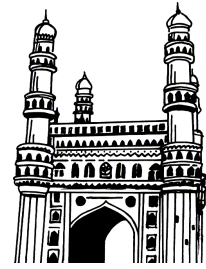


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INDIAN ACCOUNTING STANDARDS

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Accounting standard: Concept -Evolution - Difficulties in standard setting process – IASB - FASB- ASB India: Constitution - Functions – Procedure for setting standards - Need for Uniform Global Financial Reporting - Significant differences between IAS, US GAAP and Indian GAAP (AS) - IFRS Concept – Convergence of Accounting Standards - Ind AS Concept – Applicability/ Adoption of Ind AS (Road Map).

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1. Define Accounting Standards. Explain the nature of accounting standards.

Ans : (Jan.-20, Imp.)

Refer Unit-I, Q.No. 15.

2. Explain the evolution of accounting standards.

Ans : (Jan.-20, Imp.)

Refer Unit-I, Q.No. 19.

3. Explain briefly about International Accounting Standard Board ?

Ans : (Imp.)

Refer Unit-I, Q.No. 22.

4. Explain briefly about financial Accounting Standards Board (FASB).

Ans : (Imp.)

Refer Unit-I, Q.No. 24.

5. What is the organizational structure of FASB ?

Ans : (Imp.)

Refer Unit-I, Q.No. 25.

6. What is Harmonization ? Explain the Nature of Harmonization?

Ans : (Jan.-20, Imp.)

Refer Unit-I, Q.No. 29.

7. Explain the applicability of Ind As ?

Ans : (Imp.)

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1. What are financial statement? Explain the purpose of financial statements.

Ans : (Jan.-20)

Refer Unit-II, Q.No. 1.

2. What are the characteristics of financial statements?

Ans : (Imp.)

Refer Unit-II, Q.No. 4.

3. Explain briefly about Ind Accounting Standard-2 (IAS 2).

Ans : (Jan.-20)

Refer Unit-II, Q.No. 5.

4. What are accounting policies? Explain briefly about changes in accounting policies.

Ans : (Imp.)

Refer Unit-II, Q.No. 9.

5. What is Income tax? Explain the need and scope of Ind As-12.

Ans : (Imp.)

Refer Unit-II, Q.No. 17.

6. Explain the temporary differences are used in Ind AS 12.

Ans : (Imp.)

Refer Unit-II, Q.No. 20.

7. Define lease. Explain different types of leases.

Ans : (Imp.)

Refer Unit-II, Q.No. 23.

8. Explain briefly about Ind As 20 ?

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9. Explain the effect of changes in foreign exchange rates.

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1. What do you understand by Related Party disclosure?

Ans : (Jan-20, Imp.)

Refer Unit-III, Q.No. 3.

2. Explain briefly about Ind As 28 ?

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Refer Unit-III, Q.No. 5.

3. Explain the computation and procedure of Equity method ?

Ans : (Jan-20, Imp.)

Refer Unit-III, Q.No. 7.

4. What is Hyperinflation? Explain briefly about restatement of financial statements.

Ans : (Imp.)

Refer Unit-III, Q.No. 9.

5. What is Earning per share?

Ans : (Jan.-20)

Refer Unit-III, Q.No. 11.

6. What is IFR? Explain the need and objective of IFR.

Ans : (Jan.-20)

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UNIT - IV

1. Explain the concept of Ind As 101.

Ans : (Jan.-20, Imp.)

Refer Unit-IV, Q.No. 1.

2. Explain key terms used in As 105

Ans : (Imp.)

Refer Unit-IV, Q.No. 11.

3. What are the major differences between Ind AS-101 and IFRS 1?

Ans : (Imp.)

Refer Unit-IV, Q.No. 3.

4. What is business combinations? Explain the accounting for business combination.

Ans : (Imp.)

Refer Unit-IV, Q.No. 8.

5. Explain the presentation and disclosure of As 105.

Ans : (Jan.-20, Imp.)

Refer Unit-IV, Q.No. 13.

UNIT - V

1. Explain briefly about Ind As 107.

Ans : (Jan.-20, Imp.)

Refer Unit-V, Q.No. 1.

2. What is operating segment? Explain determining and disclosure of operating segment.

Ans : (Imp.)

Refer Unit-V, Q.No. 2.

3. Explain the concept of Ind As 110.

Ans : (Jan.-20, Imp.)

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4. Explain briefly about Ind As 112.

Ans : (Jan.-20, Imp.)

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5. What is fair value measurement? Explain the factors to be considered in fair value measurement.

Ans : (Imp.)

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UNIT I

INTRODUCTION:

Accounting: Meaning – Evolution – Accounting as an information system – Accounting Principles -

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1.1 ACCOUNTING

1.1.1 Meaning

Q1. Define the term Accounting.

Ans :

Meaning of Accounting

Accounting deals with the measurement or provision of assurance about financial information used by different persons, viz., lenders, managers, investors, tax authorities and other decision-makers. It measures the various economic activities which affect inflow and outflow of economic resources to develop useful information. In another words, it can be said that it serves as a language of business since it communicates the results of business operations.

Definitions

- i) **According to American Accounting Association** "Accounting is the process of identifying, measuring and communicating information to permit judgement and decisions by the users."
- ii) **According to Milagros B. Hernane,** "Accounting is a service activity. Its function is to provide quantitative information, primarily financial in nature, about economic entities that is intended to be useful in making economic decisions, and in making reasoned choices among alternate courses of action."
- iii) **According to American Institute of Certified Public Accountants** "Accounting

is the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are in part, at least, of a financial character and interpreting the results thereof."

- iv) **According to Smith and Ashburne,** "Accounting is a means of measuring and reporting the results of economic activities".
- v) **According to Bierman and Derbin,** "Accounting may be defined as the identifying, measuring, recording and communicating of financial information".

From the above definitions and the meaning of book-keeping, it may be concluded that the book-keeping involves only the recording of transactions. The accounting starts where the function of book-keeping ends.

Q2. What are the Functions of Accounting.
(or)

Elucidate the functions of Accounting.

Ans :

Accounting deals with recording, classifying, summarizing, analyzing and interpreting the financial transactions and communicating the end results to the interested parties.

The functions of accounting are as follows:

(i) Recording

Recording is a primary function of accounting. It mainly deals with recording all

the financial transactions of business in a sequential order. All financial transactions are recorded in a book called as 'Journal'. Journal is further divided into many subsidiary books and the number of subsidiary books to be maintained depends upon nature and size of the business.

(ii) Classifying

Classification deals with the organized analysis of recorded data, with an intention to group all the related entries at one place. Ledger account is the book where in all the similar entries are recorded. Ledger contains different accounts on different pages and accordingly related entries are recorded under one particular account. It helps in identifying the total expenditure incurred in one specific account.

(iii) Summarizing

Summarizing includes presenting the classified data in an acceptable and practical manner which is useful to both the internal and the external users of accounting statements. The process of summarizing involves preparing trial balance, income statement and the balance sheet.

(iv) Associated with Financial Transactions

In accounting, only those transactions are recorded which are financial in nature and are in terms of money. Transactions which are not expressed in terms of money and are non-financial in nature are not recorded in the books of account.

(v) Analyzing and Interpreting

Analyzing and interpreting is the last function of accounting. The financial data which was recorded earlier is now being analyzed and interpreted so that it can be effectively used by the end users in making various decisions related to the financial condition and profitability of the business. The data is also useful in preparing the future plans and designing the policies for accomplishing those plans.

(vi) Communicating

When accounting information is thoroughly analyzed and interpreted, it must be communicated in an effective manner to the right person. The accounting information can be communicated by preparing and distributing the accounting reports which includes the income statement and the balance sheet along with some additional information in the form of ratios, graphs, funds flow statement, etc. An accountant must effectively utilize his innovative and imaginative abilities in this process.

Q3. Explain briefly about Advantages and Disadvantages of Accounting.

Ans :

Advantages

Following are main advantages of accounting:

1. Replacement of Memory

In a large business it is very difficult for a businessman to remember all the transactions. Accounting provides records which will furnish information as and when desired and thus it replaces human memory.

2. Evidence in Court

Properly maintained accounts are often treated as a good evidence in the court to settle a dispute.

3. Settlement of Taxation Liability

If accounts are properly maintained, it will be of great assistance to the businessman in settling the income tax and sale tax liability otherwise tax authorities may impose any amount of tax which the businessman will have to pay.

4. Comparative Study

It provides the facility of comparative study of the various aspects of the business such as profits, sales, expenses etc. with that of previous year and helps the businessman to

locate significant factor leading to the change, if any.

5. **Sale of Business**

If accounts are properly maintained, it helps to ascertain the proper purchase price in case the businessman is interested to sell his business.

6. **Assistance to the Insolvent Person**

If a person is maintaining proper accounts and unfortunately he becomes insolvent (i.e. when he is unable to pay to his creditors), he can explain many things about the past with the help of accounts and can start a fresh life.

7. **Assistance to Various Parties**

It provides information to various parties, i.e., owners, creditors, investors, government, managers, research scholars, public and employees and financial position of a business enterprise from their own view point.

8. **Facilitate in Raising Loans**

Accounting facilitates raising loans from lenders by providing them the required financial information.

9. **Assistance to the Management**

Accounting assists the management in taking managerial decisions. For example, Projected Cash Flow Statement facilitates the management to know the future receipts and payments and to take decisions regarding anticipated surplus or shortage of funds.

10. **Facilitate Control Over Assets**

Accounting facilitates control over assets by providing information regarding Cash Balance, Bank Balance, Stock, Debtors, Fixed Assets, etc.

Disadvantages

Following are the main limitations of accounting:

1. **Records only Monetary Transactions**

Accounting records only those transactions which can be measured in monetary terms. Those transactions which cannot be measured

in monetary terms as conflict between production manager and marketing manager, efficient management etc., may be very important for a concern but not recorded in the business books.

2. **Effect of Price Level Changes not Considered**

Accounting transactions are recorded at cost in the books. The effect of price level changes is not brought into the books with the result that comparison of the various years becomes difficult.

For example, the sales to total assets in 2007 would be much higher than in 2002 due to rising prices, fixed assets being shown at cost and not at market price.

3. **No realistic information**

Accounting information may not be realistic as accounting statements are prepared by following basic concepts and conventions. For example, going concern concept gives us an idea that the business will continue and assets are to be recorded at cost but the book value which the asset is showing may not be actually realisable. Similarly, by following the principle of conservatism the financial statements will not reflect the true position of the business.

4. **Personal bias of the Accountant affects the accounting statements**

Accounting statements are influenced by the personal judgement of the accountant. He may select any method of depreciation, valuation of stock, amortisation of fixed assets, treatment of deferred revenue expenditure. Such judgement based on integrity and competency of the accountant will definitely affect the preparation of accounting statements.

5. **Permits alternative treatments**

Accounting permits alternative treatments within generally accepted accounting concepts and conventions. For example, method of charging depreciation may be straight line method or diminishing balance method or some other method. Similarly, closing stock may be valued by FIFO (First-in-First-Out) or LIFO (Last-in-First-out) or average price method. Application of different

methods may give different results and results may not be comparable.

6. Profit no real test of managerial performance

Profit earned during an accounting period is the test of managerial performance. Profit may be shown in excess by manipulation of accounts by suppressing such costs as depreciation, advertisement and research and development or taking excess value of closing stock. Consequently real idea of managerial performance may not be available by manipulated profit.

7. Historical in nature

Usually accounting supplies information in the form of Profit and Loss Account and Balance Sheet at the end of the year. So, the information provided is of historical interest and only gives post-mortem analysis of the past accounting information. For control and planning purposes management is interested in quick and timely information which is not provided by financial accounting.

8. Window Dressing in Balance Sheet

When an accountant resorts to window dressing in the Balance Sheet, then Balance Sheet cannot exhibit the true and fair view of the state of affairs of the business.

Q4. Explain the Importance of accounting.

Ans. :

1. Business Forecasting

Every business tries to forecast its future activities on the basis of the past experience and present practices. It wants to determine the policies and programmes well in advance. **For example**, a business may like to know the quantity and quality of goods to be manufactured in future. Accounting provides this facility to the business.

2. Correct Decision-Making

Every business house has to take many economic and financial decisions, **for example**, determination of price on the basis of cost, imports-exports, increase, or decrease

in investments, distribution of dividend, bonus, etc. All such decisions should be taken with utmost care. Any wrong decision taken may bring in many difficulties and problems. An appropriate and consistent accounting system helps in taking various decisions in the business.

3. Correct Taxation

A business house has to pay many taxes such as income-tax, sales tax, excise duty, customs, etc. The quantum of all taxes depends on the results shown by the financial accounts. A proper accounting system followed in the business helps in determining correct amount of taxes.

4. Helpful in Solving Business Disputes

The accounts maintained as per rules are documentary proof in courts of law. On the basis of the accounts a business house can sue the other and can defend itself in case of any dispute between the two. A concern can also proceed for getting declared insolvent in case its liabilities exceed its assets. Accounting helps the concern in all disputes and in the situation of insolvency.

5. Replacing Memory

Business transactions are innumerable, varied, and complex, as such it is quite impossible to memorize each and every transaction. Accounting records these transaction in writing and thus it is not necessary that the businessman should memorize all the transactions.

6. Assessing the Performance of the Business

Accounting keeps proper and systematic record of all business transactions. Income statements are prepared with these records and one is able to know the profit earned and the loss suffered by the business.

7. Assessing the Financial Status of the Business: Financial position of the business is displayed through position statement, i.e., balance sheet of the business. The statement is prepared at the end of the accounting year and reflects the true position of assets and liabilities of the business on a particular date.

8. Documentary Evidence

Accounting records can also be used as evidence in the court to substantiate the claim of the business. These records are based on documentary proof. Every entry is supported by authentic vouchers. That is why; the court accepts these records as evidence.

9. Assisting in Realization of Debts

We, in 'Accounts' prepare personal ledger accounts of all the parties. The personal account shows the exact amount due from the debtors. One can send the debtors their statement of accounts and thus enable them to verify entries and also to make early payment of the amount due. The account can also be used to prove the claim of the business against the debtors in the court.

10. Preventing and Detecting Frauds

The proper accounting system and effective arrangement of internal check prevents leakage of goods and cash. In case cheating takes place, theft or embezzlement is made and fraud is committed, accounting helps in detection of these losses and also fixes responsibility for it. Proper accounting prevents employees from committing fraud.

11. Helpful to Management

Accounting is useful to the management in various ways. It enables the management to assess the achievements of its performance. Actual performance can be compared with the desired performance or with the performance of previous years. The weaknesses of the business can be identified and corrective measures can be applied to remove them. Various profitability, sales, and liquidity ratios can be calculated, the actual performance can be evaluated and effective line of action can be decided for the future. Funds flow statement can also be prepared to understand the additional funds earned during the year and their application.

Q5. Explain the main objectives of accounting.

Ans :

Following are the main objectives of accounting:

1. Keep Systematic Records

Accounting is done to keep systematic records of financial transactions. In the absence of a scientific method of accounting, there would have been tremendous burden on the human memory which, in most cases, would have been impossible to bear.

2. Protect Business Properties

Accounting provides protection to business properties from unjustified and unwanted use. This is possible by providing the following information to the management:

- i) The amount of owner's fund invested in the business;
- ii) How much the business owes to others;
- iii) How much the business has to recover from others; and
- iv) How much business owns the assets;

3. Ascertain Operational Profit or Loss

Accounting helps in ascertaining the net profit earned or loss suffered on account of carrying the business. This is done by keeping a proper record of revenues and expenses of a particular period.

4. Ascertain Financial Position of the Business

The profit and loss account reflects the performance of the business during a particular period. However, it is also necessary to know the financial position, i.e., where do we stand. What we owe and own. The objective is met by balance sheet, which shows the state of affairs of assets and liabilities as on a given date. It serves as barometer for ascertaining the financial health of the business.

5. Facilitate Rational Decision-Making

Accounting these days has taken itself the task of collection, analysis and reporting of information at the required points of time to the required level of authority in order to facilitate rational decision-making

1.1.2 Evolution**Q6. Explain the Evolution of accounting.****(OR)****Elucidate the evolution of Accounting.***Ans :*

Accounting has evolved and emerged, as have medicine, law, and most other fields of human activity, in response to the social and economic needs of society. Book-keeping and Accounting appeared not as a chance phenomenon, but distinctly in response to a world need.

- This is true not only of the days of Paciolo but also important for present-day accounting survival. Sieveking, one of the few historians who have paid attention to the subject, says that book-keeping developed as a direct result of the establishment of partnership on a large scale.
- For centuries after the system of double entry book-keeping appeared, accounting was without methodology or any form of theory.
- It was during the nineteenth century that a move from book-keeping to accounting - a move away from the relatively simple recording and analysis of transactions toward a comprehensive accounting information system - was seen. The end of the nineteenth century was marked by the most extraordinary expansion of the business.
- Company form of organization, a phenomenon common in business world, grew at a great speed. Books about business transactions were written, conventions were followed and accounting was recognized as a system of analyzing and maintaining record about business transactions.

- In part, the new significance of accounting gained recognition because of separation between ownership and control and also due to diversification in ownership.
- The increased reliance on capital as a factor of production necessitated extensive record keeping but, finally, in the nineteenth century, a theoretical framework began to develop.
- This framework or methodology provided a technical means to measure, evaluate, and communicate information of an economic and financial nature.
- Modern business has continuity - never-ending flow of economic activities. Therefore, accounting has grown to meet a social requirement and to guide the business and industry accordingly. Accounting is moving away from its traditional procedural base, encompassing record keeping and such related work as the preparation of budgets and final accounts, towards the adoption of a role which emphasizes its social importance.
- Profit calculation now is no longer a simple comparison of financial values at the beginning and end of a transaction or series of transactions.
- It is now related to a complex set of allocations and valuations pertaining to the operational activities of a business enterprise.
- The concept of accountancy or accounting is now broader to include the description of the recording, processing, classifying, evaluating, interpreting and supplying of economic-financial information for financial statement presentation and decision-making purposes.
- In its tasks, accounting has been successful technically and methodologically.
- The use of enterprise accounting for the purpose of macro (economic or national) accounting is largely a development of this century.

- For purpose of economic policy and economic planning, these national data - to a large extent derived from commercial data - have become of great importance.
- They have given rise to a new concept of macro accounting which has presented the professional with a new sphere of operations and perspective.
- Macro accounting has particular importance in helping to build the bridge between economics and accounting, and thus offers accounting significant scope to make a contribution towards macroeconomic policy.
- Accounting, thus, has gone through many phases: simple double entry book-keeping, enterprise, government, and cost and management accounting and recently towards social accounting.
- These phases have been largely a product of changing economic and social environments. As business and society have become more complex over the years, accounting has developed new concepts and techniques to meet the ever increasing needs for financial information.
- Without such information, many complex economic developments and social and economic programmes might never have been undertaken.

1.1.3 Accounting as a information system

Q7. Explain briefly about accounting as a Information System.

Ans :

The term 'system' may be defined a set of elements which operate together in order to attain a goal. A system does not consist of random sets of elements but elements which may be identified as belonging together because of a common goal. A system contains three activities:

- (i) Input,
- (ii) Processing of input, and
- (iii) Output

A business organization is regarded as an open system which has a dynamic interplay with its environment from which it draws resources and to which it consigns its product and services.

Accounting comprises a series of activities linked together among themselves. The accounting activities form a progression of steps, beginning with observing, then collecting, recording, analyzing and finally communicating information to its users. In other words, accounting process involves the accumulation, analysis, measurement, interpretation, classification, and summarization of the results of each of the many business transaction that affected the entity during the year. After this processing, accounting then transmits or projects messages to potential decision-makers. The messages are in the form of financial statements, and the decision-makers are the users. Accounting generally does not generate the basic information (raw financial data) rather the raw financial data result from the day-to-day transactions of the enterprise.

As an information system, accounting links an information source or transmitter (generally the accountant), a channel of communication (generally the financial statements) and a set of receivers (external users). When accounting is looked upon as a process of communication, it is defined as "the process' of encoding observations in the language of the accounting system, of manipulating the signs and statements of the systems and decoding and transmitting the result."

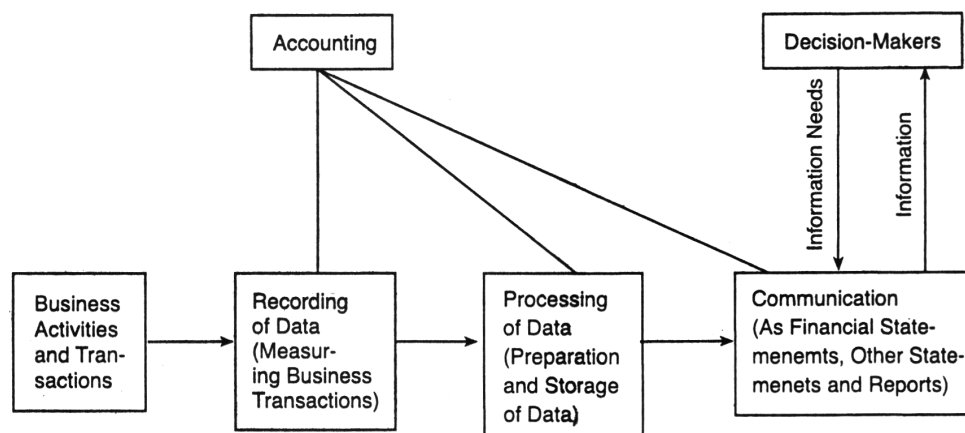


Fig.: Accounting as an information System in Business and Economic Decisions

Q8. What are the Functions of Accounting Information System (AIS).

Ans :

Accounting information systems have three basic functions:

1. The first function of an AIS is the efficient and effective collection and storage of data concerning an organization's financial activities, including getting the transaction data from source documents, recording the transactions in journals, and posting data from journals to ledgers.
2. The second function of an AIS is to supply information useful for making decisions, including producing managerial reports and financial statements.
3. The third function of an AIS is to make sure controls are in place to accurately record and process data.

Q9. What are the advantages and disadvantages information system ?

Ans :

Advantages

1. Cost Effectiveness

In the era of digitalization and artificial intelligence, each organization is moving towards cost cutting with the use of artificial intelligence. AIS has helped to reduce manual efforts and can perform the same operation more cost-effectively.

2. Time Effectiveness

AIS has assisted business organizations to reduce the amount of time involved in recording, classifying, reporting any financial information. A large quantum of manual work can be completed by AIS with much fewer efforts and time involved.

3. Easy Access (Portability)

Data stored in AIS can be retrieved via information system connected with internet anywhere and at any time. Where manually prepared books of accounts cannot be carried easily, AIS data can be.

4. Accuracy

With the involvement of AIS, the reliability of data is increased. As we had discussed earlier in this article that an AIS follows a predefined set of instructions, therefore chances of error-prone information are less and therefore AIS have an added advantage of accurate data.

Disadvantages**1. Initial Cost of Installment and Training**

While we discussed that an AIS is cost-effective, the same may not be true in the case of small business enterprises. Cost of initial setup may be high and may not actually generate value to the organization.

2. Manual Intervention

Although we discussed that AIS reduces manual intervention but the same cannot be completely eliminated. AIS needs manual intervention at a certain point of time which may bring inefficiency in the system.

3. Error Cannot be Completely Eliminated

We discussed, AIS reduces chances of error but there are chances of wrong coding in software which may lead to error-prone results, also manual intervention is still present here which can also generate an error.

4. Confidentiality

Although we discussed portability of AIS data the same can also be disastrous for an organization If such information is hacked i.e. stolen. An intruder may amend the information or he can disclose sensitive financial information.

5. Virus Attack

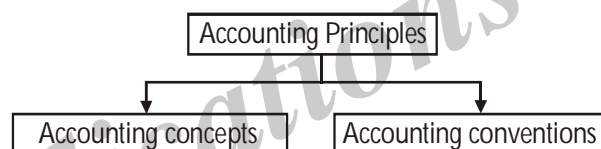
Any data stored on IS can be infected with a virus which may lead to disruption, modification of financial information stored on AIS.

1.1.4 Accounting Principles**Q10. What are Accounting Principles?**

Ans : (Jan.-20)

As accounting acts as a language which is used to communicate the accounting information to the interested parties, it must follow some standards so that it runs smoothly. These standards are nothing but the accounting principles.

Accounting principles are those rules and regulations which are followed by the accountants at the time of recording the accounting transactions. Accounting principles are defined as "a list of principles that are usually linked with the theory and procedures of accounting serving as an explanation of current practices and as a guide for selection of conventions or procedures where alternatives exist".



These principles are categorized into two groups.

- (i) Accounting concepts and
- (ii) Accounting conventions.

Q11. Explain in detail the various accounting concepts.

(or)

Describe the various accounting concepts.

Ans :

Accounting is based on few concepts which follows assumptions or rules for recording the transactions. Some important accounting concepts are as follows.

(a) Separate Entity Concept

In accounting, proprietor treats its business as a separate entity so that his business transactions does not get mixed up with his personal life. If business and personal activities are mixed up then it would be difficult to derive/draw meaningful accounting information. The separate entity concept is applicable to all forms of business

organizations for the accounting purpose. Usually, this concept seems to be unreasonable but it is very useful in drawing out the accounting information.

(b) Going Concern Concept

In this concept, the proprietor assumes that business will continue for a longer period of time in future. There is no intention of winding up the business in the near future. In this concept, accountant values the assets by calculating depreciation on the basis of expected life instead of the market values and he does not take into account the forced sale value of assets.

(c) Money Measurement Concept

This concept implies that only monetary transactions are taken into consideration at the time of preparation of accounting records. Books of account does not consider any transaction which cannot be expressed in terms of money even though it may be useful for business but it is not recorded in the books of account.

(d) Cost Concept

The cost concept is similar to going concern concept. This concept implies that,

- Only the actual price of the asset is being recorded in books of accounts and,
- This actual cost is considered as a basis for further calculations of asset. This concept explains that an asset is recorded at its cost at the time of purchase but as the time passes on its value gets reduced due to depreciation charged on it. The preparation and presentation of financial statements becomes flawless and impartial with the help of cost concept.

(e) Dual Aspect Concept

The dual aspect concept is a primary concept of accounting, it implies that every business transaction has two-fold effect i.e., dual effect. The double effect of this concept can be expressed in form of an accounting equation as,

$$\text{Capital} + \text{Liabilities} = \text{Assets}$$

or

$$\text{Capital} = \text{Assets} - \text{Liabilities}$$

This equation can also be written as,

$$\text{Equities} = \text{Assets}$$

Hence, accounting equation explains the relationship between equities and assets. It implies that every debit has a credit which is equal to the sum of the debit.

(f) Accounting Period Concept

This concept explains that even though the life of business is very long but proprietor must calculate its position regularly after certain period of time usually after one year, this is known as accounting period. At the end of every accounting period, accountant is supposed to prepare the income statement which displays the profit or loss earned during the accounting period and the balance sheet which shows the financial condition of the business till the last day of the accounting period. During the preparation of the statement, the capital and revenue expenditures must be taken carefully.

(g) Periodic Matching of Costs and Revenue Concept

The matching concept is based on the accounting period concept. According to this concept, a business in order to achieve its prime objective of profit maximization should always maintain a match between the costs and revenue within the accounting period. The term 'matching' refers to the adequate association of related revenues and expenditures.

(h) Realization Concept

According to this concept revenue is generated only through sales. The point of time when the property in goods is passed on to buyer and when he is legally entitled/liable to pay, it is considered as sales. The realization concept is not applicable for hire-purchase and contracts account.

Q12. Explain in detail the various accounting conventions.*Ans :*

Accounting conventions involves those rituals and practices which helps the accountant in the preparation of accounting statements.

Some of the important accounting conventions are,

(a) Convention of Conservatism

According to this convention, accountant must adopt the policy of playing safe and follow the rule "anticipate no profit but provide for all possible losses".

This implies that accountant must make a provision for all possible or expected losses but unearned or unrealized profit must not be included. When convention of conservatism is used inventory is valued at lower price, either at cost or market price and provision is made for bad or doubtful debts.

The main objective of this convention is to misrepresent the true financial position of the company in order to show lower net income and understated assets and liabilities.

(b) Convention of Full Disclosure

According to this convention, financial statements must provide the complete and true information about the company. Financial statements must be prepared in accordance to the laws so that it can be effectively used by proprietors, present and potential creditors and investors.

The convention of full disclosure add notes to the accounting statements.

(c) Convention of Consistency

According to this convention, a company must follow same accounting practices and methods from one period to another.

Any changing the accounting practices would result in several problems in calculating the true financial position of the company.

If suppose for calculating depreciation a company follows a straight line method in one year and diminishing reducing balance method in another year, it becomes difficult to evaluate and compare the true financial position of the company. If any advanced technique is introduced, it must be mentioned clearly in the financial statements.

(d) Convention of Materiality

According to this convention, the accountant must give importance to material details and must avoid unnecessary/unimportant details. Kohler defined "materiality means the characteristic attaching to a statement, fact or item whereby its disclosure or method of giving it expression would be likely to influence the judgement of a reasonable person".

Q13. Explain the features of accounting principles.*Ans :*

The features of accounting principles are as follows:

1. Accounting Principles are Based on General Rules

The accounting principles are based on general rules, conventions, and assumptions which are widely accepted by accountants, auditors, managers, and government agencies. It is noteworthy here that the accounting principles are neither cent percent fool-proof nor can their accuracy be tested in any laboratory.

2. Accounting Principles are Launched on the Basis of Logic and Experience

It is not proper to think that the accounting principles are the creation of any law. In fact, these are put forward on the basis of logic and experience in the preparation of financial statements. The practical requirements of business, law, government agencies, creditors, shareholders and other users do affect the formulation of accounting principles.

3. Accounting Principles are Widely Accepted

It is an important characteristic that the accounting principles are widely accepted. The accountants also take it for granted that certain alternatives in accounting can be used by concerns according to their choice. **For example**, one can use 'Asset Accrued Method' or 'Total Cash Price Method' for accounting the hire-purchase transactions.

Q14. What are the limitations of accounting principles.

Ans :

The limitations of accounting principles are as follows:

1. Lack of Complete Set of Principles

Though the American Institute of Certified Public Accountants has explained some accounting principles, yet they are not complete in themselves. That is why the accountants use different methods in accounting and try to solve their problems as per their own convenience.

3. Lack of General Acceptance of Principles

Accounting principles are not only incomplete but also deprived of from the general acceptance. Because of difference in opinion, some accountants recommend a particular view while others are opposed to it. **For example**, there are a number of methods for valuation of stock and goodwill, accounting for hire purchase system, etc.

3. Difference in the Application of Principles

One limitation of accounting principles is that all accountants do not use these principles in a similar manner. **For example**, all the accountants agree on the principle that depreciation must be charged on fixed assets, but some of them charge it on 'Straight Line Method', some on 'Diminishing Balance Method' while others use some other methods. Similarly, there are a number of systems for valuation of assets. The

accountants of different business houses are implementing the accounting principles according to their need, convenience and nature of business.

1.2 ACCOUNTING STANDARD

1.2.1 Concept

Q15. Define Accounting Standards. Explain the nature of accounting standards.

Ans : (Jan.-20, Imp.)

Accounting standards are the written statements consisting of rules and guidelines, issued by the accounting institutions, for the preparation of uniform and consistent financial statements and also for other disclosures affecting the different users of accounting information.

Accounting standards lay down the terms and conditions of accounting policies and practices by way of codes, guidelines and adjustments for making the interpretation of the items appearing in the financial statements easy and even their treatment in the books of account.

Definition

According to Accounting standards Kohler: as a "code of conduct imposed on accountants by custom law (or) professional body.

Nature

(i) Serve as a guide to the accountants

Accounting standards serve the accountants as a guide in the accounting process. They provide basis on which accounts are prepared. For example, they provide the method of valuation of inventories.

(ii) Act as a dictator

Accounting standards act as a dictator in the field of accounting. Like a dictator, in some areas accountants have no choice of their own but to opt for practices other than those stated in the accounting standards. For example, Cash Flow Statement should be prepared in the format prescribed by accounting standard.

(iii) Serve as a service provider

Accounting standards comprise the scope of accounting by defining certain terms, presenting the accounting issues, specifying standards, explaining numerous disclosures and implementation date. Thus, accounting standards are descriptive in nature and serve as a service provider.

(iv) Act as a harmonizer

Accounting standards are not biased and bring uniformity in accounting methods. They remove the effect of diverse accounting practices and policies. On many occasions, accounting standards develop and provide solutions to specific accounting issues. It is thus clear that whenever there is any conflict on accounting issues, accounting standards act as harmonizer and facilitate solutions for accountants.

Q16. Explain the importance of accounting standards ?

Ans :

The users of financial statements include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public. They use financial statements in order to satisfy some of their information needs. These needs include the following:

(a) Investors

The providers of risk capital are concerned with the risk inherent in, and return provided by, their investments. They need information to help them determine whether they should buy, hold or sell. They are also interested in information which enables them to assess the ability of the enterprise to pay dividends.

(b) Employees

Employees and their representative groups are interested in information about the stability and profitability of their employers. They are also interested in information which enables them to assess the ability of the enterprise to provide remuneration, retirement benefits and employment opportunities.

(c) Lenders

Lenders are interested in information which enables them to determine whether their loans, and the interest attaching to them, will be paid when due.

(d) Suppliers and other trade creditors

Suppliers and other creditors are interested in information which enables them to determine whether amounts owing to them will be paid when due. Trade creditors are likely to be interested in an enterprise over a shorter period than lenders unless they are dependent upon the continuance of the enterprise as a major customer.

(e) Customers

Customers have an interest in information about the continuance of an enterprise, especially when they have a long-term involvement with, or are dependent on, the enterprise.

(f) Governments and their agencies

Governments and their agencies are interested in the allocation of resources and, therefore, the activities of enterprises. They also require information in order to regulate the activities of enterprises and determine taxation policies, and to serve as the basis for determination of national income and similar statistics.

(g) Public

Enterprises affect members of the public in a variety of ways. For example, enterprises may make a substantial contribution to the local economy in many ways including the number of people they employ and their patronage of local suppliers. Financial statements may assist the public by providing information about the trends and recent developments in the prosperity of the enterprise and the range of its activities.

Q17. Explain the objectives of Accounting Standards.

Ans :

(i) For bringing uniformity in accounting methods

Accounting standards are required to bring uniformity in accounting methods by proposing standard treatments to the accounting issue. For example, AS-6(Revised) states the methods for depreciation accounting.

(ii) For improving the reliability of the financial statements

Accounting is a language of business. There are many users of the information provided by accountants who take various decisions relating to their field just on the basis of information contained in financial statements. In this connection, it is necessary that the financial statements should show true and fair view of the business concern. Accounting standards when used give a sense of faith and reliability to various users.

They also help the potential users of the information contained in the financial statements by disclosure norms which make it easy even for a layman to interpret the data. Accounting standards provide a concrete theory base to the process of accounting. They provide uniformity in accounting which makes the financial statements of different business units, for different years comparable and again facilitate decision making.

(iii) Simplify the accounting information

Accounting standards prevent the users from reaching any misleading conclusions and make the financial data simpler for everyone. For example, AS-3 (Revised) clearly classifies the flows of cash in terms of 'operating activities', 'investing activities' and 'financing activities'.

(iv) Prevents frauds and manipulations :

Accounting standards prevent manipulation of data by the management and others. By codifying the accounting methods, frauds and manipulations can be minimized.

(v) Helps auditors

Accounting standards lay down the terms and conditions for accounting policies and practices by way of codes, guidelines and adjustments for making and interpreting the items appearing in the financial statements. Thus, these terms, policies and guidelines etc. become the basis for auditing the books of accounts.

Q18. Explain the advantages and Dis-advantages of accounting standards ?

Ans :

Advantages**1. Standards Improve Reliability of Financial Statements**

Reliability of financial statements depends upon reliable accounting data. Various users of financial statements of business organization use financial statements for making some important decisions. These important decisions which they want to take should be based on fair and true financial statements standards help the accounting professionals to create a general sense of confidence. Standards also help to harmonies divergent accounting practices. Standards protect the users of financial statements by providing them financial information in which they can have confidence.

2. Helpful for Accounting Professionals

Accounting professionals, like accountants and auditors have to perform their work in changing environment of legal bindings. Accountants have to maintain their accounts in the fear of threats of stern actions. Whereas auditors are also to do audit work for detecting frauds and misleading information's presented in financial statements. Accounting standards help the accountants and auditors while performing their duties.

3. Accounting Reforms

Accounting standards are also helpful in development of a logical conceptual framework and structure for measurement of information, objectives of financial reporting. Accounting standards have helped in sweeping reforms in accounting theory as well as in accounting practices.

4. Determining Managerial and Corporate Accountability

Standards also facilitate in determining corporate and managerial accountability. Standards are important factors in assessment of managerial performance. Standards ensure consistency and comparability in place of uniformity in financial reporting. Management always concentrate on choice of best alternative for performing any activity, standards act as best choice available to them.

Disadvantages

The following are some of the limitations of Accounting Standards :

1. Companies are spread across the countries with different lines of operations and varied economic backdrops. Application of uniform Accounting Standards may sometimes prove to be a disadvantage to the company as they are not flexible and the transactions of the company are supposed to be reported as per the prescribed guidelines.
2. Another disadvantage of using accounting standards is regarding the costs for the company to comply with the standard. In many cases, company must design new procedures, which requires a large financial investment that includes employee costs, system upgrades and employee training.
3. Alternative solutions to certain accounting problems may each have arguments for and against that alternative to recommend. Therefore, the choice between the different alternative accounting treatments may become difficultly.

1.2.2 Evolution of accounting standards**Q19. Explain the Evolution of accounting standards.***Ans :***(Jan.-20, Imp.)****Introduction**

- In ancient times, traders and their groups were duty-bound to satisfy only a small group of investors from among their relatives, friends, and acquaintances about the financial propriety of their businesses.
- These days, millions of investors put their money into thousands of companies all over the world, and business organizations are legally bound to prepare financial statements for not only their creditors and investors, but also tax and other government authorities.
- The basic objective of accounting standards is to ensure that there are no differences in the approach to accounting and to standardize the presentation of accounts.
- Companies follow the general principles of accounting followed internationally, so that it is possible to compare their financial statements, which record various facets of their performance, with those of other companies.
- Globally, companies prepare their financial statements under the "Generally Accepted Accounting Principles" (GAAP), International Financial Reporting Standards (IFRS), and other standard rules and procedures followed throughout the world.

Evolution

- The evolution of the International Accounting Standards began in 1966 with a suggestion to set up a worldwide study group.
- The next year, the Accountants' International Study Group was formed, and it began to publish papers on various accounting topics, some of which formed the foundation for accounting standards that came into force later.

- In 1973, the International Accounting Standards Committee (IASC) was set up with the objective of developing accounting standards that would be internationally followed.
- The IASC issued a series of standards called the International Accounting Standards, named and numbered from IAS 1 to IAS 41 (Agriculture).
- In 2001, the International Accounting Standards Board (IASB), formed under the International Financial Reporting Standards (IFRS) Foundation, replaced the IASC.
- The IASB announced that it would follow the standards already issued by the IASC, but stated that any new standards would be known as part of a series called the International Financial Reporting Standards, evolved by the IFRS Foundation.
- The objective of the IFRS is to develop, in the public interest, a high-quality set of comprehensible, internationally accepted, and enforceable accounting standards.
The IFRS Foundation, an independent, not-for-profit organization, raises funds from banks and other organizations that desire to have international accounting standards in place in all countries.
- The IASB consists of board members who are accounting experts drawn from all over the world, who are well-versed in standards-setting and academic work.

1.2.3 Difficulties in standard setting process

Q20. How are setting accounting standards useful to accountant and Auditors ?

Ans :

1. Government as Standard Setter

The following arguments are generally given for standard setting by the government:

- (a) A government would be free of conflicts of interest more impartial and more responsive to all interests; it would not become a tool of business interests or of the accounting profession. Some argue that if the

government were to assume this responsibility, business pressure groups would have less influence than they appear to have had over the conclusion of the private as sector bodies. Also, government may not have to devote as many resources to obtaining consensus for proposed accounting reforms as do private sector standards setting bodies. It is said that non-compliance and explicit criticisms by business enterprises create difficulties in the enforcement of standards. Governments who command a reasonable majority may promulgate those accounting reforms which they desire without major and costly consensus seeking activity.

- (b) A government can better enforce compliance with accounting standards in that it is backed by the enforcement power of law. The problem of the enforcement of accounting standards would be minimized. In promulgating accounting standards and regulations the legislator would provide whatever penalties they felt necessary for non-compliance. Accounting standards, as a practical matter, have a force of law and therefore, should be established by a government.

- (c) A government would act more quickly on pressing problems and would be more responsive to the public interest. Also, the government is better equipped to control the redistributive effects of accounting standards than private sector standard setter and can more easily ameliorate their impact on any sector of society if this is desired. Private sector standard setting bodies have but minimum control over such effects. The only other way in which private standard setters can take such effects into account is by altering the substance of proposed standards so as to vary their impact on those parts of society which it is wished to either aid or protect from adverse effects. Such activities may have a cost in terms of distorting accounting standards away from what otherwise would be thought to improve the efficiency of resources allocation. The government may be better able to meet legitimate arguments concerning the economic consequences of accounting

regulations without altering what might otherwise be regarded as an accounting ideal.

2. Private Sector Standard Setting Body

Arguments have also been advanced for giving standard setting task to private sector body. These arguments may be listed as follows:

- (a) Government could neither attract enough high quality talent nor devote sufficient resources to standards setting.
- (b) A government would be susceptible to undue political influences both from special interest groups and for enforcing current government policy objectives.
- (c) Government is noted for their inflexibility and general lack of responsiveness on a timely basis to meet changing conditions. If the government were to assume prime responsibility, any incentive for the accounting profession to contribute to the standard setting process would be significantly reduced.
- (d) Government standard setting would harm the vitality of the accounting profession, decreasing the supply of professional talent devoted to standards setting and turning accountants away from independent auditing and toward client advocacy.
- (e) A private sector standard setting body would be more responsive to the needs of diverse interests; more appreciative of the complexities of modern business, hence more tolerant of judgmental decisions on the part of accounting practitioners; and more sensitive to the costs of providing and using information.

3. Standard Setting by Autonomous Agency

The standard setting task could be done by government or a private sector body. However, both the alternatives have problems. In accounting literature, it is now argued that government should delegate most, if not all, accounting decisions to some agency.

It appears a governmental agency may prove useful as compared to standard setting in public sector and private sector. Such an agency would have the clear and explicit support of the government and the Legislature. Therefore, all advantages which are claimed in favour of government as a standard setter, also accrue to such agencies. The Agency may have technical expertise and may employ qualified professionals to handle the technical matters than that of private sector accounting standard setting bodies. Such agencies should be able to promulgate accounting regulations and standards in a more speedy and efficient way than the government. The standard setting task by Agency would not imply large cost and would ensure compliance to standards. Such an agency may be more independent than a public sector or private sector body and can draw majority of its members from the concerned areas. Also, it would be accountable to society than any private sector bodies. To make such an agency accountable to society, it may be provided that it should prepare an annual report describing its activities during the period under review.

Q21. Explain various difficulties in standard setting process ?

Ans :

1. Difficulties in Definition

To agree on the scope of accounting and of principles or standards, is admittedly most difficult. Some, for example, equate accounting with public accounting, that is mainly with auditing and the problems of the auditor. Another opinion is that it (accounting) is frequently assumed to have a basis in a private enterprise economy.

Some use "principles" as a synonym for "rules or procedure". The result is that the number of principles become large and most uneven in coverage and in quality. Another group seems to equate "principles" with "convention," that is, with consensus or agreement. If this is the case, then a principle can be changed if all agree it should be (or)

alternatively, the only propositions that can qualify as principles are those that command consensus or agreement. Such disagreement leads to difficulty in standard setting and further does not make the standards totally acceptable to society.

2. Political Bargaining in Standard Setting

Earlier, but not so many years ago, accounting could be thought of as an essentially non-political subject. But, today, as the standard setting process reveals, accounting can no longer be thought of as nonpolitical. The numbers that accountants report, have a significant impact on economic behaviour. Accounting rules therefore affect human behaviour.

The stories conveyed by annual reports confirm or disappoint investor expectations and have the power to move millions (whether of money or persons). For all the bloodless image that accounting may have, people really care about the way the financial score is kept. Hence, the process by which they are made is said to be political.

3. Conflict in Accounting Theories

There has been remarkable growth in accounting theories is especially relating to income measurement, asset valuation, capital maintenance. Though much of the developments has taken place abroad, (USA, UK, Canada, Australia, etc.), accounting in other countries has also been influenced. While the theorists battled on, the various sectional interests found that the theories could be used to support their own causes and arguments.

At present, there is not a single theory in accounting which commands universal acceptance and recognition. There is no best answer to it the different terms like profit, wealth, distributable income, value, capital maintenance, and so forth. We cannot say what is the best or way to measure profit. If the profession truly wishes to be helpful it needs to discover from users, or to suggest to them, what would support their decision making, and then do develop the measures which best reflect those ideas

4. Pluralism

The existence of multiple accounting agencies has made the task of standard setting more difficult. In India, company financial reporting is influenced, although in different degrees, by Accounting Standards Board of ICAI, Ministry of Company Affairs, Institute of Cost Accountants of India, Securities and Exchange Board of India (SEBI). No one agency has jurisdiction over the entire area of accounting standards. Similarly in other countries also, there is plurality of accounting bodies.

For example, in USA there are organizations like Securities and Exchange Commission, Financial Accounting Standards Board, American Institute of Certified Public Accountants. In U.K., there are Accounting Standards Board of ICAEW and Companies Acts to deal with accounting matters and financial reporting.

If pluralism were reduced or eliminated, the path toward the goal would be smoother. However, the absence of pluralism is not a necessary condition for agreement on standards developed by a single accounting body. No one would claim that the mere absence of an obstacle constitutes a sufficient condition for success.

(i) Identification and assessment of theory

The various theories underlying alternative accounting methods should be examined for individual merit and internal consistency. In the light of the conceptual framework, the relevance of the alternative methods to the various users of accounts would be assessed.

(ii) Research into the costs and benefit of alternative methods

The role of research would be:

- (a) to examine the realism of the assumptions underlying the various methods.
- (b) to assess, and preferably quantify, the benefits accruing to users resulting from the introduction of each alternative method; and
- (c) to identify the costs and practical difficulties of implementation by field studies.

iii) Choice between alternative methods

The final stage of the process involves the exercise of judgment in the selection of an appropriate accounting policy. The standard setting body is confronted by a social choice problem similar to that faced by a Government in deciding how to allocate public expenditure and by which means taxes should be raised to pay for it. A choice may have to be made to favour certain groups of users at the expense of others, as ultimately the amount of information which can be published, is limited.

The decision involves the assessment of the benefits accruing to different users of accounts, and the costs associated with these benefits, bearing in mind that some of the users of accounts bear none of the costs. Ideally, the choice would be made from a 'neutral' viewpoint, but 'neutrality' can be determined in practice only if there exists a social welfare function for comparing various costs and benefits to different parties in a manner which is universally accepted as being 'neutral.'

1.3 IASB, CONSTITUTION AND FUNCTIONS**Q22. Explain briefly about International Accounting Standard Board ?**

Ans : (Imp.)

International accounting Standards Board (IASB), [Earlier International Accounting Standards Committee (Iasc)]

The IASC Foundation is an independent body, not controlled by any particular Government or professional organization.

- Its main purpose is to oversee the IASB in setting the accounting principles which are used by business and other organizations around the world concerned with financial reporting.
- The IASC was formed in 1973 through an agreement made by professional accountancy bodies from Australia, Canada, France, Germany, Ireland, Japan, Mexico, the Netherlands, the UK and the USA.

- In November 1999, the IASC board itself approved the constitutional changes necessary for its own restructuring. In May 2000, the IFAC unanimously approved the restructuring.

- The constitution of the old IASC was revised to reflect the new structure. A new IASC Foundation was incorporated (under the laws of the US state of Delaware), and its trustee were appointed. By early 2001, the members of the IASB were appointed, and the new structure became operational. Later that year, the IASB moved into new quarters in London. The technical staff of the IASB comprises over 20 accounting professionals - roughly quadruple the former IASC's professional staff.

In his testimony before the US Senate Committee on Banking, Housing and Urban Affairs on 14 February, 2002 in Washington, Sir David Tweedie, Chairman of the International Accounting Standards Board, stated that an international standard setter was needed for four reasons:

1. There is a recognized and growing need for international accounting standards.
2. No individual standard setter has a monopoly on the best solutions to accounting problems.
3. No national standard setter is in a position to set accounting standards that can gain acceptance around the world.
4. There are many areas of financial reporting in which national standard setter finds it difficult to act alone.

