STUDY ON
ACCOUNTING IN POWER SECTOR

Research Committee

The Institute of Chartered Accountants of India

New Delhi

Study on Accounting in Power Sector

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Foreword

The growth of the Indian economy depends heavily on performance and growth of the power sector. In India, demand for power has increased at a rate higher than the growth of the gross domestic product but the supply of power has not increased at the same rate. Accordingly, the gap between demand and supply of power has increased over the period. In order to bridge this gap and to ensure reliable and affordable quality power for all users, the government has started a reform process in the sector which, amongst others, involves allowing more private sector participation and creation of manageable business units from unbundling of SEBs and progressive privatisation thereof.

The key for success of the reform process lies, to a great extent, on making various entities in the sector more accountable for their actions. Proper financial reporting is one of the most important tools to achieve accountability. The blue print for power sector development brought out recently by the Ministry of Power recognises the criticality of the reforms in accounting in the power sector. Shri Suresh Prabhu, Hon'ble Minister of Power, Government of India, had accordingly taken the initiative to commission a Study by the Institute of Chartered Accountants of India. I am grateful to him for his vision and thrust laid on this critical aspect of the reform process. Thus, need was being felt for evaluation of the existing accounting and financial reporting framework being presently followed by the power sector and to recommend alternative framework, if necessary, keeping in view the generally accepted accounting principles (GAAPs) in India. It is heartening to note that the Research Committee of the Institute has brought out this 'Study on Accounting in Power Sector' for providing necessary guidance on adoption of GAAPs in power sector.

I express my gratitude to Shri N.V. Iyer, Chairman of the Research Committee for the previous year during which the Study was taken up and Shri R.S. Adukia, Chairman of the Research Committee for the current year, for their initiative and efforts in bringing out this Study on timely basis. I am also thankful to Shri A.A. Khan, CMD, Power Finance Corporation Ltd., for his cooperation extended in dissemination of the outcome of the exercise in its initial stages, with the State power utilities.

I would also like to thank Dr. Ashok Haldia, Secretary, ICAI, and Dr. Avinash Chander, Technical Director and other officers and staff who have made this Study an exemplary expression of excellent work.

I sincerely hope that the Study would go a long way in improving the accounting and financial reporting of power sector entities and would be of immense use to the members of the Institute as well as others.

New Delhi
April 16, 2002

Ashok Chandak
President

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Preface

Traditionally, power sector has largely been State controlled. Today, the States substantially control the country's generation capacity and the transmission network and almost the entire distribution system. Accordingly, State Electricity Boards (SEBs) are the principal entities in power sector. SEBs are following accounting and financial reporting framework as prescribed in the Electricity (Supply) Annual Accounts Rules (ESAAR), 1985, which are not compatible, in many respects, with the generally accepted accounting principles (GAAPs) in India. Further, accounting practices followed by different categories of power sector entities are not comparable.

Against the above background, this Study on Accounting in Power Sector attempts to cover various facets of accounting and financial reporting framework for power sector entities apart from seeking to provide alternative broad framework for the same. The Study discusses salient features and principal requirements of various Accounting Standards, issued by the Institute of Chartered Accountants of India, followed by a discussion on the principal requirements of ESAAR, 1985, on the subject, major areas of ESAAR which require realignment with the emerging scenario and the major issues that may arise in the course of application of the

Standards. Further, the Study also discusses the transitional issues, formats of financial statements of power sector entities and steps to be followed for implementation of the suggestions contained in this Study. The Study has an Appendix which discusses conformity/non-conformity of the accounting treatment prescribed in ESAAR with GAAPs.

I take this opportunity to place on record our appreciation of various experts for giving invaluable inputs at different stages of the preparation of the Study. This includes Shri Hemant Bhattbhatt, FCA, for preparing an Approach Paper on Power Sector Accounting and Dr. Ashok Haldia, Secretary, ICAI, assisted by Shri Lalit Kumar, Sr. Education Officer, for preparing basic draft of the Study. I am also thankful for the inputs given by various experts, mainly, Shri P. Narasimharamulu, Director (Finance), National Thermal Power Corporation Ltd. (NTPC), Shri R.K. Agarwal, Director (Accounts & Finance), Rajasthan Rajya Vidyut Prasaran Nigam Ltd. (RRVPNL), Shri K.H. Mankad, Director (Finance), BSES Limited, Shri S.C. Dhingra, Member, Uttar Pradesh Electricity Regulatory Commission (UPERC), Shri P.K. Das, Member, Rajasthan Electricity Regulatory Commission, Shri K. Sreekant, Sr. Manager (Accounts), NTPC Limited and Shri Subir Mulchandani, Dy. General Manager (Finance), Power Finance Corporation Limited at the time of consideration of the draft Study, and to hosts of SEBs who participated in the initial workshop and later at the national level conference on Power Sector. I am also thankful to Shri A.A. Khan, Chairman & Managing Director, Power Finance Corporation Ltd., for facilitating organisation of national level conference on Power Sector under the aegis of the Ministry of Power which also deliberated upon accounting issues in the Power Sector.

I would also like to thank the members of the Research Committee for providing invaluable suggestions, namely, Shri N. Nityananda,Vice-Chairman, Shri Ashok Chandak, President, Shri R. Bupathy, Vice-President, Shri N.V. Iyer , Member and immediate past Chairman of the Committee, Shri Shantilal Daga, Shri Niranjan Saha, Shri Sunil Goyal, Shri Sunil Gulati, Shri Vinod Jain, Shri G.C. Srivastava, Shri Jose Pottokaran, Shri Thomas Mathew, Shri Chandrakant B. Thakar, Shri Subhash Chandra Chawla and Shri Vishnu Anant Mahajan.

I would specially like to thank Dr. Avinash Chander, Technical Director, ICAI, Ms. Anuradha Jain, Secretary to the Research Committee and Mr. Vishal Bansal, Technical Officer, for extensively revising the draft of the Study and giving the Study its final shape and form.

I am confident that the recommendations contained in this Study will be immensely useful in establishing sound accounting and reporting system in Power Sector which would be useful in effectively bringing about reforms in power sector.

Rajkumar S. Adukia
Chairman
Research Committee

New Delhi
April 17, 2002

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1
Introduction

1.01 In the Indian Constitution, power has been placed in the list of concurrent subjects. Accordingly, the States as well as the Centre have jurisdiction over it. Till mid '70s, besides a few licensees in the private sector, the State Electricity Boards (hereinafter referred to as 'SEBs')/State Electricity Departments were the sole utilities responsible for generation, transmission and distribution of electricity. Over the period, the gap between demand and supply of power increased and SEBs/State Electricity Departments were unable to bridge this gap. Therefore, in order to supplement the efforts of the States in bridging the yawning gap between demand and supply of power, it was decided in mid '70s to set up generating stations and associated high/extra high voltage transmission lines in the Central Sector. Today, the States control about 60 per cent of the country's generation capacity, 70 per cent of the transmission network and almost 100 per cent of the distribution system[1].

1.02 Power is a critical infrastructure for economic development and for improving the quality of life. Installed power generation capacity of electricity has increased from 1362 Megawatts at the time of independence to more than 1,00,000 Megawatts[2]. Simultaneously, there has been an exponential growth in the demand for electricity throughout the length and breadth of the country. The growth in installed generation capacity has, however, not been able to keep pace with the increasing requirements and people in large number of villages still have no access to electricity. Besides, the end-users (i.e., the consumers) have to face frequent power cuts, both scheduled and unscheduled.

1.03 Based on the demand projections made in the 16th Electric Power Survey, the installed power generation capacity is required to be increased by more than 1,00,000 Megawatts by the year 2012 to bridge the gap between demand and supply of power. A massive amount of investment (approximately Rs. 8,00,000 crore[3]) would be required for the achievement of this objective. Besides this, a substantial amount of investment would also be required for renovation and modernisation of the existing installed generation capacity and for modernisation of the transmission and distribution system.

1.04 Since the Central and the State Governments were not able to provide the huge funds required for development of power sector, it was decided to allow more private sector participation in the sector. However, the investors have been wary of the sector due to lack of confidence in getting return on investment. The payment security measures taken by the Government have not yielded the desired results. The sector is required to be made financially strong through competition-led efficiency improvements and self-sustainable financial viability for attracting investments. Keeping in view this requirement, the reform process has been started since 1991 in power sector, broadly, on the following lines:

- Bringing in competitiveness by allowing more private sector participation in generation, transmission and distribution of power.
- Rationalisation of tariff and providing for transparency in the provision of subsidies.
- Segregation of generation, transmission and distribution through unbundling of SEBs and creation of manageable business units in the form of corporates.
- Progressive privatisation of the corporates emerging as a result of the above restructuring process.
- Development of independent regulatory framework for the sector.

1.05 To make reform process successful and to create desired investor confidence in the sector, various entities in the sector are required to be made more accountable for their actions. Financial reporting has for long been considered an important tool of accountability specially in the case of those private enterprises whose ownership is separate from management, e.g., enterprises formed as public limited companies. A set of financial reports produced periodically by those entrusted with the task of managing the affairs of such enterprises enables the owners to assess the efficacy of the management in carrying out its stewardship responsibilities. It also provides relevant financial information to the owners as well as other parties to enable them to take informed economic decisions. There is now an increasing realisation that various power sector entities too need to communicate relevant and reliable information concerning their operating activities and financial position to various interest groups.

1.06 At present, SEBs are following the framework of accounting and financial reporting as outlined in the Electricity (Supply) Annual Accounts Rules (ESAAR), 1985. The power sector entities registered under the Companies Act, 1956, or under a special legislation, are following the accounting and financial reporting framework mandated under the governing law. State Electricity Departments are following the Governmental Financial and Accounting Rules. This has led to an anomalous situation where the accounting practices followed by different categories of power sector entities are not comparable. The current accounting framework in power sector is also not in line, in many respects, with the Generally Accepted Accounting Principles (GAAPs), presently being followed in India.

Objectives of the Study

1.07 Against the above background, this Study seeks to review and evaluate the existing framework of accounting and financial reporting under which various principal power sector entities, particularly SEBs, are preparing their general purpose financial statements. The Study also seeks to provide alternative broad framework for accounting and financial reporting by such power sector entities, where necessary, and to bring out uniformity in accounting and financial reporting.

Scope of the Study

1.08 The Study focuses on preparation and presentation of general purpose financial statements with a view to reflect a true and fair view of the operating results and state of affairs of the principal power sector entities, particularly SEBs, in accordance with the GAAPs. In India, GAAPs include the following in the order of their hierarchical status:

- Accounting Standards and their interpretations issued by the Institute of Chartered Accountants of India
- Guidance Notes issued by the Institute of Chartered Accountants of India
- Studies, Monographs, etc., on accounting issued by the technical committees of the Institute of Chartered Accountants of India
- Opinions issued by the Expert Advisory Committee of the Institute of Chartered Accountants of India
- Prevailing accounting practices in the country.

1.09 Since the Accounting Standards constitute the principal source of GAAPs in India, this Study primarily attempts examination of the applicability of the Accounting Standards to the principal power sector entities. However, reference to the other sources of GAAPs such as the Guidance Notes has been made wherever necessary. In order to appreciate the background for the applicability of GAAPs, first an attempt has been made to study the existing legal framework with special reference to accounting and financial reporting framework applicable to various power sector entities. The transition from the existing accounting and financial reporting framework to that recommended in the Study, requires appropriately addressing the implementation issues. The Study, accordingly, deals with this aspect in a separate chapter.

1.10 The existing accounting and financial reporting framework is oriented towards the requirements of the regulatory authorities primarily for the purpose of tariff fixation. Accordingly, the treatment of various items of revenue and expenditure has been prescribed with a view to achieve the objective of the aforesaid framework, e.g., in ESAAR.

1.11 The recommendations made in the Study for the treatment of various items of revenue and expenditure are based on Indian GAAPs since the focus of this Study is to prescribe accounting framework to prepare and present the general purpose financial statements with a view to reflect true and fair view of the operating results and the state of affairs of the power sector entities. Further, it is imperative that the regulators also use the financial information based on the GAAPs since such information reflects the economic reality of the transactions and, therefore, decisions of the regulators, e.g., tariff fixation, would be economically sound.

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[1] Blue Print for Power Sector Development (August 2001) issued by the Ministry of Power, Government of India.

[2] *Ibid.*

3 *Ibid.*

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2
Existing Legal Framework for Accounting and Financial Reporting

Licensee

Generating Companies

State Electricity Boards

2.01 At present, the following types of entities are operating in power sector in India:

- State Electricity Boards set up under the Electricity (Supply) Act, 1948. These are engaged in generation, transmission and distribution of power.
- Departmentally run State Government Undertakings, i.e., State Electricity Departments.
- Generating companies that are engaged in generation of electricity as per the Electricity (Supply) Act, 1948.
- Licensees engaged in supply of power to the public as per the Indian Electricity Act, 1910.
- Entities set up under special Acts, e.g., Damodar Valley Corporation set up under the Damodar Valley Corporation Act, 1948, Bhakra Beas Management Board set up under the Punjab Re-organisation Act, 1966.

2.02 The laws governing these entities also provide for accounting and financial reporting framework to be followed by the entities. The legal framework with special reference to accounting and financial reporting applicable to these entities has been discussed later in this Chapter.

2.03 A recent development is the introduction of the Electricity Bill, 2001, in Lok Sabha. The Bill seeks to repeal the Indian Electricity Act, 1910, the Electricity (Supply) Act, 1948, and the Electricity Regulatory Commissions Act, 1998. Accordingly, upon enactment of the Electricity Bill, 2001, the provisions thereof will govern all the entities in the power sector.

2.04 Part XIII of the Bill deals with the reorganisation of the State Electricity Boards (SEBs). According to the provisions of Part XIII, any property, interest in property, rights and liabilities belonging to SEBs shall be vested, through the State Government, in a company or companies, in accordance with the transfer scheme in this regard. Such a company would be a state transmission utility or a generating company or a transmission licensee or a distribution licensee, as the case may be. Upon completion of the said transfer scheme, SEBs shall cease to exist and new companies would come into existence.

2.05 The Electricity Bill, 2001, does not contain any provision relating to accounts and audit of power sector entities. Accordingly, once the Electricity Bill, 2001, is enacted, framework of accounting and financial reporting of most of the power sector entities in the country, excepting those departmentally run and those set up under special Acts, would be governed by the relevant provisions of the Companies Act, 1956. In view of this, it may be stated that once the Electricity Bill, 2001, is enacted, review of the existing provisions of the Indian Electricity Act, 1910, and of the Electricity (Supply) Act, 1948, and the Rules made thereunder as aforesaid, would not have any relevance.

2.06 However, till the Bill is enacted, the existing position would continue to prevail. The review of the existing framework, particularly under ESAAR, is relevant for exploring the possibility as to whether the policies stated therein can continue to be applicable to the companies resulting from the SEBs upon enactment of the Electricity Bill, 2001. Various recommendations contained in this Study and applicability of the Accounting Standards for power sector entities, as discussed in this Study, would continue to have relevance for all power sector entities even on the enactment of the Electricity Bill, 2001.

2.07 The legal framework under which licensees, State Electricity Boards, and generating companies are operating with special reference to accounting and financial reporting aspects has been discussed hereinafter.

Licensee

2.08 According to the Indian Electricity Act, 1910, the term 'licensee' means “any person licensed to supply energy under Part II of the Indian Electricity Act, 1910”. Part II of the Act, *inter alia*, deals with grant of licenses, revocation or amendment of licenses, matters related to operations of licensees, besides containing provisions regarding annual accounts of the licensees. Section 3 of the Indian Electricity Act, 1910, empowers the State Government to grant a license, in consultation with the SEB, to any person to supply energy in any specified area and also to lay down or place electric supply-lines for the conveyance and transmission of energy. A licensee could be any form of organisation including a company registered under the Companies Act, 1956. A number of licensees are operating in the country in private as well as in public sector. State controlled distribution companies resulting from restructuring of some of the SEBs, e.g., Rajasthan State Electricity Board, are examples of licensees operating in the public sector. Examples of the licensees operating in the private sector are Ahmedabad Electric Company Limited, Noida Power Supply Company Limited, Dishergarh Power Supply Company Limited and privatised distribution companies in Orissa.

Accounting and Financial Reporting Framework for Licensees

2.09 Section 11(1) of the Indian Electricity Act, 1910, provides the following:

> “Every licensee shall, unless expressly exempted from the liability by his licence, or by order in writing of the State Government, prepare and render to the State Government or to

such authority as the State Government may appoint in this behalf, on or before the prescribed date in each year, an annual statement of accounts of his undertaking made upto such date, in such form, and containing such particulars, as may be prescribed in this behalf."

2.10 Sub-section (1) of Section 37 of the Indian Electricity Act, 1910, empowers the Central Electricity Board, *inter alia*, to make rules to carry out the purposes and object of the Act. Sub-section (2) of the section further stipulates that such Rules may, *inter alia*, provide for the preparation and submission of accounts by licensees in a specified form.

2.11 Pursuant to the powers granted as above, the Central Electricity Board has issued the Indian Electricity Rules, 1956. Rule 26 of the said Rules, requires that every licensee, unless exempted under Section 11 of the Indian Electricity Act, 1910, is required to prepare and render the annual statement of accounts upto the thirty first day of March each year. The State Government is empowered to require a licensee to furnish such other information, as may be desired, to the State Government or the authority appointed by it. The licensee is required to prepare accounts in the prescribed forms set out in Annexure IV and V of the Indian Electricity Rules, 1956.

2.12 Annexure IV contains summary of technical and financial particulars for the accounting period under consideration. Annexure V deals with model form of accounts. It is clearly evident from Annexures IV and V that the forms of annual accounts have been developed keeping in view the information required for regulatory and control purposes.

2.13 Clause III of the Schedule to the Indian Electricity Act, 1910, states that every licensee, unless otherwise directed by the State Government, is required to keep, at all times, the accounts of the undertaking relating to the generation, supply or distribution of energy distinct from the accounts kept by him of any other undertaking or business.

2.14 Section 57 of the Electricity (Supply) Act, 1948, is applicable to the licensee for determination of its charges to consumers. The section requires that a licensee should determine its charges on the basis of the provisions of the Sixth Schedule to the Electricity (Supply) Act, 1948. Under the Sixth Schedule, a licensee is required to so adjust its charges for the sale of electricity, whether by enhancing or reducing them, so that its Clear Profit in any year does not exceed the amount of Reasonable Return. The Schedule also lays down the manner of computing 'Reasonable Return' and 'Clear Profit'. The Schedule further lays down that in case the Clear Profit of a licensee is in excess of the amount of Reasonable Return, one third of such excess, not exceeding five percent of the amount of Reasonable Return, shall be at the disposal of the licensee. Of the balance of excess, one half is required to be appropriated to a reserve, viz., "Tariffs and Dividends Control Reserve" and the remaining half can either be distributed in the form of proportional rebate on the amounts collected from the sale of electricity and meter rentals or carried forward for distribution to the consumers in future, in such manner as the relevant State Government may direct.

2.15 As discussed earlier, a licensee can be a company registered under the Companies Act, 1956. Such a company may be preparing its general purpose financial statements according to the provisions of the Companies Act, 1956, to meet the requirements of different stake-holders in addition to the accounts required to be prepared under the Indian Electricity Act, 1910, for regulatory and control purposes. The Companies Act, 1956, contains detailed requirements relating to maintenance of accounts and preparation of financial statements. Salient features of the main requirements in this regard are given below:

- Section 209(1) prescribes the books of account that are required to be kept by the company registered under the Act. Section 209(3) states that proper books of account shall not be deemed to be kept if such books are not kept on accrual basis and according to the double entry system of accounting.

- Section 210 requires that the Board of Directors of the company shall, with regard to each financial year, lay at the annual general meeting a balance sheet at the end of the year and profit and loss account for the year.

- Section 211(1) requires that every balance sheet of the company shall give true and fair view of the state of affairs of the company as at the end of the financial year and shall be prepared in the form set out in Part I of Schedule VI to the Act, or as near thereto as circumstances admit or in such other form as may be approved by the Central Government either generally or in any particular case. In preparing the balance sheet due regard is required to be given, as far as possible, to the general instructions given under the heading "Notes" at the end of Part I of Schedule VI.

- Section 211(2) requires that every profit and loss account of the company shall give true and fair view of the profit or loss for the financial year and shall comply with the requirements of Part II of Schedule VI.

- Section 211(3A) of the Companies Act, 1956, requires that every profit and loss account and balance sheet of the company shall comply with the Accounting Standards. According to Section 211(3C), for the purposes of this requirement, the expression "Accounting Standards" means the standards of accounting recommended by the Institute of Chartered Accountants of India constituted under the Chartered Accountants Act, 1949, as may be prescribed by the Central Government in consultation with the National Advisory Committee on Accounting Standards established under Sub-section (1) of Section 210A:

  Provided that the standards of accounting specified by the Institute of Chartered Accountants of India shall be deemed to be the Accounting Standards until the Accounting Standards are prescribed by the Central Government under this sub-section.

- Section 211(3B) provides that where profit and loss account and balance sheet of the company do not comply with the Accounting Standards, the following disclosures shall be made in the financial statements of the company:

  (a) the deviation from the Accounting Standards;

  (b) the reasons for such deviation; and

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

Audit of Accounts of Licensees

2.16 The requirements of Clause II of the Schedule to the Indian Electricity Act, 1910, shall apply to the audit of accounts of the licensee not being a local authority. According to the requirements of the said clause, the annual statement of accounts of the licensee shall, before being rendered under Section 11 of the Indian Electricity Act, 1910, be examined and audited by such person as the State Government may appoint or approve in this behalf. The auditor has access to all such books and documents relating to the undertaking as are necessary for the purposes of the audit. The auditor also has the access to all vouchers and information including technical data and statements of energy generated and sold. The State Government has the power to direct the manner in which the audit should be conducted. Any report of the auditor, or such portion thereof as the State Government may direct, is required to be appended to the annual statement of accounts and shall form part of such accounts.

2.17 Apart from the above, the licensees which are companies registered under the Companies Act, 1956, are also required to get their accounts audited in terms of the provisions under the Companies Act, 1956. According to Clause II(e) of the Schedule to the Indian Electricity Act, 1910, the State Government may, if it deems fit, accept the examination and audit of an auditor appointed by the licensee. Therefore, if the licensee gets statement of accounts required to be submitted under Section 11 of the Indian Electricity Act, 1910, audited from the auditor appointed under Section 224 of the Companies Act, 1956, it would meet the requirements of the Indian Electricity Act, 1910, if the State Government deems it fit.

Generating Companies

2.18 Section 2(4-A) of the Electricity (Supply) Act, 1948, has defined the term 'generating company' as "a company registered under the Companies Act, 1956, and which has among its objects the establishment, operation and maintenance of generating stations". Section 15-A of the Act lays down the objects, jurisdiction, etc., of generating companies. According to Sub-section (2) of the section, the objects of a generating company shall include the following:

(a) establishing, operating and maintenance of generating stations and tie-lines, sub-stations and main transmission lines connected therewith;

(b) operation and maintenance of such generating stations, tie-lines, sub-stations and main transmission lines as are assigned to it by the government or governments.

Some of the companies that are engaged in generation of electricity, *inter alia*, are BSES Limited, National Thermal Power Corporation Limited (NTPC), Orissa Hydro Power Corporation Limited, Calcutta Electricity Supply Company Limited, etc. These companies are generating companies within the meaning of the Electricity (Supply) Act, 1948.

Accounting and Financial Reporting Framework for Generating Companies

2.19 According to Section 4 of the Electricity (Supply) Act, 1948, every generating company is required to furnish to the Central Electricity Authority such accounts, statistics, returns or other information relating to generation, supply and use of electricity as it may require and at such times and in such form and manner as it may direct.

2.20 Section 75A of the Electricity (Supply) Act, 1948, deals with annual reports and accounts of generating companies. Sub-section (2) of the section provides that every generating company, as soon as may be after the end of each year, should prepare a report giving an account of its activities during the previous year and shall, within six months from the date of the closure of the year, is required to forward to the competent government or where there are more than one competent government, to all such competent governments, the report together with a statement of accounts, in such form and containing such particulars as may be specified by the competent government or the competent governments, as the case may be, a copy of the balance sheet and profit and loss account and the auditor's report, in relation to the accounts of the year aforesaid.

2.21 Sub-section (4) of Section 75A of the Electricity (Supply) Act, 1948, provides that the provisions of Sub-section (2) are in addition to and not in derogation of the provisions contained in the Companies Act, 1956, in relation to reports, statement of accounts and other documents required to be prepared or kept or submitted by a company within the meaning of that Act. Electricity (Supply) Act, 1948, does not contain any separate requirement for formats of financial statements and audit of accounts of generating companies. Accordingly, the generating companies, being the companies registered under the Companies Act, 1956, are normally preparing their financial statements in accordance with the requirements of the Companies Act, 1956. Salient features of the main requirements in this regard have been discussed in paragraph 2.15 above.

2.22 Sub-section (3) of Section 75A of the Electricity (Supply) Act, 1948, provides that for the purpose of preparing the statement of accounts referred in Sub-section (2), a generating company should provide depreciation at such rate as may be specified by the Central Government, by notification in the Official Gazette. Notification No. S.O. 266(E) dated 29th March, 1994 issued by the Central Government prescribes the rates at which the depreciation on assets used for generation, transmission and supply of electricity should be charged by a generating company. The Notification also requires that the depreciation should be charged on 'straight line method'.

Audit of Accounts of Generating Companies

2.23 There are no specific provisions under the Electricity (Supply) Act, 1948, for the conduct of audit of generating companies. Since the generating companies are companies within the meaning of the Companies Act, 1956, audit is conducted in accordance with the provisions of the Companies Act, 1956.

State Electricity Boards

2.24 As mentioned earlier, State Electricity Boards (SEBs), constituted by the respective State Governments in accordance with the provisions of Section 5 of the Electricity (Supply) Act, 1948, occupy a dominant position in the power sector in India. Section 26 of the Electricity (Supply) Act, 1948, provides that the State Electricity Board shall, in respect of the whole State, have all the powers and obligations of a licensee under the Indian Electricity Act, 1910. According to the section, a State Electricity Board is not required to obtain a license under Section 3 of the Indian Electricity Act, 1910, since the Electricity (Supply) Act, 1948, is deemed to be the license of the Board for the purpose of that Act.

Accounting and Financial Reporting Framework for SEBs

2.25 According to first proviso to Section 26 of the Electricity (Supply) Act, 1948, the provisions of Section 11 of the Indian Electricity Act, 1910, dealing with annual accounts of licensee, do not apply to SEBs. Section 69 of the Electricity (Supply) Act, 1948, requires every SEB to keep proper accounts and other records in relation thereto, including a proper system of internal check. SEBs are also required to prepare an annual statement of accounts, including profit and loss account and the balance sheet in such form as the Central Government may, by notification in the Official Gazette, prescribe by rules made in this behalf in consultation with the Comptroller and Auditor General of India and the State Governments.

2.26 In exercise of the powers conferred by Section 69 of the Electricity (Supply) Act, 1948, the Central Government, in consultation with the Comptroller and Auditor General of India and the State Governments, has issued the Electricity (Supply) Annual Accounts Rules, 1985 (hereinafter referred to as 'ESAAR'). The ESAAR has three chapters. Chapter I, titled as 'Introductory', defines the terms used in ESAAR. Chapter II, titled as 'Compilation of Annual Accounts', deals with accounting period, compilation and submission of annual accounts, form and contents of the Annual Statement of Accounts, basic accounting principles and policies and their disclosures, etc. Chapter III, titled as 'Adoption of Annual Accounts', deals with adoption of annual accounts by the SEB.

2.27 ESAAR has five Annexures. Annexure I, titled as 'Annual Statement of Accounts', is in three parts. Part I of the Annexure lays down the formats of revenue account, net revenue and appropriation account, balance sheet, statement of accounting policies, notes to accounts, function-wise analysis of revenue and expenses, sources and uses of funds, etc. Part II of the Annexure contains schedules to the revenue account whereas Part III of the Annexure contains schedules to the balance sheet. It may be noted that there are 35 schedules in total that form part of revenue account and balance sheet.

2.28 Annexure II, titled as 'Chart of Accounts', is in two sections. Section 1 of the Annexure explains structure of chart of accounts whereas section 2 contains actual chart of accounts.

2.29 Annexure III, titled as 'Basic Accounting Principles and Policies', explains various accounting principles and policies that are required to be followed by SEBs in preparation and presentation of annual statement of accounts.

2.30 Annexure IV explains procedures to be followed for change over to new form of accounts whereas Annexure V to the Rules deals with various procedural matters relating to accounting transactions of SEBs.

Audit of Accounts of SEBs

2.31 According to Section 69(2) of the Electricity (Supply) Act, 1948, the accounts of SEBs are required to be audited by the Comptroller and Auditor General of India (C&AG) or by such persons as he may authorise in this behalf. Any expenditure incurred in connection with the audit is required to be borne by the SEB concerned.

2.32 According to Section 69(3) of the Electricity (Supply) Act, 1948, C&AG and any other person authorised by him in connection with the audit of accounts of the SEB shall have the same rights as C&AG has in connection with the audit of Government Accounts. Further, C&AG or person so authorised would have the right to demand production of books, accounts, connected vouchers and other documents and papers, and to inspect any of the offices of the SEB.

2.33 According to Section 69(4) of the Electricity (Supply) Act, 1948, the accounts of the SEB as certified by the C&AG or any other person authorised by him in this behalf, together with audit report thereon, are required to be forwarded to the prescribed authority and to the State Government within six months of the close of the year.

Review of ESAAR, 1985

2.34 ESAAR was issued in the year 1985 and has remained unchanged since then whereas Generally Accepted Accounting Principles are constantly evolving world-wide in a dynamic environment. The International Accounting Standards Committee (now known as International Accounting Standards Board) has issued 41 International Accounting Standards so far (of these, 35 standards are presently effective). In India, the number of Accounting Standards issued by the

Institute of Chartered Accountants of India (ICAI) have increased from 8 at the time of issuance of ESAAR (on 31st October, 1985) to 27[4] as on date. Keeping in view the changing business and economic environment and developments in financial and capital markets, ICAI has also revised various accounting standards subsequent to their issuance. Further, certain new standards are at various stages of formulation and certain existing standards are at various stages of revision. ICAI has also been issuing Guidance Notes from time to time and has also undertaken issuance of interpretations of various provisions of the Accounting Standards. Expert Advisory Committee of ICAI is issuing opinions on various accounting matters including application of Accounting Standards and Guidance Notes, etc. in specific situations. ESAAR is not compatible, in many respects, with GAAPs in India, as would be apparent from the discussion in Chapter 4. The conformity/non-conformity of the accounting treatment prescribed in ESAAR with the GAAPs is given in the Appendix to this Study. In many instances, the differences are not because of the difference in the nature of business as compared to that of other enterprises.

2.35 While ESAAR prescribes specific treatment for certain items of revenue, expenses, assets and liabilities that may arise in the normal course of business of SEBs, it does not contain treatment in respect of certain other items. In view of this, the preparers of the financial statements of SEBs may adopt different accounting policies for items not dealt with in ESAAR which would make the comparison of the financial statements of one SEB with those of another impracticable.

2.36 ESAAR has been notified by the Central Government in consultation with the State Governments and Comptroller and Auditor General of India. Such a mechanism is not appropriate to address the emerging accounting issues on timely basis.

2.37 As explained earlier, the formats of financial statements of SEBs, prescribed in ESAAR, contain 35 schedules to the balance sheet and the revenue account. These formats are basically meant for regulatory purposes and require presentation of too detailed and cumbersome information which may not have much relevance for the stakeholders other than the regulating authority and the government.

2.38 As discussed earlier, the reform process has already begun in SEBs and as a result of the reform process, SEBs are being unbundled and manageable business units are being created in respect of generation, transmission and distribution activities. These business units have varied kinds of stakeholders who are separate from their management. The enterprises whose ownership is separate from the management, e.g., joint stock companies, are required to follow GAAPs. Accordingly, manageable business units created out of unbundling of SEBs have to adopt GAAPs in preparation and presentation of their financial statements. However, it does not mean that SEBs should wait for completion of reform process for adoption of GAAPs; they should start preparing and presenting general purpose financial statements on the basis of GAAPs immediately.

2.39 For the reasons stated above, modification in ESAAR, in the present day context, is neither feasible nor would serve any worthwhile purpose. Therefore, SEBs should follow Indian GAAPs in totality. Power sector-specific accounting issues, if necessary, may be separately addressed within the framework of GAAPs.

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4 Accounting Standard (AS) 8, 'Accounting for Research and Development', would stand withdrawn for an enterprise from the date on which Accounting Standard (AS) 26, 'Intangible Assets', becomes mandatory for that enterprise.

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Applicability of GAAPs to Power Sector Entities

3.01 Accounting is often said to be a social science. It operates in an open and ever-changing economic environment. The nature of transactions entered into by various enterprises and the circumstances surrounding such transactions differ widely. This characteristic of accounting measurements historically led to the adoption of different accounting practices by different enterprises for dealing with similar transactions or situations.

3.02 Comparability is one of the important qualitative characteristics of accounting information. This implies that the information should be measured and presented in such a manner that the users are able to compare the information of an enterprise through time and with similar information of other enterprises. Adoption of different accounting practices by different enterprises for similar transactions or situations tends to reduce the comparability of accounting information.

3.03 The previous Chapter of the Study dealt with the legal framework for accounting and financial reporting within which various power sector entities, viz., licensees, generating companies and SEBs prepare and present their financial statements. In this Chapter, applicability of GAAPs, viz., Accounting Standards and Guidance Notes to various power sector entities, specially SEBs, has been discussed.

Accounting Standards

3.04 Recognising the need for bringing about a greater degree of uniformity in accounting measurements, the trend all over the world now is towards formulation of accounting standards to be adopted in preparation of accounting information and its presentation in financial statements. Accounting standards lay down the rules for measurement and presentation of accounting information by different enterprises.

3.05 At the international level, the International Accounting Standards Committee (now known as 'International Accounting Standards Board') formulates accounting standards, known as 'International Accounting Standards'. These standards provide the basis on which national accounting standards are developed in many countries. The endeavour of the International Accounting Standards Board is to promote the world-wide acceptance and observance of accounting standards formulated by it and to work generally for the improvement and harmonising of regulations, accounting standards and procedures relating to the presentation of financial statements.

3.06 In India, the task of formulating accounting standards has been taken up by the Accounting Standards Board established by the Council of the Institute of Chartered Accountants of India. In developing the accounting standards, the Board tries to integrate them, to the extent possible, with the International Accounting Standards considering the laws, customs, usages and business environment in India.

3.07 Accounting Standards issued by the Institute of Chartered Accountants of India are principally based on the fundamental accounting assumption of accrual. These standards thus reflect what can be construed as proper application of accrual accounting to different types of transactions and events.

Mandatory vs. Recommendatory Accounting Standards

3.08 As discussed in Chapter 2 of this Study, as far as the companies registered under the Companies Act, 1956, are concerned, compliance with Accounting Standards issued by the Institute of Chartered Accountants of India is a legal requirement. Similarly, the auditors of the companies are required to report on the compliance with the Accounting Standards as per the requirements of the Companies Act, 1956. As far as other enterprises are concerned, Accounting Standards, issued by the Institute of Chartered Accountants of India, are mandatory on the members of the Institute in the performance of their attest functions as per the relevant announcements made by the Institute of Chartered Accountants of India from time to time.

