered certain. Virtual certainty cannot be based merely on forecasts of performance such as business plans. Virtual certainty is not a matter of perception and is to be supported by convincing evidence. Evidence is a matter of fact. <u>To be convincing, the evidence should be available at the reporting date in a concrete form, for example, a profitable binding export order, cancellation of which will result in payment of heavy damages by the defaulting party.</u> On the other hand, a projection of the future profits made by an enterprise based on the future capital expenditures or future restructuring etc., submitted even to an outside agency, e.g., to a credit agency for obtaining loans and accepted by that agency cannot, in isolation, be considered as convincing evidence.*

Reasonable certainty vs. Virtual Certainty

Reasonable certainty would normally be achieved by:

- *examining past records of the enterprise; or*
- *by making realistic estimates of profits for the future*

Virtual certainty:

- *determination is a matter of judgement to be evaluated on a case to case basis*
- *should be supported by convincing evidence, i.e., evidence available at reporting date in concrete form*
- *cannot be based merely on forecasts of performance*

Example

Q. *A Ltd. has carried forward tax losses and has incurred loss in the current year as well. DTA has not been recognised due to no virtual certainty of future profit. However, for the year due to timing difference there is a DTL. The CFO wants to recognise the DTL but not the DTA. Please advise.*

A. Since A Ltd. has DTL on account of (say depreciation) in the current year, which is an indication of sufficient future tax liability arising on account of lesser Tax Depreciation, in such case, DTA may be recognised to the extent of DTL. [Refer EAC opinion (Volume XXXIV) and ICAI Background material for Seminars on AS-22].

Example

***Q.** A manufacturing holding company has made a provision for 100% diminution in value of investment in its subsidiary (being in heavy losses) and provision for doubtful loan given to the same subsidiary. Whether it will require the deferred tax asset to be recognised by the holding company in its separate financial statements ?*

A. *DTA can be recognised in the standalone financial statements for provision for diminution in the value of investment in the subsidiary if the there is reasonable certainty that sufficient future taxable income will be available against which DTA can be realized. Further, gains / losses from sale of investments should be chargeable / deductible for tax purposes.*

   DTA can be recognised on Provision for doubt advances, if the future write off is allowable as a deduction for Tax purposes.

Losses under the head capital gains

Q. *A Ltd. has incurred losses under the head capital gains on account of sale of certain investments which are allowed as Capital losses under the Income-Tax Act. It's CFO insists on recognizing these capital losses on the Balance sheet date on the ground that in the next year, the Company is planning to Sale certain investments which will give rise to Capital Gains Tax. Thus, the Company will be able to set-off such capital losses against the future Capital gains. Please advise whether the A Ltd. can recognise the deferred Tax asset in respect of capital losses?*

ASI 4, Losses under the head capital gains

- *If for taxation purposes, 'loss' can be set-off in future only against the income under the head 'capital gains', deferred tax asset should be recognised and carried forward only to the extent that there is a virtual certainty, supported by convincing evidence, that sufficient future taxable income will be available under the head 'Capital Gains'.*

- *Income under 'Capital gains' does not arise in the course of operating activities of an enterprise. Thus, for recognition of a DTA, the degree of certainty of such an income arising in future should be higher.*

ASI 4, Losses under the head capital gains

Examples of situations which satisfy the test are:

- *sale of an asset giving rise to capital gain (eligible to be set-off against the capital loss) after the balance sheet date but before the financial statements are approved*
- *binding sale agreement which will give rise to capital gain (eligible to be set-off against the capital loss)*

If there is a difference between the amounts of 'loss' recognised for accounting purposes and tax purposes because of cost indexation under the Act in respect of long-term capital assets

- *the DTA should be recognised and carried forward (subject to the consideration of prudence) on the amount which can be carried forward and set-off in future years as per the provisions of the Act*

Measurement and review of Deferred Tax

- *Deferred tax assets and liabilities are usually measured using the tax rates and tax laws that have been enacted. However, certain announcements of tax rates and tax laws by the government may have the **substantive effect of actual enactment**. In these circumstances, deferred tax assets and liabilities are measured using such announced tax rate and tax laws.*
- *Deferred tax assets and liabilities should not be discounted to their present value.*
- *The carrying amount of deferred tax assets should be reviewed at each balance sheet date. An enterprise should write-down the carrying amount of a deferred tax asset to the extent that it is no longer reasonably certain or virtually certain, as the case may be, that sufficient future taxable income will be available against which deferred tax asset can be realised. Any such write-down may be reversed to the extent that it becomes reasonably certain or virtually certain, as the case may be, that sufficient future taxable income will be available.*