Preface to IFRSs issued in April 2002 by IASB contains the following:

- (i) The International Accounting Standards Board (IASB) was established in 2001 as part of the International Accounting Standards Committee (IASC) Foundation. In 2010, the IASC Foundation was renamed the IFRS Foundation. The governance of the IFRS Foundation rests with twenty-two Trustees.

The Trustees' responsibilities include appointing the members of the IASB and associated councils and committees as well

as securing financing for the organization. The IASB comprises fifteen full-time members (the IFRS Foundation's Constitution provides for membership to raise to sixteen by 1 July 2012). Approval of International Financial Reporting Standards (IFRSs) and related documents, such as the Conceptual Framework for Financial Reporting, exposure drafts, and other discussion documents, is the responsibility of the IASB.

- (ii) The IFRS Interpretations Committee comprises fourteen voting members and a non-voting Chairman, all appointed by the Trustees. Before March 2010 the Interpretations Committee was called the International Financial Reporting Interpretations Committee (IFRIC).

The role of the Committee is to prepare interpretations of IFRSs for approval by the IASB and, in the context of the Conceptual Framework, to provide timely guidance on financial reporting issues. The Committee (then called the International Financial Reporting Interpretations Committee) replaced the former Standing Interpretations Committee (SIC) in 2002.

- (iii) The IFRS Advisory Council is appointed by the Trustees. Before March 2010 the IFRS Advisory Council was called the Standards Advisory Council (SAC).

It provides a formal vehicle for participation by organizations and individuals with an interest in international financial reporting. The participants have diverse geographical and functional backgrounds. The Council's objective is to give advice to the IASB on priorities, agenda decisions and on major standard setting projects.

- (iv) The IASB was preceded by the Board of IASC, which came into existence on 29 June 1973 as a result of an agreement by professional accountancy bodies in Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom and Ireland, and the United States of America. A revised Agreement and Constitution were signed in November 1982.

The Constitution was further revised in October 1992 and May 2000 by the IASC Board. Under the May 2000 Constitution, the professional accountancy bodies adopted a mechanism enabling the appointed Trustees to put the May 2000 Constitution into force. The Trustees activated the new Constitution in January 2001, and revised it in March 2002. The Constitution was further revised in July 2002, June 2005, October 2007, January 2009, January 2010 and January 2013.

Q23. What are the objectives of IASB ?

Ans :

- To develop, in the public interest, a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based on clearly articulated principles. These standards should require high quality, transparent and comparable information in financial statements and other financial reporting to help investors, other participants in the various capital markets of the world and other users of financial information make economic decisions;
- To promote the use and rigorous application of those standards;
- In fulfilling the objectives associated with (a) and (b), to take account of as appropriate, the needs of a range of sizes and types of entities in diverse economic settings;
- To promote and facilitate the adoption of IFRSs, being the standards and interpretations issued by the IASB, through the convergence of national accounting standards and IFRSs.

1.4 FINANCIAL ACCOUNTING STANDARD BOARD (FASB)

Q24. Explain briefly about financial Accounting Standards Board (FASB).

Ans :

(Imp.)

In October 1985, the FASB issued a statement of what is conceived to be its mission: "to establish and improve standards of financial

accounting and reporting for the guidance and education of the public including issuers, auditors and users of financial information.

The statement further says that the Board seeks to accomplish its mission by the following measures:

- (a) Improving the usefulness of financial reporting by focusing on certain primary characteristics (relevance, reliability, comparability, and consistency).
- (b) Keeping standards upto date.
- (c) Considering areas of financial reporting that need improvement.
- (d) Improving the general understanding of financial reporting, its nature, and its purposes.

In pursuing these aims, the Board says that it follows the following precepts:

- (1) To be objective in its decision making and preserve neutrality in the information that results from its standards.
- (2) To weigh the views of its constituents but ultimately to rely on its own judgment.
- (3) To issue standards only when benefits are expected to exceed costs
- (4) To minimize disruption when making needed changes.
- (5) To review past decisions and to make changes when necessary.

Q25. Explain the organizational structure of FASB ?

Ans :

(Imp.)

The structure for establishing financial accounting standards has been modified somewhat since the FASB's founding in 1973. The modifications were the result of recommendations made in 1977 by the Structure Committee of the Financial Accounting Foundation (FAF) the organizational structure and its relationship to its constituency.

- The FED's Board of Trustees consists of 16 members, 11 members nominated by eight organizations: the AAA, AICPA, CFA Institute,

Financial Executives International (FEI), Government Finance Officers Association, Institute of Management Accountants (IMA), Securities Industry Association, and National Association of State Auditors, Comptrollers and Treasurers. An additional five members come from at-large nominations.

- The Trustees approve all member additions and are responsible for oversight, administration, and finances of the FASB and the Governmental Accounting Standards Board (GASB).
- The FASB includes seven members, each serving five-year terms. Any individual member can serve a maximum of two terms. During their terms of office, board members must maintain complete independence. This applies not only to other employment arrangements (past, present, or future) but also to investments. "There must be no conflict, real or apparent, between the members' private interest and the public interest." The background requirement for board members is simply knowledge of accounting, finance, and business and concern for the public interest. In March 1979, for the first time the Board had a majority of members with backgrounds primarily in areas other than public counting.
- The Financial Accounting Standards Advisory Council (FASAC) is instrumental in the establishment of financial accounting standards, It is also appointed by the Board of Trustees.
- The FASAC advises the FASB on its operating and project plans, agenda and priorities, and appointment of task forces, as well as on all major or technical issues.
- The standard setting procedure starts with the identification of a problem A task force is then formed to explore all aspects of the problem. It produces a discussion memorandum identifying all issues and possible solutions, which is widely circulated to interested parties.
- The FASB then convenes a public hearing during which interested parties may make their views known to the Board.

Subsequently, an exposure draft of the final standard is issued and written comments are requested. After consideration of written comments, either another exposure draft is issued (if significant changes are deemed necessary) or the Board takes a final vote. A normal 4-to-3 majority vote is required for passing new standards.

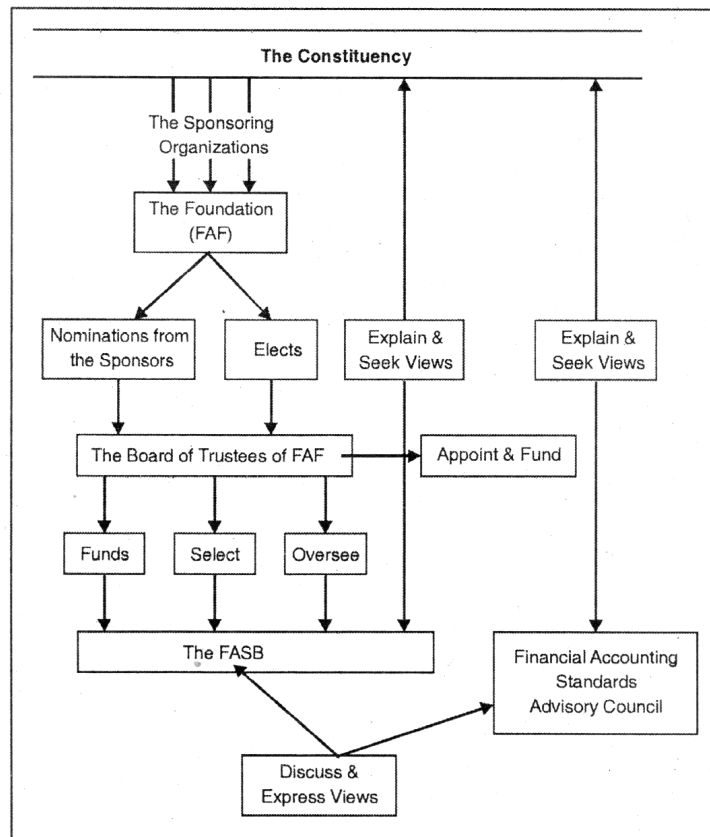


Fig : The Structure of the Board's Constituency Relationships

Before the FASB promulgates a major standard, it is required by its rules to follow extensive 'due process' procedures that gives those concerned with the subject matter of the standard plenty of opportunity to influence the outcome of the Board's deliberations. In connection with each of its major standards, the Board:

- Appoints a task force of technical experts representing a broad spectrum of preparers, auditors and users of financial information to advise on the project.
- Studies existing literature on the subject and conducts such additional research as may be necessary.
- Publishes a comprehensive discussion of issues and possible solutions as a basis for public comment.
- Conducts a public hearing.
- After the results of the public hearing and other responses have been analyzed by the Board's staff and have been considered by the Board, an exposure draft of a proposed standard is issued for the public comment and 90 to 120 days are allowed for comment. If the comments indicate that substantial revisions of the exposure draft are necessary, a second exposure draft may be issued, with further time allowed for public comment.

- The end product of the above elaborate and costly procedure is the promulgation of a statement of financial accounting standards (SFAS). Besides the formal statement, the Board also issues, Statements of Concepts, Interpretations, Technical Bulletins. Statements of Standard establish new standards or amend those previously issued. Statements of Concepts do not establish new standards or require any change in application of existing accounting principles. They establish new general concepts that will be used to guide the development of standards, and to provide guidance in solving problems. Because of their long range importance, Statements of Concepts are developed under the same extensive 'due process' the FASB must follow in developing Statements of Financial Accounting Standards on major topics. Interpretations clarify, explain or elaborate on existing standards.
- Since 1979, the Board's staff has been authorized to issue technical bulletins giving guidance on the interpretation of a standard. These (bulletins) have to be reviewed by the Board members before they are issued, but they are not pronouncements by the Board. The Board has carried out many research projects also.
- The FASB is quite productive when compared with its predecessors. As of June 2009, it issued 168 Statements of Financial Accounting Standards, as well as numerous interpretations and technical bulletins. Since establishing the FASB Accounting Standards Codification in 2009, it issued more than 58 additional accounting standards updates. In Addition, between 1978 and 2010 the FASB issued eight Statements of Financial Accounting Concepts. These statements constitute the conceptual framework, a document that is intended to provide a theoretical underpinning for the assessment of accounting standards and practices.

1.5 ACCOUNTING STANDARD BOARD (ASB)

Q26. Explain the formation of the accounting standard Board ?

Ans :

- (1) The Institute of Chartered Accountants of India (ICAI), recognizing the need to harmonize the diverse accounting policies and practices in use in India, constituted the Accounting Standards Board (ASB) on 21st April, 1977.
- (2) The composition of the ASB is fairly broad based and ensures participation of all interest groups in the standard setting process. Apart from the elected members of the Council of the ICAI nominated on the ASB, the following are represented on the ASB:
 - (i) Nominee of the Central Government representing the Department of Company Affairs on the Council of the ICAI
 - (ii) Nominee of the Central Government representing the Office of the Comptroller and Auditor General of India on the Council of the ICAI
 - (iii) Nominee of the Central Government representing the Central Board of Direct Taxes on the Council of the ICAI
 - (iv) Representative of the Institute of Cost Accountants of India
 - (v) Representative of the Institute of Company Secretaries of India
 - (vi) Representatives of Industry Associations (1 from Associated Chambers of Commerce and Industry (ASSOCITAM), 1 from Confederation of Indian Industry (CII) and 1 from Federation of Indian Chambers of Commerce and Industry (FICCI)
 - (vii) Representative of Reserve Bank Of India
 - (viii) Representative of Securities and Exchange Board of India
 - (ix) Representative of Comptroller and Auditor General of India (C&AG)

- (xi) Representatives of Academic Institutions (1 from Universities and 1 from Indian Institutes of Management)
- (xii) Representative of Financial Institutions
- (xiii) Eminent professionals co-opted by the ICAI (they may be in practice or in industry, government, education, etc.)
- (xiv) Chairman of the Research Committee and the Chairman of the Expert Advisory Committee of the ICAI, if they are not otherwise members of the Accounting Standards Board
- (xv) Representative(s) of any other body, as considered appropriate by the ICAI.

Q27. Explain the objective and functions of the Accounting standards Board ?

Ans :

Objectives :

The following are the objectives of the Accounting Standards Board:

- (i) To conceive of and suggest areas in which Accounting Standards need to be developed.
- (ii) To formulate Accounting Standards with a view to assisting the Council of the ICAI in evolving and establishing Accounting Standards in India.
- (iii) To examine how far the relevant International Accounting Standard/International Financial Reporting Standard can be adapted while formulating the Accounting Standard and to adapt the same.
- (iv) To review, at regular intervals, the Accounting Standards from the point of view of acceptance or changed conditions, and, if necessary, revise the same.
- (v) To provide, from time to time, interpretations and guidance on Accounting Standards.
- (vi) To send comments on various consultative papers such as Exposure Drafts, Discussion

Papers etc., issued by International Accounting Standards Board and various other International bodies such as Asian Oceanian Standard Setters Group (AOSSG).

- (vii) To carry out such other functions relating to Accounting Standards.

Functions

- The main function of the ASB is to formulate Accounting Standards so that such standards may be established by the ICAI in India. While formulating the Accounting Standards, the ASB will take into consideration the applicable laws, customs, usages and business environment prevailing in India.
- The ICAI, being a full-fledged member of the International Federation of Accountants (IFAC), is expected, inter alia, to actively promote the International Accounting Standards Board's (IASB) pronouncements in the country with a view to facilitate global harmonization of accounting standards. Accordingly, while formulating the Accounting Standards, the ASB will give due consideration to International Accounting Standards (IASs) issued by the International Accounting Standards Committee (predecessor body to IASB) or International Financial Reporting Standards (IFRSs) issued by the IASB, as the case may be, and try to integrate them, to the extent possible, in the light of the conditions and practices prevailing in India.
- The Accounting Standards are issued under the authority of the Council of the ICAI. The ASB has also been entrusted with the responsibility of propagating the Accounting Standards and of persuading the concerned parties to adopt them in the preparation and presentation of financial statements. The ASB will provide interpretations and guidance on issues arising from Accounting Standards. The ASB will also review the Accounting Standards at periodical intervals and, if necessary, revise the same.

1.6 PROCEDURE FOR SETTING STANDARD

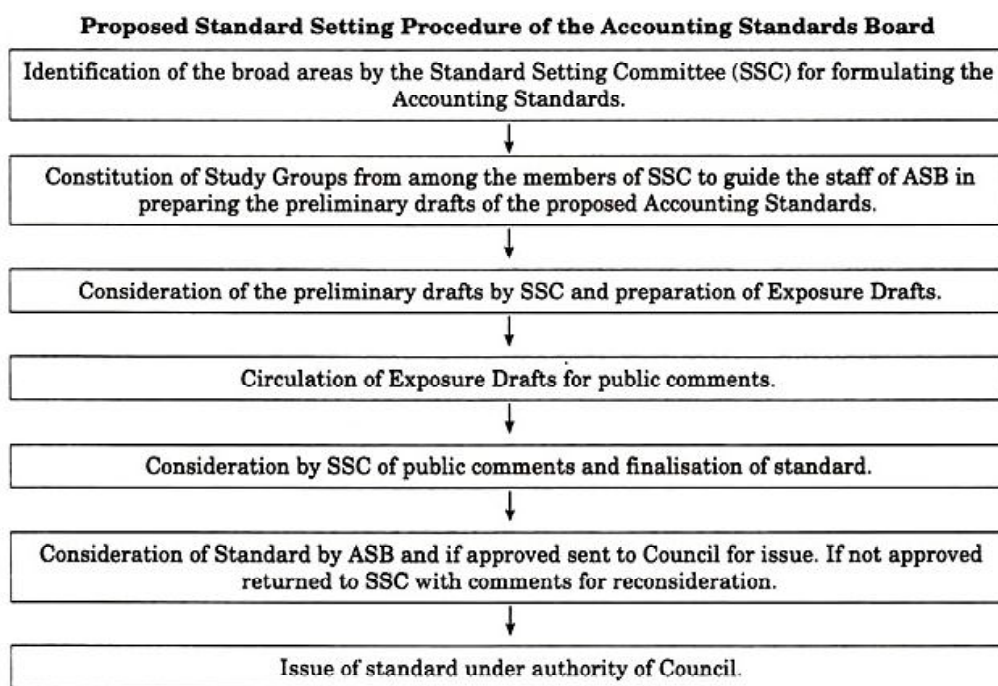
Q28. Explain the procedure for setting accounts standard ?

Ans :

1. The existing procedure for formulating and issuing accounting standard followed by the Accounting Standards Board of the ICAI is as follows:
 - i. ASB determines the broad areas in which Accounting Standards need to be formulated and the priority with regard to issuance thereof.
 - ii. In the preparation of Accounting Standard, ASB is assisted by Study Groups constituted to consider specific subjects. In the formation of Study Groups, provision is made for wide participation by the members of the Institute and others.
 - iii. The Board considers the draft as submitted by the study group and finalizes the same for issue to all members of the Council of the ICAI as well as to the bodies listed below for their comments.

Associated Chambers of Commerce and Industry, Federation of Indian Chambers of Commerce and Industry, Institute of Cost and Works Accountants of India, Standing Conference of Public Enterprises, Institute of Company Secretaries of India, Central Board of Direct Taxes, Department of Company Affairs, Comptroller and Auditor General of India, Reserve Bank of India, Indian Banks' Association, Securities and Exchange Board of India, Confederation of Indian Industries.
 - iv. ASB holds a meeting with the representatives of specified outside bodies listed above to ascertain their views.
 - v. On the basis of the comments received from the Council members as well as the outside bodies, the Board finalizes the Exposure Draft and exposes it for public comments.
 - a) To all members of the profession through the medium of their Journal.
 - b) To principal Chambers of Commerce and Industry through direct communications.
 - c) To all recognized Stock Exchanges through direct communication.
 - d) To the Institute of Cost and Works Accountants of India through direct communication.
 - e) To the Institute of Company Secretaries of India through direct communication.
 - f) To the Ministry of Corporate Affairs, Central Board of Direct Taxes and the Comptroller and Auditor General by direct communication.
 - g) To principal financial institutions, Reserve Bank of India, Life Insurance Corporation, General Insurance Corporation, Unit Trust of India and Indian Banks' Association by direct communication.
 - h) To all Regional Councils and Branches of the ICAI by direct Communication.
 - i) To all Council Members.
 - j) To Securities and Exchange Board of India by direct communication.
 - vi. After taking into account the comments received from various quarters, the draft of the proposed standard is finalised by the Board and submitted to the Council for its consideration.
 - vii. The Council of the Institute considers the final draft of the proposed Standard, and if necessary, modifies the same in consultation with ASB.

2. The Accounting Standard on the relevant subject is then issued under the authority of the Council. The Advisory Group on Accounting and Auditing set up by Reserve Bank of India in its report (January 2001) has proposed the following procedure for standard setting in India.



1.7 NEED FOR UNIFORM GLOBAL FINANCIAL REPORTING

Q29. What is Harmonization ? Explain the Nature of Harmonization?
(OR)

Elaborate the need and importance of Uniform Global financial reporting.

Ans : (Jan.-20, Imp.)

Harmonization means maintaining uniformity in financial accounting principles and practices at the international level. It implies international harmony in transactional financial reporting. It aims to narrow the areas of difference and to eliminate undesirable alternative practices in financial reporting.

- It is process of blending and combining various practices into an orderly structure, which produces synergistic result.

Harmonization refers to the degree of coordination or similarity among the various sets of national accounting standards and methods and formats of financial reporting. Harmonization is broken down into two aspects:

- (a) Material harmonization (also called de facto harmonization) refers to harmonization among accounting practices of different enterprises whether or not stemming from regulations, and
 - (b) formal harmonization (also called de jure harmonization) refers to the process or degree of harmonization present among the accounting rules or regulations of different countries or groups.
- Harmonization involves examining and comparing the different accounting systems in order to note points of agreement and disagreement, and then working towards bringing these different systems together.

- Those who believe that uniformity is desirable, would, as a first step, need to compare the different systems, then they would need to persuade others that some measure of agreement would be advantageous.
- They would then work towards harmonization, seriously attempting to remove differences. They would be working towards the acceptance of some authorized model, a set of standards. When this has been achieved, there would be uniformity.
- The steps in the harmonization process, generally speaking, appear to be comparison move towards harmonization producing agreed standards and then uniformity in this order. It is possible, of course, to stop at any point in this process.

1.8 SIGNIFICANT DIFFERENCES BETWEEN IAS, USGAAP AND INDIAN GAAP

Q30. What are the differences between IAS, USGAAP and Indian GAAP ?

Ans :

S.No.	SUBJECT	IFRS	US GAAP	INDIAN GAAP
1.	Income statement	Does not prescribe a standard format, although expenditure is present in one of two formats (function or nature). Certain minimum items must be presented on the face of the income statement	Present as either a single step or multiple - step format Expenditures are presented by function. US public companies should follow SEC regulations.	Does not prescribe a standard format ; but certain income and expenditure items are disclosed in accordance with accounting standards and the Companies Act. Industry-specific formats are prescribed by industry regulations.
2.	Statement of changes in share (stock) holder's equity	Statement shows capital transactions with owners, the movement in accumulated profit and a reconciliation of all other components of equity. The statement is presented as a primary statement except when a So RIE is presented. In this case, only disclosure in the notes applies.	Similar to IFRS except that the statement is presented as a primary statement ; SEC rules allow certain information to be included in the notes and not in the primary statement.	No separate statement is required Changes in shareholders' equity are disclosed in separate schedules of 'Share capital' and 'Reserves and surplus'.
3.	Cash flow statements format and method	Standard headings, but limited guidance on contents. Direct or indirect method is used.	Similar headings to IFRS, but more specific guidance for items included in each category. Direct or indirect method is used; SEC encourages the direct method.	Similar to IFRS. However, indirect method is required for listed companies and direct method for insurance companies.
4.	Changes in accounting estimates	Reported in income statement in the current period and future, if applicable.	Similar to IFRS	Similar to IFRS
5.	Special purpose entity (SPE)	Consolidated where the substance of the relationship indicates control.	Variable interest entities (VIEs) are consolidated when the entity	No specific guidance.

			<p>has a variable interest that will absorb the majority of the expected losses, receive a majority of the expected return or both. A voting interest entity in which the entity holds a controlling financial interest is consolidated.</p> <p>If a SPE meets the definition of a qualified SPE (QSPE), the transfer or does not consolidate the QSPE.</p>	
6.	Disclosures about significant associates	Detailed information on significant associates' assets, liabilities and results is required	Similar to IFRS	Certain disclosures are required for all associates; however, detailed information on significant associates is not required.
7.	Presentation of jointly controlled entities (joint ventures)	In consolidated financials : both proportional consolidation and equity method is permitted. In standalone financials: at cost or at fair value in accordance with IAS 39.	In consolidated financials : equity method is required except in specific circumstances. In standalone financials: at cost or equity method is used	In consolidated financials : proportional consolidation is used. In standalone financials: at cost less impairment.
8.	Purchase method - disclosure.	Disclosures include names and descriptions of combining entities, date of acquisition, cost of combination, summary of fair values and pre-acquisition IFRS values of assets and liabilities acquired, impact on results and financial position of acquirer, and reasons behind the recognition of goodwill.	Similar to IFRS, with additional disclosures regarding the reasons for the acquisition and details of allocations.	Disclosures include names and descriptions of combining entities, the effective date, consideration (paid or contingently payable), method of accounting, amount of goodwill / capital reserve, and period of goodwill amortisation.
9.	Revenue recognition	Based on several criteria, which require the recognition of revenue when risks and rewards and control have been transferred and the revenue can be measured reliably.	Similar to IFRS in principle, based on four key criteria. Extensive detailed guidance exists for specific types of transactions.	Similar to IFRS conceptually, although several differences in detail.
10.	Construction contracts	Accounted for using percentage - of - completion method. Completed contract method is prohibited.	Similar to IFRS; however, completed contract method is permitted in rare circumstances	Similar to IFRS

11.	Depreciation	Allocated on a systematic basis to each accounting period over the useful life of the asset.	Similar to IFRS	Similar to IFRS, except where the useful life is shorter as envisaged under the Companies Act or the relevant statute, the depreciation is computed by applying a higher rate.
12.	Interest expense	Recognized on an accrual basis using the effective interest method.	Similar to IFRS	Recognised on an accrual basis; practice varies with respect to recognition of discounts and premiums.
13.	Capitalization of borrowing costs	Permitted as a policy choice for all qualifying assets, but not required.	Required.	Required
14.	Deferred income taxes - general approach	Full provision method is used (some exceptions) driven by balance sheet temporary differences. Deferred tax assets are recognised if recovery is probable (more likely than not).	Similar to IFRS but with specific differences in application.	Full provision method is used driven by timing differences arising from taxable and accounting income. Deferred tax assets is recognised if realization is virtually certain or reasonably certain as applicable for entities with and without tax carry forward losses, respectively.
15.	Fringe benefits tax	Included as part of related expense (fringe benefit) which gives rise to incurrence of the tax.	Similar to IFRS	Disclosed as a separate item after 'profit before tax' on the face of income statement.
16.	Hyperinflationary economy measurement	Entities that have the currency of hyperinflationary economy as functional currency restate their financial statements using a measurement unit current at balance sheet date.	Generally does not permit inflation - adjusted financial statements; instead requires use of reporting currency (Us dollar) as functional currency. Foreign private issuers that use IFRS are permitted to omit quantification of any differences that would have resulted from application of FAS 52.	No specific guidance.
17.	Earnings per share diluted	Weighted average potential dilutive shares are used as denominator for diluted EPS. 'Treasury share' method is used for share options/warrants.	Similar to IFRS	Similar to IFRS, except in certain circumstances advance share application money received is treated as dilutive potential equity shares.
18.	Segment reporting scope and basis of formats	Public entities: primary and secondary (business and geographic) segments are reported based on risks and returns and internal	Public entities (SEC registrants); reported based on operating segments, which are based on manner in which chief operating	Similar to IFRS. Exemption only for certain SMEs having turnover or borrowings below certain threshold.

		reporting structure.	decision - maker evaluates financial information for purposes of allocating resources and assessing performance.	
19.	Discontinued operations definition	Operations and cash flows that can be clearly distinguished for financial reporting and represent a separate major line of business or geographical area of operations, or a subsidiary acquired exclusively with a view to resale.	Wider definition than IFRS: component that is clearly distinguishable operationally and for financial reporting can be : reporting segment, operating segment, reporting unit, sub - subsidiary or asset grouping.	Operations and cash flows that can be clearly distinguished for financial reporting and represent a separate major line of business or geographical area of operations.
20.	Discontinued operations measurement	Measured at lower of carrying amount and fair value less costs to sell.	Similar to IFRS	By applying other relevant accounting standards for measurement. For example, by applying accounting standard on impairment of assets, provisions, etc.

1.9 IFRS CONCEPT

Q31. What is IFRS ? Explain the merits and demerits of IFRS.

Ans :

(Imp.)

Meaning

The term ,International Financial Reporting Standards includes IFRS, IAS and interpretations originated by the IFRIC or the former Standing Interpretations Committee (SIC).

Process of setting IFRS

From 1973 to 2001, the body in charge of setting the international standards was the International Accounting Standards Committee (IASC). The principal aim of IASC was to encourage national accounting standard setters around the world to improve and harmonize national accounting standards.

IASC issued 41 numbered standards, known as International Accounting Standards (IAS), as well as a framework for the preparation and presentation of financial statements. While some of the standards issued by the IASC have been withdrawn, many are still in force. In addition, the interpretations issued by the Standing Interpretations Committee (SIC) of IASC, are still in force.

In 2001, to strengthen the independence, legitimacy and quality of the international accounting standard-setting process, the IASC Board was broad based and replaced by the International Accounting Standards Board (IASB) as the body in charge of setting the international standards.

It was decided by IASB that all effective IAS issued by the IASC as well as the interpretations issued by the SIC are adopted as its own standards. Those IAS continue to be in force to the extent they are not amended or withdrawn by the IASB. New standards issued by IASB would have prefix of ,IFRS and new interpretations would be issued by the International Financial Reporting Interpretation Committee (IFRIC)

Merits

1. IFRS brings improvement in comparability of financial information and financial performance with global peers and industry standards. This will result in more transparent financial reporting of a company's activities which will benefit investors, customers and other key stakeholders in India and overseas.
2. The adoption of IFRS is expected to result in better quality of financial reporting due to consistent application of accounting principles and improvement in reliability of financial statements. This, in turn, will lead to increased trust and reliance placed by investors, analysts and other stakeholders in a company's financial statements.
3. IFRS provide better access to the capital raised from global capital markets since IFRS are now accepted as a financial reporting framework for companies seeking to raise funds from most capital markets across the globe. Thus, IFRS increase the efficiencies of global capital management.
4. IFRS minimize the obstacles faced by Multi-national Corporations by reducing the risk associated with dual filings of accounts. A recent decision by the US Securities and Exchange Commission (SEC) permits foreign companies listed in the US to present financial statements in accordance with IFRS. This means that such companies will not be required to prepare separate financial statements under Generally Accepted Accounting Principles in the US (US GAAP). Therefore, Indian companies listed in the US would benefit from having to prepare only a single set of IFRS compliant financial statements, and the consequent saving in financial and compliance costs.
5. The impact of globalization causes spectacular changes in the development of Multi-national Corporations in India. This has created the need for uniform accounting practices which are more accurate, transparent and which satisfy the needs of the users. Implementation of uniform accounting practices i.e., IFRS will provide much better quality information.

6. Uniform accounting standards (IFRS) enable investors to understand better the investment opportunities as against multiple sets of national accounting standard.
7. With the help of IFRS, investors can increase the ability to secure cross border listing

Demerits

1. The perceived benefits from IFRS' adoption are based on the experience of IFRS compliant countries in a period of mild economic conditions. Any decline in market confidence in India and overseas coupled with tougher economic conditions may present significant challenges to Indian companies.
2. IFRS requires application of fair value principles in certain situations and this would result in significant differences in financial information currently presented, especially in relation to financial instruments and business combinations. Given the current economic scenario, this could result in significant volatility in reported earnings and key performance measures like EPS and P/E ratios. Indian companies will have to build awareness amongst investors and analysts to explain the reasons for this volatility in order to improve understanding, and increase transparency and reliability of their financial statements.
3. This situation is worsened by the lack of availability of professionals with adequate valuation skills, to assist Indian corporate in arriving at reliable fair value estimates. This is a significant resource constraint that could impact comparability of financial statements and render some of the benefits of IFRS' adoption ineffective.
4. Although IFRS are principles-based standards, they offer certain accounting policy choices to prepares of financial statements. For example, the use of a cost-based model or a revaluation model in accounting for investment properties. This could reduce consistency and comparability of financial information to a certain extent and therefore reduce some of the benefits from IFRS' adoption.

5. IFRS are formulated by the International Accounting Standards Board (IASB) which is an international standard body. However, the responsibility for enforcement and providing guidance on implementation vests with local government and accounting and regulatory bodies, such as the ICAI in India. Consequently, there may be differences in interpretation or practical application of IFRS provisions, which could further reduce consistency in financial reporting and comparability with global peers. The ICAI will have to make adequate investments and build infrastructure to ensure compliance with IFRS.

Q32. Explain the various challenges in Implementing IFRS ?

Ans :

1. There is a need for a change in several laws and regulations governing financial accounting and reporting in India. In addition to accounting standards, there are legal and regulatory requirements that determine the manner in which financial information is reported or presented in the financial statements.

For example, the Companies Act determines the classification and accounting treatment for redeemable preference shares as equity instruments of a company, whereas these may be considered to be a financial liability under IFRS. The Companies Act also prescribes the format for presentation of financial statements for Indian companies, whereas the presentation requirements are significantly different under IFRS.

Similarly, the Reserve Bank of India regulates the financial reporting for banks and other financial institutions, including the presentation format and accounting treatment for certain types of transactions. In the absence of adequate clarity and assurance that Indian laws and regulations will be amended to conform to IFRS, the conversion process may not gain momentum.

2. There is a lack of adequate professionals with practical IFRS conversion experience and therefore many companies will have to rely on external advisers and their auditors. This is magnified by a lack of preparedness amongst Indian corporate as this project may be viewed simply as a project management or an accounting issue which can be left to the finance function and auditors.

However, it should be noted that IFRS conversion will involve a fundamental change to an entity's financial reporting systems and processes. It will require a detailed knowledge of the standards and the ability to consider their impact on business transactions and performance measures

3. Another potential pitfall is viewing IFRS accounting rules as similar to Generally Accepted Accounting Principles in India (Indian GAAP), since Indian accounting standards have been formulated on the basis of principles in IFRS.

However, this view disregards significant differences between Indian GAAP and IFRS as well as differences in practical implementation and interpretation of similar standards. Further, certain Indian standards offer accounting policy choices which are not available under IFRS.

For example, use of pooling of interests method in accounting for business combinations.

4. Convergence is not just a one-time technical step but will impose practical challenges of significant business and regulatory matters like structuring of ESOP schemes, training of employees, tax planning, modification of IT system, compliance with debt covenants.
5. Educating investors to understand the changed financial reporting under IFRS is challenging due to differences in various conceptual, practical, legal and implementation methods.
6. The regulatory and legal requirements in India will pose a challenge unless the same is been addressed by respective regulatory. For example the present direct tax laws do not

address any tax implications likely to arise from IFRS transitions.

7. Complexities in the introduction of concepts such as present value and fair value measurement, recognition and the extent of disclosure required under IFRS are other challenges.

1.10 CONVERGENCE OF ACCOUNTING STANDARDS

Q33. Explain convergence of accounting standards

(or)

Distinguish between Harmonization and convergence ?

Ans :

The terms 'Harmonization' and 'Convergence' are often used interchangeably with reference to financial reporting. Both aim at importing worldwide financial reporting and to make the financial information contained in the financial reports comparable, reliable and transparent. Both aim to build a global financial reporting structure for better evaluation of companies and easing the burden of preparers and users of financial statements.

Convergence means that all standard-setters around the world should agree on a single, high-quality accounting standards. Convergence can be achieved in two ways: either adopt International Financial Reporting Standards (IFRSs) or adapt IFRS to formulate the country's own standards.

standardisation and Harmonization

Standardisation involves

- (i) More uniform application of accounting concepts, principles and rules, reporting procedures and legislation;
- (ii) Adherence to more unified charts of accounts and statements, which specify the classification categories by economic units, industries and sectors, and which preferably are applicable on an international scale; and
- (iii) Greater systematization of all accounting activities, particularly standardised plans of

accounts (this would not only include the classification charts but also the quantitative and qualitative aspects of data).

Thus, the term 'harmonization' is not the same thing as 'standardisation'. Nobes distinguishes these two terms clearly:

"Harmonization is a process of increasing the compatibility of accounting practices by setting bounds to their degree of variation. 'Standardisation' appears to imply the imposition of a more rigid and narrow set of rules. However, within accounting, these two words have almost become technical terms, and cannot rely upon normal difference in their meanings.

1.11 IND AS CONCEPT

Q34. What are Indian Accounting Standards? Explain the scope of Indian Accounting Standards.

Ans :

Ind-AS or Indian Accounting Standards govern the accounting and recording of financial transactions as well as the presentation of statements such as profit and loss account and balance sheet of a company. For long, there has been a heated debate about Indian companies moving to the globally accepted International Financial Reporting Standards (Indian Accounting) for their accounts.

But firms have resisted this shift, stating that this will lead too many changes in the capture and reporting of their numbers. Ind-AS has been evolved as a compromise formula that tries to harmonize Indian accounting rules with the Indian Accounting.

Scope

The Accounting Standard Board (ASB) has given a general description of the scope of accounting standards.

1. Attempts will be made to issue those accounting standards which are in accordance with the provisions of the applicable laws, usages, business environment and customs of the country. If a specific accounting standard is not in conformance with law because of the subsequent changes in the law,

then the provision of the said law will be in effect and the financial statements must be made in accordance with such law.

2. In our country, the local regulations which regulate the preparation and presentation of financial statements cannot be over ridden by the accounting standards. In spite of that the institute will decide the amount of subject to be revealed in the financial statements and the corresponding reports of auditor. These disclosures through proper notes explain how some specific items are to be treated. These descriptive or explanatory notes must not be considered as serious comments on the financial statements but should be used only for a better understanding.
3. Accounting standards are designed for material items only. If there is any limitation related to the use of a particular standard, then the institute will inform about it from time to time. The institute also mentions the date from which a specific standard comes into effect and the class of enterprises to which it will apply. Nevertheless, the standards will have no retrospective application, until it is mentioned.
4. To gain uniformity in the presentation of financial statements, the institute attempts to convince the government, proper authorities, business and industrial community to embrace these standards.
5. While designing the accounting standards, the aim is to focus on basic matters. The attempt is to confine accounting standards to essentials and not to make them complicated. This is to ensure that they could be used properly nationwide.
6. ASB designed standards consist of paragraphs in plain type and bold italic which have equal authority. The paragraphs which are in bold italic type signify the main principles.

Q35. Explain the benefits of Indian Accounting Standards?

Ans :

Indian Accounting Standards address this challenge by providing a high quality, internationally recognized set of accounting standards that bring transparency, accountability and efficiency to financial markets around the world.

Indian Accounting Standards bring transparency by enhancing the international comparability and quality of financial information, enabling investors and other market participants to make informed economic decisions.

Indian Accounting Standards strengthen accountability by reducing the information gap between the providers of capital and the people to whom they have entrusted their money. Our Standards provide information that is needed to hold management to account. As a source of globally comparable information, Indian Accounting Standards are also of vital importance to regulators around the world.

Indian Accounting Standards contribute to economic efficiency by helping investors to identify opportunities and risks across the world, thus improving capital allocation. For businesses, the use of a single, trusted accounting language lowers the cost of capital and reduces international reporting costs.

Lowered cost of capital - Increased insight into financial results and adherence to high-quality financial standards, as specified by Ind-AS, can benefit both companies and their investors with reduced cost of capital.

Q36. Explain the developments of Indian Accounting Standards.

Ans :

1. First Step Towards IFRSs

The Institute of Chartered Accountants of India (ICAI) is the association that sets accounting standards.

In 2006, it decided to follow the International Financial Reporting Standards (IFRSs) which are released by International Accounting Standards Board (IASB). This step was taken to strengthen acceptability and transparency of financial data provided by corporates of India through their financial statements. The Indian Government accepted this move towards IFRS.

The government of India carried out a detailed analysis of IFRS requirements and discussed the matter with different stakeholders. Finally, the government decided that it will adopt IFRSs issued by the IASB. Therefore, at the time of designing IFRS converged Indian Accounting Standards (Ind AS), it was considered that these standards are in accordance with the IFRSs and departures were made wherever needed. These changes were made by considering different factors i.e., different terminology related changes were made in order to make them consistent with the terminology used in law and it also made changes by considering the country's economic environment which is different from the economic environment from the economic environment assumed to be in existence by IFRS.

2. Government of India - Commitment to IFRS Converged Ind AS

At the beginning, it was expected that Ind AS would be implemented from the year 2011. However, the Ministry of Corporate Affairs (MCA) planned to delay implementation date of Ind AS as few issues including tax issues were still needed to be resolved.

In July 2014, Shri Arun Jaitley who was the finance minister at that time, in his budget speech announced the importance of converging the prevailing accounting standards with the IFRS by setting new Indian AS by the Indian organizations.

By considering the above announcement, the government took different steps in order to encourage the implementation of IFRS - converged Ind AS. Further, the MCA released companies (Indian Accounting Standards) Rules, 2015 on February 16, 2015 by covering redesigned road map for implementation of Ind AS for all companies except banking, insurance, non-banking financial companies and Ind AS. According to this notification, Ind AS converged with IFRS will be implemented on voluntary basis from 1st April, 2015 and compulsory from 1st April, 2016. After this, in 2016, MCA has declared road map for NBFC by declaring implementation date for Ind AS. In the same way, various road maps for implementation of Ind AS, were issued by banking and insurance regulatory authority for banking and insurance companies.

1.11.1 Applicability / Adoption of Ind As (Road map)

Q37. Explain the applicability of Ind As ?

Ans : (Imp.)

Ind ASs are applicable to different class of entities as under:

1st April 2016: Mandatory Basis

- (a) Companies listed/in process of listing on Stock Exchanges in India or Outside India having net worth > INR 5 Billion
- (b) Unlisted Companies having net worth > INR 5 Billion
- (c) Parent, Subsidiary, Associate and JV of Above

1st April 2017: Mandatory Basis

- (a) All companies which are listed / or in process of listing inside or outside India on Stock Exchanges not covered in Phase I (other than companies listed on SME Exchanges)
- (b) Unlisted companies having net worth INR 2.5 Billion or more but less than INR 5 billion
- (c) Parent, Subsidiary, Associate and JV of above

Mandatory Basis (Postponed date not yet decided)

- Scheduled commercial banks (excluding RRBs)
- Holding, subsidiary, joint venture or associate companies of scheduled commercial banks

Mandatory Basis - (Postponed date not yet decided)

- All India Term lending refinancing institutions (i.e. exim Bank, NABARD, NHB and SIDBI) as RBI notification of deferring Ind AS for banks does not cover All India term lending refinancing institutions. RBI clarification needs

Mandatory Basis - 1st April 2018

- NBFCs having a net worth of ₹ 500 crore or more.
- Holding, subsidiary, joint venture or associate companies of the above, other than those companies already covered under the corporate road map announced by MCA

1st April 2019 : Mandatory Basis

- NBFCs whose equity and/or debt securities are listed or are in the process of listing on any stock exchange in India or outside India and having a net worth less than ₹ 500 crore.
- NBFCs that are unlisted companies, having a net worth of ₹ 250 crore or more but less than ₹ 500 crore.
- Holding, subsidiary, joint venture or associate companies of companies covered above, other than those companies already covered under the corporate road map announced by MCA.

1st April 2020 : Mandatory Basis

- Insurers/insurance companies
- Holding, subsidiary, joint venture or associate companies of the above, other than those companies already covered under the corporate road map announced by MCA

Companies listed on SME exchange not required to apply Ind AS

Once Ind ASs are applicable, an entity shall be required to follow the Ind AS for all the subsequent financial statements.

Q38. Explain the Road map for Implementation of Ind AS.

Ans :

The notification dated 16th February 2015, the Ministry of Corporate Affairs (MCA) has issued the Companies (Indian Accounting Standards) Rules, 2015 (Rules) which lay down a road map for companies other than Insurance Companies, Banking Companies and Non-Banking Finance Companies (NBFC) for implementation of Ind AS converged with IFRS.

The Ind AS shall be applicable to the Companies as follows:

Particulars	Phase-I	Phase-II	Voluntary Adoption
Year of adoption	FY 2016-17	FY 2017-18	FY 2015-16
Comparative Year	FY 2015-16	FY 2016-17	FY 2014-15
Covered Companies			
(a) Listed Companies	All Companies with net worth > = INR 500 Crores	All Companies listed or in the process of being listed	Any Company could voluntarily adopt Ind AS
(b) Unlisted Companies	All Companies with net worth > = INR 500 Crores	All Companies with net worth > = INR 250 Crores	
(c) Group Companies	Applicable to Holding, Subsidiaries, Joint Ventures, or Associates of Companies covered in (a) and (b) above. This may also impact fellow Subsidiary Companies while preparing Consolidated Financial Statements of the Holding Company		

Table: Road map for Implementation of Ind AS

Exception

Companies whose securities are listed or in the process of listing on the Small and Medium Enterprises (SME) exchanges will not be required to apply Ind AS and can continue to comply with the existing Accounting Standards unless they choose otherwise.

The companies not covered under Ind AS road map shall continue to apply existing Indian GAAP; however, they can voluntarily adopt Ind AS. Once Ind AS is applied, an entity cannot switch back to Indian GAAP.

Pursuant to the introduction of the Indian Accounting Standards (Ind AS) vide notification dated 16 February 2015, by the Ministry of Corporate Affairs (MCA), companies covered by Ind AS implementation road map (corporate road map) have already implemented Ind AS on 1 April 2016 or are planning to implement it in the next accounting year. MCA has also notified a separate road map for Ind AS implementation for banks, insurance companies and Non-Banking Financial Companies (NBFCs). During this transition from accounting standards to Ind AS, most of the companies might face issues/challenges, which require immediate clarifications and interpretations.

In order to facilitate smooth implementation process and to overcome the issues/challenges faced by these companies, the Accounting Standard Board of the Institute of Chartered Accountants of India (ICAI) constituted the Ind AS Transition Facilitation Group (ITFG) on 11 January 2016 for issuing clarifications on the applicability and interpretations under Companies (Indian Accounting Standards) Rules, 2015. The ITFG has conducted six meetings till date and it has issued six bulletins to provide clarifications and interpretations on matters which are being raised before it by preparers and users of the Financial Statements and other stakeholders.

Short Question & Answers

1. Define Accounting.

Ans :

Meaning of Accounting

Accounting deals with the measurement or provision of assurance about financial information used by different persons, viz., lenders, managers, investors, tax authorities and other decision-makers. It measures the various economic activities which affect inflow and outflow of economic resources to develop useful information. In another words, it can be said that it serves as a language of business since it communicates the results of business operations.

Definitions of Accounting

- i) **According to American Accounting Association** "Accounting is the process of identifying, measuring and communicating information to permit judgement and decisions by the users."
- ii) **According to Milagros B. Hernane,** "Accounting is a service activity. Its function is to provide quantitative information, primarily financial in nature, about economic entities that is intended to be useful in making economic decisions, and in making reasoned choices among alternate courses of action."
- iii) **According to American Institute of Certified Public Accountants** "Accounting is the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are in part, at least, of a financial character and interpreting the results thereof."
- iv) **According to Smith and Ashburne,** "Accounting is a means of measuring and reporting the results of economic activities".
- v) **According to Bierman and Derbin,** "Accounting may be defined as the identifying, measuring, recording and communicating of financial information".

From the above definitions and the meaning of book-keeping, it may be concluded that the book-keeping involves only the recording of transactions. The accounting starts where the function of book-keeping ends.

2. Disadvantages of Accounting.

Ans :

Following are the main limitations of accounting:

1. Records only Monetary Transactions

Accounting records only those transactions which can be measured in monetary terms. Those transactions which cannot be measured in monetary terms as conflict between production manager and marketing manager, efficient management etc., may be very important for a concern but not recorded in the business books.

2. Effect of Price Level Changes not Considered

Accounting transactions are recorded at cost in the books. The effect of price level changes is not brought into the books with the result that comparison of the various years becomes difficult.

For example, the sales to total assets in 2007 would be much higher than in 2002 due to rising prices, fixed assets being shown at cost and not at market price.

3. No realistic information

Accounting information may not be realistic as accounting statements are prepared by following basic concepts and conventions. For example, going concern concept gives us an idea that the business will continue and assets are to be recorded at cost but the book value which the asset is showing may not be actually realisable. Similarly, by following the principle of conservatism the financial statements will not reflect the true position of the business.

4. Personal bias of the Accountant affects the accounting statements

Accounting statements are influenced by the personal judgement of the accountant. He may select any method of depreciation, valuation of stock, amortisation of fixed assets, treatment of deferred revenue expenditure. Such judgement based on integrity and competency of the accountant will definitely affect the preparation of accounting statements.

3. What are the Functions of Accounting Information System.

Ans :

Functions

Accounting information systems have three basic functions:

1. The first function of an AIS is the efficient and effective collection and storage of data concerning an organization's financial activities, including getting the transaction data from source documents, recording the transactions in journals, and posting data from journals to ledgers.
2. The second function of an AIS is to supply information useful for making decisions, including producing managerial reports and financial statements.
3. The third function of an AIS is to make sure controls are in place to accurately record and process data.

4. Disadvantages of Accounting Information System.

Ans :

1. Initial Cost of Installment and Training

While we discussed that an AIS is cost-effective, the same may not be true in the case of small business enterprises. Cost of initial setup may be high and may not actually generate value to the organization.

2. Manual Intervention

Although we discussed that AIS reduces manual intervention but the same cannot be completely eliminated. AIS needs manual intervention at a certain point of time which may bring inefficiency in the system.

3. Error Cannot be Completely Eliminated

We discussed, AIS reduces chances of error but there are chances of wrong coding in software which may lead to error-prone results, also manual intervention is still present here which can also generate an error.

4. Confidentiality

Although we discussed portability of AIS data the same can also be disastrous for an organization. If such information is hacked i.e. stolen. An intruder may amend the information or he can disclose sensitive financial information.