3.09 In respect of mandatory accounting standards, while carrying out an audit of general purpose financial statements under any law, it is the duty of the members of the Institute to examine whether the accounting standards have been complied with in the presentation of financial statements covered by their audit. In the event of any deviation from a mandatory accounting standard, it is their duty to make adequate disclosures in their audit reports so that the users of the financial statements may be aware of such deviations. In respect of a recommendatory accounting standard, the duty of members of the Institute is to examine whether the recommendations made in the standard have been followed in the presentation of financial statements covered by their audit. If the same have not been followed, the members have to consider whether, keeping in view the circumstances of the case, a disclosure in the audit report is necessary. In other words, they have to exercise their professional judgement to determine whether the departures from the recommendatory accounting standards are justified under the circumstances or not.

3.10 So far, the Institute of Chartered Accountants of India has issued 27 Accounting Standards. The details of the mandatory status and the applicability of the individual Accounting Standards, as of 1st April, 2002, is given below:

S. No.	Number of the Accounting Standard (AS)	Title of the Accounting Standard	Date from which mandatory (accounting periods commencing on or after)	Applicability
1.	AS 1	Disclosure of Accounting Policies	1-4-1991 – for companies governed by the Companies Act, 1956, as well as for enterprises other	To all enterprises

			than those specified in note 1. 1-4-1993 – for all enterprises, including those specified in note 1.	
2.	AS 2 (Revised)	Valuation of Inventories	1-4-1999	To all enterprises
3.	AS 3 (Revised)	Cash Flow Statements	1-4-2001 (See also note 2)	See note 2
4.	AS 4 (Revised)	Contingencies and Events Occurring after the Balance Sheet Date	1-4-1995	To all enterprises
5.	AS 5 (Revised)	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies	1-4-1996	To all enterprises
6.	AS 6 (Revised)	Depreciation Accounting	1-4-1995	To all enterprises
7.	AS 7	Accounting for Construction Contracts	As in case of AS 1 above	To all enterprises
8.	AS 8[5]	Accounting for Research and Development	As in case of AS 1 above	To all enterprises
9.	AS 9	Revenue Recognition	As in case of AS 1 above	To all enterprises
10.	AS 10	Accounting for Fixed Assets	As in case of AS 1 above	To all enterprises
11.	AS 11 (Revised)	Accounting for the Effects of Changes in Foreign Exchange Rates	1-4-1995	To all enterprises
12.	AS 12	Accounting for Government Grants	1-4-1994	To all enterprises
13.	AS 13	Accounting for Investments	1-4-1995	To all enterprises
14.	AS 14	Accounting for Amalgamations	1-4-1995	To all enterprises
15.	AS 15	Accounting for Retirement Benefits in the Financial Statements of Employers	1-4-1995	To all enterprises
16.	AS 16	Borrowing Costs	1-4-2000	To all enterprises
17.	AS 17	Segment Reporting	1-4-2001 (See also note 2)	See note 2
18.	AS 18	Related Party Disclosures	1-4-2001 (See also note 2)	See note 2
19.	AS 19	Leases	in respect of all assets	To all enterprises

			leased during accounting periods commencing on or after 1.4.2001	
20.	AS 20	Earnings Per Share	1-4-2001 (See also note 3)	See note 3
21.	AS 21	Consolidated Financial Statements	1-4-2001 (See also note 4)	See note 4
22.	AS 22	Accounting for Taxes on Income	See note 5	See note 5
23.	AS 23	Accounting for Investments in Associates in Consolidated Financial Statements	1-4-2002 (See also note 6)	See note 6
24.	AS 24	Discontinuing Operations	Recommendatory	
25.	AS 25	Interim Financial Reporting	See note 7	See note 7
26.	AS 26	Intangible Assets	See note 8	See note 8
27.	AS 27	Financial Reporting of Interests in Joint Ventures	See note 9	See note 9

Note 1: (a) Sole proprietary concerns/individuals

(b) Partnership Firms

(c) Societies registered under the Societies Registration Act

(d) Trusts

(e) Hindu undivided families

(f) Association of persons.

Note 2: AS 3, AS 17 and AS 18 have been made mandatory in respect of following enterprises:

(i) Enterprises whose equity or debt securities are listed on a recognised stock exchange in India, and enterprises that are in the process of issuing equity or debt securities that will be listed on a recognised stock exchange in India as evidenced by the board of directors' resolution in this regard.

(ii) All other commercial, industrial and business reporting enterprises, whose turnover for the accounting period exceeds Rs. 50 crore.

Note 3: AS 20 is mandatory in nature in respect of enterprises whose equity shares or potential equity shares are listed on a recognised stock exchange in India. An enterprise which has neither equity shares nor potential equity shares which are so listed but which discloses earnings per share, should calculate and disclose earnings per share in accordance with AS 20.

Note 4: AS 21 is mandatory if an enterprise presents consolidated financial statements. In other words, the accounting standard does not mandate an enterprise to present consolidated financial statements but, if the enterprise presents consolidated financial statements for complying with the requirements of any statute or otherwise, it should prepare and present consolidated financial statements in accordance with AS 21.

Note 5: AS 22 comes into effect in respect of accounting periods commencing on or after 1-4-2001. It is mandatory in nature for:

(a) All the accounting periods commencing on or after 01.04.2001, in respect of the following:

   (i) Enterprises whose equity or debt securities are listed on a recognised stock exchange in India and enterprises that are in the process of issuing equity or debt securities that will be listed on a recognised stock exchange in India as evidenced by the board of directors' resolution in this regard.

   (ii) All the enterprises of a group, if the parent presents consolidated financial statements and the Accounting Standard is mandatory in nature in respect of any of the enterprises of that group in terms of (i) above.

(b) All the accounting periods commencing on or after 01.04.2002, in respect of companies not covered by (a) above.

(c) All the accounting periods commencing on or after 01.04.2003, in respect of all other enterprises.

Note 6: AS 23 would come into effect in respect of accounting periods commencing on or after 1-4-2002. AS 23 is mandatory if an enterprise presents consolidated financial statements. In other words, if an enterprise presents consolidated financial statements, it should account for investments in associates in the consolidated financial statements in accordance with AS 23 from the date of its coming into effect, i.e., 1-4-2002.

Note 7: AS 25 will come into effect in respect of accounting periods commencing on or after 1-4-2002. This Accounting Standard does not mandate which enterprises should present interim financial reports, how frequently, or how soon after the end of an interim period. If an enterprise is required or elects to prepare and present an interim financial report, it should comply with this Accounting Standard.

Note 8: AS 26, Intangible Assets, will come into effect in respect of expenditure incurred on intangible items during accounting periods commencing on or after 1-4-2003 and will be mandatory in nature from that date for the following:

(i) Enterprises whose equity or debt securities are listed on a recognised stock exchange in India, and enterprises that are in the process of issuing equity or debt securities that will be listed on a recognised stock exchange in India as evidenced by the board of directors' resolution in this regard.

(ii) All other commercial, industrial and business reporting enterprises, whose turnover for the accounting period exceeds Rs. 50 crore.

In respect of all other enterprises, the Accounting Standard will come into effect in respect of expenditure incurred on intangible items during accounting periods commencing on or after 1-4-2004 and will be mandatory in nature from that date.

Note 9: AS 27, 'Financial Reporting of Interests in Joint Ventures', will come into effect in respect of accounting periods commencing on or after 01.04.2002. In respect of separate financial statements of an enterprise, this Accounting Standard is mandatory in nature from that date. In respect of consolidated financial statements of an enterprise, this Standard is mandatory in nature where the enterprise prepares and presents the consolidated financial statements in respect of accounting periods commencing on or after 01.04.2002.

Guidance Notes

3.11 The Institute of Chartered Accountants of India has issued various Guidance Notes on accounting. 'Guidance Notes' are primarily designed to provide guidance to members on matters which may arise in the course of their professional work and on which they may desire assistance in resolving issues which may pose difficulty. Guidance Notes are recommendatory in nature. While discharging his attest function, a member should examine whether the recommendations in a guidance note relating to an accounting matter have been followed or not. If the same have not been followed, the member should consider whether keeping in view the circumstances of the case, a disclosure in his report is necessary. A list of important Guidance Notes on accounting, as of 1st April, 2002, which may be relevant to power sector, is given below:

- Guidance Note on Terms Used in Financial Statements
- Mode of Valuation of Fixed Assets
- Guidance Note on Treatment of Reserve Created on Revaluation of Fixed Assets
- Guarantees & Counter-Guarantees Given by Companies
- Provision for Proposed Dividend
- Guidance Note on Treatment of Expenditure during Construction Period
- Guidance Note on Provision for Expenditure and Section 43B of the Income-Tax Act
- Guidance Note on Accrual Basis of Accounting
- Guidance Note on Accounting for Depreciation in Companies
- Guidance Note on Some Important Issues Arising from the Amendments to Schedule XIV to the Companies Act, 1956.

The above is not an exhaustive list of Guidance Notes on accounting. For this purpose, reference may be to Compendium of Guidance Notes, which is published in four volumes.

Applicability of GAAPs to Power Sector Entities

3.12 A pre-requisite for adoption of GAAPs is the existence of double entry system of book keeping and accrual basis of accounting. Certain power sector entities, particularly which are part of Government Departments, neither follow double entry system of book-keeping nor accrual basis of accounting. Double-entry system of book keeping has long been considered the scientific system of book keeping. Similarly, accrual basis of accounting is also essential in the measurement of performance of an enterprise since it relates the accomplishments (in terms of revenue) with the efforts (in terms of costs) of the enterprise during the accounting period. It is, thus, imperative that all power sector entities adopt double entry system of book keeping and accrual basis of accounting.

3.13 The next Chapter, 'Issues in Application of Accounting Standards', summarises the requirements of various Accounting Standards issued by the Institute of Chartered Accountants of India, since the Accounting Standards represent principal source of GAAPs. In respect of each accounting standard, the corresponding existing requirements in the power sector, namely, in respect of SEBs and the applicability of the standard to the power sector have been discussed. As far as the Guidance Notes on accounting are concerned, references thereto have been made in the Appendix to this Study, wherever the individual rule contained in ESAAR is in conformity/non-conformity with a Guidance Note.

5 AS 8 would stand withdrawn with effect from the date AS 26, 'Intangible Assets', becomes mandatory (See Note 8 to this Table).

4
Issues In Application of Accounting Standards

AS 10, Accounting for Fixed Assets

AS 11, Accounting for the Effects of Changes in Foreign Exchange Rates

AS 12, Accounting for Government Grants

AS 13, Accounting for Investments

AS 14, Accounting for Amalgamations

AS 15, Accounting for Retirement Benefits in the Financial Statements of Employers

AS 16, Borrowing Costs

AS 17, Segment Reporting

AS 18, Related Party Disclosures

AS 19, Leases

AS 20, Earnings Per Share

AS 21, Consolidated Financial Statements

AS 22, Accounting for Taxes on Income

AS 23, Accounting for Investments in Associates in Consolidated Financial Statements

AS 24, Discontinuing Operations

AS 25, Interim Financial Reporting

AS 26, Intangible Assets

AS 27, Financial Reporting of Interests in Joint Ventures

4.01 As observed in Chapter 3, Accounting Standards are applicable to power sector entities. In this Chapter, issues that are likely to arise in the course of application of Accounting Standards to power sector entities, with specific reference to SEBs, are discussed.

4.02 To facilitate an understanding of the requirements of Accounting Standards, their salient features and principal requirements are explained below, followed by a discussion on the principal requirements of ESAAR, 1985, on the subject, if any, major weaknesses of ESAAR and the major issues that may arise in the course of application of each Standard to power sector entities with specific reference to SEBs. It may be emphasised that the ensuing discussion on the requirements of the Standards is not intended to be exhaustive; as mentioned, the discussion is confined to the principal requirements of each Standard. While applying an Accounting Standard in a practical situation, reference should be made to the original text of the Standard. It may also be emphasised that the discussion on the issues in application of Accounting Standards is intended to address only the peculiar problems that may arise in the course of application of Accounting Standards to power sector entities more specifically to SEBs.

AS 1, Disclosure of Accounting Policies

AS 1 defines accounting policies as “the specific accounting principles and the methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements.” The Standard recognises that due to the varying circumstances in which enterprises operate, different accounting policies may be adopted by different enterprises. The major areas in which differing accounting policies are encountered include methods of depreciation, depletion and amortisation; valuation of inventories; treatment of expenditure during construction; treatment of retirement benefits; recognition of profit on long-term contracts; foreign currency translation; leasing; treatment of after-sales service costs, etc. In order that the users of financial statements can evaluate properly the working results and the financial position of an enterprise, the Standard requires the disclosure of significant accounting policies adopted in the preparation and presentation of financial statements.

Salient Features and Principal Requirements

1. All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed so as to promote a better understanding of the financial statements of an enterprise and facilitate a more meaningful comparison between financial statements of different enterprises.

2. The disclosure of significant accounting policies should form part of the financial statements and the significant accounting policies should normally be disclosed at one place.

3. Going concern, consistency, and accrual are the fundamental accounting assumptions which underlie the preparation and presentation of financial statements.

Going concern assumption implies that the enterprise has neither the intention nor the necessity of closing down or curtailing materially the scale of its operations. Thus, an enterprise is assumed to continue its operations for the foreseeable future.

Consistency assumption implies that accounting policies are consistent from one period to another.

Accrual assumption signifies that revenues and costs are recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate.

4. If the fundamental accounting assumptions are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

5. The major considerations in selecting accounting policies are prudence, substance over form, and materiality.

Prudence refers to the accounting convention according to which profits are not anticipated but recognised only when realised. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.

Substance over form implies that the accounting treatment and presentation of transactions should be governed by their substance and not merely by their legal form.

Materiality implies that financial statements should disclose all items the knowledge of which might influence the decisions of the users of the financial statements.

Principal Requirements under ESAAR, 1985

1. SEB is required to adopt, *inter alia*, the concepts of going concern, consistency and accrual basis of accounting for preparation and presentation of financial statements. ESAAR permits cash basis of accounting only in specified cases.

2. SEB is required to include, in its Annual Statement of Accounts, a Statement of Accounting Policies confirming adherence to accounting policies prescribed in ESAAR and also stating therein the departures, if any, made therefrom. SEB can depart from prescribed accounting policies only on the grounds of impracticability and for presenting true and fair view of accounts.

3. SEB is required to disclose accounting policies adopted for transactions for which no specific accounting policy is prescribed in ESAAR, if the amounts involved are material.

Applicability of AS 1 to Power sector entities

Shortcomings of ESAAR

1. ESAAR does not require disclosure of accounting policies prescribed therein as only departures therefrom are required to be disclosed, whereas AS 1 requires disclosure of all significant accounting policies. A user of the financial statements of SEB may not be aware of the accounting policies prescribed in ESAAR and therefore, may not be able to properly appreciate its performance.

2. ESAAR allows not to follow the prescribed accounting policies on the grounds of impracticability and for presenting true and fair view of accounts. The aforesaid grounds give a leeway to SEBs for not following the prescribed accounting policies. On the other hand, the Accounting Standards do not provide such a relaxation to any enterprise. This ensures uniformity of applicability of accounting standards.

Conclusion

AS 1 principally requires the disclosure of significant accounting policies and specifies the manner of their disclosure. A clear statement of significant accounting policies followed in the preparation and presentation of financial statements is necessary irrespective of the type of entity presenting the financial statements. Accordingly, power sector entities should disclose their significant accounting policies. Further, all significant accounting policies should be disclosed at one place.

AS 2, Valuation of Inventories

AS 2 applies to the valuation of all inventories except work-in-progress arising under construction contracts including directly related service contracts; work-in-progress arising in the ordinary course of business of service providers; shares, debentures and other financial instruments held as stock-in-trade; and 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.

Salient Features and Principal Requirements

1. Inventories should be valued at the lower of cost and net realisable value. In this context, cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. 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.

2. 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 and other similar items are deducted in determining the costs of purchase.

3. 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 and indirect labour.

4. 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.

5. In determining the cost of inventories in accordance with paragraph 1 above, 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.

6. 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.

7. The cost of inventories, other than those dealt with in paragraph 6 above, 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.

8. AS 2 further provides that 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.

9. The comparison of cost with net realisable value is done on an item-by-item basis. In some circumstances, however, it may be appropriate to group similar or related items, e.g., when items of inventory relate 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 compare cost and net realisable value based on a classification of inventory, for example, finished goods, or all the inventories in a particular business segment.

10. Material 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.

Principal Requirements under ESAAR, 1985

1. Freight cost is required to be included in cost of fuel at a standard freight rate determined on quarterly basis and no other expense can be included in the cost of fuel. The closing stock of fuel is required to be valued on the basis of weighted average rate which is calculated on the basis of actual quantity received.

2. Incidental expenses incurred for materials are not required to be included in cost and instead are required to be charged to Revenue Account, when incurred.

Applicability of AS 2 to Power Sector Entities

Shortcomings of ESAAR

ESAAR does not permit inclusion of incidental expenses, other than freight, in the cost of fuel even if directly related to acquisition. ESAAR also does not allow inclusion of any incidental expense in the cost of materials even if directly related to acquisition. ESAAR requires valuation of inventories of fuel and other materials at cost ignoring their net realisable value, therefore, these would be valued at cost even in cases where their net realisable value has decreased.

Conclusion

The unique feature of power sector is that electricity cannot be stored for future use. In other words, its generation and consumption have to be simultaneous and instantaneous. Therefore, there would be no inventory of finished goods and work-in-progress. Hence, in the case of power sector entities, the inventories would generally comprise materials, stores and supplies and fuels. As per AS 2, the inventories are required to be valued at the lower of cost and net realisable value.

The net realisable value of materials, stores, supplies held for use in production is to be determined with reference to the net realisable value of the final product. Thus, where the final product is expected to be sold at or above cost, materials and supplies held for use in production are to be valued at cost even if there is a decline in their price. However, when

there has been a decline in the price of materials and it is estimated that the cost of the final products will exceed their 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.

As per AS 2, cost of purchase of materials, including fuel, should include duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), freight inwards (on actual basis instead of at standard rate as in case of fuel as per ESAAR), and other expenditure directly attributable to acquisition. Other costs incurred to bring the inventories of fuel and materials to their present location and condition should also be included in cost of inventories.

AS 3, Cash Flow Statements

Salient Features and Principal Requirements

1. An enterprise should prepare a cash flow statement and present it in addition to the balance sheet and profit and loss account.

2. Cash comprises cash on hand and demand deposits with banks. Cash equivalents are "short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value". Thus, an investment is a cash equivalent only if it is readily convertible to a known amount of cash, is subject to an insignificant risk of changes in value, and has a short maturity of, say, three months or less from the date of acquisition. Investments in shares are excluded from cash equivalents unless they clearly satisfy the above criteria, i.e., they are, in substance, cash equivalents; for example, preference shares of a company acquired shortly before their specified redemption date (provided there is only an insignificant risk of failure of the company to repay the amount at maturity).

3. Cash flow statement should report the cash flows during the period classified by operating, investing and financing activities.

Operating activities are "the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities." Examples of cash flows from operating activities are cash receipts from the sale of goods/rendering of services, royalties, fees and commissions, and cash payments to suppliers for goods and services and to employees. Cash payments or refunds of income taxes are also part of cash flows from operating activities unless they can be specifically identified with financing and investing activities.

Investing activities are "the acquisition and disposal of long-term assets and other investments not included in cash equivalents." Examples of cash flows arising from investing activities are cash payments/receipts arising from acquisition or construction/ disposal of fixed assets (including intangibles), cash payments/ receipts arising from acquisition/disposal of shares, warrants or debt instruments of other enterprises (other than payments for those instruments considered to be cash equivalents and those held for dealing or trading purposes), cash payments for advances and loans made to third parties and receipts arising from the repayment thereof (other than those arising from advances and loans made by a financial enterprise).

Financing activities are "activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowings of the enterprise." Examples of cash flows arising from financing activities are cash proceeds from issuing shares, debentures, loans, notes, bonds, and other short or long-term borrowings, and cash repayments of amounts borrowed.

4. Cash flows from operating activities should be presented in the cash flow statement using either direct method or indirect method.

Under the direct method, major classes of gross cash receipts and gross cash payments are disclosed. These may be worked out either:

(a) from the accounting records of the enterprise [i.e., by analysing accounts relating to cash, bank (only those available on demand) and short term liquid investments qualifying as cash equivalents]; or

(b) by adjusting sales, cost of sales and other items in the statement of profit and loss for:

  i) changes during the period in inventories and operating receivables and payables;

  ii) other non-cash items; and

  iii) other items for which the cash effects are investing or financing cash flows.

Under the indirect method, the net cash flow from operating activities is determined by adjusting net profit or loss for the effects of:

(a) changes during the period in inventories and operating receivables and payables;

(b) non-cash items such as depreciation, provisions, deferred taxes, and unrealised foreign exchange gains and losses; and

(c) all other items for which the cash effects are investing or financing cash flows.

5. Cash flows arising from investing activities and those arising from financing activities should be classified separately. Under each, major categories of gross cash receipts and cash payments should be shown separately.

6. The following cash flows may be reported on a net basis:

(a) Cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the enterprise, e.g., acceptance and repayment of demand deposits by a bank, funds held for customers by an investment enterprise.

(b) cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short, e.g., advances made for, and the repayments of, principal amounts relating to credit card customers, and short-term borrowings, for example, those which have a maturity period of three months or less.

7. Cash flows arising from transactions in a foreign currency should be recorded in an enterprise's reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the cash flow. A rate that approximates the actual rate may be used if the result is substantially the same as would be the

case if the rates at the dates of the cash flows were used. The effect of changes in exchange rates on cash and cash equivalents held in a foreign currency represents unrealised gains/losses which are not cash flows. However, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency should be reported as a separate item in the cash flow statement in order to reconcile cash and cash equivalents at the beginning and the end of the period.

8. Cash flows from interest received, dividends received, interest paid and dividends paid should be disclosed separately. Except in the case of financial enterprises, cash flows arising from interest and dividends paid should be classified as cash flows from financing activities whereas interest and dividends received should be classified as cash flows from investing activities.

9. Cash flows arising from taxes on income should be disclosed separately and classified as cash flows from operating activities unless they can be specifically identified with financing or investing activities.

10. Investing and financing transactions that do not require the use of cash or cash equivalents should not be included in a cash flow statement. Examples of such transactions are the acquisition of fixed assets on deferred payment basis or against issue of shares, and conversion of debt to equity. Such transactions should, however, be disclosed appropriately elsewhere in the financial statements.

11. An enterprise should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the balance sheet.

12. An enterprise should disclose, together with a commentary by the management, the amount of significant cash and cash equivalent balances held by the enterprise that are not available for use by it, e.g., cash and cash equivalent balances held by a branch of the enterprise that operates in a country having exchange controls or other legal restrictions apply with the result that the balances are not available for use by the enterprise.

13. An enterprise may also disclose other relevant information, together with a commentary by the management, such as the amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities, the aggregate amount of cash flows that represent increases in operating capacity, etc.

Principal Requirements under ESAAR, 1985

Statement of Sources and Uses of Funds is required to be prepared.

Applicability of AS 3 to Power Sector Entities

Shortcomings of ESAAR

Statement of Sources and Uses of Funds (Funds Flow Statement) has the following drawbacks:

(a) Funds flow data based on movements in working capital can obscure movements relevant to the liquidity and viability of an entity. For example, a significant decrease in cash available may be masked by an increase in stock or debtors. Entities may, therefore, run out of cash while reporting increases in working capital. Similarly, a decrease in working capital does not necessarily indicate a cash shortage and a danger of failure.

(b) A funds flow statement is based largely on the difference between two balance sheets. It reorganises such data, but does not provide new data. The cash flow statement and associated notes required by AS 3 may include data not disclosed in a funds flow statement.

On the other hand, a cash flow statement has the following advantages over that provided by a Statement of Sources and Uses of Funds:

(a) As cash flow monitoring is a normal feature of business life and not a specialised accounting technique, cash flow is a concept which is more widely understood than are changes in working capital;

(b) Cash flows can be a direct input into a business valuation model and, therefore, historical cash flows may be relevant in a way not possible for funds flow data.

Conclusion

In view of the above, power sector entities should present cash flow statement as a part of financial statements. The cash flow statement should be presented in accordance with AS 3. It would also be useful to analyse the operating cash flows by activity, using preferably the direct method. This would portray a clear picture of how far each major activity is contributing to or utilising the cash resources of the entity.

AS 4, Contingencies and Events Occurring after the Balance Sheet Date

AS 4 deals with the treatment in the financial statements of contingencies and events occurring after the balance sheet.

Salient Features and Principal Requirements

1. A *contingency* is defined as "a condition or situation, the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence, or non-occurrence, of one or more uncertain future events." Thus, contingencies are conditions or situations at the balance sheet date, the financial effect of which would be determined by future events which may or may not occur.

2. The amount of a contingent loss should be provided for in the profit and loss account if:

(a) it is probable that future events will confirm that, after taking into account any related probable recovery, an asset has been impaired or a liability has been incurred as at the balance sheet date, and

(b) a reasonable estimate of the amount of the resulting loss can be made.

If either of the above conditions is not met (i.e., either the loss is not probable, or the loss is probable but its amount cannot be reasonably estimated), the following information should be disclosed in the financial statements, unless the possibility of loss is remote.

(a) The nature of the contingency;

(b) the uncertainties which may affect the future outcome;

(c) an estimate of the financial effect, or a statement that such an estimate cannot be made.

3. Contingent gains should not be recognised in the financial statements.

4. *Events occurring after the balance sheet date* are "those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and, by the corresponding approving authority in the case of any other entity."

5. Events occurring after the balance sheet date are of two types. The first type of events are those which provide further evidence for the estimation of amounts relating to conditions that existed at the balance sheet date. For example, information may be available in May that a debtor was insolvent as on March 31 (the date of the balance sheet) and only 25 paise for every rupee would be realised from his estate. This event assists in determining the amount of bad debts. In the second category are those events which are indicative of conditions that arose subsequent to the balance sheet date. These events, thus, do not relate to conditions existing at the balance sheet date. An example of such an event is the decline in market value of investments after the balance sheet date.

6. Assets and liabilities should be adjusted for events of the first type, i.e. those which provide further evidence for the estimation of amounts relating to conditions that existed at the balance sheet date. Thus, in the above case, 75% of the amount owed by the debtor should be written off as a bad debt on March 31.

7. As a general rule, events of the second type normally do not require either adjustment of assets and liabilities or disclosure in the financial statements. However, in some case, such events may indicate that the enterprise ceases to be a going concern, e.g., destruction a of major production plant by fire after the balance sheet date. If the events after the balance sheet date indicate that the going concern assumption is not appropriate, assets and liabilities should be adjusted.

8. Disclosure should be made in the report of the approving authority (e.g., report of the board of directors in the case of a company) of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise. The disclosure to be made in this regard should specify the nature of the event and an estimate of its financial effect. Where an estimate of the financial effect cannot be made, this fact should be stated.

Principal Requirements under ESAAR, 1985

1. SEB is required to disclose material contingent liabilities as on the balance sheet date.

2. As per ESAAR, events occurring after the balance sheet date are events or transactions occurring after the date of balance sheet and before the date of the auditors' report. ESAAR prescribes the following requirements with regard to events occurring after the balance sheet date:

(a) Events that provide additional evidence with respect to the conditions that existed at the date of the balance sheet and affect the estimates necessary for accrual etc., in the process of preparing annual accounts, are required to be used in evaluating the conditions on which the estimates were based. The annual accounts are required to be adjusted for any changes in estimates resulting from the use of such evidence.

(b) Events that provide evidence with respect to conditions that did not exist at the balance sheet date but arose subsequent to that date can not result in adjustment of the accounts. Some of these events, however, may be of such a nature that the omission of their disclosure may result in misleading statements and such events are required to be disclosed.

Applicability of AS 4 to Power Sector Entities

Shortcomings of ESAAR

The definition of the term ‘events occurring after the balance sheet date’, is not appropriate since, it may not be possible for the management to incorporate the effect of/disclose the events that occur after the date on which financial statements are approved, i.e., upto the date of auditors’ report as required in ESAAR.

Conclusion

The principles laid down in AS 4 should be complied with in their entirety by power sector entities.

AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

AS 5 deals with disclosure in the profit and loss account of (a) significant items arising in the course of ordinary activities of the enterprise; (b) extraordinary items; (c) prior period items; (d) changes in accounting estimates; and (e) changes in accounting policies.

Salient Features and Principal Requirements

1. All items of income and expense which are recognised in a period should be included in the determination of net profit or loss for the period unless an Accounting Standard requires or permits otherwise.

2. The following components of the net profit or loss for a period should be disclosed on the face of the profit and loss account:

   (a) profit or loss from ordinary activities; and

   (b) extraordinary items.

3. Extraordinary items should be disclosed in the profit and loss account as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be disclosed separately in the profit and loss account in a manner that its impact on current profit or loss can be perceived.

Extraordinary items are “income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly." Two criteria should thus be considered for determining whether an item is extraordinary or not. First, it should arise from events or transactions which are distinct from the ordinary activities of the enterprise. *Ordinary activities* are "activities which are undertaken by an enterprise as part of its business and such related activities in which the enterprise engages in furtherance of, incidental to, or arising from, these activities". Second, the item should not be expected to recur frequently or regularly. The Standard recognises that virtually all items of income and expense included in the determination of net profit or loss arise in the course of the ordinary activities of an enterprise and, therefore, it is only on rare occasions that an event or transaction gives rise to an extraordinary item. Also, whether an event or transaction is clearly distinct from the ordinary activities of the enterprise is determined by the nature of the event or transaction in relation to the business ordinarily carried on by the enterprise rather than by the frequency with which such events are expected to occur. In other words, merely because an item recurs infrequently, it does not qualify to be an extraordinary item if it is related to the business ordinarily carried on by the enterprise.

4. When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. Examples of situations which may give rise to such items are the write-down of inventories to net realisable value as well as the reversal of such write-downs, disposals of items of fixed assets and long-term investments, litigation settlements, and reversals of provisions (provided, of course, that they have a material impact). Disclosure of items of the above nature can be made on the face of the profit and loss account or in the notes to the financial statements.

5. The nature and amount of prior period items should be separately disclosed in the profit and loss account in a manner that their impact on the current profit or loss can be perceived.

Prior period items are defined as "income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods". Thus, prior period items are only those items which represent correction of errors or omissions in the preparation of the financial statements of one or more prior periods. Adjustments related to prior periods that are determined in the current period (e.g., wage arrears payable to workers as a result of a retrospective wage revision during the current period) are not prior period items.

Prior period items are normally included in the determination of net profit or loss for the current period. Alternatively, they may be shown in the profit and loss account after determination of current net profit or loss.

6. Accounting estimates (for example, useful lives of depreciable assets, provision for bad and doubtful debts) made in one accounting period may need revision in a subsequent period in the light of changes in the circumstances on which such estimates were based, or as a result of new information, more experience or subsequent developments. The effect of a change in an accounting estimate should be included in the determination of net profit or loss in the period of the change if the change affects the period only (e.g. a change in the estimate of the amount of doubtful debts), or in the period of the change and future periods if the change affects both (e.g. a change in the estimated useful life of a depreciable asset).

7. The nature and amount of a change in an accounting estimate which has a material effect in the current period, or which is expected to have a material effect in subsequent periods, should be disclosed. If it is impracticable to quantify the amount, this fact should be disclosed.

8. A change in an accounting policy should be made only if—

(a) the adoption of a different accounting policy is required

(i) by statute; or

(ii) for compliance with an accounting standard; or

(b) it is considered that the change would result in a more appropriate presentation of the financial statements of the enterprise.

9. A change in an accounting policy which has a material effect should be disclosed. The impact of, and the adjustments resulting from, such change, if material, should be shown in the financial statements of the period in which such change is made. Where the effect of such change is not ascertainable, wholly or in part, the fact should be indicated. If a change made in an accounting policy has no material effect on the financial statements for the current period but is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.

Principal Requirements under ESAAR, 1985

1. Various accounting policies are required to be followed consistently from year to year.

2. As per the format of Revenue Account, given in Annexure I to ESAAR, extraordinary items are required to be disclosed separately.

3. All prior period revenues or costs, arising in the current period on account of a difference between an accounting estimate made earlier and the actual values or on account of any other reason, are required to be accounted for prospectively and no retrospective restating of past year's figures is permitted.

4. Revenue belonging to prior years is not permitted to be credited directly to the reserves.

Applicability of AS 5 to Power Sector Entities

Shortcomings of ESAAR

1. ESAAR does not prescribe the circumstances in which any accounting policy, once adopted, can be changed. Evidently, an accounting policy once adopted cannot be changed even if the circumstances so warrant.

2. The terms ‘extraordinary items’ and ‘prior period revenues and costs’ have been used in ESAAR but their meaning has not been clarified. Further, as per ESAAR, ‘prior period revenues and costs’ include ‘change in accounting estimates’, whereas these terms have different connotations in GAAPs.

Conclusion

This Standard lays down requirements for accounting for prior period items, extraordinary items, changes in accounting policies and changes in accounting estimates in the Profit and Loss Account (Revenue Account in the case of SEBs) so that the users may be able to make meaningful comparisons of performance of the enterprise over time and also with other enterprises. In presenting the Revenue Account/Profit and Loss Account, the SEBs/other power sector entities, should comply fully with the requirements of this Standard.

AS 6, Depreciation Accounting[6]

Salient Features and Principal Requirements

1. The depreciable amount of a depreciable asset should be allocated on a systematic basis to each accounting period during the useful life of the asset.

Depreciable assets are assets which are expected to be used during more than one accounting period, have a limited useful life, and are held by an enterprise for use in the production or supply of goods and services, or for rental to others, or for administrative purposes and not for the purpose of sale in the ordinary course of business.

Depreciable amount of a depreciable asset refers to the historical cost, or the revalued amount, as reduced by the estimated residual value. Thus, if an item of plant and machinery is purchased for Rs. 5,00,000 and its residual value is estimated to be Rs. 10,000, the depreciable amount would be Rs. 4,90,000.

Useful life of a depreciable asset is either the period over which it is expected to be used by the enterprise, or the number of production or similar units expected to be obtained from the use of the asset by the enterprise.

2. The depreciation method selected should be applied consistently from period to period. The selection of the method depends on the type of asset, the nature of its use and the circumstances prevailing in the business. A combination of more than one method of depreciation can also be used, provided it is followed consistently.

3. A change from one method of providing depreciation to another should be made only if the adoption of the new method is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements of the enterprise. When a change in the method of depreciation is made, depreciation should be recalculated in accordance with the new method from the date of the asset coming into use. The deficiency or surplus arising from the retrospective recomputation of depreciation in accordance with the new method should be charged or credited (as the case may be) to the profit and loss account for the year in which the method of depreciation is changed.

4. The useful life of a depreciable asset should be estimated on considering the following factors:

(a) expected physical wear or tear;

(b) obsolescence;

(c) legal or other limits on the use of the asset.

The useful life of a depreciable asset may be shorter than its physical life. The determination of the useful life is a matter of estimation. In many cases, the statute governing an enterprise may lay down the basis for determining the useful life. In such a case, the management can charge a higher depreciation if, on a consideration of various factors, it estimates that the useful life of an asset is shorter than that envisaged under the provisions of the relevant statute. If, however, the management estimates that the actual useful life of the asset is longer than that envisaged under the statute, it should provide depreciation over the useful life as envisaged under the statute.

