General Clarifications on Accounting Standards

General Clarification (GC) – 9/2002 Accounting Standard (AS) 18, Related Party Disclosures

Meaning of the term 'intermediaries'

The following is the General Clarification (GC) – 9/2002, issued by the Accounting Standards Board of the Institute of Chartered Accountants of India, on AS 18, Related Party Disclosures:

Paragraphs 3 and 13 of AS 18 state as under:

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

(a) enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise (this includes holding companies, subsidiaries and fellow subsidiaries);

……."

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

The above paragraphs use the term 'intermediaries'. It is clarified that for the purpose of AS 18, this term is confined to mean enterprises which are 'subsidiaries' as defined in AS 21, Consolidated Financial Statements.

General Clarification (GC) – 10/2002 Accounting Standard (AS) 20, Earnings Per Share

Disclosure of Earnings Per Share figures in case of Extraordinary Items

The following is the General Clarification (GC) – 10/2002, issued by the Accounting Standards Board of the Institute of Chartered Accountants of India, on AS 20, Earnings Per Share:

AS 20 requires presentation of basic and diluted earnings per share figures computed on the basis of earnings including extraordinary items.

Paragraphs 50 and 51 of AS 20 provide as under:

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

51. An enterprise may wish to disclose more information than this Statement requires. Such information may help the users to evaluate the performance of the enterprise and may take the form of per share amounts for various components of net profit, e.g., profit from ordinary activities. Such disclosures are

encouraged. However, when such amounts are disclosed, the denominators need to be calculated in accordance with this Statement in order to ensure the comparability of the per share amounts disclosed."

In view of paragraphs 50 and 51 above, where an enterprise's statement of profit and loss includes extraordinary items (within the meaning of AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies), it is recommended that the following may also be presented, with appropriate description, on the face of the statement of profit and loss:

(i) Basic earnings per share computed on the basis of earnings excluding extraordinary items (net of tax expense).

(ii) Diluted earnings per share computed on the basis of earnings excluding extraordinary items (net of tax expense).

General Clarification (GC) – 11/2002

Accounting Standard (AS) 17, Segment Reporting

The following is the General Clarification (GC) – 11/2002, issued by the Accounting Standards Board of the Institute of Chartered Accountants of India, on AS 17, Segment Reporting:

Accounting Standard (AS) 17, Segment Reporting, defines 'business segment' and 'geographical segment'. It is clarified that in case, by applying these definitions, it is concluded that there is neither more than one business segment nor more than one geographical segment, segment information as per AS 17 is not required to be disclosed.

General Clarification (GC) – 12/2002

Applicability of Accounting Standards to Co-operative Societies

The following is the General Clarification (GC) – 12/2002, issued by the Accounting Standards Board of the Institute of Chartered Accountants of India, on applicability of Accounting Standards to co-operative societies:

Paragraph 3.3 of the 'Preface to the Statements of Accounting Standards' provides, inter alia, as below:

"3.3 The Institute will issue the Accounting Standards for use in the presentation of the general purpose financial statements issued to the public by such commercial, industrial or business enterprises as may be specified by the Institute from time to time and subject to the attest function of its members."

In view of the above, the accounting standards issued by the Institute shall apply in respect of financial statements of co-operative societies, which carry on commercial, industrial or business activities, and are subject to the attest function of the members of the Institute. The Accounting Standards made mandatory by the Institute, as specified in the respective standards or made mandatory by separate announcements, are also mandatory in respect of co-operative societies.

For the removal of doubts, it is clarified that even if a very small proportion of the activities of a co-operative society is considered to be commercial, industrial or business in nature, then it can not claim exemption from the application of Accounting Standards. The Accounting Standards would apply to all its activities including those which are not commercial, industrial or business in nature.

It is reiterated that mandatory status of an accounting standard implies that it will be the duty of the members of the Institute to examine whether the Accounting Standard is complied with in the presentation of financial statements covered by their audit. In the event of any deviation from the Accounting Standard, it will be their duty to make adequate disclosures in their audit reports so that the users of financial statements may be aware of such deviations.

General Clarification (GC) – 13/2002

Accounting Standard (AS) 18, Related Party Disclosures

Non-Executive Directors on the Board – whether related parties

The following is the General Clarification (GC) – 13/2002, issued by the Accounting Standards Board of the Institute of Chartered Accountants of India, on AS 18, Related Party Disclosures:

AS 18 defines "key management personnel" as under:

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

Paragraph 14 of AS 18 explains as under:

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

(I) An issue has been raised as to whether a non-executive director on the Board of Directors of a company is a key management person.

