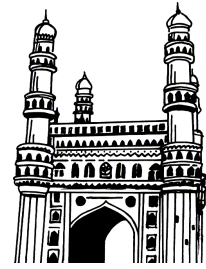


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Ans : (Imp.)

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Ans : (Imp.)

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Ans : (Imp.)

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Ans : (Imp.)

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UNIT I

INTRODUCTION :

Introduction to Accounting – Concept of Accounting Theory – Role of accounting theory – Classification of Accounting Theory – Deductive and inductive approach in theory formulation – Accounting Principles: Concepts and Conventions – Accounting standard: Concept – Evolution.

1.1 INTRODUCTION TO ACCOUNTING

Q1. Define the term Accounting.

(OR)

What is Accounting?

Ans :

Introduction

Accounting has rightly been termed as the language of the business. The basic function of a language is to serve as a means of communication. Accounting also serves this function. It communicates the results of business operations to various parties who have some stake in the business viz., the proprietor, creditors, investors, Government and other agencies. Though accounting is generally associated with business but it is not only business which makes use of accounting. Persons like housewives, Government and other individuals also make use of a accounting. For example, a housewife has to keep a record of the money received and spent by her during a particular period. She can record her receipts of money on one page of her "household diary" while payments for different items such as milk, food, clothing, house, education etc. on some other page or pages of her diary in a chronological order. Such a record will help her in knowing about:

- (i) The sources from which she received cash and the purposes for which it was utilized.
- (ii) Whether her receipts are more than her payments or vice-versa?
- (iii) The balance of cash in hand or deficit, if any at the end of a period.

Origin and Growth of Accounting

Accounting is as old as money itself. However, the act of accounting was not as developed as it is today because in the early stages of civilization, the number of transactions to be recorded were so small that each businessman was able to record and check for himself all his transactions. Accounting was practiced in India twenty three centuries ago as is clear from the book named "Arthashastra" written by Kautilya, King Chandragupta's minister. This book not only relates to politics and economics, but also explain the art of proper keeping of accounts.

However, the modern system of accounting based on the principles of double entry system owes its origin to Luca Pacioli who first published the principles of Double Entry System in 1494 at Venice in Italy. Thus, the art of accounting has been practiced for centuries but it is only in the late thirties that the study of the subject 'accounting' has been taken up seriously.

Meaning

The main purpose of accounting is to ascertain profit or loss during a specified period, to show financial condition of the business on a particular date and to have control over the firm's property. Such accounting records are required to be maintained to measure the income of the business and communicate the information so that it may be used by managers, owners and other interested parties. Accounting is a discipline which records, classifies, summarizes and interprets financial information about the activities of a concern so that intelligent decisions can be made about the concern.

Definitions

(i) **According to The American Institute of Certified Public Accountants** has defined the Financial Accounting as "the art of recording, classifying and summarizing in as significant manner and in terms of money transactions and events which in part, at least of a financial character, and interpreting the results thereof".

(ii) **According to American Accounting Association** defines accounting as "the process of identifying, measuring, and communicating economic information to permit informed judgments and decisions by users of the information.

From the above the following attributes of accounting emerge :

(i) Recording

It is concerned with the recording of financial transactions in an orderly manner, soon after their occurrence In the proper books of accounts.

(ii) Classifying

It is concerned with the systematic analysis of the recorded data so as to accumulate the transactions of similar type at one place. This function is performed by maintaining the ledger in which different accounts are opened to which related transactions are posted.

(iii) Summarizing

It is concerned with the preparation and presentation of the classified data in a manner useful to the users. This function involves the preparation of financial statements such as Income Statement, Balance Sheet, Statement of Changes in Financial Position, Statement of Cash Flow, Statement of Value Added.

(iv) Interpreting

Nowadays, the aforesaid three functions are performed by electronic data processing devices and the accountant has to concentrate mainly on the interpretation aspects of accounting. The accountants should interpret the statements in a manner useful to action.

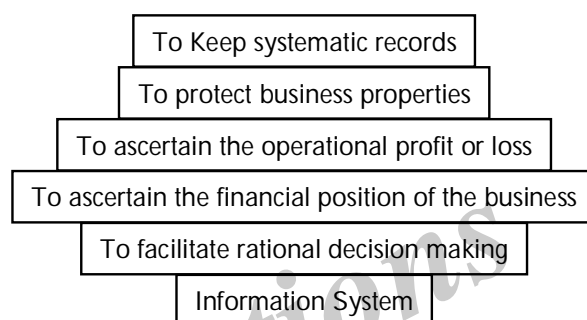
The accountant should explain not only what has happened but also (a) why it happened, and (b) what is likely to happen under specified conditions.

Q2. What are the objectives of accounting?

Ans :

(Imp.)

The following are the main objectives of accounting:

**1. To Keep Systematic Records**

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

2. To Protect Business Properties

Accounting provides protection to business properties from unjustified and unwarranted use. This is possible on account of accounting supplying the following information to the manager or the proprietor:

- (i) The amount of the proprietor's funds invested in the business.
- (ii) How much the business have to pay to others?
- (iii) How much the business has to recover from others?
- (iv) How much the business has in the form of (a) fixed assets, (b) cash in hand, (c) cash at bank, (d) stock of raw materials, work-in-progress and finished goods?

Information about the above matters helps the proprietor in assuring that the funds of the business are not necessarily kept idle or under-utilized.

3. To Ascertain the 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 expense of a particular period. The Profit and Loss Account is prepared at the end of a period and if the amount of revenue for the period is more than the expenditure incurred in earning that revenue, there is said to be a profit. In case the expenditure exceeds the revenue, there is said to be a loss. Profit and Loss Account will help the management, investors, creditors, etc. in knowing whether the business has proved to be remunerative or not. In case it has not proved to be remunerative or profitable, the cause of such a state of affairs will be investigated and necessary remedial steps will be taken.

4. To Ascertain the Financial Position of the Business

The Profit and Loss Account gives the amount of profit or loss made by the business during a particular period. However, it is not enough. The businessman must know about his financial position i.e. where he stands ?, what he owes and what he owns? This objective is served by the Balance Sheet or Position Statement. The Balance Sheet is a statement of assets and liabilities of the business on a particular date. It serves as barometer for ascertaining the financial health of the business.

5. To Facilitate Rational Decision Making

Accounting these days has taken upon itself the task of collection, analysis and reporting of information at the required points of time to the required levels of authority in order to facilitate rational decision-making. The American Accounting Association has also stressed this point while defining the term accounting when it says that accounting is the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by users of the information. Of course, this is

by no means an easy task. However, the accounting bodies all over the world and particularly the International Accounting Standards Committee, have been trying to grapple with this problem and have achieved success in laying down some basic postulates on the basis of which the accounting statements have to be prepared.

6. Information System

Accounting functions as an information system for collecting and communicating economic information about the business enterprise. This information helps the management in taking appropriate decisions. This function, as stated, is gaining tremendous importance these days.

Q3. Explain the evolution of accounting.

Ans : (Imp.)

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.

Q4. Explain briefly about Advantages and Disadvantages of Accounting.

Ans : (Imp.)

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.

Q5. Explain the Importance of accounting.

Ans :

(Imp.)

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.

Q6. **What do you understand by double entry system? Discuss its features.**

(OR)

What is double entry system?

Ans :
Meaning

Double entry also allows for the accounting equation (assets = liabilities + owner's equity) to always be in balance. In our example involving Advertising Expense, the accounting equation remained in balance because expenses cause owner's equity to decrease. In that example, the asset Cash decreased and the owner's capital account within owner's equity also decreased.

A third aspect of double entry is that the amounts entered into the general ledger accounts as debits must be equal to the amounts entered as credits.

Features

The features of double entry system are as follows :

1. **Set Rules**

Every transaction is recorded as per the set rules of personal, real and nominal accounts. For this purpose every transaction is divided in two parts.

2. **Entry in Two Accounts**

Each transaction affects two accounts whether it is a cash or credit transaction.

3. Scientific System

Each transaction is divided in two parts which are personal and impersonal and then the rules of these accounts are applied. Since it has certain rules, it can be called as a scientific system.

4. Preparation of Trial Balance

Under double entry system, a trial balance is prepared to check the arithmetical accuracy of the accounts. If the total of debit column is equal to the total of credit column, then it means the accounts are arithmetically accurate.

5. Preparation of Final Accounts

Under double entry system, the final accounts are prepared through which one can know the profit and loss earned during the year. It also tells the final position of the business on the date of preparation of final accounts.

Q7. Explain advantages and disadvantages of double entry system.

Ans :

(Nov.-20)

Advantages

It has the following advantages :

1. Scientific System

Double entry is treated as a scientific system since there are certain principles and rules of recording the transaction according to which entries are made in the books of accounts.

2. Complete Record of Transactions

All types of transactions whether they are related with personal, real, nominal accounts are recorded in the books of accounts on the basis of specified rules. Thus, it is called a complete system and helps to narrate the transactions in future easily.

3. Knowledge about Different Accounts

This system gives the information and knowledge about the different types of accounts which are maintained in the ledger. Therefore, any information relating to any person, expense or income can easily be obtained.

4. Knowledge about Financial Position

This system also enables the businessman to know the financial position of his business. It also presents the assets and liabilities of the business on a certain date.

5. Elasticity

This system is flexible in nature and it can be expanded or contracted as per the changed requirements of the business. For example, if the number of transactions in the business increases, the subsidiary books can be used.

6. Less Possibility of Fraud and Mistakes

Since this system is scientific in nature, each transaction is recorded on two sides. Thus there is less possibility of fraud, mistakes and misappropriation. In case of any fraud and mistake it can be detected and rectified quickly.

7. Suitable for all types of Businesses

This system can be used for all types of business houses whether they are sole proprietorship firms or partnership firms or joint stock companies. That's why this system of accounting is used throughout the world as it is adequate for all.

8. Comparative Study is Possible

The accounts of current year can be compared with the accounts of previous year in the double entry system. Thus, the progress of business can be measured along, with accounting. It also helps in controlling the unnecessary expenses.

9. Proof as Evidence

The books prepared under this system are recognised as evidences since they are treated as accurate, reliable and scientific.

10. Facility of Adjustments

Under this system, adjustments relating to unearned incomes, outstanding expenses, prepaid expenses and accrued income, etc. can be made at the end of the year. This helps in ascertaining the true profit or loss and actual financial position of the business.

Disadvantages

The double entry system has the following disadvantages :

1. Costlier System

A number of accounting books such as journal, ledger, cash book and subsidiary journals, etc. are maintained under this system. Therefore this system becomes costlier especially for small business houses.

2. Accounting Errors

Only the arithmetical accuracy of accounts can be checked by preparing the trial balance. But many of accounting errors, like error of omission, error of principle, error of commission and compensating errors may remain uncorrected despite the agreement of trial balance.

3. Requires Practical Knowledge

A person without the knowledge of accounts cannot record and understand the transactions. Therefore, the system needs a well educated, practical and trained professional to maintain and understand the accounts under this system.

Q8. Explain about accounting process/cycle.

Ans :

The process which starts with the transactions taking place and ends up with preparation of final accounts is known as accounting process. This process involves a sequence of activities which are repeated in every accounting period, so it is also known as accounting cycle.

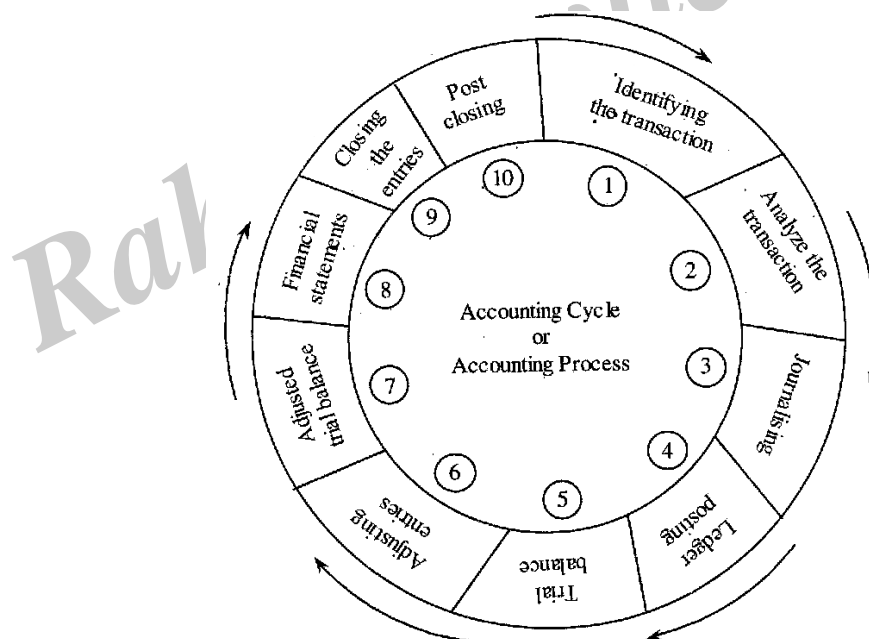


Fig : Accounting Cycle/Process

Various Steps of Accounting Cycle

Following are the steps involved in accounting cycle,

- (i) **Identifying Transaction** : The first step in accounting cycle is to identify the transaction and ascertain its source document like purchase order or sales invoice i.e., from where the transaction has been recorded.

- (ii) **Analyzing Transaction** : In this step transactions which are expressed in terms of money i.e., monetary transactions and the accounts which are affected by these transactions are identified and analyzed.
- (iii) **Journalizing** : After analyzing the transaction they are recorded in journal in the form of entries. These entries are based on principle of double entry in which every transaction has a two fold effect i.e., dual effect.
- (iv) **Ledger Posting** : When all the transactions are journalized they must be posted into ledger account. Ledger is a book wherein similar transactions are being recorded in one particular account.
- (v) **Trial Balance** : After posting the entries into ledger the entries must be posted in the trial balance in order to evaluate whether the balance of credit and debit side are equal to each other. All the ledger accounts which has debit balance are recorded in the left column and ledger accounts with credit balance are posted on the right column of the trial balance.
- (vi) **Adjusting Entries** : The accrued, deferred and estimated amounts are recorded with the help of adjustment entries. These adjustment entries are journalized and recorded into respective ledger account.
- (vii) **Adjusted Trial Balance** : The next step in accounting cycle after adjusting the accrued and deferred accounts is to prepare new trial balance which is similar to unadjusted trial balance with the only difference that the adjusting entries are included in the new trial balance.
- (viii) **Financial Statements** : In order to analyze the financial position of the company financial statements are prepared which include,
- (a) **Income Statement** : The income statement is prepared with the help of revenues and incomes earned by the company and losses and expenses incurred by the company.
- (b) **Balance Sheet** : Balance sheet is prepared with the help of assets, liabilities and equity accounts.
- (c) **Statement of Retained Earning** : It is prepared by using net income and dividend information.
- (d) **Cash Flow Statement** : Either direct or indirect method is used to extract cash flow statement from other financial statements of the company.
- (ix) **Closing the Entries** : After the preparation of financial statements the balances of temporary accounts are transferred to owner's equity.
- (x) **After-closing Trial Balance** : After closing the entries a new trial balance is prepared in order to verify whether the Debit balance is equal to the credit balance or not.

1.2 CONCEPT OF ACCOUNTING THEORY

Q9. What is meant by Accounting Theory?
(OR)

Explain the meaning of Accounting Theory?

Ans :

Definitions

- (i) **According to E. S. Hendriksen**, accounting theory is a set of broad principles that provides a general frame of reference by which accounting practices can be evaluated, and guides the development of new practices. That is, accounting theory has actually twin objectives evaluation of old practices and promotion of new practices and procedures.
- (ii) **According to American Accounting Association**, accounting theory can be defined as "a cohesive set of conceptual, hypothetical and pragmatic proposition explaining and guiding the accountants actions in identifying, measuring and communicating economic information to users of financial statement."
- (iii) **According to Perara and Mathew**, "accounting theory is the rationalization of the rules of accounting which further explains the manner in which accountants gather, record,

classify, report and interpret financial data specially when monetary amount is determined in the financial statements."

The theory, thus, attempts to build up a" developed as well as largely acceptable set of conceptual and ideological interpretations of accounting functions, together with guidelines appropriate for their executions. It was difficult earlier to convince people, both inside and outside the profession, merely by saying that "this has been the practice". Now theory has attempted to provide us with a solid and reasonable argument by which we can logically convince people as to what is what or why this is so.

1.2.1 Role of Accounting Theory

Q10. Describe the Role of Accounting Theory.

(OR)

Discuss the role of Accounting Theory.

Ans :

Following points highlights the role of accounting theory.

1. Identification of Problem Area

By clearly identifying the facts to be studied and enabling to select the relevant aspect of a phenomenon, Accounting Theory narrows the range of problem area.

2. Conceptual Frame

Accounting Theory provides a general frame of reference for the study of accounting problems which actually provides the standard against which accounting practice may be evaluated.

3. Summarization

Accounting Theories are actually summarization of current accounting practices.

4. Uniformity of Practice

One of the goals of Accounting Theory is to provide uniformity in practice to enhance the credibility of accounting. 'Generally Accepted Accounting Principles' are primarily a cluster of current accounting theories.

5. Predictive Ability

Theoretical generalizations can be used to predict further facts. Examples: prediction of earnings, corporate failure, and risk associated with equity or bond etc.

6. Development of New Practice

The existing practices may have to be replaced by the new one as Accounting operates in a dynamic socio-economic environment. During the rail road developments in UK and USA, the requirement for huge capital for fixed assets has necessitated Depreciation Accounting based on Historical Cost and persistent inflationary condition has forced the Accountants to propose for Replacement Cost Depreciation. Accounting Theory provides the accountants with guidance on the most appropriate procedures to be adopted whenever the need for a new application of practice arises.

1.2.2 Classification of Accounting Theory

Q11. Describe the various classification of accounting theory.

(OR)

Give a classification of accounting theory. How do those different kinds of accounting theories help in achieving the objects of accounting.

Ans :

(Imp.)

There are several ways of classifying accounting theories Taking foundation of accounting theories as the basis, we may classify accounting theories in the line of discussion of the earlier section, i.e., as measurement theory, information theory and decision theory. Having taken 'the time' as a basis some have classified accounting theories as pre-industrialisation theories, post-industrialisation theories and the modern theories of accounting. According to the function of accounting, the accounting theories have again been classified as stewardship accounting theory, decision usefulness theories and social responsibility accounting theories.

Accounting centres have also been the focal point at the time of classifying accounting theories.

In that case accounting theories have been grouped as business accounting theory, government accounting theory and national income accounting theories. But the most useful frame of reference, according to E. S. Hendriksen, is to classify theories as :

1. Structural or syntactical theories
2. Interpretational or semantical theories
3. Behavioral or pragmatic theories.

1. Structural or Syntactical Theories

These theories attempt to explain how accountants would react to certain situations or how they would report specific events. Actually, until very recently, accounting meant what accountants did. Thus, different accountants used to react to same situation differently. They used to report the same event in different manners.

Hence, a general framework for accounting was badly needed. The structural or syntactical theories have been developed to meet that end. These theories try to evaluate first the current practices of accountants. Then they codify some of the practices as generally acceptable and simultaneously they prescribe some new procedures or principles that the accountants in general would follow while measuring or reporting any accounting event.

Thus, structural theories are made up of both descriptive and normative theories whereby the accountants can have a guideline as to how one journal or ledger book is to be opened, what should be the format of the balance sheet or the -profit and loss account, what of historical and current cost should be treated as the basis for accounting measurement or what of cost and market price should be used for valuing stocks. Structural theories in this way outline the scope and boundary of accounting and simultaneously they specify the limit beyond which the accountants must not go. This does not mean that structural theories provide no flexibility to the accountants. They rather explain the situations that will help the accountants to choose the proper alternative.

2. Interpretational or Semantical Theories

Structural theories of accounting provide for a large number of symbols, terms, formats or

technical languages to help a systematic and scientific measurement and presentation of accounting information. But an accounting structure, although logically formulated, does not convey meaningful interpretations unless the symbols and words representing descriptions or measurement are related empirically to real world phenomena. It is often said that existing financial reports are documents which are prepared by accountants for accountants. That means the people outside accounting profession cannot understand what accountants mean to say through accounting reports.

Hence, accounting writers or researchers delve upon this interpretational aspect and ultimately we get a number of theories, known as interpretational theories, that help the users understand the structural theories of accounting. Recent attempt by the US FASB (Financial Accounting Standards Board) to provide a meaningful interpretation to different terms that are used in financial statements is an example of the aforesaid interpretational theories. Earlier attempts in this direction were made by Canning, Edwards and Bell, Sprouse and Moonitz and many other accounting personalities or accounting bodies. They all endeavoured to find ways to improve the ability of accounting information to be interpreted in terms of human observation and experience. Empirical studies, however, reveal that these interpretational theories are not so successful as yet, because different terms and concepts of accounting get different meanings even today depending upon the perception of different users or different environment.

So, the development of theories is not enough. But they should be verified or tested by researches to determine whether users of accounting information understand and correctly interpret the information producers' intended meaning.

3. Behavioural or Pragmatic Theories

The Behavioural Theories attempt to measure and evaluate the economic, psychological and sociological effects of alternative accounting procedures and reporting media. This kind of accounting theories is still in its infancy no doubt, but there is a great scope and need for development

of theories that may help in creating a behavioural change on the part of users. Not only the interpretation but also the efficient use of accounting information has been now the objective of accounting theories.

For this, attempts are needed to seek answers to some basic questions like who are the users of financial statements, what is the type of specific information wanted by them, whether the statements meet those needs or not? Since the middle of twentieth century it is being realized that accounting is useful not merely to assess the results of past performance but also that it can be more useful in decision-making by the management, present and potential investors, creditors, government and others. The most important facet of decision-making is the ability for proper prediction.

So, if accounting has to be decision-oriented, it must help prediction by users, and for this the accounting information should be so designed as to reflect a trend of occurrence of some events having analysed which the users may take decisions for future. Researches are being conducted in such behavioural areas of accounting. The progress is not so significant, but very soon perhaps we shall break through the barrier.

1.2.3 Approaches to Accounting Theory

1.2.3.1 Deductive and Inductive Approach in Theory Formulation

Q12. Explain the various approaches to accounting theory.

(OR)

Explain in detail about Deductive and Inductive Approach.

Ans :

(Imp.)

Once the objectives of accounting are established, one or more of several approaches to accounting theory must be selected in order to derive logically conceived accounting principles. These objectives, however, may be modified with the development of theory, but a change in the basic objectives might require a reformulation of the entire theoretical structure. For example, one of the

objectives of financial reporting might be to provide information to stockholders and other outsiders to permit them to make useful predictions regarding the future operations of the firm. This objective leads to the development of an operating concept of income to the enterprise and to the stockholders. But if the objective should be the measurement of the social benefits of the firm, the measurement of these benefits should include the value added to the economy and all social benefits and costs not measured directly by the mechanism of the market.

Some of the approaches to the development of accounting theory that have been suggested and used include the following:

1. The deductive Reasoning
2. The inductive approaches
3. The pragmatic (or) "common-law" approach,
4. The ethical approach

1. The Deductive Reasoning

The deductive method of reasoning in accounting is the process of starting with objectives and postulates and, from these, deriving logical principles that provide the bases for concrete or practical applications. Thus, the practical applications and rules are derived from the logical reasoning; the postulates and logically derived principles should not merely support or attempt to explain accounting conventions or currently accepted practice.

The structure of the deductive process should include the following:

- (i) The formulation of general or specific objectives of financial reporting;
- (ii) A statement of the postulates of accounting concerning the economic, political, and sociological environment in which accounting must operate;
- (iii) A set of constraints to guide the reasoning process;
- (iv) A structure, set of symbols, or frame work in which ideas can be expressed and summarized;

- (v) The development of a set of definitions;
- (vi) The formulation of principles or generalized statements of policy derived by the process of logic; and finally
- (vii) The application of the principles to specific situations and the establishment of procedural methods and rules.

2. The Inductive Approach

The process of induction involves the making of observations of detailed measurements and then drawing generalized conclusions or principles from these. Detailed observations are made for a few items, and from these, generalizations are made regarding the entire universe or a group of similar situations. These generalizations, however, are subject to later confirmation or refutation after further experimentation and observation. All principles inductively derived are, therefore, conceptually falsifiable. Thus, through the inductive process, Newton was able to observe the characteristics of motion and from these observations and measurements derive generalizations or laws of motion.

3. The Pragmatic (or) "Common-Law" Approach

Philosophical pragmatism is marked by the doctrines that the meaning of conceptions is to be sought in their practical bearings, that the function of thought is as a guide to action, and that the truth is pre-eminently to be tested by the practical consequences of belief." Thus, the pragmatic approach involves the development of ideas that are in agreement with the real world and find usefulness in realistic situations. As applied to accounting theory, the pragmatic approach involves the selection of accounting concepts and techniques based on their utility. Principles and procedures are held to be useful if they accomplish the objectives of management or if they help stockholders or other readers interpret accounting statements and aid in meeting their specific objectives. Theory that does not have an immediate practical use is assumed to be poor theory.

The method used by the AICPA prior to 1959 (and to a large extent since) in the development of accounting principles was largely pragmatic in approach. Specific procedures or techniques were studied and certain procedures were recommended on the basis of their usefulness without a reliance on a general overall framework of accounting theory and with-out the necessity for an interdependence of the several procedures recommended in different areas. The principles and procedures recommended, however, gained respectability only if they subsequently became generally accepted,

4. The Ethical Approach

The ethical approach to accounting theory places emphasis on the concepts of justice, truth, and fairness. DR Scott suggested that the basis for the determination of accounting practice reaches back to the principles underlying social organizations. His basic concepts were:

- (i) Accounting procedures must provide equitable treatment to all interested parties;
- (ii) Financial reports should present a true and accurate statement without misrepresentation;
- (iii) Accounting data should be fair, unbiased, and impartial without serving special interests. To these' basic concepts he added the requirements that accounting principles should be subject to continual revision as necessary to allow for changing conditions and that accounting principles should be applied consistently whenever possible.

Q13. Explain briefly about accounting as a Information System.

Ans :

(Imp.)

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.

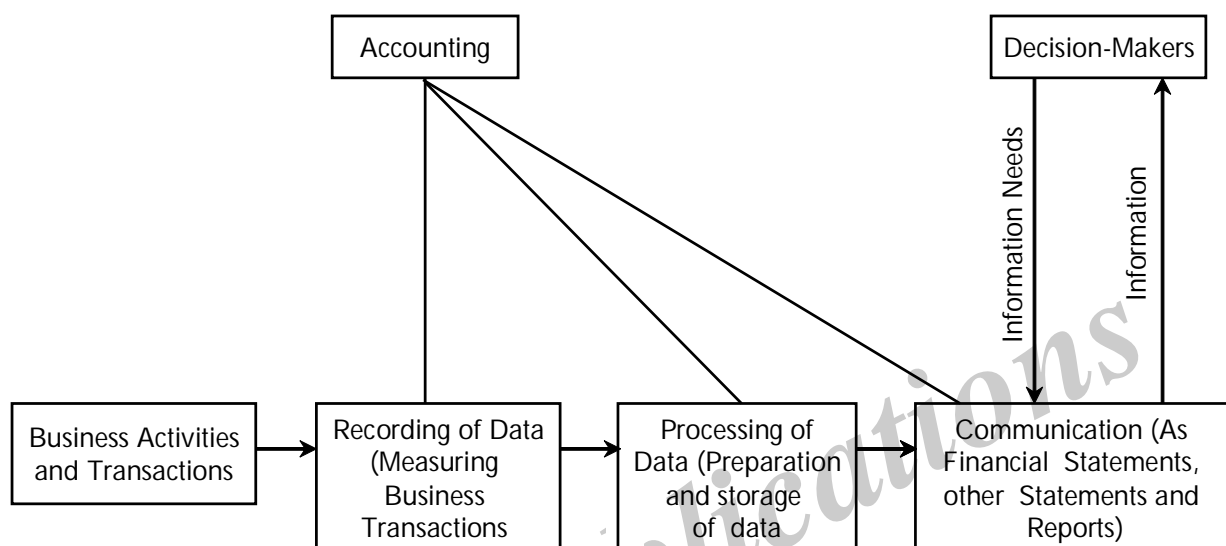


Fig.: Accounting as an information System in Business and Economic Decisions

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."

Q14. 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.

Q15. What are the advantages and disadvantages of an information system?

Ans : (Imp.)

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

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

The 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

The 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

The 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.

1.3 ACCOUNTING PRINCIPLES

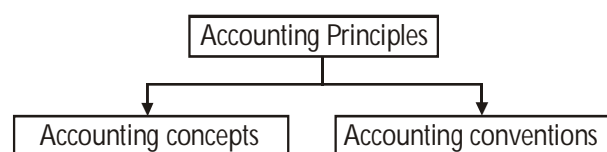
Q16. Define Accounting Principle.

Ans :

Meaning

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.

1.3.1 Concepts

Q17. Explain in detail the various accounting concepts.

(OR)

Describe the various accounting concepts.

Ans :

(Imp.)

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.

1.3.2 Conventions

Q18. Explain in detail the various accounting conventions.

Ans :

(Imp.)

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".

Q19. 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.

Q20. 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.