Re-assessment of Unrecognised Deferred Tax Assets

- *At each balance sheet date, an enterprise re-assesses unrecognized deferred tax assets. The enterprise recognises previously unrecognized deferred tax assets to the extent that it has become reasonably certain or virtually certain, as the case may be, that sufficient future taxable income will be available against which such deferred tax assets can be realised. For example, an improvement in trading conditions may make it reasonably certain that the enterprise will be able to generate sufficient taxable income in the future.*

EAC opinion on AS-22

- ***Questions for EAC opinion:***

(a) What is substantive enactment? Is presenting the budget on the floor of the house a substantive enactment? Is passing of the bill by the Lok Sabha (not by Rajya Sabha) a substantive enactment? Is passing of the bill by the Lok Sabha and Rajya Sabha (Presidents consent not yet received) a substantive enactment?

(b) In case of change in effective tax rate, what treatment should be given to opening deferred tax position. Should it be taken to free reserve or to the statement of profit and loss?

EAC opinion on AS-22

- ***EAC Opinion:***

The term 'substantively enacted' should be construed as the tax rate that has the substantive effect of actual enactment. In most cases, a tax rate is regarded as having been substantively enacted if the Bill containing such changed tax rate has been passed by the Lok Sabha and is awaiting passage through the Rajya Sabha and the President's assent. In other words, the process of enactment is substantively complete and whether the process of enactment is substantively complete is a matter of judgement, which should be determined considering the facts and circumstances and various factors.

(b) Effects of changes in effective tax rates in the next reporting period resulting into any increase or decrease in the recognised deferred tax assets or liabilities should be recognised in the statement of profit and loss and not in free reserves.

Example

Q. A Ltd. has been paying taxes @ 26% [including Cess] on its taxable income till F.Y. 2018-19. From F.Y.2019-20, the Company wants to migrate to new tax remine under section 115BAA of the Income Tax Act, 1961. The effective rate under the said scheme is 25.17% (including 10% surcharge + 4% Cess). As an Auditor, how to deal with this situation so far as provision for Current and Deferred Taxes are concerned?

A. Aspects to be examined:

- *Change in rate of current taxes (Current tax provision to be made accordingly)*
- *Impact on unused MAT Credit, if any, standing in the books*
- *Reassess Deferred Tax Asset and Liability*

Minimum Alternate Tax (ASI 6, Accounting for taxes on income in the context of Section 115JB of the Income-tax Act, 1961)

Q. A Ltd. has paid taxes under MAT @ 15% for F.Y. 19-20. It's CFO is of the opinion that the Company should also recognise the Deferred Tax Assets and Deferred Tax Liabilities using the same rate of MAT and not under the normal rate of 26%. Please advise.

- *Deferred tax assets and liabilities in respect of timing differences arising in the period of payment of tax under section 115JB should be measured using regular tax rates and not tax rate under section 115JB.*
- *If the Company expects that timing differences arising in current period would reverse in a period in which it may pay tax under section 115JB, deferred tax assets and liabilities should be measured using regular tax rates and not tax rate under section 115JB.*
- *Measurement of DTA using tax rate u/s 115JB would involve assessment of future taxable income and accounting income and therefore, is considerably subjective.*

Set-off of Deferred Taxes

- *An enterprise should offset deferred tax assets and deferred tax liabilities if:*

(a) the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and

(b) the deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the same governing taxation laws.

Presentation and Disclosure

- *Deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities.*
- *Deferred tax assets (net of the deferred tax liabilities, if any,) is disclosed on the face of the balance sheet separately after the head 'Investments' and deferred tax liabilities (net of the deferred tax assets, if any,) is disclosed on the face of the balance sheet separately after the head 'Unsecured Loans'.*
- *The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balances should be disclosed in the notes to accounts.*
- *The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.*

Presentation of DTA / DTL in Financials

Q. A Ltd. has recognised Deferred Tax Asset (on account of Disallowances) and Deferred Tax Liability (on account of depreciation) as on 31st March 2020. It has a subsidiary which as also recognised DTA and DTL in its books. While preparing Standalone and Consolidated Financial statements, CEO of A Ltd. is of opinion that only net presentation needs to be shown on face of the both the Balance sheets (standalone as well as Consolidated). Please guide him?

A. Deferred Taxes of Subsidiary cant be set off against the Deferred Taxes of the Holding Company. Thus DTA of subsidiary cant be set off against DTL of Holding Company and vice-versa. Thus net presentation can’t be shown on the face of the Balance sheet in case of Consolidated financial statements.