5. Features of Accounting Principles.

Ans :

The features of accounting principles are as follows:

1. Accounting Principles are Based on General Rules

The accounting principles are based on general rules, conventions, and assumptions which are widely accepted by accountants, auditors, managers, and government agencies. It is noteworthy here that the accounting principles are neither cent percent fool-proof nor can their accuracy be tested in any laboratory.

2. Accounting Principles are Launched on the Basis of Logic and Experience

It is not proper to think that the accounting principles are the creation of any law. In fact, these are put forward on the basis of logic and experience in the preparation of financial statements. The practical requirements of

business, law, government agencies, creditors, shareholders and other users do affect the formulation of accounting principles.

3. Accounting Principles are Widely Accepted

It is an important characteristic that the accounting principles are widely accepted. The accountants also take it for granted that certain alternatives in accounting can be used by concerns according to their choice. **For example**, one can use 'Asset Accrued Method' or 'Total Cash Price Method' for accounting the hire-purchase transactions.

6. Define Accounting Standards.

Ans :

Accounting standards are the written statements consisting of rules and guidelines, issued by the accounting institutions, for the preparation of uniform and consistent financial statements and also for other disclosures affecting the different users of accounting information.

Accounting standards lay down the terms and conditions of accounting policies and practices by way of codes, guidelines and adjustments for making the interpretation of the items appearing in the financial statements easy and even their treatment in the books of account.

Definition

According to Kohler, Accounting standards as a "code of conduct imposed on accountants by custom law (or) professional body.

7. Importance of accounting standards ?

Ans :

The users of financial statements include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public. They use financial statements in order to satisfy some of their information needs. These needs include the following:

(a) Investors

The providers of risk capital are concerned with the risk inherent in, and return provided by, their investments. They need information to help them determine whether they should buy, hold or sell. They are also interested in information which enables them to assess the ability of the enterprise to pay dividends.

(b) Employees

Employees and their representative groups are interested in information about the stability and profitability of their employers. They are also interested in information which enables them to assess the ability of the enterprise to provide remuneration, retirement benefits and employment opportunities.

(c) Lenders

Lenders are interested in information which enables them to determine whether their loans, and the interest attaching to them, will be paid when due.

(d) Suppliers and other trade creditors

Suppliers and other creditors are interested in information which enables them to determine whether amounts owing to them will be paid when due. Trade creditors are likely to be interested in an enterprise over a shorter period than lenders unless they are dependent upon the continuance of the enterprise as a major customer.

(e) Customers

Customers have an interest in information about the continuance of an enterprise, especially when they have a long-term involvement with, or are dependent on, the enterprise.

8. What are the objectives of IASB ?

Ans :

- (a) To develop, in the public interest, a single set of high quality, understandable, enforceable and globally accepted financial reporting

standards based on clearly articulated principles. These standards should require high quality, transparent and comparable information in financial statements and other financial reporting to help investors, other participants in the various capital markets of the world and other users of financial information make economic decisions;

- (b) To promote the use and rigorous application of those standards;
- (c) In fulfilling the objectives associated with (a) and (b), to take account of as appropriate, the needs of a range of sizes and types of entities in diverse economic settings;
- (d) To promote and facilitate the adoption of IFRSs, being the standards and interpretations issued by the IASB, through the convergence of national accounting standards and IFRSs.

9. What is Harmonization ?

Ans :

Harmonization means maintaining uniformity in financial accounting principles and practices at the international level. It implies international harmony in transactional financial reporting. It aims to narrow the areas of difference and to eliminate undesirable alternative practices in financial reporting.

- It is process of blending and combining various practices into an orderly structure, which produces synergistic result.

Harmonization refers to the degree of coordination or similarity among the various sets of national accounting standards and methods and formats of financial reporting. Harmonization is broken down into two aspects:

- (a) Material harmonization (also called de facto harmonization) refers to harmonization among accounting practices of different enterprises whether or not stemming from regulations, and

- (b) formal harmonization (also called de jure harmonization) refers to the process or degree of harmonization present among the accounting rules or regulations of different countries or groups.

10. Merits of IFRS.

Ans :

1. IFRS brings improvement in comparability of financial information and financial performance with global peers and industry standards. This will result in more transparent financial reporting of a company's activities which will benefit investors, customers and other key stakeholders in India and overseas.
2. The adoption of IFRS is expected to result in better quality of financial reporting due to consistent application of accounting principles and improvement in reliability of financial statements. This, in turn, will lead to increased trust and reliance placed by investors, analysts and other stakeholders in a company's financial statements.
3. IFRS provide better access to the capital raised from global capital markets since IFRS are now accepted as a financial reporting framework for companies seeking to raise funds from most capital markets across the globe. Thus, IFRS increase the efficiencies of global capital management.
4. IFRS minimize the obstacles faced by Multi-national Corporations by reducing the risk associated with dual filings of accounts. A recent decision by the US Securities and Exchange Commission (SEC) permits foreign companies listed in the US to present financial statements in accordance with IFRS. This means that such companies will not be required to prepare separate financial statements under Generally Accepted Accounting Principles in the US (US GAAP). Therefore, Indian companies listed in the US would benefit from having to prepare only a single set of IFRS compliant financial statements, and the consequent saving in financial and compliance costs.

Choose the Correct Answers

1. Accounting is the art of _____. [d]
(a) Recording (b) Classifying
(b) Summarising (d) All of the above
2. Which of the following process of accounting concerned merely with recording transactiong and keeping records [b]
(a) Journalizing (b) book keeping
(c) Ledger (d) None
3. _____ is often called "Language of business" [a]
(a) Accounting (b) Financing
(c) Cost (d) All the above
4. Which of the following is recorded in the books of accounts at their actual cost [c]
(a) Dual aspect (b) Going concern
(c) Cost concept (d) Accruual concept
5. The busines assumed to exist for an indefinite period is according to which concept [a]
(a) Going concern (b) Dual aspect
(c) Cost (d) Realization
6. According to which aconcept each trasaction has to aspect debit and cerdit [b]
(a) Going concern (b) Dual aspect
(c) Cosct (d) Reliazation
7. Recording of already occurred and realized transaction is based on on [d]
(a) Going concern (b) Dual aspect
(c) Cost (d) Relalization
8. Recording of recognized revenues and expenses are occured an basis of which concept [c]
(a) Conversation (b) Matching
(c) Accrual (d) Realization
9. Which concept disclose clearly material information to the reader [a]
(a) Convention of disclosure (b) Conservatism
(c) Consistancy (d) None
10. Which concept treats business is separate entity from the owners [a]
(a) Business entify concept (b) Money measurement concept
(c) Matching concept (d) All the above

11. Conventionally accountants measure income [b]
- (a) By applying a value added concept
 - (b) By using a transaction approach
 - (c) As a change in the value of owners equity
 - (d) As a change in the purchasing power of owners equity
12. In the transaction approach to income determination, income is measured by subtracting the expenses resulting from specific transactions during the period from revenue of the period also resulting from transactions. Under a transactions approach to income measurement, which of the following would not be considered a transaction? [c]
- (a) Sale of goods on account at 20 per cent markup
 - (b) Exchange of inventory at a regular selling price for equipment
 - (c) Adjustment of inventory in lower of cost or market inventory valuations when market is below cost
 - (d) Payment of salaries
13. Consolidated financial statements are prepared when a parent subsidiary relationship exists in recognition of the accounting concept of [b]
- (a) Materiality
 - (b) Entity
 - (c) Objectivity
 - (d) Going Concern
14. Which of the following is the best theoretical justification for consolidated financial statements? [b]
- (a) In form the companies are one entity; in substance they are separate
 - (b) In form the companies are separate; in substance they are one entity.
 - (c) In form and substance the companies are one entity
 - (d) In form and substance the companies are separate

Fill in the blanks

1. Existence of _____ is the essential feature of normative theory
2. Expand IASB _____ .
3. _____ is conscious evaluation lead to the select of the best one
4. _____ Is only those transactions which are expressed in monetary term are recorded through quantitative records are also kept.
5. _____ depends on observations to reach conclusions.
6. _____ accounting technique and practice are to the objective of accounting derived from the accounting environment.
7. _____ is an organized body of knowledge which deals with order reason, relationships, objectives.
8. _____ is an art of recording classifying and summarizing in a significant manner in terms of money transactions and events which in part, atleast of a financial characters.
9. Expand ASB _____ .
10. Expand FASB _____ .

ANSWERS

1. Value Judgement
2. International Accounting Standard board
3. Decision theory
4. Money measurement concept
5. Inductive Approach
6. Deductive Approach
7. Accounting theory
8. Financial Accounting
9. Accounting standard board
10. Financial Accounting standard board

UNIT II

INDIAN ACCOUNTING STANDARDS (IND AS-1 to 21):

Overview of Indian Accounting Standards: (Ind AS-1 to Ind AS-21): Ind AS-1: Presentation of financial statements – Ind AS-2: Inventories – Ind AS-7: Cash flow statements – Ind AS-8: Accounting policies, changes in accounting estimates and errors – Ind AS-10: Events after the Balance Sheet Date – Ind AS-11: Construction contracts – Ind AS-12: Income taxes – Ind AS-16: Property, Plant and Equipment – Ind AS-17: Leases – Ind AS-18: Revenue – Ind AS-19: Employee benefits – Ind AS-20: Accounting for Govt. Grants and Disclosure of Govt. Assistance – Ind AS-21: The effects of changes in foreign exchange rates.

2.1 IND AS -1 PRESENTATION OF FINANCIAL STATEMENTS

Q1. What are financial statement? Explain the purpose of financial statements.

Ans : (Jan.-20)

Introduction

Financial reporting is the end result of accounting process, therefore the financial reporting done through balance sheet, profit and loss account and cash flow should give a true and fair information to the users of these financial statements; how this objective of true or fair reporting should be achieved is prescribed in Ind AS-1 "Presentation of Financial Statements". This Standard lays down the principles for presentation of General Purpose Financial Statements, the structure/formats, contents of these financial statements, guidelines of specific disclosure etc. In India, Schedule III of Companies Act, 2013 also prescribes such requirements of presentation of financial statements.

Purpose

General purpose financial statements are the financial statements which are prepared without considering the specific needs of particular user, so their use is 'General' and can be used by anyone.

As per Ind AS-1, the general purpose financial statements are those financial statements intended to meet the needs of user who are not in a position to require an entity to prepare reports tailored to their particular information needs.

In nutshell, Ind AS-1 sets out

- Overall requirements for presentation of financial statements
- Guidelines for their structure
- Minimum contains requirements of financial statements i.e., Balance Sheet, Statement of Profit and loss and Cash flow Statement.
- Disclosure requirement for notes and accounting policies.

Q2. What are the objectives of Financial Statements ?

Ans :

The objective of the financial statements is to provide information useful to a wide range of users in making economic decision about:

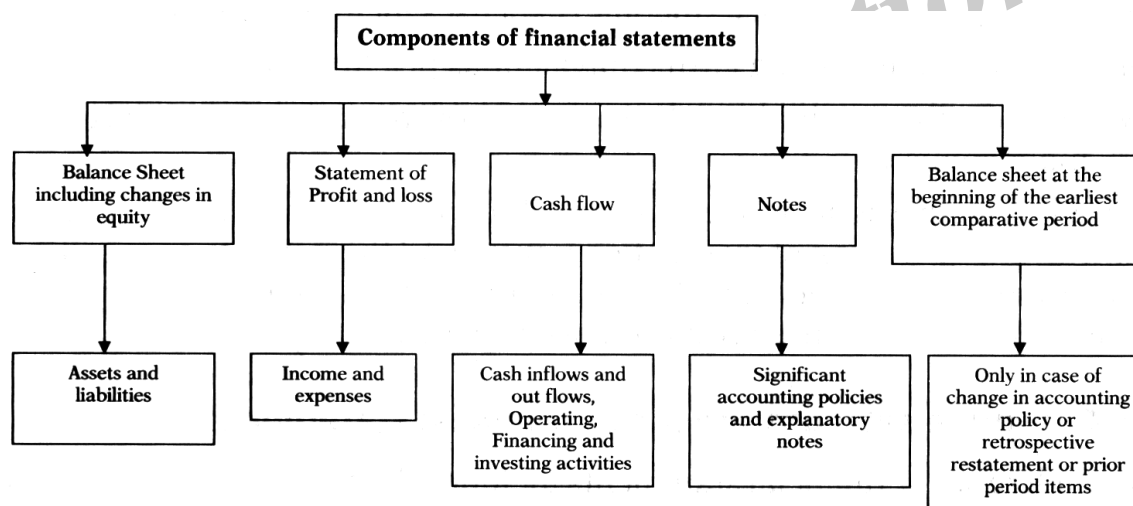
- Financial position (namely assets, liabilities and equity)
- Financial performance (Income/expenses including gains and loss)
- Cash flows (including cash equivalent as per Ind AS-7)
- To show the results, how the resources of the entity was managed by management.

Overall objective is to make true and fair presentation which requires faithful representation of transactions, event and their effects, recognition, measurement of assets and liabilities, income and expenses and also compliance of disclosure requirements as per Ind AS.

Q3. Explain the components of Financial Statements ?*Ans :*

A complete set of financial statements includes the following components:

- A balance sheet at the end of the period.
- A statement of profit and loss for the period in a single statement displaying net profit or loss and total other comprehensive income and compressive income for the period being the total of profit or loss and other comprehensive income
- Statement of changes in equity for the period.
- A statement of cash flows for the period.
- Significant accounting policies and other explanatory notes in a separate statement.
- Comparative information in respect of the preceding period.
- A balance sheet as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes retrospective statement. This is required only at the time of change in accounting policy when it is retrospectively applied and correction of errors (prior period items) restatement.

**Q4. Explain the Features of Financial Statements ?****(or)****What are the characteristics of financial statements?***Ans :***(Imp.)****i) True and fair presentation**

- Financial statements should present true and fair view of the balance sheet, profit and loss and cash flow of an entity.
- If financial statements of an entity comply with Ind ASs it should make clear and unconditional declaration that financial statements are prepared in compliance with Ind ASs.
- An entity cannot justify the incorrect accounting policy on the pretext that the same has been disclosed and explained in notes to accounts. For example, if closing inventory is valued on the

basis of cost and not on the lower of cost or realizable value, the policy followed is wrong and cannot be justified that this has been explained and disclosed in the accounting notes.

- Compliance with Ind ASs - In extremely rare circumstances if compliance would be misleading and therefore departure from an Ind AS is necessary for true and fair presentation, the entity can depart from the requirement of an Ind AS provided it makes the following disclosures:

- (a) The management has concluded that financial statements present true and fair view of the entity's financial position, performance and cash flows
- (b) It has complied with applicable Ind ASs except that it has departed from particular Ind AS to present a true and fair view
- (c) The title and number of Ind AS from which has departed

The nature of the departure, the treatment that the Standard would require, reason that why the treatment would be misleading, the treatment adopted and the financial impact of the departure on profit or loss, assets and liabilities, equity and cash flows for each period presented.

ii) Going concern

Financial statement should be prepared assuming the entity will continue its business unforeseeable future unless management intends to liquidate the entity or cease trading or has no realistic option but to close. When upon assessment it is evident that there are material uncertainties regarding the continuance of the business those uncertainties should be disclosed. In event financial statement are not prepared on going concern basis that fact should be disclosed together with the basis on which they are prepared.

iii) Accrual basis of accounting

All financial statements excluding the cash flow statement must be prepared on an accrual basis. In accrual basis of accounting the asset and liabilities are recognized when they are receivable and payable rather than when actually received or paid.

iv) Materiality and aggregation

Each material class of similar items shall be presented separately in the financial statement, material item that are dissimilar in nature or function should be separately disclosed. Items which are not material need not to be disclosed except required by law.

v) Offsetting

Assets and liabilities, income and expenses should not be offset against each other unless required or permitted by Ind ASs.

For example, presenting receivable/debtors net of allowance for doubtful debts is not offsetting. Ind AS-18, permits offsetting/deduction of trade discount or volume discount from fair value of revenue because such offsetting reflects the substance of the transactions netting off of income and related expenses arising on the same transaction is permitted for example:

- (a) Gains/losses on the disposal of non-current assets are reported after deducting the carrying value (book value) and selling expenses from the proceeds.
- (b) As per Ind AS-37, the expenditure related to recognized provision that is reimbursed under contractual provision from a third party may be netted. For example, when a warranty provision on goods sold will be reimbursed by the supplier/manufacturer.

vi) Frequency of reporting

A complete set of financial statement including comparative figure shall be presented annually. However in exceptional circumstances reporting where there is change in reporting period resulting longer or shorter period than one year, an entity should disclose.

- Reasons for a period other than one year
- That comparative figure is not entirely comparable.

vii) Comparative information

Comparative figure for previous period should be disclosed unless Ind ASs permits or require otherwise. Two of each statement i.e., Balance sheet, profit and loss, cash flows is therefore, a minimum requirement.

However when there is change in accounting policy and such change is retrospectively applied or there is retrospective restatement of item in the financial statement then the entity shall present:

- A minimum of three balance sheet, two profit or loss statement and two cash flow.
- The three balance sheet shall be of :
 - i) At the end of the current period, say 31st March 2018
 - ii) At the end of the previous period, ie. 31st March 2017
 - iii) At the beginning of the earliest comparative period i.e., 1st April 2016

When it is impracticable to re-classify comparative amounts, an entity must disclose the reason for such impracticable situation.

viii) Consistency of presentation

Entities should retain their presentation and classification of items from one period to the next. However change will be allowed only when:

- If change result in a more appropriate presentation
- Is required by an Ind AS.

A consistency in presentation enhance the comparability of the financial statement what is more appropriate is to be judged in terms of relevance and reliability.

2.2 IND AS-2 INVENTORIES

Q5. Explain briefly about Ind Accounting Standard-2 (IAS 2).

Ans :

(Jan.-20)

Inventories constitute a major portion of current assets of an entity. A primary issue in accounting for inventories is the amount of cost to be recognised as an asset and carried forward until the related revenues are recognised.

Ind AS 2 prescribes the accounting treatment for inventories, such as, determination of cost and its subsequent recognition as expense, including any write-downs of inventories to net realisable value and reversal of writedowns.

➤ Scope

Ind AS 2 applies to all inventories, except financial instruments (Ind AS 32, Financial Instruments: Presentation and Ind AS 109, Financial Instruments); and biological assets (i.e., living animals or plants) related to agricultural activity and agricultural produce at the point of harvest (Ind AS 41, Agriculture)

The Standard prescribes that the inventories shall be measured at the lower of cost and net realisable value. 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.

Inventories are assets held for sale in the ordinary course of business, in the process of production for such sale; or in the form of materials or supplies to be consumed in the production process or in the rendering of services.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. Estimates of net realisable value are based on the most reliable evidence available at the time the estimates are made, of the amount the inventories are expected to realise.

➤ Cost Formulae

The cost of inventories shall be assigned by using the first-in first-out (FIFO) or weighted average cost formula. An entity shall use the same cost formula for all inventories having a similar nature and use to the entity.

➤ Recognition as an Expense

When inventories are sold, the carrying amount of inventories shall be recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down to net realisable value and all losses of inventories shall be recognised as an expense in the period in which the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realisable value,

shall be recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

2.3 IND AS - 7 CASH FLOW STATEMENT

Q6. What is Cashflow Statement ?

Ans :

Cash flow statement is additional information to user of financial statements. This statement exhibits the flow of incoming and outgoing cash. This statement assesses the ability of the entity to generate cash and to utilize the cash. This statement is one of tools for assessing the liquidity and solvency of the entity. Cash flow information is considered useful to investors, creditors and other financial statement users to assess the following:

- An entity's ability to generate positive future cash flows
- An entity's ability to meet obligations and pay dividends and its need for external financing
- The reasons for differences between net income and associated cash receipts
- The effect on an entity's financial position of both its cash and non-cash investing and financing transactions that took place during the period.

Q7. Explain the various activities in cash flow statement ?

Ans :

A) Operating Activities

1. The amount of cash flows arising from operating activities is a key indicator of the extent to which the operations of the enterprise have generated sufficient cash flows to maintain the operating capability of the enterprise, pay dividends, repay loans and make new investments without recourse to external sources of financing. Information about the specific components of historical operating cash flows is useful, in conjunction with other information, in forecasting future operating cash flows

2. Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the enterprise. Therefore, they generally result from the transactions and other events that enter into the determination of net profit or loss. Examples of cash flows from operating activities are:

- a) cash receipts from the sale of goods and the rendering of services;
- b) cash receipts from royalties, fees, commissions and other revenue;
- c) cash payments to suppliers for goods and services;
- d) cash payments to and on behalf of employees;
- e) cash receipts and cash payments of an insurance enterprise for premiums and claims, annuities and other policy benefits;
- f) cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities; and
- g) cash receipts and payments relating to futures contracts, forward contracts, option contracts and swap contracts when the contracts are held for dealing or trading purposes

3. Some transactions, such as the sale of an item of plant, may give rise to a gain or loss which is included in the determination of net profit or loss. However, the cash flows relating to such transactions are cash flows from investing activities.

4. An enterprise may hold securities and loans for dealing or trading purposes, in which case they are similar to inventory acquired specifically for resale. Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities. Similarly, cash advances and loans made by financial enterprises are usually classified as operating activities since they relate to the main revenue-producing activity of that enterprise.

B) Investing Activities

1. The separate disclosure of cash flows arising from investing activities is important because

the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Examples of cash flows arising from investing activities are:

- a) cash payments to acquire fixed assets (including intangibles). These payments include those relating to capitalized research and development costs and self-constructed fixed assets;
- b) cash receipts from disposal of fixed assets (including intangibles);
- c) cash payments to acquire shares, warrants or debt instruments of other enterprises and interests in joint ventures (other than payments for those instruments considered to be cash equivalents and those held for dealing or trading purposes);
- d) cash receipts from disposal of shares, warrants or debt instruments of other enterprises and interests in joint ventures (other than receipts from those instruments considered to be cash equivalents and those held for dealing or trading purposes);
- e) cash advances and loans made to third parties (other than advances and loans made by a financial enterprise);
- f) cash receipts from the repayment of advances and loans made to third parties (other than advances and loans of a financial enterprise);
- g) cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and
- h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

2. When a contract is accounted for as a hedge of an identifiable position, the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged.

C) Financing Activities

The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of funds (both capital and borrowings) to the enterprise.

Examples of cash flows arising from financing activities are:

- a) cash proceeds from issuing shares or other similar instruments;
- b) cash proceeds from issuing debentures, loans, notes, bonds, and other short or long-term borrowings; and
- c) cash repayments of amounts borrowed.

Q8. Explain the various benefits of cash flow statement ?

Ans :

1. A cash flow statement, when used in conjunction with the other financial statements, provides information that enables users to evaluate the changes in net assets of an enterprise, its financial structure (including its liquidity and solvency) and its ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities.
2. Cash flow information is useful in assessing the ability of the enterprise to generate cash and cash equivalents and enables users to develop models to assess and compare the present value of the future cash flows of different enterprises.
3. It also enhances the comparability of the reporting of operating performance by different enterprises because it eliminates the

effects of using different accounting treatments for the same transactions and events.

4. Historical cash flow information is often used as an indicator of the amount, timing and certainty of future cash flows. It is also useful in checking the accuracy of past assessments of future cash flows and in examining the relationship between profitability and net cash flow and the impact of changing prices.

2.4 IND AS-8 ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS

Q9 What are accounting policies? Explain briefly about changes in accounting policies.

Ans : (Imp.)

The objective of Ind AS 8 is to prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors. The Standard is intended to enhance the relevance and reliability of an entity's financial statements and the comparability of those financial statements over time and with the financial statements of other entities.

It is clarified that disclosure requirements for accounting policies are laid down in Ind AS 1, Presentation of Financial Statements. However, the disclosures required for changes in accounting policies are as set out in this Accounting Standard.

Accounting Policies

Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

This Standard provides guidance in selection and application of the accounting policies. A two-step approach is advocated.

Step 1: requires that when an Ind AS specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the Ind AS.

Step 2 : provides that in the absence of an Ind AS that specifically applies to a transaction, other event or condition, management shall use its judgment in developing and applying an accounting policy. This judgment should result in information that is:

- relevant to the economic decision-making needs of users; and
- reliable, so that the financial statements:
 - Represent faithfully the financial position, financial performance and cash flows of the entity;
 - Reflect the economic substance of transactions, other events and conditions, and not merely the legal form;
 - Are neutral, i.e., free from bias;
 - Are prudent; and
 - Are complete in all material respects.

An entity shall select and apply the accounting policies consistently for similar transactions, other events and conditions, unless an Ind AS specifically requires or permits categorization of items for which different policies may be appropriate. If an Ind AS requires or permits such categorization, an appropriate accounting policy shall be selected and applied consistently to each category.

Changes in Accounting Policies

An entity is permitted to change an accounting policy only if the change:

- (a) is required by an Ind AS; or
- (b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

The Standard also specifies how changes in accounting policies is to be applied:

- A change in accounting policy may result due to the first time application of an Ind AS. The change shall be applied as per the transitional provisions in that Ind AS.

- If that Ind AS does not contain any transitional provisions, it shall apply the change retrospectively.
- A voluntary change in accounting policy is to be applied retrospectively. An early application of an Ind AS is not a voluntary change in accounting policy.

When it is impracticable for an entity to apply a new accounting policy retrospectively, because it cannot determine the cumulative effect of applying the policy to all prior periods, the entity will apply the new policy prospectively from the start of the earliest period practicable. It therefore disregards the portion of the cumulative adjustment to assets, liabilities and equity arising before that date. Changing an accounting policy is permitted even if it is impracticable to apply the policy prospectively for any prior period.

Q10. What are accounting estimates? Explain briefly about changes in accounting estimates.

Ans :

There are many items recognized in financial statements which cannot be used precisely or accurately in such cases entity has to make judgment estimate the value of these items like:

- Expected credit losses on Receivables
- Fair value of financial assets or financial liabilities
- Useful life of Property, Plant and Equipment and intangible assets
- Warranty obligation

To measure the value of these items to be recognized in financial statements reasonable estimates are carried out. Changes in accounting estimates may give rise to adjustment of assets, liabilities and equity during the current period.

Changes in accounting estimates :

- If changes occur regarding the circumstances in which the estimate was based
- As a result of new information, more experience or subsequent developments.

Such changes do not relate to prior periods and not correction of errors.

Change in measurement basis - Change in measurement basis applied is a change in accounting policy and not change in accounting estimates. For example, change in measurement of cost of inventory from FIFO to weighted average cost method is change in accounting policy and not change in accounting estimate. However applying better way of estimating provision for non-moving stock is not a change in accounting policy. For example, if an entity make an estimate of provision for non-moving stock based on no issue during last 12 month and the next year the estimate of non-moving stock/obsolesces is based on technical study is not an accounting policy change but only change in estimate at it is better way of estimating the provision for non-moving stock.

Q11. Explain the accounting treatment of accounting estimates.

Ans :

- The effect of change in accounting estimate is recognized prospectively in profit or loss (By including in the current period and future period profit or loss.
- A change in estimate that effects the measurement of assets or liabilities is recognized by adjusting the carrying amount of assets or liabilities, the other side of the double entry goes to profit or loss of the period in which estimate is changed
- Reversal of provision of items of expenditures should be set-off against the relevant expense line-item

A change in accounting estimate may affect not only the current period profit or loss but can also the future period profit or loss. For example, an estimate of amount of bad debts affects only the current period whereas change in estimate of useful life of asset affect both the current period and future period profit or loss due to change of amount of depreciation.

Q12. What are prior period errors?

Ans :

Prior period errors are errors committed in earlier years but discovered in current year. Prior period errors are omission from, and misstatement

in the financial statements for one or more prior periods arising from the failure to use or misuse of, reliable information that :

- Was available and
- Could reasonably be expected to have been obtained

When those prior period financial statements were authorized for issue such as:

- Mathematical mistake
- Mistake in applying accounting policies
- Misinterpretation of facts
- Frauds
- Oversights

Example: Plant purchased of ₹ 5,00,000 during the year 2017 was recorded as punch and shown as expense, this mistake was discovered in 2018.

Q13. Explain the accounting treatment of errors.

Ans :

- Material prior period error are corrected retrospectively in the first set of financial statement approved for issue after the discovery of error by:
 - Restating the comparative amounts of the prior periods presented in which the error occurred so the current period financial statement are presented as if the error had been corrected in the period in which it was originally made however entity does not re-issue the financial statements of prior period.
 - If the error occurred before the earliest prior period presented, the opening balance of assets, liabilities and equity is restated for the earliest prior period presented. For example, if financial statements of March 2012 is being prepared and error of 2009 was discovered in the current year and only one year comparative is being presented i.e., for March 2011 then the error can be retrospectively restated only for the

earliest prior period presented i.e., March 2011 (with cumulative effect from 2009). However, the opening restated assets and liabilities as on 1st April 2010 should also be presented.

- If it is not practicable to determine the period specific effect of an error on comparative information for one or more prior period presented, the opening balance of assets, liabilities and equity is restated for the earliest prior period presented.

Restatement consists of the following steps:

Step 1 - Adjust the carrying amounts of assets and liabilities at the beginning of the first period presented in the financial statements for the amount of the correction on periods prior to those presented in the financial statements.

Step 2 - Offset the amount of adjustment in Step 1 (if any) by adjusting the opening balance of retained earnings (or other components of equity or net assets, as applicable to the reporting entity) for that period.

Step 3 - Adjust the financial statements of each Individual prior period presented for the effects of correcting the error on (that specific period (referred to as the period-specific effects of the error)).

2.5 IND AS 10 EVENTS AFTER THE BALANCE SHEET DATE

Q14. Explain briefly about Ind As 10.

Ans :

The objective of Ind AS 10 is to prescribe:

- (a) when an entity should adjust its financial statements for events after the reporting period; and
- (b) the disclosures that an entity should give about the date when the financial statements were approved for issue and about events after the reporting period.

The Standard also requires that an entity should not prepare its financial statements on a going concern basis if events after the reporting period indicate that the going concern assumption is not appropriate.

Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue. Two types of events can be identified:

- (a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and
- (b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period).

However, there is an exception to the above principle. In case of a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the agreement by lender before the approval of the financial statements for issue, to not demand payment as a consequence of the breach, shall be considered as an adjusting event.

An entity shall adjust the amounts recognised in its financial statements to reflect adjusting events after the reporting period.

An entity shall not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the reporting period.

However, if non-adjusting events after the reporting period are material and their non-disclosure could influence the economic decisions that users make on the basis of the financial statements, then it shall disclose the following for each material category of non-adjusting event after the reporting period:

- (a) the nature of the event; and
- (b) an estimate of its financial effect, or a statement that such an estimate cannot be made.

If an entity receives information after the reporting period about conditions that existed at the end of the reporting period, it shall update disclosures that relate to those conditions, in the light of the new information.

Appendix A of Ind AS 10 provides guidance with regard to distribution of noncash assets as

dividends to owners. The Appendix prescribes that liability to pay such a dividend should be recognised when it is appropriately authorized and is no longer at the discretion of the entity. This liability should be measured at the fair value of assets to be distributed. Any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable should be recognised in profit or loss when an entity settles the dividend payable.

2.6 IND AS-11 CONSTRUCTION CONTRACTS

Q15. What is a construction contract?

Ans :

A construction contract is a contract specifically negotiated for the construction of an asset or a group of interrelated assets. [IAS 11.3]

Under IAS 11, if a contract covers two or more assets, the construction of each asset should be accounted for separately if (a) separate proposals were submitted for each asset, (b) portions of the contract relating to each asset were negotiated separately, and (c) costs and revenues of each asset can be measured. Otherwise, the contract should be accounted for in its entirety. [IAS 11.8]

Two or more contracts should be accounted for as a single contract if they were negotiated together and the work is interrelated. [IAS 11.9]

If a contract gives the customer an option to order one or more additional assets, construction of each additional asset should be accounted for as a separate contract if either (a) the additional asset differs significantly from the original asset(s) or (b) the price of the additional asset is separately negotiated. [IAS 11.10].

Q16. What is included in contract revenue and costs?

Ans :

Contract revenue should include the amount agreed in the initial contract, plus revenue from alternations in the original contract work, plus claims and incentive payments that (a) are expected to be collected and (b) that can be measured reliably. [IAS 11.11].

Contract costs should include costs that relate directly to the specific contract, plus costs that are attributable to the contractor's general contracting activity to the extent that they can be reasonably allocated to the contract, plus such other costs that can be specifically charged to the customer under the terms of the contract. [IAS 11.16]

Accounting

If the outcome of a construction contract can be estimated reliably, revenue and costs should be recognised in proportion to the stage of completion of contract activity. This is known as the percentage of completion method of accounting. [IAS, 11.22]

To be able to estimate the outcome of a contract reliably, the entity must be able to make a reliable estimate of total contract revenue, the stage of completion, and the costs to complete the contract. [IAS 11.23-24]

If the outcome cannot be estimated reliably, no profit should be recognised. Instead, contract revenue should be recognised only to the extent that contract costs incurred are expected to be recoverable and contract costs should be expensed as incurred. [IAS 11.32]

The stage of completion of a contract can be determined in a variety of ways - including the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs, surveys of work performed, or completion of a physical proportion of the contract work. [IAS 11.30]

An expected loss on a construction contract should be recognised as an expense as soon as such loss is probable. [IAS 11.22 and 11.36]

Disclosure

Amount of contract revenue recognised; [IAS 11.39(a)]

Method used to determine revenue; [IAS 11.39(b)]

Method used to determine stage of completion; [IAS 11.39(c)] and

For contracts in progress at balance sheet date: [IAS 11.40]

Aggregate costs incurred and recognised profit

Amount of advances received

Amount of retentions

2.7 IND AS-12 INCOME TAXES

Q17. What is Income tax? Explain the need and scope of Ind As-12.

Ans :

(Imp.)

Income taxes are an expense incurred in operating most businesses, as such are to be reflected in entity's operating results. The income taxes are to be paid on the income as computed by tax laws of the country. However, accounting income calculated in profit and loss account is not always the same as taxable income as per income tax law. There is a difference between the amount of 'net income' in the financial statements and 'taxable income' in the tax return.

Main reason of difference is the basis of calculation of income. In accounting, the accrual basis is followed for calculating the income (loss) whereas tax law does not follow the accrual system of accounting for all expenses and revenue. As the income differs therefore, the resulting tax also differs. In accounting income tax expense should be accounted for in the period in which corresponding revenue and expenses are accounted whereas the tax to be paid is based on liability to pay basis as per tax law. The items which cause difference usually get reversed/adjusted over a period of time, until they reversed/adjusted an asset and liability must be recorded on the Balance Sheet. The account used to do this balance is called 'Deferred Tax Asset/Liability'. This is called Balance Sheet approach. Some of the instances, which cause differences between the net profit as per financial statement and taxable profit, are:

- Difference in depreciation expense of an asset as claimed in financial statement and in calculating taxable profit. Generally tax law allows more depreciation than the accounting principles.
- Provision for expenses is accounted on accrual basis in accounting whereas in tax, these expenses are allowed only on cash basis by the tax authority.

Scope

Ind AS 12 "Income Taxes" must be applied in accounting for all income taxes, it includes:

- Domestic taxes on taxable profit
- Foreign taxes based on taxable profits
- Withholding taxes payable by a subsidiary, associates or joint venture on distribution to the reporting entity.

Q18. Explain the different terms used in income tax.

Ans :

- i) **Accounting Profit** is profit or loss for the period before deducting tax expense.
- ii) **Tax Profit** (tax loss) is the profit (loss) for a period on which income taxes are payable (recoverable). As determined in accordance with the rules established by the taxation authorities.
- iii) **Tax expense** (tax income) is the aggregate amount included in the determination of profit or loss for the period for current and deferred tax
- iv) **Current tax** is the amount of income taxes payable (recoverable) in respect of taxable profit (tax loss) for a period
- v) **Temporary Differences** are differences between the carrying amount of an asset or liability in the Balance sheet and its tax base.
- vi) **Deferred tax** is an accounting measure used to match the tax effect of transaction with their accounting impact. Deferred tax may either be asset or liability.
- vii) **Deferred Tax Liabilities (DTL)** is the amount of income taxes payable in future

periods in respects of taxable temporary differences. DTL generally arises when tax relief is provided in advance of an accounting expense or income is accrued and but not taxed until received.

viii) **Deferred Tax Assets (DTA)** is the amount of income taxes recoverable in future periods. DTA generally arises when tax relief is provided after an expense is deducted for accounting purpose.

ix) **Tax Base** of an asset or liability is the amount attributed to that asset or liability for tax purposes.

Q19. Define

- i) **Tax base (or) Tax base of asset**
- ii) **Tax base of liability.**

Ans :

i) **Tax base (or) Tax base of asset**

The tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to the entity when it recovers the carrying value of the asset. Where those economic benefits are not taxable, the tax base of the asset is the same as its carrying amount.

Examples

- A machine cost ₹ 10,000. For tax purposes, depreciation of ₹ 3,000 has already been deducted in the current and prior periods and the remaining cost will be deductible in future periods, either as depreciation or through a deduction on disposal. Revenue generated by using the machine is taxable; any gain on disposal of the machine will be taxable and any loss on disposal will be deductible for tax purposes for accounts purpose W.D.V. is ₹ 6,000
The tax base of the machinery is ₹ 7,000.
- Interest receivable has a carrying amount of ₹ 1,000. The related interest revenue will be taxed on cash basis.
The tax base of the interest receivable is NIL
- Trade receivables have a carrying amount of ₹ 10,000. The related revenue has already been included in taxable profit (tax loss).

The tax base of the trade receivable is ₹ 10,000

- A loan receivable has a carrying amount of ₹ 10 lakhs. The repayment of the loan will have no tax consequences.

The tax base of the loan is ₹ 10 lakhs

- Dividend receivables from a subsidiary have a carrying amount of ₹ 5,000. The dividends are not taxable.

The tax base of the dividend is ₹ 5,000.

In the case of dividend, in substance the entire carrying amount of the asset is deductible against the economic benefits. There is no taxable temporary difference. An alternative analysis is that the accrued dividends receivable have a tax base of NIL and a tax rate of Nil is applied to the resulting taxable temporary difference (₹ 5,000). Under both analyses, there is no deferred tax liability.

The formula for the tax base of asset that can be used at the end of the reporting period is as follows:

$$\text{Tax base of asset} = \text{Carrying amount} - \text{Future taxable amounts} + \text{Future deductible amounts}$$

A future taxable amount is generally the amount arising from recovery of the asset and is limited to the assets carrying amount. The future taxable amount is the income earned from the asset used or proceeds arising from its disposal that is taken into the determination of the taxable profit. If the income generated by the asset is non-taxable then both the future taxable amount and future deductible amount are Nil and the tax base is equal to the carrying amount.

ii) Tax base of liability

In the case of a liability, the tax base will be its carrying amount, less any amount that will be deducted for tax purpose in relation to the liability in future periods. For revenue received in advance, the tax base of the resulting liability is its carrying amount, less any amount of the revenue that will not be taxable in the future periods.

Examples:

- Current liabilities include accrued expenses with a carrying amount of ₹ 100. The related

expense will be deducted for tax purposes on a cash basis.

The tax base of the accrued expenses is nil

- Current liabilities include interest revenue received in advance, with a carrying amount of ₹ 100. The related interest revenue was taxed on a cash basis.

The tax base of the interest received in advance is nil

- Current liabilities include accrued expenses with a carrying amount of ₹ 100. The related expense has already been deducted for tax purposes.

The tax base of the accrued expenses is ₹ 100.

- Current liabilities include accrued fines and penalties with a carrying amount of ₹ 100. Fines and penalties are not deductible for tax purposes.

The tax base of the accrued fines and penalties is ₹ 100. Under this analysis, there is no deductible temporary difference. An alternative analysis is that the accrued fines and penalties payable have a tax base of nil and that a tax rate of nil is applied to the resulting deductible temporary difference of ₹ 100. Under both analyses, there is no deferred tax asset.

- A loan payable has a carrying amount of ₹ 100. The repayment of the loan will have no tax consequences.

The tax base of the loan is ₹ 100.

The formula for the tax base of liability other than the revenue received in advance that can be used at the end of the reporting period is as follows.

$$\text{Tax base of liability} = \text{Carrying amount} - \text{Future deductible amounts} + \text{Future taxable amounts}$$

The formula for the tax base of liability for the revenue received in advance that can be used at the end of the reporting period is as follows:

$$\text{Tax base of liability} = \text{Carrying amount} - \text{Amounts of revenue that will not be taxable in future periods.}$$

Q20. Explain the temporary differences are used in Ind AS 12.*Ans :* (Imp.)

As the Ind AS-12 follows the Balance Sheet Approach for the income tax accounting and therefore, it defines the temporary differences with respect to the Balance Sheet items, i.e., asset or liability. These differences occur when items of revenue or expense are included in both accounting profit and taxable profit, but not for the same accounting period.

For Example, interest revenue received in arrears and included in accounting profit on the basis of accrual say in 2017, however it was included in taxable profit in 2018 when it was actually received (cash basis). In the long run the total taxable profit and total accounting profit will be the same except for some exceptions (permanent differences). It is to be noted that in Ind AS-12 there is no term like permanent differences which is indirectly called exceptions to temporary differences. These temporary differences originate in one period and are capable of reversal in one or more subsequent periods. Deferred tax is the tax attributable to such temporary differences. Temporary differences may be either

- (a) **Taxable temporary differences**, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or
 - (b) **Deductible temporary differences**, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.
- i) Taxable temporary differences and deferred tax liabilities-Exception**

All taxable temporary differences give rise to a deferred tax liability and should be recognized unless excluded, these exclusion or exceptions are:

- the initial recognition of goodwill; or
- the initial recognition of an asset or liability in a transaction which:

- is not a business combination; and
- at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss). Para 22(c) of the standard further does not permit entity to recognise deferred tax liability on sub-sequent recognition also.

Taxable temporary differences and deferred tax liabilities-Exception

All taxable temporary differences give rise to a deferred tax liability and should be recognized unless excluded, these exclusion or exceptions are:

- the initial recognition of goodwill; or
- the initial recognition of an asset or liability in a transaction which:
 - is not a business combination; and
 - at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss). Para 22(c) of the standard further does not permit entity to recognise deferred tax liability on sub-sequent recognition also'

Transactions that affect profit or loss

- Interest revenue is received in arrears and is included in accounting profit on accrual basis but is included in taxable profit on a cash basis.
- Depreciation of an asset is accelerated (at a higher rate) for tax purposes.
- Development costs have been capitalised and will be amortized to the statement of profit and loss but were deducted in determining taxable profit in the period in which they were incurred.
- Prepaid expenses have already been deducted on a cash basis in determining the taxable profit of the current or previous periods. But will be deducted for accounting purpose in subsequent period when expenses accrue.

Transactions that affect the balance sheet

- Depreciation of an asset is not deductible for tax purposes and no deduction will be available for tax purposes when the asset is sold or scrapped.
- A borrower records a loan at the proceeds received (which equal the amount due at maturity), less transaction costs. Subsequently, the carrying amount of the loan is increased by amortization of the transaction costs to accounting profit. The transaction costs were deducted for tax purposes in the period when the loan was first recognized.
- (1) the taxable temporary difference is the amount of transaction costs already deducted in determining the taxable profit of current or prior periods, less the cumulative amount amortized to accounting profit;
- and (2) as the initial recognition of the loan affects taxable profit, the exception of initial recognition as stated above does not apply. Therefore, the borrower recognizes the deferred tax liability.
- A loan payable was measured on initial recognition at the amount of the net proceeds, net of transaction costs. The transaction costs are amortized to accounting determining the taxable profit of future, current or prior periods.
- (1) the taxable temporary difference is the amount of unamortized transaction costs; and
- (2) The exceptions as mentioned above prohibit recognition of the resulting deferred tax liability
- The liability component of a compound financial instrument (for example a convertible bond) is measured at a discount to the amount repayable on maturity. The discount is not deductible in determining taxable profit (tax loss). Deferred tax liability

to be recognised directly in equity showing DTL and equity component separately the equity component will be reduced to the extent of DTL.

ii) Deductible temporary differences and deferred tax assets

The deferred tax asset should be recognized for:

- All deductible temporary differences
- The carry forward of unused tax losses; and
- The carry forward of unused tax credits.

To the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that is not a business combination; and at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss). A deferred tax asset shall be recognized in accordance to the extent it is probable that temporary difference will reverse in foreseeable future and taxable profit will be available.

Example: An entity recognizes a liability of ₹ 100 for gratuity and leave encashment expenses by creating a provision for gratuity and leave encashment. For tax purposes, any amount with regard to gratuity and leave encashment will not be deductible until the entity pays the same. The tax rate is 25%.

The tax base of the liability is nil (carrying amount of ₹ 100, less the amount that will be deductible for tax purposes in respect of that liability in future periods). In settling the liability for its carrying amount, the entity will reduce its future taxable profit by an ₹ 100 and, consequently, reduce its future tax payments by ₹ 25 (₹ 100 at 25%). The difference between the carrying amount of ₹ 100 and the tax base of nil is a temporary difference of ₹ 100. Therefore, the entity recognizes a deferred tax liability of ₹ 25 (₹ 100 at 25%), provided that it is probable

that the entity will earn sufficient taxable profit in future periods to benefit from a reduction in tax payments.

Examples of circumstances that give rise to deductible temporary differences Transactions that affect profit or loss

- Retirement benefit costs are deducted in determining accounting profit as service is provided by the employee, but are not deducted in determining taxable profit until the pays either retirement benefits or contributions to a fund.
- Accumulated depreciation of an asset in the financial statements is greater than the cumulative depreciation allowed up to the end of the reporting period for tax purposes. In other words, when the carrying amount of an asset is less than its tax base.
- The net realizable value of an item of inventory, or the recoverable amount of an item of property, plant or equipment, is less than the previous carrying amount and an entity therefore reduces the carrying amount of the asset, but that reduction is ignored for tax purposes until the asset is sold.
- Preliminary expenses (or organization or other startup costs) are recognized as an expense in determining accounting profit but are not permitted as a deduction in determining taxable profit until a later period.
- Income is deferred in the balance sheet but has already been included in taxable profit in current or prior periods.
- A government grant which is included in the balance sheet as deferred income will not be taxable in future periods.

Consideration for recognition of deferred tax assets

There necessarily will be an element of judgment in making an assessment about how probable the realization of the deferred tax asset is, for those circumstances in which there is not an existing balance of deferred tax liability equal to or greater than the amount of the deferred tax asset. If it cannot be concluded that realization is probable, the deferred tax asset is not given recognition.

As a practical matter, there are number of positive and negative factors which may be evaluated in reaching a conclusion as to the amount of the deferred tax asset to be recognized. Positive factors (those suggesting that the full amount of the deferred tax asset associated with the gross temporary difference should be recorded) might include:

- Evidence of sufficient future taxable income
- Evidence of the existence of prudent, feasible tax planning strategies under management control.
- An excess of appreciated asset values over their tax bases, in amount sufficient to realize the deferred tax asset.
- A strong earnings history exclusive of the loss that created the deferred tax asset.

Although the foregoing may suggest that the reporting entity will be able to realize the benefits of the deductible temporary differences outstanding as of the date of the statement of financial position, certain negative factors should also be considered in determining whether realization of the full amount of the deferred tax benefit is probable under the circumstances. These factors could include:

- A cumulative recent history of the accounting losses. Depending on extent and length of time over which losses were experienced, this could reduce the assessment of likelihood of realization below the important "probable" method.
- A history of operating losses or of tax operating loss or credit carry forwards that have expired unused.
- Losses that are anticipated in the near future years, despite a history of profitable operations.

Thus, the process of determining how much of the computed gross deferred tax profit should be recognized involves the weighing of both positive and negative factors to determine whether, based on the preponderance of available evidence, it is probable that the deferred tax asset will be realized.

2.8 IND AS 16 PROPERTY, PLANT AND EQUIPMENT

Q21. What are PPE? Explain the scope of PPE.

Ans :

The Property, Plant and Equipment (PPE) also generally known as fixed assets; these fixed assets are tangible property in contrast to the intangible property which is dealt by another Ind AS-38. These tangible assets are:

- Held for use in production or supply of goods and services, for rental to others, or for administrative.
- Purposes expected to be used during more than one period.
- Not held for sale in the normal course of business.

The examples of Property, Plant and Equipment (PPE) are land, building, plant and machinery, furniture and fitting and office equipment etc.