5. The useful lives of major depreciable assets or classes of depreciable assets may be reviewed periodically. If, as a result of such a review, there is a revision of the useful life, the unamortised depreciable amount (the written down book value minus the estimated residual value) should be charged over the revised remaining useful life.

6. Any addition or extension which becomes an integral part of the existing asset should be depreciated over the remaining useful life of that asset. Alternatively, depreciation on such addition or extension may be provided at the rate applied to the existing asset. However, where an addition or extension retains its separate identity and is capable of being used after the existing asset is disposed of, depreciation on the same should be provided independently on the basis of an estimate of its own useful life.

7. Where the historical cost of a depreciable asset has undergone a change, depreciation should be provided on the revised unamortised depreciable amount prospectively over the residual useful life of the asset.

8. Where a depreciable asset is revalued, provision for depreciation should be based on the revalued amount and on the estimate of the remaining useful life of such asset. If the effect of revaluation on the amount of depreciation is material, the same should be disclosed separately in the year in which revaluation is carried out.

9. Where a depreciable asset is disposed of, scrapped, retired, etc. the net surplus or deficiency, if material, should be disclosed separately.

10. The historical cost or the revalued amount of each class of depreciable assets should be disclosed in the financial statements. The total depreciation for the period for each class of assets, as well as the related accumulated depreciation, should be similarly disclosed. The depreciation methods as well as the depreciation rates or the useful lives of the assets if they are different from the rates prescribed by the law governing the entity should also be disclosed.

Principal Requirements under the Electricity Laws

1. As per Section 68 of the Electricity (Supply) Act, 1948, SEBs are required to provide in each year depreciation calculated in accordance with the principles as the Central Government may, after consultation with the Central Electricity Authority, by notification in the Official Gazette, lay down from time to time. As per Sub-section (3) of Section 75A of the Electricity (Supply) Act, 1948, provides that for the purpose of preparing the statement of accounts referred to in Sub-section (2), a generating company is required to provide depreciation at such rate as may be specified by the Central Government, by notification in the Official Gazette. Notification No. S.O. 266(E) dated 29th March, 1994, issued by the Central Government, in exercise of the powers conferred by the aforesaid sections, prescribes the rates at which the depreciation on assets used for generation, transmission and supply of electricity is required to be charged. As per the Notification, depreciation is required to be charged on 'straight line method'.

2. Accounting policies relating to depreciation on fixed assets as prescribed in ESAAR 1985 are as follows:

(a) Depreciation is required to be charged on the fixed assets in use in the beginning of the year, such an amount as is required to write-off 90 per cent of the cost of an asset, on a straight line method over the 'estimated useful life of the asset'.

(b) Depreciation charge on an asset shall cease from the year following the year in which

- the year's depreciation along with the depreciation charged in the previous year(s) becomes equal to or more than 90 per cent of the cost of the asset, or

- the asset permanently ceases to be used by SEB, whichever is earlier.

(c) Depreciation charge on a newly commissioned asset shall commence in the year immediately following the year of commissioning.

Applicability of AS 6 to Power Sector Entities

Shortcomings of the Electricity Laws

1. It is not proper to provide depreciation only on the assets in existence at the beginning of the accounting period as required in ESAAR. This results in no charge of depreciation being made in respect of assets acquired during the year and charge of depreciation for the whole year in respect of assets ceased to be used during the year.

2. It is not proper to provide depreciation on the assets at the rates specified in the Notification, even where the management's estimate of the useful life of an asset is shorter than that envisaged in the Notification.

Conclusion

1. Depreciation is an important item of expense under accrual basis of accounting. Under-provision or over-provision of depreciation would vitiate the true and fair view presented by the financial statements. Therefore, power sector entities should provide depreciation in accordance with the requirements of AS 6.

2. For the sake of consistency in estimating useful life and method of providing depreciation, the government may continue to notify the rates and method of depreciation to be used by the power sector entities. However, for determining the depreciation rates, the government should consider the factors specified in the Standard for estimating useful life. Further, the rates so prescribed should be the minimum rates. Accordingly, the entity should be required to provide depreciation at the higher rates, if the management's estimate of the useful life of an asset is shorter than that envisaged by the government. Depreciation should be required to be charged on pro-rata basis on the assets purchased/disposed of, discarded, demolished or destroyed during the year.

AS 7, Accounting for Construction Contracts[7]

Accounting Standard 7 deals with accounting for construction contracts in the financial statements of enterprises undertaking such contracts. The Standard also applies to enterprises which undertake construction activities not as contractors but on their own account on a commercial basis, if they have entered into agreements for sale, e.g., a company undertaking the construction of a large commercial complex having entered into agreements for sale in respect of offices and shops.

Construction contracts involve construction of an asset or a combination of assets which together constitute a single project, e.g. bridges, dams, ships, buildings and complex pieces of equipment.

A characteristic feature of such contracts is that the construction activity extends over more than one accounting period. This raises the accounting problem of allocating revenues and related costs for ascertaining the profit or loss during the intervening accounting periods.

Salient Features and Principal Requirements

1. In accounting for construction contracts, either the percentage of completion method or the completed contract method may be used. When a particular method of accounting is adopted by a contractor for a contract, the same method should be adopted for all other contracts which meet similar criteria.

Under the *percentage of completion method*, revenue is recognised as the contract activity progresses. An attempt is made to match costs with the stage of completion reached during an accounting period. Under this method, therefore, profit on a contract is partly recognised even before the contract is completed. Under the *completed contract method*, on the other hand, revenue is recognised only when the contract is completed or substantially completed.

2. Whichever method is used, a foreseeable loss on the entire contract should be provided for in the financial statements, irrespective of the amount of work done.

3. The percentage of completion method can be used only if the outcome of the contract can be reliably estimated. In the case of fixed price contracts (i.e., contracts with a fixed price or rate, with or without cost escalation clauses), this degree of reliability would be provided if the following conditions are satisfied:

(a) Total contract revenues to be received can be reliably estimated;

(b) both the costs to complete the contract and the stage of contract performance completed at the balance sheet date can be reasonably estimated; and

(c) the costs attributable to the contract can be clearly identified so that the actual experience can be compared with prior estimates.

4. In the case of fixed price contracts, profit should normally not be recognised unless the work on a contract has progressed to a reasonable extent, e.g. unless 20% to 25% of the work has been completed.

5. In the case of cost-plus contracts (i.e., where the contractor is reimbursed the costs and allowed a profit margin), the percentage of completion method can be used if both the following conditions are satisfied:

(a) Costs attributable to the contract can be clearly identified; and

(b) costs other than those that are specifically reimbursable under the contract can be reliably estimated.

6. While recognising profit under the percentage of completion method, an appropriate allowance for future unforeseeable factors should be made on either a specific or a percentage basis.

7. The following disclosures should be made in the financial statements:

(a) The amount of construction work-in-progress;

(b) progress payments received and advances and retentions on account of contracts included in construction work-in-progress; and

(c) the amount receivable in respect of income accrued under cost-plus contracts not included in construction work-in-progress.

If both the percentage of completion method and the completed contract method are simultaneously used by a contractor, the amount of construction work-in-progress should be disclosed separately for contracts accounted for under each method.

8. Disclosure of changes in the accounting policy used for construction contracts should be made in the financial statements giving the effect of the change and its amount. However, where a contractor changes from the percentage of completion method to the completed contract method for contracts in progress at the beginning of the year, it may not be possible to quantify the effect of the change. In such cases, disclosure should be made of the amount of attributable profits reported in prior years in respect of contracts in progress at the beginning of the accounting period.

Principal Requirements under ESAAR, 1985

Power sector entities normally do not undertake construction contracts of the nature specified in the Accounting Standard. In view of this, ESAAR does not contain any accounting requirement in relation to this.

Applicability of AS 7 to Power Sector Entities

This Standard applies to contractors. As such, its applicability to power sector entities is limited. While the Standard gives an option to contractors for following either the percentage of completion method or the completed contract method, from the viewpoint of a contractee, the recognition of expenditure on various projects should be based on the stage of completion of the project. Thus, where a power project or other such asset is under construction by or on behalf of a power sector entity, it should recognise it as capital work-in-progress based on the stage of completion rather than recognising the same only when the construction is completed.

AS 8, Accounting for Research and Development[8]

As the title suggests, this Standard deals with accounting treatment of research and development costs. The Statement does not deal with the accounting implications of the research and development activities conducted for others under a contract, exploration for oil, gas and mineral deposits and research and development activities of enterprises at the construction stage.

Salient Features and Principal Requirements

1. *Research* is "original and planned investigation undertaken with the hope of gaining new scientific or technical knowledge and understanding"

2. *Development* is defined as "the translation of research findings or other knowledge into a

plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production.”

3. Research and development costs should include:

(i) salaries, wages and other related costs of personnel engaged in research and development;

(ii) costs of materials and services consumed in research and development;

(iii) depreciation of building, equipment and facilities which have alternative economic use, to the extent that they are used for research and development;

(iv) an appropriate amortisation of the cost of building, equipment and facilities which have no alternative economic use, to the extent that they are used for research and development;

(v) overhead costs related to research and development;

(vi) payment to outside bodies for research and development projects related to the enterprise; and

(vii) other costs related to research and development such as amortisation of patents and licenses.

4. Amount of research and development cost should be charged as an expense of the period in which they are incurred except where such costs may be deferred in accordance with the following paragraph.

5. Research and development costs of a project may be deferred to future periods, if the following criteria are satisfied:

(i) the product or process is clearly defined and the costs attributable to the product or process can be separately identified;

(ii) the technical feasibility of the product or process has been demonstrated;

(iii) the management of the enterprise has indicated its intention to produce and market, or use, the product or process;

(iv) there is a reasonable indication that current and future research and development costs to be incurred on the project together with expected production, selling and administration costs are likely to be more than covered by related future revenues/benefits; and

(v) adequate resources exist, or are reasonably expected to be available, to complete the project and market the product or process.

6. Wherever research and development costs are deferred, the appropriate legal requirements should also be taken into account.

7. If an accounting policy of deferral of research and development costs is adopted, it should be applied to all such projects that meet the criteria discussed above.

8. If research and development costs of a project are deferred, they should be allocated on a systematic basis to future accounting periods by reference either to the sale or use of the product or process or to the time period over which the product or process is expected to be sold or used.

9. The deferred research and development costs of a project should be reviewed at the end of each accounting period. When the criteria discussed above, which previously justified the deferral of the costs, no longer apply, the unamortised balance should be charged as an expense immediately. When the criteria for deferral continue to be met but the amount of unamortised balance of the deferred research and development costs and other relevant costs exceed the expected future revenues/benefits related thereto, such expenses should be charged as an expense immediately.

10. Research and development costs once written off should not be reinstated even though the uncertainties which had led to their being written off no longer exist.

11. The total of research and development costs, including the amortised portion of deferred costs, charged as expense should be disclosed in the profit and loss account for the period.

12. Deferred research and development expenditure should be separately disclosed in the balance sheet under the head ‘Miscellaneous Expenditure’.

Principal Requirements under ESAAR, 1985

Research and development costs incurred by SEB, as a result of which no tangible asset is created, are required to be written-off in the year of incurrence even if these are likely to result in an increase in revenue of future years. Research and development expenditure for acquiring tangible assets are required to be treated as any other cost incurred for acquiring the fixed assets.

Applicability of AS 8 to Power Sector Entities

Shortcomings of ESAAR

1. It is not stated in ESAAR which types of expenses should be included in the research and development cost. Consequently, different SEBs may include different items of expense as research and development costs.

2. Research and development activities are not likely to result in a tangible asset. Therefore, as per ESAAR all expenses incurred on research and development are likely to be expensed in the year of incurrence. However, research and development activities may result in creation of an intangible asset and, accordingly, should be capitalised as such.

Conclusion

AS 26, ‘Intangible Assets’ (discussed later), which, *inter alia*, deals with treatment of research and development costs, supersedes AS 8, with effect from the former becoming mandatory. Therefore, power sector entities should follow AS 26 with regard to accounting for research and development cost.

AS 9, Revenue Recognition

Salient Features and Principal Requirements

1. Revenue from sale of goods should be recognised when all the following conditions are fulfilled:

(a) The seller of the goods has transferred to the buyer the property in the goods for a price, or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods to a degree usually associated with ownership.

(b) No significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

(c) It is not unreasonable to expect ultimate collection of the consideration.

2. In a transaction involving rendering of services, revenue should be recognised on the basis of the performance of the services. If the performance consists of the execution of more than one act, revenue should be recognised proportionately by reference to the performance of each act (i.e., on the basis of proportionate completion method). If performance consists of the execution of a single act, or if it consists of the performance of more than one act and the acts yet to be performed are very significant in relation to the transaction as a whole, revenue should be recognised only on the completion of performance of the sole or the final act (i.e., on the basis of completed service contract method).

In either case, revenue from services should be recognised only when no significant uncertainty exists regarding the amount of the consideration that will be derived from rendering the service and about its ultimate collectability.

3. Revenue arising on account of the use of enterprise resources by others should be recognised as follows provided no significant uncertainty as to measurability or collectability exists:

(a) Interest should be recognised on a time proportion basis taking into account the principal outstanding.

(b) Royalties should be recognised on accrual basis in accordance with the terms of the relevant agreement.

(c) Dividends should be recognised when the right of the enterprise to receive the dividend payment is established.

4. Where, at the time of sale or the rendering of the service, the ultimate collection of revenue cannot be assessed with reasonable certainty, revenue recognition should be postponed, till the time when it is reasonably certain that the ultimate collection will be made. When such uncertainty arises after the making of the sale or rendering of the service, it is more appropriate to make a provision than to adjust the revenue recorded originally.

Principal Requirements under ESAAR, 1985

Revenue from sale of power is required to be recognised on accrual basis and not on the basis of actual collection of revenue from consumers. Where the sale of energy, prior to the end of a year has not been billed, a provision is required to be created for unbilled revenue at the year-end so as to treat the amount as revenue in the year of supply of power.

Treatment of certain items recoverable from consumers

Electricity Duty Electricity duty is recovered from consumers and forwarded to the Government. It is neither treated as a cost nor as an income of the SEB and is kept out of the Revenue Account altogether. The duty paid but not collected from consumers and the duty collected from consumers but not yet remitted to the Government is required to be shown separately in the accounts.

Minimum Charges In case the consumption of electricity, during a billing period, is below a specified minimum consumption level, the consumer is required to pay minimum charges. For the sake of working convenience, full amount of minimum charges is treated as revenue from sale of power.

Treatment of minimum charge levied on applicants who have delayed taking of connection Applicants who delay their Test Report are at times billed a minimum charge even though no power has been supplied to them. Such income is treated as 'Miscellaneous Charges from Consumers'. The amount receivable on this account is debited to a separate account titled as 'Sundry Debtors for Sale of Power'.

Treatment of discount allowed for timely payment Cash discounts allowed to consumers as an incentive for timely payment by the due date are required, when allowed, to be treated as a cost and shown separately as such in the Revenue Account.

Treatment of Delayed Payment Charges Charges recovered from consumers for delayed payments can not be clubbed with the revenue from sale of power but are required to be shown separately since these are more in the nature of a financial charge.

Accounting for bills raised for Thefts of Energy Income arising from the bills raised for Theft of Energy, whether on a consumer or an outsider, is treated as income and reported under a separate account head.

Applicability of AS 9 to Power Sector Entities

Shortcomings of ESAAR

1. Concepts of measurability and ultimate collection have not been recognised in ESAAR in relation to recognition of revenue. This is not as per GAAPs.

2. ESAAR does not prescribe general principles for recognition of revenue for items other than sale of power, but prescribes specific treatment in respect of certain items, which, in the case of bills raised for thefts of energy, is not as per GAAPs.

Conclusion

1. The power sector entities should follow the requirements of the Standard in their entirety for recognition of revenue arising from sale of goods, rendering of services, and use by others of enterprise resources yielding interest, royalties and dividends.

2. Specific issues that may arise in application of AS 9 to power sector entities are discussed below:

Treatment of discount allowed for timely payment

Discount allowed to consumers for timely payment should be treated as an expense of the year in which the related payment is received from the consumers and should be shown separately in the Revenue Account* .

Accounting for bills raised for Thefts of Energy

Bills raised for theft of energy, whether on a consumer or an outsider, should be recognised as revenue only in a case where realisation of the same is reasonably certain.

Revision of tariff-rates with retrospective effect

In certain circumstances, the regulating authority may increase/reduce the tariff-rates with retrospective effect. An increase in rates will lead to additional revenues in the accounting period in which the tariff rates are revised. Such additional revenue should be recognised in the Revenue Account for the period in which rates are revised and disclosed separately, if the amount involved is material. The regulating authority may permit an entity to recover charges for supply of power at a higher rate before the final award is decreed by it. The amount collected as a result of higher charges should be disclosed as 'Income received in advance' under the head 'Current Liabilities' and not treated as revenue till the final order is passed. The regulating authority may require an entity to refund certain amounts to the customers due to reduction in tariff rates with retrospective effect. Such refunds should be recorded as a liability and charged as an expense in the period in which the order is passed and disclosed separately, if the amount involved is material.

AS 10, Accounting for Fixed Assets

Salient Features and Principal Requirements

1. *A fixed asset* is defined as "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. 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. The financial statements should disclose, *inter alia*, the gross book value of fixed assets. The gross book value of a fixed asset should be either its historical cost or a revalued amount.

4. The cost of a fixed asset should be determined as below:

(a) The cost of a purchased fixed asset should comprise its purchase price and any attributable cost of bringing the asset to its working condition for its intended use.

(b) 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.

(c) When a fixed asset is acquired in exchange or in part exchange for another asset, 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. 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. Fair market value may be determined by reference either to the asset given up or to the asset acquired, whichever is more clearly evident. Similarly, a 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.

(d) Where several fixed assets are purchased for a consolidated price, the consideration should be apportioned to various assets on a fair basis as determined by competent valuers.

5. When a revaluation is made, either 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. The revaluation should not result in the net book value of the revalued assets being greater than the recoverable amount of those assets. When a fixed asset is revalued upwards, any accumulated depreciation existing at the date of the revaluation should not be credited to the profit and loss account.

6. An increase in net book value arising on revaluation of fixed assets should be credited directly to owners' interests under the head 'revaluation reserve'. However, to the extent that such increase is related to and not greater than a decrease arising on a revaluation previously recorded as a charge to the profit and loss account, it may be credited to the profit and loss account. A decrease in net book value arising on revaluation of fixed assets should, on the other hand, be charged directly to the profit and loss account 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 utilised, it may be charged directly to that account.

7. Subsequent expenditure related to an item of fixed asset should be added to its book value only if it increases the future benefits from the existing asset beyond its previously assessed standard of performance.

8. 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.

9. A fixed asset should be eliminated from the financial statements on disposal or when no further benefit is expected from its use and disposal.

10. Any profit or loss arising from retirement or disposal of fixed assets should be dealt with as below:

(a) Losses arising from the retirement or gains or losses arising from disposal of a fixed asset which is carried at cost should be recognised in the profit and loss account.

(b) Where a previously revalued item of fixed asset is disposed of, any loss or gain (i.e., the difference between net disposal proceeds and the net book value) should be charged or credited to the profit and loss account. However, 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.

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

12. The direct costs incurred in developing the patents should be capitalised and written-off over their legal term of validity or over their working life, whichever is shorter[9].

13. The amount paid for know-how for the plans, layout and designs of buildings or design of the machinery should be capitalised under the relevant asset heads, such as buildings, plant and machinery, etc. Depreciation should be calculated on the total cost of those assets, including the cost of the know-how capitalised. Know-how related to manufacturing process is usually expensed in the year in which it is incurred. Where the amount paid for know-how is a composite sum in respect of both the manufacturing process as well as plans, drawings and designs for buildings, plant and machinery, etc., such consideration should be apportioned into two parts on a reasonable basis[10].

14. The following disclosures should be made in the financial statements:

(a) Gross and net book values of fixed assets at the beginning and end of the accounting period along with additions, disposals, acquisitions and other movements during the year;

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

(c) 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 carrying out the revaluation.

Principal Requirements under ESAAR, 1985

1. Fixed assets are required to be recorded at historical cost and revaluation of fixed assets is not permissible.

2. Expenditure incurred on identification, survey and feasibility studies of a project, etc., is required to be accumulated and allocated over the "tangible" assets acquired/constructed under the project, if the project is sanctioned. If the project is rejected, the full amount of expenditure is charged to the Revenue Account as infructuous capital expenditure in the year in which the project is rejected.

3. Cost of a capital asset includes all 'actual costs' incurred to prepare the asset for use. ESAAR provides various details about the costs such as staff costs, material costs, etc., for inclusion in the cost of a capital asset. All the expenditure on additions is required to be

capitalised.

4. The expenditure having the effect of extending the useful life of an asset or increasing output or capacity or efficiency of an asset or decreasing operating costs of an asset is 'Improvement'. The entire expenditure on improvements is required to be capitalised. Treatment of expenditure incurred on alterations or renovations of building or plant is similar to that for improvements.

5. The term ‘replacements’ has been defined as ‘substitution of one fixed asset by another, particularly of an old asset by a new asset’. Expenditure on minor replacements is required to be charged to revenue as repairs and maintenance expenditure. Expenditure on major replacements is required to be capitalised. In such a case, the cost and accumulated depreciation on the old replaced assets is required to be written-off, when the expenditure on the new asset is capitalised. Replacement of any asset or part of the asset for which a separate fixed asset record is required, is considered as major replacement.

6. Full cost of all small and low value assets each costing Rs. 500 or less is required to be fully charged to revenue in the year in which the assets are put to use. ESAAR also prescribes certain exceptions to this treatment.

7. All capital expenditure is required to be accounted for through capital work-in-progress account. The expenditure is required to be transferred to appropriate fixed asset accounts when it is first put to use. Cost escalation claims made by suppliers and contractors are required to be provided for to the extent acknowledged by the SEB and capitalised when the asset is first put to use.

8. Capital spares at a generating station purchased prior to commissioning of the generating station are required to be capitalised upon capitalisation of the generating station, for which the spares are required to be purchased. Capital spares purchased subsequent to the commissioning of generating station are required to be capitalised upon purchase.

9. On retirement, scrapping or obsolescence of an asset, the cost of the asset and the accumulated depreciation thereon are required to be written-off from the fixed assets base and transferred to a separate account. In case of scrapped asset for which no scrap/salvage value is realised, the written down value of such assets is required to be charged off to the Revenue Account for the year.

10. Gain or loss arising on sale of capital assets is required to be treated as a revenue item. The gain, subject to the maximum of depreciation charged on the asset, is required to be credited to Revenue Amount for the year in which the asset is sold. Gain, if any, in excess of the accumulated depreciation charged on sold asset is required to be treated as a capital gain and credited to Capital Reserve. The loss on sale of a capital asset is required to be debited to the Revenue Account for the year in which the asset is sold.

11. In the event of loss/destruction of an asset, the cost and the accumulated depreciation on that asset are required to be withdrawn from the fixed assets block and provision for depreciation respectively. Excess of the written down value of the lost/destroyed asset over the amount of insurance claim granted is required to be charged to revenue in the year in which the insurance claim is settled.

12. In respect of the assets taken over from licensee, the amount of compensation payable for an asset is required to be treated as the cost of the asset.

Applicability of AS 10 to Power Sector Entities

Shortcomings of ESAAR

1. ESAAR contains detailed requirements of various costs to be included for the purpose of capitalisation of a fixed asset. This may result into a prescriptive approach towards determination of the cost and may result into certain costs being left out which are not specifically stated in ESAAR. On the other hand, AS 10 enunciates general principles of capitalisation of costs which do not leave any scope for omission of any specific items of costs.

2. The amount of Rs. 500 or less to be fully charged in respect of low value assets is too low in the context of the present day requirements. The amount should be revised on the lines of the requirements of Schedule XIV to the Companies Act, 1956.

3. ESAAR does not define as to what should be considered as capital spares. This is crucial for appropriate accounting treatment of the spares.

4. It is not correct as per AS 10 to treat the gain in excess of the accumulated depreciation charged on an asset as a capital reserve.

Conclusion

The principles enunciated in AS 10 regarding accounting for fixed assets should apply equally to a power sector entity as to any other entity.

AS 11, Accounting for the Effects of Changes in Foreign Exchange Rates

Accounting Standard (AS) 11 should be applied by an enterprise in accounting for transactions in foreign currencies, and in translating the financial statements of foreign branches for inclusion in the financial statements of the enterprise.

Salient Features and Principal Requirements

1. As a general rule, a transaction in a foreign currency should be recorded in terms of the rupee by applying to the foreign currency amount the exchange rate between the rupee and the foreign currency at the date of the transaction. Besides the use of actual exchange rate as at the date on which the relevant transaction occurs, the Standard also recognises the use of a rate that approximates the actual rate; for example, an average rate for a week or month may be applied to all transactions that occur during such period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is not considered proper.

2. Exchange differences arising on settlement of foreign currency transactions during an accounting period should be recognised as income or expense of the period, except as stated in paragraph 3 below. (An exchange difference results if there is a change in the exchange rate between the date of a transaction and the date of its settlement.)

3. Exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets should be adjusted in the carrying amount of the respective fixed assets.

4. As a general rule, monetary items denominated in a foreign currency should be restated at the balance sheet date using the exchange rate at such date (called the closing rate). Such monetary items include foreign currency notes, balances in bank accounts denominated in a foreign

currency, and receivables, payables and loans denominated in a foreign currency.

5. Where an enterprise has entered into a forward exchange contract with regard to a foreign exchange transaction, the difference between the forward rate (i.e., the rate at which two currencies are contracted to be exchanged at a specified future date) and the exchange rate at date of the transaction should be recognised as income or expense over the life of the contract. However, if the forward exchange contract relates to liabilities incurred for acquiring fixed assets, such difference should be adjusted in the carrying amount of the respective fixed assets.

6. Any profit or loss arising on cancellation or renewal of a forward exchange contract should be recognised as income or as expense for the period. However, if the forward exchange contract relates to liabilities incurred for acquiring fixed assets, such profit or loss should be adjusted in the carrying amount of the respective fixed assets.

7. The financial statements of a foreign branch should be translated into the reporting currency by using the following procedures:

(a) Revenue items, except opening and closing inventories and depreciation, should be translated into reporting currency of the reporting enterprise at average rate. Opening and closing inventories should be translated at the rates prevalent at the commencement and close respectively of the accounting period. Depreciation should be translated at the rates used for the translation of the values of the assets on which depreciation is calculated.

(b) As a general rule, monetary items should be translated using the closing rate.

(c) Non-monetary items other than inventories and fixed assets should be translated using the exchange rate at the date of the transaction.

(d) Fixed assets should be translated using the exchange rate at the date of the transaction. However, exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets should be adjusted in the carrying amount of the respective fixed assets.

(e) Balance in ‘head office account’, whether debit or credit, should be reported at the amount of the balance in the ‘branch account’ in the books of the head office after adjusting for unresponded transactions.

(f) The net exchange difference resulting from the translation of items in the financial statements of a foreign branch should be recognised as income or as expense for the period, except to the extent adjusted in the carrying amount of the related fixed assets.

(g) Contingent liabilities should be translated into the reporting currency of the enterprise at the closing rate. The translation of contingent liabilities does not result in any exchange difference as defined in this Standard.

8. The following disclosures should be made in the financial statements:

(a) The amount of exchange differences included in the net profit or loss for the period.

(b) The amount of exchange differences adjusted in the carrying amount of fixed assets during the accounting period.

(c) The amount of exchange differences in respect of outstanding forward exchange contracts to be recognised in the profit or loss of one or more subsequent accounting periods.

Principal Requirements under ESAAR, 1985

1. Assets, liabilities, income or expenses arising from foreign currency transactions are required to be recorded using the official exchange rate in force on the transaction date.

2. All amounts owed to/by the SEB in foreign currency, outstanding at the balance sheet date (including liability in relation to acquisition of fixed assets), are required to be translated at the official exchange rate in force as on the balance sheet date. If the amount derived on such translation is different from the amount at which the asset/liability is appearing in the books of account, the difference is credited/debited to Exchange Variance Reserve. Net debit balance, if any, in Exchange Variance Reserve is debited to the Revenue Account.

3. Gain or loss arising on account of difference between actual amount received/paid and the amount at which the item is appearing in books is also treated in the same manner as above.

4 Where any revaluation or devaluation of rupee vis-a-vis the currency in which the liability is to be discharged is more than 10% at one time, the same is not treated in accordance with the above-mentioned policy. In such a case, any increase/decrease in the amount of foreign currency liability is accounted for as an increase/decrease in the cost of the assets financed by the liability. Further, depreciation on the asset for the past years is also required to be reworked, if increase/decrease in the amount of cost is more than:

(a) Rs. 50,000/- for an asset; and

(b) 20% of the cost booked earlier.

Applicability of AS 11 to Power Sector Entities

Shortcomings of ESAAR

1. Transfer of exchange differences at the end of the period to Exchange Variance Reserve and then transferring the net debit balance of this reserve account, if any, to Revenue Account is not correct in view of the requirements of AS 11.

2. It is not correct to adjust in the cost of a fixed asset only those foreign currency differences arising on account of translation of the liabilities incurred in this regard in excess of the specified amounts in ESAAR. It is also incorrect to rework the depreciation on the asset for the past years in such cases. As per the GAAPs, depreciation should be charged on prospective basis where the cost of the fixed asset undergoes a change because of adjustment of foreign currency differences.

Conclusion

Power sector entities may enter into transactions of import of capital items. As required under AS 11, such transactions should be initially accounted for at the exchange rate prevalent on the date of the transaction. Exchange differences related to liabilities arising

on such imports should be included in the carrying amount of the respective fixed assets. The revised carrying amount should be depreciated prospectively, i.e., over the remaining useful life of the asset concerned.

Foreign exchange transactions other than those relating to import of capital items should also be accounted for in the manner required under AS 11. Accordingly, all foreign exchange differences not related to foreign currency liabilities incurred on acquisition of fixed assets should be recognised as income or expense.

AS 12, Accounting for Government Grants

Salient Features and Principal Requirements

1. *Government grants* are "assistance by government in cash or kind to an enterprise for past or future compliance with certain conditions". Government, for this purpose, includes government agencies and similar bodies whether local, national or international.

2. Government grants should not be recognised until there is reasonable assurance that (a) the grants will be received, and (b) the enterprise will comply with the conditions attached to them.

3. A government grant given for the acquisition of a specific fixed asset should be accounted for in either of the following ways:

   (a) The grant should be shown in the balance sheet as a deduction from the gross value of the relevant fixed asset.

   (b) Alternatively, the gross value of the fixed asset should be left undisturbed. Instead, where the grant relates to a non-depreciable asset, e.g., freehold land, it should be credited to capital reserve. However, if a grant related to a non-depreciable asset requires the fulfillment of certain obligations, the grant should be credited to income over the same period over which the cost of meeting such obligations is charged to income; the deferred income balance should be shown separately in the financial statements. On the other hand, if the grant relates to a depreciable asset, it should be treated as deferred income which should be recognised in the profit and loss account by allocating it over the periods and in proportions in which depreciation on the asset concerned is charged.

4. Government grants having the characteristics of promoters' contribution (e.g., grants given with reference to the total investment in an undertaking or by way of contribution toward its total capital outlay, as in the case of Central Investment Subsidy Scheme) should be credited to capital reserve.

5. Government grants in the form of non-monetary assets (such as fixed assets) given at a concessional rate should be accounted for on the basis of their acquisition cost. In case a non-monetary asset is given free of cost, it should be recorded at a nominal value (e.g., rupee one).

6. Government grants given with reference to the revenue of the enterprise should be recognised on a systematic basis in the profit and loss account over the periods necessary to match them with the related costs which they are intended to compensate. They should either be shown separately under 'other income' or deducted in reporting the related expense.

7. In some cases, a government grant may be receivable by an enterprise as compensation for

expenses or losses incurred in a previous accounting period, or for providing immediate financial support to the enterprise. Such grants should be recognised and disclosed in the profit and loss account of the period in which they are receivable.

8. In case government grants become refundable, the amount refundable should first be adjusted with reference to the relevant item in the balance sheet, e.g., in the case of a refund of a grant related to a specific fixed asset, the refund should be set off against deferred income or adjusted to effect an increase in the book value of the related fixed asset. The balance, which cannot be so adjusted, should be charged to the profit and loss account.

9. The following disclosures should be made in the financial statements:

(a) The accounting policy adopted for government grants, including the methods of presentation in the financial statements.

(b) The nature and extent of government grants recognised in the financial statements, including grants of non-monetary assets given at a concessional rate or free of cost.

Principal Requirements under ESAAR, 1985

1. Consumers' contribution, subsidies and grants towards cost of capital assets are not treated as a reduction in the 'cost' but as a capital receipt and are credited to capital reserve account, if and only if the following conditions are satisfied:

(a) the amount is not subject to any conditions to be fulfilled by the SEB or the conditions attached to the amount have been fulfilled by the SEB

(b) no part of the amount is refundable nor is likely to become refundable by the SEB.

Depreciation on the capital assets is required to be provided in the normal course on their 'full cost'.

2. Subsidies received to meet, partly or fully, shortfall of revenue as compared to cost of operations carried out or being carried out by the SEB on its own or under the directive of the body, from whom the subsidy is receivable, are credited to Revenue Account. The subsidies, the receipt whereof is dependent upon certain conditions, are not credited to Revenue Account until the SEB satisfies all such conditions.

3. An asset received as donation is required to be accounted for at its fair market value. The fair market value of the asset is debited as the cost of the asset and credited to 'Donated Capital Assets Account', which is included under a Reserve and treated in the same manner as contributions, grants and subsidies towards cost of capital assets. Donated assets which are subject to certain conditions are nevertheless treated as fixed assets but disclosed by way of a footnote indicating value of such assets. Assets received as grant are also accounted for in the same manner as donated assets.

Applicability of AS 12 to Power Sector Entities

Shortcomings of ESAAR

1. It is not proper to recognise asset-related grants as capital reserve.

2. In the context of financial statements being prepared under the historical cost convention, recognising an asset received as donation/grant at fair value is not proper.

Conclusion

Accounting treatment for government grants, as prescribed in AS 12, is based on the nature of grants and the purpose for which these are received. Accordingly, power sector entities should follow the requirements of AS 12 in their entirety for accounting for government grants. Accounting principles prescribed in AS 12 would be applicable in case of consumers' contribution and subsidies keeping in view their nature.

AS 13, Accounting for Investments

Salient Features and Principal Requirements

1 *Investments* are "assets held by an enterprise for earning income by way of dividends, interest, and rentals, for capital appreciation, or for other benefits to the investing enterprise".

2. An enterprise should disclose current investments and long term investments distinctly in its financial statements. *A current investment* is an investment that is by its nature readily realisable and is intended to be held for not more than one year from the date on which such investment is made. *A long term investment* is an investment other than a current investment.

3. The cost of an investment should include acquisition charges such as brokerage, fees and duties. Where an investment has been purchased on cum-dividend or cum-interest basis, the interest or dividend received subsequently should be allocated between pre-acquisition and post-acquisition periods. The interest or dividend relating to the pre-acquisition period represents a recovery of cost and should, accordingly, be deducted in arriving at cost.

If an investment is acquired, or partly acquired, by the issue of shares or other securities, the acquisition cost should be the fair value of the securities issued (which in appropriate cases may be indicated by the issue price as determined by statutory authorities).

If an investment is acquired in exchange for another asset, the acquisition cost of the investment should be determined by reference to the fair value of the asset given up. Alternatively, the acquisition cost of the investment may be determined with reference to the fair value of the investment acquired if it is more clearly evident.