Accounting for Taxes on Income in the situations of tax holiday under Sections 80- IA and 80-IB of the Income-tax Act, 1961

Should deferred tax be recognised for timing differences arising during the tax holiday period but which

a. reverse during the tax holiday period

b. reverse after the tax holiday period

What about timing differences which originate before the tax holiday but which

a. reverse during the tax holiday period

b. reverse after the tax holiday period

ASI 3, Accounting for Taxes on Income in the situations of tax holiday under Sections 80- IA and 80-IB of the Income-tax Act, 1961

Timing differences which reverse during the tax holiday period (whether originated in the tax holiday period or before that)

- *Do not recognise deferred tax*

Timing differences which reverse after the tax holiday period (whether originated in the tax holiday period or before that)

- *Recognise deferred tax in the year in which the timing differences originate*

  - subject to the consideration of prudence

ASI 5, Accounting for Taxes on Income in the situations of tax holiday under Sections 10A and 10B of the Income-tax Act, 1961

Timing differences which reverse during the tax holiday period

- *Do not recognise deferred tax*

Timing differences which reverse after the tax holiday period

- *Recognise deferred tax in the year in which the timing differences originate*

  - subject to the consideration of prudence

ASI 11, Accounting for taxes in income in case of an amalgamation

- ***Issue 1*:**

In case of amalgamation in nature of purchase, whether deferred tax should be recognised for differences between values of assets/liabilities arrived at for accounting purposes on fair value basis and carrying amounts for tax purposes?

- ***Solution* :**

Recognition of individual assets/liabilities at fair values as per AS 14 does not affect the statement of profit and loss. If the carrying amounts for tax purposes continue to be the same as that of the transferor enterprise, deferred tax should not be recognised for such differences as this constitutes a permanent difference. Consequent differences in amounts of depreciation for such assets in subsequent years would also be a permanent difference.

ASI 11, Accounting for taxes in income in case of an amalgamation

- ***Issue 2*:**

If the transferor enterprise has not recognised any DTA including in respect of unabsorbed depreciation and carry forward of losses since conditions relating to prudence were not fulfilled, whether transferee enterprise can recognise it if conditions relating to prudence are satisfied on a subsequent date?

- ***Solution*:**

Yes, the transferee enterprise can recognise the DTA not recognised by transferor enterprise if the conditions relating to prudence as per AS 22 are satisfied. The accounting treatment depends on nature of amalgamation as well as the accounting treatment adopted for amalgamation in accordance with AS 14.

Disclosure requirements under Schedule III

- ***In case of Deferred Tax liability, the same should be shown under the head "Non-current liabilities" after the sub-head "Long term borrowings".***

- ***In case of Deferred Tax Asset, the same should be shown under the head "Non-current Assets" after the sub-head Non-current investments.***

Few FRRB Observations

- *Deferred Tax Assets / Liabilities not shown correctly on the face of the Balance sheet*
- *Both DTA and DTL shown on the face of the Balance sheet*
- *Components of DTA/ DTL not shown in the Notes to Accounts*
- *Accounting policy on accounting for Deferred Tax Assets not disclosed*

Few FRRB Observations

- *Company having various subsidiaries –DTA/ DTL was set off among various subsidiaries and holding company and only net position was shown on the face of the Balance sheet.*
- *Recognition of DTA on business losses / unabsorbed depreciation not in line with requirement of the standard*
- *Difference between 'Reasonable Certainty' and 'Virtual Certainty' often overlooked and DTA created on C/F Losses without ascertaining Virtual Certainty backed by convincing evidence*

AS-24 Discontinuing Operations

Objective and Scope

- *To establish principles for reporting information about discontinuing operations, thereby enhancing the ability of users of financial statements to make projections of an enterprise's cash flows, earnings-generation capacity, and financial position by segregating information about discontinuing operations from information about continuing operations*
- *Applies to all discontinuing operations of an enterprise*

Key Terms

Discontinuing operation is a component :

(a) which the enterprise, pursuant to a single plan is Disposing of or Terminating through abandonment

(b) which represents a separate major line of business or geographical area of operations; and

(c) Which can be distinguished operationally and for financial reporting purposes

Understanding "Disposal"

Disposal:

- *By way of selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders;*

  or

- *in piecemeal, such as by selling off the component's assets and settling its liabilities individually.*

Understanding "Abandonment"

Abandonment:

- ***An enterprise may terminate an operation by abandonment without substantial sales of assets. An abandoned operation would be a discontinuing operation if it satisfies the criteria in the definition. However, changing the scope of an operation or the manner in which it is conducted is not an abandonment because that operation, although changed, is continuing.***