AS 18 considers only such persons as key management personnel who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. Therefore, merely being a director of a company is not sufficient unless that director has the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. Accordingly, it is clarified that non-executive directors of a company will not be considered as key management personnel under AS 18 by virtue of merely their being directors unless they have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise.

(II) Another related issue raised is as to whether a non-executive director can be considered as a related party in case he participates in the financial and/or operating policy decisions of an enterprise.

Paragraphs 2 and 3 of AS 18 provide as below:

> ***"2. This Statement applies only to related party relationships described in paragraph 3.***
>
> 3. This Statement deals only with related party relationships described in (a) to (e) below:
>
> (a) enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise (this includes holding companies, subsidiaries and fellow subsidiaries);
>
> (b) associates and joint ventures of the reporting enterprise and the investing party or venturer in respect of which the reporting enterprise is an associate or a joint venture;
>
> (c) individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual;
>
> (d) key management personnel and relatives of such personnel; and
>
> (e) enterprises over which any person described in (c) or (d) is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise."

A non-executive director, merely by virtue of his being a director, will not be covered under any one of the above. Accordingly, AS 18 is not applicable to such a non-executive director. However, a non-executive director would be covered by a related party relationship in case other requirements of the Standard are met. For instance, he is considered as a key management person as per (I) above or he is in a position to exercise control or significant influence by virtue of owning an interest in the voting power as per paragraph 3 (c) above.

General Clarification (GC) – 14/2002

Accounting Standard (AS) 17, Segment Reporting

Treatment of Interest for determining Segment Expense

The following is the General Clarification (GC) – 14/2002, issued by the Accounting Standards Board of the Institute of Chartered Accountants of India, on AS 17, Segment Reporting:

1. An issue has been raised as to whether interest expense relating to overdrafts and other operating liabilities identified to a particular segment should be included in the segment expense or not.

The definition of the term "segment expense" (paragraph 5) contained in AS 17 does not include, inter alia, ***"interest expense, including interest incurred on advances or loans from other segments, unless the operations of the segment are primarily of a financial nature."***

It is clarified that the interest expense relating to overdrafts and other operating liabilities identified to a particular segment should not be included as a part of the segment expense unless the operations of the segment are primarily of a financial nature or unless the interest

is included as a part of the cost of inventories as discussed below.

2. Another issue raised is that in case interest is included as a part of the cost of inventories where it is permissible as per the requirements of Accounting Standard (AS) 16, Borrowing Costs, read with Accounting Standard (AS) 2, Valuation of Inventories, and those inventories are part of segment assets of a particular segment, whether such interest would be considered as a segment expense.

Under AS 16, read with AS 2, interest can be added to the cost of inventories only where time is the major factor in bringing about a change in the condition of inventories. Change in the condition of inventories is an operational activity. Accordingly, such interest is resulting from the operating activities of the segment in respect of which such inventories constitute the segment asset. The definition of 'segment expense' under AS 17 comprises, inter alia, ***"the expense resulting from the operating activities of a segment that is directly attributable to the segment."*** Accordingly, interest on such inventories should be considered as a segment expense. The clause excluding the interest expense in the definition of 'segment expense' (see paragraph 1 above) does not cover such interest.

It is recommended that in this case, the amount of such interest and the fact that the segment result has been arrived at after considering such interest should be disclosed by way of a note to the segment result.

General Clarification (GC) – 15/2002 Accounting Standard (AS) 18, Related Party Disclosures

Remuneration paid to key management personnel – whether a related party transaction

The following is the General Clarification (GC) – 15/2002, issued by the Accounting Standards Board of the Institute of Chartered Accountants of India, on AS 18, Related Party Disclosures:

AS 18 defines "related party transaction" as under:

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

Paragraph 24 of AS 18 provides as under:

> "24. The following are examples of the related party transactions in respect of which disclosures may be made by a reporting enterprise:
>
> - purchases or sales of goods (finished or unfinished);
> - purchases or sales of fixed assets;
> - rendering or receiving of services;
> - agency arrangements;
> - leasing or hire purchase arrangements;
> - transfer of research and development;
> - licence agreements;
> - finance (including loans and equity contributions in cash or in kind);
> - guarantees and collaterals; and
> - management contracts including for deputation of employees."