1.4 ACCOUNTING STANDARD

1.4.1 Concept

Q21. Explain the concept of Accounting Standard.

(OR)

State the nature of accounting standard.

(OR)

What are accounting standards?

Ans : (July-21, Dec.-19, July-19, Imp.)

Meaning

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.

Q22. Explain the importance of accounting standards ?

(OR)

Explain the need of accounting standard.

Ans : (July-19, Imp.)

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.

1.4.2 Evolution**Q23. Explain the Evolution of accounting standards.****(OR)**

Explain the development of accounting standards.

*Ans :***(Dec.-18)****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.

Q24. Explain the objectives of Accounting Standards.

Ans : (Dec.-19)

(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.

Q25. Explain the advantages and Disadvantages of accounting standards ?*Ans :* (July-21, Dec.-19, Dec.-18)**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 harmonise 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 difficult.

Q26. Explain the procedure for formulating accounting standards.**(OR)**

Briefly explain the procedure of setting accounting standards in India.

Ans : (July-21, Dec.-19, July-19)

The Accounting Standard Board (ASB) which was established by Institute of Chartered Accountants of India (ICAI) on 21st April 1977 follows six steps procedure for issuing Accounting Standards in India as follows.

- **Step-1** - In the first step the ASB identifies the areas where Accounting Standards are supposed to be formulated.

- **Step-2** - ASB consults with the representatives of public sector undertakings, government officials, industry and other organisations in order to collect their opinions.
- **Step-3** - ASB seeks assistance from study and research groups which are basically formed to deal with specific subjects.
- **Step-4** - After collecting views of the representatives as specified in step-2 and assistance from research/study group, ASB prepares an exposure draft consisting of a proposed standard. This exposure draft is issued in order to collect feedback from the institute's members and general public. The exposure draft basically contains the following information,
 - (i) Meaning and definition of the terms which are used in the proposed accounting standards.
 - (ii) Accounting principles and concepts concerned with accounting standards.
 - (iii) The manner in which accounting principles are being used for developing the accounting standards.
 - (iv) Presentation and disclosure requirements as per the accounting standards.
 - (v) The category of organisations to which accounting standards are applicable.
 - (vi) The sources of data providing effective information about accounting standards.
- **Step-5** - Soon after taking into consideration the feedback collected in step-4, ASB would finalise the proposed standard and would submit it to the council of ICAI.
- **Step-6** - The council of ICAI receives the final draft of proposed accounting standard from ASB and might go for necessary modifications after consulting ASB. Finally, the modified accounting standard would be issued by the authorities of the council.

Q27. Discuss briefly about list of accounting standards in India.

Ans :

(July-21, Dec.-18)

Following are the India Accounting Standards with Corresponding IAS and IFRS.

S.No.	Ind AS	Title IAS/IFRS No.	Corresponding
1.	Ind AS 1	Presentation of Financial Statements	IAS 1
2.	Ind AS 2	Inventories	IAS 2
3.	Ind AS 7	Cash Flow Statements	IAS 7
4.	Ind AS 8	Accounting policies, Change in accounting Estimates and Errors	IAS 8
5.	Ind AS 10	Events after the Balances Sheet Date	IAS 10
6.	Ind AS 12	Income Taxes	IAS 12
7.	Ind AS 16	Property, Plant and Equipment	IAS 16
8.	Ind AS 19	Employees Benefits	IAS 19
9.	Ind AS 20	Accounting for Govt. Grants and Disclosure of Government Assistance	IAS 20
10.	Ind AS 21	The effects of changes in the Foreign Exchange Rates	IAS 21

11.	Ind AS 23	Borrowing Costs	IAS 23
12.	Ind AS 24	Related Party Disclosures	IAS 24
13.	Ind AS 27	Separate financial statements	IAS 27
14.	Ind AS 28	Investments in Associates and Joint Ventures	IAS 28
15.	Ind AS 29	Financial Reporting in Hyper Inflationary Economies	IAS 29
16.	Ind AS 32	Financial Instruments: Presentation	IAS 32
17.	Ind AS 33	Earnings Per Share	IAS 33
18.	Ind AS 34	Interim Financial Reporting	IAS 34
19.	Ind AS 36	Impairment of Assets	IAS 36
20.	Ind AS 37	Provisions, Contingent liabilities and Contingent Assets	IAS 37
21.	Ind AS 38	Intangible assets	IAS 38
22.	Ind AS 40	Investments Property	IAS 40
23.	Ind AS 41	Agriculture	IAS 41
24.	Ind AS 101	First time adoption of India Accounting Standards (Ind AS)	IFRS 1
25.	Ind AS 102	Share Based Payments	IFRS 2
26.	Ind AS 103	Business Combination	IFRS 3
27.	Ind AS 104	Insurance Contracts**	IFRS 4
28.	Ind AS 105	Non-current assets held for sale & discontinued operations	IFRS 5
29.	Ind AS 106	Exploration for and evaluation of mineral resources	IFRS 6
30.	Ind AS 107	Financial Instrument disclosure	IFRS 7
31.	Ind AS 108	Operating Segment	IFRS 8
32.	Ind AS 109	Financial Instruments	IFRS 9
33.	Ind AS 110	Consolidated Financial Statements	IFRS 10
34.	Ind AS 111	Joint Arrangement	IFRS 11
35.	Ind AS 112	Disclosure of interest in other entities	IFRS 12
36.	Ind AS 113	Fair Value Measurement	IFRS 13
37.	Ind AS 114	Regulatory Deferral Accounts	IFRS 14
38.	Ind AS 115	Revenue from Contracts with Customers	IFRS 15
39.	Ind AS 116	Leases	IFRS 16
40.	Ind AS 117*	Insurance Contracts	IFRS 17*

*This IFRSs/Ind AS are yet to be notified.

**This Ind ASs will be withdrawn from the date IFRS and Ind AS 117 is converged and notified.

Q28. Explain the Development and significance of Ind AS.

(OR)

What are Indian Accounting Standards? Explain the significance of IndAS.

Ans :

(Dec.-19, July-19, Dec.-18)

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.

Significance

1. More accessibility to foreign funding

Comprehensive guidelines that are to be followed; requisition of more details and information; and more disclosures as per Ind AS; will provide better insights into companies and will facilitate the benchmarking of the financials of Indian Companies with global peers, thereby improving the accessibility of the Indian companies to foreign funding. It encourages international investing and thereby leads to more foreign capital flows to the country.

2. Economy

Markets expand globally; the convergence with IFRS benefits the economy by increasing growth of its international business. It facilitates maintenance of efficient capital markets and also helps to increase the capital formation and thereby economic growth.

3. Investors

Investors always would want to have more information that is accurate; reliable relevant; timely and comparable across the countries. Financial Statements prepared using a common set of accounting standards helps them in better understanding investment opportunities. The confidence of the Investors 'would be more if accounting standards used are globally accepted.

4. Transparency

Phase wise mandatory adoption of Ind AS improves the 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.

5. Applicable to one, applicable to all other

Ind As facilitate common footing to all the parent, subsidiary and holding companies with its "Applicable to one, applicable to all other" policy which states that, If Ind AS becomes applicable to a company then, Ind AS shall be automatically applied to all subsidiaries, holding companies, associated companies and joint ventures irrespective of individual qualification of such companies. This brings down the confusion in the preparation and presentation of Financial Statements.

6. Harmonization with Global Financial Market

Some Indian companies are already listed on overseas stock exchanges and many more will list in the future. Internationally acceptable accounting standards will then become the language of communication for Indian companies and also this paves way for better prospects to Indian companies across the globe.

Q29. What is Convergence?

Ans :

(July-21, July-19)

The convergence of accounting standards refer to the goal of establishing a single set of accounting standards that will be used internationally and the effort is to reduce the difference between USGAAP and IFRS. Convergence means to design and maintain national accounting standards in such away that the financial statements are prepared in accordance with all the requirements of IFRS. Convergence helps in achieving harmony with IFRS.

Rahul Publications

Short Question and Answers

1. Explain the procedure for formulating accounting standards.

Ans :

The Accounting Standard Board (ASB) which was established by Institute of Chartered Accountants of India (ICAI) on 21st April 1977 follows six steps procedure for issuing Accounting Standards in India as follows.

- **Step-1** - In the first step the ASB identifies the areas where Accounting Standards are supposed to be formulated.
- **Step-2** - ASB consults with the representatives of public sector undertakings, government officials, industry and other organisations in order to collect their respective opinions.
- **Step-3** - ASB seeks assistance from study and research groups which are basically formed to deal with specific subjects.
- **Step-4** - After collecting views of the representatives as specified in step-2 and assistance from research/study group, ASB prepares an exposure draft consisting of a proposed standard. This exposure draft is issued in order to collect feedback from the institute's members and general public. The exposure draft basically contains the following information,
 - (i) Meaning and definition of the terms which are used in the proposed accounting standards.
 - (ii) Accounting principles and concepts concerned with accounting standards.
 - (iii) The manner in which accounting principles are being used for developing the accounting standards.
 - (iv) Presentation and disclosure requirements as per the accounting standards.

(v) The category of organisations to which accounting standards are applicable.

(vi) The sources of data providing effective information about accounting standards.

➤ **Step-5** - Soon after taking into consideration the feedback collected in step-4, ASB would finalise the proposed standard and would submit it to the council of ICAI.

➤ **Step-6** - The council of ICAI receives the final draft of proposed accounting standard from ASB and might go for necessary modifications after consulting ASB. Finally, the modified accounting standard would be issued by the authorities of the council.

3. State the nature of accounting standard.

Ans :

(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.

2. List of accounting standards in India.

Ans :

S.No.	Ind AS	Title IAS/IFRS No.	Corresponding
1.	Ind AS 1	Presentation of Financial Statements	IAS 1
2.	Ind AS 2	Inventories	IAS 2
3.	Ind AS 7	Cash Flow Statements	IAS 7
4.	Ind AS 8	Accounting policies, Change in accounting Estimates and Errors	IAS 8
5.	Ind AS 10	Events after the Balances Sheet Date	IAS 10
6.	Ind AS 12	Income Taxes	IAS 12

4. limitations of Accounting Standards

Ans :

- (i) 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.
- (ii) 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.
- (iii) 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.

5. Define Accounting.

Ans :

- (i) **According to The American Institute of Certified Public Accountants** has defined the Financial Accounting as "the art of recording, classifying and summarizing in as significant manner and in terms of money transactions and events which in part, at least of a financial character, and interpreting the results thereof".
- (ii) **According to American Accounting Association** defines accounting as "the process of identifying, measuring, and communicating economic information to permit informed judgments and decisions by users of the information.

From the above the following attributes of accounting emerge :

(i) Recording

It is concerned with the recording of financial transactions in an orderly manner, soon after their occurrence In the proper books of accounts.

(ii) Classifying

It is concerned with the systematic analysis of the recorded data so as to accumulate the transactions of similar type at one place. This function is performed by maintaining the ledger in which different accounts are opened to which related transactions are posted.

(iii) Summarizing

It is concerned with the preparation and presentation of the classified data in a manner useful to the users. This function involves the preparation of financial statements such as Income Statement, Balance Sheet, Statement of Changes in Financial Position, Statement of Cash Flow, Statement of Value Added.

(iv) Interpreting

Nowadays, the aforesaid three functions are performed by electronic data processing devices and the accountant has to concentrate mainly on the interpretation aspects of accounting. The accountants should interpret the statements in a manner useful to action. The accountant should explain not only what has happened but also (a) why it happened, and (b) what is likely to happen under specified conditions.

6. Advantages of Accounting

Ans :

(i) 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.

(ii) Evidence in Court

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

(iii) 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.

(iv) 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.

7. Importance of accounting.

Ans :

(i) 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.

(ii) 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.

(iii) 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.

(iv) 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.

8. What is double entry system?

Ans :

Double entry also allows for the accounting equation (assets = liabilities + owner's equity) to always be in balance. In our example involving Advertising Expense, the accounting equation remained in balance because expenses cause owner's equity to decrease. In that example, the asset Cash decreased and the owner's capital account within owner's equity also decreased.

A third aspect of double entry is that the amounts entered into the general ledger accounts as debits must be equal to the amounts entered as credits.

9. What is meant by Accounting Theory?

Ans :

Definitions

(i) According to E. S. Hendriksen, accounting theory is a set of broad principles that provides a general frame of reference by which accounting practices can be evaluated, and guides the development of new practices. That is, accounting theory has actually twin objectives evaluation of old practices and promotion of new practices and procedures.

(ii) According to American Accounting Association, accounting theory can be defined as "a cohesive set of conceptual, hypothetical and pragmatic proposition explaining and guiding the accountants actions in identifying, measuring and communicating economic information to users of financial statement."

(iii) According to Perara and Mathew, "accounting theory is the rationalization of the rules of accounting which further explains the manner in which accountants gather, record, classify, report and interpret financial data specially when monetary amount is determined in the financial statements."

10. Deductive Reasoning

Ans :

The deductive method of reasoning in accounting is the process of starting with objectives and postulates and, from these, deriving logical principles that provide the bases for concrete or practical applications. Thus, the practical applications and rules are derived from the logical reasoning; the postulates and logically derived principles should not merely support or attempt to explain accounting conventions or currently accepted practice.

The structure of the deductive process should include the following:

- (i) The formulation of general or specific objectives of financial reporting;
- (ii) A statement of the postulates of accounting concerning the economic, political, and sociological environment in which accounting must operate;
- (iii) A set of constraints to guide the reasoning process;
- (iv) A structure, set of symbols, or frame work in which ideas can be expressed and summarized;
- (v) The development of a set of definitions;
- (vi) The formulation of principles or generalized statements of policy derived by the process of logic; and finally
- (vii) The application of the principles to specific situations and the establishment of procedural methods and rules.

11. Define Accounting Principle.

Ans :

Meaning

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".

12. Separate Entity Concept

Ans :

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.

13. Money Measurement Concept

Ans :

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.

14. Dual Aspect Concept

Ans :

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.

15. Convention of Consistency

Ans :

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.

16. What are 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.

17. What is Convergence?

Ans :

The convergence of accounting standards refer to the goal of establishing a single set of accounting standards that will be used internationally and the effort is to reduce the difference between USGAAP and IFRS. Convergence means to design and maintain national accounting standards in such away that the financial statements are prepared in accordance with all the requirements of IFRS. Convergence helps in achieving harmony with IFRS.

Choose the Correct Answers

1. Accounting is the art of _____. [d]
(a) Recording (b) Classifying
(c) Summarising (d) All of the above
2. Which of the following process of accounting concerned merely with recording transaction 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) Accrual concept
5. The business 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 concept each transaction has two aspects debit and credit [b]
(a) Going concern (b) Dual aspect
(c) Cost (d) Realization
7. Recording of already occurred and realized transaction is based on [d]
(a) Going concern (b) Dual aspect
(c) Cost (d) Realization
8. Recording of recognized revenues and expenses are based on which concept [c]
(a) Conversation (b) Matching
(c) Accrual (d) Realization
9. Which concept discloses clearly material information to the reader [a]
(a) Convention of disclosure (b) Conservatism
(c) Consistency (d) None
10. Which concept treats business as a separate entity from the owners [a]
(a) Business entity concept (b) Money measurement concept
(c) Matching concept (d) All the above

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

STANDARDS RELATING TO FINANCIAL REPORTING & DISCLOSURE:

Ind AS-101: First time adoption of Indian Accounting Standards – Ind AS-1: Presentation of Financial Statements - Ind AS-7: Cash Flow Statements (Including problems) – Ind AS-8: Accounting Policies, Changes in Accounting Estimates and Errors – Ind AS-10: Events after the Balance Sheet Date -- Ind AS-24: Related Party Disclosures – Ind AS- 34: Interim Financial Reporting - Ind AS-105: Non-current assets held for sale and discontinued operations – Ind AS- 108: Operating Segments.

2.1 IND AS-101: FIRST TIME ADOPTION OF INDIAN ACCOUNTING STANDARDS

Q1. Explain the concept of Ind AS-101.

(OR)

Explain the procedure for the first time Adoption of Indian accounting standards as per AS-101.

Ans. :

(Imp.)

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.

Explanation of transition to Ind AS

The Standard requires that an entity shall explain how the transition from previous GAAP to Ind AS affected its reported Balance sheet, financial performance and cash flows.

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.

2.2 IND AS-1: PRESENTATION OF FINANCIAL STATEMENTS

Q3. What are Financial Statements? Explain the purpose of Financial Statements.

Ans : (Imp.)

Objective

This Standard prescribes the basis for presentation of general purpose financial statements to ensure comparability

- both with financial statements of previous periods and
- with the financial statements of other entities.
- It sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content.

Scope

- An entity shall apply this Standard in preparing and presenting general purpose financial statements in accordance with Indian Accounting Standards (Ind ASs).
- Consolidated Financial Statements in accordance with Ind AS 110 'Consolidated Financial Statements'
- Separate financial statements in accordance with Ind AS 27 'Separate Financial Statements'.
- This Ind AS does not apply to interim Financial Statements prepared in accordance with Ind AS 34 except para 15 to 35 of Ind AS 1.

Definitions

- (i) **According to General purpose financial statements** (referred to as 'financial statements') are those intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs.
- (ii) **According to Impracticable Applying** a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.
- (iii) **According to Indian Accounting Standards (Ind ASs)** are Standards prescribed under Section 133 of the Companies Act, 2013.

Material

Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances.

Notes

contain information in addition to that presented in the balance sheet (including statement of changes in equity which is a part of balance sheet), statement of profit and loss and statement of cash flows.

Owners

are holders of instruments classified as equity.

Profit or Loss

is the total of income less expenses, excluding comprehensive income.

Reclassification

adjustments are amounts reclassified to profit or loss in the current period that were recognised in other comprehensive income in the current or previous periods.

Total comprehensive income

is the change in equity during a period resulting from transactions and other events, other than those changes resulting from transactions with owners in their capacity as owners.

Total comprehensive income comprises all components of 'profit or loss' and of 'other comprehensive income'.

Other comprehensive income comprises items of income and expense (including reclassification adjustments) that is not recognised in profit or loss as required or permitted by other Ind ASs.

Purpose

The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. Financial statements also show the results of the management's stewardship of the resources entrusted to it. To meet this objective, financial statements provide information about an entity's:

- (a) assets;
- (b) liabilities;
- (c) equity;
- (d) income and expenses, including gains and losses;
- (e) contributions by and distributions to owners in their capacity as owners; and
- (f) cash flows.

This information, along with other information in the notes, assists users of financial statements in predicting the entity's future cash flows and, in particular, their timing and certainty.

A complete set of financial statements comprises:

- (a) a balance sheet as at the end of the period ;
- (b) a statement of profit and loss for the period;
- (c) statement of changes in equity for the period;
- (d) a statement of cash flows for the period;
- (e) notes, comprising a summary of significant accounting policies and other explanatory information; and
- (f) comparative information in respect of the preceding period;

- (g) a balance sheet as at the beginning of the preceding period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements
- (h) An entity shall present a single statement of profit and loss, with profit or loss and other comprehensive income presented in two sections. The sections shall be presented together, with the profit or loss section presented first followed directly by the other comprehensive income section.

Q4. Explain the features of financial statements.

Ans :

(Imp.)

Features

- Financial statements shall present a true and fair view of the financial position, financial performance and cash flows of an entity. Presentation of true and fair view requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework. The application of Ind ASs, with additional disclosure when necessary, is presumed to result in financial statements that present a true and fair view.
- An entity whose financial statements comply with Ind ASs shall make an explicit and unreserved statement of such compliance in the notes.
- An entity shall not describe financial statements as complying with Ind ASs unless they comply with all the requirements of Ind ASs.
- An entity cannot rectify inappropriate accounting policies either by disclosure of the accounting policies used or by notes or explanatory material.
- In the extremely rare circumstances in which management concludes that compliance with a requirement in an Ind AS would be so

misleading that it would conflict with the objective of financial statements set out in the Framework, the entity shall depart from that if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.

When an entity departs from a requirement of an Ind AS, it should be a part of its disclosure. It should disclose:

- (a) that management has concluded that the financial statements present a true and fair view ;
- (b) that it has complied with applicable Ind ASs, except that it has departed from a particular requirement to present a true and fair view;
- (c) the title of the Ind AS from which the entity has departed, the nature of the departure, including the treatment that the Ind AS would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in the Framework, and the treatment adopted; and
- (d) for each period presented, the financial effect of the departure on each item in the financial statements that would have been reported in complying with the requirement.
- (e) When an entity has departed from a requirement of an Ind AS in a prior period, and that departure affects the amounts recognised in the financial statements for the current period, it shall make the disclosures.

In the extremely rare circumstances in which management concludes that compliance with a requirement in an Ind AS would be so misleading that it would conflict with the objective of financial statements set out in the Framework, but the relevant regulatory framework prohibits departure from the requirement, the entity shall, to the maximum extent possible, reduce the perceived misleading aspects of compliance by disclosing:

- (a) the title of the Ind AS in question, the nature of the requirement, and the reason why management has concluded that complying with that requirement is so misleading in the circumstances that it conflicts with the objective

of financial statements set out in the Framework; and

- (b) for each period presented, the adjustments to each item in the financial statements that management has concluded would be necessary to present a true and fair view.

Q5. What items are included in the balance sheet?

Ans :

Balance Sheet

As a minimum, the balance sheet shall include line items that present the following amounts:

- (a) property, plant and equipment;
- (b) investment property;
- (c) intangible assets;
- (d) financial assets (excluding amounts shown under (e), (h) and (i));
- (e) investments accounted for using the equity method;
- (f) biological assets within the scope of Ind AS 41 Agriculture;
- (g) inventories;
- (h) trade and other receivables;
- (i) cash and cash equivalents;
- (j) the total of assets classified as held for sale and assets included in disposal groups classified as held for sale in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations;
- (k) trade and other payables;
- (l) provisions;
- (m) financial liabilities (excluding amounts shown under (k) and (l));
- (n) liabilities and assets for current tax, as defined in Ind AS 12, Income Taxes;
- (o) deferred tax liabilities and deferred tax assets, as defined in Ind AS 12;
- (p) liabilities included in disposal groups classified as held for sale in accordance with Ind AS 105;

- (q) non-controlling interests, presented within equity; and

- (r) issued capital and reserves attributable to owners of the parent.

Q6. How is the classification of current assets and current liabilities done?

Ans :

Current/non-current distinction

An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications in its balance sheet in accordance with paragraphs that is reliable and more relevant. When that exception applies, an entity shall present all assets and liabilities in order of liquidity.

Whichever method of presentation is adopted, an entity shall disclose the amount expected to be recovered or settled after more than twelve months for each asset and liability line item that combines amounts expected to be recovered or settled:

- (a) not more than twelve months after the reporting period, and
- (b) more than twelve months after the reporting period.

For some entities, such as financial institutions, a presentation of assets and liabilities in increasing or decreasing order of liquidity provides information that is reliable and more relevant than a current/non-current presentation because the entity does not supply goods or services within a clearly identifiable operating cycle.

An entity is permitted to present some of its assets and liabilities using a current/non-current classification and others in order of liquidity when this provides information that is reliable and more relevant. The need for a mixed basis of presentation might arise when an entity has diverse operations.

Current assets

An entity shall classify an asset as current when:

- (a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;

- (b) it holds the asset primarily for the purpose of trading;
- (c) it expects to realise the asset within twelve months after the reporting period; or
- (d) the asset is cash or a cash equivalent (as defined in Ind AS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.
- (e) An entity shall classify all other assets as non-current.
- (f) This Standard uses the term 'non-current' to include tangible, intangible and financial assets of a long-term nature. It does not prohibit the use of alternative descriptions as long as the meaning is clear.

The operating cycle of an entity is the time between the acquisition of assets for processing and their realisation in cash or cash equivalents. When the entity's normal operating cycle is not clearly identifiable, it is assumed to be twelve months. Current assets include assets (such as inventories and trade receivables) that are sold, consumed or realized as part of the normal operating cycle even when they are not expected to be realised within twelve months after the reporting period. Current assets also include assets held primarily for the purpose of trading and the current portion of non-current financial assets.

Current liabilities

An entity shall classify a liability as current when:

- (i) it expects to settle the liability in its normal operating cycle;
- (ii) it holds the liability primarily for the purpose of trading;
- (iii) the liability is due to be settled within twelve months after the reporting period; or
- (iv) it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period.
 - An entity shall classify all other liabilities as non-current.
 - Some current liabilities, such as trade payables and some accruals for

employee and other operating costs, are part of the working capital used in the entity's normal operating cycle. An entity classifies such operating items as current liabilities even if they are due to be settled more than twelve months after the reporting period.

- Other current liabilities are not settled as part of the normal operating cycle, but are due for settlement within twelve months after the reporting period or held primarily for the purpose of trading. Financial liabilities that provide financing on a long-term basis and are not due for settlement within twelve months after the reporting period are non-current liabilities.
- An entity classifies its financial liabilities as current when they are due to be settled within twelve months after the reporting period, even if:
 - (a) the original term was for a period longer than twelve months, and
 - (b) an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the reporting period and before the financial statements are approved for issue.

If an entity expects, and has the discretion, to refinance or roll over an obligation for at least twelve months after the reporting period under an existing loan facility, it classifies the obligation as non-current, even if it would otherwise be due within a shorter period. However, when refinancing or rolling over the obligation is not at the discretion of the entity, the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

Where there is 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 entity does not classify the liability as current, if the lender agreed, after the reporting period and before the approval of the financial

statements for issue, not to demand payment as a consequence of the breach.

However, an entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.

Q7. What kind of information is to be presented in the statement of profit and loss?

Ans :

The statement of profit and loss shall present, in addition to the profit or loss and other comprehensive income sections:

- (a) profit or loss;
- (b) total other comprehensive income;
- (c) comprehensive income for the period, being the total of profit or loss and other comprehensive income.

An entity shall present the following items, in addition to the profit or loss and other comprehensive income sections, as allocation of profit or loss and other comprehensive income for the period:

- (a) **profit or loss for the period attributable to:**
 - i) non-controlling interests, and
 - ii) owners of the parent.
- (b) **comprehensive income for the period attributable to:**
 - i) non-controlling interests, and
 - ii) owners of the parent.

Information to be presented in the profit or loss section of the statement of profit and loss

In addition to items required by other Ind ASs, the profit or loss section of the statement of profit and loss shall include line items that present the following amounts for the period:

- (a) revenue, presenting separately interest revenue calculated using the effective interest method;

- (b) gains and losses arising from the derecognition of financial assets measured at amortised cost;
- (c) finance costs;
- (d) impairment losses ;
- (e) share of the profit or loss of associates and joint ventures accounted for using the equity method;
- (f) if a financial asset is reclassified out of the amortised cost measurement category so that it is measured at fair value through profit or loss, any gain or loss arising from a difference between the previous amortised cost of the financial asset and its fair value at the reclassification date;
- (g) if a financial asset is reclassified out of the fair value through other comprehensive income measurement category so that it is measured at fair value through profit or loss, any cumulative gain or loss previously recognised in other comprehensive income that is reclassified to profit or loss;
- (h) tax expense;
- (i) a single amount for the total of discontinued operations.

Information to be presented in the other comprehensive income section

The other comprehensive income section shall present line items for amounts of other comprehensive income in the period, classified by nature (including share of the other comprehensive income of associates and joint ventures accounted for using the equity method) and grouped into those that, in accordance with other Ind ASs:

- (a) will not be reclassified subsequently to profit or loss; and
- (b) will be reclassified subsequently to profit or loss when specific conditions are met.

An entity shall present additional line items, headings and subtotals in the statement of profit and loss, when such presentation is relevant to an understanding of the entity's financial performance.

An entity shall not present any items of income or expense as extraordinary items, in the statement of profit and loss or in the notes.

2.3 IND AS-7: CASH FLOW STATEMENTS

Q8. What is Cash flow statement? State the objective and scope of cash flow statement.

Ans :

(Imp.)

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.

Definitions

- (i) **Cash** comprises cash on hand and demand deposits.
- (ii) **Cash equivalents** are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.
- (iii) **Cash flows** are inflows and outflows of cash and cash equivalents.
- (iv) **Operating activities** are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.
- (v) **Investing activities** are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

- (vi) **Financing activities** are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

Cash and cash equivalents

Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents, for example in the case of preference shares acquired within a short period of their maturity and with a specified redemption date.

Bank borrowings are generally considered to be financing activities. However, where bank overdrafts which are repayable on demand form an integral part of an entity's cash management, bank overdrafts are included as a component of cash and cash equivalents.

Objective

- Providing users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows.
- Assessing the ability of an entity to generate cash and cash equivalents and the timing and certainty of their generation.
- The objective of this Standard is to require the provision of information about the historical changes in cash and cash equivalents.

Scope

- An entity shall prepare a statement of cash flows in accordance with the requirements of this Standard and shall present it as an integral part of its financial statements for each period for which financial statements are presented.
- This standard requires all entities to present a cash flow statement.

- Users of an entity's financial statements are interested in how the entity generates and uses cash and cash equivalents. This is the case regardless of the nature of the entity's activities and irrespective of whether cash can be viewed as the product of the entity, as may be the case with a financial institution. Entities need cash for essentially the same reasons however different their principal revenue-producing activities might be. They need cash to conduct their operations, to pay their obligations, and to provide returns to their investors. Accordingly, this Standard requires all entities to present a statement of cash flows even the Banks and Financial Institutions.