4. Investments classified as current investments should be carried in the financial statements at the lower of cost and fair value.

5. The term *'fair value'* refers to the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction. The fair value of investments for which an active market exists is determined with reference to their market value. For example, in the case of shares which are actively traded on a stock exchange, the fair value may be determined on the basis of stock exchange quotations. Where an active market does not exist, fair value is determined in some other rational manner.

6. The comparison of cost and fair value for determining the carrying amount of current investments should be made either on an individual investment basis (i.e., cost and fair value should be compared separately for each investment) or by category of investment (i.e., cost of an entire category of investments such as preference shares should be compared with its fair value).

7. Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution should be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually.

8. Investment properties (land and buildings held as investments) should be accounted for as long term investments.

9. Where long-term investments are reclassified as current investments, transfers should be made at the lower of cost and carrying amount at the date of transfer. Where investments are reclassified from current to long-term, transfers should be made at the lower of cost and fair value at the date of transfer.

10. Any reduction in the carrying amount and any reversals of such reductions should be charged to income.

11. On disposal of an investment, the difference between the carrying amount and net disposal proceeds should be charged or credited to income. When disposing of a part of the holding of an individual investment, the carrying amount to be allocated to that part is to be determined on the basis of the average carrying amount of the total holding of the investment.

12. Further classification of current and long-term investments should be as specified in the statute governing the enterprise. In the absence of a statutory requirement, such further classification should disclose, where applicable, investments in:

(a) Government or Trust securities

(b) Shares, debentures or bonds

(c) Investment properties

(d) Others – specifying nature.

13. The following disclosures should be made in the financial statements:

(a) The accounting policies for determination of carrying amount of investments;

(b) classification of investments;

(c) the amounts included in profit and loss statement for:

(i) interest, dividends (showing separately dividends from subsidiary companies), and rentals on investments showing separately such income from long term and current investments;

(ii) profits and losses on disposal of current investments and changes in the carrying amount of such investments; and

(iii) profits and losses on disposal of long term investments and changes in the carrying amount of such investments;

(d) significant restrictions on the right of ownership, realisability of investment or the remittance of income and proceeds of disposal;

(e) the aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments;

(f) other disclosures as specifically required by the statute governing the enterprise.

Principal Requirements under ESAAR, 1985

1. Investments are required to be recorded at actual cost of acquisition including transfer charges, stamp duty etc. No adjustment can be made for the excess or shortfall of the cost over the face value of the investments.

2. No provision need be made for the depreciation in the market value of securities (bonds and debentures or government promissory notes) held by the SEB as investment (i.e. market value being lower than the cost of the investments) since it would be a fair assumption in the case of such securities that the securities would be held till maturity when full value of the security would be realised. However, there may be securities in respect of which such an assumption about holding till maturity does not hold good. No provision is created even in such cases for depreciation in the value of investments. Similarly, no provision for any appreciation in the market value of investments can be made by an SEB.

3. Gain/loss on sale of investments is credited/debited to the Net Revenue and Appropriation Account. In case the investment was against a Fund, gain/loss is credited/debited to the respective Fund Account instead of Net Revenue and Appropriation Account.

Applicability of AS 13 to Power Sector Entities

Shortcomings of ESAAR

1. It is not appropriate to require non-provision of depreciation in the value of investments taking place subsequent to their initial recording, particularly, where the investments are not held-to-maturity.

2. Credit/debit of gain/loss on sale of investments to the Net Revenue and Appropriation Account, which is similar to Profit and Loss Appropriation Account, is not appropriate.

Conclusion

The requirements of this Standard should be followed in their entirety by the power sector entities.

AS 14, Accounting for Amalgamations

Accounting Standard 14 deals with accounting for amalgamations and the treatment of any resultant goodwill or reserves. The Standard is directed principally to companies although some of its requirements also apply to financial statements of other enterprises.

Salient Features and Principal Requirements

1. *Amalgamation* means an amalgamation pursuant to the provisions of the Companies Act, 1956 or any other statute which may be applicable to companies.

2. The Standard classifies amalgamations into following two categories:

(a) amalgamation in nature of merger;

(b) amalgamation in the nature of purchase.

3. An amalgamation should be considered to be *an amalgamation in the nature of merger* when all the following conditions are satisfied:

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

(ii) Shareholders 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.

(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.

4. An amalgamation should be considered to be *an amalgamation in the nature of purchase,* when any one or more of the conditions specified in paragraph 3 is not satisfied.

5. When an amalgamation is considered to be an amalgamation in the nature of merger, the following accounting treatment (*pooling of interest method*) should be followed in the preparation of financial statements of transferee enterprise:

(a) the assets, liabilities and reserves (whether capital or revenue or arising on revaluation) of the transferor company should be recorded at their existing carrying amounts and in the same form as at the date of the amalgamation. The balance of the Profit and Loss Account of the transferor company should be aggregated with the corresponding balance of the transferee company or transferred to the General Reserve, if any.

(b) If, at the time of the amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies should be adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies should be reported in accordance with AS 5.

(c) The difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company should be adjusted in reserves.

6. When an amalgamation is considered to be an amalgamation in the nature of purchase, the following accounting treatment (*purchase method*) should be followed in the preparation of financial statements of transferee enterprise:

(a) the assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or, alternatively, the consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation. The reserves (whether capital or revenue or arising on revaluation) of the transferor company, other than the statutory reserves, should not be included in the financial statements of the transferee company except as stated in (d) below.

(b) Any excess of the amount of the consideration over the value of the net assets of the transferor company acquired by the transferee company should be recognised in the transferee company's financial statements as goodwill arising on amalgamation. If the amount of the consideration is lower than the value of the net assets acquired, the difference should be treated as Capital Reserve.

(c) The goodwill arising on amalgamation should be amortised to income on a systematic basis over its useful life. The amortisation period should not exceed five years unless a somewhat longer period can be justified.

(d) Where the requirements of the relevant statute for recording the statutory reserves in the books of the transferee company are complied with, statutory reserves of the transferor company should be recorded in the financial statements of the transferee company. The corresponding debit should be given to a suitable account head (e.g., 'Amalgamation Adjustment Account') which should be disclosed as a part of 'miscellaneous expenditure' or other similar category in the balance sheet. When the identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account should be reversed.

7. The consideration for the amalgamation should include any non-cash element at fair value. In case of issue of securities, the value fixed by the statutory authorities may be taken to be the fair value. In case of other assets, the fair value may be determined by reference to the market value of the assets given up. Where the market value of the assets given up cannot be reliably assessed, such assets may be valued at their respective net book values.

8. Where the scheme of amalgamation provides for an adjustment to the consideration contingent on one or more future events, the amount of the additional payment should be included in the consideration if payment is probable and a reasonable estimate of the amount can be made. In all other cases, the adjustment should be recognised as soon as the amount is determinable [see Accounting Standard (AS) 4, Contingencies and Events Occurring after the Balance Sheet Date].

9. For all amalgamations, the following disclosures should be made in the first financial statements following the amalgamation:

(a) names and general nature of business of the amalgamating companies;

(b) effective date of amalgamation for accounting purposes;

(c) the method of accounting used to reflect the amalgamation; and

(d) particulars of the scheme sanctioned under a statute.

10. For amalgamations accounted for under the pooling of interest method, the following additional disclosures should be made 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.

11. For amalgamations accounted for under the purchase method, the following additional disclosures should be made in the first financial statements following the amalgamation:

(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.

Principal Requirements under ESAAR, 1985

ESAAR does not contain any specific requirements regarding accounting for amalgamations.

Applicability of AS 14 to Power Sector Entities

In future, a lot of restructuring is expected to take place in the power sector. As a result, mergers and acquisitions are expected to be a common feature. The requirements of AS 14 should be applied in their entirety for accounting for such transactions.

AS 15, Accounting for Retirement Benefits in the Financial Statements of Employers

AS 15 applies to retirement benefits in the form of provident fund, superannuation/pension and gratuity. It also applies to retirement benefits in the form of leave encashment benefit, health and welfare schemes and other retirement benefits if they are in the nature of defined contribution schemes or defined benefits schemes. The Standard does not apply to those retirement benefits for which the employer's obligation cannot be reasonably estimated, e.g., ad hoc payments made to employees on retirement.

Salient Features and Principal Requirements

1. The cost of providing retirement benefits to employees should be allocated to periods during which the services are rendered by the employees. This is because an enterprise assumes obligation to pay retirement benefits in respect of an accounting period in consideration of services rendered by the employees during that period. Accounting for retirement benefit costs on cash basis, i.e., only when employees receive payments (termed as pay-as-you-go method), is not appropriate.

2. *A defined contribution scheme* is a scheme under which amounts to be paid as retirement benefits are determined by contributions to a fund together with earnings thereon. An example of a defined contribution scheme is contributory provident fund under which the employer's obligation is to contribute a certain specified percentage of salary of an employee as provident fund.

In respect of retirement benefits in the form of provident fund and other defined contribution schemes, the contribution payable by the employer for a year should be charged to the profit and loss account for the year.

3. *A defined benefit scheme* is a scheme under which amounts to be paid as retirement benefits are determined usually by reference to employee's earnings and/or years of service. Examples of defined benefit schemes are pension and gratuity. Defined benefit schemes should be accounted for as follows:

(a) An appropriate charge to the profit and loss account for a year should be made through a provision for the accruing liability. The accruing liability should be calculated according to actuarial valuation. However, if an enterprise employs only a few persons, it may calculate the accrued liability by reference to any other rational method, e.g., a method based on the assumption that such benefits are payable to all employees at the end of the accounting year.

(b) Actuarial valuations should normally be conducted at least once in every three years. Where the actuarial valuations are not conducted annually, the actuary's report should specify the amounts to be charged to the profit and loss account of each year during the inter-valuation period.

(c) In case the liability for retirement benefits is funded through a scheme administered by an insurer (e.g., Life Insurance Corporation), an actuarial certificate or a confirmation from the insurer should be obtained that the contribution payable to the insurer is the appropriate accrual of the liability for the year. The contribution payable should be charged to the profit and loss account for the year.

4. Any alterations in the retirement benefit costs arising from –

(a) introduction of a retirement benefit scheme for existing employees, or making improvements to an existing scheme (including provision of additional benefits to retired employees), or

(b) changes in the actuarial method used or assumptions adopted, should be charged or credited to the profit and loss account as they arise. A change in the actuarial method used should be treated as a change in an accounting policy and disclosed accordingly.

5. The method by which retirement benefit costs for the period have been determined should be

disclosed. In case the costs related to gratuity and other defined benefit schemes are based on an actuarial valuation, it should also be disclosed whether the actuarial valuation was made at the end of the period or at an earlier date. In the latter case, the date of the actuarial valuation should be specified and if the method by which the accrual for the period has been determined is not based on the report of the actuary, it should be briefly described.

Principal Requirements under ESAAR, 1985

ESAAR does not contain any specific requirements with regard to accounting for retirement benefits.

Applicability of AS 15 to Power Sector Entities

The requirements of this Standard should be followed by power sector entities in their entirety.

AS 16, Borrowing Costs

Salient Features and Principal Requirements

1. *Borrowing costs* are defined as "interest and other costs incurred by an enterprise in connection with the borrowing of funds." Thus, apart from interest, borrowing costs would also include the following:

(a) Commitment charges on bank borrowings and other short-term and long-term borrowings;

(b) amortisation of discounts or premiums relating to borrowings;

(c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;

(d) finance charges in respect of assets acquired under finance leases or under other similar arrangements; and

(e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest cost.

2. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Examples of qualifying assets are manufacturing plants, power generation facilities, inventories that require a substantial period of time to bring them to a saleable condition, and investment properties. Other investments, and those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired also are not qualifying assets.

3. The borrowing costs that are directly attributable to the acquisition, construction or

production of a qualifying asset are those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made.

4. To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

5. To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation should be determined by applying a capitalisation rate to the expenditure on that asset. The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalised during a period should not exceed the amount of borrowing costs incurred during that period.

6. The capitalisation of borrowing costs as part of the cost of a qualifying asset should commence when all the following conditions are satisfied:

(a) Expenditure for the acquisition, construction or production of a qualifying asset is being incurred;

(b) borrowing costs are being incurred; and

(c) activities that are necessary to prepare the asset for its intended use or sale are in progress.

Expenditure on a qualifying asset includes only such expenditure that has resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities. Expenditure is reduced by any progress payments received and grants received in connection with the asset.

The activities necessary to prepare the asset for its intended use or sale encompass more than the physical construction of the asset. They include technical and administrative work prior to the commencement of physical construction, such as the activities associated with obtaining permits prior to the commencement of the physical construction. However, such activities exclude the holding of an asset when no production or development that changes the asset’s condition is taking place. For example, borrowing costs incurred while land is under development are capitalised during the period in which activities related to the development are being undertaken. However, borrowing costs incurred while land acquired for building purposes is held without any associated development activity do not qualify for capitalisation.

7. Capitalisation of borrowing costs should be suspended during extended periods in which active development is interrupted. However, capitalisation of borrowing costs is not normally suspended during a period when substantial technical and administrative work is being carried out. Capitalisation of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale. For example, capitalisation continues during the extended period needed for inventories to mature or the extended period during which high water levels delay construction of a bridge, if such high water levels are common during the construction period in the geographic region involved.

8. Capitalisation of borrowing costs should cease when substantially all the activities necessary

to prepare the qualifying asset for its intended use or sale are complete. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

9. The financial statements should disclose:

(a) the accounting policy adopted for borrowing costs; and

(b) the amount of borrowing costs capitalised during the period.

Principal Requirements under ESAAR, 1985

1. Interest accrued on all borrowings, whether due or not and whether paid or not, is required to be provided. Total interest cost for the year, accrued as above, is required to be charged to the Revenue Account for the year except the portion of interest as discussed in the following paragraph.

The portion of the interest on borrowings, which relates to financing of capital work-in-progress upto the stage of commissioning, if so directed by the Central Government, is capitalised. The interest is capitalised only in a case where significant time periods are involved at the construction stage. Notional interest can not be capitalised on the SEB’s own funds and interest free finance.

2. Guarantee charges, commitment charges and legal charges/stamp duty for loan agreements, debenture trust deeds, bonds or debentures are charged to the Revenue Account in the year of incurrence. Provision is made at the year-end for the above costs for the year, which have accrued but are not paid.

3. Discount on issue of bonds, debentures or other securities is charged to the Revenue Account in the year in which the bonds/debentures are issued. Premium, if any, payable on redemption of bonds, debentures or other securities is charged to the Revenue Account in the year in which premium becomes payable.

Applicability of AS 16 to Power Sector Entities

Shortcomings of ESAAR

Guarantee charges, commitment charges and legal charges/stamp duty for loan agreements, etc., and discount on issue and premium payable on redemption are incurred in connection with the borrowing of funds. In view of this, treatment thereof, different from that of interest, is not warranted.

Conclusion

Requirements of this Standard should be followed by all power sector entities, including SEBs, in their entirety.

AS 17, Segment Reporting

AS 17 establishes principles for reporting financial information, about the different types of products and services an enterprise produces (business segments) and the different geographical areas in which it operates (geographical segments)

Salient Features and Principal Requirements

1. *Business segment* is defined as "a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments. Factors that should be considered in determining whether products or services are related include:

(a) the nature of the products or services;

(b) the nature of the production processes;

(c) the type or class of customers for the products or services;

(d) the methods used to distribute the products or provide the services; and

(e) if applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities."

2. *Geographical segment* is defined as "a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic environments. Factors that should be considered in identifying geographical segments include:

(a) similarity of economic and political conditions;

(b) relationships between operations in different geographical areas;

(c) proximity of operations;

(d) special risks associated with operations in a particular area;

(e) exchange control regulations; and

(f) the underlying currency risks."

3. *Reportable segment* is defined as "a business segment or a geographical segment identified on the basis of foregoing definitions for which segment information is required to be disclosed by this Statement".

4. The Standard also defines enterprise revenue, segment revenue, segment expense, segment asset and segment liability.

5. The dominant source and nature of risks and returns of an enterprise should govern whether its primary segment reporting format will be business segments or geographical segments. If the risks and returns of an enterprise are affected predominantly by differences in the products and services it produces, its primary format for reporting segment information should be business

segments, with secondary information reported geographically. Similarly, if the risks and returns of the enterprise are affected predominantly by the fact that it operates in different countries or other geographical areas, its primary format for reporting segment information should be geographical segments, with secondary information reported for groups of related products and services.

6. Internal organisation and management structure of an enterprise and its system of internal financial reporting to the board of directors and the chief executive officer should normally be the basis for identifying the predominant source and nature of risks and differing rates of return facing the enterprise and, therefore, for determining which reporting format is primary and which is secondary, except as provided in sub-paragraphs (a) and (b) below:

(a) if risks and returns of an enterprise are strongly affected both by differences in the products and services it produces and by differences in the geographical areas in which it operates, as evidenced by a "matrix approach" to managing the company and to reporting internally to the board of directors and the chief executive officer, then the enterprise should use business segments as its primary segment reporting format and geographical segments as its secondary reporting format; and

(b) if internal organisational and management structure of an enterprise and its system of internal financial reporting to the board of directors and the chief executive officer are based neither on individual products or services or groups of related products/services nor on geographical areas, the directors and management of the enterprise should determine whether the risks and returns of the enterprise are related more to the products and services it produces or to the geographical areas in which it operates and should, accordingly, choose business segments or geographical segments as the primary segment reporting format of the enterprise, with the other as its secondary reporting format.

7. Business and geographical segments of an enterprise for external reporting purposes should be those organisational units for which information is reported to the board of directors and to the chief executive officer for the purpose of evaluating the unit's performance and for making decisions about future allocations of resources except as provided in the paragraph given below.

8. If internal organisational and management structure of an enterprise and its system of internal financial reporting to the board of directors and the chief executive officer are based neither on individual products or services or groups of related products/services nor on geographical areas, sub-paragraph 6(b) above requires that the directors and management of the enterprise should choose either business segments or geographical segments as the primary segment reporting format of the enterprise based on their assessment of which reflects the primary source of the risks and returns of the enterprise, with the other as its secondary reporting format. In that case, the directors and management of the enterprise should determine its business segments and geographical segments for external reporting purposes based on the factors in the definitions stated above, rather than on the basis of its system of internal financial reporting to the board of directors and chief executive officer, consistent with the following:

(a) if one or more of the segments reported internally to the directors and management is a business segment or a geographical segment based on the factors in the definitions of terms stated above but others are not, sub-paragraph (b) below should be applied only to those internal segments that do not meet the definitions (that is, an internally reported segment that meets the definition should not be further segmented);

(b) for those segments reported internally to the directors and management that do not satisfy the definitions stated above, management of the enterprise should look to the next lower level of internal segmentation that reports information along product and service lines or geographical lines, as appropriate under the definitions stated above; and

(c) if such an internally reported lower-level segment meets the definition of business segment or geographical segment based on the factors given in definitions give above, the criteria given in the following paragraph for identifying reportable segments should be applied to that segment.

9. A business segment or geographical segment should be identified as a reportable segment if:

(a) its revenue from sales to external customers and from transactions with other segments is 10 per cent or more of the total revenue, external and internal, of all segments; or

(b) its segment result, whether profit or loss, is 10 per cent or more of:

(i) the combined result of all segments in profit, or

(ii) the combined result of all segments in loss, whichever is greater in absolute amount; or

(c) its segment assets are 10 per cent or more of the total assets of all segments.

10. A business segment or a geographical segment which is not a reportable segment as per the above paragraph may be designated as a reportable segment despite its size at the discretion of the management of the enterprise. If that segment is not designated as a reportable segment, it should be included as an unallocated reconciling item.

11. If total external revenue attributable to reportable segments constitutes less than 75 per cent of the total enterprise revenue, additional segments should be identified as reportable segments, even if they do not meet the 10 per cent thresholds stated above until at least 75 per cent of total enterprise revenue is included in reportable segments.

12. A segment identified as a reportable segment in the immediately preceding period because it satisfied the relevant 10 per cent thresholds should continue to be a reportable segment for the current period notwithstanding that its revenue, result, and assets all no longer meet the 10 per cent thresholds.

13. If a segment is identified as a reportable segment in the current period because it satisfies the relevant 10 per cent thresholds, preceding-period segment data that is presented for comparative purposes should, unless it is impracticable to do so, be restated to reflect the newly reportable segment as a separate segment, even if that segment did not satisfy the 10 per cent thresholds in the preceding period.

14. Segment information should be prepared in conformity with the accounting policies adopted for preparing and presenting the financial statements of the enterprise as a whole.

15. Assets and liabilities that relate jointly to two or more segments should be allocated to segments if, and only if, their related revenues and expenses also are allocated to those segments.

16. The disclosure requirements in paragraph 17-18 should be applied to each reportable segment based on primary reporting format of an enterprise.

17. An enterprise should disclose the following for each reportable segment:

(a) segment revenue, classified into segment revenue from sales to external customers and segment revenue from transactions with other segments;

(b) segment result;

(c) total carrying amount of segment assets;

(d) total amount of segment liabilities;

(e) total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets);

(f) total amount of expense included in the segment result for depreciation and amortisation in respect of segment assets for the period; and

(g) total amount of significant non−cash expenses, other than depreciation and amortisation in respect of segment assets, that were included in segment expense and, therefore, deducted in measuring segment result.

18. An enterprise should present a reconciliation between the information disclosed for reportable segments and the aggregated information in the enterprise financial statements. In presenting the reconciliation, segment revenue should be reconciled to enterprise revenue; segment result should be reconciled to enterprise net profit or loss; segment assets should be reconciled to enterprise assets; and segment liabilities should be reconciled to enterprise liabilities.

19. If primary format of an enterprise for reporting segment information is business segments, it should also report the following information for secondary segment:

(a) segment revenue from external customers by geographical area based on the geographical location of its customers, for each geographical segment whose revenue from sales to external customers is 10 per cent or more of enterprise revenue;

(b) the total carrying amount of segment assets by geographical location of assets, for each geographical segment whose segment assets are 10 per cent or more of the total assets of all geographical segments; and

(c) the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets) by geographical location of assets, for each geographical segment whose segment assets are 10 per cent or more of the total assets of all geographical segments.

20. If primary format of an enterprise for reporting segment information is geographical

segments (whether based on location of assets or location of customers), it should also report the following segment information for each business segment whose revenue from sales to external customers is 10 per cent or more of enterprise revenue or whose segment assets are 10 per cent or more of the total assets of all business segments:

(a) segment revenue from external customers;

(b) the total carrying amount of segment assets; and

(c) the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets).

21. If primary format of an enterprise for reporting segment information is geographical segments that are based on location of assets, and if the location of its customers is different from the location of its assets, then the enterprise should also report revenue from sales to external customers for each customer−based geographical segment whose revenue from sales to external customers is 10 per cent or more of enterprise revenue.

22. If primary format of an enterprise for reporting segment information is geographical segments that are based on location of customers, and if the assets of the enterprise are located in different geographical areas from its customers, then the enterprise should also report the following segment information for each asset−based geographical segment whose revenue from sales to external customers or segment assets are 10 per cent or more of total enterprise amounts:

(a) the total carrying amount of segment assets by geographical location of the assets; and

(b) the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets) by location of the assets.

23. In measuring and reporting segment revenue from transactions with other segments, inter−segment transfers should be measured on the basis that the enterprise actually used to price those transfers. The basis of pricing inter−segment transfers and any change therein should be disclosed in the financial statements.

24. Changes in accounting policies adopted for segment reporting that have a material effect on segment information should be disclosed. Such disclosure should include a description of the nature of the change, and the financial effect of the change if it is reasonably determinable.

25. An enterprise should indicate the types of products and services included in each reported business segment and indicate the composition of each reported geographical segment, both primary and secondary, if not otherwise disclosed in the financial statements.

Principal Requirements under ESAAR, 1985

According to ESAAR, 1985, Statement showing Function-wise Analysis of Revenue and Expenses is required to be presented.

Applicability of AS 17 to Power Sector Entities

Shortcomings of ESAAR

Function-wise analysis of revenue and expenses of the SEB, as required under ESAAR, is not sufficient for evaluating the performance of the various segments of the SEB, which are subject to risks and returns that are different from other segments.

Conclusion

Power sector entities should present segment information about their various segments in accordance with the requirements of the Standard. The activities of generation, transmission and distribution may constitute separate business segments in case of integrated power sector entities, subject to the requirements of AS 17.

AS 18, Related Party Disclosures

AS 18 applies to reporting of related party relationships and transactions between a reporting enterprise and its related parties.

Salient Features and Principal Requirements

1. This Standard deals with only following types of related party relationships:

   (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.

2. The following are deemed not to be related parties:

   (a) two companies simply because they have a director in common, unless the director is able to affect the policies of both companies in their mutual dealings;

   (b) a single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence; and

(c) the parties listed below, in the course of their normal dealings with an enterprise by virtue only of those dealings (although they may circumscribe the freedom of action of the enterprise or participate in its decision-making process):

(i) providers of finance;

(ii) trade unions;

(iii) public utilities;

(iv) government departments and government agencies including government sponsored bodies.

3. *Related party* has been defined as “Parties are considered to be related, if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions”.

4. *Related party transaction* is defined as “a transfer of resources or obligations between related parties, regardless of whether or not a price is charged”.

5. *Control* has been defined as

“(a) ownership, directly or indirectly, 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, or

(c) a substantial interest in voting power and the power to direct, by statute or agreement, the financial and/or operating policies of the enterprise”.

6. *Significant influence* has been defind as “participation in the financial and/or operating policy decisions of an enterprise, but not control of those policies.

7. In case a statute or a regulator or a similar competent authority governing an enterprise prohibits the enterprise to disclose certain information which otherwise is required to be disclosed, disclosure of such information is not warranted.

8. Disclosure of transactions between members of a group is unnecessary in consolidated financial statements because consolidated financial statements present information about the holding and its subsidiaries as a single reporting enterprise.

9. No disclosure is required in the financial statements of state-controlled enterprises as regards related party relationships with other state-controlled enterprises and transactions with such enterprises.

10. Name of the related party and nature of the related party relationship where control exists should be disclosed irrespective of whether or not there have been transactions between the related parties.

11. If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following:

(i) the name of the transacting related party;

(ii) a description of the relationship between the parties;

(iii) a description of the nature of transactions;

(iv) volume of the transactions either as an amount or as an appropriate proportion;

(v) any other elements of the related party transactions necessary for an understanding of the financial statements;

(vi) the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date; and

(vii) amounts written off or written back in the period in respect of debts due from or to related parties.

Principal Requirements under ESAAR, 1985

ESAAR does not contain any specific requirements with regard to reporting of the related party relationships and transactions between SEB and its related parties.

Applicability of AS 18 to Power Sector Entities

Without related party disclosures, there is a general presumption that transactions reflected in financial statements are consummated on an arm's-length basis between independent parties. However, that presumption may not be valid when related party relationships exist because related parties may enter into transactions which unrelated parties would not enter into. Thus, a related party relationship could have an effect on the financial position and operating results of the reporting enterprise. The power sector entities should, therefore, disclose the related party relationships and transactions in accordance with the requirements of AS 18. With regard to the state-controlled entities, it may be noted that the Standard does not require any disclosure in their financial statements as regards related party relationships with other state-controlled enterprises and transactions with such enterprises.

AS 19, Leases

AS 19 applies to accounting for of all leases except the following:

(a) lease agreements to explore for or use natural resources, such as oil, gas, timber, metals and other mineral rights; and

(b) licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights; and

(c) lease agreements to use lands.

Salient Features and Principal Requirements

1. *Lease* is defined as "an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time".

2. The definition of a lease includes agreements for the hire of an asset which contain a provision giving the hirer an option to acquire title to the asset upon the fulfillment of agreed conditions. These agreements are commonly known as hire purchase agreements. Hire purchase agreements include agreements under which the property in the asset is to pass to the hirer on the payment of the last instalment and the hirer has a right to terminate the agreement at any time before the property so passes.

3. The Standard classifies the lease into following two categories:

(a) finance lease; and

(b) operating lease

4. *A finance lease* is a lease that transfers substantially all the risks and rewards incident to ownership of an asset to the lessee. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than its form. Examples of situations which would normally lead to a lease being classified as a finance lease are:

(a) the lease transfers ownership of the asset to the lessee by the end of the lease term;

(b) the lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised;

(c) the lease term is for the major part of the economic life of the asset even if title is not transferred;

(d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and

(e) the leased asset is of a specialised nature such that only the lessee can use it without major modifications being made.

5. *An operating lease* is defined as "a lease other than a finance lease".

Financial Statements of Lessee

Finance leases

6. At the inception of a finance lease, the lessee should recognise the lease as an asset and a

liability. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of the lease. However, if the fair value of the leased asset exceeds the present value of the minimum lease payments from the standpoint of the lessee, the amount recorded as an asset and a liability should be the present value of the minimum lease payments from the standpoint of the lessee. In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease, if this is practicable to determine; if not, the lessee's incremental borrowing rate should be used.

7. Lease payments should be apportioned between the finance charge and the reduction of the outstanding liability. The finance charge should be allocated to periods during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

8. In the books of lessee, finance lease gives rise to a depreciation expense for the asset as well as a finance expense for each accounting period. The depreciation policy for a leased asset should be consistent with that for depreciable assets which are owned, and the depreciation recognised should be calculated on the basis set out in Accounting Standard (AS) 6, Depreciation Accounting. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset should be fully depreciated over the lease term or its useful life, whichever is shorter.

9. The lessee should, in addition to the requirements of AS 10, Accounting for Fixed Assets, AS 6, Depreciation Accounting, and the governing statute, should disclose, *inter alia*, assets acquired under finance lease as segregated from the assets owned, and for each class of assets, the net carrying amount at the balance sheet date.

Operating leases

10. Lease payments under an operating lease should be recognised as an expense in the statement of profit and loss of lessee on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

Financial Statements of Lessors

Finance leases

11. The lessor should recognise assets given under a finance lease in its balance sheet as a receivable at an amount equal to the net investment in the lease.

12. The recognition of finance income should be based on a pattern reflecting a constant periodic rate of return on the net investment of the lessor outstanding in respect of the finance lease.

Operating leases

13. The lessor should present an asset given under operating lease in its balance sheet under fixed assets.

14. Lease income from operating leases should be recognised in the statement of profit and loss on a straight line basis over the lease term, unless another systematic basis is more representative of the time pattern in which benefit derived from the use of the leased asset is diminished.

15. The lessor should, in addition to the requirements of AS 6, Depreciation Accounting and AS

10, Accounting for Fixed Assets, and the governing statute, should disclose, *inter alia*, for each class of assets, the gross carrying amount, the accumulated depreciation and the depreciation recognised in the statement of profit and loss for the period.

Sale and Leaseback Transactions

16. If a sale and leaseback transaction results in a finance lease, any excess or deficiency of sales proceeds over the carrying amount should not be immediately recognised as income or loss in the financial statements of a seller-lessee. Instead, it should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

17. If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately. If the sale price is below fair value, any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

Principal Requirements under ESAAR, 1985

1. Lease premium payable on acquiring lease rights for assets is treated as the cost of leasehold assets and depreciation is charged thereon over the useful life of the asset or lease period, whichever is shorter. Periodic rentals payable on leasehold assets are charged to the Revenue Account in the year in which the rentals accrue.

2. If the SEB acquires, leasehold rights for an asset with no or negligible lease premium, the fair market value of the asset is determined and debited to the asset account and credited to an account ‘Liability for Leasehold Assets’. The fair market value of the leasehold assets is depreciated over the lease period. Simultaneously, extinguishments of a proportionate amount of liability set up in the books is also affected. By the end of the lease period the liability in accounts would have been fully extinguished and a provision for depreciation equal to the amount of fair market value booked as cost would have been created. On returning the assets to lessor, the provision is set off against the amount of cost of the asset so as to close the two accounts.

Applicability of AS 19 to Power Sector Entities

Shortcomings of ESAAR

1. No distinction has been made in a finance lease and an operating lease in prescribing the accounting treatment.

2. Acquisition of an asset with no or negligible premium is of the nature of non-monetary grant. In the context of historical cost accounting, it is not appropriate to value the asset at fair value. It should be valued at nominal value of Re. 1, as prescribed in AS 12.

Conclusion

The requirements of the Standard should be followed by all the power sector entities, including SEBs, in their entirety.

AS 20, Earnings Per Share

Salient Features and Principal Requirements

1. An enterprise should present basic and diluted earnings per share on the face of the statement of profit and loss for each class of equity shares that has a different right to share in the net profit for the period with equal prominence for all periods presented. Basic and diluted earnings per share are required to be disclosed, even if the amounts disclosed are negative (a loss per share).

2. Basic earnings per share should be calculated by dividing the net profit or loss for the period attributable to equity shareholders by the weighted average number of equity shares outstanding during the period.

3. For the purpose of calculating basic earnings per share, the net profit or loss for the period attributable to equity shareholders should be the net profit or loss for the period after deducting preference dividends and any attributable tax thereto for the period.

4. For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period. The weighted average number of equity shares outstanding during the period and for all periods presented should be adjusted for events, other than the conversion of potential equity shares, that have changed the number of equity shares outstanding, without a corresponding change in resources, e.g., a bonus issue.

5. For the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares. The amount of net profit or loss for the period attributable to equity shareholders, as calculated in accordance with paragraph 3 above, should be adjusted by the following, after taking into account any attributable change in tax expense for the period:

(a) any dividends on dilutive potential equity shares which have been deducted in arriving at the net profit attributable to equity shareholders;

(b) interest recognised in the period for the dilutive potential equity shares; and

(c) any other changes in expenses or income that would result from the conversion of the dilutive potential equity shares.

6. For the purpose of calculating diluted earnings per share, the number of equity shares should be the aggregate of the weighted average number of equity shares calculated for computation of basic earnings per share and the weighted average number of equity shares which would be issued on the conversion of all the dilutive potential equity shares into equity shares. Dilutive potential equity shares should be deemed to have been converted into equity shares at the beginning of the period or, if issued later, the date of the issue of the potential equity shares.

7. For the purpose of calculating diluted earnings per share, an enterprise should assume the exercise of dilutive options and other dilutive potential equity shares of the enterprise. The assumed proceeds from these issues should be considered to have been received from the issue of shares at fair value. The difference between the number of shares issuable and the number of shares that would have been issued at fair value should be treated as an issue of equity shares for no consideration.

8. Potential equity shares should be treated as dilutive when, and only when, their conversion to

equity shares would decrease net profit per share from continuing ordinary operations.

9. If the number of equity or potential equity shares outstanding increases as a result of a bonus issue or share split or decreases as a result of a reverse share split (consolidation of shares), the calculation of basic and diluted earnings per share should be adjusted for all the periods presented. If these changes occur after the balance sheet date but before the date on which the financial statements are approved by the board of directors, the per share calculations for those financial statements and any prior period financial statements presented should be based on the new number of shares. When per share calculations reflect such changes in the number of shares, that fact should be disclosed.

10. In addition to the disclosure required in earlier paragraphs, an enterprise should also disclose the following:

(a) the amounts used as the numerators in calculating basic and diluted earnings per share, and a reconciliation of those amounts to the net profit or loss for the period;

(b) the weighted average number of equity shares used as the denominator in calculating basic and diluted earnings per share, and a reconciliation of these denominators to each other; and

(c) the nominal value of shares along with the earnings per share figures.

Principal Requirements under ESAAR, 1985

SEBs do not have any share capital. ESAAR does not contain any requirement with regard to disclosure of Earnings Per Share.