Scope

This Standard prescribes the accounting for PPE except when another Ind AS requires or permits different accounting treatments. This Standard does not apply to:

- (a) Property, plant, and equipment classified as held for sale in accordance with Ind AS 105, 'Non-Current Assets held for sale and Discontinued Operation'.
- (b) Biological assets relating to agricultural activity under Ind AS 41, 'Agricultural'.
- (c) Mineral rights, mineral reserves, and similar non-regenerative resources.
- (d) The recognition and measurement of exploration and evaluation assets (Ind AS 106).

However, this Standard does apply to items of property, plant and equipment used to develop or maintain the assets described in (b), (c) and (d) above.

Q22. Explain the measurement of PPE.

Ans :

The objective of Ind AS 16 is to prescribe the accounting treatment for property, plant and equipment so that users of the financial statements can discern information about an entity's investment in its property, plant and equipment and the changes in such investment. The principal issues in accounting for property, plant and equipment are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognised in relation to them.

Property, plant and equipment are tangible items that:

- (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- (b) are expected to be used during more than one period.

The cost of an item of property, plant and equipment should be recognised as an asset if, and only if:

- (a) it is probable that future economic benefits associated with the item will flow to the entity; and
 - (b) the cost of the item can be measured reliably.
- Entities accounting for investment property in accordance with Ind AS 40, Investment Property are required to use the cost model in this Standard. Items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this Ind AS when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory.

➤ Measurement at Recognition

An item of property, plant and equipment that qualifies for recognition as an asset should be measured at its cost.

The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised

as interest over the period of credit unless such interest is capitalised in accordance with Ind AS 23.

The cost of an item of property, plant and equipment should comprises:

- (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
- (b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.
- (c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Measurement after Recognition

An entity should choose either the cost model or the revaluation model as its accounting policy and apply that policy to an entire class of property, plant and equipment.

i) Cost Model

After recognition as an asset, an item of property, plant and equipment should be carried at its cost less any accumulated depreciation and any accumulated impairment losses.

ii) Revaluation Model

After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably should be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations should be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.

If an asset's carrying amount is increased as a result of a revaluation, the increase should be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, the increase should

be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.

If an asset's carrying amount is decreased as a result of a revaluation, the decrease should be recognised in profit or loss. However, the decrease shall be recognised in other comprehensive income to the extent of any credit balance existing in the revaluation surplus in respect of that asset. The decrease recognised in other comprehensive income reduces the amount accumulated in equity under the heading of revaluation surplus.

iii) Depreciation

Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately. The depreciation charge for each period should be recognised in profit or loss unless it is included in the carrying amount of another asset. Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.

The depreciable amount of an asset should be allocated on a systematic basis over its useful life. The depreciable amount of an asset should be determined after deducting its residual value. The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

The residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) should be accounted for as a change in an accounting estimate in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

Land and buildings are separable assets and should be accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated. Buildings have a limited useful life and therefore are depreciable assets. An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.

iv) Impairment

To determine whether an item of property, plant and equipment is impaired, an entity should apply Ind AS 36, Impairment of Assets.

v) Derecognition

The carrying amount of an item of property, plant and equipment should be derecognised:

- (a) on disposal; or
- (b) when no future economic benefits are expected from its use or disposal.

Appendix B to Ind AS 16 provides guidance for recognition of production stripping costs as an asset; initial measurement of the stripping activity asset; and subsequent measurement of the stripping activity asset. An entity shall recognise a stripping activity asset if, and only if,

- (a) it is probable that the future economic benefit (improved access to the ore body) associated with the stripping activity will flow to the entity;
- (b) the entity can identify the component of the ore body for which access has been improved; and
- (c) the costs relating to the stripping activity associated with that component can be measured reliably. The entity shall initially measure the stripping activity asset at cost. After initial recognition, the stripping activity asset shall be carried at either its cost or its revalued amount less depreciation or amortisation and less impairment losses, in the same way as the existing asset of which it is a part.

2.9 IND AS -7 LEASES

Q23. Define lease. Explain different types of leases.

Ans :

(Imp.)

Lease is an arrangement by which the lessor gives the right to use an asset for given period of time to the lessee on rent.

It involves two parties, a lessor and a lessee and an asset which is to be leased. The lessor, who

owns the asset, agrees to allow to the lessee to use it or a specified period of time in return for periodic rent payments.

The lease transactions derive its accounting complexity from number of alternatives available to the parties involved. Lease can be structured to take tax benefit. It can be used to transfer ownership of the leased asset, and it can also be used to transfer the risk of ownership.

In any event substance of transactions dictates the accounting treatment; the lease transaction (finance lease) is probably the best example of the accounting profession's substance over legal form.

If the transactions effectively transfer ownership to lessee, then the substance of the transactions is that of a sale and should be recognized as such even through transactions take form of a lease.

Types of leases

For the purpose of accounting we classify the lease into two categories as follows:

- (a) Finance lease
- (b) Operating lease

(a) Finance Leases

It is a lease, which transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee by the lessor but not the legal ownership.

In following situations, the lease transactions are called Finance Lease.

- The lessee will get the ownership of leased asset at the end of the lease term.
- The lessee has an option to buy the leased asset at the end of term at price, which is lower than its expected fair value at the date on which option will be exercised.
- The lease term covers the major part of the life of asset.
- At the beginning of lease term, present value of minimum lease payments covers substantially the initial fair value of the leased asset.

- The asset given on lease to lessee is of specialized nature and can only be used by the lessee without major modification.

Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:

- (i) If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;
- (ii) Gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equaling most of the sales proceeds at the end of the lease); and
- (iii) The lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

(b) Operating Leases

It is a lease which does not transfer substantially all the risk and reward incidental to ownership.

Classification of lease is made at the inception of the lease; if at any time the lessee and lessor agree to change the provision of lease and it results in different category of lease, it will be treated as separate agreement.

Q24. Discuss the basic terminology are used in leasing?

Ans :

(i) Guaranteed Residual value:

- **In respect of lessee:** Such part of the residual value, which is guaranteed by or on behalf of the lessee.
- **In respect of lessor:** Such part of the residual value, which is guaranteed by or on behalf of the lessee or by an independent third party.

For the lessor the residual value guaranteed by the third party can arise when the asset is leased to the third party after the first lease has expire and therefore it can be called the residual value guaranteed by the third party to the lessor.

(ii) Unguaranteed Residual value

The difference between residual value of asset and its guaranteed residual value is unguaranteed residual value.

(iii) Gross Investment

Gross investment in lease under finance lease is the sum of the following

- Minimum lease payment (from the standpoint of lessor) and
- Any unguaranteed residual value accruing to the lessor.

(iv) Interest rate implicit in the lease

When the lessor gives an asset on lease (particularly on finance lease), the total amount, which he receives over lease period by giving the asset on lease, includes the element of interest plus payment of principal amount of asset. The rate at which the interest amount is calculated can be simply called implicit rate of interest. In other words, it is implied interest rate at which the lease transaction is done. More accurately it can be expressed as under.

It is the discount rate at which

Fair Value of leased Asset (At the inception of lease)	=	Present value of [Minimum lease payment + any residual value guaranteed to the lessor]
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(v) Contingent Rent

Lease Rent fixed on the basis of percentage of sales, amount of usage, price indices, market rate of interest is called contingent rent. In other words, lease rent is not fixed, but it is based on a factor other than time.

(vi) Minimum lease payments [MLP]

For lessor	= Total lease rent to be paid by lessee over the lease terms + any guaranteed residual value (by or on behalf of lessee) - contingent rent - cost for service and tax to be paid by and reimbursed to lessor + residual value guaranteed by third party
For lessee	= Total lease rent to be paid by lessee over the lease terms + any guaranteed residual value (by or on behalf of lessee) - contingent rent - cost for service and tax to be paid by and reimbursed to lessor

Q25. Explain the accounting Treatment of Leasing ?

Ans :

I) Accounting for finance lease - In the books of lessee

(a) Initial Recognition

As it is already mentioned that legally the ownership of leased asset remains with lessor but risk and reward of leased asset is transferred to lessee therefore the substance of transactions is - lessee becomes the owner, hence the transactions are recorded by substance not by their legal form.

- Leased asset as well as liability for lease should be recognized at the lower of:
 - Fair value of the leased asset at the inception of lease, or
 - Present value of minimum lease payment from the lessee point of view, whichever is lower.

In the lessee's books, the lease asset is to be capitalised:

Asset A/c Dr.
 To Lessor (Liability) A/c

(b) Subsequent measurement

- **Apportionment of lease payment** - Each lease payment is apportioned between finance charge and principal amount. Principal amount is reduced from the outstanding lessor liability. Finance charges are allocated over the lease term in such a manner that it would produce a constant rate of return on the remaining principal balance.
- The lessee in its books should charge depreciation on finance lease asset as per Ind AS-16.
- Initial direct cost for financial lease is included in asset under lease.
- Contingent rents shall be charged as expense in the periods in which they are incurred.

II) Accounting for finance lease - In the books of lessor

The substance of finance lease is that the lessor sells leased assets to lessee:

- Therefore, the lessor should recognize asset given under finance lease as receivable at an amount equal to net investment in the lease and corresponding credit to sale of asset.

$$\text{Net Investment} = \text{Gross Investment} - \text{unearned finance income}$$

Gross Investment = (Minimum lease payment from lessor point of view + Unguaranteed residual value).

Unearned Finance Income = Gross Investment – present value of Gross Investment

- **Recognition of Finance Income**

The lessor should recognize the finance income based on a pattern reflecting, constant periodic return on the net investment outstanding in respect of the finance lease. In simple words interest/finance income will be recognized in proportion to outstanding balance receivable from lease over lease period.

- **For other than manufacturer or dealer lessor**

Initial direct costs are often incurred by lessors and include amounts such as commissions, legal fees and internal costs that are incremental and directly attributable to negotiating and arranging a lease. They exclude general overheads such as those incurred by sales and marketing team; initial direct costs are included in the initial measurement of the finance lease receivable and reduce the amount of income recognized over the lease term.

- **For manufacturer or dealer lessor**

Initial direct costs are recognized as an expense at the commencement of the lease term because they are mainly related to earning the manufacturer's or dealer's selling profit.

III) Accounting for operating lease -In the books of lessor

- Record leased out asset as per the nature of the asset ie. current or non-current.
- Charge the depreciation as per Ind AS-16.
- Recognize the lease income in the statement of profit and loss using straight-line method. If any other method, reflects more systematic allocation of earnings derived from the diminishing value of leased out asset, that approach can be adopted. Considering the Indian inflationary situation, the lease agreement contain periodic rent increase if there is periodic rent increase in line with expected inflation, so as to compensate the lessor for expected inflationary cost increase, the rental shall not be straight-lined.
- Other costs of the operating lease should be recognized as expenses in the year in which they are incurred.
- Initial direct cost of the leases shall be added to the carrying amount of the leased asset and recognized as expensed over the leased term.
- A manufacturer or dealer lessor does not recognize any selling profit on entering into an operating lease because it is not the equivalent of a sale.

iv) Accounting for operating lease - In the Books of lessee

Lease payments should be recognized as an expense in the statement of profit and loss on a straight-line basis over the lease term. If any other method is more representative of the time pattern of the user's benefit, such method can be used.

Q26. What is sale and lease back? Explain the accounting treatment of sale and lease back.

Ans :

Sale and lease back

A sale and lease back transaction involves the sale of an asset by vendor and leasing of the same asset back to the vendor.

Accounting treatment of sale and lease back

If lease back is finance lease

- Any profit or loss of sale proceeds over the carrying amount should not be immediately recognized as profit or loss in the financial statements of a seller-lessee.
- It should be deferred and amortized over lease term in proportion to the depreciation of leased asset.

Example : X Ltd. Sells machinery, WDV of which was ₹ 40 lakhs for ₹ 50 lakhs to Y Ltd. The same machinery was leased back to X Ltd. by Y Ltd. for 10 years resulting in finance lease. What should be the treatment of profit in the books of seller lessee (X Ltd).

The profit of ₹ 10 lakhs on sale of machinery by X Ltd. (seller lessee) should not be immediately recognized in books rather it should be deferred and amortized over 10 years in proportion of the depreciation amount to be charged by the X Ltd. on the machinery.

If lease back is operating lease

- Any profit or loss arising out of sale transaction is recognized immediately when sale price is equal to fair value.
- If sale price below fair value
- Profit - i.e., carrying amount is less than sale value, recognize profit immediately.
- Loss - i.e., carrying amount is more than the sale value, recognise loss immediately, provided loss is not compensated by future lease payment.
- Loss - i.e., carrying amount is more than sale price defer and amortize loss if loss is compensated by future lease payment.
- Sale price above fair value
- If carrying amount is equal to fair value which will result in profit, amortize the profit over lease period.
- Carrying amount less than fair value will result in profit - amortize and defer the profit equal to sale price less fair value and recognize balance profit immediately.
- Carrying amount is more than the fair value - which will result in loss equal to - (carrying amount less than fair value), should be recognized immediately. Profit equal to - selling price less fair value - should be amortized.

2.10 IND AS 18 REVENUE

Q27. Explain about IND As 18.

Ans :

IND AS 18 Revenue Recognition sets the guidelines as to when to recognize the revenue arising from certain types of transactions and the accounting treatment of the same.

Revenue is recognized when it is probable that future economic benefits will flow to the entity and these benefits can be measured reliably.

This Standard should be applied in accounting for revenue arising from the following transactions:

1. Sale of goods
2. Rendering of Services
3. Use of entity assets yielding Interest, Royalties or Dividends

Important Definition

- i) **Income** is the increase in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases in the liabilities that result in an increase in equity, other than contributions from equity participants.
- ii) **Revenue** is income that arises in the course of ordinary activities of an entity and if referred to by the variety of different names including sales, fees, interest, dividends, and royalties.
- iii) **Fair Value (FV)** is the amount for which an asset could be exchanged or the liability settled between knowledgeable, willing parties in an arm's length transaction.

Measurement of Revenue

Revenue is measured at FV of the consideration received or receivable after deducting trade discounts and rebates. When the inflow of cash (or cash equivalents) is deferred, FV can be less than the nominal amount of cash.

Under an effective financing transaction, the fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest.

Interest Revenue = Fair Value of consideration – Nominal Amount of consideration

The imputed rate of interest is the more clearly determinable of either:

- (a) Prevailing rate for a similar instrument of an issue with a similar credit rating
- (b) Rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services

Identification of Transaction

This standard is usually separately applied to each transaction but to reflect the substance of the transaction, it can be applied to separately identifiable components of a single transaction.

For example, when the product price includes a substantial amount for subsequent servicing, that amount is deferred and recognized as revenue when that service is performed.

On the other hand, to understand the commercial effect of series of transactions, recognition criteria can be applied together on two or more transactions at the same time.

2.11 IND AS 19 EMPLOYEE BENEFITS

Q28. What are the employee benefits? Who is an employee?

Ans :

Employee benefits are all forms of consideration given by an entity directly to the employee or their spouses, children or other dependents, to other such as trust, insurance companies in exchange of service rendered by employee.

Whether an entity is required to provide for employee benefits arising from informal practices - If the practice established by an employer as that of a consistent benefit granted either as part of union negotiations or otherwise that clearly established a pattern (e.g., a cost of living adjustment or fixed rupee increase), it could be concluded that an obligation exists and that those additional benefits should be included in the measurement of benefit obligation.

Employee

For the purpose of this standard employee includes whole time directors and management personnel. The standard is applicable to all forms of employer-employee relationships. There is no requirement for a formal employer-employee relationship. Several factors need to be considered to determine the nature of relationship.

Generally 'outsourcing contract' may not meet the definition of employer- employee relationship. However, such contracts need to be carefully examined to distinguish between a "contract of service" and a "contract for services". A "contract for services" implies a contract for rendering services, e.g., professional or technical services which is subject to limited direction and control whereas a 'contract of service' implies a relationship of an employer and employee and the person is obliged to obey orders in the work to be performed and as to its mode and manner of performance.

Q29. Explain different types of employee benefits

Ans :

S.No.	Employee Benefits	Overview of Accounting
(i)	Short term employee benefits Short-term employee benefits, such as wages, salaries and social security contributions, paid annual leave and paid sick leave, profit sharing and bonuses (if payable within 12 months and non-monetary benefits) (such as medical care, housing, cars and free or subsidized goods or service) for current employees.	When an employee has rendered services in exchange for these benefits by debiting to expense.
(ii)	Post employment benefits Post-employment benefits such as pensions, other retirement benefits, post-employment life insurance and post-employment medical care.	Such benefits may be of defined contribution plans or defined benefit plans. If covered by defined contribution plans. Contribution due on the date of balance sheet is treated as liability and excess paid is treated as asset. Accounting for defined benefit plans is complex and discussed later in this chapter
(iii)	Other long term benefits Other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long- service benefits, long-term disability benefits and, if they are payable 12 months or more after the end of the period, profit-sharing, bonuses and deferred compensation	Legal and constructive obligation under the plan is calculated on actuarial valuation and is recognized as an expense and defined benefit liability (Net of fair value of plan asset) in the balance sheet
(iv)	termination benefits Termination benefits including voluntary retirement benefits (VRS).	Termination benefits are recognized as an expense immediately.

Q30. Explain accounting treatment for short term employee benefits.

Ans :

Short-term employee benefits include items such as

- Wages, salaries and social security contribution;
- Short-term compensated absences (such as paid annual leave) where the absences are expected to occur within 12 months after the end of period in which the employees render the related employee services;
- Profit-sharing and bonuses payable within 12 months after the end of the period in which the employees render the related services; and
- Non-monetary benefits (such as medical care, housing, cars and free or subsidies goods or services for current employees).

Accounting for short-term employee benefits as classified above is simple as there is no actuarial gain or loss to be recognized, as these are accounted for on undiscounted basis. Basic principles for accounting short-term employee benefits are that the undiscounted amount of short-term employee benefits should be recognized when the employee rendered service:

- It is recognized as an expense unless another Standard such as Ind AS-16 "Property, Plant and Equipments" requires it to be included in the cost of assets.
- It is recognized as a liability if the amount of short-term benefits exceeds amount actually paid or spent.
- It is recognized as asset (pre-paid expenses) when amount actually paid exceeds the amount of short-term benefits.

i) Short-term paid absences

These are of two types - accumulating and non-accumulating. Accumulating paid absences can be carried forward if the current period's entitlement is not used in full. These may be of vesting and non-vesting types. Vesting paid absence means entitlement of cash payment is not conditional on future employment. In case of vesting type of accumulating paid absences employees are entitled to a cash payment when they leave the entity. In case of non-vesting obligation of cash payment does not arise.

Ind AS-19 requires to recognize expected cost of accumulating paid absences (both vesting and non-vesting) when the employee renders service that increases their entitlement to future paid absences. An entity should recognize non-accumulating short paid absences, when the absences occur.

Cost of non-accumulating type of paid absences is automatically computed if the employees are on the regular pay-roll. In case employees are not in the regular pay-roll, then cost should be computed during their absences in the period in which the absences occur.

Expected cost of accumulating paid absences is the additional amount that the entity has to pay as a result of the unused entitlement that has accumulated at the balance sheet date.

In case an entity allow unutilized employee benefits

Medical care, leave travel, etc., to be carried forward, whether it is required to recognize a provision in respect of carried forward benefits. A provision should be recognized for all benefits (conditional or unconditional) which an employee becomes entitled to as a result of rendering of the service and should be recorded as part of the cost of service rendered during the period in which the service was rendered which resulted the entitlement. In estimating the cost of such benefit the probability of the employee availing such benefit should be considered.

ii) Profit sharing and Bonus Plan

Under some profit-sharing plans, employees receive a share of the profit only if they remain with the entity for a specified period. Such plans create an obligation as employees render service that increases the amount to be paid if they remain in service until the end of the specified period. The measurement of such obligations reflects the possibility that some employees may leave without receiving profit-sharing payments. Similarly an entity may not have any legal obligation to pay bonus, but it may have the practice of bonus payment. As such the entity has no realistic alternative but to make the payment.

An entity should recognize the expected cost of profit-sharing and bonus payments when and only when:

- The entity has a present obligation to make such payments as a result of past events and;
- A reliable estimate of the obligation can be made.

Q31. Explain accounting treatment for post employment benefits.

Ans :

Post-employment benefits include:

- (a) Retirement benefits, e.g., gratuity and pension; and
- (b) Other benefits, e.g., post-employment life insurance and post-employment medical care.

Post-employment benefit plans are classified as - defined contribution plan or defined benefit plans.

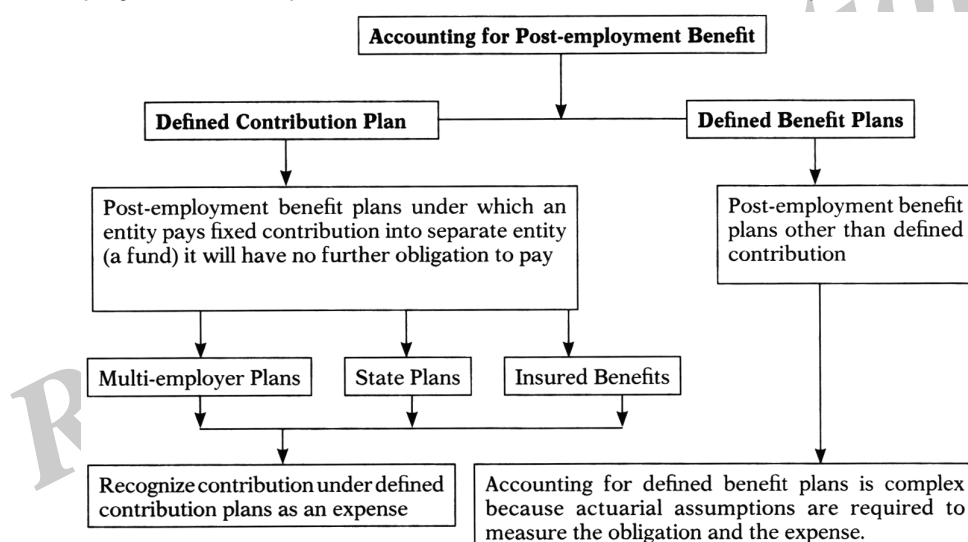


Fig.: Accounting for Post Employment Benefit

I) Defined Contribution Plans

Under defined contribution plans, the entity's obligation is limited to the amount that it agrees to contribute to the fund. Thus, the amount of the post-employment benefits received by the employee is determined by the amount of contributions paid by an employer (and also by the employee to a post-employment benefit plan or to an insurance company, together with investment returns arising from the contributions; and employer is no longer liable to pay the post-employment benefits to the employee. Defined contribution plans may be of following three types:

- Multi-employer Plans;
- State Plans;
- Insured Benefits.

a) Multi-employer Plans

Multi-employer Plans are defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that:

- Pool the assets contributed by various entities that are not under common control; and
- Use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefits levels are determined without regard to the identity of the entity that employ the employees concerned.

A multi-employer plans usually includes participation of two or more unrelated employee by creating independent e.g., Trust. The plan is usually administrated by a board of trustee; all the participating employers contribute in trust/plan for the post-employment benefit of their employees. The contribution is invested in asset/investment and is called plan asset. Thus the assets are aggregated for all employers and are available and unrestricted to pay benefits to all the employees regardless of whom they me employed by. In other words there is no segregation of assets in a particular employer's account.

Multi-employer plans may be a defined contribution plan depending upon die terms of plan. Generally multi-employer plan are defined contribution plan and therefore accounting is done accordingly. If multi-employer plan is classified as defined benefit plan the accounting shall be according to that plan which is being discussed in subsequently. Accounting for multi-employer plan treating it as defined contribution plan, is simple. Periodical contribution paid by the employer in multi-employer plan is debited in expense account and credited in Bank account. If the contribution is not paid and partly paid the amount is credited to payable account

b) State Plans

State plan are established by legislation to cover all entities or entities of a specific industry and are operated by national or local Government, example of such plan in India are Provident Fund administrated by the Govt, of India.

State plan may be categorized as defined contribution plan or defined benefit plan based on obligation under the plan. However in most of the cases such plan are defined contribution plans as entities/employer has only obligation to pay the contribution and has no obligation to pay those future benefits.

Accounting in case of State plans - As State plans are normally defined contribution plans the contribution paid by the employer is debited to expense and if payable is credited to liability account.

Whether a provident fund which guarantees a specified rate of return is a defined benefit plan ora defined contribution plan - Section 17 of the Employee Provident Fund (EPF) Act, 1952 empowers the Government to exempt any establishment from the provisions of the Employee's Provident Fund Scheme, 1952 provided that the rules of the provident fund set up by the establishment are not less favourable than those specified in section 6 of the EPF Act and the employees are also in enjoyment of other provident fund benefits which on the whole are not less favourable to the employees than the benefits provided under the Act. The rules of the provident funds set up by such establishments (referred to as exempt provident funds) generally provide for the deficiency in the rate of interest on the contributions based on its return on investment as compared to rate declared for Employees Provident Fund by the Government under paragraph 60 of the Employees Provident Fund Scheme, 1952 to be met by the employer. Such provision in the rules of the provident fund would tantamount to a guarantee of a specified rate of return. As per Ind AS-19, where in terms of any plan the entity's obligation is to provide the agreed benefits to current and former employees and the actuarial risk (that benefits will cost more than expected) and investment risk fall, in substance, on the entity, the plan would be defined benefit plan. Accordingly provident funds set up by the employers which requires interest shortfall to be met by the employer would be in effect defined benefits plans.

c) Insured Benefits

Where an employer takes insurance policy from an insurance company for meeting its obligation under post-employment benefits and the

employer has no obligation to pay benefits to the employee and the insurer has sole responsibility for paying the post-employment benefits. The payments of fixed premium under such contract are, in substance, the settlement of the employee benefit obligation. Therefore, entities treat such payment as contribution to defined contribution plan.

However if employer has the obligation to pay employee benefits when they fall due or to pay further amount if insurer does not pay, such plan shall be treated as defined benefit plan and not defined contribution plan and accounting shall be done accordingly.

II) Post-employment Benefits

a) Defined Benefit Plans

Defined benefit plans are retirement benefits plan like gratuity, pension plan that defines an amount of benefits to be provided usually as a function one or more factors such as age, year of service or compensation/salary

for example, a gratuity payment obligation at the time the employee leave the entities or retires is calculated on the basis of past service period and salary at the time of retirement. In this case benefit is defined but not the amount of liability.

The ultimate cost of defined benefit plan say gratuity is influenced by many factors such as salary at the time of retirement, total service period of retiring employee. Uncertainty about the leaving of that by resignation or by death since the ultimate cost is uncertain it is necessary to measure the employment benefit obligation by applying actuarial valuation. Actuarial valuation is done by the actuary an expert who can reliably estimate the amount of obligation under various uncertainties.

Constructive obligation. An entity shall account not only for its legal obligation under the formal terms of a defined benefit plan, but also for any constructive obligation that arises from the entity's informal practices. Informal practices give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. An example of a constructive obligation is where a change in the entity's informal practices would cause unacceptable damages to its relationship with employees.

b) Accounting for defined benefit plans

Accounting for defined benefit plan is complex because of:

- Actuarial assumptions are required to measure the obligation under the plan;
- Obligations are measured on discounted basis because they are settled many years after the employee render the service or they accrue;
- Actuarial gain or loss is possible.

To summaries the whole issue of measurement and recognition of defined benefit plan following steps are involved:

- Using actuarial techniques to make a reliable estimate of the amount of benefit that employee have earned in return for their service in the current and prior periods;
- Use the projected unit credit method to measure its obligations and costs;
- Use unbiased and mutually compatible actuarial assumptions about demographic variables (such as employee turnover and mortality and financial variables (such as future increase in salaries, changes in medical costs and certain changes in state benefits). Financial assumptions should be based on market expectations, at the balance sheet date, for the period over which the obligations are to be settled:
- Determine the discount rate by reference to market yields at the balance sheet date on Govt, bonds;
- Determine the fair value of any plan assets;
- Deduct the fair value of any plan assets from the carrying amount of the obligation. Certain reimbursement rights that do not qualify as plan assets are treated in the same way as plan assets, except that they are presented as a separate asset, rather than as a deduction from the obligation;
- Determine the total amount of actuarial gains and losses and recognize in other comprehensive;
- Where a plan has been introduced or changed recognize past service cost on a

straight-line basis over the average period until the amended benefits become vested;

- Recognize gains or losses on the curtailment or settlement of a defined benefit plan when the curtailment or settlement occurs. The gain or loss should comprise any resulting change in the present value of the defined benefit obligation and of the fair value of the plan assets and the unrecognized part of any related past service cost.

Q32. Explain the accounting for long term employee benefits.

Ans :

The accounting for long-term employee benefits is similar to post employment defined benefit plans except that all past service cost is recognized immediately.

The measurement of other long-term employee benefits is not usually subject to the same degree of uncertainty as the measurement of post-employment benefits. For this reason, this Standard requires a simplified method of accounting for other long-term employee benefits. Unlike the accounting required for post-employment benefits, this method does not recognise remeasurements in other comprehensive income and therefore remeasurement of the net defined liability is also charged to profit or loss.

Disclosure

Standard does not prescribe the disclosure requirement however disclosure may be required as per other accounting standard like Ind AS-1 on "Presentation of Financial Statements" and Ind AS-24 on "Related Parties Disclosures".

Termination Benefits

Termination benefits are employee benefits payable as a result of either an entity's decision to terminate an employee's employment before the normal retirement date; or an employee's decision to accept voluntary retirement in exchange for those benefits. The event which gives rise to an obligation is the termination rather than employee service. Therefore, an entity should recognize termination benefits as a liability and an expense when the entity is demonstrably committed to either:

- Terminate the employment of an employee or group of employees before the normal retirement date; or
- Provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.

An entity is demonstrably committed to a termination when, and only when the entity has a detailed formal plan for the termination and is without realistic possibility of withdrawal. Some employee benefits are payable regardless of the reason for the employee's departure. The payment of such benefits is certain (subject to any vesting or minimum service requirements) but the timing of their payment is uncertain. Although such benefits may be described as termination benefits, or termination gratuities, they are post-employment benefits, rather than termination benefits and an entity accounts for them as post-employment benefits. Some entities provide a lower level of benefit for voluntary termination at the request of the employee (in substance, a post-employment benefit) than for involuntary termination at the request of the entity. The additional benefit payable on involuntary termination is a termination benefit.

Accounting for Termination Benefits

Termination benefits is recognized as an expense immediately. Where termination benefits fall due more than 12 months after the balance sheet date, they should be discounted using the discount rate. In the case of an offer made to encourage voluntary redundancy the measurement of termination benefits shall be based on the number of employees expected to accept the offer.

Disclosure

- Where there is uncertainty about the number of employees who will accept an offer of termination benefits, a contingent liability exists. As required by Ind AS-37 "Provision, Contingent Liabilities and Contingent Assets" an entity discloses information about the contingent liability unless the possibility of an outflow in settlement is remote.
- As required by Ind AS-1, an entity discloses the nature and amount of an expense if it is

material. Termination benefits may result in an expense needing disclosure in order to comply with requirement.

- Where required by Ind AS-24 on "Related party Disclosures" an entity to disclose information about termination benefits for key personnel.

2.12 IND AS 20 ACCOUNTING FOR GOVT GRANTS AND DISCLOSURE OF GOVT ASSISTANCE

Q33. Explain briefly about Ind As 20 ?

Ans : (Imp.)

This Standard shall be applied in accounting for, and in the disclosure of, government grants and in the disclosure of other forms of government assistance.

Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.

Government assistance is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria. Government assistance for the purpose of this Standard does not include benefits provided only indirectly through action affecting general trading conditions, such as the provision of infrastructure in development areas or the imposition of trading constraints on competitors.

In this Standard, government assistance does not include the provision of infrastructure by improvement to the general transport and communication network and the supply of improved facilities such as irrigation or water reticulation which is available on an ongoing indeterminate basis for the benefit of an entire local community.

- Government grants, including non-monetary grants at fair value, shall not be recognised until there is reasonable assurance that:

(a) the entity will comply with the conditions attaching to them; and

(b) the grants will be received.

- A government grant may take the form of a transfer of a non-monetary asset, such as land or other resources, for the use of the entity. In these circumstances, the fair value of the non-monetary asset is assessed and both grant and asset are accounted for at that fair value.
- Government grants shall be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate.
- A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs shall be recognised in profit or loss of the period in which it becomes receivable.
- Grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.
- Government grants related to assets, including non-monetary grants at fair value, shall be presented in the balance sheet by setting up the grant as deferred income.
- Grants related to income are government grants other than those related to assets. Grants related to income are presented as part of profit or loss, either separately or under a general heading such as 'Other income'; alternatively, they are deducted in reporting the related expenses.
- A government grant that becomes repayable shall be accounted for as a change in accounting estimate (Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors). Repayment of a grant related to

income shall be applied first against any unamortised deferred credit recognised in respect of the grant.

- To the extent that the repayment exceeds any such deferred credit, or when no deferred credit exists, the repayment shall be recognised immediately in profit or loss. Repayment of a grant related to an asset shall be recognised by reducing the deferred income balance by the amount repayable.

The following matters shall be disclosed:

- (a) the accounting policy adopted for government grants, including the methods of presentation adopted in the financial statements;
- (b) the nature and extent of government grants recognised in the financial statements and an indication of other forms of government assistance from which the entity has directly benefited; and
- (c) unfulfilled conditions and other contingencies attaching to government assistance that has been recognised.

Appendix A of Ind AS 20 address the issue that whether government assistance is a government grant within the scope of Ind AS 20 and, therefore, should be accounted for in accordance within the Standard. The Appendix prescribes that government assistance to entities meets the definition of government grants in Ind AS 20, even if there are no conditions specifically relating to the operating activities of the entity other than the requirement to operate in certain regions or industry sectors. The Appendix provides that such grants shall not be credited directly to shareholders' interests.

Q34. Explain the basic terms are used in Ind As-20.

Ans :

➤ **Fair value**

Is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

➤ **Forgivable loans**

Those loans that the lender undertakes to waive repayment of under certain prescribed conditions.

➤ **Government**

For the purposes of Ind AS-20, refers not only to a government (of a country), as is generally understood, but also to government agencies and similar bodies, whether local, national, or international.

➤ **Government assistance**

Action by a government aimed at providing an economic benefit to an entity or group of entities qualifying under certain criteria. It includes a government grant and other kinds of non-monetary government assistance, such as providing, at no cost, legal advice to an entrepreneur for setting up a business in a free trade zone. It excludes benefits provided indirectly through action affecting trading conditions in general; for example, laying roads that connect the industrial area in which an entity operates to the nearest city or imposing trade constraints on foreign companies in order to protect domestic entrepreneurs in general.

➤ **Government grant**

A form of government assistance that involves the transfer of resources to an entity in return for past or future compliance (by the entity) of certain conditions relating to its operating activities. It excludes:

- Those forms of government assistance that cannot reasonably be valued
- Transactions with governments that cannot be distinguished from the normal trading transactions of the entity

➤ **Grants related to assets**

Those government grants whose primary condition is that an entity qualifying for them should acquire (either purchase or construct) a long-term asset or assets. Subsidiary conditions may also be attached to such grants. Examples of subsidiary conditions

include specifying the type of long-term assets, location of long-term assets, or periods during which the long-term assets are to be acquired or held.

➤ **Grants related to income**

Government grants other than those related to assets.

Q35. Explain various principles of grants.

Ans :

Principle 1

"Grants in recognition of specific costs are recognized as income over the same period as the relevant expense."

According to the Standard, grants in recognition of specific costs should be taken to income "over the period which matches the costs" using a "systematic and rational basis."

Principle 2

"Grants related to depreciable assets are usually recognized as income over the periods and in the proportions in which depreciation on those assets is charged."

Principle 3

"Grants related to non-depreciable assets may also require the fulfillment of certain obligations and would then be recognized as income over periods which bear the cost of meeting the obligations."

Principle 4

"Grants are sometimes received as part of a package of financial or fiscal aids to which a number of conditions are attached."

Principle 5

"A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs should be recognized as income of the period in which it becomes receivable."

Sometimes grants are awarded for the purposes of giving immediate financial support to an entity, for example, to revive an insolvent commercial business (referred to as sick unit in third world countries). Such grants are not given as incentives to invest funds in specified areas or for a

specified purpose from which the benefits will be derived over a period of time in the future. Instead such grants are awarded to compensate an entity for losses incurred in the past. Thus they should be recognized as income in the period in which the entity becomes eligible to receive such grants.

A grant may be awarded to an entity to compensate it for losses incurred in the past for operating out of an economically backward area that has been hit recently by an earthquake. During the period the entity operated in that area, the area experienced an earthquake, and thus the entity incurred massive losses. Such a grant received by the entity should be recognized as income in the year in which the grant becomes receivable.

2.13 IND AS 21 THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

Q36. Explain the need and objectives of Ind AS-21.

(OR)

Explain the effect of changes in foreign exchange rates.

Ans :

(Jan.-20, Imp.)

Needs and Objectives

If a company trades overseas, it will buy or sell goods or services in foreign currencies. For example, an Indian company buys materials from Canada, and pays for them in US dollars and then sells its finished goods in Germany, receiving payment in Euros. As the presentation/local currency is Indian Rupee (INR). Therefore, all the value of goods or services bought or sold has to be translated in rupees for the purpose of recording in the books of account.

An Indian company might have a subsidiary abroad (say in USA) and the subsidiary will trade in its own local currency i.e., US Dollar. The subsidiary will keep books of account and prepare the annual accounts in its own currency (USD). However at the year end, the holding company must consolidate the results of the overseas subsidiary into its group accounts, so that somehow, the assets and liabilities and the annual profit of the subsidiary must be translated from the foreign currency (USD) into INR.

For the translation from the foreign currency into INR, we need the foreign currency exchange rates. If foreign currency exchange rates remained constant, there would be no accounting problem. However, foreign exchange rates are continually changing, for example, that the rate of exchange between INR and USD might be ₹ 60 to \$1 at the start of the accounting year, and ₹ 63 to \$1 at the end of the year (in this example a 5% decrease in the relative strength of INR). The accounting principles are required to laid down in which the transactions from one currency to another currency is to be translated and what should be the accounting treatment of exchange difference arising on application of different foreign currency exchange rates. The Ind AS-21 answers these questions by laying down the principles for foreign currency translations.

For example, AB Ltd. New Delhi, an Indian company purchased a machine from XY Ltd. (UK) on 1st February 2018. The price of machine was £ 10,000. The exchange rate on that date was £ 1 equal to INR 90. The AB Ltd. would record machine at ₹ 900,000/- (10,000 x 90). However, AB Ltd. has 2 months credit from XY Ltd. on 31st March 2018 when AB Ltd. is about to pay, the exchange rate has changed to £ 1 equal to INR 100. AB Ltd will actually pay ₹ 10,00,000 instead of ₹ 9,00,000. The question is how these to be recorded in financial books.

Q37. Explain the scope of Ind AS-21.

Ans :

- Reporting foreign currency transactions in the functional currency in accounting for transactions and balances in foreign currencies, except for those derivative transactions and balances that are within the scope of Ind AS-109, Financial Instruments. Like, purchase and sale of goods or services, borrowings in foreign currency and purchase of assets in foreign currency
- Translation in foreign operations- In translating the results and financial position of foreign operations that is included in the financial statements of the entity by consolidation or the equity method. Like,

Consolidation of subsidiary's financial statements.

- Translation to the presentation currency- In translating an entity's results and financial position into a presentation currency. When the reporting entity has to report in currency other than the functional currency, for example, an Indian subsidiary of US company must be recorded the transaction in functional currency (INR) and reporting its results and financial position in USD (Presentation Currency)

This Standard does not apply:

- To the presentation in a statement of cash flows of the cash flows arising from transactions in a foreign currency, or to the translation of cash flows of a foreign operation (Ind AS-7, Statement of Cash Flows).
- To long-term foreign currency monetary items for which an entity has opted for the exemption given in Ind AS-101. Such an entity may continue to apply the accounting policy so opted for such long-term foreign currency monetary items.

Q38. What are the key terms used in foreign exchange rates?

Ans :

➤ Exchange difference

The difference resulting from translating a given number of units of one currency into another currency at different exchange rates.

➤ Foreign operation

A subsidiary, associate, joint venture, or branch whose activities are based or conducted in a country or currency other than those of the reporting entity.

➤ Functional currency

The currency of the primary economic environment in which the entity operates.

➤ Closing rate

The spot exchange rate at the balance sheet date.

➤ **Spot rate**

The exchange rate for immediate delivery.

➤ **Presentation currency**

The currency that is used to present the financial statements.

Q39. Explain briefly about functional currency. How to record foreign currency transactions using foreign currency?

Ans :

To getting true and fair results the transactions are generally recorded in the books in functional currency. The functional currency is the currency of primary economic environment in which an entity operates; it should be determined by looking at several factors. Like:

- This currency should be the one in which the entity normally generates and spends cash and in which transactions are normally denominated.
- Currency that mainly influences the price at which goods and services are sold
- Currency of the country whose competitive forces and regulations mainly influence the entity's pricing structure
- Currency that influences the costs of the entity
- Currency in which funds are generated
- Currency in which receipts from operating activities are retained

Functional currency of a foreign operation

In addition to above the following other factors are considered in determining the functional currency of a foreign operation such as a foreign subsidiary, and whether it is the same currency as that of the reporting entity (the reporting entity, in this context, being the entity that has the foreign operation as its subsidiary, branch, associate or joint Arrangement):

- As whether the foreign entity is an extension of the reporting entity business - In this case the functional currency of the reporting entity

will be the functional currency of the foreign operation.

- With a significant degree of autonomy- In this case the functional currency of the reporting entity may not be functional currency of the foreign operations.
- Whether the proportion of the transactions which the foreign operations have with the reporting entity is high or low. If the volume is high then the functional currency of the reporting entity will be the functional currency of the foreign operation. If the volume is low then the functional currency of the reporting entity may not be the functional currency of the foreign operations.
- The nature of the cash flows-whether cash flows from the activities of the foreign operation directly affect the cash flows of the reporting entity and are readily available for remittance to it. If the answer is yes then the functional currency of the subsidiary will be the same as the functional currency of the reporting entity.
- Whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligations without funds being made available by the reporting entity. In this case the functional currency of the reporting entity may not be the functional currency of the foreign operation.
- Whether it has to depend upon fund from the reporting entity to repay its dues-in this case the functional currency of the reporting entity will become the functional currency of the foreign operation.

When the above indicators are mixed and the functional currency is not obvious the management of the reporting company determines the functional currency which faithfully represents the financial transactions.

Change in functional currency

The entity's functional currency reflects the transactions, events, and conditions under which the entity conducts its business. Once decided on,

the functional currency does not change unless there is a change in the underlying nature of the transactions and relevant conditions and events.

Where there is a change in the functional currency, it should be applied from the date of change. A change must be linked to a change in the nature of the underlying transactions. For example, a change in the major market may lead to a change in the currency that influences sales prices. The change is accounted for prospectively not retrospectively.

Recording foreign currency transactions using functional currency

A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity:

- buys or sells goods or services whose price is denominated in a foreign currency;
- borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or
- otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

Initial recognition

Foreign currency transactions should be recorded initially at the spot rate of exchange at the date of the transaction. An approximate rate can be used. For example, in general, an average rate for a particular period can be used, but if exchange rates are fluctuating wildly, an average rate cannot be used.

- Reporting at the ends of subsequent reporting periods Subsequently, at each balance sheet date:
- Foreign currency monetary amounts should be reported using the closing rate.
- Non-monetary items measured at historical cost should be reported using the exchange rate at the date of the transaction.
- Non-monetary items carried at fair value should be reported at the rate that existed when the fair values were determined.

Recognition of exchange differences

- Exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous financial statements shall be recognised in profit or loss in the period in which they arise. The exception is that exchange differences arising on monetary items that form part of the reporting entity's net investment in a foreign operation are recognized in the group financial statements within a separate component of equity. They are recognized in profit or loss on disposal of the net investment.
- The exchange difference arising on monetary items that form part of the reporting entity's net investment in a foreign operation is recognized in profit or loss in the separate financial statements of the reporting entity or the individual financial statements of the foreign operation, as appropriate.
- If a gain or loss on a non-monetary item is recognized in equity (e.g., property, plant, and equipment revalued under Ind AS-16), any foreign exchange gain or loss element is also recognized in equity.
- Ind AS-109 requires that exchange differences on monetary items that qualify as hedging instruments in a cash flow hedge are recognised initially in other comprehensive income to the extent that the hedge is effective.

Q40. Define Disposol of a foreign entity.

Ans :

An entity may dispose or partially dispose of its interest in a foreign operation through sale, liquidation, repayment of share capital or abandonment of all, or part of, that entity. A write-down of the carrying amount of a foreign operation,

either because of its own losses or because of an impairment recognised by the investor, does not constitute a partial disposal. Accordingly, no part of the foreign exchange gain or loss recognised in other comprehensive income is reclassified to profit or loss at the time of a write-down.

Accounting treatment of cumulative translation difference on disposal of foreign operation - When a foreign operation is disposed of, the cumulative amount of the exchange differences in equity relating to that foreign operation shall be recognized in profit or loss when the gain or loss on disposal is recognized.

Partial disposal-On the partial disposal of a subsidiary that includes a foreign operation, the entity shall re-attribute the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income to then on-controlling interests in that foreign operation.

In any other partial disposal of a foreign operation the entity shall reclassify to profit or loss only the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income.

RBI Guidelines on partial disclosure

.It has been observed that banks have been recognizing gains in profit & loss account from Foreign Currency Translation Reserve (FCTR) on repatriation of accumulated profits/retained earnings from overseas branch by treating the same as partial disposal.

The matter has been examined taking into consideration; inter alia, the views of the Institute of Chartered Accountants of India. It is clarified that the repatriation of accumulated profits shall not be considered as disposal or partial disposal of interest in non-integral foreign operations as per AS 11. The Effects of Changes in Foreign Exchange Rates. Accordingly, banks shall not recognise in the profit and loss account the proportionate exchange gains or losses held in the foreign currency translation reserve on repatriation of profits from overseas operation

Short Question & Answers

1. Objectives of financial statements.

Ans :

The objective of the financial statements is to provide information useful to a wide range of users in making economic decision about:

- Financial position (namely assets, liabilities and equity)
- Financial performance (Income/expenses including gains and loss)
- Cash flows (including cash equivalent as per Ind AS-7)
- To show the results, how the resources of the entity was managed by management.

Overall objective is to make true and fair presentation which requires faithful representation of transactions, event and their effects, recognition, measurement of assets and liabilities, income and expenses and also compliance of disclosure requirements as per Ind AS.

2. What is Cashflow Statement ?

Ans :

Cash flow statement is additional information to user of financial statements. This statement exhibits the flow of incoming and outgoing cash. This statement assesses the ability of the entity to generate cash and to utilize the cash. This statement is one of tools for assessing the liquidity and solvency of the entity. Cash flow information is considered useful to investors, creditors and other financial statement users to assess the following:

- An entity's ability to generate positive future cash flows
- An entity's ability to meet obligations and pay dividends and its need for external financing
- The reasons for differences between net income and associated cash receipts
- The effect on an entity's financial position of both its cash and non-cash investing and financing transactions that took place during the period.

3. What are prior period errors?

Ans :

Prior period errors are errors committed in earlier years but discovered in current year. Prior period errors are omission from, and misstatement in the financial statements for one or more prior periods arising from the failure to use or misuse of, reliable information that :

- Was available and
- Could reasonably be expected to have been obtained

When those prior period financial statements were authorized for issue such as:

- Mathematical mistake
- Mistake in applying accounting policies
- Misinterpretation of facts
- Frauds
- Oversights

Example: Plant purchased of ₹ 5,00,000 during the year 2017 was recorded as purchase and shown as expense, this mistake was discovered in 2018.

4. Tax base of liability.

Ans :

In the case of a liability, the tax base will be its carrying amount, less any amount that will be deducted for tax purpose in relation to the liability in future periods. For revenue received in advance, the tax base of the resulting liability is its carrying amount, less any amount of the revenue that will not be taxable in the future periods.

Examples:

- Current liabilities include accrued expenses with a carrying amount of ₹ 100. The related expense will be deducted for tax purposes on a cash basis.

The tax base of the accrued expenses is nil

- Current liabilities include interest revenue received in advance, with a carrying amount of ₹ 100. The related interest revenue was taxed on a cash basis.

The tax base of the interest received in advance is nil

- Current liabilities include accrued expenses with a carrying amount of ₹ 100. The related expense has already been deducted for tax purposes.

The tax base of the accrued expenses is ₹ 100.

- Current liabilities include accrued fines and penalties with a carrying amount of ₹ 100. Fines and penalties are not deductible for tax purposes.