- ***Business enterprises frequently close facilities, abandon products or even product lines, and change the size of their work force in response to market forces. While those kinds of terminations generally are not, in themselves, discontinuing operations as defined in this Standard, they can occur in connection with a discontinuing operation.***

Situations-not treated as Discontinuing Operations

- **Gradual phasing out of a product line or class of service.**
- **Discontinuation of certain products**
- **Shifting or closure of some marketing offices or manufacturing units**
- **Closing of a facility for cost savings**
- **However, a combination of above events or in combination with some other circumstances, it might be a case for discontinuing operations**

Understanding "Segment" / Line of business

- *A reportable business segment or geographical segment as defined in Accounting Standard (AS) 17, Segment Reporting, would normally satisfy criterion (b) of the definition of a discontinuing operation, that is, it would represent a separate major line of business or geographical area of operations.*

- *A part of such a segment may also satisfy criterion (b) of the definition. For an enterprise that operates in a single business or geographical segment and therefore does not report segment information, a major product or service line may also satisfy the criteria of the definition.*

Component distinguished operationally and for financial reporting purposes

- *A component can be distinguished operationally and for financial reporting purposes - [criterion (c) of the definition of a discontinuing operation] if all the following conditions are met:*

  (a) the operating assets and liabilities of the component can be directly attributed to it;

  (b) its revenue can be directly attributed to it;

  (c) at least a majority of its operating expenses can be directly attributed to it.

- *Assets, liabilities, revenue, and expenses are directly attributable to a component if they would be eliminated when the component is sold, abandoned or otherwise disposed of. If debt is attributable to a component, the related interest and other financing costs are similarly attributed to it.*

Recognition & Measurement

- This standard deals only with Presentation and Disclosure in the financial statement.
- This standard does not deal with any recognition and measurement principles. For this purpose, provisions of other Accounting Standards should be applied.
- For example:

  AS-2 Valuation of Inventories

  AS-4 Contingencies and Event Occurring after the Balance Sheet Date

  AS-10 Accounting for Property, Plant and Equipment

  AS-28 Standard on Impairment of Assets

Certain Practical Aspects

- Infrequently occurring events, which may require separate disclosure as per AS- 5 do not necessarily be on account of Discontinuing Operations.

- Discontinuing Operations on its own shall not affect the going concern assumptions.

- A component can be distinguished operationally and for financial reporting purpose only if its operating assets, liabilities, its revenue and major of its operating expenses can be directly attributed to a component.

- Certain assets commonly used by different segment can not fit into this criteria.

Initial Disclosure Event

Initial Disclosure Event is the earliest occurrence of one of the following-

- Entering into binding sale agreement for substantially all of the assets attributable to the Discontinuing Operation.

- Enterprise's Governing body has approved a detailed, formal plan for the discontinuance and made an announcement of the plan.

COMPONENTS OF DETAILED FORMAL PLAN

Detailed formal plan normal generally includes:

- Identification of Major Assets to be disposed off
- Expected method of disposal
- Expected time frame of disposal
- The principal locations affected
- Approx. number of employees to be compensated for termination of service
- Estimated proceeds to be realised by disposal

COMPONENTS OF DETAILED FORMAL PLAN

- Practically such comprehensive plans encompassing all aspects are difficult to find. Generally one finds discussions in the governing body (Board) on different aspects at different point of time.

- However, if concrete decision of assets to be disposed off and price band is approved, it may be considered as sufficient indication of a detailed plan.

WHAT IS ANNOUNCEMENT ?

- If the main features for the plan for discontinuance is announced to lenders, stock exchanges, creditors, trade unions, media etc., one can consider this as an announcement.

- For this purpose, web-site of the company, internal news letters, press conference announcements, correspondence with the stock exchanges etc. can be considered.

- In case, one does not find such event, one may have to wait upto sale agreement or MOU date for sale of substantial assets of the Discontinuing Operations.

INITIAL DISCLOSURE

An enterprise should give following information in its financial statements beginning with the financial period in which the ‘Initial Disclosure Event’ occurs:

- A description of discontinuing operation
- Segment in which it is reported as per AS 17
- Date and nature of Initial Disclosure Event
- A time by which the discontinuation is expected to be completed.
- The carrying amounts of the assets to be disposed off.

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- A time by which the discontinuation is expected to be completed.
- The carrying amounts of the assets to be disposed off.

INITIAL DISCLOSURE (contd..)