Q9. State the benefits of cashflow statement.

Ans :

Benefits

- A statement of cash flows, when used in conjunction with the rest of the finance statements, provides information that enables users to evaluate the changes in net assets of an entity, 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.
- Cash flow information is useful in assessing the ability of the entity 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 entities.
- It also enhances the comparability.
- 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.

Q10. Explain the various activities of cashflow statement.

Ans :

(Dec.-18)

The statement of cash flows shall report cash flows during the period classified by operating, investing and financing activities.

An entity presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business. Classification by activity provides information that allows users to assess the impact of those activities on the financial position of the entity and the amount of its cash and cash equivalents. This information may also be used to evaluate the relationships among those activities.

1) Operating activities

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

1. cash receipts from the sale of goods and the rendering of services;
2. cash receipts from royalties, fees, commissions and other revenue;
3. cash payments to suppliers for goods and services;
4. cash payments to and on behalf of employees;
5. cash receipts and cash payments of an insurance entity for premiums and claims, annuities and other policy benefits;
6. cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities; and
7. cash receipts and payments from contracts held for dealing or trading purposes.

Some transactions, such as the sale of an item of plant, may give rise to a gain or loss that is included in recognised profit or loss. The cash flows relating to such transactions are cash flows from investing activities.

The cash receipts from rents and subsequent sales of such assets are also cash flows from operating activities.

An entity 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 institutions are usually classified as operating activities since they relate to the main revenue-producing activity of that entity.

II) Investing activities

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. Only expenditures that result in a recognized asset in the balance sheet are eligible for classification as investing activities.

Examples of cash flows arising from investing activities are:

1. cash payments to acquire property, plant and equipment, intangibles and other long-term assets.
2. cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;
3. cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);
4. cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);
5. cash advances and loans made to other parties (other than advances and loans made by a financial institution);
6. cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution);
7. 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
8. 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.

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.

III) 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 capital to the entity.

Examples of cash flows arising from financing activities are:

1. cash proceeds from issuing shares or other equity instruments;
2. cash payments to owners to acquire or redeem the entity's shares;
3. cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings;
4. cash repayments of amounts borrowed; and
5. cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

Q11. Show the format of cash flow statement as per Accounting Standard - 3 (AS-7).

Ans :

The formats for preparation of cash flow statement given by Accounting Standard No.-3 (Old) and Accounting Standard No.-7 (New) are as follows,

Format of Cash Flow Statement as per AS-7 (Direct Method)

Particulars	Amount (₹)	Amount (₹)
Cash Flows from Operating Activities		
Cash Receipts from Customers	xxx	
Cash Paid to Suppliers and Employees	(xxx)	
Cash Generated from Operations	xxx	
Income Taxes Paid	(xxx)	
Cash Flow Before Extraordinary Item	xxx	
Proceeds from Earthquake Disaster Settlement	xxx	
Net cash from (used in) operating activities (A)	xxx	xxx
Cash Flows from Investing Activities		
Purchase of Fixed Assets	(xxx)	
Purchase or Sale of Investments	xxx	
Interest Received	xxx	
Dividend Received	xxx	
Net cash flows from (used in) investing activities (B)	xxx	xxx
Cash Flows from Financing Activities		
Proceeds from Issue of Share Capital	xxx	
Proceeds from Long-term Borrowings	xxx	
Repayment of Long-term Borrowings	(xxx)	
Interest Paid	(xxx)	
Dividend Paid	(xxx)	
Net Cash Flows From (used in) financing activities (C)	(xxx)	(xxx)
Net increase or decrease in cash and cash equivalents (A + B + C)		xxx
Add: Cash and cash equivalents at the beginning of the period		xxx
Cash and cash equivalents at the end of the period		xxx

Revised Format of Cash Flow Statement as per AS-7 (Indirect Method)

Particulars	Amount (₹)	Amount (₹)
Cash Flows from Operating Activities:		
Net profit Before Tax and Extraordinary items (As per Working Note)		xxx
Adjustments for Non-Cash and Non-Operating Items		
Add: Items to be added such as:	xxx	
Depreciation	xxx	
Interest on Debentures, Loans and Borrowings	xxx	
Loss on Sale of Fixed Assets	xxx	
Loss on Sale of Investments	xxx	
Provision for Doubtful Debts	xxx	
Provision for Discount on Debtors	xxx	
Preliminary Expenses Written Off	xxx	
Amortisation of Assets	xxx	
Intangible Assets such as Goodwill, Patents, Trade Marks etc should be written off		xxx
Less: Items to be deducted such as:	xxx	
Interest Income	xxx	
Dividend Income	xxx	
Rental Income	xxx	
Gain/Profit on Sale of Fixed Assets	xxx	
Gain/Profit of Fixed Assets	xxx	
Appreciation of Fixed Assets	xxx	(xxx)
Operating Profit Before Working Capital Changes	xxx	
Adjustment for Changes in Working Capital:		xxx
Add: Decrease in Current Assets (except cash and cash equivalents) such as:	xxx	
Decrease in Inventories/Stock	xxx	
Decrease in Trade Receivables (Debtors and Bills Receivables)	xxx	
Decrease in Prepaid Expenses	xxx	
Decrease in Accrued Income	xxx	
Add: Increase in Current Liabilities, such as:	xxx	
Increase in Trade Payables (Creditors and Bills Payables)	xxx	
Increase in Outstanding Expenses	xxx	
Increase in Income Received in Advance	xxx	xxx
Less: Increase in Current Assets (As stated above)		
Less: Decrease in Current Liabilities (As stated above)	xxx	(xxx)
Cash Generated from Operations		xxx
Less: Income Tax Paid (Net of Tax Refund Received)		xxx
Cash Flow Before Extraordinary Items		xxx
Add/Less: Extraordinary items		xxx
Net Cash Flow From (or Used in) Operating Activities	xxx	

Cash Flows from Investing Activities		
Proceeds from Sale of Fixed (Tangible) Assets	xxx	
Proceeds from Sale of Fixed (Intangible) Assets such as Goodwill, Patents etc.	xxx	
Proceeds from Sale of Non-Current Investments	xxx	
Interest Received	xxx	
Dividend Received	xxx	
Rent Received	xxx	
Purchase of Fixed (Tangible) Assets	(xxx)	
Purchase of Fixed (Intangible) Assets like Goodwill	(xxx)	
Purchase of Non-Current Investments	(xxx)	xxx
Net Cash Flow from (used in) Investing Activities		xxx
Cash Flows Financing Activities		
Proceed from Issue of Share and Debentures	xxx	
Proceeds from Other Long-term Borrowings and Loans	xxx	
Raising of Bank Overdraft and Cash Credit	xxx	
Repayment of Loans and Other Long-term Borrowings	(xxx)	
Payment of Dividend (Final and Interim Dividend)	(xxx)	
Interest on Debentures and Loans	(xxx)	
Redemption of Preference Shares and Debentures	(xxx)	
Payment on Buy-back of shares	(xxx)	
Net Cash Flow (Used in) Financing Activities		xxx
Net Increase (Decrease) in Cash and Cash Equivalents		xxx
Add: Cash and Cash Equivalents in the beginning of the year		xxx
<u>Cash and Cash Equivalents at the End of the year</u>		<u>xxx</u>

Working Note**Calculation of Net Profit Before Tax**

Particulars	Amount (₹)
Net Profit as per Statement of Profit and Loss for the Current year	xxx
or	
Difference between Closing Balance and Opening Balance of Surplus as per Balance Sheet i.e; Balance in the Statement of Profit and Loss	xxx
or	
Net Profit of the Current Year (after appropriations)	xxx
Add: Transfer to Reserves	xxx
Provision for Tax made for the current year	xxx
Final or Proposed Dividend paid during the year	xxx
Interim Dividend paid during the year	xxx
Extraordinary items, if any, debited to Statement of Profit and Loss	xxx
Less: Extraordinary items, if any, credited as income in the Statement of Profit and Loss	(xxx)
Refund of Tax	(xxx)
Net Profit Before Tax and Extraordinary Items	xxx

PROBLEMS

1. An entity sold a machinery (Book Value ₹ 1,00,000) for ₹ 72,000. The loss of ₹ 28,000 debited to the Profit & Loss Account. Is this transaction as Operating Activity?

Sol :

Operating Activities are the principal revenue generating activities. Investing Activities relate to the acquisition and disposal of long-term assets and other investments that are not Cash Equivalents. However, Cash payments to manufacture or acquire assets held for rental to others and subsequently held for sale as per Para 68A of Ind AS 16, are Cash Flows from Operating Activities. Cash receipts from rents and subsequent sales of such assets are also Cash Flows from Operating Activities.

The amount of ₹ 72,000 i.e. the sale proceeds should be shown as an Inflow under Investing Activities. ₹ 28,000 i.e. loss on sale of asset should be added back to derive Operating Cash Flow, under Indirect Method.

2. Golden Ltd acquired Fixed Assets viz. Plant and Machinery for ₹ 60 Lakhs. During the same year, it also sold Furniture and Fixtures for ₹ 15 Lakhs. Can the Company disclose, Net Cash Outflow towards Purchase of Fixed Assets in the Statement of Cash Flows?

Sol :

Acquisition and Disposal of Fixed Assets is not prescribed for Net-Basis reporting.

The Company cannot disclose Net Cash Flow in respect of acquisition of Plant and Machinery and disposal of Furniture and Fixtures.

3. Company A acquires 70% of the equity stake in Company B on July 20, 20X1.

The consideration paid for this transaction is as below:

(a) Cash consideration of Rs.15,00,000

(b) 200,000 equity shares having face of Rs.10 and fair value of Rs.15 per share.

On the date of acquisition, Company B has cash and cash equivalent balance of Rs. 2,50,000 in its books of account.

On October 10, 20X2, Company A further acquires 10% stake in Company B for cash consideration of Rs. 8,00,000.

Advise how the above transactions will be disclosed/presented in the statement of cash flows as per Ind AS 7.

Sol :

- As per Ind AS 7, the aggregate cash flows arising from obtaining control of subsidiary shall be presented separately and classified as investing activities.
- As per Ind AS 7, the aggregate amount of the cash paid or received as consideration for obtaining subsidiaries is reported in the statement of cash flows net of cash and cash equivalents acquired or disposed of as part of such transactions, events or changes in circumstances.

Further, investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows. Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

3. As per Ind AS 7, cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control shall be classified as cash flows from financing activities, unless the subsidiary is held by an investment entity, as defined in Ind AS 110, and is required to be measured at fair value through profit or loss.
4. Considering the above, for the financial year ended March 31, 20X2 total consideration of Rs. 15,00,000 less Rs. 2,50,000 will be shown under investing activities as "Acquisition of the subsidiary (net of cash acquired)".
5. There will not be any impact of issuance of equity shares as consideration in the cash flow statement however a proper disclosure shall be given elsewhere in the financial statements in a way that provides all the relevant information about the issuance of equity shares for non-cash consideration.
Further, in the statement of cash flows for the year ended March 31, 2003, cash consideration paid for the acquisition of additional 10% stake in Company B will be shown under financing activities.

4. **Following is the balance sheet of Kuber Limited for the year ended 31st March, 2002**

Particulars	2002	2001
ASSETS		
Non-current Assets		
Property, plant and equipment	13,000	12,500
Intangible assets	50	30
Other financial assets	145	170
Deferred tax asset (net)	855	750
Other non-current assets	800	770
Total non-current assets	14,850	14,220
Current assets		
Financial assets		
Investments	2,300	2,500
Cash and cash equivalents	220	460
Other current assets	195	85
Total current assets	2,715	3,045
Total Assets	17,565	17,265
EQUITY AND LIABILITIES		
Equity		
Equity share capital	300	300
Other equity	12,000	8,000
Total equity	12,300	8,300
Long-term borrowings	2,000	5,000
Other non-current liabilities	2,740	3,615
Total non-current liabilities	4,740	8,615

Current liabilities		
Financial liabilities		
Trade payables	150	90
Bank Overdraft	75	60
Other current liabilities	300	200
Total current liabilities	525	350
Total liabilities	5,265	8,965
Total Equity and Liabilities	17,565	17,265

Additional Information

- Profit after tax for the year ended 31 st March, 2002- Rs. 4,450 lacs
- Interim Dividend paid during the year - Rs. 450 lacs
- Depreciation and amortisation charged in the statement of profit and loss during the current year are as under
 - Property, Plant and Equipment - Rs. 500 lacs
 - Intangible Assets - Rs. 20 lacs
- During the year ended 31st March, 2002 two machineries were sold for Rs.10 lacs. The carrying amount of these machineries as on 31st March, 2002 is Rs.60 lacs.
- Income taxes paid during the year Rs.105 lacs Using the above information of Kuber Limited, construct a statement of cash flows under indirect method. Other non-current / current assets and liabilities are related to operations of Kuber Ltd. and do not contain any element of financing and investing activities.

*Sol.:***Statement of Cash Flows**

Particulars	Rs. in lacs	Rs.
Cash flow from operating activities		
Net Profit after Tax	4,450	
Add: Tax Paid	105	
	4,555	
Add: Depreciation & Amortisation (500 + 20)	520	
Less: Gain on Sale of Machine (70-60)	(10)	
Less: Increase in Deferred Tax Asset (855-750)	(105)	
	4,960	
Change in operating assets and liabilities		
Add: Decrease in financial asset (170 - 145)	25	
Less: Increase in other non-current asset (800 - 770)	(30)	
Less: Increase in other current asset (195 - 85)	(110)	
Less: Decrease in other non-current liabilities (3,615 - 2,740)	(875)	

Add: Increase in other current liabilities (300 -100)	100	
Add: Increase in trade payables (150-90)	60	
	4,130	
Less: Income Tax	(105)	
Cash generated from Operating Activities		4,025
Cash flows from Investing Activities		
Sale of Machinery	70	
Purchase of Machinery [13,000-(12,500 - 500-60)]	(1,060)	
Purchase of Intangible Asset [50-(30-20)]	(40)	
Sale of Financial asset - Investment (2,500 - 2,300)	200	
Cash outflow from Investing Activities		(830)
Cash flows from Financing Activities		
Dividend Paid	(450)	
Long term borrowings paid (5,000 - 2,000)	(3,000)	
Cash outflow from Financing Activities		(3,450)
Net Cash outflow from all the activities		(255)
Opening cash and cash equivalents (460 - 60)		400
Closing cash and cash equivalents (220 - 75)		145

5. **Calculate Cash from Operations.**

Purchases	` 1,50,000
Sales	` 2,00,000
Expenses	` 20,000
Creditors at the Beginning of the year	` 30,000
Creditors at the end of the year	` 40,000

Ans :

(July-21)

Calculation of Cash from Operations (If Profit is not Given)

$$\begin{aligned}
 \text{Cash from Operation} &= \text{Cash Sales} - (\text{Cash Purchases} + \text{Cash Operating Expenses}) \\
 &= 2,00,000 - (1,40,000 + 20,000) \\
 &= 2,00,000 - 1,60,000 \\
 &= ` 40,000
 \end{aligned}$$

Working Notes

$$\begin{aligned}
 \text{Cash Purchases} &= (\text{Total Purchases} + \text{Opening Creditor}) - \text{Closing Creditor} \\
 &= (1,50,000 + 30,000) - 40,000 \\
 &= 1,80,000 - 40,000 \\
 &= ` 1,40,000
 \end{aligned}$$

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

Q12. 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.

Q13. 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.

Q14. 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.

Q15. 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.

Q16. 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**

Q17. Explain in brief about adjusting events after the reporting period as per Ind AS-10.

Ans :

(Dec.-19)

According to Ind AS 10, "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;

- (i) Those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and

- ii) those that are indicative of conditions that arose after the reporting period (non adjusting events after the reporting period)".

Depending on the management structure, regulatory requirements, and procedures followed in compiling and finalising the financial statements, the process for authorising the financial statements for issuance will vary.

In some situations, after the financial statements have been approved by the Board for issue, the entities are obligated to present them to its shareholders for approval. In such circumstances, the financial statements are approved for release on the date of the Board's approval, not the day on which the financial statements are approved by the shareholders.

In some situations, an entity's management is required to submit its financial statements for approval to a supervisory board which is entirely made up of non-executives; the financial statements are approved for issue when the management gives approval for distribution to the supervisory board in such instances.

Even if those events occur after the public announcement of profit or other specified financial information, events after the reporting period include all events up to the day when the financial statements are approved for issue.

Adjusting Events after the Reporting Period

In case of adjusting events after the reporting period, the same should be reflected by the entity by adjusting the amounts recognised in its financial statements. Instances of adjusting events are as follows:

The conclusion of a court action after the reporting period that confirms that the company had a present obligation at the end of the reporting period. In accordance with Ind AS 37: Provisions, Contingent Liabilities, and Contingent Assets, the entity changes any previously recognised provision connected to this court matter or recognises a new provision. As the settlement includes additional evidence that would be assessed properly, the entity does not simply reveal a contingent responsibility. Information received after the reporting period suggesting that an asset was impaired at the end of the reporting period or that the amount of a previously recognised impairment loss for that asset needs to be amended.

Few examples are:

- A customer's bankruptcy after the reporting period usually confirms that a loss on a trade receivable existed at the end of the reporting period and that the business needs to reduce the trade receivable's carrying amount; and
- Inventory sales after the reporting period may provide proof of their net realisable value at the end of the period.
- The calculation of the cost of assets purchased or the proceeds from assets sold before the reporting period ends
- The assessment of the amount of profit-sharing or incentive payments beyond the reporting period, if the corporation had a present legal or constructive obligation to make such payments at the end of the reporting period as a result of actions that occurred before that date. (Ind AS 19 Employee Benefits).
- Discovering fraud or errors that show that the financial statements are not correct.

In case of non adjusting events after the reporting period, the entity should not adjust the amounts recognised in its financial statements.

A drop in the market value of investments between the end of the reporting period and the date when the financial statements are approved for issue is an example of a non-adjusting event after the reporting period. The decrease in market value is usually unrelated to the state of the investments at the conclusion of the reporting period, but rather reflects on events that have arisen subsequently. As a result, the amounts recognised in the financial statements for investments are not adjusted. Similarly, even if it may be necessary to provide additional disclosure, the company does not update the amounts declared for the investments as of the end of the reporting period.

"If an entity declares dividends to holders of equity instruments (as defined in Ind AS 32 Financial Instruments: Presentation) after the reporting period, the entity shall not recognise those dividends as a liability at the end of the reporting period".

After the reporting period, if the Management determines that it intends to liquidate the entity or cease trading, or it has no realistic alternative but to do so, then, the financial statements should not be prepared on a going concern basis by the entity.

If the operating results and the financial position deteriorate after the reporting period, it may be necessary to reconsider whether the going concern assumption is still valid. If the assumption of the going concern is not appropriate any longer, the impact is so widespread that Ind AS 10 demands a fundamental change in the accounting foundation, rather than a correction to the amounts recognised within the scope of original basis of accounting.

Q18. What are the non adjusting events after the reporting period.

Ans :

Non-disclosure of non-adjusting material events that occur after the reporting period could have an impact on the economic decisions that users make based on the financial statements. As a result, after the reporting period, an organisation must declare for each material type of non-adjusting event; the nature of such an event; and an estimate of the financial impact, or a declaration that such an estimate is impossible to make.

The following are instances of non-adjusting events that would normally result in disclosure after the reporting period:

- A major business combination or disposal of a major subsidiary;
- Announcement of a plan for discontinuance of an operation;
- Major purchases of assets; classification of assets as held for sale and other disposals of assets, or expropriation of major assets, i.e., action of taking away of property from its owner for public use by the government;
- The damage of a major production plant by fire;
- Major restructuring announced or commenced;
- Major ordinary share and the potential ordinary share transactions;
- Abnormal changes in the prices of the asset or in the rates of foreign exchange;
- Changes in the tax laws or tax rates which have a significant effect on the current and deferred tax assets and liabilities
- Entering into significant commitments (guarantees) or contingent liabilities; and
- Major litigation arising only due to the events that occurred (after the reporting period).

2.6 IND AS-24: RELATED PARTY DISCLOSURES

Q19. Explain briefly about related party disclosures.

Ans. : (Dec.-18, Imp.)

- (i) AS 18 uses the term "relatives of an individual", whereas Ind AS 24 uses the term "a close member of the family of a person". AS 18 covers the spouse, son, daughter, brother, sister, father and mother who may be expected to influence, or be influenced by, that individual in his/her dealings with the reporting enterprise.

However, definition of close members of family as per Ind AS 24 includes 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) dependants of that person or that person's spouse or domestic partner.

Hence, the definition as per Ind AS 24 is much wider.

- (ii) AS-18 defines state-controlled enterprise as "an enterprise which is under the control of the Central Government and/or any State Government(s)". However, in Ind AS 24, there is extended coverage of Government Enterprises, as it defines a government-related entity as "an entity that is controlled, jointly controlled or significantly influenced by a government." Further, "Government refers to government, government agencies and similar bodies whether local, national or international."
- (iii) AS 18 covers key management personnel (KMP) of the entity only, whereas, Ind AS 24 covers KMP of the parent as well. Ind AS 24 also covers the entity, or any member of a group of which it is a part, providing key management personnel services to the

reporting entity or to the parent of the reporting entity.

- (iv) Under Ind AS 24 there is extended coverage in case of joint ventures. Two entities are related to each other in both their financial statements, if they are either co-venturers or one is a venturer and the other is an associate. Whereas as per AS 18, co-venturers or coassociates are not related to each other.
- (v) AS 18 mentions that where there is an inherent difficulty for management to determine the effect of influences which do not lead to transactions, disclosure of such effects is not required whereas Ind AS 24 does not specifically mention this. (Paragraph 18 of AS 18)
- (vi) AS 18 does not specifically cover entities that are post employment benefit plans, as related parties. However, Ind AS 24 specifically includes post employment benefit plans for the benefit of employees of an entity or its related entity as related parties.
- (vii) Ind AS 24 requires an additional disclosure as to the name of the next most senior parent which produces consolidated financial statements for public use, whereas AS 18 has no such requirement. (Paragraph 13 of Ind AS 24)
- (viii) Ind AS 24 requires extended disclosures for compensation of KMP under different categories, whereas AS 18 does not specifically require the same.
- (ix) Ind AS 24 requires "the amount of the transactions" need to be disclosed, whereas AS 18 gives an option to disclose the "Volume of the transactions either as an amount or as an appropriate proportion". (Paragraph 23(iv) of AS 18 and paragraph 18 (a) of Ind AS 24)
- (x) Ind AS 24 requires disclosures of certain information by the government-related entities, whereas AS 18 presently exempts the disclosure of such information.
- (xi) AS 18 includes definition and clarificatory text, primarily with regard to control, substantial interest (including 20% threshold), significant

influence (including 20% threshold). However, Ind AS 24 neither defines these terms nor it includes such clarificatory text and allows respective standards to deal with the same.

Q20. P Ltd hold 80% voting rights of Q Ltd. and Q Ltd. hold 52% voting power in R Ltd. P Ltd also hold 25% of voting interest in R Ltd. State with reason would P Ltd be a related party to R Ltd.

[Note: As per New Accounting Standards of India, AS-18 is converted or modified as AS-24]

Ans : (Dec.-18)

The Accounting Standard AS-24 described the "Related party disclosures". It defines that the related party must have the ownership right directly or indirectly. Party can acquire such rights by holding more than one-half of the voting power of a company. The AS-24 also defines significant influence as the participation of the party is the financial or operating decisions of a company. However, the party will not have control on those decisions.

In this case, P Ltd has control in R Ltd but through Q Ltd. However, as per AS-24, the significant influence can only be exercised when an investing party i.e P Ltd. holds voting right through intermediaries (directly or indirectly) which is 20% or more of voting percent. Here, 52% which is more than 20%. Therefore in this case as per AS-24 related party disclosure is required.

Q21. Ram is a Director of two companies A Ltd and B Ltd. He purchased goods from A Ltd. Should the two companies report the above purchases as transaction with related party as per AS 18.

[Note: As per New Accounting Standards of India, AS-18 is converted or modified as AS-24]

Ans : (July-18)

Ram is a Director of two companies A Ltd. and B Ltd. Ram purchased goods from A Ltd., so only, A Ltd. can consider this purchase as related party transaction. B Ltd. cannot report Ram's

purchases as transaction with related party because Ram has purchased goods from A Ltd., not B Ltd. Ram is a related party for A Ltd. and B Ltd. but A Ltd. and B Ltd. are not related parties. As per AS-24, A Ltd can report Ram's purchases as related party transaction but B Ltd. cannot do so.

2.7 IND AS-34: INTERIM FINANCIAL REPORTING

Q22. Explain briefly about Interim Financial Reporting.

Ans :

Objective

Ind AS 34 prescribes the minimum content for an interim financial report and lays down the principles for the recognition and measurement in the complete or condensed financial statements for the interim period. Timely and trustworthy interim financial reporting leads to an improved ability of the users of the reports to understand the capacity of an entity in generation of the earnings and cash flows and its financial position.

Scope

Ind AS 34 does not specify which entities must publish interim financial reports, how often they must be published, or how soon after the end of an intermediate period they must be published. Governments, Securities Regulators, Stock Exchanges, and Accounting Bodies, on the other hand, frequently require the firms with publicly traded debt or equity instruments to publish interim financial reports.

Ind AS 34 is applicable in case the entity is required to or chooses to publish its interim financial report as per Ind ASs.

Each financial report, whether annual or interim, on its own, is evaluated for conformity with the Ind ASs. An entity might have provided interim financial reports for a financial year not complying with Ind AS 34 do not prevent its annual financial statements being prepared in conformity with Ind ASs. (The fact that an entity may not have provided interim financial reports during a particular financial year or may have provided interim financial reports that do not comply with this Standard does not

prevent the entity's annual financial statements from conforming to Ind ASs if they otherwise do so.)

In case, interim financial reports of an entity are described as being in compliance with Ind ASs, then, it must as well comply with all of the requirements of the Standard.

Definitions

- (i) "Interim period is a financial reporting period shorter than a full financial year".
- (ii) "Interim financial report means a financial report containing either a complete set of financial statements (as described in Ind AS 1, Presentation of Financial Statements, or a set of condensed financial statements (as described in this Standard) for an interim period".

Q23. 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.

Q24. 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.

Q25. Explain the significant events and transactions of Ind AS-34.*Ans :*

The list of significant events and transactions for which disclosures would be required to be made:

- The writing down of inventories to net realisable value and their reversal;
- Recognition of a loss from the impairment of assets and their reversal of such an impairment loss;
- The reversal of provisions if any, for the costs of restructuring;
- Acquisitions; commitments for purchase and disposals of the items of property, plant and equipment;
- Litigation settlements, and corrections of prior period errors;
- Changes in the business or economic circumstances that are affecting the fair value of financial assets and financial liabilities of the entity, whether they have been recognised at fair value or amortised cost;
- Any loan defaulted or breach of a loan agreement which has not been remedied before the end of the reporting period;
- Related party transactions;
- Transfers between levels of the fair value hierarchy used in measuring the fair value of financial instruments;
- Changes made in the classification of financial assets due to the change in the purpose or use of assets; and
- Changes in the contingent liabilities / contingent assets

Guidance regarding disclosure requirements has been provided by the individual Ind ASs for most of the items. In case an event / transaction is significant for understanding the changes that have taken place in the entity's performance or its financial position since the last annual reporting period; then, its interim financial report should provide for an explanation of and give an update to the relevant information that is included in the financial statements of the last annual reporting period.

**2.8 IND AS-105: NON-CURRENT ASSETS
HELD FOR SALE AND DISCONTINUED
OPERATIONS**

Q26. Explain key terms used in Ind 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

- i) Represents a separate major line of business or geographical area of operations,
- ii) Is part of a single co-ordinated plan to dispose of a separate major line of business or area of operations; or
- iii) 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:

- i) Its operating assets and liabilities can be directly attributed to it;
- ii) Its income (gross revenue) can be directly attributed to it; and
- iii) At least a majority of its operating expenses can be directly attributed to it
- iv) 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:

- i) An operating segment (Ind AS-108), would normally satisfy this criterion
- ii) A part of a segment may also satisfy this criterion
- iii) For an entity that does not report segment information, a major product or service line may also satisfy the criteria of the definition
- iv) 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.

Q27. 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.

Q28. Discuss the Ind AS-105 related to non current asset held for sale and discontinued operations.

Ans :

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, i.e., 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;

Q29. ZEE Ltd. is a manufacturer of LED Bulbs. The company decided to change the design of the bulbs. So, it purchased a new plant and changed the production process. State with reason if you would consider this as discounting operation as per AS 24.

[Note: As per New Accounting Standards of India, AS-24 is converted or modified as AS-105]

Ans :

In response to market forces, business enterprises often close facilities, abandon products or product line and size of their workforce. These terminations are not discontinuing operations until they satisfy decision criteria. According to AS-105, disposing substantially in its entity does not meet decision criteria. Hence change over is not a discontinuing operation.

Thus, it is not a discontinuing operations as per AS-105.

Q30. What is Discontinuing Operations.