The tax base of the accrued fines and penalties is ₹ 100. Under this analysis, there is no deductible temporary difference. An alternative analysis is that the accrued fines and penalties payable have a tax base of nil and that a tax rate of nil is applied to the resulting deductible temporary difference of ₹ 100. Under both analyses, there is no deferred tax asset.

- A loan payable has a carrying amount of ₹ 100. The repayment of the loan will have no tax consequences.

The tax base of the loan is ₹ 100.

The formula for the tax base of liability other than the revenue received in advance that can be used at the end of the reporting period is as follows.

$$\text{Tax base of liability} = \text{Carrying amount} - \text{Future deductible amounts} + \text{Future taxable amounts}$$

The formula for the tax base of liability for the revenue received in advance that can be used at the

end of the reporting period is as follows:

$$\text{Tax base of liability} = \text{Carrying amount} - \text{Amounts of revenue that will not be taxable in future periods.}$$

5. Define lease.

Ans :

Lease is an arrangement by which the lessor gives the right to use an asset for given period of time to the lessee on rent.

It involves two parties, a lessor and a lessee and an asset which is to be leased. The lessor, who owns the asset, agrees to allow to the lessee to use it for a specified period of time in return for periodic rent payments.

The lease transactions derive its accounting complexity from number of alternatives available to the parties involved. Lease can be structured to take tax benefit. It can be used to transfer ownership of the leased asset, and it can also be used to transfer the risk of ownership.

In any event substance of transactions dictates the accounting treatment; the lease transaction (finance lease) is probably the best example of the accounting profession's substance over legal form.

If the transactions effectively transfer ownership to lessee, then the substance of the transactions is that of a sale and should be recognized as such even though transactions take form of a lease.

6. What are the employee benefits?

Ans :

Employee benefits are all forms of consideration given by an entity directly to the employee or their spouses, children or other dependents, to other such as trust, insurance companies in exchange of service rendered by employee.

Whether an entity is required to provide for employee benefits arising from informal practices - If the practice established by an employer as that of a consistent benefit granted either as part of union negotiations or otherwise that clearly established a pattern (e.g., a cost of living adjustment or fixed rupee increase), it could be concluded that an obligation exists and that those additional benefits should be included in the measurement of benefit obligation.

7. What is sale and lease back?

Ans :

Sale and lease back

A sale and lease back transaction involves the sale of an asset by vendor and leasing of the same asset back to the vendor.

Accounting treatment of sale and lease back

If lease back is finance lease

- Any profit or loss of sale proceeds over the carrying amount should not be immediately recognized as profit or loss in the financial statements of a seller-lessee.
- It should be deferred and amortized over lease term in proportion to the depreciation of leased asset.

Example : X Ltd. Sells machinery, WDV of which was ₹ 40 lakhs for ₹ 50 lakhs to Y Ltd. The same machinery was leased back to X Ltd. by Y Ltd. for 10 years resulting in finance lease. What should be the treatment of profit in the books of seller lessee (X Ltd).

The profit of ₹ 10 lakhs on sale of machinery by X Ltd. (seller lessee) should not be immediately recognized in books rather it should be deferred and amortized over 10 years in proportion of the depreciation amount to be charged by the X Ltd. on the machinery.

8. Explain various principles of grants.

Ans :

Principle 1

"Grants in recognition of specific costs are recognized as income over the same period as the relevant expense."

According to the Standard, grants in recognition of specific costs should be taken to income "over the period which matches the costs" using a "systematic and rational basis."

Principle 2

"Grants related to depreciable assets are usually recognized as income over the periods and in the proportions in which depreciation on those assets is charged."

Principle 3

"Grants related to non-depreciable assets may also require the fulfilment of certain obligations and would then be recognized as income over periods which bear the cost of meeting the obligations."

Principle 4

"Grants are sometimes received as part of a package of financial or fiscal aids to which a number of conditions are attached."

Principle 5

"A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs should be recognized as income of the period in which it becomes receivable."

9. Define disposal of a foreign entity.

Ans :

An entity may dispose or partially dispose of its interest in a foreign operation through sale, liquidation, repayment of share capital or abandonment of all, or part of, that entity. A write-down of the carrying amount of a foreign operation, either because of its own losses or because of an impairment recognised by the investor, does not constitute a partial disposal. Accordingly, no part of the foreign exchange gain or loss recognised in other comprehensive income is reclassified to profit or loss at the time of a write-down.

Accounting treatment of cumulative translation difference on disposal of foreign operation - When a foreign operation is disposed of, the cumulative amount of the exchange differences in equity relating to that foreign operation shall be recognized in profit or loss when the gain or loss on disposal is recognized.

Partial disposal-On the partial disposal of a subsidiary that includes a foreign operation, the entity shall re-attribute the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income to then on-controlling interests in that foreign operation.

In any other partial disposal of a foreign operation the entity shall reclassify to profit or loss only the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income.

10. Types of leases.

Ans :

For the purpose of accounting we classify the lease into two categories as follows:

- (a) Finance lease
- (b) Operating lease

(a) Finance Leases

It is a lease, which transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee by the lessor but not the legal ownership.

In following situations, the lease transactions are called Finance Lease.

- The lessee will get the ownership of leased asset at the end of the lease term.
- The lessee has an option to buy the leased asset at the end of term at price, which is lower than its expected fair value at the date on which option will be exercised.
- The lease term covers the major part of the life of asset.
- At the beginning of lease term, present value of minimum lease payments covers substantially the initial fair value of the leased asset.
- The asset given on lease to lessee is of specialized nature and can only be used by the lessee without major modification.

Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:

- (i) If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;
- (ii) Gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equaling most of the sales proceeds at the end of the lease); and
- (iii) The lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

(b) Operating Leases

It is a lease which does not transfer substantially all the risk and reward incidental to ownership.

Classification of lease is made at the inception of the lease; if at any time the lessee and lessor agree to change the provision of lease and it results in different category of lease, it will be treated as separate agreement.

11. What is a construction contract?

Ans :

A construction contract is a contract specifically negotiated for the construction of an asset or a group of interrelated assets. [IAS 11.3]

Under IAS 11, if a contract covers two or more assets, the construction of each asset should be accounted for separately if (a) separate proposals were submitted for each asset, (b) portions of the contract relating to each asset were negotiated separately, and (c) costs and revenues of each asset can be measured. Otherwise, the contract should be accounted for in its entirety. [IAS 11.8]

Two or more contracts should be accounted for as a single contract if they were negotiated together and the work is interrelated. [IAS 11.9]

If a contract gives the customer an option to order one or more additional assets, construction of each additional asset should be accounted for as a separate contract if either (a) the additional asset differs significantly from the original asset(s) or (b) the price of the additional asset is separately negotiated. [IAS 11.10].

Choose the Correct Answer

1. Cost of Inventory includes [d]
(a) Cost of purchase (b) Cost of conversion
(c) Other costs (d) All the above
2. _____ activities constitute the primary revenue generating activities of a firm [a]
(a) Operating (b) Financing
(c) Investing (d) All of the above
3. The generally accepted accounting assumptions are _____ [c]
(a) Going concern (b) Consisting
(c) Both (d) None of the above
4. _____ methods are used, when it is impractical to calculate the cost [a]
(a) Standard cost (b) FIFO
(c) LIFO (d) All of the above
5. _____ from dividend must recognised [c]
(a) Expenditure (b) Goods
(c) Revenue (d) None of the above
6. Which accounting standard deals with presentation of financial statements. [c]
(a) Ind AS 16 (b) Ind AS 21
(c) Ind AS 1 (d) Ind AS 17
7. Which accounting standard deals with PPE. [a]
(a) Ind AS 16 (b) Ind AS 21
(c) Ind AS 1 (d) Ind AS 17
8. Example of fixed asset [d]
(a) Machinery (b) Building
(c) Furniture (d) All of the above
9. _____ is the amount for which an asset could be exchange (or) settled [b]
(a) Foreign currency (b) Fair value
(c) Average rate (d) All of the above
10. _____ is the mean of the exchange rates in force during a period [c]
(a) Foreign currency (b) Fair value
(c) Average rate (d) All of the above

Fill in the blanks

1. _____ should present true and fair view of the balance sheet, profit and loss and cash flow of an entity.
2. _____ constitute a major portion of current assets of an entity.
3. _____ is additional information to user of financial statements.
4. _____ (tax income) is the aggregate amount included in the determination of profit or loss for the period for current and deferred tax.
5. _____ of an asset or liability is the amount attributed to that asset or liability for tax purposes.
6. The Property, Plant and Equipment (PPE) also generally known as _____ .
7. The _____ transactions derive its accounting complexity from number of alternatives available to the parties involved.
8. VRS stands for _____ .
9. _____ in recognition of specific costs are recognized as income over the same period as the relevant expense.
10. FCTR stands for _____ .

ANSWERS

1. Financial statements
2. Inventories
3. Cash flow statement
4. Tax expense
5. Tax base
6. Fixed assets
7. Lease
8. Voluntary retirement benefits
9. Grants
10. Foreign currency translation reserve

UNIT III

INDIAN ACCOUNTING STANDARDS (IND AS-23 to 41)

Overview of Indian Accounting Standards: (Ind AS-23 to Ind AS-41):

Ind AS-23: Borrowing costs - Ind AS-24: Related party disclosure - Ind AS-27: Separate financial statements - Ind AS-28: Investments in associates and Joint ventures - Ind AS-29: Financial Reporting in Hyper Inflationary economies - Ind AS-32: Financial instruments: Presentation - Ind AS-33: Earnings Per Share - Ind AS-34: Interim financial reporting - Ind AS-36: Impairment of assets - Ind AS-37: Provisions, contingent liabilities and contingent assets - Ind AS-38: Intangible assets - Ind AS-40: Investment property - Ind AS-41: Agriculture.

3.1 IND AS 23 BORROWING COSTS

Q1. Explain briefly about Ind AS 23.

Ans :

Borrowing costs are defined as interest and other costs incurred relating to borrowing of funds. It includes the following costs or charges:

- Interest expenses calculated using the effective interest rate method
- Finance charges when the asset acquired under finance leases.
- Exchange difference arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

Effective interest rate method

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to make it equal to the net carrying amount of the financial asset or financial liability. This is somewhat akin to internal rate of return. When applying the effective interest method, an entity generally amortize any fees, paid or received, transaction costs and other premium or discounts included in the calculation of the effective interest rate over the expected life of the instrument. However, shorter period is used if this is the period to which the fees paid or received, transaction costs, premiums or discounts related

Direct Borrowing Cost

As per this Ind AS, borrowing cost, which is directly attributable to the acquisition, construction or production of qualifying asset should be capitalized as part of cost of the asset. Other borrowing costs are recognized as expenses.

Qualifying asset

An asset which takes substantial period of time to get ready for its intended use or sale, is called qualifying asset.

Examples of qualifying assets:

- Any tangible fixed assets, which are in construction process or acquired tangible fixed assets, which are not ready for use or resale such as plants and machinery.
- Any intangible assets, which are in development phase or acquired but not ready for use or resale, such as patent.
- Investment property.
- Inventories that require a substantial period (i.e. generally more than one accounting period) to bring them to a saleable condition except the inventories .

Following are the examples which are not qualifying assets:

- Financial asset;
- Inventories that are manufactured, or otherwise produced, over a short period of time;

- Assets which are ready for their intended use or sale when acquired.

Conditions for capitalization of borrowing cost

Following conditions should be satisfied for capitalization of borrowing costs:

- Those borrowing costs, which are directly attributable to the acquisition, construction or production of qualifying asset, are eligible for capitalization. Directly attributable costs are those costs that would have been avoided if the expenditure on the qualifying asset had not been made.
- Qualifying assets will give future economic benefit to the enterprise and the cost can be measured reliably.

Amount of borrowing costs eligible for capitalization

- Specific borrowing Amount of borrowing cost to be = Actual borrowing cost incurred during capitalized (Amount borrowed is the period less any income on the specifically for the purchase of temporary investment of borrowed qualifying assets.

General Borrowings

When the amount borrowed is generally used for the purpose of obtaining qualifying asset:

- Amount of borrowing cost to be capitalized should be determined by applying a capitalization rate to the expenditure on that asset. The capitalization rate should be weighted average of borrowing cost.
- Amount of borrowing cost capitalized during a period should not exceed the amount of borrowing cost incurred during that period.
- The average carrying amount of the asset during a period including borrowing cost previously capitalized, is normally a reasonable approximation of the expenditure to which capitalization rate is applied in that period.

Q2. Define substantial period.

Ans :

The "substantial period" of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of 12 months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of facts and circumstances of the case. In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale should be considered. The following assets ordinarily take twelve months or more to get ready for intended use or sale unless the contrary can be proved by the enterprise:

- Assets that are constructed or otherwise produced for an enterprise's own use, e.g. assets constructed under major capital expansions
- Assets intended for sale or lease that are constructed or otherwise produced as discrete projects (for example, ships or real estate developments). In case of inventories, substantial period time is considered to be involved where time is the major factor in bringing about a change in the condition of inventories. For example, liquor is often required to be kept in store for more than twelve months for maturing.

The manufacturing plants, power generation facilities etc. are qualifying assets as in these cases; normally a period of more than 12 months is required for getting them ready for their intended use. Therefore, a rebuttable presumption of a period of twelve months is considered "substantial period of time".

3.2 IND AS 24 RELATED PARTY DISCLOSURE

Q3. What do you understand by Related Party disclosure?

Ans :

(Jan-20, Imp.)

The objective of Ind AS 24 is to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss

may have been affected by the existence of related parties and by transactions and outstanding balances, including commitments, with such parties.

Related party disclosure requirements as laid down in this Standard do not apply in circumstances where providing such disclosures would conflict with the reporting entity's duties of confidentiality as specifically required in terms of a statute or by any regulator or similar competent authority.

In case a statute or a regulator or a similar competent authority governing an entity prohibits the entity to disclose certain information which is required to be disclosed as per this Standard, disclosure of such information is not warranted.

For example, banks are obliged by law to maintain confidentiality in respect of their customers' transactions and this Standard would not override the obligation to preserve the confidentiality of customers' dealings.

A related party is a person or entity that is related to the entity that is preparing its financial statements. (in the Standard referred as 'reporting entity')

- (a) A person or a close member of that person's family is related to a reporting entity if that person:
 - (i) Has control or joint control of the reporting entity;
 - (ii) Has significant influence over the reporting entity; or
 - (iii) Is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.
- (b) An entity is related to a reporting entity if any of the following conditions applies:
 - (i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
 - (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
 - (iii) Both entities are joint ventures of the same third party.

- (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
- (v) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.
- (vi) The entity is controlled or jointly controlled by a person identified in (a).
- (vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).
- (viii) The entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.

A related party transaction is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.

Close members of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity including:

- (a) That person's children, spouse or domestic partner, brother, sister, father and mother;
- (b) Children of that person's spouse or domestic partner; and
- (c) Dependents of that person or that person's spouse or domestic partner.

Relationships between a parent and its subsidiaries shall be disclosed irrespective of whether there have been transactions between them. An entity shall disclose the name of its parent and, if different, the ultimate controlling party. If neither the entity's parent nor the ultimate controlling party produces consolidated financial statements available for public use, the name of the next most senior parent that does so shall also be disclosed.

An entity shall disclose key management personnel compensation in total and for each of the following categories:

- (a) Short-term employee benefits;
- (b) Post-employment benefits;
- (c) Other long-term benefits;
- (d) Termination benefits; and
- (e) Share-based payment.

If an entity has had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements. At a minimum, disclosures shall include:

- (a) the amount of the transactions;
- (b) the amount of outstanding balances, including commitments, and:
 - (i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and
 - (ii) details of any guarantees given or received;
- (c) provisions for doubtful debts related to the amount of outstanding balances; and
- (d) the expense recognized during the period in respect of bad or doubtful debts due from related parties. (Paragraph 18 of the Standard)

The Standard requires that the disclosures, as per paragraph 18 of the Standard, shall be made separately for each of the following categories:

- (a) the parent;
- (b) entities with joint control of, or significant influence over, the entity;
- (c) subsidiaries;
- (d) associates;
- (e) joint ventures in which the entity is a joint venturer;
- (f) key management personnel of the entity or its parent; and
- (g) other related parties.

Items of a similar nature may be disclosed in aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the entity.

Disclosure of details of particular transactions with individual related parties would frequently be too voluminous to be easily understood. Accordingly, items of a similar nature may be disclosed in aggregate by type of related party. However, this is not done in such a way as to obscure the importance of significant transactions. Hence, purchases or sales of goods are not aggregated with purchases or sales of fixed assets. Nor a material related party transaction with an individual party is clubbed in an aggregated disclosure.

A reporting entity is exempt from the disclosure requirements of paragraph 18 of the Standard in relation to related party transactions and outstanding balances, including commitments, with:

- (a) a government that has control or joint control of, or significant influence over, the reporting entity; and
- (b) another entity that is a related party because the same government has control or joint control of, or significant influence over, both the reporting entity and the other entity.
- (c) the name of the government and the nature of its relationship with the reporting entity (i.e. control, joint control or significant influence);
- (d) the following information in sufficient detail to enable users of the entity's financial statements to understand the effect of related party transactions on its financial statements:
 - (i) the nature and amount of each individually significant transaction; and
 - (ii) for other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent.

Types of transactions include those listed in paragraph 21 of the Standard.

3.3 IND AS 27 SEPARATE FINANCIAL STATEMENTS

Q4. Explain briefly about Ind As 27 ?

Ans :

The objective of Ind AS 27 is to prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. The Standard shall be applied in accounting for investments in subsidiaries, joint ventures and associates when an entity elects, or is required by law, to present separate financial statements.

Separate financial statements are those presented by a parent (i.e., an investor with control of a subsidiary) or an investor with joint control of, or significant influence over, an investee, in which the investments are accounted for at cost or in accordance with Ind AS 109, Financial Instruments.

When an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either:

- (a) at cost, or
- (b) in accordance with Ind AS 109, Financial Instruments.

The entity shall apply the same accounting for each category of investments. Investments accounted for at cost shall be accounted for in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations, when they are classified as held for sale (or included in a disposal group that is classified as held for sale). The measurement of investments accounted for in accordance with Ind AS 109 is not changed in such circumstances.

3.4 IND AS 28 INVESTMENT IN ASSOCIATES AND JOINT VENTURES

Q5. Explain briefly about Ind As 28 ?

Ans :

(Jan.-20)

Where one company has a controlling investment in another company, a parent-subsidiary relationship is formed and accounted for as a group.

Companies may also have substantial investments in other entities without actually having control. Thus, a parent-subsidiary relationship does not exist between the two.

If the investing company can exert significant influence over the financial and operating policies of the investee company, it will have an active interest in its net assets and results.

The nature of the relationship differs from that of a simple investment i.e., it is not a passive interest. Presenting the investment at cost in the investor's financial statements would not fairly present the investment interest.

The cost method for accounting for associates and joint venture would simply not reflect the economic reality of the investor's interest in an entity. The operations of associate and joint venture are significant part of the reporting entity's (i.e., the investor's) management decisions and operational skills. Thus, the clearly demonstrable need to reflect substance, rather than mere form, made the development of the equity method highly desirable.

To correct this accounting issue and to reflect the true nature of interest in the accounts of the investing entity of the net assets and results of the Investee, the associate investor reflects in its accounts, the investment through the use of equity accounting.

Q6. Define,

- i) **Joint Control**
- ii) **Joint Venture**

Ans :

(i) Joint Control

Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. Business run under such arrangement is called a Joint Venture.

(ii) Joint Venture

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

Earlier the accounting for investment in joint ventures was based on the concept of control and therefore, proportionate consolidation method was being applied to consolidate the assets and liabilities of the investee entity.

Now the equity method is applied to an investment in a joint venture since the investor has an interest in the net assets of the joint venture. The investor has no direct interest in the underlying assets or liabilities of the venture and can therefore not recognize such assets or liabilities through proportionate consolidation method.

Q7. Explain the computation and procedure of Equity method ?

Ans : (Jan-20, Imp.)

- Under the equity method, on initial recognition the investment in an associate or a joint venture is recognized at cost.
- The carrying amount is increased or decreased to recognize the investor's share of the profit or loss of the investee after the date of acquisition. The investor's share of the investee's profit or loss is recognized in the investor's profit or loss.
- Distributions received from an investee reduce the carrying amount of the investment.
- Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's other comprehensive income. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences.

Equity Method Procedures for computation

- On acquisition of the investment, any difference between the cost of the investment and the entity's share of the net fair value of the investee's identifiable assets and liabilities is accounted for as follows:
 - (a) Goodwill relating to an associate or a joint venture is included in the carrying

amount of the investment and not recognized separately. Amortization of that goodwill is not permitted.

- (b) Any excess of the entity's share of the net fair value of the investee's identifiable assets and liabilities over the cost of the investment is recognized directly in equity as capital reserve in the period in which the investment is acquired.

➤ Appropriate adjustments to the entity's share of the associate's or joint venture's profit or loss after acquisition are made in order to account, for example, for depreciation of the depreciable assets based on their fair values at the acquisition date. Similarly, appropriate adjustments to the entity's share of the associate's or joint venture's profit or loss after acquisition are made for impairment losses such as for goodwill or property, plant and equipment.

➤ Gains and losses resulting from 'upstream' and 'downstream' transactions between an entity (including its consolidated subsidiaries) and its associate or joint venture are recognized in the entity's financial statements only to the extent of unrelated investors' interests in the associate or joint venture. 'Upstream' transactions are, for example, sales of assets from an associate or a joint venture to the investor.

'Downstream' transactions are, for example, sales or contributions of assets from the investor to its associate or its joint venture. The investor's share in the associate's or joint venture's gains or losses resulting from these transactions is eliminated.

➤ If an associate or a joint venture has outstanding cumulative preference shares that are held by parties other than the entity and are classified as equity, the entity computes its share of profit or loss after adjusting for the dividends on such shares, whether or not the dividends have been declared.

➤ If an entity's share of losses of an associate or a joint venture equals or exceeds its interest in the associate or joint venture, the entity discontinues recognizing its share of further losses.

- After the entity's interest is reduced to zero, additional losses are provided for, and a liability is recognized, only to the extent that the entity has incurred legal or constructive obligations or made payments on behalf of the associate or joint venture. If the associate or joint venture subsequently reports profits, the entity resumes recognizing its share of those profits only after its share of the profits equals the share of losses not recognized.
- The entity's financial statements shall be prepared using uniform accounting policies for like transactions and events in similar circumstances unless, in case of an associate, it is impracticable to do so.
- If an associate or a joint venture uses accounting policies other than those of the entity for like transactions and events in similar circumstances, adjustments shall be made to make the associate's or joint venture's accounting policies conform to those of the entity when the associate's or joint venture's financial statements are used by the entity in applying the equity method.
- When the financial statements of an associate or a joint venture used in applying the equity method are prepared as of a date different from that used by the entity, adjustments shall be made for the effects of significant transactions or events that occur between that date and the date of the entity's financial statements. In any case, the difference between the end of the reporting period of the associate or joint venture and that of the entity shall be no more than three months. The length of the reporting periods and any difference between the ends of the reporting periods shall be the same from period to period.

Q8. Explain the important requirements of Ind As 28.

Ans :

- **Separate financial statements**
Ind AS-27 provides that in the separate financials of the investor, the investment in the associate or joint venture may be carried

at either cost or in terms of Ind AS-109. This is an accounting policy choice that the investor must make and apply consistently across all investments in associate or joint ventures that it holds respectively.

➤ **Consistency of accounting policies**

Financial statement should be prepared using uniform accounting policies. If the accounting policies of the associate or joint venture differ from the reporting entity, adjustments should be made to the financial statements of the associate or joint venture to conform to those of the reporting entity unless, in case of an associate it is impracticable to do so.

➤ **Different Reporting dates**

The most recent available financial statements of the associate or joint venture are used to apply the equity method. If the reporting dates of the entity and the associate or joint venture differ, financial statements on the reporting date of the entity are prepared for the associate or joint venture, unless it is impracticable to do so. If the reporting dates differ, adjustments are required for the effect of significant transactions that occur between the dates. Ind AS-28 requires that a reporting date difference of no more than three months is permissible. The length of the reporting period and difference in reporting dates must be applied consistently from year to year.

➤ **Treatment of cumulative preference shares**

If an associate has out-standing cumulative preference shares, held by parties other than the investor that are classified as equity, the investor computes its share of the profits or losses after deducting dividends due to the preference shareholders, whether or not declared.

➤ **Share of losses exceeding the interest**

If an entity's share of losses exceeds its interest in the associate or joint venture, the recognition of its share of further losses is discontinued. Losses incurred after the investment in associate or joint venture is reduced to zero are applied to other interests

in reverse order of seniority (i.e., priority in liquidation).

➤ **Further losses recognized as liability**

If the entity's interest is reduced to zero, any further losses are only recognized as a liability to the extent that the entity has incurred legal or constructive obligations (Ind AS-37) or made payments on behalf of the associate or joint venture. If the associate or joint venture is again profitable, the entity only resumes recognizing its share of profits after the share of losses not recognized are eliminated.

➤ **Contribution of non-monetary assets**

If an investor makes a contribution of a non-monetary asset to an associate or joint venture in exchange for an equity interest in the associate or joint venture, the fair value of the asset is in principle capitalized as part of the investment. If such a contribution lacks commercial substance, the gain (or) loss is regarded as unrealized and is not recognized.

3.5 IND AS 29 FINANCIAL REPORTING IN HYPER INFLATIONARY ECONOMICS

Q9. What is Hyperinflation? Explain briefly about restatement of financial statements.

Ans : (Imp.)

The distortion in understanding the financial position and results of operations becomes more serious when there is rampant/hyperinflation in the economy.

In a hyperinflationary economy, reporting of operating results and financial position in the local currency without restatement is not useful. Money loses purchasing power at such a rate that comparison of amounts from transactions and other events that have occurred at different times, even within the same accounting period, is misleading.

- Where the preference is to keep wealth in non-monetary assets or in a stable foreign currency. Any local currency would be immediately invested in order to attempt to maintain its purchasing power.

- Where prices are quoted in a stable foreign currency and the population regards monetary amounts in that currency, as effectively a local currency.

- Where transactions are priced at an amount that includes compensation for the future expected loss of the purchasing power of the local currency. This characteristic would be taken into account even if the credit period is quite short.

- Where prices, wages, and interest rates are closely linked to a price index

- Where cumulative inflation rates over a period of three years approaches or exceeds 100%

Although Ind AS-29 sets out the characteristics that may indicate a hyperinflationary economy, it also states that judgment will have to be used in determining whether restatement of the financial statements of the entity is required.

Restatement of Financial Statements

The financial statements of an entity whose functional currency is the currency of a hyperinflationary economy, whether they are based on a:

- historical cost approach or;
- Current cost approach - shall be stated in terms of the measuring unit current at the end of the reporting period.

The corresponding figures for the previous period required by Ind AS-1, Presentation of Financial Statements and any information in respect of earlier periods shall also be stated in terms of the measuring unit current at the end of the reporting period. For the purpose of presenting comparative amounts in a different presentation currency, paragraphs 42(b) and 43 of Ind AS-21, The Effects of Changes in Foreign Exchange Rates apply.

i) **Historical Cost Financial Statements: Balance Sheet**

Ind AS-29 requires the restatement of financial statements including the cash flow statements and requires the use of a general price index. For example, Turkey Petrol Refinery Co. published in its 2014 accounts that cumulative

inflation in Turkey was 227% for the three years to December 2014. The entity restates comparatives and discloses that it uses the Turkish countryside wholesale prices index.

It is preferable that all entities in the same country use the same index:

- Monetary items are already stated in the measuring unit at the balance sheet dates and are therefore not restated.
- All non-monetary items are restated using the change in the general price index between the date that those items were acquired and the current balance sheet date, unless they are carried at current values (e.g., net realizable value and market value) at the balance sheet date, in which case they are not restated.
- Any gain or loss on the restatement of non-monetary items is included in the statement of profit and loss. It is a requirement to disclose this net gain or loss separately.
- The index is applied from the dates on which accounting for hyper-inflation was first applicable to these items.
- Some non-monetary assets are carried at values determined at an earlier date than that of the financial statements.
- Examples are the revaluation of property or equipment. In this case, the carrying amounts are restated from the date the assets were revalued.
- **The restated amounts are compared to:**
 - Recoverable amounts in the case of non-current assets,
 - Net realizable value in the case of inventory,
 - Market value in the case of current investments, and reduced if they exceed the above values.
- An associate operating in the hyperinflationary economy should have its financial statements restated in accordance with Ind AS-29.

- Opening owners' equity should be restated using the Standard, but retained earnings and revaluation surplus should not be restated. Any revaluation surplus arising prior to the application of the Standard is eliminated.
- Restated retained earnings are the balancing figure in the restated balance sheet

ii) **Historical Cost Financial Statements: Statement of Profit and Loss**

This Standard requires that all items in the statement of profit and loss are expressed in terms of the measuring unit current at the end of the reporting period. Therefore all amounts need to be restated by applying the change in the general price index from the dates when the items of income and expenses were initially recorded in the financial statements.

The gain or loss on the net monetary position shall be included in profit or loss and separately disclosed.

Example: An entity keeps three weeks' inventory of raw materials on hand and has a substantial amount of finished goods inventory. The entity operates in a hyperinflationary environment. Advise the entity as to how to restate its inventory.

Solution: A general price index should be used, but the problem will be maintaining records of the acquisition dates of the raw materials and the nature and timing of the conversion cost to finished inventory. Systems need to be developed to accumulate this information in order to use general price indices. If there are low inventory levels, the problem is minimized. In this case, the general price indices for the most recent month will be used together with the aged inventory lists to restate inventory.

iii) **Current cost financial statements: Balance Sheet**

Items stated at current cost are not restated because they are already expressed in terms of the measuring unit current at the end of the reporting period. Other items in the balance sheet are restated in accordance with this Ind AS.

Current cost financial statements: Statement of Profit and Loss

The current cost statement of profit and loss, before restatement, generally reports costs current at the time at which the underlying transactions or events occurred. Cost of sales and depreciation are recorded at current costs at the time of consumption; sales and other expenses are recorded at their money amounts when they occurred. Therefore all amounts need to be restated into the measuring unit current at the end of the reporting period by applying a general price index.

The gain or loss on the net monetary position shall be included in profit or loss and separately disclosed.

3.6 IND AS 32 FINANCIAL INSTRUMENTS PRESENTATION

Q10. Explain briefly about Ind AS 32.

Ans :

The objective of Ind AS 32 is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset.

The principles in this Standard complement the principles for recognizing and measuring financial assets and financial liabilities in Ind AS 109, Financial

Instruments, and for disclosing information about them in Ind AS 107,

Financial Instruments: Disclosures

This Standard defines Financial Instrument, Financial Asset, Financial Liability, Equity Instrument, Puttable Financial Instruments.

Presentation

This standard requires an issuer to classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the

substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument. An instrument is an equity instrument if it evidences a residual interest in the net assets of the entity and both the following conditions are met:

- (a) The instrument includes no contractual obligation to deliver cash or another financial asset to another entity; or to exchange financial assets or financial liabilities under potential unfavourable condition to the issuer.
- (b) In case of settlement by the issuer's own equity instruments, it should be fixed to fixed contracts (no. of equity instruments and the price per unit of equity instruments is fixed).

Puttable Financial Instruments

As an exception, puttable instruments are classified as an equity instrument even if they meet the definition of financial liability. A puttable instrument is a financial instrument that gives the holder of the instrument the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder.

Settlement Options

In case a derivative financial instruments provides an option to one party to choose between various modes of settlement (settlement net in cash or by exchanging shares for cash), such derivative instrument should be a financial asset or a financial liability unless all of the settlement alternatives would result in it being an equity instrument.

Compound Financial Instruments

It may be possible that a non-derivative financial instrument may contain both component of liability and component of equity as well. Such components shall be classified separately as financial liabilities or equity instruments.

Example, bonds with an option to convert into equity.

Treasury shares

If an entity reacquires its own equity instruments, those instruments ('treasury shares') shall be deducted from equity. No gain or loss shall

be recognized in profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instruments. Such treasury shares may be acquired and held by the entity or by other members of the consolidated group. Consideration paid or received shall be recognized directly in equity.

Interest, dividends, losses and gains

An entity should recognize all interest, dividends, losses and gains related to the financial instrument as income or expense in profit or loss. Distributions to holders or transaction cost of an equity transaction should be recognized by the entity directly in equity.

Offsetting a financial asset and a financial liability

An entity should offset a financial asset and a financial liability and the net amount should be presented in the balance sheet only when it has:

- (a) current legally enforceable right to set off the recognized amounts; and
- (b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

An entity that undertakes a number of financial instrument transactions with a single counterparty may enter into a 'master netting arrangement' with that counterparty. Such an agreement provides for a single net settlement of all financial instruments covered by the agreement in the event of default on, or termination of, any one contract.

Consolidated financial statements

An entity in its consolidated financial statements, when classifying a financial instrument (or a component of it) should consider all terms and conditions agreed between members of the group and the holders of the instrument in determining whether the group as a whole has an obligation to deliver cash or another financial asset in respect of the instrument or to settle it in a manner that results in liability classification.

3.7 IND AS-33 EARNINGS PER SHARE

Q11. What is Earning per share?

Ans :

(Jan.-20)

Earnings Per Share (EPS) is a financial ratio that gives the information regarding earning available to each equity/ordinary share. It is very important financial ratio for assessing the performance of the company. A company must be able to sustain its earnings in order to dividend to its shareholders and reinvest in the business so as to achieve future growth. Investors also look for growth in EPS from one year to the next. The EPS is a figure based on past data and it can be easily manipulated by change in accounting policies and by merger and acquisition. The chances of manipulation increases when incentive to hire management is based on EPS and resultant share prices in the market. To minimize the manipulation in the EPS there is a need of standard which will prescribe the computation of EPS.

Definitions :

- **An ordinary share** is an equity instrument that is subordinate to all other classes of equity instruments
- **An equity instrument** is any contract that evidences a residual interest in the assets of an entity after deducting all its liabilities.
- **A potential ordinary share** is a financial instrument or other contract that may entitle its holder to ordinary share. For example:
 - Convertible instruments
 - Share options and warrants
 - Share purchase plants
 - Share which will be issued subject to certain conditions being met
- **Options warrant and their equivalents** are financial instruments that give the holder the right to purchase ordinary shares.
- **Dilution** is reduction in EPS (or an increase in loss per shares) resulting from the assumption that convertible instruments are converted that warrants/options are exercised or that ordinary shares are issued upon the satisfaction of specified conditions.

- Continently issuable ordinary shares are ordinary shares issuable for little or no cash or other consideration upon the satisfaction of specified conditions.
- Put options on ordinary shares are contract that give the holder the right to sell ordinary shares at a specified price for a given period.

Q12. Explain different types of EPS.

Ans :

There are two types of earnings per share (EPS), which are to be reported by the entity on the face of the statement of profit and loss account

- i) Basic EPS
- ii) Diluted EPS

i) Basic earnings per share

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

For the purpose of calculating basic earnings per share, the amounts attributable to ordinary equity holders of the parent entity in respect of:

- (a) profit or loss from continuing operations attributable to the parent entity; and
- (b) profit or loss attributable to the parent entity shall be the amounts in (a) and (b) adjusted for the after-tax amounts of preference dividends, differences arising on the settlement of preference shares, and other similar effects of preference shares classified as equity.

Where any item of income or expense which is otherwise required to be recognized in profit or loss in accordance with Indian Accounting Standards is debited or credited to securities premium account/ other reserves, the amount in respect thereof shall be deducted from profit or loss from continuing operations for the purpose of calculating basic earnings per share.

For the purpose of calculating basic earnings per share, the number of ordinary shares shall be the weighted average number of ordinary shares outstanding during the period. (Paragraph 19 of the Standard.

The weighted average number of ordinary shares outstanding during the period and for all periods presented shall be adjusted for events, other than the conversion of potential ordinary shares that have changed the number of ordinary shares outstanding without a corresponding change in resources.

ii) Diluted earnings per share

Diluted earnings per share shall be calculated by an entity by adjusting profit or loss attributable to ordinary equity holders of the parent entity, and the weighted average number of shares outstanding, for the effects of all dilutive potential ordinary shares.

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

For the purpose of calculating diluted earnings per share, the number of ordinary shares shall be the weighted average number of ordinary shares calculated in accordance with paragraphs 19 and 26, plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares.

Potential ordinary shares shall be treated as dilutive when, and only when, their conversion to ordinary shares would decrease earnings per share or increase loss per share from continuing operations.

An entity uses profit or loss from continuing operations attributable to the parent entity as the control number to establish whether potential ordinary shares are dilutive or anti-dilutive. In determining whether potential ordinary shares are dilutive or anti-dilutive, each issue or series of potential ordinary shares is considered separately rather than in aggregate.

3.8 IND AS 34 INTERIM FINANCIAL REPORTING

Q13. What is IFR? Explain the need and objective of IFR.

Ans : (Jan.-20)

Interim financial reporting is the reporting for periods of shorter than a full financial year, generally for a period of three months or quarterly results. The companies are required to publish the financial results on a quarterly basis.

As per this Standard, Interim Financial Report means a financial report containing either a complete set of financial statement or set of condensed financial statement for an interim period. Interim period is a period of reporting shorter than a full financial year.

Need and Objective

Timely and reliable interim financial reporting improves the ability of users to understand an entity's capacity to generate earnings and cash flows and its financial condition and liquidity.

In general the basic objective of Interim Financial Reporting (IFR) is to provide frequent and timely assessment of entity's performance. However interim reporting has inherent limitation, which is not the case of annual accounts as the reporting period is shortened, the effect of errors in estimations and allocation are magnified. The proper allocation of operation expenses is a significant concern. The main problems are:

- Proper allocation of operating expenses.
- Some operating expenses may be incurred in one interim period and yet benefit the full year operation. For example, advertising expenses, repair and maintenance expenses.
- Seasonal fluctuation - for some entities revenue may be seasonal or cyclical and therefore concentrated in certain interim period.
- Year-end events. For example-Bonus, Incentive based on target.
- Determination of appropriate amount of provision - pension, gratuity, litigation, contingencies etc.

- Income-tax expenses - one interim period may have profit and next interim period may have losses.

The objective of this standard is to prescribe the minimum content of Interim Financial Report (IFR) and to prescribe the principles for recognition and measurement in a complete or condensed financial statement for an interim period.

Q14. Explain the principles of recognition and measurement.

Ans :

As the objective of this Standard is to prescribe the principle for recognition and measurement of income, expenses, assets and liabilities in a complete or condensed financial statements *ie.* Balance Sheet, Statement of profit and loss, Statement of Cash flow and Accounting Notes and Policies, there may be two distinctive principles/views of recognition and measurement of income and expenses in interim financial reporting:

- (i) Integral View
- (ii) Discrete View

(i) Integral view

This approach treats the interim period as a component/part of the full year. Under this approach, items are allocated to interim periods based on estimates of the total amount for the full year. Costs and expenses are accrued or deferred between interim periods to 'smooth' the results across the year. In practice a full 'integral' approach would involve creating a separate series of accounting standards for interim financial reporting to formalize the criteria to be used for estimating the full year out-turn, dealing with uncertainty and other issues.

(ii) Discrete view

An approach to view the interim period in essentially the same manner as a full year, figures are calculated and accruals and estimates made in exactly the same manner as would be the case at the year end.

Ind AS-34 resolves the debate by prescribing the discrete view in general. As per the Standard, income and expenses should be recognized/

measured on year to date basis for interim reporting. Year to date basis means financial reporting for the period, which begins on the first day of the fiscal and year ends on given interim date.

Ind AS-34 requires that an entity apply the same accounting policies in its interim financial statements as in its annual statements may seem to suggest that interim period measurements are made as if each interim period stands alone as an independent reporting period. However, by providing that the frequency of an entity's reporting shall not affect the measurement of its annual results, Year-to-date measurements may involve changes in estimates of amounts reported in prior interim periods of the current financial year. But the principles for recognizing assets, liabilities, income, and expenses for interim periods are the same as in annual financial statements.

Q15. Explain the form and content of interim financial statements.

Ans :

An interim financial report can contain either a complete set of financial "Statements or a set of condensed financial statements.

Complete financial statements

If an entity opts to prepare and presents a complete set of financial statements in the interim financial reporting. It should be prepared in the same format and as per the contents and requirements of annual financial statements.

Condensed financial statements

A condensed interim financial reporting should contain the following minimum information:

- Headings and sub-totals that was included. In the most recent annual financial statements
- Selected Explanatory Notes
- Additional items or notes if there omission makes the interim financial reporting misleading

- Basic and diluted earning per share for the interim period as per Ind AS-33 (not to be annualized) (on the face Statement of profit and loss)

Selection of explanatory notes

Criteria adopted for selection of explanatory notes to be included in interim financial report is updating the financial information, it is assumed that the users of interim financial report are having access to the most recent annual financial statements therefore notes to interim financial report should provide information on financial year to date basis. However it is necessary to disclose any events or transactions, which are material for understanding the interim financial reporting.

The reporting entity

If the reporting entity's most recent annual financial statements were prepared on a consolidated basis, then the interim report should be prepared on the same basis. To publish an interim report that dealt only with the reporting entity and not with its subsidiaries would not be consistent or comparable with the most recent annual financial statements. If the most recent consolidated financial statements included the parent entity's financial statements then the interim financial report may, but is not required, to do so.

Q16. Define materiality.

Ans :

Materiality is one of the most fundamental concepts underlying financial report; therefore Standard provides that in deciding how to recognize measure, classify or disclose an item for interim financial reporting purposes, materiality should be assessed in relation to the interim period financial data.

Information is material if its misstatement that is omission or error could influence the economic decisions of users taken on the basis of the financial information.

The overriding objective is to ensure that an interim financial report includes all information that is relevant to understanding an entity's financial position and performance during the interim period.

3.9 IND AS 36 IMPAIRMENT OF ASSETS

Q17. Explain briefly about Ind As 36 ?

Ans :

The objective of Ind AS 36 is to prescribe the procedures that an entity applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and the Standard requires the entity to recognize an impairment loss. The Standard also specifies when an entity should reverse an impairment loss and prescribes disclosures.

An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset. However, irrespective of whether there is any indication of impairment, an entity shall also:

(a) test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment annually by comparing its carrying amount with its recoverable amount. This impairment test may be performed at any time during an annual period, provided it is performed at the same time every year. Different intangible assets may be tested for impairment at different times. However, if such an intangible asset was initially recognized during the current annual period, that intangible asset shall be tested for impairment before the end of the current annual period.

(b) test goodwill acquired in a business combination for impairment annually in accordance with the Standard.

If there is an indication that an asset may be impaired, recoverable amount shall be estimated for individual asset. If it is not possible to estimate the recoverable amount of the individual asset, the entity shall determine the recoverable amount of the cash generating unit to which the asset belongs (the asset's cash generating unit).

A cash-generating unit is the smallest identifiable group of assets that generates cash inflows

that are largely independent of the cash inflows from other assets or groups of assets.

Measuring cash generating unit

The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs of disposal and its value in use.

It is not always necessary to determine both an asset's fair value less costs of disposal and its value in use. If either of these amounts exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Costs of disposal are incremental costs directly attributable to the disposal of an asset or cash-generating unit, excluding finance costs and income tax expense.

Value in use is the present value of the future cash flows expected to be derived from an asset or cash-generating unit.

The following elements shall be reflected in the calculation of an asset's value in use:

- (a) An estimate of the future cash flows the entity expects to derive from the asset;
- (b) Expectations about possible variations in the amount or timing of those future cash flows;
- (c) The time value of money, represented by the current market risk-free rate of interest;
- (d) The price for bearing the uncertainty inherent in the asset; and
- (e) Other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.

Estimates of future cash flows shall include:

- (a) Projections of cash inflows from the continuing use of the asset;
- (b) Projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset (including cash outflows to prepare the asset

for use) and can be directly attributed, or allocated on a reasonable and consistent basis, to the asset; and

- (c) net cash flows, if any, to be received (or paid) for the disposal of the asset at the end of its useful life.

Future cash flows shall be estimated for the asset in its current condition. Estimates of future cash flows shall not include estimated future cash inflows or outflows that are expected to arise from:

- (a) a future restructuring to which an entity is not yet committed; or
- (b) improving or enhancing the asset's performance.

Estimates of future cash flows shall not include:

- (a) cash inflows or outflows from financing activities; or
- (b) income tax receipts or payments.

Recognizing and measuring an impairment loss

If, and only if, the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable amount. That reduction is an impairment loss.

An impairment loss shall be recognized immediately in profit or loss, unless the asset is carried at revalued amount in accordance with another Standard (for example, in accordance with the revaluation model in Ind AS 16). Any impairment loss of a revalued asset shall be treated as a revaluation decrease in accordance with that other Standard.

An impairment loss shall be recognized for a cash-generating unit (the smallest group of cash-generating units to which goodwill or a corporate asset has been allocated) if, and only if, the recoverable amount of the unit (group of units) is less than the carrying amount of the unit (group of units). The impairment loss shall be allocated to reduce the carrying amount of the assets of the unit (group of units) in the following order:

- (a) first, to reduce the carrying amount of any goodwill allocated to the cash-generating unit (group of units); and
- (b) then, to the other assets of the unit (group of units) pro rata on the basis of the carrying amount of each asset in the unit (group of units).

However, an entity shall not reduce the carrying amount of an asset below the highest of:

- (a) its fair value less costs of disposal (if measurable);
- (b) its value in use (if determinable); and
- (c) zero.

The amount of the impairment loss that would otherwise have been allocated

to the asset shall be allocated pro rata to the other assets of the unit (group of units).

Goodwill

For the purpose of impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be allocated to each of the acquire's cash-generating units, or groups of cash-generating units, that is expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquire are assigned to those units or groups of units.

The annual impairment test for a cash-generating unit to which goodwill has been allocated may be performed at any time during an annual period, provided the test is performed at the same time every year. Different cash generating units may be tested for impairment at different times. However, if some or all of the goodwill allocated to a cash-generating unit was acquired in a business combination during the current annual period, that unit shall be tested for impairment before the end of the current annual period.

The Standard permits the most recent detailed calculation made in a preceding period of the recoverable amount of a cash-generating unit to which goodwill has been allocated to be used in the impairment test of that unit in the current period provided specified criteria are met.

Reversing an impairment loss

An entity shall assess at the end of each reporting period whether there is any indication that an impairment loss recognized in prior periods for an asset other than goodwill may no longer exist or may have decreased. If any such indication exists, the entity shall estimate the recoverable amount of that asset.

An impairment loss recognized in prior periods for an asset other than goodwill shall be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. A reversal of an impairment loss for a cash generating unit shall be allocated to the assets of the unit, except for goodwill, pro rata with the carrying amounts of those assets.

A reversal of an impairment loss for an asset other than goodwill shall be recognized immediately in profit or loss, unless the asset is carried at revalued amount in accordance with another Indian Accounting Standard (for example, the revaluation model in Ind AS 16). Any reversal of an impairment loss of a revalued asset shall be treated as a revaluation increase in accordance with that other Indian Accounting Standard.

An impairment loss recognized for goodwill shall not be reversed in a subsequent period.

3.10 IND AS 37 PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS
Q18. Define

i) Provision, ii) Liability

iii) Present Obligation

Ans :

(i) Provisions

Provisions are liabilities of uncertain timing or amount. To become a provision first it should be a liability which can be measured only by using a substantial degree of estimation.

(ii) Liability

A liability is present obligation of the entity arising from past events the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

(iii) Present obligation

An obligation is a present obligation if based on evidence available its existence on the balance sheet date is considered probable i.e. More likely than not. A present obligation exists when the entity has no realistic alternatives but to make the transfer of economic benefits because of past obligating event.

The term 'Probable' is prone to subjective evaluation, somebody may say that chances under particular situation for an outcome is more than 70%, it is probable but some other may say if chance of occurrence or non occurrence is 50% or more, it is probable. As per US GAAP "Probable" indicates "Likely to occur".

Example of Provision - Induga Electronics Ltd. manufactures and sells the TV sets under the terms of the contract of sale, the manufacturer undertakes to make good by repairs or replacement, manufacturing defect that become apparent within three years from the date of the sale. By experience it is probable (more likely than not) that there will be some claims under the warranties.

Whether provision for warranties is required or not as per Ind AS-37. Yes, it is required because:

- There is present obligation as a result of past obligating event- the past event is the sale of the TV set, which gives rise to present obligation
- An outflow of resources embodying economic benefits in settlement is probable for the warranties as a whole in the form of repairs, replacement which will cause outflow resources.
- No doubt for recognition of provision, reliable estimate of warranties has to be made based on the past experience and relevant situations.