Applicability of AS 20 to Power Sector Entities

Earnings Per Share is considered as an important indicator of the enterprise's performance and disclosure of the same helps in evaluating the enterprise's performance in a better way. Accordingly, the power sector entities, registered under the Companies Act, 1956, and other entities having share capital, should be required to disclose Earnings Per Share in accordance with the Standard.

In power sector, in case of certain entities, it is possible that the entire capital consists of an unclassified grant. This is expected to be only a temporary phenomenon, and by restructuring and by conversion of SEBs into corporate entities, this situation is undergoing a change. In the intervening period, it should be presumed that shares of the face value of Re. 1 have been issued and earnings per share should be calculated accordingly and disclosed as per AS 20.

AS 21, Consolidated Financial Statements

The Standard applies to the preparation and presentation of consolidated financial statements for a group of enterprises under the control of a parent and to the accounting for investments in subsidiaries in the separate financial statements of a parent.

Salient Features and Principal Requirements

1. *Subsidiary* is defined as "an enterprise that is controlled by another enterprise (known as the parent)".

2. *Parent* is defined as "an enterprise that has one or more subsidiaries".

3. *Control* is defined as:

"(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."

4. A parent which presents consolidated financial statements should present these statements in addition to its separate financial statements and must consolidate all subsidiaries, domestic as well as foreign, except those mentioned in paragraph 5.

5. 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 AS 13, Accounting for Investments. The reasons for not consolidating a subsidiary should be disclosed in the consolidated financial statements.

6. In preparing consolidated financial statements, the financial statements of the parent and its subsidiaries should be combined on a line by line basis by adding together like items of assets, liabilities, income and expenses. In order that the consolidated financial statements present financial information about the group as that of a single enterprise, the following steps should be taken:

(a) the cost to the parent of its investment in each subsidiary and the parent's portion of equity of each subsidiary, at the date on which investment in each subsidiary is made, should be eliminated;

(b) any excess of the cost to the parent of its investment in a subsidiary over the parent's portion of equity of the subsidiary, at the date on which investment in the subsidiary is made, should be described as goodwill to be recognised as an asset in the consolidated financial statements;

(c) when the cost to the parent of its investment in a subsidiary is less than the parent's portion of equity of the subsidiary, at the date on which investment in the subsidiary is made, the difference should be treated as a capital reserve in the consolidated financial statements;

(d) minority interests in the net income of consolidated subsidiaries for the reporting period should be identified and adjusted against the income of the group in order to arrive at the net income attributable to the owners of the parent; and

(e) minority interests in the net assets of consolidated subsidiaries should be identified and presented in the consolidated balance sheet separately from liabilities and the equity of the parent's shareholders. Minority interests in the net assets consist of:

(i) the amount of equity attributable to minorities at the date on which investment in a subsidiary is made; and

(ii) the minorities' share of movements in equity since the date the parent-subsidiary relationship came in existence.

Where the carrying amount of the investment in the subsidiary is different from its cost, the carrying amount is considered for the purpose of above computations.

7. Intragroup balances and intragroup transactions and resulting unrealised profits are eliminated in full. Unrealised losses resulting from intragroup transactions are also eliminated unless cost cannot be recovered.

8. The financial statements used in the consolidation should be drawn up to the same reporting date. If it is not practicable to draw up the financial statements of one or more subsidiaries to such date and, accordingly, those financial statements are drawn up to different reporting dates, adjustments should be made for the effects of significant transactions or other events that occur between those dates and the date of the parent's financial statements. In any case, the difference between reporting dates should not be more than six months.

9. Consolidated financial statements should be prepared using uniform accounting policies for like transactions and other events in similar circumstances. If it is not practicable to use uniform accounting policies in preparing the consolidated financial statements, that fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.

10. An investment in an enterprise should be accounted for in accordance with Accounting Standard (AS) 13, Accounting for Investments, from the date that the enterprise ceases to be a subsidiary and does not become an associate.

11. Minority interests should be presented in the consolidated balance sheet separately from liabilities and the equity of the parent's shareholders. Minority interests in the income of the group should also be separately presented.

12. In a parent's separate financial statements, investments in subsidiaries should be accounted for in accordance with Accounting Standard (AS) 13, Accounting for Investments.

13. The following additional disclosures should be made in the consolidated financial statements:

(a) a list of all subsidiaries including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held;

(b) where applicable:

(i) the nature of the relationship between the parent and a subsidiary, if the parent does not own, directly or indirectly through subsidiaries, more than one-half of the voting power of the subsidiary;

(ii) the effect of the acquisition and disposal of subsidiaries on the financial position at the reporting date, the results for the reporting period and on the corresponding amounts for the preceding period; and

(iii) the names of the subsidiary(ies) of which reporting date(s) is/are different from that of the parent and the difference in reporting dates.

Principal Requirements under ESAAR, 1985

1. Annual accounts of an SEB are required to reflect the transactions of the SEB and of any other body in which the SEB has ownership rights as a sole owner, partner or a member of association of persons and in the management of which the SEB can exercise and actually exercises significant influence.

2. Where the transactions of any other body are required to be reflected as per para 1 in more than one SEB's accounts, each SEB reflects the assets, liabilities, income and expenses of that body in proportion of its ownership share in that body.

3. Interest acquired by an SEB in any body whose transactions do not require incorporation into the SEB's accounts is required to be disclosed at cost, as investment. In such cases, the excess or shortfall of SEB's share of the net assets of the body over the cost of acquiring the interest in that body is required to be disclosed in the SEB's accounts by way of a note.

Applicability of AS 21 to Power Sector Entities

Shortcomings of ESAAR

1. It appears that as per the above requirements of ESAAR full consolidation is required where the SEB can and actually exercises significant influence over another body. The term 'significant influence' has not been defined in ESAAR. As per AS 21, full consolidation is required only where 'control', as distinguished from 'significant influence', can be exercised.

2. ESAAR does not lay down procedures for incorporation of transactions of other bodies in which the SEB exercises significant influence.

3. ESAAR requires that in case transactions of any other body are required to be reflected in more than one SEB's accounts, the assets, liabilities, incomes and expenses of that body are to be reflected in the SEB's accounts in proportion of its ownership share in that body. This would mean that irrespective of the ownership interest, proportionate consolidation has to be done. This is not as per GAAPs, according to which the degree of consolidation depends on ownership interest, viz., more than 50% ownership interest representing unilateral control requires full consolidation under AS 21, between 20% to 50% ownership interest representing significant influence requires adoption of equity method under AS 23 and equal ownership interest representing joint control requires proportionate consolidation under AS 27.

4. It appears that ESAAR requires SEBs to prepare only one set of financial statements

incorporating its interests in the other bodies. GAAPs on the other hand require such statements to be prepared in addition to separate financial statements.

Conclusion

Power sector entities should be required to prepare Consolidated Financial Statements in addition to the separate financial statements as per the Standard. Further, special consideration should be given to the requirements of AS 23 and AS 27 while preparing the Consolidated Financial Statements.

AS 22, Accounting for Taxes on Income

AS 22 applies to accounting for taxes on income including to the determination of the amount of the expense or saving related to taxes on income and the disclosure of such an amount in the financial statements.

Salient Features and Principal Requirements

1. *Current tax* is defined as "the amount of income tax determined to be payable (recoverable) in respect of the taxable income (tax loss) for a period".

2. *Deferred tax* is defined as "the tax effect of timing differences".

3. *Timing differences* are defined as "the 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. Unabsorbed depreciation and carry forward of losses which can be set-off against future taxable income are also considered as timing differences.

4. Permanent differences are defined as "the differences between taxable income and accounting income for a period that originate in one period and do not reverse subsequently".

5. 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. In other words, tax effects of timing differences are also included in the tax expense in the statement of profit and loss and as deferred tax assets (subject to the consideration of prudence) or as deferred tax liabilities, in the balance sheet.

6. Deferred tax is required to be recognised for all the timing differences, subject to the consideration of prudence in respect of deferred tax assets as set out in paragraphs 7 and 8 below.

7. Except in the situations stated in paragraph 8, deferred tax assets should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised.

8. 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.

9. At each balance sheet date, an enterprise re-assesses unrecognised deferred tax assets. The

enterprise recognises previously unrecognised 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.

10. 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.

11. Deferred tax assets and liabilities should be measured using the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet.

12. Deferred tax assets and liabilities should not be discounted to their present value.

13. 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.

14. 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.

15. 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.

16. 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.

17. 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 also be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.

Principal Requirements under ESAAR, 1985

An SEB is required to create a provision for the tax payable on its income or profits determined in accordance with the provisions of the relevant tax laws. Such a provision is treated as a charge against the revenue before arriving at net profit for the year. Any excess/short-fall in the provision for the current/prior period is required to be credited/charged to the Revenue Account for the year in which such excess or shortfall is established.

Applicability of AS 22 to Power Sector Entities

Shortcomings of ESAAR

ESAAR requirements, with regard to accounting for taxes on income, are based on the 'taxes payable method'. It is now universally accepted that the 'taxes payable method' does not result in proper matching of the tax expense with the related income. Since the 'tax effect accounting method' results in proper matching of the tax expense with the related income, this method is appropriate for accounting for taxes on income.

Conclusion

All the power sector entities should follow AS 22 for accounting for taxes on income, the requirements of which are based on the 'tax effect accounting method'.

Specific issue that arises in application of AS 22 to power sector entities is discussed below:

Certain power sector entities recover their income-tax liability from their customers separately from the charges for power sold to them. In this context, a question is often raised as to whether AS 22 is applicable to such entities. As per an opinion[11], issued by the Expert Advisory Committee of the Institute of Chartered Accountants of India, the recovery of the Income-tax by power sector entities from their customers is a form of consideration received for the supply of power. The Income-tax, being a direct tax, is a charge on the entity's income and has to be borne by entity itself. Accordingly, Income-tax is the liability of the entity. Therefore, the requirements of AS 22, relating to charge of current tax and deferred tax are applicable to such power sector entities.

AS 23, Accounting for Investments in Associates in Consolidated Financial Statements

AS 23 deals with accounting for investments in associates in the consolidated financial statements of an investor. If an enterprise presents consolidated financial statements, it should account for investments in associates in the consolidated financial statements in accordance with AS 23.

Salient Features and Principal Requirements

1. *An associate* is defined as "an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor".

2. *Significant influence* is defined as "the power to participate in the financial and/or operating policy decisions of the investee but not control over those policies". Significant influence does not extend to power to govern the financial and/or operating policies of an enterprise. Significant influence may be gained by share ownership, statute or agreement. As regards share ownership, if an investor holds, directly or indirectly through subsidiary(ies), 20% or more of the voting power of the investee, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly through subsidiary(ies), less than 20% of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.

3. The existence of significant influence by an investor is usually evidenced in one or more of the following ways:

(a) Representation on the board of directors or corresponding governing body of the investee;

(b) participation in policy making processes;

(c) material transactions between the investor and the investee;

(d) interchange of managerial personnel; or

(e) provision of essential technical information.

4. *The equity method* is defined as "a method of accounting whereby the investment is initially recorded at cost, identifying any goodwill/capital reserve arising at the time of acquisition. The carrying amount of the investment is adjusted thereafter for the post acquisition change in the investor's share of net assets of the investee. The consolidated statement of profit and loss reflects the investor's share of the results of operations of the investee."

5. An investment in an associate should be accounted for in consolidated financial statements under the equity method except when:

(a) the investment is acquired and held exclusively with a view to its subsequent disposal in the near future; or

(b) the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.

Investments in such associates should be accounted for in accordance with AS 13, Accounting for Investments. The reasons for not applying the equity method in accounting for investments in an associate should be disclosed in the consolidated financial statements.

6. An investor should discontinue the use of the equity method from the date that:

(a) it ceases to have significant influence in an associate but retains, either in whole or in part, its investment; or

(b) the use of the equity method is no longer appropriate because the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.

From the date of discontinuing the use of the equity method, investments in such associates should be accounted for in accordance with AS 13, Accounting for Investments. For this purpose, the carrying amount of the investment at that date should be regarded as cost thereafter.

7. Many of the procedures appropriate for the application of the equity method are similar to the consolidation procedures set out in AS 21, Consolidated Financial Statements. Furthermore, the broad concepts underlying the consolidation procedures used in the acquisition of a subsidiary are adopted on the acquisition of an investment in an associate.

8. Goodwill/capital reserve arising on the acquisition of an associate by an investor should be

included in the carrying amount of investment in the associate but should be disclosed separately.

9. In using equity method for accounting for investment in an associate, unrealised profits and losses resulting from transactions between the investor (or its consolidated subsidiaries) and the associate should be eliminated to the extent of the investor's interest in the associate. Unrealised losses should not be eliminated if and to the extent the cost of the transferred asset cannot be recovered.

10. The most recent available financial statements of the associate are used by the investor in applying the equity method; they are usually drawn up to the same date as the financial statements of the investor. When the reporting dates of the investor and the associate are different, the associate often prepares, for the use of the investor, statements as at the same date as the financial statements of the investor. When it is impracticable to do this, financial statements drawn up to a different reporting date may be used. The consistency principle requires that the length of the reporting periods, and any difference in the reporting dates, are consistent from period to period.

11. When financial statements with a different reporting date are used, adjustments are made for the effects of any significant events or transactions between the investor (or its consolidated subsidiaries) and the associate that occur between the date of the associate's financial statements and the date of the investor's consolidated financial statements.

12. The investor usually prepares consolidated financial statements using uniform accounting policies for the like transactions and events in similar circumstances. In case an associate uses accounting policies other than those adopted for the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to the associate's financial statements when they are used by the investor in applying the equity method. If it is not practicable to do so, that fact is disclosed along with a brief description of the differences between the accounting policies.

13. If an associate has outstanding cumulative preference shares held outside the group, the investor computes its share of profits or losses after adjusting for the preference dividends whether or not the dividends have been declared.

14. If, under the equity method, an investor's share of losses of an associate equals or exceeds the carrying amount of the investment, the investor ordinarily discontinues recognising its share of further losses and the investment is reported at nil value. Additional losses are provided for to the extent that the investor has incurred obligations or made payments on behalf of the associate to satisfy obligations of the associate that the investor has guaranteed or to which the investor is otherwise committed. If the associate subsequently reports profits, the investor resumes including its share of those profits only after its share of the profits equals the share of net losses that have not been recognised.

15. Where an associate presents consolidated financial statements, the results and net assets to be taken into account are those reported in that associate's consolidated financial statements.

16. The carrying amount of investment in an associate should be reduced to recognise a decline, other than temporary, in the value of the investment, such reduction being determined and made for each investment individually.

17. An appropriate listing and description of associates including the proportion of ownership interest and, if different, the proportion of voting power held should be disclosed in the consolidated financial statements.

18. Investments in associates accounted for using the equity method should be classified as

long-term investments and disclosed separately in the consolidated balance sheet. The investor's share of the profits or losses of such investments should be disclosed separately in the consolidated statement of profit and loss. The investor's share of any extraordinary or prior period items should also be separately disclosed.

19. The name(s) of the associate(s) of which reporting date(s) is/are different from that of the financial statements of an investor and the differences in reporting dates should be disclosed in the consolidated financial statements.

20. In case an associate uses accounting policies other than those adopted for the consolidated financial statements for like transactions and events in similar circumstances and it is not practicable to make appropriate adjustments to the associate's financial statements, the fact should be disclosed along with a brief description of the differences in the accounting policies.

Principal Requirements under ESAAR, 1985

1. Annual accounts of an SEB are required to reflect the transactions of the SEB and of any other body in which the SEB has ownership rights as a sole owner, partner or a member of association of persons and in the management of which the SEB can exercise and actually exercises significant influence.

2. Where the transactions of any other body are required to be reflected as per para 1 in more than one SEB's accounts, each SEB reflects the assets, liabilities, income and expenses of that body in proportion of its ownership share in that body.

3. Interest acquired by a SEB in any body whose transactions do not require incorporation into the SEB's accounts is required to be disclosed, at cost as investment. In such cases, the excess or shortfall of SEB's share of the net assets of the body over the cost of acquiring the interest in that body is required to be disclosed in the SEB's accounts by way of a note.

Applicability of AS 23 to Power Sector Entities

Shortcomings of ESAAR

1. It appears that as per the above requirements full consolidation is required where the SEB can and actually exercises significant influence over another body. The term 'significant influence' has not been defined in ESAAR. As per AS 21, full consolidation is required only where 'control', as distinguished from 'significant influence' can be exercised. In case 'significant influence' has the same meaning as specified in AS 23, equity method is required to be followed for the purpose of preparation of consolidated financial statements.

2. ESAAR does not lay down procedures for incorporation of transactions of other bodies in which the SEB exercises significant influence.

3. ESAAR requires that in case transactions of any other body are required to be reflected in more than one SEB's accounts, the assets, liabilities, incomes and expenses of that body are to be reflected in the SEB's accounts in proportion of its ownership share in that body. This would mean that irrespective of the ownership interest, proportionate consolidation has to be done. This is not as per GAAPs, according to which the degree of consolidation depends on ownership interest, viz., more than 50% ownership interest representing unilateral control requires full consolidation under AS 21, between 20% to 50% ownership interest representing significant influence requires adoption of equity method under AS 23 and equal ownership interest representing joint control requires proportionate consolidation under AS 27.

Conclusion

All the power sector entities should account for investments in associates in the Consolidated Financial Statements (prepared as per AS 21) according to the equity method as per the requirements of this Standard.

AS 24, Discontinuing Operations

The Standard establishes 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-generating capacity, and financial position by segregating information about discontinuing operations from information about continuing operations.

Salient Features and Principal Recommendations

1. *A discontinuing operation* is defined as “a component of an enterprise:

   (a) that the enterprise, pursuant to a single plan, is:

      (i) disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders; or

      (ii) disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually; or

      (iii) terminating through abandonment; and

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

   (c) that can be distinguished operationally and for financial reporting purposes.”

2. 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 per definition of the term, they can occur in connection with a discontinuing operation.

3. A reportable business segment or geographical segment as defined in 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.

4. 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.

5. 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.

6. With respect to a discontinuing operation, the initial disclosure event is the occurrence of one of the following, whichever occurs earlier:

(a) the enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or

(b) the enterprise's board of directors or similar governing body has both (i) approved a detailed, formal plan for the discontinuance and (ii) made an announcement of the plan.

7. An enterprise should apply the principles of recognition and measurement that are set out in other Accounting Standards for the purpose of deciding as to when and how to recognise and measure the changes in assets and liabilities and the revenue, expenses, gains, losses and cash flows relating to a discontinuing operation.

8. An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

(a) a description of the discontinuing operation(s);

(b) the business or geographical segment(s) in which it is reported as per AS 17, Segment Reporting;

(c) the date and nature of the initial disclosure event;

(d) the date or period in which the discontinuance is expected to be completed if known or determinable;

(e) the carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;

(f) the amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;

(g) the amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto; and

(h) the amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

9. When an enterprise disposes of assets or settles liabilities attributable to a discontinuing operation or enters into binding agreements for the sale of such assets or the settlement of such liabilities, it should include, in its financial statements, the following information when the events occur:

(a) for any gain or loss that is recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation, (i) the amount of the pre−tax gain or loss and (ii) income tax expense relating to the gain or loss; and

(b) the net selling price or range of prices (which is after deducting expected disposal costs) of those net assets for which the enterprise has entered into one or more binding sale agreements, the expected timing of receipt of those cash flows and the carrying amount of those net assets on the balance sheet date.

10. In addition to the disclosures in above paragraphs, an enterprise should include, in its financial statements, for periods subsequent to the one in which the initial disclosure event occurs, a description of any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled and the events causing those changes.

11. The disclosures required by paragraphs 8, 9 and 10 should continue in financial statements for periods up to and including the period in which the discontinuance is completed. A discontinuance is completed when the plan is substantially completed or abandoned, though full payments from the buyer(s) may not yet have been received.

12. If an enterprise abandons or withdraws from a plan that was previously reported as a discontinuing operation, that fact, reasons therefor and its effect should be disclosed.

13. Any disclosures required by this Standard should be presented separately for each discontinuing operation.

14. The disclosures required by paragraphs 8, 9, 10, 11, 12 and 13 should be presented in the notes to the financial statements except the following which should be shown on the face of the statement of profit and loss:

(a) the amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto; and

(b) the amount of the pre-tax gain or loss recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation.

15. 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.

16. Disclosures in an interim financial report in respect of a discontinuing operation should be made in accordance with AS 25, Interim Financial Reporting, including:

(a) any significant activities or events since the end of the most recent annual reporting period relating to a discontinuing operation; and

(b) any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled.

Principal Requirements under ESAAR, 1985

ESAAR does not contain any specific requirement on the subject.

Applicability of AS 24 to Power Sector Entities

Since the information about discontinuing operations would enhance the utility of the information presented in the financial statements, all power sector entities should be required to present information about discontinuing operations in accordance with the requirements of this Standard.

AS 25, Interim Financial Reporting

This Standard prescribes the minimum content of an interim financial report and prescribes the principles for recognition and measurement in a complete or condensed financial statements for an interim period. Timely and reliable interim financial reporting improves the ability of investors, creditors, and others to understand an enterprise's capacity to generate earnings and cash flows, its financial condition and liquidity.

Salient Features and Principal Requirements

1. *Interim period* is defined as a "financial reporting period shorter than a full financial year."

2. *Interim financial report* means a "financial report containing either a complete set of financial statements or a set of condensed financial statements (as described in this Statement) for an interim period."

3. An interim financial report should include, at a minimum, the following components:

   (a) condensed balance sheet;

   (b) condensed statement of profit and loss;

   (c) condensed cash flow statement; and

   (d) selected explanatory notes.

4. An enterprise may also present a complete set of financial statements in its interim financial report, rather than a set of condensed financial statements or may also include, in condensed interim financial statements, more than the minimum line items or selected explanatory notes. The recognition and measurement principles set out in this Standard apply also to complete financial statements for an interim period.

5. If an enterprise prepares and presents a complete set of financial statements in its interim financial report, the form and content of those statements should conform to the requirements as applicable to annual complete set of financial statements.

6. If an enterprise prepares and presents a set of condensed financial statements in its interim financial report, those condensed statements should include, at a minimum, each of the headings and sub-headings that were included in its most recent annual financial statements and the selected explanatory notes. Additional line items or notes should also be included if their omission would make the condensed interim financial statements misleading.

7. If an enterprise presents basic and diluted earnings per share in its annual financial statements in accordance with AS 20, Earnings Per Share, basic and diluted earnings per share should be presented in accordance with AS 20 on the face of the statement of profit and loss, complete or condensed, for an interim period.

8. If an enterprise's annual financial report included the consolidated financial statements, the interim financial report includes both the consolidated financial statements and separate financial statements, complete or condensed.

9. An enterprise should include the following information, as a minimum, in the notes to its interim financial statements, if material and if not disclosed elsewhere in the interim financial report:

(a) a statement that the same accounting policies are followed in the interim financial statements as those followed in the most recent annual financial statements or, if those policies have been changed, a description of the nature and effect of the change;

(b) explanatory comments about the seasonality of interim operations;

(c) the nature and amount of items affecting assets, liabilities, equity, net income, or cash flows that are unusual because of their nature, size, or incidence (see paragraphs 12 to 14 of AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies);

(d) the nature and amount of changes in estimates of amounts reported in prior interim periods of the current financial year or changes in estimates of amounts reported in prior financial years, if those changes have a material effect in the current interim period;

(e) issuances, buy-backs, repayments and restructuring of debt, equity and potential equity shares;

(f) dividends, aggregate or per share (in absolute or percentage terms), separately for equity shares and other shares;

(g) segment revenue, segment capital employed (segment assets minus segment liabilities) and segment result for business segments or geographical segments, whichever is the enterprise's primary basis of segment reporting (disclosure of segment information is required in an enterprise's interim financial report only if the enterprise is required, in terms of AS 17, Segment Reporting, to disclose segment information in its annual financial statements);

(h) the effect of changes in the composition of the enterprise during the interim period, such as amalgamations, acquisition or disposal of subsidiaries and long-term investments, restructurings, and discontinuing operations; and

(i) material changes in contingent liabilities since the last annual balance sheet date.

The above information should normally be reported on a financial year-to-date basis. However, the enterprise should also disclose any events or transactions that are material to an understanding of the current interim period.

10. The disclosures required by other Accounting Standards are not required if an enterprise's interim financial report includes only condensed financial statements and selected explanatory notes rather than a complete set of financial statements.

11. Interim reports should include interim financial statements (condensed or complete) for periods as follows:

(a) balance sheet as of the end of the current interim period and a comparative balance sheet as of the end of the immediately preceding financial year;

(b) statements of profit and loss for the current interim period and cumulatively for the current financial year to date, with comparative statements of profit and loss for the comparable interim periods (current and year-to-date) of the immediately preceding financial year;

(c) cash flow statement cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year.

12. The enterprises whose business is highly seasonal are encouraged to report financial information for the twelve months ending on the interim reporting date and comparative information for the prior twelve-month period in addition to the information called for in the preceding paragraph.

13. If an estimate of an amount reported in an interim period is changed significantly during the final interim period of the financial year but a separate financial report is not prepared and presented for that final interim period, the nature and amount of that change in estimate should be disclosed in a note to the annual financial statements for that financial year.

14. An enterprise should apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements.

15. An enterprise that reports half-yearly, uses information available by mid-year or shortly thereafter in making the measurements in its financial statements for the first six-month period and information available by year-end or shortly thereafter for the twelve-month period. The twelve-month measurements will reflect any changes in estimates of amounts reported for the first six-month period. The amounts reported in the interim financial report for the first six-month period are not retrospectively adjusted. The nature and amount of any significant changes in estimates is required to be disclosed.

16. An enterprise that reports more frequently than half-yearly, measures income and expenses on a year-to-date basis for each interim period using information available when each set of financial statements is being prepared. Amounts of income and expenses reported in the current interim period will reflect any changes in estimates of amounts reported in prior interim periods of the financial year. The amounts reported in prior interim periods are not retrospectively adjusted. The nature and amount of any significant changes in estimates is required to be disclosed.

17. Revenues that are received seasonally or occasionally within a financial year should not be anticipated or deferred as of an interim date if anticipation or deferral would not be appropriate at the end of the enterprise's financial year.

18. Costs that are incurred unevenly during an enterprise's financial year should be anticipated or deferred for interim reporting purposes if, and only if, it is also appropriate to anticipate or defer that type of cost at the end of the financial year.

19. The measurement procedures to be followed in an interim financial report should be designed to ensure that the resulting information is reliable and that all material financial information that is relevant to an understanding of the financial position or performance of the enterprise is appropriately disclosed. While measurements in both annual and interim financial reports are often based on reasonable estimates, the preparation of interim financial reports generally will require a greater use of estimation methods than annual financial reports.

20. A change in accounting policy, other than one for which the transition is specified by an Accounting Standard, should be reflected by restating the financial statements of prior interim periods of the current financial year.

Principal Requirements under ESAAR, 1985

ESAAR does not contain any specific requirement on the subject.

Applicability of AS 25 to Power Sector Entities

Timely and reliable interim financial reporting improves the ability of investors, creditors, and others to understand an enterprise's capacity to generate earnings and cash flows, its financial condition and liquidity. Accordingly, all power sector entities should be required to present, as a minimum, condensed balance sheet, condensed statement of profit and loss, condensed cash flow statement, and selected explanatory notes on a quarterly basis.

AS 26, Intangible Assets

AS 26 applies to accounting for intangible assets, except:

(a) intangible assets that are covered by another Accounting Standard;

(b) financial assets[12];

(c) mineral rights and expenditure on the exploration for, or development and extraction of, minerals, oil, natural gas and similar non-regenerative resources; and

(d) intangible assets arising in insurance enterprises from contracts with policyholders.

AS 26 applies to, among other things, expenditure on advertising, training, start-up, research and development activities. Research and development activities are directed to the development of knowledge. Therefore, although these activities may result in an asset with physical substance (for example, a prototype), the physical element of the asset is secondary to its intangible component, that is the knowledge embodied in it.

Salient Features and Principal Requirements

1. *Intangible asset* is defined as "an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes".

2. If an item covered by this Standard does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. However, if the item is acquired in an amalgamation in the nature of purchase, it forms part of the goodwill recognised at the date of the amalgamation.

3. Some intangible assets may be contained in or on a physical substance such as a compact disk (in the case of computer software), legal documentation (in the case of a license or patent) or film (in the case of motion pictures). The cost of the physical substance containing the intangible assets is usually not significant. Accordingly, the physical substance containing an intangible asset, though tangible in nature, is commonly treated as a part of the intangible asset contained in or on it.

4. In some cases, an asset may incorporate both intangible and tangible elements that are, in practice, inseparable. In determining whether such an asset should be treated under AS 10, Accounting for Fixed Assets, or as an intangible asset under this Standard, judgement is required to assess as to which element is predominant. For example, computer software for a computer controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as a fixed asset. The same applies to the operating system of a computer. Where the software is not an integral part of the related hardware, computer software is treated as an intangible asset.

5. The definition of an intangible asset requires that an intangible asset be identifiable. To be identifiable, it is necessary that the intangible asset is clearly distinguished from goodwill. An intangible asset can be clearly distinguished from goodwill if the asset is separable. An asset is separable if the enterprise could rent, sell, exchange or distribute the specific future economic benefits attributable to the asset without also disposing of future economic benefits that flow from other assets used in the same revenue earning activity. Separability is not a necessary condition for identifiability since an enterprise may be able to identify an asset in some other way.

6. An enterprise controls an asset if the enterprise has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits. Market and technical knowledge may give rise to future economic benefits. An enterprise controls those benefits if, for example, the knowledge is protected by legal rights such as copyrights, a restraint of trade agreement (where permitted) or by a legal duty on employees to maintain confidentiality. Specific management or technical talent is unlikely to meet the definition of an intangible asset, unless it is protected by legal rights to use it and to obtain the future economic benefits expected from it, and it also meets the other parts of the definition.

7. The future economic benefits flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the enterprise.

8. An intangible asset should be recognised if, and only if:

(a) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and

(b) the cost of the asset can be measured reliably.

9. An enterprise should assess the probability of future economic benefits using reasonable and supportable assumptions that represent best estimate of the set of economic conditions that will exist over the useful life of the asset.

10. An intangible asset should be measured initially at cost.

11. The cost of an intangible asset comprises its purchase price, including any import duties and other taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), and any directly attributable expenditure on making the asset ready for its intended use. If an intangible asset is acquired in exchange for shares or other securities of the reporting enterprise, the asset is recorded at its fair value, or the fair value of the securities issued, whichever is more clearly evident.

12. Intangible asset acquired free of charge, or for nominal consideration, by way of a government grant should be accounted for in accordance with the requirements of AS 12, Accounting for Government Grants.

13. Cost of intangible asset acquired in exchange or part exchange of another asset is determined in accordance with the principles laid down in this regard in AS 10, Accounting for Fixed Assets.

14. Internally generated goodwill should not be recognised as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost.

15. No intangible asset arising from research (or from the research phase of an internal project) should be recognised. Expenditure on research (or on the research phase of an internal project) should be recognised as an expense when it is incurred.

16. An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an enterprise can demonstrate all of the following:

(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale;

(b) its intention to complete the intangible asset and use or sell it;

(c) its ability to use or sell the intangible asset;

(d) how the intangible asset will generate probable future economic benefits. Among other things, the enterprise should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;

(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and

(f) its ability to measure the expenditure attributable to the intangible asset during its development reliably.

17. Enterprise assesses the future economic benefits to be received from the asset using the principles in Accounting Standard on Impairment of Assets[13]. If the asset will generate economic benefits only in combination with other assets, the enterprise applies the concept of cash-generating units as set out in Accounting Standard on Impairment of Assets.

18. Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognised as intangible assets.

19. The cost of an internally generated intangible asset is the sum of expenditure incurred from the time when the intangible asset first meets the recognition criteria. The cost of an internally generated intangible asset comprises all expenditure that can be directly attributed, or allocated on a reasonable and consistent basis, to creating, producing and making the asset ready for its intended use.

20. Expenditure on an intangible item should be recognised as an expense when it is incurred unless:

(a) it forms part of the cost of an intangible asset that meets the recognition criteria as laid down in this Standard; or

(b) the item is acquired in an amalgamation in the nature of purchase and cannot be recognised as an intangible asset. If this is the case, this expenditure (included in the cost of acquisition) should form part of the amount attributed to goodwill (capital reserve) at the date of acquisition (see AS 14, Accounting for Amalgamations).

21. Expenditures recognised as an expense when incurred include:

(a) expenditure on start-up activities (start-up costs), unless this expenditure is included in the cost of an item of fixed asset under AS 10. Start-up costs may consist of preliminary expenses incurred in establishing a legal entity such as legal and secretarial costs, expenditure to open a new facility or business (pre-opening costs) or expenditures for commencing new operations or launching new products or processes (pre-operating costs);

(b) expenditure on training activities;

(c) expenditure on advertising and promotional activities; and

(d) expenditure on relocating or re-organising part or all of an enterprise.

22. Expenditure on an intangible item that was initially recognised as an expense by a reporting enterprise in previous annual financial statements or interim financial reports should not be recognised as part of the cost of an intangible asset at a later date.

23. Subsequent expenditure on an intangible asset after its purchase or its completion should be recognised as an expense when it is incurred unless:

(a) it is probable that the expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and

(b) the expenditure can be measured and attributed to the asset reliably.

If these conditions are met, the subsequent expenditure should be added to the cost of the intangible asset.

24. After initial recognition, an intangible asset should be carried at its cost less any accumulated amortisation and any accumulated impairment losses.

25. The depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortisation should commence when the asset is available for use.

26. The useful life of an intangible asset may be very long but it is always finite. Uncertainty justifies estimating the useful life of an intangible asset on a prudent basis, but it does not justify choosing a life that is unrealistically short.

27. If control over the future economic benefits from an intangible asset is achieved through legal rights that have been granted for a finite period, the useful life of the intangible asset should not exceed the period of the legal rights unless:

(a) the legal rights are renewable; and

(b) renewal is virtually certain.

28. The amortisation method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise. If that pattern cannot be determined reliably, the straight-line method should be used. The amortisation charge for each period should be recognised as an expense unless another Accounting Standard permits or requires it to be included in the carrying amount of another asset.

29. The residual value of an intangible asset should be assumed to be zero unless:

(a) there is a commitment by a third party to purchase the asset at the end of its useful life; or

(b) there is an active market for the asset and:

(i) residual value can be determined by reference to that market; and

(ii) it is probable that such a market will exist at the end of the asset's useful life.

30. The amortisation period and the amortisation method should be reviewed at least at each financial year end. If the expected useful life of the asset is significantly different from previous estimates, the amortisation period should be changed accordingly. If there has been a significant change in the expected pattern of economic benefits from the asset, the amortisation method should be changed to reflect the changed pattern. Such changes should be accounted for in accordance with AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in

Accounting Policies.

31. To determine whether an intangible asset is impaired, an enterprise applies Accounting Standard on Impairment of Assets[14].

32. In addition to the requirements of Accounting Standard on Impairment of Assets, an enterprise should estimate the recoverable amount of the following intangible assets at least at each financial year end even if there is no indication that the asset is impaired:

(a) an intangible asset that is not yet available for use; and

(b) an intangible asset that is amortised over a period exceeding ten years from the date when the asset is available for use.

The recoverable amount should be determined under Accounting Standard on Impairment of Assets and impairment losses recognised accordingly.