Ans :

Discontinuing operation refers to the part of a business enterprise which is geographically segmented and differentiated operationally or for financial reporting purposes. Such part of a business enterprise is disposed off in a significant way or partially. The planned or unplanned change in the product line is not considered as discontinuing

operation. An operation is discontinued in any of the following ways,

- (i) Demerger or spin-off.
- (ii) Abandonment.
- (iii) Disposal of assets and settlement of liabilities.

2.9 IND AS-108: OPERATING SEGMENTS

Q31. What are Operating Segments?

Ans :

(July-21, Dec.-19)

An operating segment is a component of an entity:

- (a) engaged in business activities from which revenues may be earned and expenses may be incurred including the revenues and expenses which are relating to the transactions with other components of the same entity,
- (b) whose operating results are reviewed regularly by chief operating decision maker of the entity for making decisions about the resources that are to be allocated to the segment and assess the performance, and
- (c) for which discrete financial information is available.

An operating segment may engage in business activities for which it has not yet earned revenues.

Not every part of an organisation is an operating segment or a subset of an operating segment. A corporate headquarters or some functional departments, for example, may not produce revenues or may earn revenues that are primarily incidental to the entity's activities and thus are not operating segments. Post employment benefit programmes are not operating segments for the purposes of this Ind AS.

The function of 'Chief operating decision maker' is allocation of the resources to the operating segments and assesses their performance; most of the cases the chief operating decision maker of an entity is its chief executive officer or the chief operating officer.

An entity may produce various reports in which its business activities are presented in a number

of ways. Other factors, such as the nature of each component's business activities, the existence of managers responsible for them, and information presented to the Board of Directors, may identify a single set of components as constituting an entity's operating segments if the chief operating decision maker uses more than one set of segment information.

Generally, an operating segment has a segment manager who is directly accountable to and who maintains regular contact with the chief operating decision maker to discuss operating activities, financial results, forecasts, or plans for the segment. The term 'segment manager' identifies a function, not necessarily a manager with a specific title. For some operational segments, the chief operating decision maker may also be the segment manager. A manager can be the segment manager for multiple operating segments.

Q32. What are various disclosures to be made as per Ind AS-108?

Ans :

(July, Imp.)

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 re-quirements)

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).

Q33. Explain basis and reconciliation of operating segment.*Ans :***(July-21, Imp.)**

- 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 account-ing 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 measure-ment 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 report- able 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).

PROBLEM

6. Bharath Ltd. provides the following information.

(` in lakhs)

Segment	Revenue	Net Profit	Assets
A	2,000	800	5,000
B	200	50	400
Total	2,200	850	5,400

You are required to identify the reportable segments.

Ans.:

(July-21, July-18)

The following are the calculations to identify reportable segment.

Segment	A	B	Total
Basis			
Segment Revenue	2,000	200	2,200
Revenue of segment as a percentage of total revenue to all segments	$\frac{2,000}{2,200} \times 100 = 90.91\%$	$\frac{200}{2,200} \times 100 = 9.09\%$	
Segment Net Profit	800	50	850
Net profit of a segment as a percentage of total net profit of all segments	$\frac{800}{850} \times 100 = 94.12\%$	$\frac{50}{850} \times 100 = 5.88\%$	
Segment Assets	5,000	400	5,400
Segment assets as a percentage of total sum or assets to all segment	$\frac{5,000}{5,400} \times 100 = 92.59\%$	$\frac{400}{5,400} \times 100 = 7.41\%$	

(a) Segment Revenue

Segment-A is identified as a reportable segment because its revenue as a percentage of total revenue of all segments (i.e., A + B) is 90.91% i.e., more than 10%.

(b) Segment Net Profit

Segment-A is identified as a reportable segment because its profit as a percentage of total net profit of all segments (i.e., A + B) is 94.12% i.e. more than 10%.

(c) Segment Assets

Segment-A is identified as reportable segment because its assets as a percentage of total sum of assets of all segments (i.e., A + B) is 92.59% i.e more than 10%.

[Note: As external sales revenue is not given separately for segment A and B, it is not possible to check 75% criteria].

Basis	Reportable Segment
Revenue	A
Net Profit	A
Assets	A

Therefore, 'A' is a 'Reportable Segment'.

Short Question and Answers

1. What are Operating Segments?

Ans :

An operating segment is a component of an entity:

- (a) Engaged in business activities from which revenues may be earned and expenses may be incurred including the revenues and expenses which are relating to the transactions with other components of the same entity,
- (b) Whose operating results are reviewed regularly by chief operating decision maker of the entity for making decisions about the resources that are to be allocated to the segment and assess the performance, and
- (c) For which discrete financial information is available.

An operating segment may engage in business activities for which it has not yet earned revenues.

Not every part of an organisation is an operating segment or a subset of an operating segment. A corporate headquarters or some functional departments, for example, may not produce revenues or may earn revenues that are primarily incidental to the entity's activities and thus are not operating segments. Post employment benefit programmes are not operating segments for the purposes of this Ind AS.

The function of 'Chief operating decision maker' is allocation of the resources to the operating segments and assesses their performance; most of the cases the chief operating decision maker of an entity is its chief executive officer or the chief operating officer.

An entity may produce various reports in which its business activities are presented in a number of ways. Other factors, such as the nature of each component's business activities, the existence of managers responsible for them, and information presented to the Board of Directors, may identify a single set of components as constituting an entity's operating segments if the chief operating decision maker uses more than one set of segment information.

2. Explain the various activities of cash-flow statement.

Ans :

I) Operating activities

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

1. cash receipts from the sale of goods and the rendering of services;
2. cash receipts from royalties, fees, commissions and other revenue;
3. cash payments to suppliers for goods and services;
4. cash payments to and on behalf of employees;
5. cash receipts and cash payments of an insurance entity for premiums and claims, annuities and other policy benefits;
6. cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities; and
7. cash receipts and payments from contracts held for dealing or trading purposes.

II) Investing activities

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. Only expenditures that result in a recognized asset in the balance sheet are eligible for classification as investing activities.

Examples of cash flows arising from investing activities are:

1. cash payments to acquire property, plant and equipment, intangibles and other long-term assets.
2. cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;
3. cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);
4. cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);

III) 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 capital to the entity.

Examples of cash flows arising from financing activities are:

1. Cash proceeds from issuing shares or other equity instruments;
2. Cash payments to owners to acquire or redeem the entity's shares;
3. Cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings;

3. What are Financial Statements?

Ans :

- (i) **According to General purpose financial statements** (referred to as 'financial statements') are those intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs.

- (ii) **According to Impracticable Applying** a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.

- (iii) **According to Indian Accounting Standards (Ind ASs)** are Standards prescribed under Section 133 of the Companies Act, 2013.

4. Explain the features of financial statements.

Ans :

- Financial statements shall present a true and fair view of the financial position, financial performance and cash flows of an entity. Presentation of true and fair view requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework. The application of Ind ASs, with additional disclosure when necessary, is presumed to result in financial statements that present a true and fair view.
- An entity whose financial statements comply with Ind ASs shall make an explicit and unreserved statement of such compliance in the notes.
- An entity shall not describe financial statements as complying with Ind ASs unless they comply with all the requirements of Ind ASs.
- An entity cannot rectify inappropriate accounting policies either by disclosure of the accounting policies used or by notes or explanatory material.
- In the extremely rare circumstances in which management concludes that compliance with a requirement in an Ind AS would be so misleading that it would conflict with the objective of financial statements set out in the Framework, the entity shall depart from that if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.

5. What is Cash flow 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.

Definitions

- (i) **Cash** comprises cash on hand and demand deposits.
- (ii) **Cash equivalents** are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.
- (iii) **Cash flows are** inflows and outflows of cash and cash equivalents.
- (iv) **Operating activities** are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.
- (v) **Investing activities** are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

6. What are accounting policies?*Ans :*

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.

7. What are 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.

8. 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.

9. Discontinuing Operations

Ans :

Discontinuing operation refers to the part of a business enterprise which is geographically segmented and differentiated operationally or for financial reporting purposes. Such part of a business enterprise is disposed off in a significant way or partially. The planned or unplanned change in the product line is not considered as discontinuing operation. An operation is discontinued in any of the following ways,

- (i) Demerger or spin-off.
- (ii) Abandonment.
- (iii) Disposal of assets and settlement of liabilities.

10. Prior period items

Ans :

Prior period items are those incomes or expenses which emerged in current period as a consequence of both errors and omissions in preparation of financial statements for one or more periods.

The nature and amount of these items must be disclosed separately in profit and loss statement in such a way that their influence on current profit can be realized. It includes,

- (i) The nature of prior period error.
- (ii) The effect of such error in financial statements.
- (iii) The disclosure should not be repeated for financial statement of subsequent period.

Choose the Correct Answer

1. 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 (b) Profit or loss as a financing cost
(c) General reserve account (d) All of the above
2. 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
3. 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
4. _____ activities constitute the primary revenue generating activities of a firm [a]
(a) Operating (b) Financing
(c) Investing (d) All of the above
5. The generally accepted accounting assumptions are _____ [c]
(a) Going concern (b) Consistency
(c) Both (d) None of the above
6. _____ from dividend must be recognised [c]
(a) Expenditure (b) Goods
(c) Revenue (d) None of the above
7. 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
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 exchanged (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. _____ statements shall present a true and fair view of the financial position, financial performance and cash flows of an entity.
4. _____ statement is additional information to user of financial statements.
5. _____ comprises cash on hand and demand deposits.
6. _____ are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.
7. _____ activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.
8. _____ activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.
9. _____ policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.
10. _____ errors are errors committed in earlier years but discovered in current year.

ANSWERS

1. Financial statements
2. Inventories
3. Financial
4. Cash flow
5. Cash
6. Operating activities
7. Investing
8. Financing
9. Accounting
10. Prior period

UNIT III

STANDARDS PROVIDING GUIDANCE ON FINANCIAL STATEMENT ITEMS:

Ind AS-2: Inventories (Including simple problems) -- Ind AS-11: Construction contracts (Including simple problems) - Ind AS-12: Income taxes – Ind AS-16: Property, Plant and Equipment – Ind AS-17: Leases (Including simple problems)- Ind AS-18: Revenue – Ind AS-20: Accounting for Government Grants and Disclosure of Government Assistance – Ind AS-23: Borrowing Costs – Ind AS-38: Intangible Assets.

3.1 IND AS-2: INVENTORIES

Q1. Explain the objective and scope of Ind AS-2.

Ans : (Dec.-18)

Objective

The objective of this Standard is to prescribe the accounting treatment for inventories. A primary issue in accounting for inventories is the amount of cost to be recognized as an asset and carried forward until the related revenues are recognized. This Standard deals with the determination of cost and its subsequent recognition as an expense, including any write-down to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

Scope

This Standard applies to all inventories, except:

- (a) Financial instruments ; and
- (b) Biological assets (i.e living animals or plants) related to agricultural activity and agricultural produce at the point of harvest.

This Standard does not apply to the measurement of inventories held by:

- (a) Producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at net realizable value in accordance with well-established practices in those industries. When such inventories are measured at net realizable value, changes in that value are recognized in profit or loss in the period of the change.

- (b) Commodity broker-traders who measure their inventories at fair value less costs to sell. When such inventories are measured at fair value less costs to sell, changes in fair value less costs to sell are recognized in profit or loss in the period of the change.

Broker-traders are those who buy or sell commodities for others or on their own account.

Inventories are assets:

- (a) Held for sale in the ordinary course of business;
- (b) In the process of production for such sale; or
- (c) In the form of materials or supplies to be consumed in the production process or in the rendering of services.

In case of service providers, inventories include the cost of service for which the entity has not yet recognized the revenue.

1. Net Realisable Value

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. It refers to the net amount that an entity expects to realize from the sale of inventory in the ordinary course of business.

2. Fair Value

Fair value reflects the price at which an orderly transaction to sell the same inventory in the principal (or most advantageous) market for that inventory would take place between market participants at the measurement date.

The former is an entity-specific value; the latter is not. Net realisable value for inventories may not equal fair value less costs to sell.

Q2. What are the techniques for the measurement of inventories? Explain.

Ans : (Dec.19)

Measurement of inventories

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.

Costs of purchase of inventories includes

- Purchase price,
- Import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and
- Transport, handling and
- Other costs directly attributable to the acquisition of finished goods, materials and services.
- Trade discounts, rebates and other similar items are deducted in determining the costs of purchase

Costs of conversion of inventories include

- Costs directly related to the units of production, such as direct material, direct labour and other direct expenses; and
- Systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods
- Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and equipment, and the cost of factory management and administration.

➤ Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

➤ The allocation of fixed production overheads to the costs of conversion is based on the normal capacity of the production facilities.

➤ Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance.

➤ The actual level of production may be used if it approximates normal capacity.

➤ The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognized as an expense in the period in which they are incurred.

➤ In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost.

➤ When joint products are produced or when there is a main product and a by-product and the costs of conversion of each product are not separately identifiable they are allocated between the products on a rational and consistent basis.

➤ The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production.

➤ In case of by-products which are by their nature immaterial, then they are often measured at net realisable value and this value is deducted from the cost of the main product.

Other costs

Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition.

Following costs are excluded from the cost of inventories and recognized as expenses in the period in which they are incurred are:

- (a) Abnormal amounts of wasted materials, labour or other production costs;
- (b) Storage costs, unless those costs are necessary in the production process before a further production stage;
- (c) Administrative overheads that do not contribute to bringing inventories to their present location and condition; and
- (d) selling costs.

Q3. What are the techniques for the measurement of cost.

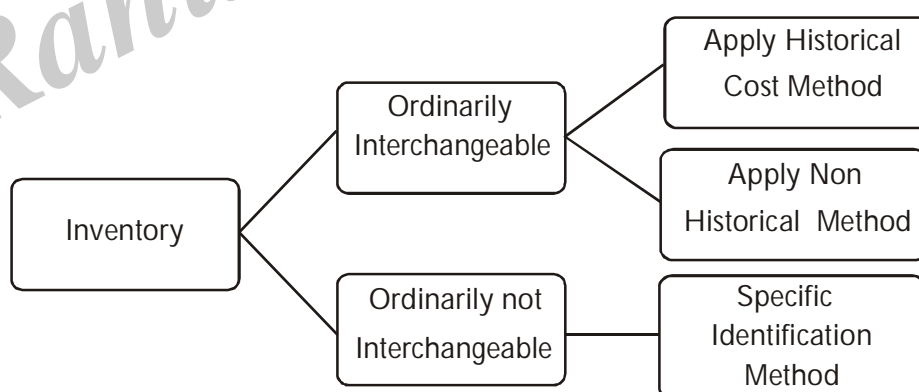
Ans :

Techniques for the measurement of cost

Techniques for the measurement of the cost of inventories, such as the Standard cost method or the Retail method, may be used. Standard costs take into account normal levels of materials and supplies, labour, efficiency and capacity utilization which are regularly reviewed /revised in the light of current conditions.

The retail method is often used in the retail industry for measuring inventories of large numbers of rapidly changing items with similar margins.

The cost of the inventory is determined by reducing the sales value of the inventory by the appropriate percentage gross margin.

Cost Formulas

- The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects shall be assigned by using specific identification of their individual costs. This is the appropriate treatment for items that are segregated for a specific project, regardless of whether they have been bought or produced.
- Specific identification of costs is inappropriate when there are large numbers of items of inventory that are ordinarily interchangeable. In such circumstances, the method of selecting those items that remain in inventories could be used to obtain predetermined effects on profit or loss. The cost of

inventories, other than those dealt with in paragraph 23, 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. For inventories with a different nature or use, different cost formulas may be justified.

- The FIFO formula assumes that the items of inventory that were purchased or produced first are sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced.
- In case of Weighted average cost formula the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the entity.

Net realisable value

- The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined. The cost of inventories may also not be recoverable if the estimated costs of completion or the estimated costs to be incurred to make the sale have increased. The practice of writing inventories down below cost to net realisable value is consistent with the view that assets should not be carried in excess of amounts expected to be realized from their sale or use.
- Inventories are usually written down to net realisable value item by item. In some circumstances, however, it may be appropriate to group similar or related items.
- 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 realize. These estimates take into consideration fluctuations of price or cost directly relating to events

occurring after the end of the period to the extent that such events confirm conditions existing at the end of the period.

- Estimates of net realisable value also take into consideration the purpose for which the inventory is held. For example, the net realisable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price. If the sales contracts are for less than the inventory quantities held, the net realisable value of the excess is based on general selling prices.
- Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when a decline in the price of materials indicates that the cost of the finished products exceeds net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value.

A new assessment is made of net realisable value in each subsequent period. When the circumstances that previously caused inventories to be written down below cost no longer exists or when there is clear evidence of an increase in net realisable value because of changed economic circumstances, the amount of the write-down is reversed so that the new carrying amount is the lower of the cost and the revised net realisable value.

Recognition as an expense

When inventories are sold, the carrying amount of those inventories shall be recognized as an expense in the period in which the related revenue is recognized. The amount of any write-down of inventories to net realisable value and all losses of inventories shall be recognized as an expense in the period 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 recognized as a reduction in the amount of inventories recognized as an expense in the period in which the reversal occurs.

Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another asset in this way are recognized as an expense during the useful life of that asset.

Q4. What are the disclosures to be made in Ind AS-2?

Ans :

The financial statements shall disclose:

- (a) The accounting policies adopted in measuring inventories, including the cost formula used
- (b) The total carrying amount of inventories and the carrying amount in classifications appropriate to the entity
- (c) The carrying amount of inventories carried at fair value less costs to sell
- (d) The amount of inventories recognized as an expense during the period
- (e) The amount of any write-down of inventories recognized as an expense in the period
- (f) The amount of any reversal of any write-down that is recognized as a reduction in the amount of inventories recognized as expense in the period
- (g) The circumstances or events that led to the reversal of a write-down of inventories in accordance with paragraph 34; and
- (h) The carrying amount of inventories pledged as security for liabilities.

PROBLEMS

1. Avishkar Ltd.'s normal production capacity is 1,00,000 units and the Fixed Overheads are estimated at ₹5,00,000. Give the treatment of Fixed Production Overhead under Ind AS - 2, if actual production during a period was -

- (i) 84,000 units
- (ii) 1,00,000 units;
- (iii) 1,20,000 units.

Sol :

Fixed Production Overhead Rate (based on Normal Capacity) = ₹5,00,000/1,00,000 units = ₹5 per unit
Fixed Overhead is treated as under -

Particulars	Situation (i)	Situation (ii)	Situation (iii)
1. Normal Production	1,00,000 units	1,00,000 units	1,00,000 units
2. Actual Production	84,000 units	1,00,000 units	1,20,000 units
3. Difference in Production (1-2)	16,000 units (short)	Nil	20,000 units (Excess)
4. Recovery Rate to be used as per Ind As - 2	Normal Rate = ₹5 per unit	Normal Rate = ₹5 per unit	Revised Rate = = ₹5,00,000 / 1,20,000 units = ₹4.167 p.u.
5. Recovered Cost	84,000 × ₹5 = ₹4,20,000	1,00,000 units × ₹5 = ₹5,00,000	1,20,000 units × ₹4.167 p.u. = ₹5,00,000
6. Balance treated as Period Cost	₹80,000	Nil	Nil

2. In a production process, Normal Waste is 4% of input. 6,000 MT of input were put in process resulting in a wastage of 300 MT. Cost per MT of input is ₹ 1,250. The entire quantity of waste is on stock at the year-end. Compute the value of Inventory.

Sol.:

Abnormal Amounts of Waste Materials, Labour or other Production Costs are excluded from cost of inventories and such costs are recognized as expenses in the period in which they are incurred.

Normal Waste is 4% of 6,000 MT i.e. 240 MT and Abnormal Waste is 300 MT – 240 MT = 60 MT.

Cost of Normal Waste 240 MT will be included in determining the cost of inventories at the year-end.

Cost of Abnormal Waste 60 MT ₹ 1,250 i.e. ₹ 75,000 will be charged to Profit and Loss Account.

3. A firm (dealer of T.V) has purchased 100 T.Vs on deferred payment basis for ₹ 5,000 per month per T.V. The amount is to be paid in twelve monthly equal installments. The cash cost per unit of T.V. is ₹ 56,000. At the end of year, 25 T.Vs were in the stock. What should be the Cost of Inventories?

Sol.:

Interest Expense = Deferred Payment Price (-) Cash Cost = (5,000 × 12 Months) – 56,000 = ₹ 4,000.

Inventory should be valued only at Cash ₹ 56,000 p.u. Interest Expense ₹ 4,000 should not be included in Valuation of Inventory.

Conclusion:

- (i) Value of Inventory = ₹ 56,000 × 20 units = ₹ 14,00,000
- (ii) Cost of Inventory sold to be recognized as Expense in the Statement of P&L = ₹ 56,000 × 75 units = ₹ 42,00,000
- (iii) Interest Expense to be recognized as an Expense in the Statement of P&L = ₹ 4,000 × 100 units = ₹ 4,00,000.

4. In a manufacturing process of Mars Ltd, one by-product BP emerges besides two main products MP1 and MP2 apart from scrap. Details of cost of production process are here under:

Item	Unit	Amount	Output	Closing Stock 31-3-20X1
Raw material	14,500	1,50,000	MP I - 5,000 units	250
Wages	-	90,000	MP II - 4,000 units	100
Fixed overhead	-	65,000	BP - 2,000 units	
Variable overhead	-	50,000		

Average market price of MP1 and MP2 is ₹ 60 per unit and ₹ 50 per unit respectively, by-product is sold @ ₹ 20 per unit. There is a profit of ₹ 5,000 on sale of by-product after incurring separate processing charges of ₹ 8,000 and packing charges of ₹ 2,000, ₹ 5,000 was realized from sale of scrap.

Required: Calculate the value of closing stock of MP1 and MP2 as on 31-03-20X1.

Sol :

As per Ind 2 'Inventories', most by-products as well as scrap or waste materials, by their nature, are immaterial. They are often measured at net realizable value and this value is deducted from the cost of the main product.

1) Calculation of NRV of By-product BP

Selling price of by-product	2,000 units × 20 per unit	40,000
Less: Separate processing charges of by- product BP		8,000
Packing charges		2,000
Net realizable value of by-product BP		<u>30,000</u>

2) Calculation of cost of conversion for allocation between joint products MP1 and MP2

Raw material		1,50,000
Wages		90,000
Fixed overhead		65,000
Variable overhead		50,000
Less: NRV of by-product BP (See calculation 1)	30,000	
Sale value of scrap	<u>5,000</u>	<u>(35,000)</u>
Joint cost to be allocated between MP1 and MP2		3,20,000

3) Determination of "basis for allocation" and allocation of joint cost to MP1 and MP2

Particulars	MP 1	MP 2
Output in units (a)	5,000	4,000
Sales price per unit (b)	60	50
Sales value (a × b)	3,00,000	2,00,000
Ratio of allocation		
Joint cost of ₹ 3,20,000 allocated in the ratio of 3:2 (c)	3	2
Cost per unit [c/a]	38.4	32

4) Determination of value of closing stock of MPI and MP2

Particulars	MP 1	MP 2
Closing stock in units	250 units	100 units
Cost per unit	38.4	32
Value of Closing stock	9,600	3,200

5. From the following calculate the Cost of Inventories as per AS 2.

Purchases ₹ 8,00,000; Freight and Duties ₹ 54,000; Storage cost of finished goods ₹ 36,000; Direct Labour ₹ 3,80,000; Selling cost ₹ 1,24,000.

Sol.:

(July - 19)

The calculation of cost of inventories as per As-2 is as follows,

Purchases	= ` 8,00,000
Freight and Duties	= ` 54,000
Direct Labour	= ` 3,80,000
Cost of Inventories is	<u>` 12,34,000.</u>

[Note: As per AS-2, cost of inventories does not include storage cost and selling cost, so these two costs are not considered in the calculation of cost of inventories].

6. From the following information, calculate the cost of Inventories, purchases ` 10,00,000; Direct Labour ` 6,40,000 ; Rent for storage of Finished goods ` 1,20,000 ; Selling and Distribution Cost ` 2,80,000, Direct expenses ` 3,20,000.

Sol.:

(Dec.-18)

$$\begin{aligned}
 \therefore \text{Cost of Inventory} &= \text{Purchases} + \text{Direct labour} + \text{Direct Expenses} \\
 &= 10,00,000 + 6,40,000 + 3,20,000 \\
 &= ` 19,60,000
 \end{aligned}$$

Rent for storage, selling and distribution costs will not be included in cost of inventories.

3.2 IND AS-11: CONSTRUCTION CONTRACTS

Q5. What is a construction contract?

Ans.:

(July-19)

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.

Q6. What are combining and segmenting construction contracts? Explain.

Ans.:

(July-19)

- The Ind AS 11 requirements are typically implemented to each building contract separately.
- When number of assets have been covered by a contract, then the construction of each of the assets shall be treated as a separate contract, proposals to be submitted separately for each of the

assets and are subjected to separate negotiations, wherein, both the customer and the contractor have a say to accept or reject that particular part of the contract in relation to each of the assets where identification of costs and revenues for each asset is possible.

- When a group of contracts, whether with a single customer or several customers is negotiated as a single package; the contracts are so closely interrelated that they are effectively part of a single project with an overall profit margin; and the contracts are performed concurrently or in a continuous sequence, the group of contracts is treated as a single construction contract.
- A contract may offer the option for the customer to create an extra asset, or it may be modified to include the construction of an additional asset. When the additional asset differs considerably in design, technology, or function from the asset or assets covered by the original contract, it must be considered as a distinct construction contract; alternatively the asset's price is negotiated independently of the initial contract price.

Q7. What are contract costs?

Ans :

Contract expenses include costs that are directly related to the contract, costs that are due to contract activity in general and may be assigned to the contract, and any additional costs that are explicitly charged to the customer under the contract's terms.

- Site labour costs, including site supervision; costs of materials used in construction; depreciation of plant and equipment used in the contract; costs of moving plant, equipment, and materials to and from the contract site; costs of hiring plant and equipment; costs of design and technical assistance that is directly related to the contract are all costs that are directly related to the contract.
- Any incidental income not included in the contract revenue, such as income from the sale of surplus materials and the disposal of

plant and equipment at the conclusion of the contract, may reduce these costs at times.

- Insurance, costs of design and technical support that are not directly tied to a single contract and construction overheads are examples of expenditures that can be attributed to contract activity in general and can be allocated to the specific contracts. These costs are assigned using systematic and sensible techniques that are consistently applied to all costs with similar characteristics. The allocation is based on normal building activity levels.
- Construction overheads include the costs of payroll preparation and processing for construction staff. Borrowing expenses are another cost that can be attributed to contract activity in general and assigned to specific contracts.
- Some general administration and development expenditures for which reimbursement is stated in the contract are examples of costs that are particularly chargeable to the client under the terms of the contract.
- Costs that cannot be linked to contract activity or assigned to a contract are not included in the construction contract's costs. General administration costs for which no payment is specified in the contract; selling costs; research and development expenditures for which no reimbursement is stipulated in the contract; and depreciation of idle plant and equipment not used on a specific contract are examples of such costs.
- Contract costs are the costs incurred as a result of a contract from the time it was first secured to the time it was finally completed. However, if costs directly related to a contract and incurred in securing the contract can be identified and assessed accurately and it is likely that the contract will be obtained, they are included as part of the contract costs. When expenditures associated with securing a contract are recognized as an expense in the period in which they are incurred, they are not included in contract costs when the contract is obtained in a later period.

PROBLEMS

7. MGR Construction Company commenced a contract on 1-4-2016. The fixed price agreed for the contract was ₹ 50,00,000. The company incurred ₹ 18,50,000 in the year 2016-2017 for completing 45% work and have received ₹ 15,00,000 as progress payment from the customer. Calculate the amount of profit to be transferred by MGR Construction Company to their profit and Loss A/c as per the % of completion method for the year ended 2016-2017.

[Note: As per New Accounting Standards of India, AS-7 is converted or modified as AS-11]

Sol.:

(July - 19)

Given,

Fixed price agreed for the contract = ₹ 50,00,000

Cost incurred for completing 45% of work = ₹ 18,50,000

Progress payment received = ₹ 15,00,000

Calculating Contract Cost yet to be Incurred or Estimated Cost to Complete

Work	Cost
For 45%	18,50,000
For 55%	?
(i.e 100% - 45% = 55%)	

$$= \frac{18,50,000 \times 0.55}{0.45}$$

$$= 22,61,111.111 \approx 22,61,111$$

In case of percentage of completion method, the following formula is used to find out percentage of completion,

$$\text{Percentage of Completion} = \frac{\text{Cost to Date}}{\text{Cost Incurred} + \text{Estimated Cost to Complete}} \times 100$$

$$\text{Percentage of completion} = \frac{18,50,000}{18,50,000 + 22,61,111} \times 100$$

$$= \frac{18,50,000}{41,11,111} \times 100$$

$$= 45\%$$

Profit/Loss From Construction = Contract Revenue – Contract Cost.

Contract Revenue = Contract price × 45%

$$= 50,00,000 \times \frac{45}{100}$$

$$= ₹ 22,50,000$$

Given, Contract Cost = ₹ 18,50,000

$$\therefore \text{Profit From Construction} = ₹ 22,50,000 - ₹ 18,50,000 \\ = ₹ 4,00,000$$

\therefore The amount of profit to be transferred to profit and loss A/c of MGR construction company for the year ended 2016-17 is ₹ 4,00,000.