Q19. What is contingent liability?

Ans :

As per the Ind AS, a contingent liability is a possible obligation that arises from past event and existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control

of the entity. To be called Contingent Liability the following conditions must be fulfilled:

- Possible obligation as a result of past event.
- Existence of which will be confirmed only by the occurrence or non-occurrence of future event.
- Future event not wholly within the control of the entity.

Possible obligation

An obligation is a possible obligation if based on the evidence available, its existence at the balance sheet date is considered not probable.

It must be noted that for contingent liability the existence of possible obligation should be 'Not Probable' whereas for 'Provisions' it should be 'Probable'.

Present Obligation presented as a contingent liability

In the following two situations even present obligations as against possible obligation can be recognized as contingent liability:

- Where there is remote possibility of an outflow of resources embodying economic benefits to settle the obligation.
- The reliable estimates of the amount of present obligation cannot be made.

Disclosure of Contingent Liabilities

An entity shall not recognize a contingent liability but only to disclose the same in the financial statements. The amount of contingent liabilities is disclosed at best estimate of the expenditure required to settle possible obligation. Where the effect of the time value of money is material, the amount of contingent liabilities shall be disclosed at present value.

Q20. Explain briefly about contingent asset.

Ans :

As per Ind AS-37, contingent asset is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within control of the entity.

To be called a 'Contingent Asset' the following conditions must be fulfilled:

- Possible asset as a result of past events.
- Existence of contingent assets is to be confirmed by occurrence and non-occurrence of one or more future events.
- Future event not wholly within the control of the entity.

Disclosure of Contingent Assets

An entity shall not recognize a contingent asset but only to disclose the same in the financial statements. The amount of contingent assets is disclosed at best estimate of the realizable value of the contingent assets. Where the effect of the time value of money is material, the amount of contingent assets shall be disclosed at present value.

Recognition of Provisions

Provision should be recognized in books when the following conditions are satisfied:

- Entity has a present legal or constructive obligation as a result of past events.
- Present obligation must exist on balance sheet date.
- Present obligation must be probable causing outflow of resources embodying economic benefits.
- No provision for cost that needs to be incurred to operate in the future or future operating losses.
- It is not necessary to identify the party to whom obligation is owed - it may be public at large.
- When obligation arises due to changes in the law, provisions should be recognized only when the legislation is virtually certain to be enacted.
- When there are a number of similar obligations (example - product warranties) to consider the outflow of resources 'probable' the class of obligation as a whole should be taken and 'probable' outflow of resources should not be considered on case-to-case basis.

- It is necessary that reliable estimate of the obligation can be made. In other words if amount cannot be estimated reliably, provision cannot be recognized.
- No provision for that future expenditure which can be avoided by future action is made because there is present obligation for that future expenditure.
- Future operating cost not recognized - Financial statements deal with the financial position of an entity at the end of its reporting period and not possible position in the future. Therefore, no provision is recognized for costs that need to be incurred to operate in the future.

3.11 IND AS 38 INTANGIBLE ASSETS

Q21. What is an Intangible asset?

Ans :

The general meaning of 'intangible' is 'without physical substance'. There are some assets that may not have a physical substance, but are still a valuable resource for an entity. They enable for business to run and earn profit in the same manner as tangible assets do.

Before discussing intangible assets, it is imperative to know the meaning of 'asset' in accounting. To become an asset it should be:

- Controlled by an entity as a result of past events and,
- From which future economic benefits are expected to flow to the entity.

Definition of Intangible Asset

Intangible asset is an identifiable non-monetary asset without physics substance. Thus the intangible asset has the following characteristics:

- i) Identifiability
- ii) As asset controlled by an entity
- iii) Future economic benefits

i) Identifiability

The intangible asset must be separate i.e., it should be capable of being separated from the entity, and sold/transferred.

For example, Import license can be separated from the entity and sold.

When the asset arise from contractual or other legal rights, regardless of whether the asset is separable and transferable or not. For example, Landing rights for aircraft were awarded by the government to Jet Airways, an aviation company. As per the terms of the agreement, these rights are not transferable. They are intangible assets even if they are not transferable.

ii) Controlled by an entity Control means:

- Power to obtain future economic benefits; and
- Power to restrict the access of others to those benefits

Thus power normally stems from a legal right e.g. copyright, but the legal right is not a necessary condition, because an entity may be able to control the future economic benefit in some other way.

For Example, expenditure incurred in obtaining market and technical knowledge, increasing the staff skills and building customer loyalty may be expected to generate future economic benefits. However, control over the actions of employees and customers is unlikely to be sufficient to meet the definition criterion especially where there are noncontractual rights.

An entity may seek to protect the technical talent or knowledge of certain skilled staff by including a "non-compete" or 'restraint of trade' clause into their contracts of employment.

iii) Future economic benefits

These may be seen by any one of the following ways:

- Revenue from the sale of products and services
- Cost savings
- Other benefits resulting from the use of an asset

For Example, Bright Co. manufactures automobiles components. It acquires an item of Japanese technical know-how. After the use of this know-how in the production process, the cost of production is expected to be reduced in future. The technical know-how is an intangible asset.

Q22. Explain different types of intangible asset.

Ans :

Market related

- Trademarks, trade names
- Service marks, collective marks, certification marks
- Trade dress (unique colour, shape or package design)
- Newspaper mastheads
- Internet domain names
- Non-competition agreement

Customer related

- Customer lists
- Order or production backlog
- Customer contracts and related customer relationships
- Non-contractual customer relationships

Artistic related

- Plays, operas, ballets
- Books, magazine, newspapers, other literacy works
- Musical works such as compositions, song lyrics, advertising jingles
- Pictures, photographs
- Video and audio visual material including motion pictures, music videos, TV programmes

Contract base

- Licensing, royalty, standstill agreement
- Advertising, construction, management, service or supply contracts

- Lease agreements
- Construction permits
- Franchise agreements
- Operating and broadcast rights
- Use right such as drilling, water, air, mineral, timber cutting and route authorities
- Service contracts (for example, mortgage servicing contracts)
- Employment contract Technology based
- Patent technology
- Research and development
- Computer software and mask works
- Unpatented technology
- Databases including title plants
- Trade secrets such as secret formulas, processes, recipes.

Q23. What is the cost of Intangible asset?

Ans :

The cost of acquisition depends on the way the intangible asset is acquired:

Separate acquisition -When an intangible asset is acquired separately, its cost can be measured separately. Its cost consists of purchase price, any import duties and non-refundable purchase taxes and directly attributable expenses.

Deferred payments are included at the cash price equivalent and the difference between this amount and the payments made are treated as interest.

The cost cannot be included are:

- Costs of introducing new products or services, such as advertising
- Costs of conducting new business
- Administration costs and other general overheads cost
- Costs incurred while an asset that is ready for use is awaiting deployment
- Costs of redeployment of an asset

- Initial operating losses incurred from operation.

Business combination- The cost of an intangible asset acquired in a business combination is its fair value at the date of acquisition, irrespective of whether the intangible asset had been recognized by the acquire before the business combination.

The fair value of intangible assets acquired in business combination can normally be measured with sufficient reliability to be recognized separately from goodwill.

There is a rebuttable presumption that if the intangible asset has a finite useful life, its fair value can be measured reliably

Fair value at the date of the acquisition might be measured using:

- The current bid price in an active market (where one exists)
- The price of the most recent, similar transactions for similar assets
- Multiples applied to relevant indications such as earnings
- Discounted future net cash flows

Although an intangible asset acquired as part of the business combination may meet the recognition criteria, this may only be possible if it is considered to be part of a related tangible or intangible asset.

- **Government grant** - Sometimes an entity acquires an intangible in the form of license to operate Radio or T.V. station, Telecom operation right, Import quotas etc. free of cost or at nominal value. As per Ind AS-20 'Accounting for Government Grant and Disclosure of Govt. Assistance', non-monetary assets acquired free of cost should be recognized at fair value.
- **Exchange of assets** - The cost of an intangible asset acquired in exchange for a non-monetary asset (or a combination of monetary and non-monetary assets) is measured at fair value unless:
 - The exchange transaction lacks commercial substance; or

- The fair value of neither the asset received nor the asset given up is reliably measurable.

Q24. Explain measurement after recognition of intangible asset.

Ans :

i) Cost model

An intangible asset shall be carried at cost less any accumulated amortization and any accumulated impairment losses.

ii) Revaluation model

An intangible asset shall be carried at revalued amount, being fair value at the date of the revaluation less any subsequent accumulated amortization and any accumulated impairment losses.

- If an entity chooses the revaluation model as accounting policy for intangible assets then all the other assets in its class shall also be accounted for using the same model unless there is no active market for those assets.
- Fair value must be determined by reference to an active market. This is different to the treatment of revaluation under Ind AS-16 where depreciated replacement cost can be used when there is no evidence of market value.
- Revaluation must be sufficiently regular that carrying amount is not materially different from fair value.
- The revaluation model does not allow:
 - The revaluation of intangible assets that have not previously been recognized as assets;
 - The initial recognition of intangible assets at amount other than their cost.
- If as a result of revaluation the carrying amount of intangible asset is increased, the increase shall be recognized in Other Comprehensive Income (OCI) and accumulated in equity under the heading of "Re-valuation Surplus".

- If as a result of revaluation the carrying amount of intangible asset is decreased, the decrease shall be recognized in profit and loss.
- Revaluation surplus included in equity may be transferred directly to the retained earnings when the surplus is realized on the retirement or disposal of an asset.

Q25. What is Amortization

Ans :

Amortization is the process of allocating an amount (in the case of intangible assets) to expense over the period of useful life. As we provide the depreciation on the Property, Plant and Equipment (fixed assets), this process of providing depreciation is called amortization in case of intangible assets.

Factors

- Expected usage of the asset by the entity
- Typical product life cycles for the asset
- Public information on estimates of useful lives of similar types of assets that are similarly used
- Technical, technological, commercial or other obsolescence
- Expected actions by competitors or potential competitors.

3.12 IND AS 40 INVESTMENT PROPERTY

Q26. Explain briefly about Ind As 40.

Ans :

Ind AS 40, Investment Property

The objective of Ind AS 40 is to prescribe the accounting treatment for investment property and related disclosure requirements.

Investment property is property (land or a building—or part of a building—or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:

- (a) use in the production or supply of goods or services or for administrative purposes; or
- (b) sale in the ordinary course of business.

Recognition

Investment property shall be recognized as an asset when, and only when:

- (a) it is probable that the future economic benefits that are associated with the investment property will flow to the entity; and
- (b) the cost of the investment property can be measured reliably.

Measurement at recognition

An investment property shall be measured initially at its cost. Transaction costs shall be included in the initial measurement.

The initial cost of a property interest held under a lease and classified as an investment property shall be as prescribed for a finance lease by paragraph 20 of Ind AS 17, i.e., the asset shall be recognised at the lower of the fair value of the property and the present value of the minimum lease payments.

An equivalent amount shall be recognised as a liability in accordance with that same paragraph.

Measurement after recognition

The Standard permits an entity to adopt as its accounting policy the cost model prescribed in paragraph 56 of the Standard to all of its investment property. However, the Standard requires all entities to measure the fair value of investment property, for the purpose of disclosure.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See Ind AS 113, Fair Value Measurement).

Cost model

After initial recognition, an entity shall measure all of its investment properties in accordance with Ind AS 16's requirements for cost model, other than those that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations. Investment properties

that meet the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale) shall be measured in accordance with Ind AS 105.

Disposals

An investment property shall be recognized (eliminated from the balance sheet) on disposal or when the investment property is permanently withdrawn from use and no future economic benefits are expected from its disposal.

Gains or losses arising from the retirement or disposal of investment property shall be determined as the difference between the net disposal proceeds and the carrying amount of the asset and shall be recognised in profit or loss (unless Ind AS 17 requires otherwise on a sale and leaseback) in the period of the retirement or disposal.

The amount of consideration to be included in the gain or loss arising from the derecognition of an investment property is determined in accordance with the requirements for determining the transaction price in Ind AS 115. Subsequent changes to the estimated amount of the consideration included in the gain or loss shall be accounted for in accordance with the requirements for changes in the transaction price in Ind AS 115.

Compensation from third parties for investment property that was impaired, lost or given up shall be recognised in profit or loss when the compensation becomes receivable

3.13 IND AS 41 AGRICULTURE

Q27. What do you understand by Ind AS 41?

Ans :

Introduction

Traditionally all agriculture activities were accounted for at historical cost. As a result, gains were accounted for only on the sale of agricultural produce to a customer. There was a lot of diversity in accounting for agricultural activities, as assets related to agricultural activities and changes in those assets were excluded from the scope of international accounting standards.

There was a greater need of financial statements based on sound and generally acceptable principles.

Objective

The main objective of Ind AS-41 is to establish accounting standards for agricultural activity. This Standard applies to:

- Biological assets,
- Agricultural produce at the point of harvest, and
- Government grants.

This Standard does not apply to:

- land related to agricultural activity (see Ind AS 16 Property, Plant and Equipment and Ind AS 40 Investment Property);
- Bearer plants related to agricultural activity (see Ind AS 16). However, this Standard applies to the produce on those bearer plants.
- Government grants related to bearer plants (see Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance).
- Intangible assets related to agricultural activity (see Ind AS 38 Intangible Assets).

Definitions of Key Terms

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

- **Agricultural activity** is the management by an entity of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets.
- **Agricultural produce** is the harvested product of the entity's biological assets.
- **A bearer plant** is a living plant that:
 - (a) is used in the production or supply of agricultural produce;
 - (b) is expected to bear produce for more than one period; and

(c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.

- **A biological asset** is a living animal or plant.
- **Biological transformation** comprises the processes of growth, degeneration, production, and procreation that cause qualitative or quantitative changes in a biological asset.
- **Costs to sell** are the incremental costs directly attributable to the disposal of an asset, excluding finance costs and income taxes.
- **A group of biological assets** is an aggregation of similar living animals or plants.
- **Harvest** is the detachment of produce from a biological asset or the cessation of a biological asset's life processes.

The following are not bearer plants:

- Plants cultivated to be harvested as agricultural produce (for example, trees grown for use as lumber);
- Plants cultivated to produce agricultural produce when there is more than a remote likelihood that the entity will also harvest and sell the plant as agricultural produce, other than as incidental scrap sales (for example, trees that are cultivated both for their fruit and their lumber); and
- Annual crops (for example, maize and wheat).

When bearer plants are no longer used to bear produce they might be cut down and sold as scrap, for example, for use as firewood. Such incidental scrap sales would not prevent the plant from satisfying the definition of a bearer plant.

Produce growing on bearer plants is a biological asset.

Recognition and Measurement

An entity should recognize a biological asset or agricultural produce when the entity:

- Controls the asset as a result of past events;
- It is probable that future economic benefits will flow to the entity;

- The fair value or cost of the asset should be able to be measured reliably.

Any biological asset should be measured initially and at each balance sheet date, at its fair value less estimated cost to sell. The only exception to this is where the fair value cannot be measured reliably.

Agricultural produce should be measured at fair value less cost to sell at the point of the harvest. Unlike a biological asset, there is no exception in cases in which fair value cannot be measured reliably. According to Ind AS-41, agricultural produce can always be measured reliably. Cost to sell includes brokers' and dealers' commissions, any levies by regulatory authorities and commodity exchanges, and any transfer taxes and duties. They exclude transport and other costs necessary to get the assets to a market.

In deciding on the fair value for a biological asset or agricultural produce, it is possible to group together items in accordance with, for example, their age or quality. Entities often contract to sell their biological assets or produce at a future date. These contract prices do not necessarily represent fair value. Therefore, the fair value of a biological asset or produce is not necessarily adjusted because of the existence of a contract. In many cases, these contracts may in fact be onerous contracts, as defined in Ind AS-37. If an active market exists for the asset or produce, then the price in that market may be the best way of determining fair value.

If an entity has access to different active markets, then the entity will choose the most relevant and reliable price that is the one at which it is most likely to sell the asset.

If an active market does not exist, then these methods can be used to determine fair value:

- The most recent market transaction price
- Market prices for similar assets after adjustment to reflect any differences in the asset

- Any benchmarks within the sector, such as the value of cattle per kilogram.

In some cases, market prices or values may not be available for an asset in its present condition. In these cases, the entity can use the present value of the expected net cash flow from the asset discounted at a current market pretax rate. In some circumstances, costs may be an indicator of fair value, especially where little biological transformation has taken place or the impact of biological transformation on the price is not expected to be significant.

Gain and Losses

Any gain on the initial recognition of biological assets at fair value less cost to sell and any changes in the fair value less cost to sell of biological assets during the reporting period are included in profit or loss for the period. Any gain on the initial recognition of agricultural produce at fair value less cost to sell will be included in profit or loss for the period to which it relates. All costs related to biological assets that are measured at fair value are recognized in profit or loss when incurred, except for costs to purchase biological assets.

The Standard does not explicitly prescribe how to account for subsequent expenditure related to biological assets. A gain or loss can, therefore, arise when an animal is born, plants and animals grow, plants are harvested, or animals generate agricultural produce. Losses can arise on the initial recognition of the purchase of animals, as their fair value less cost to sell are likely to be less than the purchase price plus any transaction and transportation costs.

Fair Value Reliability

Ind AS- 41 presumes that fair value can be measured reliably for a biological asset. However, it is possible that this presumption can be rebutted for a biological asset that, when it is first recognized, does not have a quoted market price in an active market and for which other valuation methods are clearly inappropriate or unworkable. In this case, the asset is measured at cost less accumulated depreciation and any impairment losses. All the other biological assets of the entity still must be measured at fair value. If circumstances do change and fair value becomes reliably measurable, then the entity must switch its valuation method to fair value less cost to sell.

If a non-current biological asset meets the criteria to be classified as held for sale or is included in a disposal group in accordance with Ind AS-105, then it is presumed that fair value can be measured reliably.

Short Question & Answers

1. Define substantial period.

Ans :

The "substantial period" of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of 12 months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of facts and circumstances of the case. In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale should be considered. The following assets ordinarily take twelve months or more to get ready for intended use or sale unless the contrary can be proved by the enterprise:

- (a) Assets that are constructed or otherwise produced for an enterprise's own use, e.g. assets constructed under major capital expansions
- (b) Assets intended for sale or lease that are constructed or otherwise produced as discrete projects (for example, ships or real estate developments). In case of inventories, substantial period time is considered to be involved where time is the major factor in bringing about a change in the condition of inventories. For example, liquor is often required to be kept in store for more than twelve months for maturing.

2. Joint Venture.

Ans :

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

Earlier the accounting for investment in joint ventures was based on the concept of control and therefore, proportionate consolidation method was being applied to consolidate the assets and liabilities of the investee entity.

Now the equity method is applied to an investment in a joint venture since the investor has an interest in the net assets of the joint venture. The

investor has no direct interest in the underlying assets or liabilities of the venture and can therefore not recognize such assets or liabilities through proportionate consolidation method.

3. What is hyperinflation?

Ans :

The distortion in understanding the financial position and results of operations becomes more serious when there is rampant/hyperinflation in the economy.

In a hyperinflationary economy, reporting of operating results and financial position in the local currency without restatement is not useful. Money loses purchasing power at such a rate that comparison of amounts from transactions and other events that have occurred at different times, even within the same accounting period, is misleading.

- Where the preference is to keep wealth in non-monetary assets or in a stable foreign currency. Any local currency would be immediately invested in order to attempt to maintain its purchasing power.
- Where prices are quoted in a stable foreign currency and the population regards monetary amounts in that currency, as effectively a local currency.
- Where transactions are priced at an amount that includes compensation for the future expected loss of the purchasing power of the local currency. This characteristic would be taken into account even if the credit period is quite short.
- Where prices, wages, and interest rates are closely linked to a price index
- Where cumulative inflation rates over a period of three years approaches or exceeds 100%

4. What is earning per share?*Ans :*

Earnings Per Share (EPS) is a financial ratio that gives the information regarding earning available to each equity/ordinary share. It is very important financial ratio for assessing the performance of the company. A company must be able to sustain its earnings in order to dividend to its shareholders and reinvest in the business so as to achieve future growth. Investors also look for growth in EPS from one year to the next. The EPS is a figure based on past data and it can be easily manipulated by change in accounting policies and by merger and acquisition. The chances of manipulation increases when incentive to hire management is based on EPS and resultant share prices in the market. To minimize the manipulation in the EPS there is a need of standard which will prescribes the computation of EPS.

5. Diluted earnings per share.*Ans :*

Diluted earnings per share shall be calculated by an entity by adjusting profit or loss attributable to ordinary equity holders of the parent entity, and the weighted average number of shares outstanding, for the effects of all dilutive potential ordinary shares.

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

For the purpose of calculating diluted earnings per share, the number of ordinary shares shall be the weighted average number of ordinary shares calculated in accordance with paragraphs 19 and 26, plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares.

6. What is IFR?*Ans :*

Interim financial reporting is the reporting for periods of shorter than a full financial year, generally for a period of three months or quarterly results. The companies are required to publish the financial results on a quarterly basis.

As per this Standard, Interim Financial Report means a financial report containing either a complete set of financial statement or set of condensed financial statement for an interim period. Interim period is a period of reporting shorter than a full financial year.

7. Define materiality.*Ans :*

Materiality is one of the most fundamental concepts underlying financial report; therefore Standard provides that in deciding how to recognize measure, classify or disclose an item for interim financial reporting purposes, materiality should be assessed in relation to the interim period financial data.

Information is material if its misstatement that is omission or error could influence the economic decisions of users taken on the basis of the financial information.

The overriding objective is to ensure that an interim financial report includes all information that is relevant to understanding an entity's financial position and performance during the interim period.

8. What is contingent liability?*Ans :*

As per the Ind AS, a contingent liability is a possible obligation that arises from past event and existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. To be called Contingent Liability the following conditions must be fulfilled:

- Possible obligation as a result of past event.
- Existence of which will be confirmed only by the occurrence or non-occurrence of future event.
- Future event not wholly within the control of the entity.

9. What is an intangible asset?

Ans :

The general meaning of 'intangible' is 'without physical substance'. There are some assets that may not have a physical substance, but are still a valuable resource for an entity. They enable for business to run and earn profit in the same manner as tangible assets do.

Before discussing intangible assets, it is imperative to know the meaning of 'asset' in accounting. To become an asset it should be:

- Controlled by an entity as a result of past events and,
- From which future economic benefits are expected to flow to the entity.

Definition of Intangible Asset

Intangible asset is an identifiable non-monetary asset without physics substance. Thus the intangible asset has the following characteristics:

- i) Identifiability
- ii) As asset controlled by an entity
- iii) Future economic benefits

10. Different types of intangible asset.

Ans :

Market related

- Trademarks, trade names
- Service marks, collective marks, certification marks
- Trade dress (unique colour, shape or package design)
- Newspaper mastheads
- Internet domain names
- Non-competition agreement

Customer related

- Customer lists
- Order or production backlog
- Customer contracts and related customer relationships
- Non-contractual customer relationships

Artistic related

- Plays, operas, ballets
- Books, magazine, newspapers, other literacy works
- Musical works such as compositions, song lyrics, advertising jingles
- Pictures, photographs
- Video and audio visual material including motion pictures, music videos, TV programmes

Contract base

- Licensing, royalty, standstill agreement
 - Advertising, construction, management, service or supply contracts
 - Lease agreements
 - Construction permits
 - Franchise agreements
 - Operating and broadcast rights
 - Use right such as drilling, water, air, mineral, timber cutting and route authorities
 - Service contracts (for example, mortgage servicing contracts)
 - Employment contract Technology based
 - Patent technology
 - Research and development
-

11. What is Amortization?

Ans :

Amortization is the process of allocating an amount (in the case of intangible assets) to expense over the period of useful life. As we provide the depreciation on the Property, Plant and Equipment (fixed assets), this process of providing depreciation is called amortization in case of intangible assets.

Factors

- Expected usage of the asset by the entity
- Typical product life cycles for the asset
- Public information on estimates of useful lives of similar types of assets that are similarly used
- Technical, technological, commercial or other obsolescence
- Expected actions by competitors or potential competitors.

Choose the Correct Answers

1. Ind As 41 deals with [a]
(a) Agriculture (b) Earnings per share
(b) Intangible assets (d) Investment Property
2. Ind As 33 deals with [b]
(a) Agriculture (b) Earnings per share
(b) Intangible assets (d) Investment Property
3. Ind As 38 deals with [c]
(a) Agriculture (b) Earnings per share
(b) Intangible assets (d) Investment Property
4. Ind As - 36 applies to which of the following assets ? [d]
(a) Inventories (b) Financial assets
(c) Assets held for sale (d) Property, plant and equipment
5. Asset is impaired when : [d]
(a) Carrying amount is less than the fair value less cost of disposal.
(b) Carrying amount is more than discounted future cash flow
(c) Fair value less cost of disposal is less than value in use
(d) Carrying amounts more than its recoverable amount
6. Value - in - use is : [b]
(a) The market value
(b) The discounted present value of future cash flows arising from use of the asset and from its disposal
(c) The higher of an asset's fair value less cost to sell and its market value.
(d) The amount at which the asset is recognized in the balance sheet
7. If the fair value less costs to sell cannot be determined : [b]
(a) The asset is not impaired
(b) The recoverable amount is the value - in - use
(c) The net realizable value is used
(d) The carrying value of the asset remains the same

8. If assets are to be disposed of : [a]
- (a) The recoverable amount is the fair value less costs to sell
 - (b) The recoverable amount is the value - in - use
 - (c) The asset is not impaired
 - (d) The recoverable amount is the carrying value
9. When calculating the estimates of future cash flows, which of the following cash flows should not be included ? [b]
- (a) Cash flows from disposal
 - (b) Income - tax payments
 - (c) Cash flows from the sale of assets produced by the asset
 - (d) Cash outflows on the maintenance of the asset
10. An impairment loss that relates to an asset that has been revalued should be recognized in : [b]
- (a) Profit or loss
 - (b) Revaluation surplus that relates to the revalued asset.
 - (c) Opening retained profits
 - (d) Any reserve in equity

Fill in the blanks

1. _____ costs are defined as interest and other costs incurred relating to borrowing of funds.
2. An asset which takes substantial period of time to get ready for its intended use or sale, is called _____ asset.
3. _____ is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities.
4. _____ items are already stated in the measuring unit at the balance sheet dates and are therefore not restated.
5. _____ shall be calculated by dividing profit or loss attributable to ordinary equity holders of the parent entity
6. IFR stands for _____
7. _____ are liabilities of uncertain timing or amount.
8. A _____ is present obligation of the entity arising from past events the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
9. The _____ depends on the way the intangible asset is acquired.
10. _____ is the process of allocating an amount to expense over the period of useful life.

ANSWERS

1. Borrowing
2. Qualifying
3. Joint control
4. Monetary
5. Basic earnings per share
6. Interim Financial Reporting
7. Provisions
8. Liability
9. Cost of acquisition
10. Amortization

UNIT IV

INDIAN ACCOUNTING STANDARDS (IND AS-101 to 106) :

Overview of Indian Accounting Standards: (Ind AS 101 to Ind AS 106):

Ind AS-101: First time adoption of Indian Accounting Standards – Ind AS-102: Share based payments – Ind AS-103: Business Combinations – Ind AS -104: Insurance contracts – Ind AS-105: Non-current assets held for sale and discontinued operations – Ind As-106: Exploration for and evaluation of mineral resources.

4.1 IND AS 101 FIRST TIME ADOPTION OF INDIAN ACCOUNTING

Q1. Explain the concept of Ind As 101.

Ans : (Jan.-20, Imp.)

Ind AS 101, First Time Adoption of Indian Accounting Standards

The objective of Ind AS 101 is to ensure that an entity's first Ind AS financial statements, and its interim financial reports for part of the period covered by those financial statements, contain high quality information that:

- (a) is transparent for users and comparable over all periods presented;
- (b) provides a suitable starting point for accounting in accordance with Ind AS; and
- (c) can be generated at a cost that does not exceed the benefits.

An entity shall apply the Standard in its first Ind AS financial statements and each interim financial report, if any, that it presents in accordance with Ind AS 34 for part of the period covered by its first Ind AS financial statements.

An entity shall prepare and present an opening Ind AS Balance Sheet at the date of transition to Ind AS. This is the starting point for its accounting in accordance with Ind AS.

Accounting policies

An entity shall use the same accounting policies in its opening Ind AS Balance Sheet and throughout all periods presented in its first Ind AS

financial statements. Those accounting policies shall comply with each Ind AS effective at the end of its first Ind AS reporting period, except as specified in Ind AS 101.

An entity shall, in its opening Ind AS Balance Sheet:

- (a) recognise all assets and liabilities whose recognition is required by Ind AS;
- (b) not recognise items as assets or liabilities if Ind AS do not permit such recognition;
- (c) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind AS; and
- (d) apply Ind AS in measuring all recognised assets and liabilities.

The accounting policies in opening Ind AS Balance Sheet may differ from those that it used for the same date using previous GAAP. The resulting adjustments arise from events and transactions before the date of transition to Ind AS shall be recognised directly in retained earnings.

This Ind AS establishes two categories of exceptions to the principle that an entity's opening Ind AS Balance Sheet shall comply with each Ind AS:

- (a) Ind AS 101 prohibit retrospective application of some specific aspects of other Ind AS.
- (b) Ind AS 101 grant exemptions from some specific requirements of other Ind AS.

Presentation and Disclosure

The Standard does not provide exemptions from the presentation and disclosure requirements in other Ind AS. The Standard requires that an entity's first Ind AS financial statements shall include at least three Balance Sheets, two Statements of profit and loss, two Statements of cash flows and two Statements of changes in equity and related notes, including comparative information for all statements presented.

Q2. What are the mandatory and optional exceptions for first time adoptions?

Ans :

Mandatory Exemptions

Ind AS-101 offer mandatory exemptions by prohibiting retrospective applications of some aspects of other Ind ASs while preparing the opening Ind AS balance sheet. These are:

- (a) Derecognition of financial assets and financial liabilities
- (b) hedge accounting
- (c) non-controlling interests
- (d) classification and measurement of financial assets
- (e) impairment of financial assets embedded derivatives
- (g) government loans
- (h) Estimates

Optional Exemptions

An entity may elect to use one or more of the following exemptions:

- (a) share-based payment transactions
- (b) insurance contracts
- (c) deemed cost of PPE, intangible assets and investment property
- (d) leases
- (e) cumulative translation differences
- (f) investments in subsidiaries, joint ventures
- (g) assets and liabilities of subsidiaries, associates and joint ventures

- (h) compound financial instruments
- (i) designation of previously recognised financial instruments
- (j) fair value measurement of financial assets or financial liabilities initial recognition
- (k) decommissioning liabilities included in the cost of property, plant and equipment
- (l) financial assets or intangible assets accounted for in accordance with Ind AS-11 Service concession Arrangements
- (m) borrowing costs
- (n) extinguishing financial liabilities with equity instruments
- (o) severe hyperinflation
- (p) joint arrangements
- (q) stripping costs in the production phase of a surface mine
- (r) designation of contracts to buy or sell a non-financial item
- (s) revenue from contracts with customers, and
- (t) non-current assets held for sale and discontinued operations
- (u) Business combination (Ind AS-103) before the date of transition

➤ Deemed Cost for Property, Plant and Equipment

India has provided an additional option in the form of carve out for exemption to use carrying value of all items of Property, plant and equipment on the date of transaction in accordance with the previous GAAP as an acceptable starting point under Ind AS subject to adjustment of decommissioning liability and there is no change in its functional currency on the date of transition to Ind ASs.

This option can also be availed for intangible assets covered by Ind AS 38 and investment property covered by Ind AS 40.

➤ Use of deemed cost for oil and gas assets

If an entity uses the exemption for oil and gas assets, it shall disclose that fact and the basis on which carrying amounts determined under previous GAAP were allocated.

➤ **Use of deemed cost for investments in subsidiaries, joint ventures and associates**

Similarly, if an entity uses a deemed cost in its opening Ind AS Balance Sheet for an investment in a subsidiary, joint venture or associate in its separate financial statements, the entity's first Ind AS separate financial statements shall disclose:

- the aggregate deemed cost of those investments for which deemed cost is their previous GAAP carrying amount;
- the aggregate deemed cost of those investments for which deemed cost is fair value; and
- the aggregate adjustment to the carrying amounts reported under previous GAAP.

From the above transitional provision it is clear that an entity can carry its investment in a subsidiary at fair value but if the company has more than one subsidiaries, all the investment in all subsidiaries has to be valued at fair value. However, it can opt to carry the investment in associate at cost and joint venture also at cost. The vice-versa is also permitted.

➤ **Use of deemed cost for operations subject to rate regulation**

If an entity uses the exemption for operations subject to rate regulation, it shall disclose that fact and the basis on which carrying amounts were determined under previous GAAP.

➤ **Long Term Foreign Currency Monetary Items**

A first-time adopter may continue the policy adopted for accounting for exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP.

➤ **Joint ventures - transition from proportionate consolidation to the equity method**

When changing from proportionate consolidation to the equity method, an entity shall recognise its investment in the joint venture at transition date to Ind ASs. That initial investment shall be measured as the aggregate of the carrying amounts of the assets and liabilities that the entity had previously proportionately consolidated, including any goodwill arising from acquisition.

Q3. What are the major differences between Ind AS-101 and IFRS 1?

Ans :

(Imp.)

- IFRS 1 denotes previous GAAP as the basis to accounting that a first-time adopter used immediately before adopting IFRS. However, Ind AS-101 defines previous GAAP as the basis of accounting that a first-time adopter used for its reporting requirement in India immediately before adopting Ind AS. The change makes it mandatory for Indian entities to consider the financial statements prepared in accordance with existing notified Indian accounting standards as was applicable to them as previous GAAP when it transitions to Ind ASs.
- The first-time adopter shall account for the resulting change in the retained earnings as at the transition date except in certain specific instances where it requires adjustment in the goodwill. In such specific instances where IFRS 1 allows adjustment in the goodwill, under Ind AS-101 it can be adjusted with the Capital reserve to the extent such adjustment amount does not exceed the balance available in Capital reserve.
- Ind AS-101 in addition to exemptions provided under IFRS 1, also provides certain optional exemptions relating to the long-term for-foreign currency monetary items and service concession arrangements relating to toll roads.
- Certain exemptions in IFRS 1 refer to transitional provisions of other IFRSs. However Ind ASs do not provide transitional provisions, accordingly wherever considered an appropriate transitional provision in other IFRSs has been incorporated in the respective exemptions in Ind AS-101.
- Deletion of borrowing cost exemptions not relevant for India: IFRS 1 provides for transitional adjustment requiring companies to apply the provisions of IAS 23 prospectively after the transition date to IFRS. However, this was considered as not relevant in Indian situation as AS-16 always required an entity to capitalize borrowing costs as compared to IAS 23 where it provided an option to expense out such borrowing cost

- **Inclusion/modification of existing exemptions** to make it relevant for India. For example,

1. Paragraph D7AA has been added to provide for transitional relief from the retrospective application of Ind AS 16: Property, Plant and Equipment. Paragraph D7AA, provides an entity option to use carrying values of all such assets as on the date of transition to Ind ASs, in accordance with previous GAAP as an acceptable starting point under Ind AS. Paragraph 27AA has been included in Ind AS 101 which requires the disclosure that if an entity adopts for first time exemption the option provided in accordance with paragraph D7AA, the fact and the accounting policy shall be disclosed by the entity until such time that those items of property, plant and equipment, investment properties or intangible assets, as the case may be, are significantly depreciated, impaired or de-recognised from the entity's Balance Sheet.
2. Paragraph D9AA has been added to provide for transitional relief while applying Ind AS 17: Leases. D9AA provides an entity to use the transition date facts and circumstances for lease arrangements which includes both land and building elements to assess the classification of each element as finance or an operating lease at the transition date to Ind ASs. Also, if there is any land lease newly classified as finance lease then the first time adopter may recognise assets and liability at fair value on that date; any difference between those fair values is recognised in retained earnings.
3. Paragraph D35AA has been added to provide for transitional relief while applying Ind AS 105 - Non-current Assets Held for Sale and Discontinued Operations. Paragraph D35AA provides an entity to use the transitional date circumstances to measure such assets or operations at the lower of carrying value and fair value less cost to sell.

4.2 IND AS 102 SHARE BASED PAYMENT

Q4. Explain briefly about share based payment.

Ans :

Introduction

Transactions whereby entities purchase goods or services from other parties, such as supplier and employees, by issuing shares or share options to those other parties are increasingly common. Share scheme are a common feature of director and executive remuneration and in some countries the authorities may offer tax incentives to encourage more companies to offer shares to employees. Companies whose shares or share options are regarded as a valuable 'currency' commonly use share-based payment to obtain employee and professional services.

The increasing use of share-based payment has raised questions about the accounting treatment of such transactions in company financial statements. If a company pays its employees in cash, an expense is recognized in profit or loss, but if the payment is in share option, expense may not be recognized as there is no cost incurred, as the granting of shares or options does not require to entity to sacrifice cash or other assets.

However, this argument is unsound because it ignores the fact that a transaction has occurred. The employees have provided valuable services to the entity in return for valuable shares or options.

Scope

Ind AS-102 applies to all share-based payment transactions in which an entity acquires or receives goods or services. Good include inventories, consumables, property, plant and equipment, intangible assets and other non-financial assets. There are three types of share-based payments:

- Equity-settled share-based payment transactions,
- Cash-settled share-based payment transactions, and

- Share-based payment transaction with cash alternatives.

This Standard does not apply to:

- Share issued as consideration in a business combination (Ind AS-103 "Business Combination") and
- Certain contract transactions falling within Ind AS-32 "Financial Instruments: Presentation" or Ind AS-109 "Financial Instruments".

Key Terms

i) Fair value

The amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction.

ii) Grant Date

The date at which the entity and another party (including an employee) agree to a share-based payment arrangement, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. At grant date the entity confers on the counterparty the right to cash, other assets, or equity instruments of the entity, provided the specified vesting conditions, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained.

iii) Intrinsic value

The difference between the fair value of the shares to which the counterparty has the (conditional or unconditional) right to subscribe or which it has the right to receive, and the price (if any) the counterparty is (or will be) required to pay for those shares. For example, a share option with an exercise price of ₹ 15, on a share with a fair value of ₹ 20, has an intrinsic value of ₹ 5.

iv) Measurement date

The date at which the fair value the equity instruments granted is measured for the purposes of this Ind AS. For transactions with

employees and others providing similar services, the measurement date is grant date. For transactions with parties other than employees (and those providing similar services), the measurement date is the date the entity obtains the goods or the counterparty renders service.

v) Share Option

A contract that gives the holder the right, but not the obligation, to subscribe to the entity's shares at a fixed or determinable price for a specified period of time.

vi) Vest

To become an entitlement. Under a share-based, payment arrangement, a counterparty's right to receive cash, other assets or equity instruments of the entity vests when the counterparty's entitlement is no longer conditional on the satisfaction of any vesting conditions.

vii) Vesting conditions

A condition that determine whether the entity receives the services that entitle the counterparty to receive cash, other assets or equity instruments of the entity, under a share-based payment arrangement. A vesting condition is either a service condition or a performance condition.

viii) Vesting Period

The period during which all the specified vesting conditions of a share-based payment arrangement are to be satisfied.

Q5. What do you understand by equity settled share based payment transactions?

Ans :

i) Recognition

An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received.

The entity shall recognise a corresponding increase in equity if the goods or services were

received in an equity-settled share-based payment transaction or a liability if the goods or services were acquired in a cash-settled share-based payment transaction.

When the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, they shall be recognised as expenses.

ii) Measurement

The issue here is how to measure the 'cost' of the goods and services received and the equity instruments (e.g. the share options) granted in return.

The general principle in Ind AS-102 is that an entity recognises the goods or services received and the corresponding increase in equity. It should measure these at the fair value of the goods or services received. Where the transaction is with parties other than employees, there is a rebuttable presumption that the fair value of the goods or services received can be estimated reliably.

If the fair value of the goods or services received cannot be measured reliably, the entity should measure their value by reference to the fair value of the equity instruments granted.

Where the transaction is with a party other than an employee, fair value should be measured at the date the entity obtains the goods or the counterparty renders service.

Where shares, share options or the other equity instruments are granted to employees as part of their remuneration package, it is not normally possible to measure directly the services received. For this reason, the entity should measure the fair value of the employee service received by reference to the fair value of the equity instruments granted. The fair value of those equity instruments should be measured at grant date.

iii) Determining the fair value of equity instrument granted

Where a transaction is measured by reference to the fair value for the equity instruments granted, fair value is based on market prices if available, taking into account the terms and conditions upon which those equity instruments were granted.

If market prices are not available, the entity should estimate the fair value of the equity instruments granted using a valuation technique, such as the option pricing model.

iv) Transactions in which services are received

- If the equity instruments granted vest immediately, the counterparty is not required to complete a specified period of service before becoming unconditionally entitled to the equity instruments. It is presumed that the services have already been received (in the absence of evidence to the contrary). The entity should recognise the services received in full with a corresponding increase in equity, on the grant date.
- If the equity instruments granted do not vest until the counterparty completes a specified period of service, the entity should account for those services as they are rendered by the counterparty during the vesting period. For example, if an employee is granted share options on condition that he or she completes 3 years' service, then the services to be rendered by the employee as consideration for the share options will be received in the future, over that 3 year vesting period.
- Estimate of the number of equity instrument expected to vest. The entity should recognise an amount for the goods or services received during the vesting period based on the best available estimate of the number of equity instruments expected to vest. It should revise that estimate if subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates. On vesting date, the entity should revise the estimate to equal the number of equity instrument that actually vest.

Q6. Explain cash settled share based payment transactions.

Ans :

For cash-settled share-based payment transactions, the entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled,

the entity shall re-measure the fair value of the liability at the end of each reporting period and at the date of settlement, with any changes in fair value recognised in profit or loss for the period.

Examples of this type of transaction include:

- Share appreciation rights granted to employees: the employees becomes entitled to the future cash payment (rather than an equity instrument), based on the increase in the entity's share price from a specified level over a specified period of time; or
- An entity might grant to its employees a right to receive a future cash payment by granting to them a right to shares that are redeemable.

The entity should recognise the services received and a liability to pay for those services, as the employees render service. For example, shares appreciation rights do not vest until the employees have completed a specified period of service, the entity should recognise the services received and the related liability over that period.

4.3 IND AS 103 BUSINESS COMBINATIONS

Q7. What is business?

Ans :

Meaning

- (a) A business is an integrated set of activities, and asset conducted and managed for the purpose of providing (a) a return to investors and (b) lower costs or other economic benefits to participants. It generally consists of inputs, processes and resulting outputs that are or will be used to generate revenue.

A business consists of three elements:

- i) **Input** -Any economic resources that creates or can create outputs when one or more processes are applies to it, e.g., non-current assets etc.
- ii) **Process** - Any system, standard, protocol, convention or rule that when applied to an inputs(s), create outputs,

e.g. management processes, workforce, etc.

- iii) **Output** -The result of inputs and processes applied to those inputs that provide or can provide a return in the form of dividend, lower costs or other economic benefits directly to investors or other owners.

- (b) Determining whether a particular set of assets and activities is a busi-ness should be based on whether the integrated set is capable of being conducted and managed as a business by a market participant. Thus, in evaluating whether a particular set is a business, it is not relevant whether a seller operated the set as a business or whether the acquirer intends to operate the set as a business.
- (c) In the absence of evidence to the contrary, a particular set of assets and activities in which goodwill is present shall be presumed to be a business. However, a business need not have goodwill.

Q8. What is business combinations? Explain the accounting for business combination.

Ans :

(Imp.)

A transaction (or) other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as 'true mergers' or 'mergers of equals' are also business combinations as that term is used in this Ind AS.

A business combination is an act of bringing together of separate entities or businesses into one reporting unit. The result of business combination is one entity (the acquirer) obtains control of one or more businesses. If an entity obtains control over other entities which are not businesses, the act is not a business combination.

A business combination in which all the combining entities or businesses are ultimately controlled by the same parties before and after the combination is excluded from the scope of the

business combination, such a transaction is accounted for applying Appendix C to Ind AS-103 by pooling interest method.

From the definition of Business Combination, it is clear that for business combination, the control by one entity of another is sufficient and both the entity may continue to exist which is not the case in AS-14 'Amalgamations'. For example, if X Ltd. acquires 70% shares of Y Ltd., then it is a case of business combination even if X Ltd. and Y Ltd. will continue to exist however X Ltd. becomes a holding (Parent) company of Y Ltd. and therefore, they become one reporting entity by reporting consolidated financial statements.

Accounting for Business Combination

A business combination is accounted for applying acquisition method. Application of acquisition method has the following steps:

- (a) Identifying the acquirer
- (b) Determining the acquisition date
- (c) Recognising and measuring the identifiable assets acquired and liabilities assumed and any non-controlling interest in the acquiree
- (d) Recognising and measurement goodwill or gain from bargain purchase
- (e) Disclosures

(a) Identify the acquirer

Most of the time, it is straightforward - the acquirer is usually the investor who acquires an investment or a subsidiary. The acquiree is the business that the acquirer obtains control of in business combination.

Sometimes, it is not so clear. The most common example is a merger. When two companies merge together and create just one company, the acquirer is usually the bigger one with larger fair value.

While applying the guidance in Ind AS-110 does not clearly indicate which of the combining

entities, is the acquirer, the following factors as described in Ind AS-103 shall be considered in making that determination:

- (i) In a business combination effected primarily by transferring cash or other assets or by incurring liabilities, the acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.
- (ii) In a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issues its equity interests. However, in some business combinations, commonly called 'reverse acquisitions', the issuing entity is the acquiree.
- (iii) The acquirer is usually the combining entity whose relative size (measured in, for example, assets, revenues or profit) is significantly greater than that of the other combining entity or entities.
- (iv) In a business combination involving more than two entities, determining the acquirer shall include a consideration of, among other things, which of the combining entities initiated the combination, as well as the relative size of the combining entities.
- (v) A new entity formed to effect a business combination is not necessarily the acquirer. If a new entity is formed to issue equity interests to effect a business combination, one of the combining entities that existed before the business combination shall be identified as the acquirer. In contrast, a new entity that transfers cash or other assets or incurs liabilities as consideration may be the acquirer.

A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes. The entity whose equity interests are acquired (the legal acquiree) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition. For example, reverse acquisitions sometimes occur when a private operating entity wants to become a public entity but does not want

to register its equity shares. To accomplish that, the private entity will arrange for a public entity to acquire its equity interests in exchange for the equity interests of the public entity. In this example, the public entity is the legal acquirer because it issued its equity interests, and the private entity is the legal acquiree because its equity interests were acquired.

- the public entity as the acquiree for accounting purposes (the accounting acquiree); and
- the private entity as the acquirer for accounting purposes (the accounting acquirer).

The accounting acquiree must meet the definition of a business for the transaction to be accounted for as a reverse acquisition, and all of the recognition and measurement principles in this Ind AS, including the requirement to recognise goodwill, apply.

(b) Determine the acquisition date

The acquisition date is the date on which the acquirer obtains control of the acquiree.

It is generally the date on which the acquirer legally transfers the consideration (the payment for the investment), acquires the assets and assumes the liabilities of the acquiree the closing date.

However, it can be earlier or later than the closing date, too. It depends on the contractual arrangements in the written agreements, if something like that exists.

(c) Recognise and measure the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree

Acquired assets and liabilities: An acquirer or investor shall recognise all identifiable assets acquired, liabilities assumed and non-controlling interests in the acquiree separately from goodwill.

For example, a subsidiary can have some unrecognized internally generated intangible assets meeting separability criterion. In such a case, an acquirer needs to recognize these assets, too.

All assets and liabilities are measured at acquisition-date fair value.

Often, investors need to perform “fair value adjustments” at acquisition date, because assets and liabilities are often valued in a different way - either at cost less accumulated depreciation, at amortized cost, etc.

(d) Recognising and measurement goodwill

Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized.

Goodwill is measured at the acquisition date as the excess of 1 over 2 below:

1. The aggregate of
 - The fair value of consideration transferred
 - The amount of any non-controlling interest recognized
 - In a business combination achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree
2. The assets and liabilities recognized in accordance with Ind AS-103.

Goodwill may arise in the acquiring group's consolidated financial statements when a new subsidiary is acquired, goodwill can also arise in the separate financial statements of an acquiring entity where it purchases the business and assets of another company.