33. An intangible asset should be derecognised (eliminated from the balance sheet) on disposal or when no future economic benefits are expected from its use and subsequent disposal. Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the statement of profit and loss.

34. An intangible asset that is retired from active use and held for disposal is carried at its carrying amount at the date when the asset is retired from active use. At least at each financial year end, an enterprise tests the asset for impairment under Accounting Standard on Impairment of Assets and recognises any impairment loss accordingly.

35. The financial statements should disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:

(a) the useful lives or the amortisation rates used;

(b) the amortisation methods used;

(c) the gross carrying amount and the accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period.

36. The financial statements should also disclose:

(a) if an intangible asset is amortised over more than ten years, the reasons why it is presumed that the useful life of an intangible asset will exceed ten years from the date when the asset is available for use. In giving these reasons, the enterprise should describe the factor(s) that played a significant role in determining the useful life of the asset;

(b) a description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the financial statements of the enterprise as a whole;

(c) the existence and carrying amounts of intangible assets whose title is restricted and the carrying amounts of intangible assets pledged as security for liabilities; and

(d) the amount of commitments for the acquisition of intangible assets.

37. The financial statements should disclose the aggregate amount of research and development expenditure recognised as an expense during the period.

Principal Requirements under ESAAR, 1985

As per Schedule 24 to the balance sheet, intangible assets include payments to acquire rights to receive power from other bodies and expenses for forming and organising the SEB. As per Annexure V to ESAAR, intangible assets are amortised over the period over which benefits are expected from the expenditure. With regard to research and development costs, see discussion under AS 8.

Applicability of AS 26 to Power Sector Entities

Shortcomings of` ESAAR

1. On incurrence of expenses for forming and organising the SEB no intangible asset is acquired or created that can be recognised. Therefore, recognition of the same as intangible asset is not proper.

2. ESAAR does not deal with intangible assets in a comprehensive manner.

3. For research and development expenses refer to discussion under AS 8.

Conclusion

The Standard lays down recognition, measurement and disclosure criteria for various intangible assets in a comprehensive manner and the requirements of the Standard should be followed by all the power sector entities in their entirety.

AS 27, Financial Reporting of Interests in Joint Ventures

AS 27 applies to accounting for interests in joint ventures and the reporting of joint venture assets, liabilities, income and expenses in the financial statements of venturers and investors, regardless of the structures or forms under which the joint venture activities take place.

Salient Features and Principal Requirements

1. *Joint venture* is defined as “a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control”.

2. *Joint control* is “the contractually agreed sharing of control over an economic activity”. *Control* is “the power to govern the financial and operating policies of an economic activity so as to obtain benefits from it”.

3. *Proportionate consolidation* is defined as “a method of accounting and reporting whereby a venturer's share of each of the assets, liabilities, income and expenses of a jointly controlled entity is reported as separate line items in the venturer's financial statements”.

4. This Standard identifies three broad types of joint venture – jointly controlled operations, jointly controlled assets and jointly controlled entities – which are commonly described as, and

meet the definition of, joint ventures. The following characteristics are common to all joint ventures:

(a) two or more venturers are bound by a contractual arrangement; and

(b) the contractual arrangement establishes joint control.

5. The contractual arrangement establishes joint control over the joint venture. Such an arrangement ensures that no single venturer is in a position to unilaterally control the activity. The arrangement identifies those decisions in areas essential to the goals of the joint venture which require the consent of all the venturers and those decisions which may require the consent of a specified majority of the venturers.

6. The contractual arrangement may identify one venturer as the operator or manager of the joint venture. The operator does not control the joint venture but acts within the financial and operating policies which have been agreed to by the venturers in accordance with the contractual arrangement and delegated to the operator.

7. *Jointly controlled operations* involve the use of the assets and other resources of the venturers rather than the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves. An example of a jointly controlled operation is when two or more venturers combine their operations, resources and expertise in order to manufacture, market and distribute, jointly, a particular product, such as an aircraft. Different parts of the manufacturing process are carried out by each of the venturers. Each venturer bears its own costs and takes a share of the revenue from the sale of the aircraft, such share being determined in accordance with the contractual arrangement.

8. In respect of its interests in jointly controlled operations, a venturer should recognise in its separate financial statements and consequently in its consolidated financial statements:

(a) the assets that it controls and the liabilities that it incurs; and

(b) the expenses that it incurs and its share of the income that it earns from the joint venture.

9. *Jointly controlled assets* involve the joint control, and often the joint ownership, by the venturers of one or more assets contributed to, or acquired for the purpose of, the joint venture and dedicated to the purposes of the joint venture. The assets are used to obtain economic benefits for the venturers. Each venturer may take a share of the output from the assets and each bears an agreed share of the expenses incurred. These joint ventures do not involve the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves. Each venturer has control over its share of future economic benefits through its share in the jointly controlled asset.

10. In respect of its interest in jointly controlled assets, a venturer should recognise, in its separate financial statements, and consequently in its consolidated financial statements:

(a) its share of the jointly controlled assets, classified according to the nature of the assets;

(b) any liabilities which it has incurred;

(c) its share of any liabilities incurred jointly with the other venturers in relation to the joint venture;

(d) any income from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and

(e) any expenses which it has incurred in respect of its interest in the joint venture.

11. *A jointly controlled entity* is a joint venture which involves the establishment of a corporation, partnership or other entity in which each venturer has an interest. The entity operates in the same way as other enterprises, except that a contractual arrangement between the venturers establishes joint control over the economic activity of the entity. A jointly controlled entity maintains its own accounting records and prepares and presents financial statements in the same way as other enterprises in conformity with the requirements applicable to that jointly controlled entity.

12. In a venturer's separate financial statements, interest in a jointly controlled entity should be accounted for as an investment in accordance with AS 13, Accounting for Investments.

13. In its consolidated financial statements, a venturer should report its interest in a jointly controlled entity using proportionate consolidation except

(a) an interest in a jointly controlled entity which is acquired and held exclusively with a view to its subsequent disposal in the near future; and

(b) an interest in a jointly controlled entity which operates under severe long-term restrictions that significantly impair its ability to transfer funds to the venturer.

Interest in such a jointly controlled entity should be accounted for as an investment in accordance with AS 13, Accounting for Investments.

14. Many of the procedures appropriate for the application of proportionate consolidation are similar to the procedures for the consolidation of investments in subsidiaries, which are set out in AS 21, Consolidated Financial Statements.

15. For the purpose of applying proportionate consolidation, the venturer uses the consolidated financial statements of the jointly controlled entity.

16. In case, the losses pertaining to one or more investors in a jointly controlled entity exceed their interests in the equity[15] of the jointly controlled entity, such excess, and any further losses applicable to such investors, are recognised by the venturers in the proportion of their shares in the venture, except to the extent that the investors have a binding obligation to, and are able to, make good the losses. If the jointly controlled entity subsequently reports profits, all such profits are allocated to venturers until the investors' share of losses previously absorbed by the venturers has been recovered.

17. A venturer should discontinue the use of proportionate consolidation from the date that:

(a) it ceases to have joint control over a jointly controlled entity but retains, either in whole or in part, its interest in the entity; or

(b) the use of the proportionate consolidation is no longer appropriate because the jointly controlled entity operates under severe long-term restrictions that significantly impair its ability to transfer funds to the venturer.

18. From the date of discontinuing the use of the proportionate consolidation, interest in a jointly controlled entity should be accounted for:

(a) in accordance with Accounting Standard (AS) 21, Consolidated Financial Statements, if the venturer acquires unilateral control over the entity and becomes parent within the meaning of that Standard; and

(b) in all other cases, as an investment in accordance with Accounting Standard (AS) 13, Accounting for Investments, or in accordance with Accounting Standard (AS) 23, Accounting for Investments in Associates in Consolidated Financial Statements, as appropriate. For this purpose, cost of the investment should be determined as under:

(i) the venturer's share in the net assets of the jointly controlled entity as at the date of discontinuance of proportionate consolidation should be ascertained, and

(ii) the amount of net assets so ascertained should be adjusted with the carrying amount of the relevant goodwill/capital reserve as at the date of discontinuance of proportionate consolidation.

19. When a venturer contributes or sells assets to a joint venture, recognition of any portion of a gain or loss from the transaction should reflect the substance of the transaction. While the assets are retained by the joint venture, and provided the venturer has transferred the significant risks and rewards of ownership, the venturer should recognise only that portion of the gain or loss which is attributable to the interests of the other venturers. The venturer should recognise the full amount of any loss when the contribution or sale provides evidence of a reduction in the net realisable value of current assets or an impairment loss.

20. When a venturer purchases assets from a joint venture, the venturer should not recognise its share of the profits of the joint venture from the transaction until it resells the assets to an independent party. A venturer should recognise its share of the losses resulting from these transactions in the same way as profits except that losses should be recognised immediately when they represent a reduction in the net realisable value of current assets or an impairment loss.

21. In case of transactions between a venturer and a joint venture in the form of a jointly controlled entity, the requirements of paragraphs 19 and 20 should be applied only in the preparation and presentation of consolidated financial statements and not in the preparation and presentation of separate financial statements of the venturer.

22. An investor in a joint venture, which does not have joint control, should report its interest in a joint venture in its consolidated financial statements in accordance with AS 13, Accounting for Investments, AS 21, Consolidated Financial Statements or AS 23, Accounting for Investments in Associates in Consolidated Financial Statements, as appropriate.

23. In the separate financial statements of an investor, the interests in joint ventures should be accounted for in accordance with Accounting Standard (AS) 13, Accounting for Investments.

24. Operators or managers of a joint venture should account for any fees in accordance with AS 9, Revenue Recognition.

25. A venturer should disclose the following information in its separate financial statements as well as in consolidated financial statements:

(a) aggregate amount of the following contingent liabilities, unless the probability of loss is remote, separately from the amount of other contingent liabilities:

(i) any contingent liabilities that the venturer has incurred in relation to its interests in joint ventures and its share in each of the contingent liabilities which have been incurred jointly with other venturers;

(ii) its share of the contingent liabilities of the joint ventures themselves for which it is contingently liable; and

(iii) those contingent liabilities that arise because the venturer is contingently liable for the liabilities of the other venturers of a joint venture.

(b) aggregate amount of the following commitments in respect of its interests in joint ventures separately from other commitments:

(i) any capital commitments of the venturer in relation to its interests in joint ventures and its share in the capital commitments that have been incurred jointly with other venturers; and

(ii) its share of the capital commitments of the joint ventures themselves.

(c) a list of all joint ventures and description of interests in significant joint ventures. In respect of jointly controlled entities, the venturer should also disclose the proportion of ownership interest, name and country of incorporation or residence.

26. A venturer should disclose, in its separate financial statements, the aggregate amounts of each of the assets, liabilities, income and expenses related to its interests in the jointly controlled entities.

Principal Requirements under ESAAR, 1985

1. Annual accounts of an SEB are required to reflect the transactions of the SEB and of any other body in which the SEB has ownership rights as a sole owner, partner or a member of association of persons and in the management of which the SEB can exercise and actually exercises significant influence.

2. Where the transactions of any other body are required to be reflected as per para 1 in more than one SEB's accounts, each SEB reflects the assets, liabilities, income and expenses of that body in proportion of its ownership share in that body.

3. Interest acquired by a SEB in any body whose transactions do not require incorporation into the SEB's accounts is required to be disclosed, at cost as investment. In such cases, the excess or shortfall of SEB's share of the net assets of the body over the cost of acquiring the interest in that body is required to be disclosed in the SEB's accounts by way of a note.

Applicability of AS 27 to Power Sector Entities

Shortcomings of ESAAR

1. It appears that as per the above requirements of ESAAR full consolidation is required where the SEB can and actually exercises significant influence over another body. The term 'significant influence' has not been defined in ESAAR. As per AS 21, full consolidation is required only where 'control', as distinguished from 'significant influence', can be exercised. In case the situation, contemplated in paragraph 1 above, results in joint control, proportionate consolidation should be done as per AS 27.

2. ESAAR does not lay down procedures for incorporation of transactions of other bodies.

3. ESAAR requires that in case transactions of any other body are required to be reflected in more than one SEB's accounts, the assets, liabilities, incomes and expenses of that body are to be reflected in the SEB's accounts in proportion of its ownership share in that body. This would mean that irrespective of the ownership interest, proportionate consolidation has to be done. This is not as per GAAPs, according to which the degree of consolidation depends on ownership interest, viz., more than 50% ownership interest representing unilateral control requires full consolidation under AS 21, between 20% to 50% ownership interest representing significant influence requires adoption of equity method under AS 23 and equal ownership interest representing joint control requires proportionate consolidation under AS 27.

Conclusion

Power sector entities should report their interests in joint ventures in separate as well as in the Consolidated Financial Statements (prepared as per AS 21) in accordance with the requirements of this Standard.

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[6] The Institute of Chartered Accountants of India has issued Accounting Standard (AS) 26, 'Intangible Assets'. Accounting Standard (AS) 6, 'Depreciation Accounting', with regard to the amortisation (depreciation) of intangible assets, would stand withdrawn for an enterprise from the date on which AS 26 becomes mandatory for that enterprise.

[7] Accounting Standards Board has issued the Exposure Draft of the revised Accounting Standard (AS) 7. The Exposure Draft of the revised Standard permits the usage of only percentage of completion method for Accounting for Construction Contracts.

[8] The Institute of Chartered Accountants of India has issued Accounting Standard (AS) 26, 'Intangible Assets'. Accounting Standard (AS) 8, 'Accounting for Research and Development', would stand withdrawn for an enterprise from the date on which AS 26 becomes mandatory for that enterprise.

[9] The Institute of Chartered Accountants of India has issued Accounting Standard (AS) 26, 'Intangible Assets'. These requirements of Accounting Standard (AS) 10, 'Accounting for Fixed Assets', would stand withdrawn for an enterprise from the date on which AS 26 becomes mandatory for that enterprise.

[10] Ibid.

[11] Published in October 2001 issue of the Institute's Journal, 'The Chartered Accountant'.

[12] A *financial asset* is any asset that is:

(a) cash;

(b) a contractual right to receive cash or another financial asset from another enterprise;

(c) a contractual right to exchange financial instruments with another enterprise under conditions that are potentially favourable; or

(d) an ownership interest in another enterprise.

13 A separate Accounting Standard on 'Impairment of Assets', which is being formulated, will specify the requirements relating to impairment of assets.

14 A separate Accounting Standard on 'Impairment of Assets', which is being formulated, will specify the requirements relating to impairment of assets.

15 Equity is the residual interest in the assets of an enterprise after deducting all its liabilities.

* As a limited revision to the Study, the Research Committee decided that this treatment should be followed for discount allowed for timely payment. The consequential amendments have been made in other parts of the Study.

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5
Formats of Financial Statements

5.01 Financial statements are the end-product of the accounting process. It is through these statements that financial information is communicated to various users to assist them in taking economic decisions concerning the reporting entity.

Qualitative characteristics of financial information in financial statements

5.02 Financial statements are means of communication of financial information to users. For this communication to be effective, it must have certain qualitative characteristics. The 'Framework for the Preparation and Presentation of Financial Statements', issued by the Institute of Chartered Accountants of India, describes these qualitative characteristics as follows.

Understandability

An essential quality of the information provided in financial statements is that it must be readily understandable by users. For this purpose, it is assumed that users have a reasonable knowledge of business and economic activities and accounting and study the information with reasonable diligence. Information about complex matters that should be included in the financial statements because of its relevance to the economic decision-making needs of users should not be excluded merely on the ground that it may be too difficult for certain users to understand.

Relevance

To be useful, information must be relevant to the decision-making needs of users. Information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations.

The predictive and confirmatory roles of information are interrelated. For example, information about the current level and structure of asset holdings has value to users when they endeavour to predict the ability of the enterprise to take advantage of opportunities and its ability to react to adverse situations. The same information plays a confirmatory role in respect of past predictions about, for example, the way in which the enterprise would be structured or the outcome of planned operations.

Information about financial position and past performance is frequently used as the basis for predicting future financial position and performance and other matters in which users are directly interested, such as dividend and wage payments, share price movements and the ability of the enterprise to meet its commitments as they fall due. To have predictive value, information need not be in the form of an explicit forecast. The ability to make predictions from financial statements is enhanced, however, by the manner in which information on past transactions and events is displayed. For example, the predictive value of the statement of profit and loss is enhanced if unusual, abnormal and infrequent items of income and expense are separately disclosed.

Materiality

The relevance of information is affected by its materiality. Information is material if its misstatement (i.e., omission or erroneous statement) could influence the economic decisions of users taken on the basis of the financial information. Materiality depends on the size and nature of the item or error, judged in the particular circumstances of its misstatement. Materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which the information must have if it is to be useful.

Reliability

To be useful, information must also be reliable. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent.

Information may be relevant but so unreliable in nature or representation that its recognition may be potentially misleading. For example, if the validity and amount of a claim for damages under a legal action against the enterprise are highly uncertain, it may be inappropriate for the enterprise to recognise the amount of the claim in the balance sheet, although it may be appropriate to disclose the amount and circumstances of the claim.

Faithful Representation

To be reliable, information must represent faithfully the transactions and other events it either purports to represent or could reasonably be expected to represent. Thus, for example, a balance sheet should represent faithfully the transactions and other events that result in assets, liabilities and equity of the enterprise at the reporting date which meet the recognition criteria.

Most financial information is subject to some risk of being less than a faithful representation of that which it purports to portray. This is not due to bias, but rather to inherent difficulties either in identifying the transactions and other events to be measured or in devising and applying measurement and presentation techniques that can convey messages that correspond with those transactions and events. In certain cases, the measurement of the financial effects of items could be so uncertain that enterprises generally would not recognise them in the financial statements; for example, although most enterprises generate goodwill internally over time, it is usually difficult to identify or measure that goodwill reliably. In other cases, however, it may be relevant to recognise items and to disclose the risk of error surrounding their recognition and measurement.

Substance Over Form

If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. The substance of transactions or other events is not always consistent with that which is apparent from their legal or contrived form. For example, where rights and beneficial interest in an immovable property are transferred but the documentation and legal formalities are pending, the recording of acquisition/disposal (by the transferee and transferor respectively) would in substance represent the transaction entered into.

Neutrality

To be reliable, the information contained in financial statements must be neutral, that is, free from bias. Financial statements are not neutral if, by the selection or presentation of information, they influence the making of a decision or judgement in order to achieve a predetermined result or outcome.

Prudence

The preparers of financial statements have to contend with the uncertainties that inevitably surround many events and circumstances, such as the collectability of receivables, the probable useful life of plant and machinery, and the warranty claims that may occur. Such uncertainties are recognised by the disclosure of their nature and extent and by the exercise of prudence in the preparation of the financial statements. Prudence is the inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated. However, the exercise of prudence does not allow, for example, the creation of hidden reserves or excessive provisions, the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses, because the financial statements would then not be neutral and, therefore, not have the quality of reliability.

Completeness

To be reliable, the information in financial statements must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.

Comparability

Users must be able to compare the financial statements of an enterprise through time in order to identify trends in its financial position, performance and cash flows. Users must also be able to compare the financial statements of different enterprises in order to evaluate their relative financial position, performance and cash flows. Hence, the measurement and display of the financial effects of like transactions and other events must be carried out in a consistent way throughout an enterprise and over time for that enterprise and in a consistent way for different enterprises.

An important implication of the qualitative characteristic of comparability is that users be informed of the accounting policies employed in the preparation of the financial statements, any changes in those polices and the effects of such changes. Users need to be able to identify differences between the accounting policies for like transactions and other events used by the same enterprise from period to period and by different enterprises. Compliance with Accounting Standards, including the disclosure of the accounting policies used by the enterprise, helps to achieve comparability.

The need for comparability should not be confused with mere uniformity and should not be allowed to become an impediment to the introduction of improved accounting standards. It is not appropriate for an enterprise to continue accounting in the same manner for a transaction or other event if the policy adopted is not in keeping with the qualitative characteristics of relevance and reliability. It is also inappropriate for an enterprise to leave its accounting policies unchanged when more relevant and reliable alternatives exist.

Users wish to compare the financial position, performance and cash flows of an enterprise over time. Hence, it is important that the financial statements show corresponding information for the preceding period(s).

Constraints on Relevant and Reliable Information

5.03 The Framework recognises that there are certain constraints on provision of relevant and reliable information in financial statements. These are as follows.

Timeliness

If there is undue delay in the reporting of information it may lose its relevance. Management may need to balance the relative merits of timely reporting and the provision of reliable information. To provide information on a timely basis it may often be necessary to report before all aspects of a transaction or other event are known, thus impairing reliability. Conversely, if reporting is delayed until all aspects are known, the information may be highly reliable but of little use to users who have had to make decisions in the interim. In achieving a balance between relevance and reliability, the overriding consideration is how best to satisfy the information needs of users.

Balance between Benefit and Cost

The balance between benefit and cost is a pervasive constraint rather than a qualitative characteristic. The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is, however, substantially a judgmental process. Furthermore, the costs do not necessarily fall on those users who enjoy the benefits. Benefits may also be enjoyed by users other than those for whom the information is prepared. For these reasons, it is difficult to apply a cost-benefit test in any particular case. Nevertheless, standard-setters in particular, as well as the preparers and users of financial statements, should be aware of this constraint.

Formats

5.04 As discussed in Chapter 2, ESAAR prescribes the formats in which various State Electricity Boards are required to prepare their financial statements. As per the formats, SEBs are required to prepare Statements of Accounting Policies, Notes on Accounts, Function-wise analysis of Revenue and Expenditure, Sources and Uses of Funds, and Capital Base and Surplus in addition to Revenue Account, Net Revenue and Appropriation Account, and Balance Sheet. There are 35 schedules to the Revenue Account and the Balance Sheet. A perusal of these formats suggests that these have been designed primarily to meet the information needs of the Government and regulating authorities for development and regulation of SEBs.

5.05 The power sector scenario is undergoing a considerable change with the restructuring of SEBs. In the changed scenario, potential investors, lenders, trade creditors and public, etc., are also important stakeholders in SEBs in addition to the Government and regulating authorities. The financial statements prepared as per ESAAR designed to meet the information needs of the Government and other regulating authorities do not satisfy the information needs of other stakeholders. Accordingly, all power sector entities, including SEBs, should prepare general purpose financial statements presenting true and fair view of operating results and state of affairs for a wider range of stakeholders.

5.06 As discussed earlier, power sector entities, such as generating companies, are preparing their general purpose financial statements according to the requirements of the Companies Act, 1956. Under the Act, the companies are required to follow the Accounting Standards issued by the Institute of Chartered Accountants of India and are preparing financial statements in the formats set out in Schedule VI to the Act. Financial statements prepared in accordance with the said formats are well understood by various stakeholders and these statements satisfy their information needs to a fairly large extent. Accordingly, it can be stated that the financial statements prepared in accordance with the formats as prescribed under Schedule VI to the Companies Act, 1956, largely fulfill the requirements of general purpose financial statements.

5.07 In view of the above, all power sector entities, including SEBs, should prepare their general purpose financial statements in the formats set out in Schedule VI to the Companies Act, 1956. In the preparation and presentation of the financial statements the requirements of the Accounting Standards, issued by the Institute of Chartered Accountants of India, should be followed as discussed in Chapter 4.

5.08 The recommendations made in the Study for the treatment of various items of revenue and expenditure are based on Indian GAAPs since the focus of this Study is to prescribe accounting framework to prepare and present the general purpose financial statements with a view to reflect true and fair view of the operating results and the state of affairs of the power sector entities. Further, it is imperative that the regulators also use the financial information based on the GAAPs since such information reflects the economic reality of the transactions and, therefore, decisions of the regulators, e.g., tariff fixation, would be economically sound.

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Implementation Issues

6.01 Keeping in view the comparative analysis and review of the accounting system followed in power sector, especially SEBs, the following actions would be required, in order to be compatible and in compliance with the accounting and financial reporting framework as suggested:

- Identifying the gap between the accounting system being followed presently and the Generally Accepted Accounting Principles (GAAPs) in India;

- Ascertaining the financial impact of these differences and carrying out necessary changes in the accounts of the year in which the suggested system is implemented; and

- Adherence to the Indian GAAPs from the year in which the new system is implemented.

6.02 The above process is the normal process for change in an accounting system and, therefore, should not pose any insurmountable problems. However, for a smooth transition the following multi-pronged approach may be followed.

Development of Accounting Manual

6.03 Presently, the power sector entities, especially SEBs, are following accounting and financial reporting framework as laid down by the law and law prescribes the detailed requirements with regard to accounting of items of revenue and expenses, assets and liabilities. It is suggested that under the revised framework, instead of prescribing detailed accounting requirements in law, an Accounting Manual should be developed for uniform adherence by the entire power sector. The Accounting Manual should include guidelines on how the total accounting system is to be broken down into its constituent elements, what documents and records are required in support of various kinds of transactions, how those transactions are to be recorded in the books of account, what would be the contents and frequency of various accounting reports to be generated, and what procedures are to be followed in preparation of periodic financial statements. The Manual may also include guidelines on how to change the accounting treatments from the existing system to the revised accounting system as per the GAAPs. An Accounting Manual brings about uniformity in the accounting process and minimises the need for application of subjective judgements.

6.04 ESAAR prescribes the chart of accounts with a scientific codification scheme. The structure of the chart of accounts is compatible with the revised system of financial accounting and reporting. It would, however, be appropriate that a software be developed which would simplify accounting in State Electricity Boards.

Training

6.05 Implementation of the recommendations made in this Study would require drastic changes in the accounting and financial reporting framework currently followed by the power sector entities, especially SEBs. In order that the accounting personnel can fully understand the new accounting and reporting framework, it is of utmost importance that they are given proper training before the system is actually put into operation. For this purpose, it may be useful to develop a common training programme (including training material) for use by power sector entities. The Institute of Chartered Accountants of India is in the process of developing a general background material on accounting standards for training programmes. In training, co-operation among different States would be extremely useful and would avoid the duplication of efforts.

Employees' Participation in Transition Process

6.06 The degree of success with which the recommendations made in this Study can be implemented depends to a large extent on the co-operation of accounting personnel working in power sector entities. It is important that they are involved in the process of transition right from the beginning. It would be useful to explain to them the need for such transition. In turn, one expects useful suggestions from them based on their experience which should be duly considered while adapting the recommendations of this Study in a particular situation. There can be no doubt that once the relative advantages of the new system are brought home to them and they are made to feel as catalysts for the change, their co-operation would make the process of transition smooth and expeditious.

Audit

6.07 Presently, the accounts of State Electricity Boards are audited by the Comptroller and Auditor General of India or by such person as he may authorise in this behalf. The emphasis of such audit is on propriety, economy, efficiency and effectiveness. It is felt that once the power sector entities adopt the recommendations made in this Study, it would be necessary to have a financial audit of financial statements presented by SEBs also, on lines similar to those in the case of other power sector entities. It is felt that this task can best be performed by professional auditors (i.e., practising chartered accountants) considering their specialisation in this form of audit. Thus, while professional auditors may report on 'true and fair view' of financial statements, the Comptroller and Auditor General of India or the person authorised by him in this behalf, may continue to concentrate on aspects of propriety etc., as hithertofore. It may be mentioned that the practice of entrusting financial audit to chartered accountants is already in vogue in government companies and a number of other public sector enterprises. It is recognised that certain legislative changes would be required to implement the above recommendations.

Utilising the Services of Chartered Accountants

6.08 Implementation of the recommendations made in this Study would involve substantial changes in the manner of recording transactions and preparing financial statements for SEBs. It is felt that the services of chartered accountants can be gainfully utilised by SEBs for smooth and effective implementation of the recommendations made in this Study. By virtue of their specialised education and training augmented by their rich exposure to a wide variety of practical situations, chartered accountants are eminently suited to designing accounting systems that take cognisance of the specific requirements of an individual enterprise. It is felt that the services of chartered accountants can be particularly utilised in areas of preparation of accounting manual and training of accounting personnel.

Legislative Changes

6.09 As discussed in Chapter 2, the existing accounting and financial reporting framework for various power sector entities, especially SEBs, is governed by the law applicable to such entities. Therefore, implementation of the recommendations made in this Study would require amendments to relevant Act, Rules, etc. As discussed earlier, the basic purpose of the Study is to review and evaluate the existing framework of accounting and financial reporting and provide broad alternative framework. Accordingly, the Study has not identified the precise changes that would need to be made in the law in this behalf. The Government would, therefore, need to review its legislative framework to identify the changes to be made therein.

6.10 The regulatory framework for the power sector in India is still evolving. The effect of the regulatory actions might lead to accounting issues. Based on the experience in other countries and, otherwise, it is felt that the existing framework of the Indian GAAPs would be able to handle these emerging issues appropriately. However, in order to ensure uniformity and consistency, it might be necessary to give technical guidance or interpretation of Accounting Standards for the accounting issues which concern the power sector. The Institute, through the Accounting Standards Board, Accounting Standards Interpretation Sub-Committee, Research Committee and Expert Advisory Committee, would be able to deal with such issues.

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Appendix

Critical Analysis of Accounting Principles and Policies Prescribed under ESAAR 1985 vis-à-vis GAAPs

Basic Accounting Principles and Policies (Annexure III of ESAAR, 1985)		**Comments**
Para No.	**Description**	
1.	**Basic Accounting Principles**	
1.1	A Board shall follow the basic accounting principles laid down in the following paragraphs in the preparation of its Annual Accounts.	
	Entity of a Board for the Purpose of Annual Accounts	
1.2	Annual Accounts of a Board shall reflect the transactions of the Board and of any other body in which the Board has ownership rights as a sole owner, partner or a member of association of persons and in the management of which the Board can exercise and actually exercises significant influence.	The requirements of ESAAR are not in line with GAAPs as prescribed in AS 21, AS 23 and AS 27.
1.3	A mere right to receive a part or whole of the power generated by any other body, whether at cost or at a prefixed rate shall not be the ground for reflecting the transactions of such body in a Board's accounts.	
1.4	Where the transactions of any other body have to be reflected in more than one Board's accounts in accordance with the paragraph 1.2, each Board shall reflect the assets, liabilities, income and expenses of that body in proportion of its ownership share in that body.	
1.5	Interest acquired by a Board in any body whose transactions do not require incorporation into a Board's accounts in accordance with the paragraph 1.2 shall be disclosed, at cost, in Board's accounts as investments. In such cases the excess or shortfall of Board's share of the net assets of the body over the cost of acquiring the interest in that body shall be disclosed in the Board's accounts by way of a note.	
	Historical cost convention	
1.6	In a Board's accounts, Assets, Liabilities, Expenses and	The requirements of

	Revenue shall be recorded at the amounts at which the transactions took place. This policy implies that no revaluation of assets or liabilities shall be done for adjusting them to replacement cost, current cost, etc. Similarly depreciation on replacement cost basis shall also not be permitted.	ESAAR are in line with GAAPs except to the extent that AS 10 permits revaluation of fixed assets and AS 6 permits charging of depreciation on revalued amounts.
1.7	*Going concern concept* Financial statements of a Board shall be drawn up on the premise that its business will continue indefinitely.	The requirement of ESAAR is not in line with GAAPs as prescribed in AS 1, according to which an enterprise is normally viewed as going concern, i.e., as continuing in operation for the foreseeable future.
1.8	*Consistency concept* Uniform accounting policies shall be applied on the same basis from year to year. Even the accounting policies followed in respect of areas not specifically covered hereafter or in cases where departure from the prescribed accounting policy is permitted, shall be followed consistently from year to year.	The requirements of ESAAR are not in line with GAAPs as prescribed in AS 5 which permits change in accounting policy in specified circumstances.
1.9 1.10	*True and fair presentation* Accounts of a Board shall present a true and fair view of the financial position and results of operations of the Board. True and fair view implies the disclosure of all information necessary for a reader's understanding of the financial position and results of operations of the Board. The objective of prescribing the forms of annual accounts of a Board is to prescribe the minimum and uniform disclosure required by all Boards. Additional information in the accounts or by way of notes may be given if it is necessary to ensure true and fair presentation.	The requirements of ESAAR are not strictly in line with GAAPs since apart from disclosure, recognition and measurement of items in financial statements are equally important to reflect true and fair view of the financial position and results of operations.
1.11	*Cash basis of accounting only where prescribed* The cash basis of accounting *i.e.* the practice of booking costs, revenues, assets and liabilities, when money is received or paid and not when accrued shall not be adopted by a Board except in the specific cases where cash basis is prescribed in this Annexure or in Annexure V. In all other cases, a Board shall follow commercial accounting system	The exception in ESAAR regarding adoption of cash basis of accounting in specified cases is not as per GAAPs including

	which requires recording of transactions by which revenues, costs, assets and liabilities are reflected in the accounts for the period in which they accrue.	AS 1.
1.12	*No retrospective adjustments to prior period revenue/costs* All prior period revenue or costs arising on account of a difference between an accounting estimate made for accrual and the actual values involved or on account of any other reason shall be accounted for prospectively and no retrospective restating of past year's figures shall be permitted.	The requirements of ESAAR are not strictly in line with GAAPs as prescribed in AS 5.
1.13	*Comparative figures for previous year* Comparative figures for the previous year shall be given in the Annual Accounts. No regrouping of previous year's figures shall be permitted except in cases where a different basis for the figures for the same item has been adopted during the current year.	The requirements of ESAAR are in line with GAAPs.
1.14	*Reserves not to absorb charge against revenue* Reserves of a Board whether created out of appropriation from surplus of past years or in any other manner shall not be used (except in prescribed circumstances) for absorbing the costs which would otherwise be a charge against the revenue of the current year, past years or future years.	The requirements of ESAAR are in line with GAAPs.
1.15	*Revenues not to be directly credited to reserves* No reserves shall be given any credit for any amount which should otherwise be treated as revenue for the current year, past years or future years.	
1.16	*Offsetting of assets and liabilities* In the balance sheet of a Board, assets and liabilities shall be set off against each other only when a legal right of offset exists. Payables to one party shall therefore not be set off against receivables from the same party unless the Board has a legal right to offset the two.	The requirements of ESAAR are in line with GAAPs.
1.17	*Events occurring after the balance sheet date* All events or transactions occurring after the date of balance sheet and before the date of the auditors' report shall be treated in the following manner: (1) Two types of subsequent events and transactions require consideration by the Board. (2) The first type consists of those events that provide additional evidence with respect to the conditions that existed at the date of the balance sheet and affect the estimates necessary for accrual etc. in the process of preparing annual accounts. All information that becomes available prior to the finalisation of the annual accounts should be used in evaluating the conditions on which the estimates were based. The annual accounts shall be adjusted for any changes in	Events occurring after the balance sheet date as considered by ESAAR are not as per AS 4, since as per the Standard, the said term means those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the

	estimates resulting from the use of such evidence. Identifying the events that require adjustment in accounts calls for the exercise of judgment and knowledge of the facts. For example, a loss on an uncollectible receivable as a result of a consumer's deteriorating financial condition leading to bankruptcy subsequent to the balance sheet date would be indicative of his poor financial condition existing at the balance sheet date, thereby calling for adjustment of the accounts. On the other hand, a similar loss resulting from a consumer's major casualty such as a fire or flood subsequent to the balance sheet date would not be indicative of conditions existing, in respect of the consumer at the balance sheet date and adjustment would not be called for. (3) The second type consists of events that provide evidence with respect to conditions that did not exist at the balance sheet date but arose subsequent to that date. Some of these events, however, may be of such a nature that the omission of their disclosure may result in misleading statements. Examples of this type of event (which should not result in adjustment to accounts but which do require disclosure) are takeover of a licensee, loss from fire, flood etc.	approving authority.
1.18	*No deferment of loss write off* The Revenue Account for a Board shall reflect full amount of the loss, if any, to the Board due to any natural calamities like cyclone, flood, etc., on recurring events like fire or possibly recurring events like receipt of inferior grade of coal. No part of the loss shall be deferred for write off over future years.	The requirements of ESAAR are in line with GAAPs.
1.19	*3% Return and the treatment of unusual and extra-ordinary gains and losses and prior year income and expenses* In a Board's Revenue Account, all unusual and extraordinary losses or gains and prior periods' income and expenses shall be disclosed separately. However, for the purpose of compliance with Section 59 requiring minimum surplus of 3% on fixed assets base, such unusual and extraordinary losses and gains and prior period credits and charge shall be considered in the same way as other usual and recurring income expenses, losses or gains for the year. Such a treatment will reflect (and not conceal by ignoring such items) that the Board's operating surplus has been affected during the year on account of such items.	The requirements of ESAAR insofar as they relate to treatment of unusual and extraordinary items are in line with GAAPs.
2.	**Accounting Policies**	
2.1	Transactions of a Board shall be accounted for in accordance with the Accounting Policies laid down herein below. The prescribed Accounting Policies are classified under the following sections:	

	(1) Capital Expenditure and Fixed assets (2) Fuel and Materials Accounting (3) Borrowings and investments (4) Other Accounting Areas	
	1. Capital Expenditure and Fixed Assets	
2.2	*Disclosure at Historical Cost and no Revaluation of Fixed Assets.* Fixed Assets of a Board shall be recorded in the books of accounts and disclosed in annual accounts at Historical cost. This policy implies that no revaluation of fixed assets shall be done for adjusting them to replacement cost, current cost, etc. Similarly depreciation on replacement cost shall also not be permitted.	AS 10 permits revaluation of fixed assets and prescribes accounting treatment for the same.
2.3	***Survey and Feasibility Studies*** *Expenditure on Project Identification* Expenditure incurred on identification, survey and feasibility studies of a project, before the project is considered for sanction or rejection, shall be accumulated in an account provided for this purpose. Later, if the project is rejected, the full amount of expenditure shall be charged to Revenue as infructuous capital expenditure in the year in which the project is rejected. If the project is sanctioned, the expenditure shall be charged to capital work-in-progress account for that project. Any expenditure incurred on detailed feasibility studies etc. after a project is sanctioned shall also be charged to the capital work-in-progress account for that project. The aggregate of the expenditure incurred before and after sanction of a project shall be allocated over the “tangible” assets acquired/constructed under the project, in the same manner as the revenue expenditure chargeable to capital works are to be allocated.	The requirements of ESAAR are broadly in line with GAAPs as prescribed in Guidance Note on Treatment of Expenditure during Construction Period.
2.4 2.5 2.6	*Cost of capital assets* Cost of a capital asset shall include all ‘actual costs’ incurred to prepare the asset for use subject to the exception and the bases of determining costs prescribed in the following paragraphs. *Treatment of Materials related Costs* All materials related costs recorded at an accounting unit under which only capital construction activities are carried out shall be charged to capital works. At a location under which capital construction as well as O&M activities are being carried out, only the following costs shall be charged to works:	The requirements of ESAAR are broadly in line with GAAPs as prescribed in AS 10 and Guidance Note on Treatment of Expenditure during Construction Period.