8. **Miracle Construct Inc. is executing a significant project of constructing the tallest building in the country. The project is expected to take three years to complete-**

The company has signed a fixed price contract of ₹ 12,00,000 for the construction of this prestigious tower.

The details of the costs incurred till date in the first year are

Site Labour Cost	₹ 10,00,000
Cost of Construction Material	₹ 30,00,000
Depreciation	₹ 5,00,000
Marketing & Selling Costs to get the Tallest building in the country the right expenses	₹ 10,00,000
Total	₹ 55,00,000

Total Contract Cost estimated to complete ₹ 55,00,000 required, Calculate the % if completion and amounts if Revenue, Costs and profits to be recognized under AS-7 [Note: As per New Accounting Standards of India, AS-7 is converted or modified as AS-11]

Sol :

(July - 21)

Fixed price contract = ₹ 12,00,000

Estimated Cost to Complete Contract = ₹ 55,00,000

Calculation of Total contract cost Incurred till date

Particulars	Amount (₹)
Site labour cost	10,00,000
Cost of Construction material	30,00,000
Depreciation	5,00,000
Total Contract Cost	45,00,000

$$\text{Percentage of Completion (\%)} = \frac{\text{Cost incurred till date}}{\text{Estimated Total Cost}}$$

$$\begin{aligned} \text{Estimated Total Cost} &= \text{Total contract cost} + \text{Estimated cost to complete contract} \\ &= ₹ 45,00,000 + ₹ 55,00,000 = ₹ 1,00,00,000 \end{aligned}$$

$$\text{Percentage of completion (\%)} = \frac{45,00,000}{1,00,00,000} = 45\%$$

Revenue, Costs and Profits to be Recognized

$$\text{Revenue} = 12,00,000 \times 0.45 = 5,40,000$$

$$\text{Costs} = 10,00,000 \times 0.45 = 4,50,000$$

$$\begin{aligned} \text{Profit} &= \text{Revenue} - \text{Costs} \\ &= 5,40,000 - 4,50,000 \end{aligned}$$

$$\text{Profit} = 90,000$$

Note: As per Ind AS-11 Marketing and selling costs is excluded from calculating total contract costs.

9. On 1st December, 20X1, Vishwakarma Construction Co. Ltd. a contract to construct a building for ₹ 85 lakhs. On 31st March, 20X2, the company found that it had already spent ₹ 64,99,000 on the construction. Prudent estimate of additional cost for completion was ₹ 32,01,000. What amount should be charged to revenue in the final accounts for the completion was ₹ 32,01,000. What amount should be charged to revenue in the final accounts for the year ended 31st March, 20X2 as per Ind As 11 ?

Sol :

Particular	₹
Cost incurred till 31st March, 20X2	64,99,000
Prudent estimate of additional cost for completion	32,01,000
Total cost of construction	97,00,000
Less : Contract price	(85,00,000)
Total foreseeable loss	12,00,000

According to para 33 of Ind As 11, the amount of ₹ 12,00,000 is recognized as an expense.

$$\text{Contract work in progress} = \frac{64,99,000}{97,00,000} \times 100 = 67\%$$

$$\text{Proportion of total contract value recognized as turnover} = 67\% \text{ of ₹ } 85,00,000$$

$$= ₹ 56,95,000.$$

10. A Limited enters with a customer a 3 year construction contract for 10,00,000. The estimated total costs are ₹ 7,00,000. In year 2, the management has to revise the estimated costs. The contract however remains profitable. The relevant figures are as under :

Particulars	Amount (₹)		
	Year 1	Year 2	Year 3
Estimated Revenue	10,00,000	10,00,000	10,00,000
Estimated total costs	6,00,000	8,50,000	8,50,000
Estimated total profits	4,00,000	1,50,000	1,50,000
Costs incurred till date	3,00,000	6,80,000	8,50,000
Percentage of completion (based on cost)	50%	80%	100%
Cumulative recognized profits (Estimated revenue × percentage completion - costs incurred till date)	<u>2,00,000</u>	<u>1,20,000</u>	<u>1,50,000</u>
Recognized profit for the year	<u>2,00,000</u>	<u>(80,000)</u>	<u>30,000</u>

Sol :

The asset or liability at the end of each year will be computed as under :

Particulars	Amount (₹)		
	Year 1	Year 2	Year 3
Costs incurred till date	3,00,000	6,80,000	8,50,000
Cumulative recognized profits (losses)	2,00,000	1,20,000	1,50,000
Progress billings *	4,00,000	8,50,000	9,50,000
Gross amount due from customers at the year end (Amount recognized as an asset)	1,00,000		50,000
Gross amount due to customers (Amount recognized as an liability) at the year end		(50,000)	

11. A contract to build a bridge across a river is under execution by a firm of contractors. From the following details, indicate the relevant disclosure that has to be made by the firm in its accounts for the year ended 31st March, 2017, under the relevant Ind As.

Particulars	₹ in lakhs
Contract price	2,000
Work certified upto 31-03-2017	1,200
Work pending certification	480
Estimated further costs to complete the contract	520
Amounts received from the contracted so far	1,000
Amounts still to be received	500

Sol :

The relevant disclosures under Ind As 11 are given below :

Particulars	₹ in lakhs
Contract revenue recognized till 31st March, 2017 by percentage completion method (W.N.3)	1,527
Contract expenses incurred till 31st March, 2017 (W.N.2)	1,680
Recognized expected losses till recognized as an expense for the year 31st March, 2017 (W.N.1)	(200)
Gross amount due to customers (W.N.4)	20
Amount of retention i.e. Progress billings (not received from contract)	500

Working Notes :

1. Calculation of profit / loss for the year ended 31st March, 2017

Particulars	₹ in lakhs
Total estimated cost of construction (1,200 + 480 + 520)	2,200
Less : Total contract price	<u>(2,000)</u>
Total foreseeable loss to be recognized as expense	<u>200</u>

According to Ind As 11 "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

2. Contract work-in-progress i.e. cost incurred to date (₹ in lakhs)

Particulars	₹ in lakhs
Work certified	1,200
Work not certified	<u>480</u>
Total foreseeable loss to be recognized as expense	<u>1,680</u>

3. Proportion of total contract value recognized as revenue

Percentage of completion of contract to total estimated cost of construction

$$= (1,680 / 2,200) \times 100 = 76.36\%$$

Revenue to be recognized till date = 76.36% of ₹ 2,000 lakhs = ₹ 1,527 lakhs.

4. Amount due from / to customers = Contract costs + Recognized profits - Recognized expected losses - (Progress payments received + Progress payments to be received)

$$= ₹ [1,680 + Nil - 200 - (1,000 + 500)] \text{ lakhs}$$

$$= ₹ [1,680 - 200 - 1,500] \text{ lakhs}$$

Amount due to customers (shown as a liability) = ₹ 20 lakhs.

3.3 IND AS-12: INCOME TAXES

Q8. 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.

Q9. Explain the different terms used in income tax.

Ans : (Imp.)

- 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.

Q10. Define

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

Ans. :

(Imp.)

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:

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

Q11. 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 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 recognize deferred tax liability on sub-sequence recognition also.

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 - 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 recognize deferred tax liability on sub-sequence 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 recognized 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 ₹ 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 entity 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 forgoing 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.

3.4 IND AS-16: PROPERTY, PLANT AND EQUIPMENT

Q12. Explain the objective and scope of Ind AS-16.

Ans :

(July.-19, Dec.-19)

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 recognized 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 recognized 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.

Indian Accounting Standards (Ind AS)

An Overview

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 recognized in accordance with this Ind AS when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory.

Q13. Explain key terms used in Ind AS-16.

Ans : (July-19, Dec.-19)

Definitions

The following are the meanings specified for the terms that are used in this Standard.

1. A Bearer Plant

Is a living plant that is used in the production or supply of agricultural produce; is expected to bear produce for more than one period; and has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales

2. Carrying Amount

Is the amount at which an asset is recognized after deducting any accumulated depreciation and accumulated impairment losses.

3. Cost

Is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognized in accordance with the specific requirements of other Indian Accounting Standards, e.g., Ind AS 102, Share-based Payment.

4. Depreciable Amount

Is the cost of an asset, or other amount substituted for cost, less its residual value.

5. Depreciation

Is the systematic allocation of the depreciable amount of an asset over its useful life.

6. Entity - Specific Value

Is the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.

7. 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 (Ind AS 113 : Fair Value Measurement)

8. An Impairment Loss

Is the amount by which the carrying amount of an asset exceeds its recoverable amount.

9. Property, Plant and Equipment

Are tangible items that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and are expected to be used during more than one period Recoverable amount is the higher of an asset's fair value less costs to sell and its value in use.

10. Residual Value of an Asset

Is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

11. Useful Life

Is the period over which an asset is expected to be available for use by an entity; or the number of production or similar units expected to be obtained from the asset by an entity.

12. Recognition

The cost of an item of property, plant and equipment shall be recognized as an asset if, and only if it is probable that future economic benefits associated with the item will flow to the entity; and the item can be measured reliably.

Q14. Explain the measurement of PPE.

Ans. :

(Imp.)

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 recognized 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 recognized in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, the increase should be recognized in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognized in profit or loss.

If an asset's carrying amount is decreased as a result of a revaluation, the decrease should be recognized in profit or loss. However, the decrease shall be recognized in other comprehensive income to the extent of any credit balance existing in the revaluation

surplus in respect of that asset. The decrease recognized 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 recognized 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 derecognized:

- (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 recognize 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.

PROBLEMS

12. **X Ltd. Purchased a Plant and Machinery on 1-4-2017 and following are the costs incurred; Original Cost ` 35,00,000; Insurance during transit of Plant and Machinery ` 2,00,000; Annual maintenance cost ` 2,00,000; Cost of Inspection ` 3,00,000; Installation and assembling cost ` 5,00,000; Annual Interest on Loan for purchase of Plant and Machinery ` 1,00,000. Calculate the amount to be recognized as cost of Property, Plant and Equipment.**

Sol :

(July-19)

[Note : As per New Accounting standards of India, As 10 is converted as As-16]

Calculation of cost of plant and Machinery as per AS-16

Particulars	Amount (₹)
Original cost of Plant and Machinery	35,00,000
Insurance during transit of Plant and Machinery	2,00,000
Annual Maintenance Cost	2,00,000
Cost of Inspection	3,00,000
Installation and Assembling Cost	5,00,000
Total Cost	47,00,000

The amount to be recognized as cost of property, plant and equipment is ₹ 47,00,000.

[Note: Interest on loan for purchase of plant and machinery is not considered as directly attributable cost and therefore cannot be capitalized. Interest on loan is not considered in the calculation of cost of plant and machinery].

3.5 IND AS-17: LEASES

Q15. Define lease. Explain different types of leases.

Ans :

(July-19, Imp.)

Meaning

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 though 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.

Q16. Discuss the objective and scope of Ind AS-17.

Ans :

(July-19)

Objective

To prescribe for lessees and lessor the appropriate accounting policies and disclosures that are applicable in relation to the leases.

Scope

The applicability of this standard is for all leases except to: (a) explore for or use of non-regenerative resources (minerals, oil, and natural gas etc) and (b) for lease of certain items motion picture films, manuscripts, plays, video recordings, patents and copyrights. The standard is applicable in case of the agreements where the right to use assets is transferred.

Ind AS-17 is not applicable to the lease of assets where Ind AS 40: Investment Property; Ind AS 41: Agriculture is applicable; and to the agreements which are in the form of contracts for services where the right to use the assets by the lessee is not transferred.

Q17. 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]
-----------------------------------------------------------	---	-------------------------------------------------------------------------------------------

(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

Q18. 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.

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

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.

Q19. What is sale and lease back? Explain the accounting treatment of sale and lease back.

Ans :

(Imp.)

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 a 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, recognize 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.

PROBLEMS

13. Calculate minimum lease payments for A Ltd. who took an asset on a 5 years lease from B Ltd. using the following information:

Payments over the lease term	₹ 1,000 per month
Contingent rent	₹ 20,000
Cost for services given by B Ltd.	₹ 40,000
Taxes to be reimbursed to B Ltd.	₹ 15,000
Residual value guaranteed by A Ltd.	₹ 5,000
Fair value of asset after 5 years	₹ 6,000

Also, A Ltd. has an option to purchase the asset after a period of 5 years at ₹ 2,000. It is reasonably certain that A Ltd. will exercise the option.

Required

Calculation Minimum Lease Payments.

Sol :

Particulars	Amount (₹)
Payments over the lease term (1,000 × 12 × 5)	60,000
Contingent rent	-
Cost for services given by B Ltd.	-
Taxes to be reimbursed to B Ltd.	-
Residual value guaranteed by A Ltd.	5,000
Payment made for option to purchase the asset	2,000
Minimum lease payments for A Ltd.	67,000

14. A Ltd. leased a machinery to B. Ltd on the following terms.

Particulars	(₹ In Lakhs)
Fair Value of the Machinery	20.0
Lease term	5 years
Lease Rental per Annum	5.00
Guaranteed Residual Value	1.00
Expected Residual Value	2.00
Internal Rate of Return	15%

Find out the Present Value of Lease.

Sol.:

(July-21)

Given,

Fair value of the machinery = ₹ 20 lakhs

Lease rent (n) = 5 years

Lease rental per annum = 5 lakhs

Guaranteed Residual Value = 1 lakh

Expected Residual Value = 2 lakhs

Internal Rate of Return (r) = 15%

Calculation of Present Value of Lease

Year	Minimum Lease Payment (MLP)	Discount Rate 15%	Present Value (PV)
1.	5,00,000	0.8696	4,34,800
2.	5,00,000	0.7561	3,78,050
3.	5,00,000	0.6575	3,28,750
4.	5,00,000	0.5718	2,85,900
5.	(5,00,000 + 1,00,000) 6,00,000	0.4972	2,98,320
			17,25,820

∴ Present Value of Lease is ₹ 17,25,820

15. From the following details, calculate the amount to be recorded as an asset and liability in the books of lessee on 1-4-2018. Fair value of the asset at the inception of the lease ₹ 5,00,000.

Year	Lease Rent (₹)	Discounting Factor at 10%
31-3-2019	2,00,000	0.9091
31-3-2020	2,00,000	0.8265
31-3-2021	2,00,000	0.7513

The lease period of 3 years is equal to the life of the asset and it has ₹ 40,000 as residual value at the end of the 3rd year.

Sol.:

(July-19)

Given,

Fair value of the asset at the inception of the lease = ₹ 5,00,000

Lease period = 3 years

Lease rent per annum = ₹ 2,00,000

Residual value at the end of 3rd year = ₹ 40,000

Discount Factor = 10%

Calculation of Present Value of MLP

Year	Minimum lease payment	Discount Factor	Present Value (P.V)
31-3-2019	2,00,000	0.9091	1,81,820
31-3-2020	2,00,000	0.8265	1,65,300
31-3-2021	2,40,000	0.7513	1,80,312
	2,00,000 + 40,000		5,27,432

[**Note:** The MLP of 3rd year will be 2,40,000 (i.e., lease rent per annum + residual value)].

Present value of MLP i.e., 5,27,432 is more than fair value of ₹ 5,00,000, so the amount to be recorded as an asset and liability in the books of lessee on 1-4-2018 is ₹ 5,00,000.

3.6 IND AS-18: REVENUE

Q20. Explain the objective and scope of Ind AS-18.

Ans :

(July-21, Dec.-18)

Objective

To provide for the accounting treatment of revenue arising from certain types of transactions and events; determination of recognition of revenue is a primary issue in accounting. Revenue is recognized when it is probable that the future economic benefits will flow to the entity and that those benefits can be reliably measured. Ind AS 18 identifies various circumstances in which the criteria will be met and, revenue, therefore, will be recognized; and also provides for practical guidance on the application of these criteria.

Scope

- This Standard applies to revenue originating from the sale of goods, the performance of services, and the use by others of entity assets earning interest, royalties, and dividends.
- Goods comprise of goods that are produced for sale by the entity and goods purchased for resale, such as merchandise purchased by a store or land and other property held for resale.
- The rendering of services often entails the entity carrying out a contractually agreed duty over a specified time period. The services may be provided in a single session or over several sessions. Some contracts for rendering of the services, such as project managers and architects, are closely tied to construction contracts. The revenue generated by these contracts is not dealt with under this Standard, but rather in accordance with the rules for construction contracts set forth in Ind AS 11 Construction Contracts.
- Agreements for real estate development are included in the definition of a Construction Contract in Ind AS 11. As a result, revenue derived from such agreements is not covered by this Standard.
- The use of entity assets by others generates revenue in the form of interest charges for the use of cash or cash equivalents or amounts due to the entity; royalties charges for the use of long-term assets of the entity, such as patents, trademarks, copyrights, and computer software; and distributions of profits as dividends to holders of equity investments in proportion to the equity investment's value

- This Standard excludes revenue from lease agreements (Ind AS 17 Leases); dividends arising from equity investments (Ind AS 28 Investments in Associates); insurance contracts (Ind AS 104 Insurance Contracts); and changes in the fair value of financial assets and financial liabilities or their disposition; changes in the fair value of other current assets; initial recognition and changes in the fair value of biological assets related to agricultural activity (Ind AS 41 Agriculture); initial recognition of agricultural produce (Ind AS 41 Agriculture); and mineral ores extraction.

Q21. Explain important definitions of Ind AS-18.

Ans : (Dec.-18)

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 is 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.

Q22. How is revenue measure?

Ans : (Dec.-18)

- The amount of revenue generated by a transaction is normally agreed upon between the company and the asset's buyer or user. It is calculated using the fair value of the consideration received or receivable, which includes any trade discounts and volume rebates that the organization allows.
- The most common kind of consideration is cash or cash equivalents received or receivable. The fair value of the consideration

may be less than the nominal amount of cash received or receivable when the inflow of cash or cash equivalents is deferred.

- The fair value of the consideration is established by discounting all future receipts using an imputed rate of interest when the arrangement essentially comprises a financing transaction. The imputed rate of interest is either:
- (a) The current rate for a similar instrument from an issuer with a similar credit rating; or
- (b) A rate of interest that reduces the nominal amount of the instrument to the current cash sales price of the goods or services
- When goods or services are exchanged or swapped for goods or services of identical nature and value, the transaction is not considered a revenue-generating transaction. This is common with commodities like oil or milk, when suppliers trade or swap inventories in different areas to meet the demand in a specific location on a timely manner.
- When commodities are sold or services are rendered in exchange for items or services that are not equivalent, the trade is considered a revenue-generating transaction. The income is calculated based on the fair market value of the products or services received, less any cash or financial equivalents transferred.

Q23. How the revenue is recognized as per Ind AS-18?

(OR)

Explain the standard of revenue recognition.

Ans : (Dec.-18)

The revenue is recognized in four different ways.

1. Identification of the Transaction

- The recognition criteria outlined in Ind AS 18 are normally applied to each transaction independently. In other cases, however, the recognition criteria must be applied to the

separately identifiable components of a single transaction in order to reflect the transaction's substance.

- When a product's selling price contains an identifiable amount for future servicing, for example, that money is deferred and recognized as revenue throughout the period in which the service is provided.
- When two or more transactions are related in such a way that the commercial effect cannot be understood without reference to the entire series of transactions, the recognition requirements are applied to all of them. For example, a business may* sell items while simultaneously entering into a separate arrangement to repurchase the products at a later date, effectively negating the transaction's substantive effect; in this scenario, the two transactions are treated as one.

2. Sale of Goods

Revenue from the sale of the goods shall be recognized if all the following conditions are satisfied:

- (a) The significant risks and rewards of ownership of the goods has been transferred to the buyer by the entity;
- (b) The entity neither retains a continuing managerial involvement to the degree that is usually associated with the ownership nor effective control over the goods that are sold;
- (c) The reliable measurement of the amount of the revenue can be made;
- (d) The economic benefits associated with the transaction probably will flow to the entity; and
- (e) The costs that are incurred or to be incurred in respect of the transaction can be reliably measured

The transaction is not considered as a sale if the entity retains significant ownership risks, and revenue is not recognized. The entity may retain significant risks and rewards of ownership in the following situations:

- (a) The entity retains an obligation for the unsatisfactory performance not covered by the normal warranty provisions;
- (b) The receipt of revenue from a particular sale is contingent on the buyer deriving revenue from its sale of the goods;
- (c) The goods are shipped subject to installation and installation is a significant part of the contract that the entity has yet to complete; and
- (d) The buyer has the right to cancel the purchase for a reason specified in the sales contract and the entity is unsure about the likelihood of return.
- The transaction as a sale and revenue is recognized if an entity retains only a little risk of ownership. For example, a vendor may keep legal title to the items merely to shield the sum owed from being collected. If the entity has transferred major risks and benefits associated with ownership, the transaction is treated as a sale, and revenue is recognized. A retail sale where a refund is promised if the consumer is not happy is another example of an entity holding only a minor risk of ownership.
- Revenue and expense matching is recognizing the revenue and expenses that are related to the same transaction or other event at the same time; when the other elements for the recognition of revenue have been met, expenses such as warranties and other costs to be spent after the shipment of the items can be measured correctly. When expenses cannot be reliably measured, income cannot be recognized; in such cases, whatever consideration already received for the sale of the items is recognized as a liability.

3. Rendering of Services

Revenue connected with a transaction involving the rendering of services shall be recognized by reference to the stage of completion of the transaction at the end of the reporting period when the outcome of the transaction may be fairly estimated. When all of the following requirements are met, the outcome of a transaction can be accurately predicted:

- (a) The amount of revenue can be reliably measured;
 - (b) The economic benefits associated with the transaction will probably flow to the entity;
 - (c) The stage of the completion of the transaction can be reliably measured at the end of the reporting period; and
 - (d) The costs incurred and the costs to complete the transaction can be measured reliably
- The percentage of completion method refers to the recognition of revenue based on the stage of completion of a transaction; revenue is recognized in the accounting periods in which the services are performed. Revenue recognition on this basis, gives useful information on the scope of service activity and performance during a given period.
- Revenue is recognized only when it is likely that the transaction's economic benefits will be passed on to the company. When there is a question regarding the collectability of an amount that has already been recorded as revenue, the uncollectible amount, or the amount for which recovery is no longer likely, is recorded as an expense rather than an adjustment to the amount of revenue already recorded.

4. Interest, Royalties and Dividends

Revenue arising from the use of entity assets by others yielding interest, royalties, and dividends is recognized when: (a) the economic benefits associated with the transaction are likely to flow to the entity; and (b) the amount of the revenue can be measured reliably,

- Interest is recognized using the effective interest method as set out in Ind AS 39. When unpaid interest accrues prior to the purchase of an interest-bearing investment, the subsequent receipt of interest is split between the pre-acquisition and post-acquisition periods, with only the post-acquisition component being recognized as revenue.
- Royalty is recognized on an accrual basis. Royalties are earned in accordance with the provisions of the relevant agreement and are normally recognized as such, unless the substance of the agreement requires revenue to be recognized in a more regular and sensible manner.

PROBLEMS

16. Perfect Ltd. received advance from a customer for sale of goods on 20th March 2016, however the goods were sent to the customer on 1st October 2016 and balance of payment was received on 2nd April 2017. State with reason when shall the revenue be recognized as per As 18.

Sol.:

(Dec.-18)

Note : As per New Accounting Standards of India, As 9 is converted as As-18

As per accounting standard-18,

In case of "Revenue from sale of goods" – partial payment received in the form of advance, revenue shall be recognized when the goods are delivered to the buyer.

Received advance on 20th March 2016

Goods delivered to customer on 1st October 2016

Received full payment on 2nd April 2017.

So, In this case, revenue shall be recognized on 1st October 2016.

3.7 IND AS-20: ACCOUNTING FOR GOVERNMENT GRANTS AND DISCLOSURE OF GOVERNMENT ASSISTANCE

Q24. Explain briefly about Ind As 20 ?

Ans : (July-21, 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 recognized 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 recognized in profit or loss on a systematic basis over the periods in which the entity recognizes 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 recognized 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 unamortized deferred credit recognized 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

recognized immediately in profit or loss. Repayment of a grant related to an asset shall be recognized 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 recognized 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 recognized.

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.

Q25. 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.

Q26. 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.

3.8 IND AS-23: BORROWING COSTS**Q27. Explain briefly about Ind AS-23.***Ans :***(Dec.-18)**

Ind AS 23, Borrowing Costs Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognized as an expense.

Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds.

Recognition

An entity shall capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. An entity shall recognize other borrowing costs as an expense in the period in which it incurs them.

A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

To the extent that an entity borrows funds specifically for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalization as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.

To the extent that an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalization by applying a capitalization rate to the expenditures on that asset. The capitalization rate shall be the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding

during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs that an entity capitalizes during a period shall not exceed the amount of borrowing costs it incurred during that period.

An entity shall begin capitalising borrowing costs as part of the cost of a qualifying asset on the commencement date. The commencement date for capitalizations is the date when the entity first meets all of the following conditions:

- (a) it incurs expenditures for the asset;
- (b) it incurs borrowing costs; and
- (c) it undertakes activities that are necessary to prepare the asset for its intended use or sale.

An entity shall suspend capitalization of borrowing costs during extended periods in which it suspends active development of a qualifying asset.

An entity shall cease capitalising borrowing costs when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

An entity shall disclose

- (a) The amount of borrowing costs capitalised during the period; and
- (b) The capitalization rate used to determine the amount of borrowing costs eligible for capitalization.

PROBLEM

- 17. Revised Ltd made an agreement for construction of Machinery which is not yet complete. They have taken a loan of ₹ 30,00,000 at 10% p.a for the above purpose. Explain the accounting treatment of the borrowing costs as per As 16.**

Sol.:

(Dec.-18)

[Note : As per New accounting standards of India As 16 is converted as As 23]

According to AS-23, Borrowing costs can be capitalized, if borrowing costs directly attributable to the acquisition, development of qualifying asset".

Here, qualifying asset means, an asset which consumes significant time to get prepared for its intended use or sale.

In this case, machinery is accounted for qualifying asset (getting prepared on agreement for sale), its borrowing cost can be capitalized.

Loan amount = 30,00,000

Borrowing cost = 30,00,000 @ 10%

= 3,00,000.

3.9 IND AS-38: INTANGIBLE ASSETS

Q28. Discuss the objective and scope of Ind AS-38.

Ans.:

(July-21, July-19)

Objective

As per Ind AS 38, an entity is required to recognize an intangible asset only if certain specific conditions are met; it also provides for the calculation of the carrying amount of intangible assets and requires for disclosures with regard to intangible assets.

Scope

Ind AS 38 is applicable to accounting of intangible assets. However this standard is not applicable to the following: those of the accounting standards that fall within the scope of another standard; financial assets covered in Ind AS 32; recognition and measurement, exploration and evaluation of assets as covered by Ind AS 106; expenditure incurred on the extraction and development of non - regenerative resources such as oil, natural gas, minerals etc.

Q29. What are Intangible Assets?**(OR)**

Explain the various terms used in Ind AS-38.

Ans : (July-21, July-19, Imp.)

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

1. Amortisation

Is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

2. Asset

Is a resource: (a) controlled by an entity as a result of past events; and (b) from which future economic benefits are expected to flow to the entity.

3. Carrying Amount

Is the amount at which an asset is recognized in the balance sheet after deducting any accumulated amortisation and accumulated impairment losses thereon.

4. Cost

It the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction, or, when applicable, the amount attributed to that asset when initially recognized in accordance with the specific requirements of other Indian Accounting Standards, e.g., Ind AS 102, Share - based Payment.

5. Depreciable Amount

Is the cost of an asset, or other amount substituted for cost, less its residual value.

6. Development

Is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.

7. Entity - specific Value

Is the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.

8. 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.

9. Impairment Loss

Is the amount by which the carrying amount of an asset exceeds its recoverable amount.

10. Intangible Asset

Is an identifiable non-monetary asset without physical substance.

11. Monetary Assets

Are money held and assets to be received in fixed or determinable amounts of money.

12. Research

Is an original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

13. Residual Value

Of an intangible asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

14. Useful Life

Is (a) the period over which an asset is expected to be available for use by an entity; or (b) the number of production or similar units expected to be obtained from the asset by an entity.

15. An asset is identifiable

If it either: (a) is separable, i.e., is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or (b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

16. An Intangible Asset shall be recognized

If, and only if: (a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and (b) the cost of the asset can be measured reliably. An entity shall assess the probability of expected future economic benefits using reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset.

Q30. Explain the various models applicable for recognizing the carrying cost.

Ans :

(July-21)

An entity should choose either the cost model or the revaluation model as its accounting policy. If an intangible asset is accounted for using the revaluation model, all the other assets in its class should also be accounted for using the same model, unless there is no active market for those assets.

Cost Model- After initial recognition, an intangible asset should be carried at its cost less any accumulated amortisation and any accumulated impairment losses.

Revaluation Model- After initial recognition, an intangible asset shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses. For the purpose of revaluations

under this Standard, fair value shall be measured by reference to an active market. Revaluations shall be made with such regularity that at the end of the reporting period the carrying amount of the asset does not differ materially from its fair value.

The revaluation model is applied after an asset has been initially recognized at cost. However, if only part of the cost of an intangible asset is recognized as an asset because the asset did not meet the criteria for recognition until part of the way through the process, the revaluation model may be applied to the whole of that asset.