Goodwill is measured as a residual. Where an entity acquires less than 100% of a business, goodwill could be one of two different amounts depending on the choice an entity makes when it decides how to measure non-controlling interest (NCI). Non-controlling interest may be measured using the:

- Fair value method; or
- Proportionate share method

e) Disclosures

The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination that occurs either:

- during the current reporting period; or
- after the end of the reporting period but before the financial statements are approved for issue.

4.4 IND AS 104 INSURANCE CONTRACTS**Q9. Define Insurance contracts.**

Ans :

A contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

The following are examples of contracts that are insurance contracts, if the transfer of insurance risk is significant:

- Insurance against theft or damage to property
- Insurance against product liability, professional liability, civil liability or legal expenses
- Life insurance
- Life-contingent annuities and pensions
- Disability and medical cover
- Surety bonds, fidelity bonds, performance bonds and bid bonds
- Credit insurance that provides for specified payments to be made to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument

- Product warranties. Product warranties issued by another party for goods sold by a manufacturer, dealer or retailer are within the scope of this Ind AS. However, product warranties issued directly by a manufacturer, dealer or retailer are outside its scope, because they are within the scope of Ind AS-115 and Ind AS-37
- Travel insurance
- Reinsurance contracts.

Q10. State the importance of Ind As 104.

Ans :

The objective of Ind AS 104 is to specify the financial reporting for insurance contracts by any entity that issues such contracts (described as an insurer). In particular, this Ind AS requires:

- (a) limited improvements to accounting by insurers for insurance contracts.
- (b) disclosure that identifies and explains the amounts in an insurer's financial statements arising from insurance contracts and helps users of those financial statements understand the amount, timing and uncertainty of future cash flows from insurance contracts.

An insurance contract is a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

The Standard applies to all insurance contracts (including reinsurance contracts) that the entity issues and reinsurance contracts that it holds and financial instruments that it issues with a discretionary participation feature and Ind AS 107, Financial Instruments: Disclosures, requires disclosure about financial instruments, including financial instruments that contain such features.

The Ind AS exempts an insurer from some requirements of other Ind AS.

However, the Ind AS:

- (a) prohibits provisions for possible claims under contracts that are not in existence at the end of the reporting period (such as catastrophe and equalisation provisions).
- (b) requires a test for the adequacy of recognised insurance liabilities and an impairment test for reinsurance assets.
- (c) requires an insurer to keep insurance liabilities in its statement of financial position until they are discharged or cancelled, or expire, and to present insurance liabilities without offsetting them against related reinsurance assets.

The Ind AS permits an insurer to change its accounting policies for insurance contracts only if the change makes the financial statements more relevant and no less reliable, or more reliable and no less relevant. In particular, an insurer may continue any of the following practices, although it may continue using accounting policies that involve them:

- (a) measuring insurance liabilities on an undiscounted basis.
- (b) measuring contractual rights to future investment management fees at an amount that exceeds their fair value as implied by a comparison with current fees charged by other market participants for similar services.
- (c) using non-uniform accounting policies for the insurance contracts of subsidiaries.

The Ind AS permits an insurer to change its accounting policies so that it remeasures designated insurance liabilities to reflect current market interest rates and recognises changes in those liabilities in profit or loss. Without this permission, an insurer would have been required to apply the change in accounting policies consistently to all similar liabilities.

The Ind AS requires disclosure to help users understand:

- (a) the amounts in the insurer's financial statements that arise from insurance contracts.
- (b) the nature and extent of risks arising from insurance contracts

4.5 IND AS 105 NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS
Q11. Explain key terms used in As 105*Ans :***(Imp.)**➤ **Asset held for sale**

A non-current asset that will be recovered through - selling the asset rather than usage.

➤ **Disposal group**

A group of assets, and possibly some liabilities, that an entity intends to dispose of in a single transaction. Current assets which form part of a disposal group form part of held for sale (disposal group).

➤ **Discontinued operation**

A component of an entity that either has been disposed of; or is classified as held for sale; and

- represents a separate major line of business or geographical area of operations,
- is part of a single co-ordinated plan to dispose of a separate major line of business or area of operations; or
- is a subsidiary acquired exclusively with a view to resale.

Discontinued operations may qualify as restructuring as defined by Ind AS-37 'Provisions, Contingent Liabilities and Contingent Assets' but not all restructuring will be treated as discontinued operations.

➤ **Component of an entity**

Operations and cash flows that are clearly distinguishable from the remainder of the entity - both operationally and for financial reporting purposes. So a component will have been a cash-generating unit (or a group of cash-generating units) when held for use".

➤ **Distinguishable**

A discontinued operations must be distinguishable operationally and for reporting purposes. This will be case if:

- Its operating assets and liabilities can be directly attributed to it;
- Its income (gross revenue) can be directly attributed to it; and
- At least a majority of its operating expenses can be directly attributed to it
- Elements are directly attributable to a component if they would be eliminated when the component is discontinued

➤ **Separate major line of business**

A discontinued operation must be a separate major line of business or geographical area of operations:

- An operating segment (Ind AS-108), would normally satisfy this criterion
- A part of a segment may also satisfy this criterion
- For an entity that does not report segment information, a major product or service line may also satisfy the criteria of the definition
- Business entities frequently close facilities, abandon products or even products lines, and change the size of their work force in response to market forces. These changes are not usually discontinued operations but they can occur in connection with a discontinued operation.

For example:

- Gradual or evolutionary phasing out of a product line or class of service;
- Discontinued of several products within an ongoing line of business
- Shifting of some production or marketing activities for a particular line of business from one location to another;
- Closing of a facility to achieve productivity improvements or other cost savings; and

- Sale of a subsidiary whose activities are similar to those of the parent or other subsidiaries or associates within a consolidated group.

➤ **A single co-ordinated plan**

A discontinued operation may be disposed of in its entirety or piecemeal but always pursuant to an overall co-ordinated plan to discontinue the entire component.

Q12. Explain the measurement of Non-current assets.

Ans :

Principle

An entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less cost to sell. Immediately before initial classification as held for sale, carrying amount is measured in accordance with applicable Ind AS.

Time Value

When the sale is expected to occur beyond one year, the entity shall measure the costs to sell at their present value. Any increase in the present value of the costs to sell that arises from the passage of time shall be presented in profit or loss as a financing cost.

Subsequent measurement

On subsequent remeasurements of a disposal group, the carrying amounts of any assets and liabilities, shall be re-measured in accordance with applicable Ind ASs before the fair value less costs to sell of the disposal group is re-measured.

Impairment losses and reversals

Impairment losses for initial or subsequent write-downs to fair value less costs to sell must be recognized. Reversals are recognized but not exceeding the cumulative impairment loss that has been recognized.

Depreciation

Held for sale non-current assets are not depreciable (amortized). However, interest and other expenses attributable to the liabilities of a disposal group will continue to be recognized.

Q13. Explain the presentation and disclosure of As 105.*Ans. :* (Jan.-20, Imp.)**Presentation and Disclosure**

An entity shall disclose:

- A single amount in the statement of profit and loss comprising the total of:
 - The post-tax profit or loss of discontinued operations, and
 - The post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation.
- An analysis of the single amount may be presented in the notes or in the statement of profit and loss:
 - The revenue, expenses and pre-tax profit or loss of discontinued operations;
 - The related income-tax expense as required by Ind AS-12;
 - The gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation; and
 - The related income-tax expense as required by Ind AS-12.

If it is presented in the statement of profit and loss it shall be presented in a section identified as relating to discontinued operations, ie. separately from continuing operations.

The analysis is not required for disposal groups that are newly acquired subsidiaries that meet the criteria to be classified as held for sale on acquisition.

- The net cash flows attributable to the operating, investing and financing activities of discontinued operations. These disclosures may be presented either in the notes or in the financial statements.

- These disclosures are not required for disposal groups that are newly acquired subsidiaries that meet the criteria to be classified as held for sale on acquisition.
- The amount of income from continuing operations and from discontinued operations attributable to owners of the parent. These disclosures may be presented either in the notes or in the statement of profit and loss.
- Ceases to classify as held for sale, the results of operations of the component previously presented in discontinued operations shall be reclassified and included in income from continuing operations for all periods presented. The amounts for prior periods shall be described as having been re-presented.
- Held for sale non-current assets (Separate Classification)
 - A non-current asset classified as held for sale and the assets of a disposal group classified as held for sale separately from other assets in the balance sheet.
 - The liabilities of a disposal group classified as held for sale shall be presented separately from other liabilities in the balance sheet.
 - Those assets and liabilities shall not be offset and presented as a single amount.
 - The major classes of assets and liabilities classified as held for sale shall be separately disclosed either in the balance sheet or in the notes.
 - Any cumulative income or expense recognised in other comprehensive income relating to a non-current asset (or disposal group) classified as held for sale present separately.

Additional Disclosure

In the notes in the period in which a non-current asset (or disposal group) has been either classified as held for sale or sold:

- A description of the non-current asset;
- A description of the facts and circumstances of the sale, or leading to the expected disposal, and the expected manner and timing of that disposal;
- The gain or loss recognised and, if not separately presented in the statement of profit and loss, the caption in the statement of profit and loss that includes that gain or loss;

4.6 IND AS 106 EXPLORATION FOR AND EVALUATION OF MINERAL RESOURCES

Q14. Explain the meaning of exploration and evaluation of mineral resources

Ans :

- **Exploration and evaluation assets**
Exploration and evaluation expenditures recognised as assets in accordance with the entity's accounting policy.
- **Exploration and evaluation expenditures**
Expenditures incurred by an entity in connection with the exploration for and evaluation of mineral resources before the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.
- **Exploration for and evaluation of mineral resources**
The search for mineral resources, including minerals, oil, natural gas and similar non-regenerative resources after the entity has obtained legal rights to explore in a specific area, as well as the determination of the technical feasibility and commercial viability of extracting the mineral resource.

Q15. What are the reasons for issuing Ind AS-106? Explain the objectives and scope of Ind AS-106.

Ans :

Reason for Issuing Standard Ind AS-106

Exploration and evaluation expenditures are incurred by an entity in connection with the

exploration for and evaluation of mineral resources before the technical feasibility and commercial viability of extracting mineral resources are demonstrable. Such types of expenditures are specifically excluded from Ind AS-16 and Ind AS-38. Accounting practices varied greatly in this area, Ind AS-106 was issued as an interim guidance so that an entity has at least some guidance until a complete standard is issued in the future. It is only a short-term solution to the problems of accounting in this area.

Ind AS-106 is related to Ind AS-38's distinction between research and development phases, where research costs are expensed and development costs are capitalised. The problem is that the exploration for and evaluation of mineral resources is not quite research and not quite development, hence separate accounting guidelines were needed. The Ind AS-106 prescribes such interim guidelines for these expenditures.

Objective

The objective of this Ind AS is to specify the financial reporting for the exploration for and evaluation of mineral resources. The Ind AS requires:

- To provide limited improvements to existing accounting practices
- To apply this Standard in the recognition of impairment
- To provide guidelines for disclosure relating to amounts arising from exploration and evaluation of mineral resources within the financial statements.

Scope

An entity shall apply this Ind AS to exploration and evaluation expenditures that it incurs. An entity shall not apply this Ind AS to expenditures incurred:

- Before the exploration for and evaluation of mineral resources, such as expenditures incurred before the entity has obtained the legal rights to explore a specific area.
- After the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.

The scope of Ind AS-106 is, therefore, very narrow.

Overview of Phases

Pre - Not yet exploring for resources e.g. No legal right	Exploration and evaluation	Post - Demonstrated technical feasibility and commercial viability
Ind AS-106 does not apply- Expense (usually)	Ind AS-106 applies	Ind AS-38, <i>Intangible Assets</i> applies

The Post-exploration and evaluation phase is also called the 'Construction' phase.

Implications

- Entities must develop separate accounting policies for costs incurred in each of the phases. They must therefore be able to identify them separately
- Ind AS-106 does not give any examples for pre-exploration and evaluation costs. However, these would include:
 - Costs of obtaining speculative seismic or other data, and
 - Costs of geological or geophysical analysis on such data.

Such costs are expensed as 'research' costs

- Exploration and evaluation activities cease when technical feasibility and commercial viability are demonstrable. At this point:
 - Capitalization of exploration and evaluation assets ceases.
 - Exploration and evaluation assets are tested for impairment
 - Exploration and evaluation assets are reclassified.

Q16. Explain the measurement of exploration and evaluation assets

Ans :

i) Measurement of exploration and evaluation assets

Measurement at recognition - Exploration and evaluation assets shall be measured initially at cost.

Elements of cost of exploration and evaluation assets - An entity shall determine an accounting policy specifying which expenditures are recognised as exploration and evaluation assets and apply the policy consistently. In making this determination, an entity considers the degree to which the expenditure can be associated with finding specific mineral resources.

The following are examples of expenditures that might be included in the initial measurement of exploration and evaluation assets (the list is not exhaustive):

- Acquisition of rights to explore
- Topographical, geological, geochemical and geophysical studies

- exploratory drilling
- trenching
- sampling; and
- activities in relation to evaluating the technical feasibility and commercial viability of extracting a mineral resource.

In accordance with Ind AS-37, Provisions, Contingent Liabilities and Contingent Assets, an entity recognises any obligations for removal and restoration that are incurred during a particular period as a consequence of having undertaken the exploration for and evaluation of mineral resources.

ii) Measurement after recognition

Apply either:

- Cost model; or
- Revaluation model.
- **Cost Model** - Exploration and evaluation assets are depreciated when available for use. For example, a license may be amortized on a straight- line or unit of production basis.
- **Revaluation Model** - The revaluation model must be applied consistently according to the classification assets:
 - Tangible (Ind AS-16 Revaluation Model)
 - Intangible (Ind AS-38 Revaluation Model)

Short Question & Answers

1. Optional exceptions for first time adoptions.

Ans :

Optional Exemptions

An entity may elect to use one or more of the following exemptions:

- (a) share-based payment transactions
- (b) insurance contracts
- (c) deemed cost of PPE, intangible assets and investment property
- (d) leases
- (e) cumulative translation differences
- (f) investments in subsidiaries, joint ventures
- (g) assets and liabilities of subsidiaries, associates and joint ventures
- (h) compound financial instruments
- (i) designation of previously recognised financial instruments
- (j) fair value measurement of financial assets or financial liabilities initial recognition
- (k) decommissioning liabilities included in the cost of property, plant and equipment
- (l) financial assets or intangible assets accounted for in accordance with Ind AS-11 Service concession Arrangements
- (m) borrowing costs
- (n) extinguishing financial liabilities with equity instruments
- (o) severe hyperinflation
- (p) joint arrangements
- (q) stripping costs in the production phase of a surface mine
- (r) designation of contracts to buy or sell a non-financial item
- (s) revenue from contracts with customers, and

(t) non-current assets held for sale and discontinued operations

(u) Business combination (Ind AS-103) before the date of transition

2. Cash settled share based payment transactions.

Ans :

For cash-settled share-based payment transactions, the entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity shall re-measure the fair value of the liability at the end of each reporting period and at the date of settlement, with any changes in fair value recognised in profit or loss for the period.

Examples of this type of transaction include:

- Share appreciation rights granted to employees: the employees become entitled to the future cash payment (rather than an equity instrument), based on the increase in the entity's share price from a specified level over a specified period of time; or
- An entity might grant to its employees a right to receive a future cash payment by granting to them a right to shares that are redeemable.

The entity should recognise the services received and a liability to pay for those services, as the employees render service. For example, shares appreciation rights do not vest until the employees have completed a specified period of service, the entity should recognise the services received and the related liability over that period.

3. What is business?

Ans :

A business is an integrated set of activities, and assets conducted and managed for the purpose of providing (a) a return to investors and (b) lower costs or other economic benefits to participants. It generally consists of inputs, processes and resulting outputs that are or will be used to generate revenue.

A business consists of three elements:**i) Input**

Any economic resources that creates or can create outputs when one or more processes are applied to it, e.g., non-current assets etc.

ii) Process

Any system, standard, protocol, convention or rule that when applied to an input(s), create outputs, e.g. management processes, workforce, etc.

iii) Output

The result of inputs and processes applied to those inputs that provide or can provide a return in the form of dividend, lower costs or other economic benefits directly to investors or other owners.

4. What is business combinations?

Ans :

A transaction (or) other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as 'true mergers' or 'mergers of equals' are also business combinations as that term is used in this Ind AS.

A business combination is an act of bringing together of separate entities or businesses into one reporting unit. The result of business combination is one entity (the acquirer) obtains control of one or more businesses. If an entity obtains control over other entities which are not businesses, the act is not a business combination.

A business combination in which all the combining entities or businesses are ultimately controlled by the same parties before and after the combination is excluded from the scope of the business combination, such a transaction is accounted for applying Appendix C to Ind AS-103 by pooling interest method.

From the definition of Business Combination, it is clear that for business combination, the control by one entity of another is sufficient and both the entity may continue to exist which is not the case in AS-14 'Amalgamations'. For example, if X Ltd. acquires 70% shares of Y Ltd., then it is a case of business combination even if X Ltd. and Y Ltd. will continue to exist however X Ltd. becomes a holding (Parent) company of Y Ltd. and therefore, they become one reporting entity by reporting consolidated financial statements.

5. Define insurance contracts.

Ans :

A contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

The following are examples of contracts that are insurance contracts, if the transfer of insurance risk is significant:

- Insurance against theft or damage to property
- Insurance against product liability, professional liability, civil liability or legal expenses
- Life insurance
- Life-contingent annuities and pensions
- Disability and medical cover
- Surety bonds, fidelity bonds, performance bonds and bid bonds
- Credit insurance that provides for specified payments to be made to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument

6. Meaning of exploration and evaluation of mineral resources.*Ans :***➤ Exploration and evaluation assets**

Exploration and evaluation expenditures recognised as assets in accordance with the entity's accounting policy.

➤ Exploration and evaluation expenditures

Expenditures incurred by an entity in connection with the exploration for and evaluation of mineral resources before the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.

➤ Exploration for and evaluation of mineral resources

The search for mineral resources, including minerals, oil, natural gas and similar non-regenerative resources after the entity has obtained legal rights to explore in a specific area, as well as the determination of the technical feasibility and commercial viability of extracting the mineral resource.

7. Scope of Ind AS 106.*Ans :*

An entity shall apply this Ind AS to exploration and evaluation expenditures that it incurs. An entity shall not apply this Ind AS to expenditures incurred:

- Before the exploration for and evaluation of mineral resources, such as expenditures incurred before the entity has obtained the legal rights to explore a specific area.
- After the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.

Choose the Correct Answer

1. Which of the following transactions involving the issuance of shares does not come within the definition of a "share-based" payment under IND AS 102? [c]
 - (a) Employee share purchase plans.
 - (b) Employee share option plans.
 - (c) Share-based payment relating to an acquisition of a subsidiary
 - (d) Share appreciation rights.
2. An entity shall not apply this Ind AS 104 to: [c]
 - (a) Product warranties issued directly 'By a manufacturer, dealer or retailer.
 - (b) employers' assets and liabilities under employee benefit plans and retirement benefit obligations reported by defined benefit retirement plans.
 - (c) Both
 - (d) None of the above
3. The issuer of an insurance contract that contracts contain a discretionary participation feature: [d]
 - (a) may recognise all premiums received as revenue without separating any portion that relates to the equity component .
 - (b) need to separate the portion that relates to the equity component and a portion of profit or loss may be attributable to that feature.
 - (c) may not recognise all premiums received as revenue without separating any portion that relates to the equity component.
 - (d) a and c
4. For classifying a non-current asset (or disposal group) as held for sale which of the following is not a necessary criteria. [d]
 - (a) The asset (or disposal group) is available for immediate sale
 - (b) The terms of asset sale must be usual and customary for sales of such Assets
 - (c) The sale must be highly probable
 - (d) All of the above
5. When the sale is expected to occur beyond one year, the entity shall measure the costs to sell at their present value Any increase in the present value of the costs to sell that arises from the passage of time shall be presented in: [b]
 - (a) Capital reserve account a
 - (b) Profit or loss as a financing cost
 - (c) General reserve account
 - (d) All of the above

6. On subsequent remeasurement of a disposal group, the carrying amounts of any assets and liabilities that are not within the scope of the measurement requirements of this Ind AS, but are included in a disposal group classified as held for sale, shall be: [b]
- (a) Remeasured at the fair value less costs to sell of that disposal group
 - (b) Remeasured in accordance with applicable Ind ASs before the fair value less costs to sell of the disposal group is remeasured.
 - (c) remeasured in accordance with applicable ind Ass
 - (d) All of the above
7. State which one is correct according to Ind AS 105 [d]
- (a) The impairment loss recognised for a disposal group shall reduce the ' carrying amount of the non-current assets in the group that are within the scope of the measurement requirements of this Ind AS.
 - (b) The impairment gain recognised for a disposal group shall increase the carrying amount of the non-current assets in the group that are within the scope of the measurement requirements of this ind AS
 - (c) None of the above
 - (d) All the above
8. Ind AS 105 deals with [d]
- (a) Share based payments
 - (b) Business combination
 - (c) Insurance contracts
 - (d) Non-current assets held for sale and discontinued operations
9. Ind AS 102 deals with [a]
- (a) Share based payments
 - (b) Business combination
 - (c) Insurance contracts
 - (d) Non-current assets held for sale and discontinued operations
10. Ind AS 104 deals with [c]
- (a) Share based payments
 - (b) Business combination
 - (c) Insurance contracts
 - (d) Non-current assets held for sale and discontinued operations

Fill in the blanks

1. _____ whereby entities purchase goods or services from other parties, such as supplier and employees, by issuing shares or share options to those other parties are increasingly common.
2. _____ The amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable,
3. _____ To become an entitlement.
4. A _____ is an integrated set of activities, and asset conducted and managed for the purpose
5. _____ is an asset representing the future economic benefits arising from other assets acquired
6. A _____ operations must be distinguishable operationally and for reporting purposes.
7. When the sale is expected to occur beyond one year, the entity shall measure the costs to sell at their _____ .
8. _____ expenditures recognised as assets in accordance with the entity's accounting policy.
9. The objective of Ind AS 101 is to ensure that an entity's first _____ .
10. Ind AS 101 prohibit _____ of some specific aspects of other Ind AS.

ANSWERS

1. Transactions
2. Fair value
3. Vest
4. Business
5. Goodwill
6. Discontinued
7. Present value
8. Exploration and evaluation
9. Ind AS financial statements
10. Retrospective application

UNIT V

INDIAN ACCOUNTING STANDARDS (IND AS-107 to 115) :

Overview of Indian Accounting Standards: (Ind AS 107 to Ind AS 115):

Ind AS-107: Financial instrument: disclosure – Ind AS-108: Operating segments – Ind AS-109: Financial instruments – Ind AS - 110: Consolidated financial statements – Ind AS-111: Joint arrangement - Ind AS – 112: Disclosure of interest in other entities – Ind AS-113: Fair Value Measurement –Ind AS-114: Regulatory Deferral Accounts – Ind AS-115: Revenue from Contracts with customers.

5.1 IND AS 107 FINANCIAL INSTRUMENT DISCLOSURE

Q1. Explain briefly about Ind As 107.

Ans : (Jan.-20, Imp.)

The objective of the Ind AS 107 is to require entities to provide disclosures in their financial statements that enable users to evaluate:

- (a) The significance of financial instruments for the entity's financial position and performance; and
- (b) The nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks.

The qualitative disclosures describe management's objectives, policies and processes for managing those risks. The quantitative disclosures provide information about the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel.

Together, these disclosures provide an overview of the entity's use of financial instruments and the exposures to risks they create.

The Ind AS applies to all entities, including entities that have few financial instruments (e.g., a manufacturer whose only financial instruments are

accounts receivable and accounts payable) and those that have many financial instruments (e.g., a financial institution most of whose assets and liabilities are financial instruments).

When this Ind AS requires disclosures by class of financial instrument, an entity shall group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. An entity shall provide sufficient information to permit reconciliation to the line items presented in the statement of financial position.

The principles in this Ind AS complement the principles for recognising, measuring and presenting financial assets and financial liabilities in Ind AS 32, Financial Instruments: Presentation and Ind AS 109, Financial Instruments.

5.2 IND AS 108 OPERATING SEGMENTS

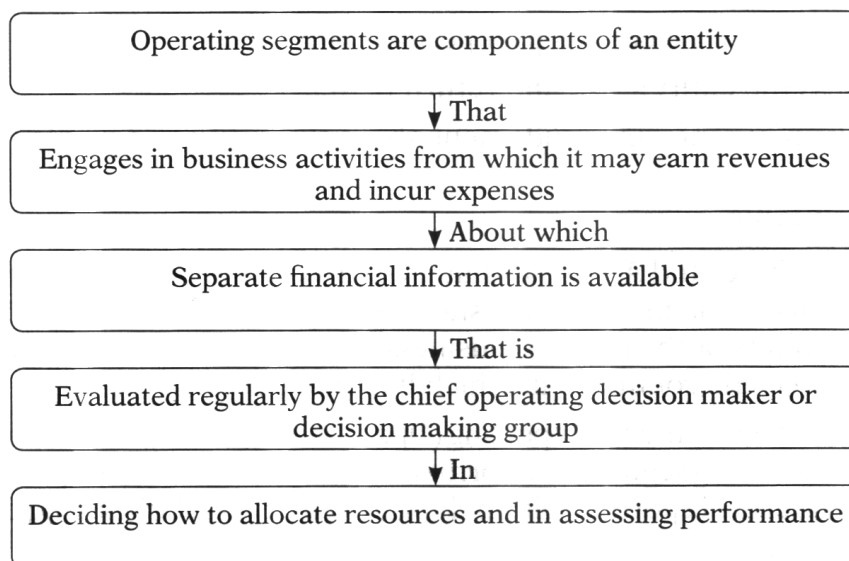
Q2. What is operating segment? Explain determining and disclosure of operating segment.

Ans : (Imp.)

The entities are required to disclose information about their operating segments now the question is what is operating segment which is to be reported in the financial statements.

Reportable segments are operating segments or aggregation of operating segments that meet specified criteria.

Operating segment



The term 'chief operating decision maker' identifies a function, not necessarily a manager with specific title. That function is to allocate resources and to assess the performance of the entity's operating segments.

Example: A Company has four operating segments for the purpose of management reporting; Retail Banking, the Card Services Group, the Commercial Group, and the Home Loans Group. In addition, the category of Corporate Support/Treasury and Other includes the community lending and investment operations as well as the Treasury function-which manages the Company's interest rate risk, liquidity position and capital. The Corporate Support function provides facilities, legal, accounting and finance, human resources and technology services.

Determining reportable segments

Ind AS-108 adopts a management approach to determine operating segments. An entity must report separate information about each operating segment that:

- Has been identified as meeting the definition of an operating segment; and
- Segment total is 10% or more of total:
 - Revenue (internal and external) of all operating segments or
 - Profit of all segments not reporting a loss or all segments in loss if greater, or
 - Assets of all operating segments.

At least 75% of the entity's total external revenue must be reported by the operating segment identified. Whereas this is not case, additional segments must be identified (even if they do not meet the 10% thresholds).

Aggregation

Two or more operating segments may be aggregated if the segments have similar economic characteristics and the segments are similar in each of the following respects:

- The nature of the products or services
- The nature of the productions process

- The type or class of customer for their products or services
- The methods used to distribute their products provide their services and
- If allocable, the nature of the regulatory environment.

Operating segments that do not meet any of the quantitative thresholds may be reported separately if management believes that information about the segment would be useful to users of the financial statements.

Disclosure

Core principles

- An entity must disclose information to enable users of its financial statements to evaluate:
 - The nature and financial effects of its business activities; and
 - The economic environments in which it operates
- This includes:
 - General information
 - Information about reported segment profit or loss, segment assets, segment liabilities and the basis of measurement; and
- This information must be disclosed for every period for which a state-ment of profit and loss is prepared. Reconciliation of amounts in the Balance Sheet is required for which date at which Balance sheet is prepared.

General information

The factors used to identify reportable segments, including:

- The basis of Organization (e.g. around products and services, geo-graphical areas, regulatory environments or a combination of factors and whether segments have been aggregated) and
- Types of products and services from which each reportable segment derives its revenue.

Example (Basis of Organisation): ETC Ltd's reportable segments are strategic businesses

that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. Most of the businesses were acquired as individual units, and the management at the times of the acquisition was retained.

Example (Types of products and services): ETC Ltd. has five reportable segments: machine parts, lazer, prototyping, waterjet and finance. The machine parts segment produces parts for sale to aviation equipment manufacturers. The lazer segment produces lazer cutters to serve the petrochemical industry. The prototyping segment produces plastics for sale to the pharmaceutical industry. The waterjet segment produces cutting equipment for sale to car manufacturers and jewellers. The finance segment is responsible for parts of ETC Ltd's financial operations including financing customer purchases of products from other segments and car leasing operations.

Information about profit or loss, assets and liabilities

The following measures must be reported for each reportable segment:

- i) Profit or loss
- ii) Total assets

The disclosures of total assets and liabilities are only required if such information is regularly reported to the chief operating decision maker.

i) Profit or loss

The following must also be disclosed if the specified amounts are regularly provided to the chief operating decision maker (even if not included in the measure of segment profit or loss):

- Revenue from external customers
- Intersegment revenues
- Interest revenue-Interest revenue may be reported net of its interest expenses if the majority of the segment's revenues are from interest and the chief operating decision maker relies primarily on reporting of net interest revenue.
- Interest expenses
- Depreciation and amortization

- Other material items of income and expense required by Ind AS-1, Presentation of Financial Statements (i.e., write-downs, restructurings, disposals, discontinued operations, litigation settlements and reversal of provisions)
- Entity's interest in the profit or loss of associates and joint ventures accounted for by the equity method
- Income tax expense or income
- Material non-cash items other than depreciation and amortization; and
- Impairment losses also have to be disclosed (but as an Ind AS-36 requirements)

ii) Assets

The following must also be disclosed if the specified amounts are regularly provided to the chief operating decision maker (even if not included in the measure of segment assets):

- The investment in associates and joint ventures accounted for the equity method; and
- Additions to non-current (other than financial instrument, deferred tax assets and post-employment benefits assets).

Q3. Explain basis and reconciliation of operating segment.

Ans :

Basis of measurements

- The amount of each segment item reported is measured in the same way as reported to the chief operating decision maker.
- Segment information is no longer required to conform to the accounting policies adopted for preparing and presenting the consolidated financial statements.
- If the chief operating decision maker uses more than one measurement criteria of an operating segment's profit or loss, the segment's assets or the segment's liabilities,

the reported measurement criteria should be those that are most consistent with those used in the entity's financial statements.

- An explanation of the measurement of segment profit or loss, segment assets and segment liabilities must disclose, as a minimum:
 - The basis of accounting for intersegment transaction;
 - The nature of any differences between the measurements of the reportable segment and the entity's financial statements (if not apparent from the reconciliation required);
 - Differences could include accounting policies and policies for allocation of centrally incurred costs, jointly used assets or jointly utilized liabilities;
 - The nature of any changes from prior periods in the measurement method used and the effect, if any, of those changes on the measure of segment profit or loss;
 - The nature and effect of any asymmetrical allocations to reportable segment, for example, the allocation of depreciation expense with the related depreciable assets.

Reconciliation

- Reconciliation of the total of the reportable segments with the entity are required for all of the following:
 - Revenue
 - Profit or loss (before tax and discontinued operations)
 - Assets
 - Liabilities (if applicable)
 - Every other material items
- All material reconciling items must be separately identified and described (e.g. arising from different accounting policies).

5.3 IND AS 109 FINANCIAL INSTRUMENTS**Q4. What are financial instrument?***Ans :*

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Financial liability it is necessary to understand the difference between financial liability and equity.

The financial instrument is financial liability if there is a contractual obligation on the issuer either to deliver cash or other financial asset to the holder.

An equity instrument is any contract that evidences a residual interest in the asset of an entity after deducting all liabilities.

Although the holder of an equity instrument may be entitled to a pro rata share of any distribution out of equity, the issuer does not have a contractual obligation to make such a distribution.

Q5. Define financial asset.*Ans :*

Any asset that is :

- (a) Cash;
- (b) An equity instrument of another entity;
- (c) A contractual right:
 - To receive cash or another financial asset from another entity; or
 - To exchange financial assets or financial liabilities with another entity under conditions those are potentially favourable to the entity
- (d) A contract that will or may be settled in the entity's own equity instruments that is:
 - A non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instrument; or
 - A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial.

asset for a fixed number of the entity's own equity instruments.

Cash is a financial asset because it represents the medium of exchange and is therefore the basis on which all transactions are measured and recognized in financial statements. A deposit of cash with a bank or similar financial institution is a financial asset because it represents the contractual right of the depositor to obtain cash from the institution or to draw a cheque or similar instrument against the balance in favour of a creditor in payment of a financial liability.

Example : Abhishek deposited ₹ 5,00,000 in State Bank of India. A deposit of cash is financial asset for Abhishek as it represents contractual right of Abhishek to obtain cash or draw cheque from the bank equally it is financial liability for the State Bank of India, as bank has to pay the money back to Abhishek whenever he wants.

Common examples of financial assets representing a contractual right to receive cash in the future are:

- (a) Trade accounts receivable
- (b) Notes receivable
- (c) Loans receivable and
- (d) Bonds receivable

Under **Leases, a finance lease**, the amount to be received by the lessor from the lessee is regarded as receivables and therefore is a financial asset for the lessor. However under the operating lease, the amount of the lease rent is not a financial asset for the lessor except the lease rent which has become due and not received by the lessor. The reason being the lessor continues to account for the leased asset itself rather than any amount receivable in the future under the operating lease contract.

Assets which are not a financial assets:

- Physical assets such as inventories, property, plant and equipment;
- Leased assets;
- Intangible assets such as patents and trademarks are not financial assets;
- Prepaid expenses;
- Income tax refund.

An equity instrument of another entity.

Q6. What are financial liabilities? Explain the classification are exceptions of financial liabilities.

Ans :

A financial liability (or a part of a financial liability) shall be derecognised when, and only when, it is extinguished (obligation specified in the contract is discharged or cancelled or expires).

An entity shall account for a substantial modification of the terms of contracts as an extinguishment of the original financial liability and the recognition of a new financial liability. Any difference between the carrying amount of a financial liability extinguished or transferred and the consideration paid should be recognised in profit or loss.

Classification: Financial Liabilities

An entity shall classify all financial liabilities as subsequently measured at amortised cost, except for:

- (a) financial liabilities at fair value through profit or loss.
- (b) financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies.
- (c) financial guarantee contracts.
- (d) commitments to provide a loan at a below-market interest rate.
- (e) contingent consideration recognised by an acquirer in a business combination to which Ind AS 103 applies.

An entity may, at initial recognition, irrevocably designate a financial liability as measured at fair value through profit or loss.

Exception of financial liability

However as exception to the definition of a financial liability, a puttable instrument that includes

such an obligation is classified as equity instrument if it has the following feature:

➤ **Instrument Specific features:**

- Holder is entitled for a pro-rata share of the entity's net assets on liquidation.
- Puttable instrument is subordinate to all other classes of instrument.
- All instruments in the class have identical features.
- Contractual obligation shall not be under potentially unfavourable conditions to an entity.
- Total expected cash flows based substantially on P/L or change in the recognised net assets or change in fair value of recognition and unrecognized net assets of the entity over the life of instruments.

➤ **Issuer Specific feature** - Issuer must have no other financial instrument or contract that has:

- Total cash flows based substantially on P/L, change in recognized net assets or change in fair value of the recognized and unrecognized net assets of the entity;
- The effect of substantially restricting or fixing the residual return to the puttable instrument holder.

Q7. Explain different types of derivative instrument.

Ans :

A derivative is a financial instrument or other contract with all three of the following characteristics:

➤ **Value changes in response to Underlying**

Its value changes in response to a change in a specified interest rate, financial instrument

price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable (known as the underlying items)

➤ **No Initial Net Investment/ Very Low Investment**

It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.

➤ **It is settled at a future date**

It is settled at a future period. The settlement can either by delivery of the underlying or cash settlement. In case of cash settlement no delivery of underlying takes place rather difference is settled in cash.

i) Forward Contract

It is the simplest form of a Derivatives Contract. Basically forward contract is a valid contract settled at some future point of time. For example a forward contract involving settlement in six month's time in which one party (the purchaser) promises to purchase ₹ 10 lakhs face value of fixed interest rate government bonds, in exchange of ₹ 10 lakhs cash; and the other party (the seller) promises to deliver ₹ 10 lakhs face value of fixed rate government bonds in exchange for ₹ 10 lakhs cash. During the six months, both parties have a contractual right and a contractual obligation to exchange financial instruments. If the market price of the government bonds rises above ₹ 10 lakhs, the conditions will be favourable to the purchaser and unfavourable to the seller; if the market price falls below ₹ 10 lakhs, the effect will be the opposite. However, both parties to a forward contract have an obligation to perform at the agreed time.

ii) Option

As mentioned above both parties to a forward contract has an obligation to perform at the agreed time. However under Option contract the option-holder has a right not an obligation to exchange the financial asset but the writer (seller) of the option has the obligation to exchange the financial asset upon exercise of the option. The nature of the holder's right and writer's obligation are not affected by the likelihood that the option will be exercised.

Thus, the purchaser has a contractual right (a financial asset) similar to the right under a call option held and a contractual obligation (a financial liability) similar to the obligation under a put option written; the seller has a contractual right (a financial asset) similar to the right under a put option held and a contractual obligation (a financial liability) similar to the obligation under a call option written. As with options, these contractual rights and obligations constitute financial assets and financial liabilities separate and distinct from the underlying financial instruments (the bonds and cash to be exchanged). Both parties to a forward contract have an obligation to perform at the agreed time, whereas performance under an option contract occurs only if and when the holder of the option chooses to exercise it.

iii) Others

Many other types of derivative instruments embody a right or obligation to make a future exchange, including interest rate and currency swaps, interest rate caps, collars and floors, loan commitments, note issuance facilities and letters of credit. An interest rate swap contract may be viewed as a variation of a forward contract in which the parties agree to make a series of future exchanges of cash amounts, one amount calculated with reference to a floating interest rate and the

other with reference to a fixed interest rate. Futures contracts are another variation of forward contracts, differing primarily in that the contracts are standardized and traded on an exchange.

Q8. What are Embedded derivative? Explain accounting treatment of the embedded derivative.

Ans :

An embedded derivative is a component of a hybrid contract that also includes a non-derivative / cost-with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.

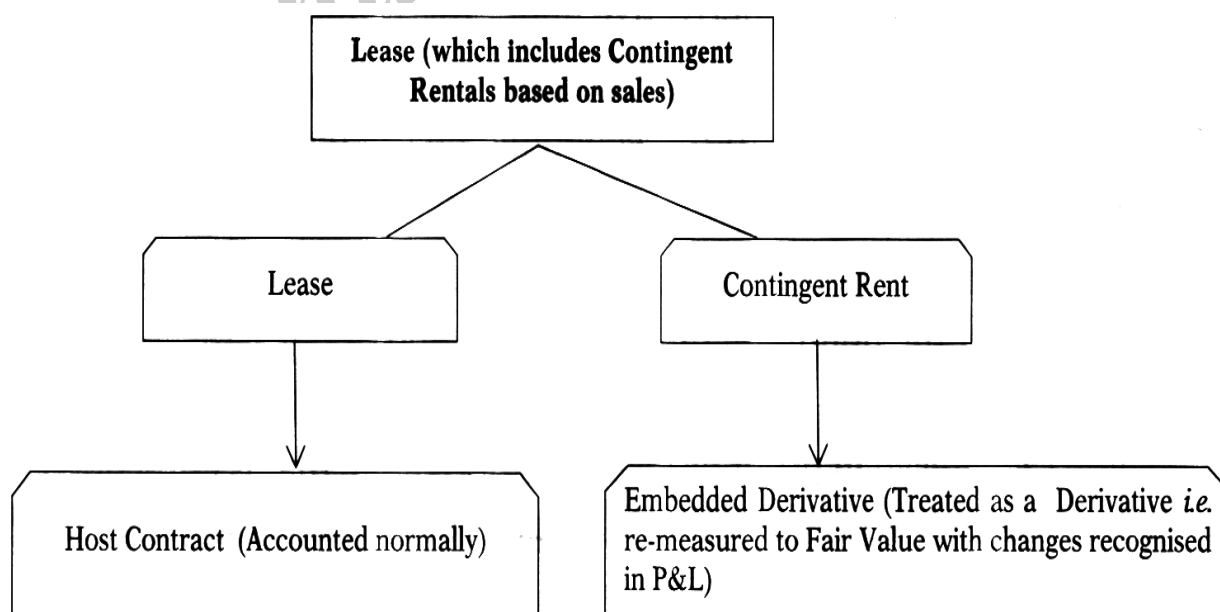
For example, A company with \$ as its functional currency buys raw materials for use in production from a UK company that has £ as its functional currency. The transaction is denominated in €. As this is not the functional currency of either party to the transaction an embedded derivative has been included in the purchase contract. There are now two elements to the contract:

- (i) Contract to buy/sell goods; and
- (ii) Movement on the \$/€ and £/€ exchange rates.

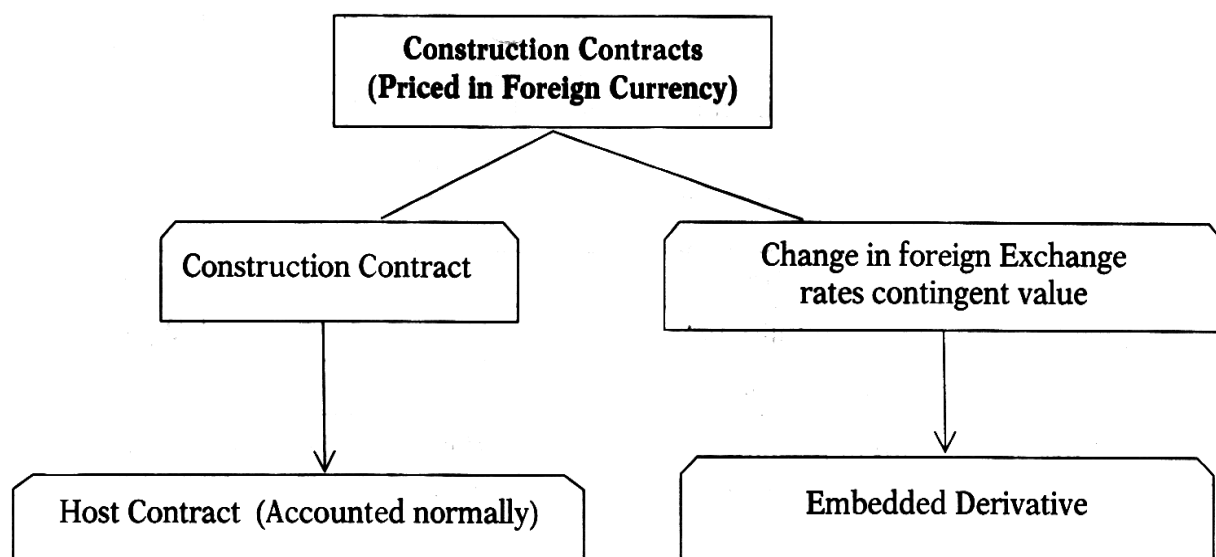
The contract to buy/sell goods is the host contract. The movement in exchange rates is the embedded derivative.

A derivative that is attached to a financial instrument but is contractually transferable independently of that instrument, or has a different counterparty, is not an embedded derivative, but a separate financial instrument.

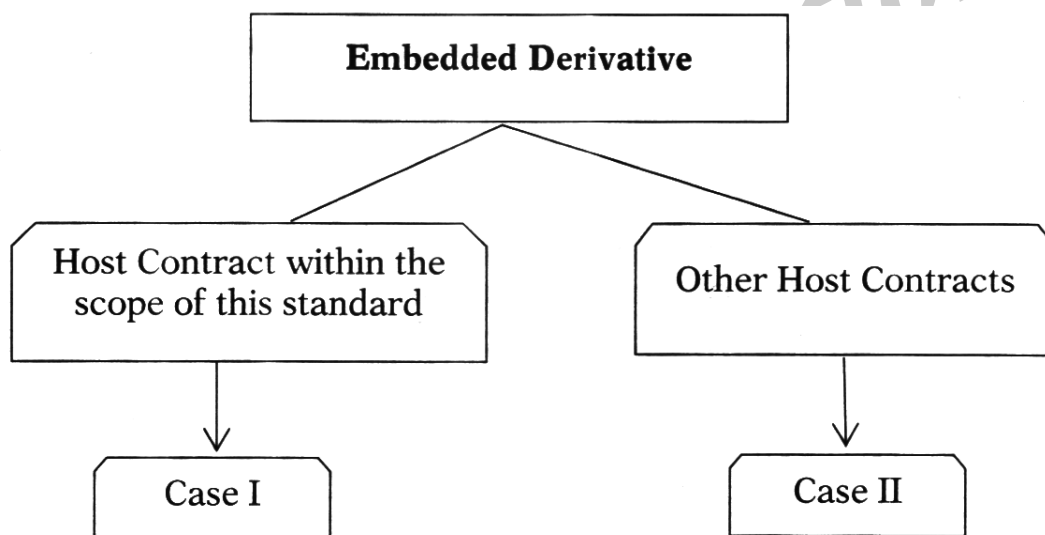
Case -1



Case -2



Accounting Treatment of Embedded Derivatives

**Case I:**

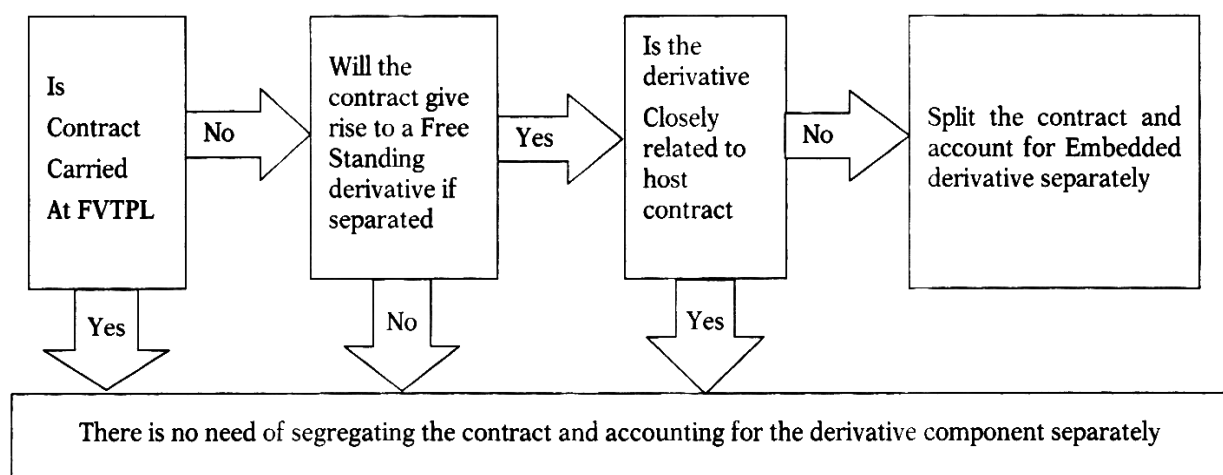
If a hybrid contract contains a host that is an asset within the scope of this Standard, an entity shall apply the requirements of classification and measurement rules to the entire hybrid contract.

Case II:

If a hybrid contract contains a host that is not an asset within the scope of this Standard, an embedded derivative shall be separated from the host and accounted for as a derivative under this Standard if, and only if:

- The economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host;
- A separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and

- The hybrid contract is not measured at fair value with changes in fair value recognised in profit or loss (i.e. a derivative that is embedded in a financial liability at fair value through profit or loss is not separated).
 - If an embedded derivative is separated, the host contract shall be accounted for in accordance with the appropriate Standards. This Standard does not address whether an embedded derivative shall be presented separately in the balance sheet.
 - If an entity is required by this Standard to separate an embedded derivative from its host, but is unable to measure the embedded derivative separately either at acquisition or at the end of a sub-sequent financial reporting period, it shall designate the entire hybrid contract as at fair value through profit or loss.



Q9. Explain De-recognition of financial instruments.

Ans :

De-recognition of financial instrument means removal of an asset or a liability from the books as a result of sale payment, re-negotiation or default by the counter party. De-recognition is the end of the life cycle of an asset or a liability that begins with its recognition.