	(1) Inland freight on imported capital equipment (2) Freight on Local Capital Equipment (3) Testing charges - Capital Equipment (4) Incidental Stores Expenses - Capital Equipment (5) Octroi on Capital Equipment (6) Advertisement for tenders, etc. for purchase of capital equipment *Imported Equipments*	
2.7	Capital equipments, spares and other materials imported by the Board shall be valued as follows for receipts and issues accounting: (1) Cost Freight CI.F value Insurance **PLUS** (2) Customs Duty	
	Outside Labour/Contractor Charges	
2.8	All labour charges or contractor charges payable to outsiders for work done by them in respect of capital jobs shall be included in the cost of concerned capital assets. *Employee Cost of Board's Staff*	The requirements of ESAAR are in line with GAAPs as prescribed in AS 10 and Guidance Note on Treatment of Expenditure during Construction Period.
2.9	All employee costs in respect of construction units shall be fully charged as cost of capital assets.	
2.10	For an O&M-cum-capital unit, the procedure for accounting Employee Costs shall be as follows: (1) Temporary employees-monthly payments such as salaries/wages, dearness allowance, overtime and other allowances shall be capitalised. Some temporary employees may be entitled to retirement benefits. Monthly contribution to Provident Fund and Family Pension Scheme should also be capitalised. If however, any temporary employees are entitled to annual payment like bonus, no part of it should be capitalised by the time of bonus payment, the relevant capital jobs/project that they worked on might have been completed and closed and the asset cost already determined and transferred to fixed assets. For the sake of uniformity, no capitalisation of such annual payments shall be done even if the jobs are not closed. (2) Additional emoluments (e.g. Project allowance) to O & M staff for working additionally on a capital project shall be recorded in a separate account on accrual and shall be fully capitalised. (3) A separate payment shall be prepared for a group of permanent staff members, if any, deployed	ESAAR is not clear as to the capitalisation of service cost of temporary employees since it is not specifically indicated whether their services are directly or indirectly attributable to the construction activity. Non-capitalisation of proportionate amount of retirement benefits and annual payments to employees working on capital jobs is not as per GAAPs.

	exclusively or largely on capital jobs. The costs should be booked under a distinct department code such as 'construction' or 'Project Section' etc. All monthly payments (salaries, overtime, D.A. and other allowances) recorded under such department codes shall be fully capitalised. However, no part of retirement benefits and annual payments should be capitalised. (4) In respect of other permanent employee who work on both capital and O&M jobs without additional emoluments, no part of the employee costs shall be capitalised.	
2.11 2.12	*Expenses chargeable to capital works* All expenses in respect of construction units shall be fully chargeable as cost of capital assets. At an O&M-cum-capital location (where both capital and O&M work is being carried out) only the following expenses shall be capitalised : (1) Insurance on assets under construction. (2) Legal charges and stamp fees in connection with agreements with capital suppliers/contractors. (3) Fees payable to foreign technician for capital projects. (4) Expenses incurred for foreign technician for capital projects. (5) Technical documentation and design charges. (6) Other consultancy charges-Projects (Which includes architectural fees) (7) Power consumed for construction. No part of any other Administration and general expenses shall be charged to capital works.	The requirements of ESAAR are broadly in line with GAAPs as prescribed in Guidance Note on Treatment of Expenditure during Construction Period. However, difference may arise, if there is any expenditure directly related to capital work but is not specified in the list provided in ESAAR in this regard.
2.13	*Capitalisation of depreciation* Depreciation on construction facilities (earthmovers, cement mixers, etc.) shall be capitalised. Similarly, depreciation on fixed assets used for construction of other assets (e.g. depreciation on vehicles transferred to a project, depreciation on building, furniture and fixtures, vehicles and office equipments at construction division or construction circles) shall also be charged to capital works.	The requirements of ESAAR are in line with GAAPs as prescribed in Guidance Note on Treatment of Expenditure during Construction Period.
2.14	*No Capitalisation of Losses* Some losses may be involved in execution of capital projects for example irrecoverable advances to contractors, loss of assets or damage to assets at construction stage and shortage observed upon physical verification of stores at construction divisions. No part of any loss should be	The requirements of ESAAR are not in line with GAAPs as prescribed in Guidance Note on Treatment of

	capitalised and included in the cost of assets.	Expenditure during Construction Period, to the extent that the losses are normal.
2.15	*No Capitalisation of Income* No income shall be capitalised and reduced from the cost of any asset. Even in cases where the income is identifiable to one or more specific assets, no capitalisation of such income shall be done. The policy is however, subject to a different treatment prescribed for revenue during trial stage.	The requirements of ESAAR are not in line with GAAPs as prescribed in Guidance Note on Treatment of Expenditure during Construction Period, according to which income during construction period should be deducted from indirect expenditure, if the income is attributable to specific project.
2.16	*Subsequent Increase/Decrease in Costs* All subsequent increase or decrease in capital expenditure shall be identified to relevant assets and the cost accounted for earlier for that asset shall be charged accordingly.	The requirements of ESAAR are in line with GAAPs.
2.17	*Subsequent increase/decrease in staff costs and other expenses* Any subsequent increase or decrease in the staff costs and other expenses which were charged to capital works in the past shall be treated as follows : (1) If the increase or decrease has taken place during the same accounting year (as the year in which the expenses were originally charged to works), the amount of increase or decrease should be added to; or deducted from, the staff costs and expenses chargeable to works for the period in which the increase/decrease has taken place. (2) If the increase/decrease has taken place in the accounting years subsequent to the accounting year in which the relevant staff costs and other expenses were incurred, the amount of increase/decrease shall be ignored for the purpose of capitalisation of expenses in the subsequent years.	The requirements of ESAAR are not in line with GAAPs.
2.18	*Land and Land Rights* Land cost shall comprise of the following: (1) Purchase price of land	The requirements of ESAAR are broadly in line with GAAPs as prescribed in Guidance

	(2) Compensation for acquisition of land (3) Compensation for trees and crops on the acquired land (4) Legal charges, stamp duty, etc. incurred in order to secure effective title (5) Land revenue and other taxes paid during the stage of land development (6) Site preparation costs such as cost of leveling hills or filling low spots cost of clearing trees, etc.` (7) Cost of demolishing as unwanted structure if the land is acquired with structure.	Note on Treatment of Expenditure during Construction Period, except site preparation cost and cost of land improvement.
2.19	Cost of land improvements having a limited life such as cost of landscaping, gardens, sidewalls, fences and digging for sewage system shall be added to Cost of Land as 'Cost of Land Development'.	
	Buildings	
2.20	In case of purchase/acquisition of a building, the building costs shall include following items: (1) Purchase price (2) Compensation for acquisition of Building (3) Payments to tenants to cancel their tenancy rights (4) Expenses such as legal charges, stamp duty, etc. incurred for securing an effective title (5) Repair, alterations and improvements to put the building in usable condition (6) Architect's fees for remodelling, alterations, improvements, before the building is first put to use	The requirements of ESAAR are broadly in line with GAAPs except that the costs which are directly attributable to the acquisition of building but not included in paragraphs 2.20 and 2.21 would not be capitalised even though they are directly attributable.
2.21	Cost of a constructed building shall include the following items: (1) Cost of construction comprising of materials, labour, contractor charges and depreciation on construction machinery. (2) Surveying. (3) Cost of obtaining permits, sanctioned plans, occupation certificates from Municipal or other bodies (4) Architectural fees (5) Insurance on uncompleted structure (6) Cost of excavation (excavation is not a cost of land development).	
	Additions, Improvements, Replacement and Repairs	
2.22	Expenditure on additions, improvements, replacement and	The requirements of

	repairs and maintenance shall be treated in accordance with the policies prescribed in the following paragraphs.	ESAAR are broadly in line with GAAPs except that capitalisation of alterations / renovations expenditure unless these are of the nature of ‘improvements’.
	Repairs before Commissioning of Assets	
2.23	Any expenditure on repairs or rehabilitation of an asset purchased by the Board (whether second hand or new) incurred before commissioning the asset ‘for putting the asset in usable condition’ shall be treated as a cost of that capital asset.	
	Repairs and Maintenance	
2.24	Any expenditure on restoring an asset back upto the level of output/efficiency/performance at which it was, when it was first put to use is repairs expenditure. Any expenditure on maintaining the asset upto the level of output/efficiency/ performance at it was, when it was first put to use is maintenance expenditure.	
2.25	Expenditure on repairs and maintenance shall be charged to revenue in the year in which it is incurred. This shall be done regardless of the amount of any repairs or maintenance expenditure.	
	Additions	
2.26	Additions may bring into existence a new asset or increase the physical size of an asset through expansion, extension etc. All expenditure on additions shall be capitalised.	
	Improvements	
2.27	An expenditure having the effect of extending the useful life of an asset or increasing output or capacity or efficiency of an asset or decreasing operating costs of an asset is ‘Improvement’. Expenditure on improvement may involve replacement of old (e.g. replacing a transformer by another transformer of higher capacity) or may not involve replacement of old (e.g. expenditure on acid resistance lining in a tank in water treatment plant). All expenditure on improvements shall be capitalised.	
	Alterations/Renovations	
2.28	In case of alterations or renovations of building or plant, the treatment of expenditure shall be similar to that for improvements.	
	Rearrangement	
2.29	All expenditure on rearrangement (of plan layout, office layout etc.) shall be charged to revenue in the year in which the expenditure is incurred.	
	Replacements	
2.30	Replacements can be defined as ‘Substitution of one fixed asset by another, particularly of an old asset by a new asset or of an old part by a new part’. Expenditure on minor	

	replacements shall be charged to revenue as Repairs and Maintenance Expenditure. Major replacement expenditure shall be capitalised. However, the cost and accumulated depreciation of the old replaced assets shall be withdrawn when the expenditure on the new replacing asset is capitalised. A broad criterion of distinguishing minor and major shall be that replacement of any asset or part of the asset for which a separate fixed assets record is required shall be considered major replacement.	
	Piecemeal Rebuilding	
2.31	An asset may be rebuilt by replacement of its components over a period of time instead of at one time. The criteria fixed for 'minor' and 'major' replacements shall in such cases be applied to the aggregate of expenditures on replacement in an asset and accounted for accordingly.	
	Shifting an asset to another Place	
2.32	Any expenditure incurred on shifting assets from one place to another place shall, regardless of the amount of expenditure, be charged to revenue in the year in which the expenditure is incurred.	The requirements of ESAAR are in line with GAAPs.
	Contributions, Grants and Subsidies Towards Cost of Capital Assets	
2.33	Contributions, Grants and Subsidies towards cost of Capital Assets shall be treated in accordance with the policies laid down in the following paragraphs.	The requirements of ESAAR are not in line with GAAPs as prescribed in AS 12.
2.34	Amount receivable as consumer's contribution, subsidy or grant towards capital assets shall be credited to appropriate account set out in Chart of Accounts only if the following conditions are satisfied: (1) the amount is not subject to any conditions to be fulfilled by the Board or the conditions attached to the amount have been fulfilled by the Board, (2) no part of the amount is refundable nor is likely to become refundable by the Board,	
2.35	Consumers' Contribution, subsidies and grants towards cost of capital assets shall not be treated as a reduction in the 'cost' but as a capital receipt to be credited to capital reserve account.	
2.36	Accounting for cost of a capital asset shall be done in the normal course without considering any contribution, subsidy or grants towards the cost of the asset. Depreciation shall also be charged in the normal course on the 'full cost' of the asset.	
	Full Write-off of Small and Low Value Items	
2.37	Full cost of all small and low value assets each costing Rs.	The amount of Rs. 500

	500 or less shall be fully charged to revenue in the year in which the assets are put to use. No part of the cost of such items shall therefore be included in the cost of fixed assets nor shall any depreciation be charged thereon.	is too low in the context of the present day requirements.
	Exceptions	
2.38	The policy for full write-off stated in paragraph 2.37 above shall not apply to: (1) Items of a type for which a specific classification has been prescribed for the purpose of depreciation under the Electricity (Supply) Act, 1948. (2) Items included under the classifications 'Furniture & Fixture' and 'Office Equipments'.	
2.39	The accounting policy for write-off of small and low value assets prescribed in paragraph 2.37 shall not apply to cost of granting each service connection.	
	Criteria to apply to whole Asset and not to individual components	
2.40	In applying the accounting policy for full write-off of small and low value items, the asset as a whole shall be recognised and the individual spare parts or components of the asset shall not be treated separately. The criterion of Rs. 500 should therefore be applied to the aggregate expenditure.	
	Piecemeal Building of Assets	
2.41	Assets may be completely built over a considerable period of time rather than at one time. The cut-off criteria for write-off should in such cases be applied to the aggregate of expenditures and accounted for accordingly.	
	Commissioning of Assets	
2.42	All capital expenditure shall be accounted for through capital work-in-progress accounts. On commissioning of assets, the expenditure shall be transferred to appropriate fixed assets accounts. Transfer from capital work-in-progress accounts to fixed asset accounts is referred to in this section as "Capitalisation of Assets". The accounting policies prescribed for capitalisation of assets are laid down in the following paragraphs.	The requirements of ESAAR are not in line with GAAPs as prescribed in Guidance Note on Treatment of Expenditure during Construction Period.
	Capitalisation When Asset is first put to use	
2.43	An asset shall be capitalised when it is first put to use.	
	Assets which are 'commissionable' but not actually commissioned	
2.44	An asset which is installed/constructed and is in 'unsuitable/ commissionable' condition but is 'not commissioned/put to use' shall not be capitalised until it is actually put to use.	

2.45	All costs incurred on capital assets (including costs incurred on maintaining the assets which are ready but await the actual commissioning) shall be charged as the cost of the assets. *No waiting for Finishing Touches*	
2.46	Cost of an asset incurred up to the stage of commissioning of the asset should be capitalised when it starts being used without waiting for any finishing touches which may not be significant in work and value. Costs of, such finishing touches when completed, should be accounted for and added to the cost of the asset capitalised earlier. *Technical Certificate*	
2.47	Commissioning of an asset is a technical matter which involves consideration of various factors such as trial, testing to ensure whether the asset is in usable condition etc. Capitalisation of assets shall therefore be done on issue of Asset commissioning certificate from the relevant Technical Authority of the Board.	
2.48	*Capitalisation regardless of disputes with Contractors* Mere disputes with contractors/suppliers regarding the fulfillment of the terms and conditions of contract with them shall not be permitted to withhold or defer capitalisation of assets concerned. Cost of the assets determined on the basis of the contract should be capitalised by making necessary provision for liability to contractors/suppliers acknowledged by the Board.	The requirements of ESAAR are in line with GAAPs.
2.49	*Capitalisation regardless of Non-finalisation of Contractors' Bills, etc.* Mere non-submission of interim or final bills by suppliers or contractors shall not be permitted to withhold capitalisation of assets. In cases where bills are not received or are received but not passed, a provision should be made for an amount as per the contract. The cost of assets concerned shall be determined accordingly and capitalised when assets are first put to use.	The requirements of ESAAR are broadly in line with GAAPs, except the requirement of timing of capitalisation, i.e., when the asset is first put to use.
2.50	*Escalation Claims* Cost escalation claims made by suppliers and contractors should be provided for to the extent the claims are acknowledged by the Board and cost of assets inclusive of such provision shall be capitalised when the asset is first put to use.	The requirements of ESAAR are broadly in line with GAAPs, except the requirement of timing of capitalisation, i.e., when the asset is first put to use.
2.51	*Rural Electrification Schemes*	

	Cost of assets forming basic infrastructure for an electrification scheme shall be capitalised, when the infrastructure is first put to use and lines are energized. The subsequent expenditure on granting service connections, shall be capitalised as and when each service connection is granted. Capitalisation of individual service connections shall not be withheld or deferred until the targetted number of service connections are granted.	The requirements of ESAAR are broadly in line with GAAPs, except the requirement of timing of capitalisation, i.e., when the asset is first put to use.
2.52	*Full Capitalisation of Common Facilities* Certain assets may constitute common facilities, such as coal handling plant at a power station project which would provide services to say 3 units. Full cost of such common facilities assets shall be capitalised when the assets are first put to use.	The requirements of ESAAR are broadly in line with GAAPs, except the requirement of timing of capitalisation, i.e., when the asset is first put to use.
2.53	*Full Capitalisation of Underutilized Assets* An asset, once put to use, even if underutilised, shall be capitalised for its full cost.	The requirements of ESAAR are in line with GAAPs.
2.54 2.55 2.56	*Commissioning of Power Station* The prescribed accounting policy for capitalisation of power station assets is laid down below: (1) All costs incurred prior to commencement of trial stage shall be capitalised. (2) All costs and revenue during the trial stage shall be treated in the manner prescribed in paragraph 2.56 titled "Cost and Revenue at Trial Stage". (3) At the end of the trial stage, the generating plant shall be treated as 'commissioned'. *Commissioning of Transmission Lines and Sub-stations* On commissioning of a transmission lines, all the assets which are put to use shall be capitalised and the total cost of such assets shall be transferred from capital work-in-progress accounts to Fixed Asset Accounts. All expenses incurred before commissioning of transmission lines and sub-station shall be included in the cost of the assets. *Costs and Revenue during Trial Stage* Costs incurred and revenue earned (from sale of power generated by the unit under trial) during the period of trial stage shall be treated as follows: (1) Full period of trial stage or the period of three months from the commencement of trial stage (whichever is	The requirements of ESAAR are broadly in line with GAAPs as prescribed in Guidance Note on Treatment of Expenditure during Construction Period.

	shorter) shall be called capitalisable period. (2) Trial stage costs incurred during the capitalisable period shall be treated as capital costs of assets involved. (3) Revenue earned from the sale of power generated (by the unit under trial) during the capitalisable period shall be treated as reduction in capital costs. (4) The excess of costs as per (2) above over the revenue as per (3) above shall be added to the costs of the assets involved at the trial stage. If the amount of revenue is greater than the amount of costs, the excess shall be deducted from the cost of the assets involved at trial stage. (5) All trial stage costs incurred or revenue earned after the end of capitalisable period shall be taken to Revenue Account without capitalisation of any part of it.	
 2.57 2.58 2.59	*Capitalisation of Capital Spares at Generating Stations* "Capital spares at a Generating Station" purchased prior to commissioning of the generating station shall be capitalised upon "Capitalisation of the Generating Station" for which the spares are purchased. Capital spares purchased subsequent to the commissioning of generating station shall be capitalised upon purchase. *Capitalisation of Spare Units/Service Units* Assets which are to be classified as spare Units/Service Units in accordance with the accounting policy recommended under the section 'Other Accounting policies' shall be capitalised when they are 'Put into usable condition' regardless of whether they are actually used or not.	The requirements of ESAAR are strictly not in line with GAAPs as prescribed in AS 2 and AS 10. Paragraph 2.59 may create anomalous situation when applied along with paragraphs 2.43 and 2.44.
 2.60	*Depreciation* The accounting policies relating to depreciation on fixed assets are laid down in the following paragraphs: (1) The Board shall charge as depreciation on the fixed assets in use in the beginning of the year, such an amount as is required to write-off 90 per cent of the cost of an asset, on a straight line method over the 'estimated useful life of the asset'. (2) Depreciation charge on an asset shall cease from the year following the year in which - the year's depreciation along with the depreciation charged in the previous year(s) becomes equal to	The requirements of ESAAR are not in line with GAAPs as prescribed in AS 6 and Guidance Note on Accounting for Depreciation in Companies.

	or more than 90 per cent of the cost of the asset, or - the asset permanently ceases to be used by the Board whichever is earlier. (3) Depreciation charge on a newly commissioned asset shall commence in the year immediately following the year of commissioning.	
2.61	*Depreciation on Leasehold Assets* In respect of leasehold assets, the depreciation to be charged every year shall be such an amount as is required to write off 100 per cent (unlike 90 per cent for other assets) of the cost of leasehold asset, on a straight line method, – over the estimated useful life of the asset; or – over the period of the lease; whichever is shorter. In Considering the lease, the renewal clause, if any, in the lease agreement shall be ignored.	The requirements of ESAAR are not strictly in line with GAAPs as prescribed in AS 19.
2.62	Expenditure on development/improvement on leasehold assets shall be depreciated in such a way that full amount of such expenditure, can be written-off, on straight line method; – over the estimated useful life of assets; or – the balance of the lease period; whichever is shorter. In considering the lease period, the renewal clause, if any, in the lease agreement shall be ignored.	The requirements of ESAAR are in line with GAAPs.
2.63	*Second Hand Assets* Second hand assets i.e. assets used by the previous owner (for whatever number of years) and acquired by the Board shall be depreciated over: - the estimated useful life of those assets ascertained by the State Government; and - where no such period is ascertained by the State Government 'Half of the estimated useful life of new assets of that class' (as if half the life is expired).	The requirements of ESAAR are not in line with GAAPs as prescribed in AS 6.
2.64	*Assets of Common Retirement Date* Assets which are of use only collectively in a group and an individual asset in that group is of no use in isolation after the	The requirements of ESAAR are in line with

	other assets of the group are retired/scrapped, are defined as 'Assets of Common Retirement Date'. The period of estimated useful life adopted for the purpose of charging depreciation shall be "common" for all the assets in the group of 'Assets of Common Retirement Date'.	GAAPs.
	Retrospective Reworking of Depreciation	
2.65	Retrospective reworking of accumulated depreciation owing to change in the amount of cost of an asset for the reasons mentioned in 2.124 shall be made only where the increase/decrease in the amount of cost is more than; – Rs.50,000 for an asset; and – 20 per cent of the cost booked earlier. In all other cases, the depreciation in the balance life of the asset should be increased or decreased proportionately so that 90 per cent of full cost (or 100 per cent in case of lease-hold assets) is depreciated over the estimated useful life of the asset.	The requirements of ESAAR are not in line with GAAPs as prescribed in AS 6.
	Depreciation of Assets used for Construction	
2.66	Assets used for construction are classified as under: (1) Construction Facilities (2) Project Assets (3) Fixed Asset	The requirements of ESAAR with regard to capitalisation of depreciation are broadly in line with GAAPs except the requirement of non-provision of depreciation during first year of commissioning.
2.67	By 'construction facilities' is meant those assets which are intended for use on one or the other capital protect.	
2.68	Depreciation shall be charged on assets classified as construction facilities in the normal manner as it is charged on assets used for O&M except that the amount of depreciation shall be debited not to Depreciation Account but to 'Capital WIP-Revenue Expenses Reclassified Account'.	
2.69	Certain assets acquired/constructed as a part of a project may be used for construction of other assets of the same project. Such assets should not be capitalised when they are first put to use. Capitalisation should not be withheld till commissioning of say power plant itself. Depreciation is not chargeable in the first year of commissioning. From the subsequent year, deprecation should be charged in the normal manner. However, the depreciation so charged shall be reclassified and charged to cost of other assets of the project.	
2.70	Fixed Assets used for construction means those assets which have been, on their commissioning, transferred to Fixed	

	Assets accounts, and are now deployed on any project at construction stage.	
2.71	Depreciation on such assets shall be charged in the normal manner. The amount of depreciation charged on such assets shall be later reclassified and charged to capital works.	
	Provisional Depreciation	
2.72	Board shall ensure that there is no asset which is in service but not depreciated for reasons such as: (1) Precise cost not known, (2) Estimated useful life not known, or (3) The responsibility for maintenance and/or accounting of newly constructed/acquired assets not known. Boards shall endeavour to remove any such reasons at the earliest and shall in the meantime charge at least provisional depreciation on the assets concerned.	The requirements of ESAAR are broadly in line with GAAPs in this regard.
	Retirement, Scrapping, Obsolescence and Sale of Assets	
2.73	The accounting policies relating to retirement, scrapping, obsolescence and sale of assets are laid down in the following paragraphs.	The requirements of ESAAR are in line with GAAPs.
	Cost of Retirement, Scrapping, Sale of Assets	
2.74	All costs incurred on retirement, scrapping and sale of assets shall be charged to Revenue Account in the year in which the costs are incurred. Examples of such cost are: (1) Building/Civil Works demolition costs (2) Plant decommissioning costs (3) Site restoration costs (4) Expenses like legal charges and stamp duty for transfer of title to the purchaser (5) Freight etc. on transfer of assets to any Asset/Scrap Disposal Authority in the Board (6) Expenditure on freight etc. on delivery of the sold assets/scrap to the purchaser.	
	Withdrawal of cost and Depreciation	
2.75	On retirement, scrapping, obsolescence of an asset, the cost of the asset and the accumulated depreciation on it shall be withdrawn from the fixed asset base and transferred to a separate account provided for this purpose.	
	Loss on Scrapping of Assets	
2.76	In case of scrapped asset for which no scrap/salvage value is realised, the written down value of such assets shall be charged off as "Written down value of assets scrapped" in	

	the Revenue Account for the year in which the scrapped assets are found unrealisable.	
	Gain or Loss on Sale of Assets	
2.77	Gain or loss arising on sale of capital assets shall be treated as a revenue item. The gain shall, subject to paragraph 2.78 be credited to Revenue Amount for the year in which the asset is sold and the loss on sale of a capital asset shall be debited to the Revenue Account for the year in which the asset is sold.	The requirements of ESAAR are not in line with GAAPs as prescribed in AS 10 and AS 12.
2.78	The gain on sale of assets shall be treated as a Revenue item only to the extent of total depreciation charged on the sold asset. Gain if any in excess of the accumulated depreciation charged by the Board on the sold asset shall be treated as a capital gain and credited to Capital Reserve.	
2.79	For the purpose of computing gain or loss on sale of an asset also the contributions, grants and subsidies towards cost of any capital asset sold shall not be reduced from the cost of the asset sold.	
	Date of Acquisition not known	
2.80	In case of assets scrapped/destroyed/sold for which the date of acquisition is not known, it shall be assumed, for the purpose of withdrawal of cost and depreciation that the asset concerned was the oldest asset of that type in use at that accounting unit.	The requirements of ESAAR are in line with GAAPs.
	Loss of Assets	
2.81	In the event of loss/destruction of an asset, the cost and the accumulated depreciation on that asset shall be withdrawn from the fixed assets block and provision for depreciation respectively.	The requirements of ESAAR are in line with GAAPs.
	Write-off of Loss	
2.82	Excess of the written down value of the lost/destroyed asset over the amount of insurance claim granted shall be charged to revenue in the year in which the insurance claim is settled.	
	Other Accounting Policies	
2.83	The accounting policies for all other matters in relation to capital assets are laid down in the following paragraphs.	The requirements of ESAAR are not in line with GAAPs since ESAAR does not lay down criteria for classifying spares as capital spares and, accordingly, the treatment thereof would not be as per GAAPs in respect of those spares which cannot be
	Capital Spares at Generating Stations	
2.84	The accounting policy in respect of capital spares at generating stations is given below: (1) The capital spares at generating stations should be treated as a capital asset. (2) Accounting shall be done together for the entire 'lot' of the spares and not item by item.	

	(3) The total cost of the spares shall be capitalised. (4) No accounting shall be done at the time of issue of such spares for replacement in the generating plant. (5) However, on the other hand, depreciation shall be charged on cost of the entire lot of spares. (6) For the purpose of charging depreciation, the estimated useful life of the spares shall be assumed to be equal to the estimated useful life of the generating plant. (7) On this basis, depreciation equal to 100% (not 90% as in case of other assets) of the cost of spares shall be charged by the time the generating plant is to be retired. (8) On expiry of the life, the spares will therefore be valueless. (9) The spares remaining unutilised may be sold along with the retired generating plant. Entire sale proceeds should be treated as gain on sale of assets since 100% depreciation is charged in the past. (10) In respect of the stock of spares remaining unsold on retirement of the plant, no accounting shall he necessary. (11) If some spares are sold and some are not sold, the accounting is necessary only for spares sold i.e. treat the sale proceeds as gain on sale of assets. (12) If some spares are transferred by the generating station to another generating station requiring them, no accounting is necessary in such case.	considered as capital spares as per the criteria laid down by GAAPs.
	Takeover of Licensee	
2.85	In respect of the assets taken over from licensee, the amount of compensation payable for an asset shall be treated as and accounted for as the cost of the asset.	The requirements of ESAAR are in line with GAAPs except the requirements relating to depreciation (see comments in this regard against paragraph 2.63).
2.86	Even where the takeover itself or the compensation determined by the Board for takeover has been disputed by the licensee, the assets shall be provisionally valued at the compensation determined by the Board.	
2.87	Depreciation shall also be charged as in the normal course based on the provisional valuation. Estimated useful life shall be as fixed by the State Government. If State Government has not fixed any life, half of normal life shall be adopted.	
	Spare Units/Service Units	
2.88	The accounting policies prescribed for spare units/service units are given below. The term 'spare unit' covers both spare units and service units.	The requirements of ESAAR are in line with GAAPs except the

	(1) All spare units shall be capitalized when they are purchased and put into ‘usable’ condition (ignoring the fact that they are not actually being used and lying in stores unutilised). (2) Depreciation on spare units shall be charged in normal course as charged for the same type of assets which are ‘in use’. (3) When the original units are removed for repairs or maintenance and the spare units are installed, no accounting adjustments are necessary. (4) Expense on repair or maintenance on the removed units shall be charged to revenue. (5) No accounting entry will be passed either - when the removed unit is Put back into usable condition; or - when it is actually used again in place of some other unit removed for repair or maintenance; or - the repaired unit is installed back in its place and the spare unit installed earlier (Step No. 3 above) is removed and brought back to stores. (6) When the removed unit is considered irreparable, it will be considered to be a retired asset (if the estimated life is over) or scrapped asset (if estimated life is not over) and accordingly the subsequent accounting for retirement, scrapping and sale shall be done. (7) Simultaneously with retirement/scrapping of the original unit, the cost and accumulated depreciation on the spare unit shall be transferred to Fixed Assets account. (8) If one new spare unit is purchased (so as to keep total stock at its position) it will be capitalised and thereafter the above procedure shall again be followed in respect of it. (9) Thus essentially, the capital asset additions shall be recognised when a new unit is purchased and a “deduction” is recognised when any unit is retired/scrapped. All transfers within the entire stock of installed units plus spare units could not involve any accounting.	requirements relating to depreciation. (see comments in this regard against paragraph 2.60).
2.89	*Formation of a New Board* On formation of a new Sate Electricity Board, the geographical territories of an existing Board may get transferred to the new Board. The fixed assets of the existing Board may also get transferred at Book value (cost	The requirements of ESAAR are in line with GAAPs.

	less accumulated depreciation) to the new board. In all cases of transfer, the new Board shall not account for the book value at the net cost but shall incorporate gross cost as well as accumulated depreciation in its books of account. Depreciation on such assets should also continue to be charged on the gross cost in the same manner as the Board holding that asset hitherto would have charged.	
	Finance related Costs	
2.90	The accounting policies for treatment of costs related to funds utilised for the purpose of construction/acquisition of assets are prescribed in the following paragraphs.	The requirements of ESAAR are not in line with GAAPs as prescribed in AS 16.
	Costs relating to Borrowings	
2.91	Guarantee charges, commitment charges, legal charges/stamp duty for loan agreements/ bonds/ debentures, advertisement costs in a public issue of bonds, commission on issue of bonds/debentures and such other costs shall be charged to revenue in the year in which the costs are included.	
	Discount/Commission/Redemption Premium on Bonds/ Debentures, etc.	
2.92	Discounts on issue of bonds/debentures shall be charged to revenue in the year in which bonds/ debentures are issued. Premium payable on redemption of bonds/debentures shall be charged to revenue in the year in which the premium becomes payable.	The requirements of ESAAR are not in line with GAAPs as prescribed in AS 16.
	Capitalisation of Interest on Funds utilised at Construction Stage	
2.93	No Capitalisation of an imputed interest cost (notional interest) on the Board's own funds and interest free finance shall be permitted.	The requirements of ESAAR are in line with GAAPs as prescribed in AS 16.
2.94	Every year, a portion of the interest payable on the interest bearing borrowings which relate to financing of capital assets at constructions stage i.e., till the point of commissioning of assets shall be computed in the manner prescribed in paragraph 1.42 of Annexure V and if so directed by Central Government, be capitalised.	
2.95	The amount of interest so computed and capitalised shall be reduced from the amount of interest for the year and only the balance amount shall be chargeable to the Revenue Account for the year.	
2.96	No part of interest shall be capitalised in respect of assets which involve no time period or involve insignificant time periods for bringing the asset into usable condition. Example of such cases are: ➢ purchase of new vehicles.	