Q31. Explain the treatment of revaluation gains and losses.

Ans :

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

However, the increase should be recognized in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognized in profit or loss.

If an intangible asset's carrying amount is decreased as a result of a revaluation, the decrease should be recognized in profit or loss. However, the decrease should be recognized in other comprehensive income to the extent of any credit balance in the revaluation surplus in respect of that asset.

Useful Life

Useful life is:

- (a) the period over which an asset is expected to be available for use by an entity; or
- (b) the number of production or similar units expected to be obtained from the asset by an entity.

The accounting for an intangible asset is based on its useful life. An intangible asset with a finite useful life is amortised, and an intangible asset with an indefinite useful life is not.

Many factors are considered in determining the useful life of an intangible asset.

PROBLEMS

- 18. A Pharmaceutical Company is engaged in research of a new process for its product. It has incurred an expenditure of ₹ 20,00,000 on research. The Development of the process has begun and ₹ 12,00,000 is spent on it, this will result in future economic benefits. Explain the accounting treatment of the above items as per AS 26.**

Sol.:

(July-19)

Research Expenditure

According to AS-38, the expenditure of ₹ 20,00,000 on research must be expensed in the year in which it is incurred. Therefore, it must be written off as an expenses in that year itself.

Development Expenditure

According to AS-38, the expenditure on development can be treated as an asset only if all the conditions listed below are satisfied.

- (i) Technical feasibility of the product,
- (ii) Product availability for usage or sale,
- (iii) Determination of cost incurred,
- (iv) Probability of external market, or
- (v) The realistic expectation that there will be enough future revenues which can cover cost.

The pharmaceutical company is expecting future economic benefits from the development expenditure of ₹ 12,00,000. So, it is assumed that the pharmaceutical company has met one of the requirements.

Short Question and Answers

1. Application of As - 26.

Ans :

Ind AS 38 is applicable to accounting of intangible assets. However this standard is not applicable to the following: those of the accounting standards that fall within the scope of another standard; financial assets covered in Ind AS 32; recognition and measurement, exploration and evaluation of assets as covered by Ind AS 106; expenditure incurred on the extraction and development of non - regenerative resources such as oil, natural gas, minerals etc.

2. Government Grants.

Ans :

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.

3. Property, Plant and Equipment.

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 recognized 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 recognized 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.

4. Explain the objective and scope of Ind AS-2.

Ans :

Objective

The objective of this Standard is to prescribe the accounting treatment for inventories. A primary issue in accounting for inventories is the amount of cost to be recognized as an asset and carried forward until the related revenues are recognized. This Standard deals with the determination of cost and its subsequent recognition as an expense, including any write-down to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

Scope

This Standard applies to all inventories, except:

- (a) Financial instruments ; and
- (b) Biological assets (i.e living animals or plants) related to agricultural activity and agricultural produce at the point of harvest.

This Standard does not apply to the measurement of inventories held by:

- (a) Producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at net realizable value in accordance with well-established practices in those industries. When such inventories are measured at net realizable value, changes in that value are recognized in profit or loss in the period of the change.
- (b) Commodity broker-traders who measure their inventories at fair value less costs to sell. When such inventories are measured at fair value less costs to sell, changes in fair value less costs to sell are recognized in profit or loss in the period of the change.

5. 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.

6. What is Income tax.

Ans :

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.

7. 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 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.

8. Types of leases

Ans :

(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.

9. Explain the various terms used in Ind AS-38.

Ans :

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

1. Amortisation

Is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

2. Asset

Is a resource: (a) controlled by an entity as a result of past events; and (b) from which future economic benefits are expected to flow to the entity.

3. Carrying Amount

Is the amount at which an asset is recognized in the balance sheet after deducting any accumulated amortisation and accumulated impairment losses thereon.

4. Cost

It the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction, or, when applicable, the amount attributed to that asset when initially recognized in accordance with the specific requirements of other Indian Accounting Standards, e.g., Ind AS 102, Share - based Payment.

5. Depreciable Amount

Is the cost of an asset, or other amount substituted for cost, less its residual value.

6. Development

Is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.

10. Explain the treatment of revaluation gains and losses.

Ans :

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

However, the increase should be recognized in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognized in profit or loss.

If an intangible asset's carrying amount is decreased as a result of a revaluation, the decrease should be recognized in profit or loss. However, the decrease should be recognized in other comprehensive income to the extent of any credit balance in the revaluation surplus in respect of that asset.

Useful Life

Useful life is:

- (a) the period over which an asset is expected to be available for use by an entity; or
- (b) the number of production or similar units expected to be obtained from the asset by an entity.

The accounting for an intangible asset is based on its useful life. An intangible asset with a finite useful life is amortised, and an intangible asset with an indefinite useful life is not.

Many factors are considered in determining the useful life of an intangible asset.

Choose the Correct Answers

1. Cost of Inventory includes [d]
(a) Cost of purchase (b) Cost of conversion
(c) Other costs (d) All the above
3. The generally accepted accounting assumptions are _____. [c]
(a) Going concern (b) Consisting
(c) Both (d) None of the above
7. Which accounting standard deals with PPE. [a]
(a) Ind AS 16 (b) Ind AS 21
(c) Ind AS 1 (d) Ind AS 17
3. Ind As 38 deals with [c]
(a) Agriculture (b) Earnings per share
(b) Intangible assets (d) Investment Property
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. A _____ is a contract specifically negotiated for the construction of an asset or a group of interrelated assets.
2. _____ are an expense incurred in operating most businesses, as such are to be reflected in entity's operating results.
3. _____ is the amount of income taxes payable (recoverable) in respect of taxable profit (tax loss) for a period
4. _____ tax may either be asset or liability.
5. _____ of an asset or liability is the amount attributed to that asset or liability for tax purposes.
6. Ind As - 16 deals with _____
7. _____ is an arrangement by which the lessor gives the right to use an asset for given period of time to the lessee on rent.
8. A _____ transaction involves the sale of an asset by vendor and leasing of the same asset back to the vendor.
9. _____ 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.
10. _____ is the amount for which an asset could be exchanged or the liability settled between knowledgeable, willing parties in an arm's length transaction.

ANSWERS

1. Construction contract
2. Income taxes
3. Current tax
4. Deferred
5. Tax Base
6. Property, Plant and Equipment
7. Lease
8. Sale and lease back
9. Revenue
10. Fair Value (FV)

UNIT IV

STANDARDS RELATING TO BUSINESS ACQUISITIONS AND CONSOLIDATIONS:

Ind AS-28: Investments in Associate and Joint Ventures - Ind AS-103: Business Combinations – Ind AS-110: Consolidated Financial Statements – Ind AS-111: Joint Arrangements – Ind AS- 112: Disclosure of interest in other entities

4.1 IND AS-28: INVESTMENTS IN ASSOCIATE AND JOINT VENTURES

Q1. Discuss the accounting standard related to investments in associate and joint venture.

Ans : (Imp.)

Objective & Scope

Ind AS 28 prescribes the accounting for investments in associates; and sets out the requirements for the application of the Equity Method for accounting of investments in the associates and joint ventures.

Scope

Ind AS is applicable to all the entities that are investors with joint control of, or significant influence over, an investee.

Definitions

- "An associate is an entity over which the investor has significant influence".
- "Consolidated financial statements are the financial statements of a group in which assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity".
- "The equity method is a method of accounting whereby the investment is initially recognized at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income".

- "A joint arrangement is an arrangement of which two or more parties have 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".
- "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".
- "A joint venturer is a party to a joint venture that has joint control of that joint venture".
- "Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies".

And the terms control of an investee; group; parent; separate financial statements; and subsidiary- are defined in Ind AS 27, Separate Financial Statements, and Ind AS 110, Consolidated Financial Statements, and the same holds good with regard to Ind AS 28.

Q2. Explain the computation and procedure of Equity method ?

Ans : (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.

Q3. 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.

4.2 IND AS-103: BUSINESS COMBINATIONS

Q4. Define the following terms

(i) **Business**

(ii) **Business combination**

Ans :

(i) **Business**

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 business 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 acquire 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.

(ii) **Business combination**

Business combinations is concerned with accounting done for business combinations but excludes business combinations of entities which are under common control. Whereas Ind AS 103 facilitates assistance relating to accounting of the business combination under common control and need those combinations for utilizing pooling of interest method. The amendment states that any variation in consideration paid and share capital of the transferor must be transferred to separate part of equity known as 'common control transaction capital reserve' instead of determining goodwill/capital reserve.

Meaning

According to Ind AS 103, Business combination refers to the merging or acquiring of two businesses where an merger or acquirer gain control over other businesses.

In other words, the combination of one or more business into one business unit is known as business combination. The pooling of interest method is used, if the business is under the control of same person.

Q5. Explain the objectives and scope of Ind AS-103.

Ans :

Objective

The objective of Ind AS 103 is to improve the relevance of the data provided, reliability and comparability of the information provided in the financial statements by the reporting entity about a business combination and its effects. For accomplishing the same, Ind AS 103 laid down principles and requirements for the acquirer as to how:

(a) The recognition and measurement of the identifiable assets acquired and the liabilities that are assumed and non-controlling interest if any in the acquire is done in the financial statements;

(b) To recognize and measure the goodwill acquire in the business combination or a gain from a bargain purchase ; and

- (c) To determine what information to be disclosed to enable the users of the financial statements to evaluate the nature of the business combination and its financial effects.

Scope

Ind AS 103 is applicable to transactions or other events which meet the definition of a business combination; and is not applicable to: (a) the accounting for the joint arrangement formation in the financial statements of such joint arrangement itself (b) when an asset or a group of assets not constituting the business are acquired; wherein, the acquirer is supposed to identify and recognize the individual identifiable assets that are acquired and the liabilities which are assumed (c) when an investment entity is acquired as defined by "Ind AS 110 Consolidated Financial Statements" (d) investment made in a subsidiary which is required to be measured at fair value.

Q6. What is measurement principle? Explain the exceptions to the recognition and measurement principle under AS-103.

Ans :

(Imp.)

The acquirer is required to measure the identifiable assets that are acquired and the assumed liabilities at fair values on date of their acquisition.

For every business combination, the acquirer should measure at the date of acquisition, the non-controlling interest components in the acquire that are the present ownership interests and entitle a proportionate share to the holders of the entity's net assets in case of liquidation at either the fair value; or the present ownership instruments. The acquisition date fair value is the measurement of components of non-controlling interests, unless another measurement is required by Ind AS.

Exceptions

(a) Contingent Liabilities

- The acquirer shall recognize if it is a present obligation that arises from past events and its fair value can be measured reliably.

(b) Exceptions to the Recognition and Measurement Principles

- Income taxes

- Deferred tax assets or liabilities arising from acquired assets or liabilities accounted in accordance with Ind AS 12
- Employee benefits
- Accounted in accordance with Ind AS 19
- Indemnification assets
- Shall be measured and recognized on the basis of the indemnified item.
- Leases in which the acquire is the lessee
- Recognize right-of-use assets and lease liabilities in accordance with Ind AS 116.
- Exemption available to short-term leases and lease of low value assets.
- Measure the lease liability at the present value of the remaining lease payments (as defined in Ind AS 116) as if the acquired lease were a new lease at the acquisition date.
- measure the right-of-use asset at the same amount as the lease liability, adjusted to reflect favourable or unfavourable terms of the lease when compared with market terms

(c) Exceptions to the Measurement Principles

- Re acquired rights.
- Measured at fair value based on remaining contractual term ignoring the fair value effect of renewal.
- Share-based payment transactions.
- Measured in accordance with Ind AS 102 (Market Based Measure).
- Assets held for sale
- Measured in accordance with Ind AS 105 (i.e., fair value less costs to sell).

Q7. What is bargain purchase? How is goodwill recognized and measured from a bargain purchase?

Ans :

Goodwill is measured as the difference between the consideration transferred in exchange for the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities

assumed. In extremely rare circumstances, an acquirer will make a bargain purchase in a business combination, where the value of acquired identifiable assets and liabilities exceeds the consideration transferred; the acquirer shall recognize a gain (bargain purchase). The gain shall be recognized by the acquirer in Other Comprehensive Income on the acquisition date and accumulate the same in equity as capital reserve, if there exists a clear evidence of the underlying reasons for classifying the business combination as a bargain purchase.

If there does not exist clear evidence of the underlying reasons for classifying the business combination as a bargain purchase, then the gain shall be recognized directly in equity as capital reserve.

Reverse Acquisitions

A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting. 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.

Q8. What is measurement period?

Ans :

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete.

During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognized and additional assets and liabilities that existed at the acquisition date to reflect new information obtained.

The measurement period ends as soon as the acquirer receives the information it was seeking or learns that more information is not obtainable.

The measurement period shall not exceed one year from the acquisition date.

Subsequent measurement and accounting

In general, an acquirer shall subsequently measure and account for assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination in accordance with other applicable Ind AS for those items, depending on their nature. However, Ind AS 103 provides guidance on subsequently measuring and accounting for the following assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination:

- (a) Reacquired rights;
- (b) Contingent liabilities recognized as of the acquisition date;
- (c) Indemnification assets; and
- (d) Contingent consideration.

Business combinations of entities under common control Common control business combination means a business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.

4.3 IND AS-110: CONSOLIDATED FINANCIAL STATEMENTS

Q9. Explain the objective and scope of Ind AS-110.

Ans :

(Imp.)

Objective

The objective of Ind AS 110 is to set principles for the presentation and preparation of consolidated financial statements in case an entity controls one or more other entities.

Ind AS 110

- (a) Requires the parent entity which controls one or more subsidiary entities to present the consolidated financial statements.
- (b) Establishes control as the basis for consolidation by defining the principle of control.

- (c) Explains how to use the principle of control to determine whether an investor controls an investee and, as a result, whether the investee must be consolidated.
- (d) Specifies the accounting rules for consolidated financial statements preparation; and
- (e) Defines what an investment entity is and sets out an exception for consolidating a particular subsidiary of an investment entity.

Ind AS 110 does not deal with the accounting requirements with regard to business combinations and their effect on consolidation, including goodwill that is arising from such a business combination.

Scope

Ind AS 110 is applicable to all parent entities that are required to present consolidated financial statements, excepting

- (a) In the following cases
 - (i) That the entity is a wholly or a partially owned subsidiary of another entity and all its other owners, including those owners who are otherwise not entitled to vote, have been informed about that the parent is not presenting the consolidated financial statements, and they do not object for the same;
 - (ii) Debt or equity instruments of the entity are not being traded in public;
 - (iii) It has not filed the financial statements, and is not in the process of filing the same with a securities commission or other regulatory organizations for the purposes of issue of any class of instruments in a public market; and (iv) ultimate or any other intermediate parent of the entity produces the consolidated financial statements complying with the Ind ASs and are available for the use of the public.
- (b) Ind AS 110 is not applicable to the post-employment benefit plans or any other long-term plans for the employee benefits as they are covered by Ind AS19, Employee Benefits.
- (c) An investment entity is not required to present consolidated financial statements in case it is measuring all of its subsidiaries at the fair value through profit or loss.

Q10. Explain the key terms are used in Ind AS-110.

Ans :

- **Consolidated Financial Statements**
"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".
- **Control of an Investee**
"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".
- **Decision Maker**
"An entity with decision-making rights that is either a principal or an agent for other parties".
- **Group**
"A parent and its subsidiaries".
- **Investment Entity**
"An entity that:
 - (a) Obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services.
 - (b) Commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and
 - (c) Measures and evaluates the performance of substantially all of its investments on a fair value basis".
- **Non-controlling Interest**
"Equity in a subsidiary not attributable, directly or indirectly, to a parent".
- **Parent**
"An entity that controls one or more entities".
- **Power**
"Existing rights that give the current ability to direct the relevant activities".
- **Protective Rights**
Rights designed to protect the interest of the party holding those rights without giving that

party power over the entity to which those rights relate.

➤ **Relevant Activities**

"For the purpose of this Ind AS, relevant activities are activities of the investee that significantly affect the investee's returns".

➤ **Removal Rights**

"Rights to deprive the decision maker of its decision-making authority".

➤ **Subsidiary**

"An entity that is controlled by another entity".

Q11. Discuss in detail Ind AS-110 related to consolidated financial statements.

Ans :

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.

4.4 IND AS-111: JOINT ARRANGEMENTS

Q12. What is joint arrangement? Explain the classification of joint arrangement.

Ans :

Meaning

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.

Q13. Explain the objective & scope and key terms of Ind As 111?

Ans :

Objective

The objective of this Ind AS is to set principles for the financial reporting by the entities having an interest in the arrangements that are jointly controlled. To achieve the goal, this Ind AS defines joint control and requires a party to a joint arrangement to analyze its rights and obligations to determine the type of joint arrangement in which it is involved and account for those rights and obligations in line with that form of joint arrangement. This Ind AS shall be applied by all the entities which are a party to a joint arrangement.

Definitions

"A joint arrangement is an arrangement of .which two or more parties have joint control. A joint arrangement has the following characteristics: (a) The parties are bound by a contractual arrangement (b) The contractual arrangement gives two or more of those parties joint control of the arrangement".

Keyterms

- (i) **"A Joint Arrangement** is either a joint operation or a joint venture".
- (ii) **"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".

(iii) "Joint Operation

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".

(iv) "Joint Operator

A party to a joint operation that has joint control of that joint operation".

(v) "Joint Venture

A joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement".

(vi) "Joint Venturer

A party to a joint venture that has joint control of that joint venture".

(vii) "Party to a Joint Arrangement

An entity that participates in a joint arrangement, regardless of arrangement whether that entity has joint control of the arrangement".

(viii) "Separate Vehicle

A separately identifiable financial structure, including separate legal entities or entities recognized by statute, regardless of whether those entities have a legal personality".")

Q14. 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 recognize 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 venturers.

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.

4.5 IND AS- 112: DISCLOSURE OF INTEREST IN OTHER ENTITIES

Q15. Explain the objective and scope of Ind AS-112.

Ans :

Objective

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.

Scope

Ind AS 112 shall be applied by an entity having an interest in any of the following: (a) subsidiaries (b) joint arrangements (joint operations/ joint ventures) (c) associates (d) unconsolidated structured entities.

Ind AS 112 is not applicable to: (a) the post-employment benefit plans or other employee benefit plans which are long-term and which are covered as per Ind AS 19, Employee Benefits, (b) Separate financial statements of the entity as covered by Ind AS 27: Separate Financial Statements. However, if an entity has interests in unconsolidated structured entities and prepares the separate financial statements as only financial statements of the entity, it shall then apply the requirements as specified while preparing the separate financial statements, (c) An interest in a joint arrangement held by an entity that participates in the arrangement but does not have joint control of it, unless the interest has a significant impact on the arrangement or is an interest in a structured company, (d) An interest it has in another entity which is accounted for in accordance with "Ind AS 109: Financial Instruments".

An entity shall however, apply Ind AS 112: (i) when that interest is an interest in an associate or a joint venture that, in accordance with Ind AS 28: Investments in Associates and Joint Ventures, is measured at fair value through profit or loss; or (ii) when that interest is an interest in an unconsolidated structured entity.

Q16. What are significant judgement and assumptions?

Ans :

(Imp.)

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.

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 recognized (if not presented separately).

Q17. What information is required to be disclosed by an entity with regard to the interest in subsidiary?

Ans :

(Imp.)

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.

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.

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.

Nature, Extent and Financial Effects of an Entity's Interests in Joint Arrangements and Associates

An entity shall disclose:

- (a) For each of the joint arrangements and associates that are material to the reporting entity.
 - (i) The joint arrangement or associate's name.

- (ii) the nature of the relationship that the entity has with the joint arrangement or associate.
 - (iii) The principal place of business and the country of incorporation, in case is different from the joint arrangement's or associate's principal place of business.
 - (iv) The proportion of the ownership interest or participating share that is held by the entity and, in case different, then, the proportion of voting rights held in case applicable.
- (b) for every joint venture and associate which is material to the reporting entity:
- (i) The method of measurement of the investment.
 - (ii) Summarized financial information.
- (c) The financial information relating to investments in joint ventures and associates.

Risks associated with an Entity's Interests in Joint Ventures and Associates

An entity shall disclose:

- (a) Commitments that it has got in relation to its joint ventures separately from that of the amount of other commitments as specified.
- (b) **In accordance with "Ind AS 37: Provisions, Contingent Liabilities and Contingent Assets"**, unless the probability of such a loss is remote, contingent liabilities 'Which are incurred relating to the interests it has in joint ventures or associates, separately from the amount of other contingent liabilities.

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.

Short Questions and Answers

1. 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.

2. Business combination.

Ans :

Business combinations is concerned with accounting done for business combinations but excludes business combinations of entities which are under common control. Whereas Ind AS 103 facilitates assistance relating to accounting of the business combination under common control and need those combi- nations for utilizing pooling of interest method. The amendment states that any variation in consideration paid and share capital of the transferor must be transferred to separate part of equity known as 'common control transaction capital reserve' instead of determining goodwill/ capital reserve.

Meaning

According to Ind AS 103, Business combination refers to the merging or acquiring of two businesses where an merger or acquirer gain control over other businesses.

In other words, the combination of one or more business into one business unit is known as business combination. The pooling of interest method is used, if the business is under the control of same person.

3. Objectives of Ind AS-103.

Ans :

The objective of Ind AS 103 is to improve the relevance of the data provided, reliability and comparability of the information provided in the financial statements by the reporting entity about a business combination and its effects. For accomplishing the same, Ind AS 103 laid down principles and requirements for the acquirer as to how:

- (a) The recognition and measurement of the identifiable assets acquired and the liabilities that are assumed and non-controlling interest if any in the acquire is done in the financial statements;
- (b) To recognize and measure the goodwill acquire in the business combination or a gain from a bargain purchase ; and
- (c) To determine what information to be disclosed to enable the users of the financial statements to evaluate the nature of the business combination and its financial effects.

4. What is measurement principle?

Ans :

The acquirer is required to measure the identifiable assets that are acquired and the assumed liabilities at fair values on date of their acquisition.

For every business combination, the acquirer should measure at the date of acquisition, the

non-controlling interest components in the acquire that are the present ownership interests and entitle a proportionate share to the holders of the entity's net assets in case of liquidation at either the fair value; or the present ownership instruments. The acquisition date fair value is the measurement of components of non-controlling interests, unless another measurement is required by Ind AS.

5. What is bargain purchase?

Ans :

Goodwill is measured as the difference between the consideration transferred in exchange for the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. In extremely rare circumstances, an acquirer will make a bargain purchase in a business combination, where the value of acquired identifiable assets and liabilities exceeds the consideration transferred; the acquirer shall recognize a gain (bargain purchase). The gain shall be recognized by the acquirer in Other Comprehensive Income on the acquisition date and accumulate the same in equity as capital reserve, if there exists a clear evidence of the underlying reasons for classifying the business combination as a bargain purchase.

If there does not exist clear evidence of the underlying reasons for classifying the business combination as a bargain purchase, then the gain shall be recognized directly in equity as capital reserve.

6. What is measurement period?

Ans :

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete.

During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognized and additional assets and liabilities that existed at the acquisition date to reflect new information obtained.

The measurement period ends as soon as the acquirer receives the information it was seeking or learns that more information is not obtainable.

The measurement period shall not exceed one year from the acquisition date.

7. Objective of Ind AS-110.

Ans :

The objective of Ind AS 110 is to set principles for the presentation and preparation of consolidated financial statements in case an entity controls one or more other entities.

Ind AS 110

- (a) Requires the parent entity which controls one or more subsidiary entities to present the consolidated financial statements.
- (b) Establishes control as the basis for consolidation by defining the principle of control.
- (c) Explains how to use the principle of control to determine whether an investor controls an investee and, as a result, whether the investee must be consolidated.
- (d) Specifies the accounting rules for consolidated financial statements preparation; and
- (e) Defines what an investment entity is and sets out an exception for consolidating a particular subsidiary of an investment entity.

8. 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.

9. Classification of joint arrangement.

Ans :

- **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.

10. Objectives of Ind AS - 112.

Ans :

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.

Choose the Correct Answers

1. The expenses of business combination includes _____. [d]
(a) Advisory and legal fee (b) Consultation fee
(c) Maintenance fee (d) All the above
2. Ind AS-28 deals with _____. [a]
(a) Investments in Associate and Joint Venture
(b) Inventories
(c) Joint Arrangements
(d) Business combination
3. In equity method, securities are recorded at _____. [b]
(a) Original value (b) Nominal value
(c) Fair value (d) Cost less value
4. The _____ method is used in accounting investments. [b]
(a) Fair value (b) Equity
(c) Both (a) and (b) (d) Sum value
5. _____ mandates the parent and subsidiaries to prepare consolidated financial statements [b]
(a) Ind AS-111 (b) Ind AS-110
(c) Ind AS-112 (d) Ind AS-28
6. The financial statements of a group of firms are called _____. [a]
(a) Consolidated Financial statements (b) Common size
(c) Cash flow statements (d) None of the above
7. The accounting treatment of joint arrangement depends upon _____. [c]
(a) Joint operations (b) Joint operations
(c) Both (a) and (b) (d) All the above
8. The one party controlling the arrangement does not constitute _____. [a]
(a) Joint Arrangement (b) Joint control
(c) Joint operation (d) Both (a) and (b)
9. Joint AS-103 deals with _____. [c]
(a) Joint control (b) Joint Arrangements
(c) Business combination (d) Construction contract
10. Ind AS-111 is applicable to _____. [b]
(a) Joint venture (b) Joint arrangement
(c) UCSE (d) Subsidiaries

Fill in the blanks

1. _____ 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.
2. Ind As - 28 deals with _____.
3. _____ combinations is concerned with accounting done for business combinations but excludes business combinations of entities which are under common control.
4. A _____ acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting.
5. _____ "Existing rights that give the current ability to direct the relevant activities".
6. _____ "An entity that is controlled by another entity".
7. _____ "An entity with decision-making rights that is either a principal or an agent for other parties".
8. A _____ 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.
9. Ind As-112 deals with _____ .
10. _____ is prepared by a parent company with uniform accounting policies.

ANSWERS

1. Joint
2. Investments in Associate and Joint
3. Business
4. Reverse
5. Power
6. Subsidiary
7. Decision Maker
8. Joint operation
9. Disclosure of Interest in Other Entities
10. Disclosure of Interest in Others Entities

UNIT V

FINANCIAL REPORTING:

Financial reporting – Concept – Development in Financial reporting objectives: True blood Report (USA) – The Corporate Report (UK) – Stamp Report (Canada) - Objectives of Financial Reporting – Qualities of Financial Reporting- Recent trends in Corporate Reporting in India.

5.1 FINANCIAL REPORTING

5.1.1 Concept

Q1. Define Financial Reporting.

(OR)

What do you mean by Financial Reporting?

Ans :

Meaning

Financial reporting may be defined as communication of published financial statements and related information from a business enterprise to third parties (external users) including shareholders, creditors, customers, governmental authorities and the public. It is the reporting of accounting information of an entity (individual, firm, company, government enterprise) to a user or group of users.

Company financial reporting is a total communication system involving the company as issuer (preparer); the investors and creditors as primary users, other external users; the accounting profession as measurers and auditors; and the company law regulatory or administrative authorities.

Q2. Explain the need and purpose of financial reporting.

(OR)

Need of financial reporting.

Ans :

(Imp.)

Generally speaking, the term 'financial reporting' is used to mean general purpose external financial reporting. Often it is said that the purpose

of financial reporting is the preparation of general purpose reports for external users. Despite the fact that financial reports are mainly intended (legally) for shareholders, they can be, and are, used by a number of other external users

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 different needs for information.

These needs include the following:

(a) Investors

The providers of risk capital and their advisors 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. Shareholders 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 that 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 that 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 continuation 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, determine taxation policies and as the basis for 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.

Purpose

Financial reporting objectives in accounting literature so far has focused on general purpose financial reporting which aims to satisfy the information needs of all potential users.

Company law provisions in almost all countries of the world have consistently accepted the utility of general purpose financial reporting. Due to this, the separate (specific) needs of specific users have been largely ignored on the assumption that general purpose reports can satisfy the information needs of all external users.

However, a reasoning has also been made suggesting that the needs of specific users may be better served by presenting specific purpose reports to help them in their separately identifiable decision functions. For instance, financial reports submitted to obtain credit or loans, or government, or financial reports given to trade and industry, may not satisfy other users' needs and expectations.

However, the proposal of specific purpose reports in company financial reporting is criticized on some counts.

- (i) Firstly, the cost of the developing 'specialized reports to satisfy special requirements of specific users may exceed the benefits when the company financial reporting policy is determined in its totality.
- (ii) Secondly, specialized needs of specific users cannot be ascertained with any degree of certainty.
- (iii) Thirdly, issuing multiple reports about the financial results of an enterprise can create confusion among various users. Multiple reports increase the perceived complexity of the environment. Such changes in perceived environment complexity induce changes in decision-makers' cognitive processing capabilities and, in turn, can decrease the effectiveness of decision-making by users.
- (iv) Fourthly, multiple reports may not be desirable and practicable from the standpoint of information economics.

To conclude, company financial reporting, in future, will continue to adhere to general purpose reporting system to aid investors, creditors, and other external users in their economic decisions.