In respect of Discontinuing Operations:

- Revenue and expenses from ordinary activities
- Pre-tax profits or loss and tax expenses relating to such operations (to be disclosed on the face of the profit & loss account)
- Net cash flows of such operations
- Important to note that segment reporting disclosures are different than what is required by this standard

OTHER DISCLOSURES

- On disposal of assets or settlement of liabilities or on entering into binding agreement for disposal / settlement, the financial statements of an enterprise should include the following-
  - Gain / loss recognised on the disposal / settlement including amount of pre-tax gain / loss and income-tax thereon (to be disclosed on the face of the profit and loss account).
- In case enterprise has entered into binding sale agreements (when impact is not recognised in financial statements)
  - Net selling price or range of prices (after deducting expected disposable costs)
  - The expected timing of receipt of consideration.
  - The carrying value of such Net assets on the balance sheet date.

Disclosure updations

- Financial statement for a period subsequent to the one in which initial disclosure event occurs should disclose;
  - Details of significant changes, if any, in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled.
  - Event triggering those changes.
- The disclosures should continue for a periods up to and including the period in which discontinuance is completed i.e. plan is substantially completed or abandoned.
- For abandonment and withdrawal of plan;
  - the facts, reasons and effects should be disclosed, including reversal of impairment loss or any provisions

Restatement of Prior periods

- **Comparative information for prior periods that is presented in financial statements prepared after the initial disclosure event should be restated to segregate assets, liabilities, revenue, expenses, and cash flows of continuing and discontinuing operations.**

Case study 1

- A Ltd. has one common unit for manufacturing Computers and Peripherals. Peripheral segment was not considered as separate segment. It decides to close down manufacturing of Peripheral products on account of competition and substantial reduction in selling price. However, it continues to manufacture computer from that unit.

  - Whether the same can be treated as Discontinuing Operation?

  - Would the conclusion differ, if A Ltd. has a plan to continue sale of Peripheral products by purchasing from the third party?

Response

Based on the facts of the case, it is clear that peripheral segment was not treated as a separate segment.

- Closure of peripheral manufacturing shall not be treated as Discontinuing Operation as computers are continued to be manufactured from the same place.
- It will not make any difference if trading of peripheral products continue, in the present case.
- However, if manufacturing was only of peripherals, the additional facts will make difference, as one may argue that there is no change in the product line and only form is changed.
- However, if factory was considered as separate geographical segment, one may have to consider it as Discontinuing operations.

Case study 2

- A Ltd. is manufacturing Electronic goods which are sold within India (locally) and also outside India in different countries. It has identified certain geographical segment for AS- 17. If the Company decides to stop its operation in China. Whether that should be treated as Discontinuing Operations?

Response

- The response will depend upon segments considered for the purpose of AS - 17. If China was considered as separate geographical segment, it should be treated as Discontinuing Operations. If China business was not tracked separately on materiality ground, it may not be Discontinuing Operations.

CASE STUDY - 3

- Y Ltd. manufactures cosmetic products amongst other items. It has only one factory in Gujarat to manufacture cosmetic products. While going through board minutes, it is noticed that during the board meeting in the year 2019-20, there was lot of discussion on closure of manufacturing unit at Gujarat, on account of frequent labour troubles and unviable operations. CFO of the Company was also given power to negotiate for disposal of the factory at not less than Rs. 100 Crores However, there was no announcement to the outsiders in this regard.
- On 15.5.2020, CFO reports to the Board that no party is coming forward to purchase the unit, but one party is willing to buy at Rs. 85 Crores, subject to adjustment arising out of due diligence exercise. In the same board meeting the board agrees to price reduction and give power to CFO and MD to finalise MOU with the party.
- A Company Secretary points out that approval of shareholders is required for this purpose. The Company Secretary is asked to send notice for calling of EGM. Notice is sent to the shareholders on 20.5.2020.

CASE STUDY - 3 (contd.)

- Now at the time of finalising accounts of the Company on 30.6.2020, whether it can be treated as Discontinuing Operation?

Response

Following points needs consideration:

It should be noted that no announcement of plan was made in the year 2019-20.

- By sending notice to the shareholders on 20.5.2020, it will be considered as announcement at that point of time.
- As there is no Initial Disclosure Event in the year 2019-20, no disclosure is required as per this standard.
- However, event occurring after the balance sheet date but before finalisation of accounts need to be disclosed by way of a note as per AS - 4.
- Auditor may need to consider possible impairment of assets in the year 2019-20. There is enough indication of impairment of assets on the balance sheet date. Subsequent event should be used for estimation of impairment.

Thank you