	➢ purchase of furniture items. ➢ purchase of office equipments.	
2.97	The amount of interest capitalised shall be included in the cost of the assets which involve significant time period at construction stage and the same shall, along–with the basic cost of assets, be depreciated in normal course, over the expected useful life of assets.	
	II. Fuel and Materials Accounting	
	Fuel Accounting	
2.98	The accounting policies for Fuel Accounting are laid down in the following paragraphs.	The requirements of ESAAR are not in line with GAAPs.
	Basis of Valuation of Receipts of Fuel	
2.99	Valuation of fuel receipts shall be based on the actual quantity and quality of fuel received as determined in accordance with Annexure V and shall cover two elements of cost viz. fuel cost and freight for fuel receipts.	
2.100	Freight cost for coal shall be booked at a standard fright rate to be fixed for each quarter for each power station on the basis of colliery-wise expected supplies as per Coal Allotment Programme.	
	Treatment of Other Costs relating to Fuel	
2.101	The costs relating to receipts and stocks of fuel other than the freight cost and fuel cost shall not be added to the value of fuel received, consumed or in stock. These costs when incurred (whether paid or not) shall be charged to revenue through the relevant account provided for these costs.	
	Accounting for Inferior Grade of Coal	
2.102	In respect of the wagons allotted to and received by a Board, in the event of receipt of a grade of Coal inferior to the grade billed, the excess, if any, of the amount billed over the amount payable for the inferior grade of Coal actually received, shall be treated as a loss on inferior grade of coal, if the same is not recoverable from the collieries. Such treatment shall be given, as far as possible, in the year of such receipts.	The requirements of ESAAR are in line with GAAPs.
	Accounting for Superior Grade of Coal	
2.103	In respect of the wagons allotted to and received by a Board, in the event of receipt of a grade of Coal superior to the grade billed, the excess, if any, of the amount payable for the superior grade of Coal actually received over the amount billed shall be treated as a gain on superior grade of Coal. Such treatment shall, as far as possible, be given in the year of such receipts.	The requirements of ESAAR are not in line with GAAPs.

	Accounting for Losses or Gains on Settlement of Claims with Railways for Missing Wagons	
2.104	No provision shall be made for the losses or credit taken for the gains which are likely to arise on settlement of the claims with Railways which remain unsettled at the year-end.	The requirements of ESAAR with regard to non-provision of expected losses on settlement of claims are not in line with GAAPs.
2.105	Losses or gains on settlement of claims should be booked in the accounts on intimation of the decision by the Railways to the Board of the claims which are settled by them.	
	Basis of Valuation of Fuel Consumed and Fuel Stock	
2.106	The rate adopted for valuation of fuel consumed shall be a weighted average rate computed in the following manner: $$\frac{\text{Value of stock at beginning of the month plus value of 'Net receipts' during the month.}}{\text{Quantity of stock at the beginning of the month plus Quantity of 'Net Receipts' during the month.}}$$	The requirements of ESAAR are not in line with GAAPs since net realisable value has not been considered for valuation of inventories of fuel.
2.107	The fuel stocks at the end of a month shall also be valued at the abovementioned weighted average rate. Notes : (1) Net receipts would mean receipts after deducting the transit loss of fuel. Transit loss shall be valued at the average receipt rate for the month. (2) Quantity and value of all fuel receipts during the month shall regardless of their grades, be aggregated for this purpose.	
	Treatment of Excess/Shortage on Physical Verification of Fuel Stocks	
2.108	The value of shortage, on physical verification of fuel stocks at the year-end, will be treated as a cost of fuel consumed and the value of excess, as a reduction in cost of fuel consumed.	The requirements of ESAAR are in line with GAAPs to the extent shortage/excess does not represent abnormal loss/gain.
	Materials Accounting *Accounting for Materials Transactions*	
2.109	Accounting for all material transactions shall be in the same period in which the physical event of receipts, issues etc. takes place. Similarly, liability for all materials received and accepted by the Board shall be created in the month in which the materials are accepted.	The requirements of ESAAR are not in line with GAAPs.
	Accounting for Incidental Expenses	
2.110	Incidental expenses incurred shall not be linked to the actual materials receipts/ issues and therefore shall not be	

	treated as Materials Cost. These expenses shall be treated as a period cost and shall be charged to the Revenue Account of the period in which these expenses are incurred. *Recognition of Consumption*	
2.111	Accounting for consumption shall closely follow the physical transactions. Issues of materials in respect of specific works shall be forthwith treated as consumption. Where there are lump-sum withdrawal of materials, consumption shall be recognised only when the exact end-use is established.	
	III. Borrowings and Investments	
	Interest on Borrowings	
2.112	Provision shall be made every year for the interest accrued on all borrowings including State Government loans whether such interest is due or not and whether it is actually paid or not. In the event of interest payment to State Government not being effected in pursuance of Section 67-A of the Act, the same may be considered as deferred liability. The deferred liability in such cases only means deferment of payments and not deferment of the charge to Revenue Account.	The requirements of ESAAR are in line with GAAPs.
2.113	Total interest cost for the year including interest on State Government loans shall, subject to capitalisation of a portion of interest as per paragraph 2.114 be charged to Revenue Account for the year.	
2.114	A portion of the interest on borrowings which relates to financing of capital work-in-progress upto the stage of commissioning shall, if so directed by Central Government be capitalised in accordance with paragraphs 2.93 to 2.97.	
	Cost Relating to Borrowings	
2.115	Guarantee charges, commitment charges and legal charges/stamp duty for loan agreements, debenture trust deeds, bonds or debentures shall be charged to revenue in the year in which the costs are incurred. Provision shall be made at the year-end for the above costs for the year, which have accrued but are not paid. *Discount and Redemption Premium on Bonds etc.*	The requirements of ESAAR are not in line with GAAPs as prescribed in AS 16.
2.116	Discount on issue of bonds, debentures or other securities offered by a Board shall be charged to Revenue in the year in which the bonds/debentures are issued.	
2.117	Premium, if any, payable on redemption of bonds, debentures or other securities shall also be charged to Revenue Account in the year in which premium becomes payable.	
	Treatment of Income and Investments	
2.118	Income from investment shall be credited to the Revenue Account for the year in which the income has accrued.	The requirements of ESAAR are in line with

2.119	However, if the investments are held as earmarked investments against any Fund such as Pension Fund, Gratuity Fund etc., the income from such investments may be credited directly to the respective Fund. Provision shall be made for the income from investments (whether to be credited to Revenue Account or a Fund) which has accrued but not received by the Board.	GAAPs as prescribed in AS 13. The Standard, however, does not deal with recognition of income from investments held as earmarked investments against any fund.
2.120	*Investments to be Recorded 'at Cost'* Investments shall be recorded in the books of accounts at actual cost of acquisition including transfer charges, stamp duty etc. No adjustment shall be made for the excess or shortfall of the cost over the face value of the investments.	The requirements of ESAAR relating to determination of cost of investments are in line with GAAPs as prescribed in AS 13.
2.121	*Treatment of Loss/Gain relating to Investments* Gain on sale of investments shall be credited to the Net Revenue and Appropriation Account. Similarly if any Redemption premium is received on maturity of securities, the same shall also be credited to Net Revenue and Appropriation Account. Loss on sale of investments shall be debited to Net Revenue and Appropriation Account. In case of investments against a Fund the credit for the gain or debit for the loss shall not be given to the Revenue Account but to the respective Fund Account itself.	The requirements of ESAAR are not in line with GAAPs as prescribed in AS 13.
	IV. Other Accounting Areas	
2.122	*Foreign Currency Transactions* When a foreign currency transaction is being first recorded in a Board's book of accounts, the assets, liabilities, income or expenses arising from the foreign currency transaction shall be translated at the official exchange rate in force on the transactions date.	The requirements of ESAAR are in line with GAAPs as prescribed in AS 11.
2.123	All amounts owed to the Board or owed by the Board in foreign currency outstanding at the balance sheet date (including liability in relation to acquisition of fixed assets) shall be translated at the official exchange rate in force as on the balance sheet date. If the amount derived on such translation is different from the amount at which the receivable or liability is appearing in the books of account, the difference shall be recorded in the books as under: (1) Increase in the amount of receivable or decrease in the amount of the liability shall be treated as a gain and be credited to Exchange Variance Reserve. (2) Decrease in the amount of receivable or increase in the amount of liability shall be treated as a loss and shall be debited to Exchange Variance Reserve. If *as*	The requirements of ESAAR are not in line with GAAPs as prescribed in AS 11.

	a result of such debit, the net balance in reserve account is a debit balance, the amount of debit balance shall be charged to revenue for the year as "Loss on Exchange Rate Variation". Gain or loss arising on account of difference between actual amount received/paid and the amount at which the item is appearing in books shall also be treated in the same manner as above.	
2.124	Where any revaluation or devaluation of rupee vis-a-vis the currency in which the liability is to be discharged is more than 10% at one time, the same shall not be treated in accordance with the abovementioned policy. The policy relating to treatment of such situation shall be as follows: (1) the increase or decrease in the amount of foreign currency liability shall be accounted for as an increase or decrease in the cost of the assets financed by the liability. (2) the depreciation for the past years shall also be reworked for the assets where the conditions laid down in paragraph 2.65 for retrospective reworking of depreciation are fulfilled.	
	Loss due to Fire, Flood, Cyclone, etc.	
2.125	All losses on account of flood, cyclone, fire, etc., shall be treated as the loss for the year in which the loss was incurred. Such a charge against revenue shall be reduced, (1) by the insurance claim granted by the insurer where assets are insured with an outside insurer; (2) by the amount of reserve created where the Board follows self insurance practice; and (3) by subsidy, if any, received from Government etc., specifically for meeting the loss. In the case referred to in sub-point (2) above, the excess amount set aside, if any, in respect of the assets may be written back to Revenue Account.	The requirements of ESAAR are in line with GAAPs.
	Income-Tax	
2.126	Provision shall be made every year, for the tax payable by the Board on its income or profits in accordance with provisions of the relevant tax law. Such a provision shall be treated as a charge against the revenue before arriving at the Board's profit for the purpose of computing surplus for the year under Section 59.	The requirements of ESAAR are not in line with GAAPs as prescribed in AS 22.
2.127	Any excess or shortfall of the provision for income period credit or prior period charge in the revenue account for the year in which such excess or shortfall is established.	
	Timing of Accounting for Revenue	

2.128	Revenue from sale of power shall be accounted for on an accrual basis. The accounting for revenue shall thus be totally delinked from the timing and the extent of actual collection of revenue from consumers. Where the sale of energy prior, to the end of a year has not been billed, a provision for such unbilled revenue shall be made at the year-end so as to treat the amount as revenue in the year of supply of power.	The requirements of ESAAR are not in line with GAAPs as prescribed in AS 9 since the concepts of measurability and ultimate collection have not been recognised.
	Treatment of certain items recoverable from consumers	
2.129	The accounting policy on treatment of certain items recoverable from consumers is laid down below with reference to each such item: (1) *Electricity Duty* – Electricity duty recovered from consumers and forwarded to the Government is neither a cost nor an income to the Board. It should thus be kept out of the Revenue Account altogether. The point of time the liability to pay Electricity Duty to the Government arises would differ from State to State – it may arise either on assessment or on collection. In order to reflect the liability truly in either case, the amount of duty assessed but not collected from consumers and the amount of duty collected from consumers but not yet remitted to the Government shall be shown separately in the accounts. (2) *Minimum Charges* – Minimum Charges levied in case of consumption below a specific minimum consumption during a billing period or during a year shall, for the sake of working convenience, be treated fully as revenue from sale of power although strictly only a part thereof relates to sale of power. (3) *Treatment of Minimum charge levied on Applicants who have delayed taking of connection* – Applicants who delay their Test Report are at times billed a minimum charge even though no power has been supplied to them. Such income shall be treated as “Miscellaneous Charges from Consumers”. The amount receivable on this account shall also be accounted for in an account separate from ‘Sundry Debtors for Sale of Power’. (4) *Treatment of discount allowed for timely payment* – Cash discounts allowed to consumers as an incentive for timely payment by the due date should when allowed, be treated as a cost and shown separately as such in the Revenue Account. (5) *Treatment of Delayed Payment Charges* – Charges recovered from consumers for delayed payments should not be clubbed with the revenue from sale of power but shown separately since these are more in	The requirement of ESAAR, with regard to treatment of bills raised for theft of energy is not in line with GAAPs as prescribed in AS 9.

	the nature of a financial charge. (6) *Accounting for bills of Thefts of Energy* – Income arising from the bills raised for Theft of Energy, whether on a consumer or an outsider, shall be treated as income and reported under a separate account head provided for such revenue.	
2.130	*Cheque Received and in Hand to be Regarded as Cash* Cheques and bank drafts received will be treated as cash until they are deposited in bank and will be included as 'Cash on Hand' in the accounts. Banking of such cheques and drafts will, therefore, be considered as deposit of cash in the Bank Account.	Technically correct practice would be to show such cheques as 'Cheques in Hand'.
2.131	*Subsidies* Subsidies which are available to assist a Board to meet, partly or fully, shortfall of revenue as compared to cost of operations of a specific type of a specific activity carried out or being carried out by the Board on its own or under the directive of the body from whom the subsidy is receivable shall be credited to Revenue Account.	The requirements of ESAAR are broadly in line with GAAPs as prescribed in AS 12, except those in 2.133.
2.132	The subsidies, the receipt whereof is dependent upon the Board satisfying certain conditions shall not be taken credit for to Revenue Account until the Board satisfies all such conditions.	
2.133	Where a claim for subsidy of revenue nature is made but no intimation of granting of the claim has so far been received the outstanding amount for the current year and for the past years should be shown as a deduction in the Reserve Schedule.	

Procedural Matters Relating to Accounting Transactions (Annexure V of ESAAR, 1985)[1]		**Comments**
Para No.	**Description**	
1.2(1)	*Assets received as Donation /Grant* – An Asset received as donation shall be accounted for at its fair market value. The fair market value shall be debited as the cost of the asset and credited to 'Donated Capital Assets Account', which shall be included under a Reserve and be treated in the same manner as Contributions, Grants and Subsidies towards cost of capital assets. Donated assets which are subject to certain conditions shall nevertheless be treated as fixed assets but be disclosed by way of a foot note indicating value of such assets. Assets received as grant shall also be accounted for in the same manner as donated assets.	The requirements of ESAAR are not in line with GAAPs as prescribed in AS 12.
1.2(2)	*Exchange of Assets* – Where an asset is exchanged for another asset, the asset surrendered shall be deemed to	The requirements of ESAAR are not in line

	have been disposed of at its fair market value. Gain or loss based on the fair market value shall be accounted for in the normal course. The cost of the asset acquired in exchange shall be deemed to be the fair market value of the asset surrendered plus any additional consideration given or minus any additional consideration received.	with GAAPs as prescribed in AS 10.
1.2(3)	*Leasehold Assets* – Lease Premium payable on acquiring lease rights for assets shall be treated as the cost of leasehold assets. Depreciation shall be charged on such cost in the manner prescribed for Depreciation on Leasehold Assets. Periodic rentals payable on leasehold assets shall be charged to Revenue in the year in which the rentals accrue. If the Board acquires, leasehold rights for an asset with no or negligible lease premium, the fair market value of the asset shall be determined and the amount required to state the asset at its fair market value shall be debited to the asset and credited to an account 'Liability for Leasehold Assets'. The fair market value of the leasehold assets shall be depreciated over the lease period. Simultaneously extinguishments of a proportionate amount of liability set up in the books shall also be affected. By the end of the lease period the liability in accounts would have been fully extinguished and a provision for depreciation equal to the amount of fair market value booked as cost would have been created. On returning the assets to lessor, the provision shall be set off against the amount of cost of the asset so as to close the two accounts.	The treatment prescribed under ESAAR where lease premium is payable is in line with GAAPs, if the lease is finance lease as per AS 19. The treatment in respect of leasehold rights with no or negligible lease premium is not as per GAAPs as prescribed in AS 12.
1.10	*Land as a future Plant Site* Land may be purchased or acquired as a future plant site for projects which are yet to be taken up (e.g. land purchased for a project which is sanctioned in principle but detailed survey and investigation is continuing). Cost of such land shall be debited to capital work-in-progress account (Project code 99- Not identifiable to any specific project code).	The requirements of ESAAR are not in line with GAAPs.
1.11	*Purchase of a Building alongwith land* When a building is purchased alongwith the land, the purchase cost shall be allocated between the land and the building based upon a technical and commercial appraisal. If a part of the purchase consideration towards land is for lease rights to the land, that part should be appropriately classified as leasehold land.	The requirements of ESAAR are in line with GAAPs as prescribed in AS 10.
1.12	*Assets Awaiting Conveyance in favour of the Board* In the case of purchased assets, wherein formal conveyance is delayed and the Board has in the meantime put the asset to use, the cost of the asset shall be shown as fixed assets. The fact of pending conveyance of the asset may be disclosed by way of a note to the accounts.	The requirements of ESAAR are in line with GAAPs.

1.16	*Certain Amounts may not be Grants/ Subsidy.* Certain amounts receivable by the Board may be computed with reference to the cost of capital assets or progress on a capital project but in fact are actually in the nature of interest free loans. Such amounts shall not be treated as grants or subsidy towards cost of capital assets.	The requirements of ESAAR are in line with GAAPs.
1.25	*Periodic Review of Prescribed 'Estimated useful life'* Central Government shall periodically carry out an exercise to assess the need for any change in the 'estimated useful life of assets' prescribed by it, required in view of technological changes in the assets normally used by various Boards of the country. Based on the findings of the exercise, such changes shall be made to the schedule of prescribed period of estimated useful life of assets as are considered necessary by the Central Government. All changes to the schedule of prescribed period of estimated useful life shall be prospective and shall be applicable only for depreciation chargeable in subsequent years.	The requirements of ESAAR are in line with GAAPs.
1.27	*Subsequent Change in the Purpose of use of an Asset* Any change in the purpose of use of an asset shall be recognised only prospectively for charging depreciation in the years subsequent to such change. For example, Building containing Diesel Generating Sets is to be depreciated over say 30 years, the DG sets are scraped earlier since they were obsolete in technology and the building is, after some notifications, used for say office purpose (for which estimated life is say 50 years). The change in the estimated useful life of the asset owing to a change in the purpose for which the asset is used, shall be recognised only for future depreciation.	The requirements of ESAAR are in line with GAAPs as prescribed in AS 6.
1.28	*Wear & Tear during Construction Stage* In a project period of say 4 to 5 years, assets which were constructed in say first year but lying idle until completion of other assets, do suffer wear and tear during the following 3 to 4 years. No depreciation shall be charged towards such wear and tear of such idle assets at construction stage.	The requirements of ESAAR are not in line with GAAPs as prescribed in AS 6.
1.29	*Assets Transferred to Other Divisions / Circles* In respect of the assets transferred between accounting units during the year, the accounting unit which held the assets at the beginning of the year, shall charge full year's depreciation on the transferred assets and no depreciation on the assets shall be charged for the year by the transferee location(s).	The requirements of ESAAR are not in line with GAAPs.
	Provision for Loss on Obsolescence	

1.32	Provision shall be made for loss, if any, expected to arise from the obsolescence, determined by the Board of any of its capital assets whether in service or removed from service. Similar provision shall be made for loss from obsolescence of capital spares. The provision shall be utilised to meet the loss arising on disposal/scrapping of those assets.	The requirements of ESAAR are not in line with GAAPs.
	Assets taken over from Licensee	
1.33	The accounting policy prescribed for assets taken over from licensee requires adoption of provisional valuation in case of disputes. On final valuation of the taken over assets the following procedures should be adopted- (1) Any increase or decrease from the provisional valuation shall be adjusted to the cost of the assets. (2) Small and low value assets shall be written off. (3) Depreciation on all the balance assets which are capitalised shall be reworked from the date on which the assets were vested in the Board. (4) Difference between the provisional depreciation and the reworked depreciation shall be credited or debited (as the case may be) to the Revenue Account for the year in which final valuation of taken over assets is done. Such debit or credit shall be disclosed in the Revenue Account as Prior Period Gain or Charge.	The requirements of ESSAR are in line with GAAPs except the retrospective reworking of depreciation.
1.34	The reworking of depreciation referred to in the above paragraph shall also incorporate changes, if any, made to the estimates of useful life of the assets which were adopted for charging provisional depreciation. This may be necessary when the State Government has finally fixed the estimated useful life. If however, the final estimate of useful life is made after the reworking of depreciation, then the changes in life shall be recognised only for future depreciation without any retrospective reworking.	
	Disputed Claims under Warranty for Repairs	
1.35	Suppliers/Contractors of capital equipments may have provided warranty of repairs of assets. Board's claims under such warranties may get disputed by Suppliers/Contractors. Repairs expenditure incurred by the Board for which the reimbursement is claimed but is disputed shall be fully charged to Revenue Account for the year in which the costs are incurred. Reimbursement when granted by the supplier should be credited to Revenue Account in the year of receipt of reimbursed amount.	The requirements of ESAAR are in line with GAAPs.
	Excess/ Deficits observed on Physical Verification	
1.36	Any excess observed on physical verification of assets	The requirements of

	shall be brought into Board's books by valuing each excess item at one rupee each. The credit will be given to miscellaneous income account.	ESAAR are in line with GAAPs.
1.37	The written down value of assets not found on physical verification and established after investigation, as deficit shall be written off by transferring the cost and accumulated depreciation on such assets to the Revenue Account.	
	Certain Disclosures required to Board's Accounts	
1.38	Board's accounts shall disclose by way of a note- (1) Book value of assets, if any, which are likely to require surrender of the assets by the Board to the Suppliers/Lenders since the Board has failed to make certain payments in respect of purchase price of the asset or loans raised on the security of such assets. (2) The Assets in respect of which an effective title is not vested in the Board.	The requirements of ESAAR are in line with GAAPs.
	Liabilities for Capital Supplies / Capital Works	
1.39	The accounting procedures relating to providing of liability in respect of Capital Supplies/Capital Works shall be as follows: (1) Liability to Supplier/Contractor shall be created by the Board on acceptance by the Board of the goods supplied by supplier or works carried out by Contractor. (2) Capital supplies in respect of which the property in the goods has passed to the Board although the Board has actually not received the goods shall be accounted for at the year end as capital supplies in transit and corresponding the liability towards the supplier shall be created in Boards books. (3) At the year end, the capital works completed by contractors in respect of which bills are not received by the Board or received but not passed shall be identified and certified by Board's engineers and provided for in accounts to create liability to Contractors as ascertained on the basis of the contracts. This requirement shall not apply to contracts with total contract value of less than Rs. 25 lakhs. (4) In respect of imported capital equipment kept in Bonded warehouse, no provision need be made for the customs duty which will become payable on removal of the equipments from the bonded warehouse.	The requirements of ESAAR are in line with GAAPs except non-provision of customs duty payable on removal of the equipments from the bonded warehouse.

1.40	*Cash Discount* Cash discounts earned by the Board on making timely or early payments to Suppliers/Contractors shall not be reduced from the cost of the assets but shall be credited to Revenue Account as an income for the year in which the cash discount is earned.	The requirements of ESAAR are in line with GAAPs.
1.41	*Interest on Advances to Suppliers / Contractors* Interest receivable by the Board on advances to suppliers and contractors for capital supply/works shall not be deducted from the cost of the assets purchased or constructed but shall be credited to Revenue Account as an income for the year in which the interest income accrues.	The requirements of ESAAR are in line with GAAPs.
1.42	*Capitalisation of Interest on funds utilised during construction stage* In computing the interest on funds utilised during construction stage of capital assets, the following factors shall be taken into consideration : (1) The full amount of interest payable for the year would be considered for this purpose. (2) Arrears of interest shall not distort the computation of interest on funds utilised construction as these arrears are required to be debited to a Restructuring Account and then adjusted to surplus/losses. (3) In view of the difficulties in identifying a source to its use, no attempt shall be made for source use identification. (4) The exercise of computation of capitalisable interest shall be carried out at head office of the Board. (5) This exercise shall be carried out considering rupees in thousands only.	The manner of computation of interest as required in ESAAR would result in capitalisation of interest different from that as per GAAPs as prescribed in AS 16.
1.43	Interest on funds utilised during construction stage of capital assets shall, for the purpose of capitalisation of such interest be computed as outlined below: (1) The Net Assets shown in the Balance Sheet shall be split into : (a) Assets at Construction Stage (ACS) (This would be established with reference to Schedule 21 to the Balance Sheet). (b) Balance Net Assets (BNA). (2) The ACS computed under 1(a) above shall be reduced by excess, if any, of Liability for Capital Supply Works over Capital Stores and Advances	

for Capital Supply/Works.

(3) BNA shall be derived after the balance current liabilities are, netted off against the current assets.

(4) Total Funds as per Balance Sheet will be first classified as under.

(a) Borrowing for Working Capital

(b) Payments due on Capital Liabilities

(c) Loans having an initial period of interest-holiday

(d) Other interest-free liabilities

(e) Reserve Funds

(f) Reserves and Surplus

(g) Interest-bearing capital liabilities.

(5) Matching of each of the above-mentioned different items of funds with the Assets for the purpose of determining 'Interest-bearing ACS' and 'Interest-bearing BNA' shall be carried out as under :

(a) Borrowing for Working capital and payments due on capital liabilities shall be deemed to be financing BNA and therefore deducted from BNA.

(b) Capital loans which provide an interest-free period for the first few years shall be fully appropriated against the ACS on the grounds that interest-holiday is specifically to provide interest-free finance at construction stage.

(c) Interest-free capital liability, if any, shall be proportionately divided over ACS and BNA.

(d) Reserve funds shall be set-off against the investments made against the funds.

(e) Reserves, surplus and the excess of Reserve fund over its investment as per 5(d) above shall be added up to determine, 'Own Funds'. 'Own Funds' shall be divided proportionately over ACS and BNA.

(f) Where the Board has negative 'Own Funds' in its Balance Sheet because of accumulated losses, no adjustment of own funds shall be made (meaning that a part of the funds of capital liabilities is sunk by way of losses).

(6) Balance ACS and BNA after carrying out the matching as described in (5) above would represent 'Interest-bearing ACS'(IB-ACS) and 'Interest-bearing BNA' (IB-BNA). The aggregate of the two should be equal to interest-bearing capital liabilities

	(as reduced by negative own funds, if any). (7) Interest-bearing ACS at the beginning of the year and at the end of the year shall be used to determine 'Average Interest-Bearing ACS.' Similarly, 'Average Interest-Bearing BNA' shall be computed. (8) The interest payable for the year on capital liabilities shall be proportionately divided over the average IB-ACS and average IB-BNA. (9) The portion of interest payable allocated to IB-ACS would represent the amount of interest to be capitalised.	
	Accounting for Coal Wagons in Transit	
2.15	Coal wagons in transit would mean wagons allotted to an SEB and dispatched by the collieries but which are: - not received by Board by the year-end - not claimed from the Railways as 'missing wagons'.	The requirements of ESAAR are in line with GAAPs.
2.16	Coal wagons in transit at the year-end shall, whether or not any payment is made to the collieries for those wagons, be disclosed as coal-in-transit at the amount billed by the collieries.	
2.17	Liability in respect of coal wagons in transit which are not paid for by the SEB for the year-end would be provided for at the year-end at an amount equal to the amount billed by the collieries.	
	Basis for Valuation of Gas Consumption	
2.19	Valuation of gas consumption would be at the purchase order rate applicable to the receipts during the month.	The requirements of ESAAR are not in line with GAAPs.
	Materials Accounting	
2.20	Accounting procedure relating to materials cost are laid down herein below: (1) Stores which are exclusively catering to the requirements of construction projects shall be treated as 'Capital Stores'. (2) Stores which are providing materials for both capital and O&M purposes shall book purchase related transactions basically as an O&M stores except that the value of issues on capital jobs shall be booked separately. (3) Fast moving items shall be covered by a standard rate system in which receipts, issues and stocks shall be valued at scientifically determined standard rate and the variance between actual	The requirements of ESAAR are generally not in line with GAAPs as prescribed in AS 2.

costs and standard rate shall be collected in a separate account called 'Materials Cost Variance'.

(4) In case of items not covered by the Standard Rate system, the receipts shall be valued at Basic price plus Excise Duty plus Sales Tax. In such cases, the issues shall be valued at the weighted average rate applicable to the closing stock of the previous month. Where the closing stock of the previous month is nil, the valuation of issues shall be at the rate of first receipt of the month.

(5) Subsequent increase/decrease in the cost of receipts shall be adjusted in the issue rate prospectively and no retrospective adjustment shall be made to the value of past issues made out of concerned receipts or to the assets constructed out of such issues.

(6) Freight on materials purchased (whether incurred and billed by supplier or incurred by the Board) shall not be treated as materials cost and shall be recorded in the separate account provided for this purpose.

(7) All other incidental costs such as packing charges, octroi, etc. shall also not be treated as materials cost and shall be recorded in a separate account provided for this purpose.

(8) Returns from out of the materials issued in the past shall be valued at the issue rate applicable for the month in which the materials are returned.

(9) The prescribed basis of valuation of issues and returns may lead to certain anomalies in stock values. Such anomalies, if any, shall be removed at the end of every quarter and the amount by which the stock values required adjustment shall be accounted for in a separate account prescribed for this purpose.

(10) The liability to be created on the receipt of material shall be made

- at the standard rate in case of fast moving items, and
- at the purchase order rate in case of other items.

(11) Accounting for advance adjusted and recoveries and deductions made from a suppliers bill passed by the Board and recognition of the liability for the net amount due on that bill shall not be deferred till the actual discharge of the net liability.

(12) Loss on shortage in materials stock shall be

	provided for in the period in which the shortages are observed.	
	Treatment of Materials Cost Variance	
2.21	Under the standard rate system referred to above, materials cost variance if any, in respect of receipts at construction locations or at O&M locations shall not be charged to Revenue Account or to Capital Works.	
2.22	The balance in the 'Materials Cost Variance Account' at the year-end shall be treated as follows: (1) Credit balance shall be created to a Reserve called 'Reserve for Materials Cost Variance'. (2) Debit balance shall be debited to the 'Reserve for Materials Cost Variance'. If as a result of such debit the net balance in this Reserve account is a debit balance, the amount of debit balance shall be charged to Revenue account for the year.	
2.23	Accounting treatment for materials cost variance prescribed above assumes that the standard rates are fixed appropriately and that a system exists for periodic revision of rates whenever significant variances are being observed.	
2.24	The amount of materials cost variance recorded by construction division and circles and treated on the above lines shall be shown by way of note in the Fixed Assets Schedule in the Board's annual accounts.	
	Deferred Credit Usance Bills	
3.2	Usance bills may be issued by a Board under Deferred Credit Scheme. Such bills may include even the interest for future years. In a balance sheet, such interest portion should be shown as a deduction from the amount of outstanding usance bills.	The requirements of ESAAR are in line with GAAPs.
	Debentures issued as Collateral Security	
3.3	Debentures or any other debt certificates issued as a collateral security shall not be recorded in the books as a liability but be disclosed by way of a note.	The requirements of ESAAR are in line with GAAPs.
	Provision for Depreciation or Appreciation in value of Investment	
3.4	No provision need be made for the depreciation in the market value of securities (Bond and Debentures or government promissory notes) held by the Board as investments (i.e. market value being lower than the cost of the investments) since it would be a fair assumption in the case of such securities that the securities would be held till maturity when full value of the securities would be realised. However, there may be securities in respect	The requirements of ESAAR are not in line with GAAPs as prescribed in AS 13.

	of which such an assumption about holding till maturity does not hold good. No provision shall be created even in such cases for depreciation in the value of investments. Similarly, no provision for any appreciation in the market value of investment shall be made by a Board.	
4.3	*Accounting for Write-Off of Bad Debts* Any receivables for sale of power to be written off shall be charged to the Revenue Account as bad debts written off without touching the general provision for doubtful debts directly.	The requirements of ESAAR are not in line with GAAPs.
4.4	*Disclosure of Unissued Cheques* Cheques which are prepared under authorised payment vouchers but remained unissued at the year end (i.e. not yet issued to payee) will, in accordance with the prescribed accounting policy, be debited to relevant liability account on preparation of such cheques. However, since such cheques are not issued to payee and therefore liability not actually discharged, the total amount of such cheques shall be disclosed in Board's Accounts under a separate account 'Liability under Unissued Cheques'. Correspondingly, the bank balance shall be restored to the level existing before debiting such unissued cheques.	The requirements of ESAAR are in line with GAAPs.
4.5	*Provision for Obsolescence* Provision shall be made every year to cover the loss arising from technological obsolescence to the extent such loss has been determined, in respect *of* fixed assets in use, construction stores or operating stores in stock and assets under construction. Such provision shall be treated as a charge against the revenue for the year.	The requirements of ESAAR are not in line with GAAPs.
4.8	*Research and Development Costs* Research and development costs incurred by a Board as a result of which no tangible asset is acquired by the Board shall be written-off in the year of incurring the costs. This shall be done even in cases where the R&D cost are expected to result in an increase in revenue of future years. The R&D expenditure for acquiring tangible assets shall be treated like expenditure for acquiring any other fixed asset.	The requirements of ESAAR are not in line with GAAPs as prescribed in AS 8 and AS 26.
` **4.9**	*Amortisation of Intangible Assets* Intangible assets of a Board shall be amortised over the period estimated to be benefited. A proportionate amount (calculated with reference to the benefits during the year such as additional revenue arising as a result of the asset) shall be charged to revenue account for each of such years benefited.	The requirements of ESAAR are in line with GAAPs as prescribed in AS 26. However, AS 26 also lays down rebuttable presumption that

		useful life of intangible assets would not exceed ten years.
4.10	*Transmission of Power* If a Board receive power from one State for onward transmission to another State under purchase/ sale arrangement between the former State and the latter State, the intermediary transmitting Board shall show the units so transmitted as a deduction from its gross figures of units purchased and units sold.	The accounting treatment in this case would depend upon the agreement between the parties involved.
4.11 **4.12**	*Disclosure of Contingent Liabilities* The amount of contingent liabilities (as on the date of the Balance Sheet) which are material shall be disclosed in the annual accounts of the Board. Contingent liability would mean an obligation relating to current year or past years which is dependent upon the happening or non-happening of an event. Example of contingent liabilities are : (1) claim by the supplier or contractor for a price higher than the one adopted by the Board for booking liability to him in relation to purchases or contract work during the current year or past years. This would include all cost escalation claims for supplies/works. (2) claim for refund of an increase in tariff made by consumers or by anyone else by contesting it in a court of law. (3) claim by the lenders for a higher interest or for a penal interest for any default in repayment installments or in paying interest or for any other reason. (4) claim against the Board for payment of tax on income or profit of the Board or for excise duty, levies etc. not accepted by the Board.	The requirements of ESAAR are in line with GAAPs as prescribed in AS 4.
4.13	*Refunds of Customs Duty / Port Trust Charges* Refunds of customs duty or port trust charges shall be credited to revenue unless the amounts are material in which case the portion, if any, relating to import of capital assets shall be deducted from the cost of the assets.	The requirements of ESAAR are in line with GAAPs.

[1] This part of the Appendix discusses only those paragraphs of Annexure V to ESAAR, 1985, which lay down accounting principles and policies that are different from Annexure III. Accordingly, accounting principles and policies already analysed in connection with Annexure III and purely procedural matters are not dealt with.

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