Meanwhile, in order to achieve the objectives of financial reporting (through general purpose reports) there is a continuous need to investigate many vital aspects relating to general purpose financial reports such as identifying potential users and user groups, identifying information needs of such users, determining the feasibility of providing general purpose information to meet these needs, determining the manner of reporting such information, and having a feedback from the users regarding the use and relevance of general purpose information.

5.2 DEVELOPMENT IN FINANCIAL REPORTING OBJECTIVES

Q3. Describe briefly the Developments on Financial Reporting Objective.

(OR)

State the recent developments in financial reporting objective.

Ans :

(Imp.)

The subject of financial reporting objectives has been generally recognized as very important in accounting area since a long time. Many accounting bodies and professional institutes all over the world have made attempts to define the objectives of financial statements and financial reporting which are vital to the development of financial accounting theory and practice.

It describes developments in this area at the international level, particularly USA and UK. It can be rightly said that most of the attempts in the area of financial reporting objectives has been made in USA and UK and accounting developments in these countries have great impact on accounting developments and practices in other countries of the world.

I. USA

in USA, the development of financial reporting can be understood with the help of following factors.

1. Accounting Principles Board (APB) Statement No. 4:

In USA, the APB Statement No. 4 "Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises", (1970) was the first publication which formulated the objectives of financial statements.

These objectives may be summarized as follows:

1. The particular objectives of financial statements are to present fairly, and in conformity with generally accepted accounting principles, financial position, results of operations, and other changes in financial position.

2. The general objectives of financial statements are:

- (a) To provide reliable information about economic resources and obligations of a business enterprise in order to:
 - (i) Evaluate its strengths and weakness,
 - (ii) Show its financing and investment,
 - (iii) Evaluate its ability to meet its commitments, and
 - (iv) Show its resource base for growth;
- (b) To provide reliable information about changes in net resources resulting from a business enterprise's profit-directed activities in order to:
 - (i) Show to investors expected dividend return,
 - (ii) Show the operation's ability to pay creditors and suppliers, provide jobs for employees, pay taxes, and generate funds for expansion,
 - (iii) Provide management with information for planning and control, and
 - (iv) Show its long-term profitability;
- (c) To provide financial information useful for estimating the earnings potential of the firm;
- (d) To provide other needed information about changes in economic resources and obligations; and
- (e) To disclose other information relevant to statement users' needs.

3. The qualitative objectives of financial accounting are the following:

- (a) Relevance, which means selecting the information most likely to aid users in their economic decisions.
- (b) Under-standability, which implies not only that the selected information must be intelligible but also that the users can understand it.

- (c) Verifiability, which implies that the accounting results may be corroborated by independent measurers using the same measurement methods.
- (d) Neutrality, which implies that the accounting information is directed towards the common needs of users rather than the particular needs of specific users.
- (e) Timeliness, which implies an early communication of information to avoid delays in economic decision-making.
- (f) Comparability, which implies that differences should not be the result of different financial accounting treatments.
- (g) Completeness, which implies that all the information that 'reasonably' fulfils the requirements of other qualitative objectives should be reported.

2. **A Statement of Basic Accounting Theory (ASOBAT), AAA, (1966)**

In 1966, the executive committee of American Accounting Association (AAA) published 'A Statement of Basic Accounting Theory (ASOBAT)' as "an integrated statement of basic accounting theory which will serve as a guide to educators, practitioners, and others interested in accounting. The committee may want to consider the role, nature, and limitations of accounting."

In ASOBAT, accounting is defined as, "the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by users of the information."

In ASOBAT, theory is defined as "a cohesive set of hypothetical, conceptual and pragmatic principles forming a general frame of reference for a field of study." The objectives of ASOBAT is,

- (i) To command and control the executives and resources of a business.
- (ii) To protect the resources of a business by maintaining report of such resources.

- (iii) To identify the decision areas related to resources and make effective decisions.
- (iv) To determine the purpose and goal of business.

3. **True blood Report**

To develop objectives of financial statements, a Study Group was appointed in 1971 by American Institute of Certified Public Accountants under the Chairmanship of Robert M. Trueblood. The Study Group solicited the views of more than 5000 corporations, professional firms, unions, public interest groups, national and international accounting organizations and financial publications.

The Study Group conducted more than 50 interviews with executives from all sectors of the business and from government. To elicit the widest possible range of views, 35 meetings were held with institutional and professional groups representing major segments of the US economy.

4. **Statement on Accounting Theory and Theory Acceptance (SATTA)**

In 1973, the executive committee of American Accounting Association (AAA) has modified or updated the ASOBAT to 'Statement on Accounting Theory and Theory Acceptance (SATTA)'. This updation is resulted because of employment of new tools, analytical techniques in dealing with the issues related to accounting. The committee has identified the 3 approaches to accounting theory which are as follows,

(i) **Classical Approach**

In classical approach, SATTA classified it into normative and deductive. But, some classical writers called SATTA as inductive approach.

(ii) **Economic Information Approach**

Economic information approach deals with the problems related to benefits and cost of production usage and other informations.

(iii) Decision Usefulness Approach

Decision usefulness approach is concerned with the reports, information needs and decisions related to the financial statements. This approach is further classified into two approaches,

- (a) Decision Model Approach and
- (b) Decision Maker Approach.

5. Financial Accounting State Board (FASB) Concept No. 1

In November 1978, Financial Accounting State Board (FASB) issued the "Objectives of Financial Reporting by Business Enterprises". The objectives issued by FASB includes the following,

- (i) To aid the investors, creditors and users in analyzing the timing, amount, cash receipts of a business.
- (ii) To provide information to users in making rational decisions related to investment, credit etc.
- (iii) To provide report and information related to the performance of a business to investors and creditors for analyzing.
- (iv) To provide economic resources information to users.
- (v) To provide information in connection with the business cash flows and its borrowing from other sources.

6. Statement of Financial Accounting Concepts (SFAC)

Statement of Financial Accounting concept is issued by FASB as a replacement to FASB concepts statements No. 1 and No. 2. The description and explanation of SFAC is classified into chapters i.e., chapter 1 and chapter 3, as follows,

Chapter 1

Chapter 1 of SFAC deals with the general purpose financial reporting objectives.

Chapter 2

Chapter 3 of SFAC deals with the qualitative features of financial information.

5.2.1 True blood Report (USA)**Q4. Write about True blood Report.**

(OR)

Describe the recommendations made in true blood report.

Ans :

(Imp.)

To develop objectives of financial statements, a Study Group was appointed in 1971 by American Institute of Certified Public Accountants under the Chairmanship of Robert M. Trueblood. The Study Group solicited the views of more than 5000 corporations, professional firms, unions, public interest groups, national and international accounting organizations and financial publications.

The Study Group conducted more than 50 interviews with executives from all sectors of the business and from government. To elicit the widest possible range of views, 35 meetings were held with institutional and professional groups representing major segments of the US economy.

The Study Group submitted its report to AICPA in October 1973. The objectives developed in the Study Group Report are as follows:

1. The basic objective of financial statements is to provide information useful for making economic decisions.
 2. An objective of financial statements is to serve, primarily, those users who have limited authority, ability, or resources to obtain information and who rely on financial statements as their principal source of information about an enterprise's economic activities.
 3. An objective of financial statements is to provide information useful to investors and creditors for predicting, comparing and evaluating potential cash flows to them in terms of amount, timing and related uncertainty.
 4. An objective of financial statements is to provide users with information for predicting, comparing, and evaluating enterprise earning power.
 5. An objective of financial statements is to supply information useful in judging management's ability to utilize enterprise resources effectively in achieving the primary enterprise goal.
 6. An objective of financial statements is to provide factual and interpretative information about transactions and other events which is useful for predicting, comparing and evaluating enterprise earning power. Basic underlying assumptions with respect to matters subject to interpretation, evaluation, prediction, or estimation should be disclosed.
 7. An objective is to provide a statement of financial position useful for predicting, comparing and evaluating enterprise earning power. This statement should provide information concerning enterprise transactions and other events that are part of incomplete earning cycles. Current values should also be reported when they differ significantly from historical costs. Assets and liabilities should be grouped or segregated by the relative uncertainty of the amount and timing of prospective realization of liquidation.
 8. An objective is to provide a statement of periodic earnings useful for predicting, comparing and evaluating enterprise earning power. The net result of completed earning cycles and enterprise activities resulting in recognizable progress towards completion of incomplete cycles should be reported. Changes in values reflected in successive statements of financial position should also be reported, but separately, since they differ in terms of their certainty realization.
 9. An objective is to provide a statement of financial activities useful for predicting, comparing, and evaluating enterprise earning power. This statement should report mainly on factual aspects of enterprise transactions having or expected to have significant cash consequences. This statement should report data that require minimal judgement and interpretation by the compiler.
 10. An objective of financial statements is to provide information useful for the predictive process. Financial forecasts should be provided when they will enhance the reliability of users' predictions.
 11. An objective of financial statements for governmental and non-profit organizations is to provide information useful for evaluating the effectiveness of management of resources in achieving the organization's goals. Performance measures should be qualified in terms of identified goals.
 12. An objective of financial statements is to report on those activities of the enterprise affecting society which can be determined and described or measured and which are important to the role of the enterprise in its social environment.
- The twelve objectives recommended in the report seem to fall into five tiers as described in Figure. Tier I is the basic objective which underlies all financial reporting. Tier II objectives identify the financial statement users and their needs. Tier III objectives translate users' needs in terms of enterprise.
- Tier IV objectives describe information about the enterprise which satisfied or is presumed to satisfy

users' needs. Tier V objectives concern skeletal financial statements directed at communicating the information identified by the objectives in Tier IV.

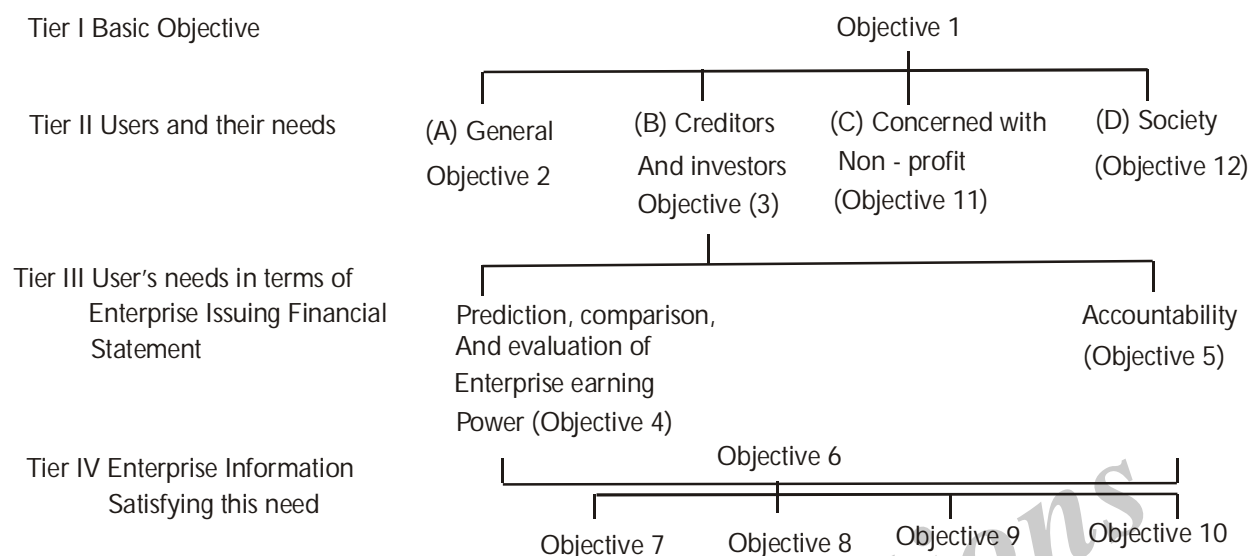


Fig. : Trueblood Report on Objectives of Financial Statements

5.2.2 The Corporate Report (UK)

Q5. Write about the Corporate Report.

Ans :

The Accounting Standards Steering Committee of the Institute of Chartered Accountants in England and Wales Published 'The Corporate Report' in 1976 as a discussion paper covering the scope and aims of published financial reports, public accountability of economic entities, working concepts as a basis for financial reporting, and most suitable means of measuring and reporting the economic position, performance and prospects of undertakings.

The Corporate Report's main findings are as follows:

- First, the basic philosophy and starting point of The Corporate Report is that financial statements should be appropriate to their expected use by potential users. In others words, they should attempt to satisfy the information needs of their users.
- Second, the report assigned responsibility for reporting to the 'economic entity' having an impact on society through its activities. The economic entities are itemized as limited companies, listed and unlisted; pension schemes, charitable and other trusts, and not-for-profit organization; non-commercially oriented Central Government departments and agencies, partnerships and other forms of un-incorporate business enterprises; trade unions and trade and professional association; local authorities, and nationalized industries and other commercially oriented public sector bodies.
- Third, the report defined users as those having a reasonable right to information and whose information needs should be recognized by corporate reports. The users are identified as the equity investor group, the loan creditor group, the employee group, the analyst-adviser group, the business contact group, the government, and the public.
- Fourth, to satisfy the fundamental objectives of annual reports set by the basic philosophy, seven desirable characteristics are cited, namely, that the corporate report be relevant, understandable, reliable, complete, objective, timely, and comparable.

➤ Fifth, after documenting the limitations of current reporting practices, the report suggests the need for the following additional statements:

1. A statement of value added, showing how the benefits of the efforts of an enterprise are shared among employees, providers of capital, the state and reinvestment.
2. An employment report, showing the size and composition of the work force relying on the enterprise for its livelihood, the work contribution of employees, and the benefits earned.
3. A statement of money exchange with government, showing the financial relationship between the enterprise and the state.
4. A statement of transactions in foreign currency, showing the direct cash dealing, between the United Kingdom and other countries.
5. A statement of future prospects, showing likely future profit, employment, and investment levels.
6. A statement of corporate objectives showing management policy and medium-term strategic targets.

Finally, after assessing six measurement bases (historical cost, purchasing power, replacement cost, net realization value, value to the firm, and net present value) against three criteria (theoretical acceptability, utility, and practicality) the report rejected the use of historical cost in favour of current values accompanied by the use of general index adjustment.

5.2.3 Stamp Report (Canada)

Q6. Discuss about Stamp Report.

(OR)

Write about Canadian Stamp Report.

Ans :

(Imp.)

The Canadian Institute of Chartered Accountants (CICA) published a report in June 1980 on 'Corporate Reporting: Its Future Evolution' which was written by Edward Stamp.

Popularly known as Stamp Report, it mentions the following as the important objectives of company financial reporting:

1. One of the primary objectives of published corporate financial reports is to provide an accounting by management to both equity and debt investors, not only a management's exercise of its stewardship function but also of its success (or otherwise) in achieving the goal of producing a satisfactory economic performance by the enterprise and maintaining it in a strong and healthy financial position.
2. It is an objective of good financial reporting to provide such information in such a form as to minimize uncertainty about the validity of information, and to enable the user to make his own assessment of the risks associated with the enterprise.
3. It is necessary that the standards governing financial reporting should have ample scope for innovation and evolution as improvements become feasible.
4. The objectives of financial reporting should be taken to be directed towards the need of users who are capable of comprehending a complete (and necessarily sophisticated) set of financial statements or alternatively, to the needs of experts who will be called on by the unsophisticated users to advise them.

The Stamp Report has not found FASB's Conceptual Framework and objectives on financial reporting suitable and useful for Canada because of the environmental difference between USA and Canada. This is true not only in case of any particular country but applicable equally to other countries as well.

Financial reporting — its objectives and scope — are influenced by the economic, legal, political, institutional and social factors prevailing in a country. Therefore, these factors need to be considered before developing financial reporting objectives in any country.

5.3 OBJECTIVES OF FINANCIAL REPORTING

Q7. State the objectives of Financial Reporting?

Ans :

An evaluation of company financial reporting requires some agreement on its objectives. Financial reporting is not an end in itself but is a means to certain objectives.

While there is no final statement on objectives, to which all parties (of financial reporting) have agreed, some consensus has been developing on the objectives of financial reporting.

At present, the following may be described as the primary objectives of financial reporting:

- (a) Investment Decision-making.
- (b) Management Accountability.

(a) Investment Decision-Making

The basic objective of financial reporting is to provide information useful to investors, creditors and other users in making sound investment decisions. These decisions concern the efficient allocation of investment funds and the selection among investment opportunities.

The investors while making investment decisions aim to determine the amount and certainty of a company's future earning power in order to estimate their future cash return in dividends and capital appreciation. Earning power is the ability of a business firm to produce continuous earnings from the operating assets of the business over a period of years, which may differ from accounting net income.

The financial statements and other business data are analyzed in relation to the enterprise's environment to project this future earning power. Investors compare returns on alternative investments relative to risk, which (risk) is the degree of uncertainty of future returns. The risk premium is a measure of uncertainty which is defined as the possible variation of the actual from the expected return.

- (i) The investment decision process may be pictured as a three-legged stool. One leg is the analysis of the company and its securities and of the industry in which it operates.
- (ii) The second is the assessment of the economic environment, including the business outlook, financial markets and interest rates, international trade and finance, and political and regulatory developments.
- (iii) The third is the portfolio decision in which these two streams of information are integrated into an investment appraisal related to the objectives of the investor—individual or fund.

Portfolio decisions sort out expected rates of return relative to risk, as the investor (portfolio manager) seeks that combination of securities which will produce the highest total return available within the risk constraints adopted for the portfolio. In this continual winnowing process, investment funds tend to flow toward the most favourably situated companies and industries and away from the weaker and less promising areas.

Investment decision and investment values, both, are comparative, not absolute. In all investment decisions, comparison is made in order to determine the most attractive (greatest) returns in relation to risk first, comparison between one type of security vs. another; second, comparison between one company vs. another within each category; third, comparison within a company over time.

Comparison requires uniform standards of measurement. Where different accounting measurements are used in similar situations, investors and financial analysts make their own accounting adjustments to achieve comparability, provided adequate information is available to do so.

But the attribute of comparability can be achieved at a lower cost (associated with financial reporting system), and with equal benefit for all investors, by eliminating the alternatives.

(b) Management Accountability

A second basic objective of financial reporting is to provide information on management accountability to judge management's effectiveness in utilizing the resources and running the enterprise.

Management of an enterprise is periodically accountable to the owners not only for the custody and sale-keeping of enterprise resources, but also for their efficient and profitable use and for protecting them to the extent possible from unfavorable economic impacts of factors in the economy such as technological changes, inflation or deflations.

Q8. Explain the users in financial reporting.

Ans :

The company financial reporting is intended to provide external users information that is useful in making business and economic decisions, that is, for making reasoned choices among alternative uses of scarce resources in the conduct of business and economic activities. Thus, users are potentially interested in the information provided by financial reporting.

Among the potential users are owners, lenders, suppliers, potential investors and creditors, employees, management, directors, customers, financial analysts and advisors, brokers, stock exchanges, lawyers, economists, taxing authorities, regulatory authorities, legislators, financial press and reporting agencies, labour unions, trade associations, business researchers, teachers and students, and the public.

Some users—such as owners, creditors, and employees—have or contemplate having direct economic interests in particular business enterprises. Managers and directors, who are charged with managing the enterprise in the interest of owners, also have a direct interest.

Some users—such as financial analysts and advisors, regulatory authorities, and labour unions—have indirect interests because they advise or represent those who have or contemplate have direct interests.

Potential users of financial information most directly concerned with a particular business enterprise are generally interested in its ability to generate favourable cash flows because their decisions relate to amounts, timing, and uncertainties of expected cash flows.

To investors, lenders, suppliers, and employees, a business enterprise is a source of cash in the form of dividends or interest and, perhaps, appreciated market price, repayment of borrowing, payment of goods or services, or salaries or wages.

They invest cash, goods, or service in an enterprise and expect to obtain sufficient cash in return to make the investment worthwhile. To customers, a business enterprise is a source of goods or services, but only by obtaining sufficient cash, to pay for the resources it uses and to meet its other obligations, can the enterprise provide those goods or services.

To managers, the cash flows of a business enterprise are a significant part of their management responsibilities, including their accountability to directors and owners. Many, if not most, of their decisions have cash flow consequences for the enterprise.

Thus, investors, creditors, employees, customers, and managers significantly share a common interest in an enterprise's ability to generate favourable cash flows. Other potential users of financial information share the same interest, derived from investors; creditors, employees, customers, or managers whom they advise or represent or derived from an interest in how those groups (and especially shareholders) are fair.

Some of the potential users listed above may have specialized needs but also have the power to obtain the information needed. For example, the information needed to enforce tax laws and regulations are specialized needs.

However, although the taxing authorities often use the information in financial statements for their purposes, they also have statutory authority to require the specific information they need to fulfill their functions, and do not need to rely on information provided to other groups.

Some investors and creditors or potential investors and creditors may also be able to require a business enterprise to provide specified information to meet a particular need. For example, a bank or insurance company negotiating with an enterprise for a large loan or purchase of securities can often obtain desired information by making the information a condition for completing the loan transaction.

Some users of financial information can obtain more information about an enterprise than others. This is clearly so for managers, but it also holds true for others, such as large scale equity shareholders and creditors. Financial statements are, it is argued, especially important to those who have limited access to information and limited ability to interpret it.

Q9. What are the benefits of financial reporting?

Ans :

Benefits of financial reporting may be listed as follows:

1. Economic Decisions Making

The ultimate goal of any economy is to maximize the social welfare for which an efficient allocation of resources is required. This goal is of particular significance in developing economies where resources are not plentiful. The availability of capital is one of the scarce and major productive factors needed to pursue economic activity and to achieve the goal of efficient allocation of resources.

Companies compete in the securities market to obtain their capital as easily as possible. Since owners of capital like business enterprises, attempt to maximize their own wealth and well-being, they require information to help them in making sound economic decisions. This process is assumed to lead to the broader social goal of efficient allocation of resources throughout the economy.

2. Cost of Capital

Adequate disclosure in annual reports is expected, in the long run, to enhance market

price of company's share in the investment market. Higher prices of company shares resulting from the full disclosure will have a favourable impact on the company's cost of capital. It also enhances the future marketability of subsequent issue of company's shares.

Choi argues that if analysts are kept well informed then, over the long run, an individual company's shares prices will be relatively higher. Higher security prices would mean that a primary security issue could be priced higher and that the net proceeds from the issue would be higher. Thus the firm would experience larger receipt from a given issue and hence experience a lower cost of capital.

3. Equilibrium in Share Prices

Adequate disclosure will tend to minimise the fluctuations in company's share prices. Fluctuations in share prices occur because of the ignorance prevailing in the investment market. Fluctuations show an element of uncertainty in investment decisions. If the securities market are in possession of full information, the ignorance and uncertainty will be reduced and share prices will tend to maintain equilibrium.

Besides, increased disclosures would prevent fraud and manipulations and would minimise chances of their occurrences. Additionally all investors would be treated equally as far as the availability of significant financial information is concerned.

Ethics in disclosure demands that no caste system for release of corporate information—telling the sophisticated first and the general public later or not at all—should be followed by corporate managements.

Miller and Bahnson have suggested the following four axioms regarding quality financial reporting:

- (i) Incomplete information creates uncertainty.
- (ii) Uncertainty creates for investors and creditors.

- (iii) Risk makes investors and creditors demand a higher rate of return.
- (iv) A higher rate of return of investors and creditors is a higher cost of capital for the firm and produces lower security prices.

In a positive perspective and for positive thinkers, the above four axioms can also be stated in the following different terms:

- (i) More complete information reduces uncertainty.
- (ii) Less uncertainty reduces risk for investors and creditors.
- (iii) Reduced risk makes investors and creditors satisfied with a lower rate of return.
- (iv) A lower rate of return for investors and creditors is a lower cost of capital for the firm and produces higher stock prices.

4. Employee Decisions

Employee decisions may be based on perceptions of a company's economic status acquired through financial statements. In particular, prospective and present employees may use the financial reports to assess risk and growth potential of a company and therefore, job security and future promotional possibilities.

These decisions affect the allocation of human capital in the economy. Labour unions and individual employees may use financial statement data as a basis for making contractual wage and employment benefit demands. Should this occur, data that incorrectly reflect the economic position and prospects of an enterprise may mislead employees into making or justifying unrealistic demands.

5. Customer Decisions

The data presented in financial statements may affect the decision of a company's customers and hence have economic consequences. Customers, like employees, may use financial statement data to predict the likelihood and/or timing of a firm going

bankrupt or being unable to meet its commitments.

This information may be important in estimating the value of a warranty or in predicting the availability of supporting services or continuing supplies of goods over an extended period of time.

6. Manager's Decisions

The accounting data published in financial reports may have economic effects through its impact on the behaviour of the managers of corporate enterprises. The inclusion of accounting numbers in management compensation schemes or the fear of market misinterpretation of accounting reports may influence a manager's operating and financing decisions.

Shareholders prefer accounting procedures that mirror economic events as closely as possible. However, shareholders also must be concerned that the managers might manipulate the reported data to increase their compensation.

5.4 QUALITIES OF FINANCIAL REPORTING

Q10. Explain the various qualities of financial reporting information.

Ans :

(Imp.)

A study of attributes of the information disclosed in an Annual Report helps in determining the criteria for selecting and evaluating the information. The primary qualities of accounting information are relevance and reliability. If either of these qualities is completely missing, the information will not be useful. To be relevant, information must be timely and it must have predictive value or feedback value or both. To be reliable, information must have representational faithfulness and it must be verifiable and neutral. Comparability, including Consistency, is a secondary quality that interacts with relevance and reliability to contribute to the usefulness of information. Finally, benefits-costs and materiality are constraints, which are primarily quantitative rather than qualitative in character. To be useful and worth providing, the benefit of information should exceed its cost.

Usefulness can be regarded as the primary and most significant attribute of an information system. Information, in order to be useful, should have the characteristics of relevance, reliability, understandability, comparability, materiality and practicality, i.e., feasibility.

1. Relevance

Relevance is the most important attribute of information to be disclosed. If the information disclosed is not relevant to the needs of the users, then, the whole of the exercise of corporate disclosure is futile. Relevance is a quality of accounting information, which makes it useful to a decision-maker. Information must, of course, be logically related to a decision in order to be relevant to it. Information is said to be relevant if it has the capacity to confirm or change a decision maker's expectations. Therefore, it can be said that relevant information is that which satisfies the informational needs of the users and helps them in evaluating the management and its policies for the purpose of their decisions.

Thus financial reporting should provide information that is useful to the present and the potential investors and creditors and other users in making rational investment, credit and similar decisions.

2. Reliability

To be useful, the information must also be reliable. Information has the quality of reliability when it is free from material error and bias and can be depended upon by the users to represent faithfully that which it either purports to represent or could reasonably be expected to represent. It is for the purpose of reliability that the financial reports are required to be audited by the independent auditors.

It is the responsibility of the Management to report reliable information in annual reports. The goal of reliable information can be achieved by the Management if it applies generally accepted accounting principles appropriate to the enterprises circumstances, maintains proper and effective system of

accounts and internal control, and prepares adequate financial statements. If corporate Managements decide to disclose uncertainties and assumptions in annual reports, they will increase the reliability and thus the value of the information expressed therein. For information to be reliable; it must be verifiable to some degree, and it must be free from bias, i.e., objectivity or neutrality. Freedom from bias means that, facts have been impartially determined and reported. It also means that techniques used in developing data should be free of built in bias.

3. Understandability

The information should be presented in reports in such a way that it can be understood by reasonably well informed as well as by sophisticated readers. Accounting information is more understandable if it is quantifiable; at least to some extent it is consistent, comparable with similar information and is simple. Thus, quantifiability, consistency, comparability and simplicity of information help in making the reports understandable to the users. Understandability refers to the presentation of the information in clearest form so as to enable the reader to understand without any difficulty and make best use of the information and be free from confusion.

4. Comparability

Comparability is an outcome of consistency. The prime objective of comparability should be to facilitate the making of predictions and financial decisions by the creditors, investors and others. Comparability can be viewed from two angles, i.e., comparability of information between the periods in case of a single firm and comparability between the firms.

Consistency has been recognized as one of the significant conventions of accounting. Consistency makes the information comparable and thus helps the readers of the financial statements in deriving important information for decision-making. Explanation of the company's accounting policies,

adoption of the generally accepted accounting principles and accounting standards will make the information consistent and hence comparable.

Though 'comparability' is desired, but it should not become an impediment to the introduction of improved accounting standards. It is also inappropriate for an organization to stick to the same accounting policies, when more relevant and reliable alternatives exist.

5. Materiality

Materiality determines which information should be presented in the financial statements. There is no definite criterion for determining the materiality of information. Information is said to be material if its omission or misstatement would influence the economic decisions taken by the users based on the financial statements. Thus, it can be said that information is material if it is relevant to the decisions of the users. Hence, materiality and relevance have much in common; both are defined by reference to the needs of users in making economic decisions.

Kohler's dictionary defines materiality as the characteristics attaching to a statement, fact or item whereby its disclosure or the method giving it expression would likely to influence the judgment of a reasonable person.