An issue has been raised as to whether remuneration paid to key management personnel is a related party transaction. Another related issue raised is whether remuneration paid to non-executive directors on the Board of Directors is a related party transaction.

As per the definition of the related party transaction, the transaction should be between related parties to qualify as a related party transaction.

It is clarified that since key management personnel are related parties under AS 18, remuneration paid to key management personnel will be a related party transaction requiring disclosures under AS 18. In case non-executive directors on the Board of Directors are not related parties (see General Clarification (GC) 13) remuneration paid to them will not be considered a related party transaction.

General Clarification (GC) – 16/2002

Accounting Standard (AS) 21, Consolidated Financial Statements

Definition of 'Control'

The following is the General Clarification (GC) – 16/2002, issued by the Accounting Standards Board of the Institute of Chartered Accountants of India, on AS 21, Consolidated Financial Statements:

AS 21 defines "control" and "subsidiary" as under:

> ***"Control:***
>
> ***(a) the ownership, directly or indirectly through subsidiary(ies), of more than one-half of the voting power of an enterprise; or***

(b) control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise so as to obtain economic benefits from its activities.

A subsidiary is an enterprise that is controlled by another enterprise (known as the parent)."

A query has been raised that in case an enterprise is controlled by two enterprises; one controls by virtue of ownership of majority of the voting power of that enterprise and the other controls, by virtue of an agreement or otherwise, the composition of the board of directors so as to obtain economic benefits from its activities, whether in such a case both the controlling enterprises should consolidate the financial statements of the first mentioned enterprise.

The Board, while recognising that the above situation will occur rarely, is of the view that in such a case, the first mentioned enterprise will be considered as subsidiary of both the controlling enterprises within the meaning of AS 21 and, therefore, both the enterprises should consolidate the financial statements of that enterprise as per the requirements of AS 21.

General Clarification (GC) – 17/2002

Accounting Standard (AS) 21, Consolidated Financial Statements

Exclusion of a subsidiary from consolidation

The following is the General Clarification (GC) – 17/2002, issued by the Accounting Standards Board of the Institute of Chartered Accountants of India, on AS 21, Consolidated Financial Statements:

Paragraph 11 of AS 21 provides as under:

"11. A subsidiary should be excluded from consolidation when:

(a) control is intended to be temporary because the subsidiary is acquired and held exclusively with a view to its subsequent disposal in the near future; or

(b) it operates under severe long-term restrictions which significantly impair its ability to transfer funds to the parent.

In consolidated financial statements, investments in such subsidiaries should be accounted for in accordance with Accounting Standard (AS) 13, Accounting for Investments. The reasons for not consolidating a subsidiary should be disclosed in the consolidated financial statements."

An issue has been raised that in case an enterprise owns majority of the voting power of another enterprise but all the shares are held as 'stock-in-trade', whether this will amount to temporary control within the meaning of paragraph 11(a) above. It is clarified that where an enterprise owns majority of voting power by virtue of ownership of the shares of another enterprise and all the shares held as 'stock-in-trade' are acquired and held exclusively with a view to their subsequent disposal in the near future, the control by the first mentioned enterprise would be considered to be temporary within the meaning of paragraph 11(a).

General Clarification (GC) – 18/2002

Accounting Standard (AS) 21, Consolidated Financial Statements

Accounting for taxes on income in the consolidated financial statements

The following is the General Clarification (GC) – 18/2002, issued by the Accounting Standards Board of the Institute of Chartered Accountants of India, on AS 21, Consolidated Financial Statements:

An issue has been raised that for preparing consolidated financial statements, whether the tax expense (comprising current tax and deferred tax) would be recomputed in the context of consolidated information or the tax expense appearing in the separate financial statements of the parent and its subsidiaries should be aggregated and no further adjustments should be made for the purposes of consolidated financial statements.

It is clarified that the tax expenses appearing in the separate financial statements of parent and subsidiaries do not require any adjustment for the purpose of consolidated financial statements. In view of this, while preparing consolidated financial statements, the tax expense to be shown in the consolidated financial statements will be the aggregate of the amounts of tax expenses appearing in the separate financial statements of the parent and its subsidiaries. ■