A) De-recognition of financial assets

An entity de-recognizes a financial asset only when:

- The contractual rights to the cash flows from the financial asset expires.
- It transfers the financial asset and the transfer qualifies for de-recognition.

An entity transfers a financial asset only if, it does either of the following:

- Transfers the contractual rights to receive the cash flows of the financial asset.
- Retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients, subject to certain conditions.

Ind AS-109 prescribes the principles for

- (a) Completes de-recognition of financial asset
- (b) Partial de-recognition
- (c) De-recognition combined with recognition of new liability

(a) Complete de-recognition of an asset

Transfers of financial assets take many forms. A transferor may sell financial assets receiving in exchange, cash or other assets with no continuing involvement with the assets sold. The accounting for such transfers as sales with corresponding de-recognition of the assets is well established.

(b) de-recognition of an asset

At the other extreme is a transaction where the buyer has an unconditional option to return the assets at the original price, usually with interest. It might choose to do so, for example, if a receivable become doubtful. Again, the accounting is straightforward.

The transaction is treated as financing, with both asset and liability on balance sheet, because control of the assets is not transferred.

(c) Partial de-recognition

Between the two extremes are transactions where the seller retains certain interests in the assets transferred. For example, a transferor may pledge financial assets as collateral or may retain servicing rights, or retain some or all of the credit risk in the assets transferred. In recent years such transfers have grown in volume, variety and complexity, frequently raising the issues of whether the assets should be considered to have been sold or as collateral for borrowings and whether or not transfer should be recognized.

Practices in accounting for transfers of financial assets have been inconsistent, causing confusion amongst both preparers and users of financial statement. Ind AS-109 seeks to eliminate these inconsistencies and to reduce the confusion by establishing principles to distinguish sales from secured borrowings.

The rules on de-recognition focus on whether control of the contractual rights that comprise an asset has been transferred from the seller to the buyer. Control, as defined by Ind AS-110, "Consolidated Financial Statements", is power to govern the financial

and operating policies of an entity so as to obtain benefits from its activities.

Ind AS-109 takes a 'substance over form' approach in determination whether the assumption is negated, by requiring the positions of both the seller and the buyer to be considered. To illustrate the principle of transfer of control the standard provides a flow chain to evaluate whether and to what extent a financial asset is de-recognized

B) De-recognition of financial liability

A financial liability (or a part of financial liability) is de-recognized only when the liability is extinguished. That is obligation under the contract is discharged or cancelled or expired. The obligation is discharged by paying the creditor in cash, other financial assets or goods or services, or obligation is legally released. If the debtor pays to the third party, this does not relieve him from the primary obligation to the creditor if there is no legal release. The debtor has to obtain release from the creditor.

If the debtor transfers a financial asset to settle the financial liability, it should de-recognize the asset at its fair value and de-recognize the liability with the difference charges to profit and loss account.

If a new debt instrument is issued with a different terms and conditions in exchange of the existing debt instrument then the debtor should recognize new financial liability and de-recognize the existing financial liability with the difference charges to profit and loss account.

Exchange/Modification of financial liability

An exchange between an existing borrower and lender of debt instruments with substantially different terms shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

Similarly, a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

The difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and

the consideration paid, including any non-cash assets transferred or liabilities assumed, shall be recognised in profit or loss.

The above requirement of Ind AS 109 Financial instruments regarding de-recognition of financial liability can be summarized as under:

- The borrower makes a payment to the lender towards the redemption or repurchase of a debt instrument.
- The borrower is legally released from the primary responsibility for the financial liability (this condition can be satisfied even if the borrower has given a guarantee) or
- There is an exchange between an existing lender and borrower of debt instrument with substantially different terms or a substantially modification of the terms of an existing debt instrument.

5.4 IND AS 110 CONSOLIDATED FINANCIAL STATEMENTS

Q10. Explain the concept of Ind As 110.

Ans :

(Jan.-20, Imp.)

The objective of Ind AS 110, is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.

Consolidated Financial Statements are the financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.

The Standard requires an entity that is a parent to present Consolidated Financial Statements (CFS). A limited exemption is available to some entities. The Standard defines the principle of control and establishes control as the basis for determining which entities are consolidated in the consolidated financial statements.

An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

An investor controls an investee, if and only if, the investor has all the following:

- (a) Power over an investee - when the investor has existing rights that give it the current ability to direct the relevant activities, i.e., the activities that significantly affect the investee's returns.
- (b) Exposure, or rights, to variable returns from its involvement with the investee - An investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor's returns from its involvement have the potential to vary as a result of the investee's performance. The investor's returns can be only positive, only negative or both positive and negative.
- (c) The ability to use power over the investee to affect the amount of the investor's returns - An investor controls an investee if the investor not only has power over the investee and exposure or rights to variable returns from its involvement with the investee, but also has the ability to use its power to affect the investor's returns from its involvement with the investee. Thus, an investor with decision-making rights shall determine whether it is a principal or an agent.

A parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

Accounting Requirements

A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances. Intragroup balances and transactions must be eliminated.

Non-controlling interests in subsidiaries shall be presented in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent.

Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (i.e., transactions with owners in their capacity as owners).

If parent loses control over the subsidiary, the parent shall:

- (a) derecognize the assets and liabilities of former subsidiary;
- (b) recognizes any investment retained in the subsidiary at its fair value in accordance with Ind AS 109;
- (c) recognizes gain and loss associated with the loss of control.

5.5 IND AS 111 JOINT ARRANGEMENT

Q11. What is joint arrangement? Explain the classification of joint arrangement.

Ans :

A joint arrangement is an arrangement of which two or more parties have into control and the following characteristics are present:

- The parties are bound by a contractual arrangement; and
- The contractual arrangement gives two or more of the parties joint control of the arrangement.

Types and classification of a joint arrangement

A joint arrangement can be classified as a joint operation or a joint venture:

- **A joint operation** is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Those parties are called joint operators.
- **A joint venture** is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Those parties are called joint venturers.

Q12. Explain accounting treatment of joint venture.

Ans :

The methods prescribed for accounting for joint arrangements depend on their classification as either a joint operation or a joint venture.

Joint operators account for joint operations by treating their operation in the same way as their own operations. That is, the joint operator accounts for its share of assets, liabilities, revenues and expense from the arrangement.

The joint venturer's accounting should reflect the arrangement's economic substance rather than the joint venture's structure or form. The profit-sharing arrangement between the investors in a joint arrangement is key in determining the share of net assets to reflect in equity-accounting.

A joint venturer shall recognise its interest in a joint venture as an investment and shall account for that investment using the equity method in accordance with Ind AS-28, Investments in Associates and Joint Ventures, unless the entity is exempted from applying the equity method as specified in that standard.

The table below shows how different types of investor's account for joint arrangements:

	Consolidated financial statements	Separate financial statements
Joint operations	<p>A joint operator is required to recognize in relation to its interest in a joint operation:</p> <ul style="list-style-type: none"> ■ Its assets, including its share of any assets held jointly; ■ Its liabilities, including its share of any liabilities incurred jointly; ■ Its revenue from the sale of its share of the output arising from the joint operation; ■ Its share of the revenue from the sale of the output by the joint operation; and ■ Its expenses, including its share of any expenses incurred jointly. 	The same accounting applies as in the consolidated financial statements.
Joint ventures	Accounted for in accordance with the equity method, unless a scope exclusion applies.	Investment is measured at cost or in accordance with Ind AS-109.

Disclosure

Ind AS-112 includes the mandatory disclosures for subsidiaries, joint arrangements, associates and unconsolidated structured entities. This section considers disclosures for joint arrangements only.

The standard's objective is to disclose information that helps reader of financial statements to evaluate the nature, risks and financial effect associated with entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities (Ind AS-112). Reporting entities should disclose any additional information that is necessary to meet this objective (Ind AS-112).

The disclosure requirements can be summarized into the following three categories:

- Significant judgments and assumptions.
- Nature extent and financial effect of the investment in a joint arrangement.
- The risks associated with joint ventures.

The disclosure requirements outlined in Ind AS-112 do not apply to parties to a joint arrangement that do not share joint control, except where these parties significantly influence the arrangement.

5.6 IND AS 112 DISCLOSURE OF INTEREST IN OTHER EQUITIES

Q13. Explain briefly about Ind AS 112.

Ans :

(Jan.-20, Imp.)

The objective of Ind AS 112 is to require an entity to disclose information that enables users of its financial statements to evaluate:

- (a) the nature of, and risks associated with, its interests in other entities; and
- (b) the effects of those interests on its financial position, financial performance and cash flows.

The Standard shall be applied by an entity that has an interest in a subsidiary, a joint arrangement (i.e., joint operation or joint venture), an associate or an unconsolidated structured entity.

Significant judgements and assumptions

Ind AS 112 requires that an entity shall disclose information about significant judgements and assumptions it has made (and changes to those judgements and assumptions) in determining:

- (a) that it has control of another entity;
- (b) that it has joint control of an arrangement or significant influence over another entity; and
- (c) the type of joint arrangement (i.e., joint operation or joint venture) when the arrangement has been structured through a separate vehicle.

i) Investment entity status

When a parent determines that it is an investment entity in accordance with Ind AS 110, the investment entity shall disclose information about significant judgements and assumptions it has made in determining that it is an investment entity. If the investment entity does not have one or more of the typical characteristics of an investment entity, it shall disclose its reasons for concluding that it is nevertheless an investment entity.

When an entity becomes, or ceases to be, an investment entity, it shall disclose the change of investment entity status and the reasons for the change. In addition, an entity that becomes an investment entity shall disclose the effect of the change of status on the financial statements for the period presented, including:

- (a) the total fair value, as of the date of change of status, of the subsidiaries that cease to be consolidated;
- (b) the total gain or loss, if any, calculated in accordance with Ind AS 110; and
- (c) the line item(s) in profit or loss in which the gain or loss is recognised (if not presented separately).

ii) Interest in Subsidiaries

Ind AS 112 requires that an entity should disclose information that enables users of its consolidated financial statements:-

- (a) to understand:
 - (i) the composition of the group; and
 - (ii) the interest that non-controlling interests have in the group's activities and cash flows; and

- (b) to evaluate:

- (i) the nature and extent of significant restrictions on its ability to access or use assets, and settle liabilities, of the group;
- (ii) the nature of, and changes in, the risks associated with its interests in consolidated structured entities;
- (iii) the consequences of changes in its ownership interest in a subsidiary that do not result in a loss of control; and
- (iv) the consequences of losing control of a subsidiary during the reporting period.

iii) Interest in unconsolidated subsidiaries (investment entities)

Ind AS 112 requires that an investment entity that, in accordance with Ind AS 110, is required to apply the exception to consolidation and instead account for its investment in a subsidiary at fair value through profit or loss should disclose that fact.

For each unconsolidated subsidiary, an investment entity shall disclose:

- (a) the subsidiary's name;
- (b) the principal place of business (and country of incorporation if different from the principal place of business) of the subsidiary; and
- (c) the proportion of ownership interest held by the investment entity and, if different, the proportion of voting rights held.

If an investment entity is the parent of another investment entity, the parent shall also provide the above disclosures for investments that are controlled by its investment entity subsidiary.

An investment entity is required to make disclosures regarding the nature and extent of any significant restrictions on the ability of an unconsolidated subsidiary to transfer funds to the investment entity in the form of cash dividends or to repay loans or advances made to the unconsolidated subsidiary by the investment entity and any current commitments or intentions to provide financial or other support to an unconsolidated subsidiary, etc.

iv) Interest in joint arrangements and associates

Ind AS 112 requires that an entity should disclose information that enables

users of its financial statements to evaluate:

- (a) the nature, extent and financial effects of its interests in joint arrangements and associates, including the nature and effects of its contractual relationship with the other investors with joint control of, or significant influence over, joint arrangements and associates; and
- (b) the nature of, and changes in, the risks associated with its interests in joint ventures and associates.

v) Interests in unconsolidated structured entities

Ind AS 112 also requires that an entity should disclose information that enables users of its financial statements:

- (a) to understand the nature and extent of its interests in unconsolidated structured entities; and
- (b) to evaluate the nature of, and changes in, the risks associated with its interests in unconsolidated structured entities.

5.7 IND AS 113 FAIR VALUE MEASUREMENT

Q14. What is fair value measurement? Explain the factors to be considered in fair value measurement.

Ans. :

(Imp.)

The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Fair value is a market-based measurement, not an entity-specific measurement. For some assets and liabilities, observable market transactions or market information might be available. For other assets and liabilities, observable market transactions and market information might not be available.

Entity specific measurement value is that amount at which the market would value the future

cash flows expected by the entity through the use (or settlement) or realize (or pay) of an asset (or a liability). The assumptions used in an entity-specific measurement reflect the entity's expected use of an asset or settlement of a liability and the role of the entity's proprietary skills in that use or settlement. Entity specific measurement is sometimes referred to as value in use or value to the entity.

However, the objective of a fair value measurement in both cases is the same:

- To estimate the price at which an orderly transaction to sell the asset or to transfer the liability
- Would take place between market participants at the measurement date
- Under current market conditions (i.e., an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability).

Ind AS-113 stipulates the following factors that should be considered in fair value measurement:

- i) The asset or liability
- ii) The transaction
- iii) Market participants
- iv) The price

In addition, there are considerations that are specific to:

- Non-financial assets
- Liabilities and Equity
- Financial instrument

i) Asset or liability

A fair value measurement related to a particular asset or liability. It should, therefore, incorporate the asset or liability's specific characteristics, for example:

- The condition and location of the assets;
- Restriction, if any, on the sale or use of the asset.

ii) The Transaction

Fair value measurement in Ind AS-113 assumes that the asset or liability exchanged in an

orderly transaction between market participants under current market conditions at the measurement date.

Principal market- Ind AS-113, management determines fair value based on a transaction that would take place in the principal market or, in its absence, the most advantageous market. If there is a principal market, the price in the market must be used even if prices in other markets are more advantageous. The reference transactions may be actual or hypothetical.

The principal market is the market with the greater volume and level of activity for the asset or liability.

Most advantageous market - The market that maximizes the amount that would be received to sell the asset or minimizes the amount that would be paid to transfer the liability, after taking into account transaction costs and transport costs.

For non - financial assets, identifying potential markets will be based on the highest and best use' valuation premise, from the perspective of market participants. In order to determine the highest and best use of a non-financial asset, the reporting entity may need to consider multiple markets. In practice most non-financial assets are already employed in their 'highest and best use', so this requirement is not as onerous as it may seem.

Example: (Principal or most advantageous market) In a territory there are two available markets for soya bean:

(a) Export

this is the market where the higher prices would be available for the producer, but there are limitations in the volumes that can be sold in this market because the government sets a limit on the volume of exports and each producer needs to get an authorisations to export its production. It is rare for the government to authorize more than 25% of the production for export.

(b) Domestic

the prices are lower in this market as compared to the export market, but there are no restrictions in terms of volume (other than the demand of the product by purchasers)

Producers intend to sell all of the productions they can in the export market and, when they do not have any further authorization to export, they sell the remaining production in the domestic market.

Therefore, the most advantageous market is the export market, as this is the one that gives the higher benefits to the produces. But in terms of volume, the domestic market is the principal market for the producers and therefore is the one which should be used to determine fair value.

iii) Market participants

Ind AS-113 emphasis that a fair value measurement should be based on the assumptions of market participants (that is, it is not an entity-specific measurement). Market participants are buyers and sellers in the principal (or most advantageous) market for the asset or liability that are:

- **Independent:** The transaction counterparties are not related parties as defined in Ind AS-24; however, this does not preclude related-party transaction prices from being used as valuation inputs if there is evidence that the transactions were on market terms.
- **Knowledgeable:** Transaction counterparts have a reasonable un-derstanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary.
- Able to transact in the asset or liability
- Willing to transact in the asset or liability: Transaction counterparties are motivated but not forced or otherwise compelled to transact.

iv) Price

Under Ind AS-113, fair value is based on the exit price (the price that would be received to sell an asset or would be paid to transfer a liability), not the (transaction price) entry price (the price that was paid for the asset or that was received to assume the liability). Conceptually, entry and exit prices are different. The exit price concept is based on current expectation about the sale or transfer price from the perspective of market participants.

It was deliberated carefully before arriving at the conclusion to use an exit price. There are arguments against the use of exit prices. For example, one might argue that the exit price is not relevant when an entity intends to use an asset rather than sell it.

However, even if an entity intends to use the asset, exit price is still appropriate in a fair value measurement. This is because the exit price reflects expectations about future cash flows by selling it to a market participant that would use it in the same way. A market participant will only pay for benefits that it expects to generate from the asset's use or sale. A similar logic applies to liabilities, in that a market participant would reflect expectations about cash outflows necessary to fulfil an obligation.

Fair value takes account of any restrictions on the sale or use of an asset, if those restrictions relate to the asset rather than to the holder of the asset and a market participant would take those restrictions into account in determining the price that he is prepared to pay.

Considerations specific to non-financial assets

Ind AS-113 requires the fair value of a non-financial asset to be measured based on its highest and best use from a market participant's perspective. This requirement does not apply to financial instruments, liabilities or equity. The highest and best use takes into account the use of the asset that is:

- **physically possible:** takes into account the physical characteristics that market participants would consider (for example, property location or size);
- **legally permissible:** takes into account legal restrictions on use of the asset that market participants would consider (for example, local government regulations regarding use of asset for commercial purpose); or
- **Financially feasible:** takes into account whether a use of the asset generates adequate investment returns for market participants. This should incorporate the costs of converting the asset to that use.

The highest and best use of a property is determined by reference to its use and not its

classification. For example, if an entity uses the revaluation model in Ind AS-16 for its head office property the determination of fair value will be based on whether the highest and best use of the property is as an office or for some other purpose and not on whether the property is owner-occupied or an investment property.

Highest and best use is determined from the perspective of market participants. It does not matter whether the entity intends to use the asset differently.

Considerations specific to liabilities and equity

Ind AS-113 requires the fair value of liabilities and equity to be based on the price that would be obtained if the liability or equity instrument is transferred to another market participant without settling or extinguishing the liability. This means that it would be inappropriate to assume that the fair value of the liability/equity instrument is the extinguishment or settlement amount.

The fair value of the liability or equity instrument is generally derived by:

- (a) using the quoted price in an active market for the identical liability held by another party as an asset (for example, actively-quoted debt security prices);
- (b) using other observable inputs if the price in (a) is not available, for example, quoted price in an inactive market for the identical liability held by another party as an asset;
- (c) using another valuation technique if the observable inputs in (b) are not available, such as:
 - **An income approach:** this approach uses a present value technique that takes into account the future cash outflows that a market participant would expect to receive from holding the liability or equity instrument as an asset; and
 - **A market approach:** under this approach, fair value is determined using quoted prices for similar liabilities held by other parties as assets.

Non-performance risk

The fair value of a liability reflects the effect of non-performance risk, which is the risk that an entity will not fulfil an obligation; Non-performance risk includes, but may not be limited to, an entity's own credit risk. Non- performance risk is assumed to be the same before and after the transfer of the liability.

Considerations specific to financial instruments

Inputs based on bid and ask prices: Bid and ask prices are common within markets for securities, financial instruments and commodities. If an input within the fair value hierarchy is based on bid prices and ask prices, the price within the bid-ask spread that is most representative of fair value in the circumstances is used to measure fair value.

Ind AS-113 does not preclude the use of mid-market pricing or other pricing conventions that are used by market participants as a practical expedient for fair value. Once management has established which convention it is using, it should follow its accounting policy consistently.

Q15. Explain the Techniques of fair value measurement.

Ans :

AS-113 describes three classes of valuation technique:

i) Market approach

A valuation technique that uses prices and other relevant information generated by market transactions involving identical or comparable (that is, similar) assets, liabilities, or a group of assets and liabilities, such as a business. Examples include:

- Valuation techniques using market multiples derived from comparable transactions
- Matrix pricing: A mathematical technique used principally to value some types of financial instruments, such as debt securities, without relying exclusively on quoted prices for the specific securities, but rather relying on the securities' relationship to other benchmark quoted securities.

ii) Income approach

Valuation techniques that convert future amounts (for example, cash flows or income and expenses) to a single current (that is, discounted) amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts. Examples include:

- Present value technique
- Multiple-period excess earnings method
- Option pricing models. These include the Black-Scholes-Merton formula and binomial model that incorporate present value techniques and reflect both time value and an option's intrinsic value.

iii) Cost approach

A valuation technique that reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).

5.8 IND AS 114 REGULATORY DEFERRAL ACCOUNTS
Q16. What is regulatory deferral accounts? Discuss its features.

Ans :

Certain entities provide goods or services to customers at a price or rate subject to rate regulation by the government.

For example, supply of gas or electricity. Rate regulations ensure that specified cost are recovered by the supply, simultaneously the prices charged to customer are fair and reasonable. These twin objectives mean that prices charged to customers at a particular time do not necessarily cover the cost incurred by the supplier at that time. In this case the recovery of such cost is deferred. In other words entities that are subject to rate regulation to capitalised and defer expenditures that non-rate-regulated entities would recognise as expenses.

Similarly these rate regulated entities are permitted to defer income that non-rate-regulated entities would recognise the income in profit or loss. The resulting regulatory deferral accounts balances are presented in varieties of ways. They are often described as Regulatory Asset and Regulatory Liabilities.

Main features of this Standard

This Standard:

- Permits an entity that adopts IFRS (Ind AS) to continue to use, in its first and subsequent IFRS (Ind AS) financial statements, its previous GAAP accounting policies for recognition, measurement, impairment and de-recognition of regulatory deferral account balances without specifically considering the requirement of Ind AS-8. Previous GAAP for India is guidance on Accounting for Rate Regulated Activities, which is effected from 1st April 2015.
- Requires entities to present regulatory deferral account balances as separate line items in the statement of financial position and to present movements in those account balances as separate line items in the statement of profit or loss and other comprehensive income; and
- Requires specific disclosures to identify the nature of, and risks associated with, the rate regulation that has resulted in the recognition of regulatory deferral account balance in accordance with this Standard.

In simple words, the Ind AS-114 allows the accounting as per the previous GAAP i.e., accounting as per guidance note on Accounting for Rate Regulated Activities however the presentation of regulatory deferral accounts in the financial statements of Indian companies has to be done as per Ind AS-114 and also the few requirements of disclosures.

Q17. Explain the factors of regulatory deferral accounts.

Ans :

- statutes or regulations that specifically provide for the recovery of the cost in rates;
- formal approvals from the regulator specifically authorizing recovery of the cost in rates;
- previous formal approvals from the regulator allowing recovery for substantially similar costs (precedents) for a specific entity or other entities in the same jurisdiction;

- written approval from the regulator (although not a formal approval) approving future recovery in rates;
- uniform regulatory guidance providing for the treatment of various costs that the regulator typically follows in setting rates;
- opinions of independent experts regarding recoverability of the cost on the basis of regulations and past practice;
- Any additional evidence provided by events after the balance sheet date, where appropriate as per the applicable Accounting Standard.

5.9 IND AS 115 REVENUE FROM CONTRACTS WITH CUSTOMERS
Q18. Explain briefly about Ind AS 115.

Ans :

The objective of Ind AS 115 is to establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer.

The standard applies to all contracts with customers, except the lease contracts within the scope of Ind AS 17, Leases; insurance contracts within the scope of Ind AS 104, Insurance Contracts; financial instruments and other contractual rights or obligations; and non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers.

The core principle of Ind AS 115 is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Revenue shall be recognised by an entity in accordance with this core principle by applying the following five steps:

1. Identify contract with a customer

This Standard defines a 'contract' and a 'customer' and specifies five mandatory

criteria to be met for identification of a contract.

2. Identify performance obligations in contract

At contract inception, assess the goods or services promised and identify as a performance obligation each promise to transfer to the customer either:

- (a) a good or service (or a bundle of goods or services) that is distinct; or
- (b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

3. Determine transaction price

This Standard uses transaction price approach instead of fair value approach in Ind AS 18 while determining amount of consideration. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised may include fixed amounts, variable amounts, or both. If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer. Estimate amount of variable consideration by using either the expected value method or the most likely amount method. The transaction price is also adjusted for the effects of the time value of money if the contract includes a significant financing component for any consideration payable to the customer.

4. Allocate the transaction price to the performance obligations in the contract

An entity typically allocates the transaction price to each performance obligation on the basis of the relative stand-alone selling prices of each distinct good or service promised in the contract. If a stand-alone selling price is

not observable, an entity estimates it. Sometimes, the transaction price includes a discount or a variable amount of consideration that relates entirely to a part of the contract. The requirements specify when an entity allocates the discount or variable consideration to one or more, but not all, performance obligations in the contract. Any subsequent changes in the transaction price shall be allocated to the performance obligations on the same basis as at contract inception. Amounts allocated to a satisfied performance obligation shall be recognised as revenue, or as a reduction of revenue, in the period in which the transaction price changes.

5. Recognise revenue when the entity satisfies a performance obligation

An entity recognises revenue when it satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service). The amount of revenue recognised is the amount allocated to the satisfied performance obligation. A performance obligation may be satisfied at a point in time or over time. If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time. For performance obligations satisfied over time, an entity recognises revenue over time by selecting an appropriate method (output methods and input methods) for measuring the entity's progress towards complete satisfaction of that performance obligation.

Treatment of Contract Costs

Ind AS 115 specifies the following requirements for contract costs:

1. Incremental costs of obtaining a contract

Those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained. An entity shall recognise these costs as an asset if the entity expects to recover those costs. Costs to obtain a contract that

would have been incurred regardless of whether the contract was obtained shall be recognised as an expense when incurred, unless those costs are explicitly chargeable to the customer regardless of whether the contract is obtained.

2. Costs to fulfil a contract

If costs incurred in fulfilling a contract are not within scope of another Standard, entity shall recognise an asset from the costs incurred to fulfil a contract only if some specified criteria are met. If costs incurred in fulfilling a contract are within scope of another Standard, entity shall account for those costs in accordance with those other Standards.

Contract costs recognised as an asset shall be amortised on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates.

An impairment loss shall be recognised in profit or loss to the extent that the carrying amount of contract costs recognised as an asset exceeds the remaining amount of consideration that the entity expects to receive in exchange for the goods or services to which the asset relates after deducting the costs that relate directly to providing those goods or services and that have not been recognised as expenses.

Presentation

When either party to a contract has performed, an entity shall present the contract in the balance sheet as a contract asset or a contract liability, depending on the relationship between the entity's performance and the customer's payment.

- If a customer pays consideration, or an entity has a right to an amount of consideration that is unconditional (i.e. a receivable), before the entity transfers a good or service to the customer, the entity shall present the contract as a contract liability when the payment is made or the payment is due (whichever is earlier).
- If an entity performs by transferring goods or services to a customer before the customer pays consideration or before payment is due, the entity shall present the contract as a

contract asset, excluding any amounts presented as a receivable.

- An entity shall present any unconditional rights to consideration separately as a receivable.

Sale with a right of return

To account for the transfer of products with a right of return (and for some services that are provided subject to a refund), an entity shall recognise all of the following:

- revenue for the transferred products in the amount of consideration to which the entity expects to be entitled (therefore, revenue would not be recognised for the products expected to be returned);
- a refund liability; and
- an asset (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability.

Warranties

If customer has the option to purchase warranty separately, the warranty is a distinct service because the entity promises to provide the service to the customer in addition to the product that has the functionality described in the contract. In that case, entity shall account for the promised warranty as a performance obligation and allocate a portion of the transaction price to that performance obligation.

Principal versus agent considerations

When another party is involved in providing goods or services to a customer, the entity shall determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (i.e. the entity is a principal) or to arrange for those goods or services to be provided by the other party (i.e. the entity is an agent). An entity determines whether it is a principal or an agent for each specified good or service promised to the customer. A specified good or service is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer. If a contract with a customer includes more than one specified good or service, an entity could be a principal for some specified goods or services and an agent for others.

Repurchase agreements

Repurchase agreements generally come in three forms viz. (i) an entity's obligation to repurchase the asset (a forward); (ii) an entity's right to repurchase the asset (a call option); and an entity's obligation to repurchase the asset at the customer's request (a put option).

Bill-and-hold arrangements

A bill-and-hold arrangement is a contract under which an entity bills a customer for a product but retains physical possession of the product until it is transferred to the customer at a point in time in the future. Ind AS 115 specifies four criteria that must be fulfilled for a customer to have obtained control of a product in a bill-and-hold arrangement.

Disclosure

The objective of the disclosure requirements is for an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. To achieve that objective, an entity shall disclose qualitative and quantitative information about all of the following:

- its contracts with customers
- the significant judgements, and changes in the judgements, made in applying this Standard to those contracts and
- any assets recognised from the costs to obtain or fulfil a contract with a customer

Appendix D of Ind AS 115 gives guidance on the accounting by operators for public-to-private service concession arrangements. This Appendix applies to both (a) infrastructure that the operator constructs or acquires from a third party for the purpose of the service arrangement; and (b) existing infrastructure to which the grantor gives the operator access for the purpose of the service arrangement. Infrastructure within the scope of this Appendix shall not be recognised as property, plant and equipment of the operator because the contractual service arrangement does not convey the right to control the use of the public service infrastructure to the operator.

Short Question & Answers

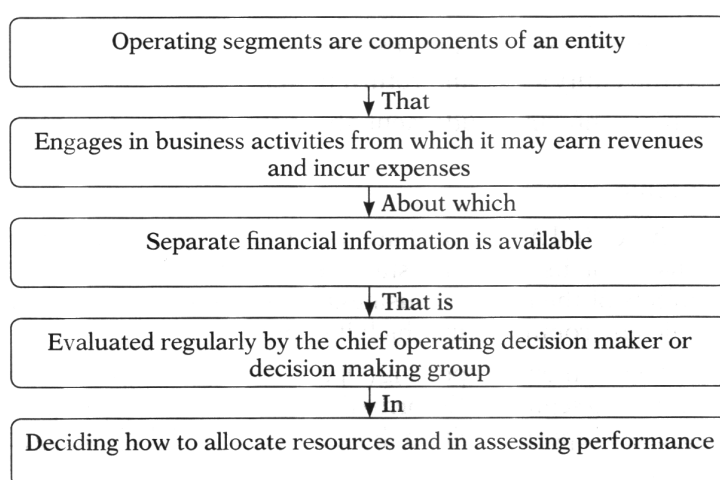
1. What is operating segment?

Ans :

The entities are required to disclose information about their operating segments now the question is what is operating segment which is to be reported in the financial statements.

Reportable segments are operating segments or aggregation of operating segments that meet specified criteria.

Operating segment



2. What is financial instrument?

Ans :

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Financial liability it is necessary to understand the difference between financial liability and equity.

The financial instrument is financial liability if there is a contractual obligation on the issuer either to deliver cash or other financial asset to the holder.

An equity instrument is any contract that evidences a residual interest in the asset of an entity after deducting all liabilities.

Although the holder of an equity instrument may be entitled to a pro rata share of any distribution out of equity, the issuer does not have a contractual obligation to make such a distribution.

3. Exception of financial liability

However as exception to the definition of a financial liability, a puttable instrument that includes such an obligation is classified as equity instrument if it has the following feature:

➤ **Instrument Specific features:**

- Holder is entitled for a pro-rata share of the entity's net assets on liquidation.
- Puttable instrument is subordinate to all other classes of instrument.
- All instruments in the class have identical features.
- Contractual obligation shall not be under potentially unfavourable conditions to an entity.
- Total expected cash flows based substantially on P/L or change in the recognised net assets or change in fair value of recognition and unrecognized net assets of the entity over the life of instruments.

➤ **Issuer Specific feature** - Issuer must have no other financial instrument or contract that has:

- Total cash flows based substantially on P/L, change in recognized net assets or change in fair value of the recognized and unrecognized net assets of the entity;
- The effect of substantially restricting or fixing the residual return to the puttable instrument holder.

4. Forward Contract*Ans :*

It is the simplest form of a Derivatives Contract. Basically forward contract is a valid contract settled at some future point of time. For example a forward contract involving settlement in six month's time in which one party (the purchaser) promises to purchase ₹ 10 lakhs face value of fixed interest rate government bonds, in exchange of ₹ 10 lakhs cash; and the other party (the seller) promises to deliver ₹ 10 lakhs face value of fixed rate government bonds in exchange for ₹ 10 lakhs

cash. During the six months, both parties have a contractual right and a contractual obligation to exchange financial instruments. If the market price of the government bonds rises above ₹ 10 lakhs, the conditions will be favourable to the purchaser and unfavourable to the seller; if the market price falls below ₹ 10 lakhs, the effect will be the opposite. However, both parties to a forward contract have an obligation to perform at the agreed time.

5. What are embedded derivative?*Ans :*

An embedded derivative is a component of a hybrid contract that also includes a non-derivative /together with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.

For example, A company with \$ as its functional currency buys raw materials for use in production from a UK company that has £ as its functional currency. The transaction is denominated in €. As this is not the functional currency of either party to the transaction an embedded derivative has been included in the purchase contract. There are now two elements to the contract:

- (i) Contract to buy/sell goods; and
- (ii) Movement on the \$/€ and £/€ exchange rates.

6. What is joint arrangement?*Ans :*

A joint arrangement is an arrangement of which two or more parties have into control and the following characteristics are present:

- The parties are bound by a contractual arrangement; and
- The contractual arrangement gives two or more of the parties joint control of the arrangement.

Types and classification of a joint arrangement

A joint arrangement can be classified as a joint operation or a joint venture:

- **A joint operation** is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Those parties are called joint operators.
- **A joint venture** is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Those parties are called joint venturers.

7. Fair value measurement.

Ans :

The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Fair value is a market-based measurement, not an entity-specific measurement. For some assets and liabilities, observable market transactions or market information might be available. For other assets and liabilities, observable market transactions and market information might not be available.

Entity specific measurement value is that amount at which the market would value the future cash flows expected by the entity through the use (or settlement) or realize (or pay) of an asset (or a liability). The assumptions used in an entity-specific measurement reflect the entity's expected use of an asset or settlement of a liability and the role of the entity's proprietary skills in that use or settlement. Entity specific measurement is sometimes referred to as value in use or value to the entity.

8. Factors of regulatory deferral accounts.

Ans :

- statutes or regulations that specifically provide for the recovery of the cost in rates;

- formal approvals from the regulator specifically authorizing recovery of the cost in rates;
- previous formal approvals from the regulator allowing recovery for substantially similar costs (precedents) for a specific entity or other entities in the same jurisdiction;
- written approval from the regulator (although not a formal approval) approving future recovery in rates;
- uniform regulatory guidance providing for the treatment of various costs that the regulator typically follows in setting rates;
- opinions of independent experts regarding recoverability of the cost on the basis of regulations and past practice;
- Any additional evidence provided by events after the balance sheet date, where appropriate as per the applicable Accounting Standard.

9. Revenue from contracts with customers .

Ans :

(a) Identify contract with a customer

This Standard defines a 'contract' and a 'customer' and specifies five mandatory criteria to be met for identification of a contract.

(b) Identify performance obligations in contract

At contract inception, assess the goods or services promised and identify as a performance obligation each promise to transfer to the customer either:

- (i) a good or service (or a bundle of goods or services) that is distinct; or
- (ii) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

10. Treatment of contract costs.*Ans ;***(a) Incremental costs of obtaining a contract**

Those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained. An entity shall recognise these costs as an asset if the entity expects to recover those costs. Costs to obtain a contract that would have been incurred regardless of whether the contract was obtained shall be recognised as an expense when incurred, unless those costs are explicitly chargeable to the customer regardless of whether the contract is obtained.

(b) Costs to fulfil a contract

If costs incurred in fulfilling a contract are not within scope of another Standard, entity shall recognise an asset from the costs incurred to fulfil a contract only if some specified criteria are met. If costs incurred in fulfilling a contract are within scope of another Standard, entity shall account for those costs in accordance with those other Standards.

Contract costs recognised as an asset shall be amortised on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates.

Choose the Correct Answer

1. What are the principal objectives of Ind AS 107? [b]
- (a) To provide presentation and disclosure requirements for financial instruments.
 - (b) To require disclosures about the significance of financial instruments for an entity's financial position and financial performance and qualitative and quantitative information about exposure to risks arising from financial instruments.
 - (c) To set out specified balance sheet and income statement formats for financial entities.
 - (d) To require disclosures about an entity's exposure to off-balance-sheet instruments and other complex transactions.
2. Which of the following types of information does Ind AS 107 not require to be disclosed about the significance of financial instruments? [d]
- (a) Carrying amounts of categories of financial instruments.
 - (b) Fair values of financial instruments.
 - (c) Information about the use of hedge accounting.
 - (d) Information about financial instruments, contracts, and obligations under share-based payment transactions.
3. What are the three specific quantitative disclosure requirements. [d]
- (a) Liquidity risk
 - (b) Credit risk
 - (c) Market risk
 - (d) All of the above
4. What is Liquidity risk? [a]
- (a) The risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities
 - (b) The risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.
 - (c) The risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in currency liquidity
 - (d) All the above
5. Financial instruments deals with [b]
- (a) Ind AS 108
 - (b) Ind AS 107
 - (c) Ind AS 114
 - (d) Ind AS 112
6. Operating segments deals with [a]
- (a) Ind AS 108
 - (b) Ind AS 107
 - (c) Ind AS 114
 - (d) Ind AS 112

7. Regulatory deferral accounts deals with [c]
(a) Ind AS 108 (b) Ind AS 107
(c) Ind AS 114 (d) Ind AS 112
8. Ind AS 113 deals with [a]
(a) Fair measurement (b) Revenue from contracts with customers
(c) Financial instruments (d) Consolidated financial instruments
9. Ind AS 115 deals with [b]
(a) Fair measurement (b) Revenue from contracts with customers
(c) Financial instruments (d) Consolidated financial instruments
10. Ind AS 109 deals with [c]
(a) Fair measurement (b) Revenue from contracts with customers
(c) Financial instruments (d) Consolidated financial instruments

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Fill in the blanks

1. The objective of the Ind AS 107 is to require entities to provide disclosures in _____ .
2. _____ assets such as inventories, property, plant and equipment;
3. _____ of financial instrument means removal of an asset or a liability from the books as a result of sale payment, re-negotiation or default by the counter party.
4. The objective of Ind AS 110, is to establish principles for the presentation and preparation of _____ .
5. CFS stands for _____ .
6. A joint arrangement can be classified as a _____ .
7. _____ is a market-based measurement, not an entity-specific measurement.
8. A _____ is a contract under which an entity bills a customer for a product.
9. Repurchase agreements generally in _____ forms.
10. An entity shall classify all financial liabilities as subsequently measured at _____ .

ANSWERS

1. Their financial statements
2. Physical
3. De-recognition
4. Consolidated financial statements
5. Consolidated financial statements
6. Joint operation or a joint venture
7. Fair value
8. Bill-and-hold arrangement
9. Three
10. Amortised cost

FACULTY OF COMMERCE
M.Com.(CBCS) I - Semester Examination
Model Paper - I
INDIAN ACCOUNTING STANDARDS

Time : 3 Hours]

[Max. Marks : 80

Note: Answer all the questions from Part - A and Part - B. Each question carries 4 marks in Part - A and 12 marks in Part - B.

SECTION - A (5 × 4 = 20)

ANSWERS

- | | |
|-----------------------------------|----------------------|
| 1. What is Harmonization ? | (Unit - I, SQA. 9) |
| 2. Types of leases. | (Unit - II, SQA. 10) |
| 3. Define substantial period. | (Unit - III, SQA. 1) |
| 4. What is business combinations? | (Unit - IV, SQA. 4) |
| 5. Fair value measurement. | (Unit - V, SQA. 7) |

SECTION - B (5 × 12 = 60)

Note: Answer all the questions by using internal choice in not exceeding 4 pages each.

- | | |
|--|------------------------|
| 6. (a) Explain briefly about International Accounting Standard Board? | (Unit - I, Q.No. 22) |
| OR | |
| (b) What are the differences between IAS, USGAAP and Indian GAAP? | (Unit - I, Q.No. 30) |
| 7. (a) Explain accounting for post employment benefits. | (Unit - II, Q.No. 31) |
| OR | |
| (b) (i) Explain the Features of Financial Statements ? | (Unit - II, Q.No. 4) |
| (ii) What is Income tax? Explain the need and scope of Ind As-12. | (Unit - II, Q.No. 17) |
| 8. (a) (i) What do you understand by Related Party disclosure. | (Unit - III, Q.No. 3) |
| (ii) What is earning per share? | (Unit - III, Q.No. 11) |
| OR | |
| (b) (i) Explain briefly about Ind As 23. | (Unit - III, Q.No. 1) |
| (ii) What is IFR? Explain the need and objective of IFR. | (Unit - III, Q.No. 13) |
| 9. (a) Explain briefly about share based payment. | (Unit - IV, Q.No. 4) |
| OR | |
| (b) What are the reasons for issuing Ind AS-106? Explain the objectives and scope of Ind AS-106. | (Unit - IV, Q.No. 15) |
| 10. (a) (i) Explain basis and reconciliation of operating segment. | (Unit - V, Q.No. 3) |
| (ii) What is joint arrangement? Explain the classification of joint arrangement. | (Unit - V, Q.No. 11) |
| OR | |
| (b) (i) Explain De-recognition of financial instruments. | (Unit - V, Q.No. 9) |
| (ii) Explain briefly about Ind As 107. | (Unit - V, Q.No. 1) |

FACULTY OF COMMERCE
M.Com.(CBCS) I - Semester Examination
Model Paper - II
INDIAN ACCOUNTING STANDARDS

Time : 3 Hours]

[Max. Marks : 80

Note: Answer all the questions from Part - A and Part - B. Each question carries 4 marks in Part - A and 12 marks in Part - B.

SECTION - A (5 × 4 = 20)

ANSWERS

- | | |
|------------------------------------|----------------------|
| 1. Define Accounting Standards. | (Unit - I, SQA. 6) |
| 2. What are the employee benefits? | (Unit - II, SQA. 6) |
| 3. What is hyperinflation? | (Unit - III, SQA. 3) |
| 4. Define insurance contracts. | (Unit - IV, SQA. 5) |
| 5. What are embedded derivative? | (Unit - V, SQA. 5) |

SECTION - B (5 × 12 = 60)

Note: Answer all the questions by using internal choice in not exceeding 4 pages each.

- | | |
|--|---------------------|
| 6. (a) Explain briefly about accounting as a Information System. | (Unit - I, Q.No. 7) |
|--|---------------------|

OR

- | | |
|--|-----------------------|
| (b) What is IFRS ? Explain the merits and demerits of IFRS. | (Unit - I, Q.No. 31) |
| 7. (a) (i) What are the objectives of Financial Statements ? | (Unit - II, Q.No. 2) |
| (ii) What are PPE? Explain the scope of PPE. | (Unit - II, Q.No. 21) |

OR

- | | |
|--|------------------------|
| (b) (i) What is Cashflow Statement ? | (Unit - II, Q.No. 6) |
| (ii) What is sale and lease back? Explain the accounting treatment of sale and lease back. | (Unit - II, Q.No. 26) |
| 8. (a) (i) Explain briefly about contingent asset. | (Unit - III, Q.No. 20) |
| (ii) What do you understand by Ind As 41? | (Unit - III, Q.No. 27) |

OR

- | | |
|---|------------------------|
| (b) (i) Define substantial period. | (Unit - III, Q.No. 2) |
| (ii) Explain different types of EPS. | (Unit - III, Q.No. 12) |
| 9. (a) Explain the concept of Ind As 101. | (Unit - IV, Q.No. 1) |

OR

- | | |
|---|-----------------------|
| (b) Explain the presentation and disclosure of As 105. | (Unit - IV, Q.No. 13) |
| 10. (a) (i) What are financial liabilities? Explain the classification and exceptions of financial liabilities. | (Unit - V, Q.No. 6) |
| (ii) Explain the factors of regulatory deferral accounts. | (Unit - V, Q.No. 17) |

OR

- | | |
|---------------------------------------|----------------------|
| (b) Explain briefly about Ind As 115. | (Unit - V, Q.No. 18) |
|---------------------------------------|----------------------|

FACULTY OF COMMERCE
M.Com.(CBCS) I - Semester Examination
Model Paper - III
INDIAN ACCOUNTING STANDARDS

Time : 3 Hours]

[Max. Marks : 80

Note: Answer all the questions from Part - A and Part - B. Each question carries 4 marks in Part - A and 12 marks in Part - B.

SECTION - A (5 × 4 = 20)

ANSWERS

- | | |
|--|-----------------------|
| 1. Disadvantages of Accounting Information System (AIS). | (Unit - I, SQA. 4) |
| 2. What is Cashflow Statement ? | (Unit - II, SQA. 2) |
| 3. What is Amortization? | (Unit - III, SQA. 11) |
| 4. Optional exceptions for first time adoptions. | (Unit - IV, SQA. 1) |
| 5. Treatment of contract costs. | (Unit - V, SQA. 10) |

SECTION - B (5 × 12 = 60)

Note: Answer all the questions by using internal choice in not exceeding 4 pages each.

- | | |
|---|----------------------|
| 6. (a) Explain the evolution of accounting standards. | (Unit - I, Q.No. 19) |
|---|----------------------|

OR

- | | |
|---|-----------------------|
| (b) (i) FASB | (Unit - I, Q.No. 24) |
| (ii) ASB | (Unit - I, Q.No. 26) |
| 7. (a) (i) Explain briefly about Ind Accounting Standard-2 (IAS 2). | (Unit - II, Q.No. 5) |
| (ii) Explain accounting treatment for short term employee benefits. | (Unit - II, Q.No. 30) |

OR

- | | |
|--|-----------------------|
| (b) (i) Explain various principles of grants. | (Unit - II, Q.No. 35) |
| (ii) Explain the various activities in cash flow statement ? | (Unit - II, Q.No. 7) |
| 8. (a) What do you understand by Related Party disclosure? | (Unit - III, Q.No. 3) |

OR

- | | |
|--|------------------------|
| (b) Explain briefly about Ind As 36 ? | (Unit - III, Q.No. 17) |
| 9. (a) What is business combinations? Explain the accounting for business combination. | (Unit - IV, Q.No. 8) |

OR

- | | |
|---|-----------------------|
| (b) State the importance of Ind As 104. | (Unit - IV, Q.No. 10) |
| 10. (a) Explain briefly about Ind As 112. | (Unit - V, Q.No. 13) |

OR

- | | |
|---|----------------------|
| (b) What is regulatory deferral accounts? Discuss its features. | (Unit - V, Q.No. 16) |
|---|----------------------|

FACULTY OF COMMERCE
M.Com. I - Semester (CBCS) Examination
January - 2020
INDIAN ACCOUNTING STANDARDS

Time : 3 Hours]

[Max. Marks : 80

Note: Answer All the questions from Part - A and any Five questions from Part - B.

PART - A (5 × 4 = 20 Marks)
[Short Answer Type]

Answer all questions in not more than one page each

1. Define Accounting Principle (Unit-I, Q.No. 10)
2. What do you mean by construction contracts? (Unit-II, SQA. 11)
3. Explain briefly about related party disclosure. (Unit-III, Q.No. 3)
4. What do you understand about business combinations? (Unit-IV, SQA - 4)
5. Explain briefly about fair value measurement. (Unit-V, SQA - 7)

PART - B (5 × 12 = 60 Marks)
[Short Answer Type]

Note: Answer all questions by using internal choice in not exceeding 4 pages each

6. (a) Explain the concept of Accounting Standard and its evolutions. (Unit-I, Q.No. 15, 19)
OR
(b) Elaborate the need and importance of uniform global financial reporting. (Unit-I, Q.No. 29)
7. (a) Discuss the significance of Ind AS – 1 and Ind AS – 2. (Unit-II, Q.No. 1, 5)
OR
(b) Explain the effects of changes in foreign exchange rates. (Unit-II, Q.No. 36)
8. (a) Discuss the accounting standard related to investments in associates and joint ventures. (Unit-III, Q.No. 5, 7)
OR
(b) Explain the salient features of Ind AS-33 and Ind AS-34. (Unit-III, Q.No. 11, 13)
9. (a) Explain the procedure for first time adoption of Indian Accounting standards as per AS-101. (Unit-IV, Q.No. 1)
OR
(b) Discuss the Ind. AS-105 related to non-current assets held for sale and discontinued operations. (Unit-IV, Q.No. 13)
10. (a) Discuss the salient features of financial instrument disclosure as per Ind. AS - 107. (Unit-V, Q.No. 1)
OR
(b) Explain the procedure for the preparation of consolidated financial statements as per Ind. AS - 110. (Unit-V, Q.No. 10)