6. Practicality

The usefulness of information is destroyed if it cannot meet the criterion of practicality, which has two significant characteristics, i.e., information must be worth more than it costs to present, and secondly, it must be available on a timely basis. Thus, the first characteristic signifies that the value of the information to the preparers and users must exceed the respective costs to them. Timeliness emphasizes that the information must be made available when it is needed and before it loses its capacity to influence decisions. Timeliness itself cannot make information relevant but non-reporting of information on time can rob information of its relevance.

Information has time value. Information delayed is information denied.

7. Completeness

As per Accounting Principle Board of America, 'completeness' implies that all the information that is reasonably needed to fulfill the requirement of the other qualitative objectives should be reported. A decision maker requires the information which is not only understandable but also reliable and comparable with the information about alternative opportunities and previous experience. The accounting information can be said to be complete if it fulfills the statutory requirements and materiality aspects. Full information must be provided so that users of accounting can take right decisions at the right time. An omission can cause information to be false or misleading and thus unreliable and different in terms of its relevance. At the same time, it is not possible to include everything in the Financial Statements that is required by the potential users as it would not be cost beneficial and also not understandable. Therefore, completeness should be within the bounds of materiality and cost.

5.5 RECENT TRENDS IN CORPORATE REPORTING IN INDIA

Q11. Bring out Recent Trends in Corporate Reporting in India.

Ans :

(Imp.)

1. Social Reporting

No corporate body is an island unto itself. It has to live in the society and each one of its activities is connected with the society it exists in. The business units are using scarce resources of the society and taking infrastructure facilities from the society. Hence, they should be accountable towards the society which provides these resources and from which the facilities are received. The process of communicating about the action, which has the impact on the society, is termed

as Social Reporting. It may involve qualitative, quantitative, financial and non-financial disclosures, which are voluntary. Such reporting has the additional advantages of enhancing the stewardship role of the Management as well as the image of the issuing corporations. The objective of the Financial Statements should be to report on the activities of the enterprise that affect the society, which can be determined and described or measured and which are important to the role of the enterprise in its social environment.

2. Human Resource Accounting

Successful operation of any organization depends upon the effective and significant utilization of men, materials and money. The dichotomy in accounting between human and non-human capital is fundamental. The latter is recognized as an asset and is therefore recorded in the books and reported in the Financial Statements, whereas the former is totally ignored by the Accountants.

An asset, whether tangible or intangible, can be defined as something, which is capable to generate future income stream. From this point of view, human resources are as good as other physical or intangible assets, which an enterprise owns for production of goods and services and earning profitability on its investments. In fact, human resource is the only 'active asset' in the asset portfolio of an organization and its performance, profitability and growth depend to a large extent on the quality of its human resource. Buildings, Plants, Computers and other physical and financial resources are unproductive without human efforts and decisions.

In our traditional accounting practices, the heavy amount incurred on recruitment, selection, placement, training and development of the personnel is generally treated as revenue expenditure and hence it is debited to Profit and Loss Account of the period during which such amount is incurred. But today, it is argued that these expenditures are incurred by an enterprise to get the benefit of the services of its manpower force in future

and it is against the accounting principle to treat them completely of a revenue nature. In fact, such expenditure should be capitalized and shown in the Balance Sheet. The failure of professional accountants to treat human resources as assets just like physical and financial assets attracted the attention of academics and, in seventies, the concept of Human Resource Accounting (HRA) has evolved, which emphasizes that human resources should be treated like physical assets and should be shown in the Balance Sheet of the enterprise.

3. Environmental Reporting

Accounting for Environment is one of the basic constituents of Social Accounting and has been rapidly emerging as an important dimension of corporate accounting and reporting practices. Rapid industrialization has created various types of pollution like water pollution, air pollution, noise pollution etc. This shows bad effects on the environment, which creates threat to the survival of the human beings. Environmental issues like global warming, environmental degradation, deforestation, emission of gases and excessive explosion require special treatment in accounts and also require specific reporting in the Balance Sheet of a company. The relation between corporation and their environment is a growing concern nowadays. It embraces a wider and broad spectrum in both thinking and practice.

The environment accountants all over the world are deliberating to codify the methods of ascertaining cost of maintaining ecological investment. Environmental Accounting is a new branch of accounting, which has two major aspects:

- (i) Cost of providing free of noise pollution, pollution free air, water, soil and atmosphere; and
- (ii) Benefits that the community will gain in terms of national health i.e., striking a balance between economic growth and maintenance of environment within the permitted parameters.

4. Value Added Statement

The concept of value added is considerably old. It originated in USA, in the 18th Century and periodically, accountants have deliberated upon as to whether the concept should be incorporated in financial accounting practice. Value Added is the wealth a reporting entity has been able to create through the collective effort of capital, management and employees. In economic terms, value added is the market price of the output of an enterprise less the price of the goods and services acquired by transfer from other firms. Value Added can provide a useful measure in gauging performance and activity of the reporting entity. Value Added Statement shows the value added by an organization to the materials and services purchased by it from outside and its distribution amongst the groups, which have contributed to it.

5. Performance Measurement

Performance Measurement plays a vital role in every organization as it is often viewed as a forward-looking system of measurements that assist the managers to predict the company's economic performance and spot the need for changes in operations. The performance of a firm gets reflected on its valuation by the capital market. Market valuation reflects investor's perception about the current performance of the firm and also their expectation on its future performance. They build their expectations on the estimated growth of the business in terms of return on capital. Investors measure overall performance of a firm to decide whether to invest in the firm or to continue with the firm or to exit from it.

6. Economic Value Added

Economic Value Added (EVA) was developed by a New York Consulting firm, Stern Stewart & Co in 1982 to promote value-maximizing behavior in corporate managers. It is a new version of the age-old 'Residual Income' concept recognized by the economists since the 1770's. Both EVA and 'Residual Income'

concepts are based on the principle that a firm creates wealth for its owners only if it generates surplus over the cost of the total invested capital. It is a single, value-based measure that was intended to evaluate business strategies, capital projects and to maximize long-term shareholders wealth. Value that has been created or destroyed by the firm during the period can be measured by comparing profits with the cost of capital used to produce them. Therefore, managers can decide to withdraw value-destructive activities and invest in projects that are critical to the shareholder's wealth. This will lead to an increase in the market value of the company. However, activities that do not increase shareholders value might be critical to the customer's satisfaction or social responsibility.

7. Inflation Accounting

Traditional Accountancy is purely based on the historical cost. If the values of the monetary units remain stable, only then, it conveys the same facts. In the context of continuous rise in the price levels, it is now argued that the historical cost convention for reporting income and financial position has become a misnomer and accounts prepared in perfect obedience to the historical cost concept are grossly misleading. Thus, they do not reflect the current economic realities. As a result the statements of affairs never show the true and fair picture. It leads to a number of problems such as the problem of replacement of fixed assets and inventories, overstatement of profit, maintenance of real capital in the business, etc. Of late, there has been a considerable debate on the necessity for preparing and presenting the financial statements adjusted for the effects of inflation and the appropriate methodology for the preparation of such statements. Only the Inflation Accounting System regularly records all the items in the financial statements at their current values.

8. Brand Value

An asset-structure of a corporate entity consists of both tangible and intangible assets. Traditionally, accountants regarded tangible assets as the only productive or earning generating assets and gave undue importance in their maintenance and accounting. Accounting principles and standards also laid stress on accounting on these tangibles. However, in a modern competitive environment, the corporate value and earning power are decided by and generated by both the classes of assets, often more by intangibles than tangibles. The value of a business increasingly lurks not in physical and financial assets that are on the Balance Sheet but in intangibles: brands, patents, franchises, software, research programs, ideas, expertise, etc. The difficulty of measuring the cost and economic benefits dissuaded accountants from properly accounting for intangibles.

9. Ratio Analysis

Ratio Analysis is among the best tools available to analyze the financial performance of a company. It allows Inter-company and Intra-company comparison and analysis. Ratios' also provide a bird's eye view of the financial condition of the company. In assessing the financial stability of a firm Management should, apart from profitability, be interested in relative figures rather than in absolute figures. In fact, an analysis of the Financial Statements is possible only when the figures are expressed as percentages or ratios. There is a growing body of evidence that ratios can be directly helpful as a basis for making predictions. It is of major importance for financial analysis. It engages qualitative measurement and show precisely how adequate is one key item in relation to another. Not only are those who manage a company, but also its shareholders and creditors are interested in knowing about the financial position and/or earning capacity of that concern. There are two main ways to analyze a ratio:

- In a trend analysis, the behavior of the ratio across the time is studied;
- In a comparative analysis, the performance of a firm at a single point of time relative either to other firms in the industry or to some other generally accepted industry standard is studied.

10. Segment Reporting

Financial reporting in respect of business and geographical segments is one of the suggested accounting procedures followed in U.S.A. and U.K. A segment report can further be subdivided into a primary segment report concerning core segment and a secondary segment report concentrating on other important segments. It provides the user of financial information data relating to relative size, profit, contribution and growth trend of different business and geographical segments.

Financial reporting is not a static discipline. It changes and evolves in response to new legislation, requirements of the Regulators and changes in accounting standards, as well as various other demands from other stakeholder groups and new initiatives.

Integrated reporting in financial reporting goes beyond the numbers. It gives details as to how the company is creating value and also provides details around environmental, social and other corporate governance related steps it undertakes.

Short Question and Answers

1. Define Financial Reporting.

Ans :

Financial reporting may be defined as communication of published financial statements and related information from a business enterprise to third parties (external users) including shareholders, creditors, customers, governmental authorities and the public. It is the reporting of accounting information of an entity (individual, firm, company, government enterprise) to a user or group of users.

Company financial reporting is a total communication system involving the company as issuer (preparer); the investors and creditors as primary users, other external users; the accounting profession as measurers and auditors; and the company law regulatory or administrative authorities.

2. Need of financial reporting.

Ans :

(a) Investors

The providers of risk capital and their advisors 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. Shareholders 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 that 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 that 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 continuation 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, determine taxation policies and as the basis for national income and similar statistics.

3. Accounting Principles Board

Ans :

In USA, the APB Statement No. 4 "Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises", (1970) was the first publication which formulated the objectives of financial statements.

These objectives may be summarized as follows:

1. The particular objectives of financial statements are to present fairly, and in conformity with generally accepted accounting principles, financial position, results of operations, and other changes in financial position.

2. The general objectives of financial statements are:

- (a) to provide reliable information about economic resources and obligations of a business enterprise in order to:
 - (i) Evaluate its strengths and weakness,
 - (ii) Show its financing and investment,
 - (iii) Evaluate its ability to meet its commitments, and
 - (iv) Show its resource base for growth;
- (b) To provide reliable information about changes in net resources resulting from a business enterprise's profit-directed activities in order to:
 - (i) Show to investors expected dividend return,
 - (ii) Show the operation's ability to pay creditors and suppliers, provide jobs for employees, pay taxes, and generate funds for expansion,
 - (iii) Provide management with information for planning and control, and
 - (iv) Show its long-term profitability;
- (c) To provide financial information useful for estimating the earnings potential of the firm;
- (d) To provide other needed information about changes in economic resources and obligations; and
- (e) To disclose other information relevant to statement users' needs.

3. The qualitative objectives of financial accounting are the following:

- (a) Relevance, which means selecting the information most likely to aid users in their economic decisions.
- (b) Under-standability, which implies not only that the selected information must be intelligible but also that the users can understand it.

4. A Statement of Basic Accounting Theory

Ans :

In 1966, the executive committee of American Accounting Association (AAA) published 'A Statement of Basic Accounting Theory (ASOBAT)' as "an integrated statement of basic accounting theory which will serve as a guide to educators, practitioners, and others interested in accounting. The committee may want to consider the role, nature, and limitations of accounting."

In ASOBAT, accounting is defined as, " the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by users of the information."

5. True blood report.

Ans :

To develop objectives of financial statements, a Study Group was appointed in 1971 by American Institute of Certified Public Accountants under the Chairmanship of Robert M. Trueblood. The Study Group solicited the views of more than 5000 corporations, professional firms, unions, public interest groups, national and international accounting organizations and financial publications.

The Study Group conducted more than 50 interviews with executives from all sectors of the business and from government. To elicit the widest possible range of views, 35 meetings were held with institutional and professional groups representing major segments of the US economy.

6. Corporate Report.

Ans :

The Accounting Standards Steering Committee of the Institute of Chartered Accountants in England and Wales Published 'The Corporate Report' in 1976 as a discussion paper covering the scope and aims of published financial reports, public accountability of economic entities, working concepts as a basis for financial reporting, and most suitable means of measuring and reporting the economic position, performance and prospects of undertakings.

The Corporate Report's main findings are as follows:

- First, the basic philosophy and starting point of The Corporate Report is that financial statements should be appropriate to their expected use by potential users. In other words, they should attempt to satisfy the information needs of their users.
- Second, the report assigned responsibility for reporting to the 'economic entity' having an impact on society through its activities. The economic entities are itemized as limited companies, listed and unlisted; pension schemes, charitable and other trusts, and not-for-profit organizations; non-commercially oriented Central Government departments and agencies, partnerships and other forms of unincorporated business enterprises; trade unions and trade and professional associations; local authorities, and nationalized industries and other commercially oriented public sector bodies.

7. Stamp Report.

Ans :

The Canadian Institute of Chartered Accountants (CICA) published a report in June 1980 on 'Corporate Reporting: Its Future Evolution' which was written by Edward Stamp.

Popularly known as Stamp Report, it mentions the following as the important objectives of company financial reporting:

1. One of the primary objectives of published corporate financial reports is to provide an accounting by management to both equity and debt investors, not only a management's exercise of its stewardship function but also of its success (or otherwise) in achieving the goal of producing a satisfactory economic performance by the enterprise and maintaining it in a strong and healthy financial position.
2. It is an objective of good financial reporting to provide such information in such a form as to minimize uncertainty about the validity of information, and to enable the user to make his own assessment of the risks associated with the enterprise.
3. It is necessary that the standards governing financial reporting should have ample scope for innovation and evolution as improvements become feasible.
4. The objectives of financial reporting should be taken to be directed towards the need of users who are capable of comprehending a complete (and necessarily sophisticated) set of financial statements or alternatively, to the needs of experts who will be called on by the unsophisticated users to advise them.

Choose the Correct Answer

1. The parties interested in financial reporting are _____. [d]
(a) Investors (b) Shareholders and Creditors
(c) Government officials and Customers (d) All the above.
2. The managers provide _____ decisions to the shareholders of a company. [c]
(a) Operating (b) Financing
(c) Both (a) and (b) (d) Investing.
3. _____ approach deals with the problems related to benefits and cost. [c]
(a) Classical (b) Decision usefulness
(c) Economic Information (d) Accounting.
4. In _____ year, Financial Accounting State Board (FASB) issued the "Objectives of Financial Reporting by Business Enterprises" [a]
(a) 1978 (b) 1981
(c) 1977 (d) 1993
5. _____ written a report on 'Corporate Reporting: Its Future Evolution Known a 'Stamp report'. [b]
(a) Robert M. Trueblood (b) Edward Stamp
(c) Edward clink (d) Stuart kells.
6. The primary objectives of financial reporting are _____. [d]
(a) Investment Decision Making (b) Management Accountability
(c) Corporate Financial Management (d) Both (a) and (b).
7. _____ is one of the latest system which helps the big organizations in inventory management, supply chain management, procurement, logistics and supply etc. [a]
(a) Enterprise Resource Planning (ERP) (b) Management
(c) Digital Accounting (d) Artificial intelligence.
8. The qualitative characteristics of financial reporting are _____etc. [d]
(a) Understandability (b) Relevance
(c) Reliability (d) All of the above.
9. _____ facilitates the user to find out the similarities as well as differences and then compare them with economic development. [c]
(a) Neutrality (b) Consistence
(c) Comparability (d) Timeliness.
10. _____ has introduced qualities or characteristics of financial reporting which makes the accounting information useful. [a]
(a) SFACNo.2 (b) SFACNo.I
(c) ASOBAT (d) FASB.

Fill in the blanks

1. _____ reporting may be defined as communication of published financial statements and related information from a business enterprise to third parties.
2. APB stands for _____.
3. ASOBAT stands for _____.
4. SATTA stands for _____.
5. _____ approach is concerned with the reports, information needs and decisions related to the financial statements.
6. _____ decisions may be based on perceptions of a company's economic status acquired through financial statements.
7. The data presented in _____ may affect the decision of a company's customers and hence have economic consequences.
8. _____ is the most important attribute of information to be disclosed.
9. _____ is an outcome of consistency.
10. _____ determines which information should be presented in the financial statements.

ANSWERS

1. Financial
2. Accounting Principles Board
3. A Statement of Basic Accounting Theory
4. Statement on Accounting Theory and Theory Acceptance
5. Decision usefulness
6. Employee
7. Financial statements
8. Relevance
9. Comparability
10. Materiality

FACULTY OF COMMERCE
B.Com. V -Semester (CBCS) Examination
July - 2021
ACCOUNTING STANDARDS

Time: 2 Hours

Max. Marks: 80

PART - A (4 × 5 = 20 Marks)

(Short Answer Type)

Note: Answer any FIVE of the following questions.

1. State the procedure for issuing Accounting Standards. (Unit-I, SQA-1)
2. The company deals in three products, A, B and C which are neither similar nor interchangeable. At the time of closing of its account for the year 2014 - 2015, the historical cost and Net Realizable value of the items of closing stock are determined as follows. (Out of Syllabus)

Item	Historical Cost (in Lakhs)	Net Realizable Value (in Lakhs)
A	40	28
B	32	32
C	16	24

3. Pooling Interest Method. (Out of Syllabus)
4. Discontinuing Operations (Unit-II, SQA-9)
5. List out any 5 INDAS with names and numbers. (Unit-I, SQA-3)
6. Calculate Cash from Operations. (Unit-II, Prob. 5)

Purchase	₹ 1,50,000
Sales	₹ 2,00,000
Expenses	₹ 20,000
Creditors at the Beginning of the year	₹ 30,000
Creditors at the end of the year	₹ 40,000

7. A Ltd. leased machinery to B Ltd on the following terms

(Unit-III, Prob. 14)

	(` In Lakhs)
Fair Value of the Machinery	20.0
Lease term	5 years
Lease Rental per Annum	5.00
Guaranteed Residual Value	1.00
Expected Residual Value	2.00
Internal Rate of Return	15%

Find out the Present Value of Lease

8. Standard IFRS Requirements.

(Out of syllabus)

PART - B (4 × 15 = 60 Marks)

Note: Answer any four questions.

9. Define Accounting Standards. Explain the advantages and limitation of Accounting standards.

(Unit-I, Q.No. 21, 25)

10. Discuss briefly about list of Accounting Standards in India ?

(Unit-I, Q.No. 27)

11. (i) Discuss briefly about AS-7 Accounting for Construction Contracts?

(Unit-III, Q.No. 5, 6)

(ii) Miracle Construct Inc. is executing a significant project of constructing the tallest building in the country. The project is expected to take three years to complete.

The Company has signed a fixed price contract of ` 12,00,000 for the construction of this prestigious tower. The details of the costs incurred till date in the first year are

Site Labour Cost	` 10,00,000
Cost of Construction Material	` 30,00,000
Depreciation	` 5,00,000
Marketing & Selling Costs to get the Tallest building in the country the right Expenses	` 10,00,000
Total	` 55,00,000

Total Contract Cost estimated to Complete ` 55,00,000 required, Calculate the % of completion and amounts of Revenue, Costs and profits to be recognized under AS - 7.

(Unit-III, Prob. 8)

12. (i) Discuss briefly about Revenue Recognition (AS-9)

(Unit-III, Q.No. 20)

(ii) A company lodged a claim to Insurance Company for ` 5,00,000 in September 2006. The claim was settled in February 2007 for ` 3,50,000. How will you record the short fall in claim settlement in the books of the company ?

(Out of syllabus)

13. (i) Explain AS-17 Segment Reporting. (Unit-II, Q.No. 31, 32, 33)

- (ii) X Ltd. provides the following information

Segment	Revenue	Net Profit	(` in Lakhs)Assets
A	2000	800	5000
B	200	50	400
Total	2200	850	5400

You are required to identify the Reportable Segment.

(Unit-II, Prob. 6)

14. (i) Explain in detail AS-12 (Accounting for Government Grants)? (Unit-III, Q.No. 24)

- (ii) Explain the treatment of the following :

- (i) A firm purchased a fixed for ` 350 Lakhs on which the Govt Grant received was 40%
- (ii) Capital subsidy received from the Central Govt. the setting up a plant in the notified backward region. Cost of Plant is ` 600 Lakhs, subsidy received ` 200 Lakhs
- (iii) For setting up water treatment plant ` 75 Lakhs received from the State Government.
- (iv) ` 30 Lakhs received for providing medical facilities to employees from local authority.

(Out of Syllabus)

15. (i) Explain AS-26 Accounting for Intangibles. (Unit-III, Q.No. 28, 29, 30)

- (ii) PQR Ltd. Disposes off on Intangible Asset for ` 10,00,000 and the the carrying cost was ` 8,00,000 after using it for 10 years. How should the disposal of Intangible Asset be treated in the books?

(Out of syllabus)

16. (i) Explain the terms

- (a) Provisions
- (b) Contingent Liabilities
- (c) Contingent Assets under Standard as per AS-229 ?

(Out of syllabus)

- (ii) On 31st December 2002 Co. finds there are twenty law suits out Standing which have not been settled till approval of Accounts by Board of Directors. The possible outcomes as estimated by the Board is as follows :

	Probability	Loss (₹)
In Respect of Five Cases (win)	100%	-
Next ten cases (win)	60%	-
Lose (Low damages)	30%	60,000
Lose (High damages)	10%	1,00,000
Remaining Five Cases		
Win	50%	-
Lose (Low damages)	30%	50,000
Lose (High damages)	20%	1,05,000

Out Come of each situation must be taken as separate entity. Ascertain the Amount of Contingent Loss and The Accounting treatment in respect of there Loss.

(Out of syllabus)

17. What are Indian Accounting Standards ? Explain the scope of Indian Accounting standard's

(Out of syllabus)

18. What is Convergence ? Explain the significance of INDAS.

(Unit-I, Q.No. 29, 28)

FACULTY OF COMMERCE**B.Com. V - Semester (CBCS) Examination****November / December - 2019****ACCOUNTING STANDARDS**

Time : 3 Hours]

[Max. Marks : 80

PART - A (5 × 4 = 20 Marks)**[Short Answer Type]****Note:** Answer any **FIVE** of the following questions

1. Explain the nature of Accounting Standards. (Unit-I, SQA. 3)
2. Explain the "Concept of Materiality". (Out of Syllabus)
3. What are the objectives of AS-10? (Unit-III, SQA. 3)
4. Discuss briefly the application of AS-26. (Unit-III, SQA. 1)
5. What are the contents of Exposure Draft? (Out of Syllabus)
6. List of Accounting Standards in India. (Unit-I, SQA. 3)
7. Explain "Reportable Segments" as per AS-17. (Unit-II, SQA. 1)
8. Write about the carve outs relating to Ind AS-10. (Out of Syllabus)

PART - B (5 x 12 = 60 Marks)**[Essay Answer Type]****Note :** Answer the following questions.

9. (a) What are the objectives of Accounting Standards? Explain its advantages and limitations (Unit-I, Q.No. 24, 25)
- OR
- (b) Explain the procedure for formulating Accounting Standards. (Unit-I, Q.No. 26)
10. (a) Explain in detail AS-2 (Valuation of Inventories). (Unit-III, Q.No. 1, 2)
- OR
- (b) Discuss in detail AS-4 (Contingencies and Events occurring after Balance Sheet Date). (Unit-II, Q.No. 17)
11. (a) Explain the disclosure requirements for Property, Plant and Equipment as per AS-10. (Unit-III, Q.No. 12, 13)
- OR
- (b) Shyam Ltd. purchased a plant for ₹ 30,000 on 30th Nov. 2013, payable after 6 months. The company entered into a Forward Contract for 6 months @ ₹ 62.15 per dollar on 30th Nov. 2013 the exchange rate was ₹ 60.75 per dollar How will you recognize the Profit or Loss on Forward Contract in the books of Shyam Ltd for the year ended 31st March 2014? (Out of Syllabus)

12. (a) Discuss the objectives of AS-29. Discuss in detail, Accounting for Provision and Accounting for Contingent Liabilities.

(Out of Syllabus)

OR

- (b) From the following details of Ahmed Ltd for the year ended 31-3-2008. Calculate the Deferred Tax Asset Liability as per AS-22.

(Out of Syllabus)

	₹
Accounting Profit	4,00,000
Book Profit as per MAT	3,50,000
Profit as per income Tax Act	50,000
Tax Rate	30%
MAT Rate	7.5%

13. (a) What are Indian Accounting Standards? Explain the significance of Indian AS.

(Unit-I, Q.No. 28)

OR

- (b) Compare:

(Out of Syllabus)

- (a) AS - 10 with Ind. AS-16
(b) AS - 18 with Ind. AS-24.

FACULTY OF COMMERCE
B.Com. - V Semester (CBCS) Examination
June / July - 2019
ACCOUNTING STANDARDS

Time : 3 Hours]

[Max. Marks : 80

PART - A (5 × 4 = 20 Marks)
[Short Answer Type]

Note: Answer any five of the following questions

1. Explain about IFRs. (Out of Syllabus)
2. What are the fundamental accounting assumptions as per As 1 ? (Out of Syllabus)
3. From the following calculate the cost of inventories as per AS 2. (Unit-III, Prob. 5)
Purchases Rs. 8,00,000; Freight and Duties Rs. 54,000; Storage cost of finished goods Rs. 36,000, Direct Labour Rs. 3,80,000; Selling cost Rs. 1,24,000.
4. Write a short note on Accounting for Investments. (Out of Syllabus)
5. X Ltd. took over Y Ltd. on 1-4-2018 and discharged consideration for the business as follows : (Out of Syllabus)
 - a) Issued 20,000 fully paid equity shares of Rs. 10 each to the equity share holders of Y Ltd.
 - b) Issued 10,000 fully paid up 12% preference shares of Rs. 10 each at a premium of 10%.
 - c) Discharge debentures of Y Ltd Rs. 80,000 by issuing equal amount of debentures of X Ltd.Calculate the purchase consideration as per AS 14.
6. Ram is a Director of two companies A Ltd and B Ltd. He purchased goods from A Ltd. Should the two companies report the above purchases as transaction with related party as per AS 18. (Unit-II, Q.No. 21)
7. Explain contingent liability and contingent asset as per AS 29. (Out of Syllabus)
8. List out any 4 IND AS with names and numbers. (Unit-I, SAQ. 3)

PART - B (5 x 12 = 60 Marks)
[Essay Answer Type]

Note : Answer the following questions.

9. (a) What are Accounting standards. State their need and objectives. (Unit-I, Q.No. 21, 22, 24)
OR
(b) Briefly explain the procedure of setting accounting standards in India. (Unit-I, Q.No. 26)

10. (a) (i) Explain Cash Flow Statement as per AS 3. (Unit-II, Q.No. 8)
 (ii) Segregate the following activities into: (Unit-II, Q.No. 10)
 a) Operating b) Investing c) Financing activities
 Sale of Machinery, Repayment of Long Term Loan, Cash Purchases,
 Purchase of Investments, Salaries paid, proceeds from issue of shares.

OR

- (b) (i) Explain AS 7 Accounting for Construction Contracts. (Unit-III, Q.No. 5, 6)
 (ii) MGR Construction Company commenced a contract on 1-4-2016. (Unit-III, Prob. 7)
 The fixed price agreed for the contract was Rs. 50,00,000.
 The company incurred Rs. 18,50,000 in the year 2016-2017 for
 completing 45% work and have received Rs. 15,00,000 as progress
 payment from the customer. Calculate the amount of profit to be
 transferred by MGR Construction Company to their Profit and
 Loss A/c as per the % of completion method for the year ended
 2016-17.
11. (a) (i) Explain the Accounting Standard on Property, Plant and Equipment. (Unit-III, Q.No. 12, 13)
 (ii) X Ltd. purchased a Plant and Machinery on 1-4-2017 and following (Unit-III, Prob. 12)
 are the costs incurred; Original Cost Rs. 35,00,000; Insurance
 during transit of Plant and Machinery Rs. 2,00,000; Annual
 maintenance cost Rs. 2,00,000; Cost of Inspection Rs. 3,00,000;
 Installation and assembling cost Rs. 5,00,000; Annual Interest on
 Loan for purchase of Plant and Machinery Rs. 1,00,000.
 Calculate the amount to be recognized as cost of Property, Plant
 and Equipment.

OR

- (b) (i) Explain AS 17 Segment Reporting. (Unit-II, Q.No. 31)
 (ii) Bharath Ltd provides the following information. (Unit-II, Prob. 6)

(Rs. in lakhs)

Segment	Revenue	Net Profit	Assets
A	2,000	800	5,000
B	200	50	400
Total	2,200	850	5,400

You are required to identify the reportable segments.

12. (a) (i) Explain the Standard on Accounting for Leases. (Unit-III, Q.No. 15, 16)
 (ii) From the following details, calculate the amount to be recorded as (Unit-III, Prob. 15)
 an asset and liability in the books of lessee on 1-4-2018. Fair value
 of the asset at the inception of the lease Rs. 5,00,000.

Year	Lease Rent (Rs.)	Discounting Factor at 10%
31-3-2019	2,00,000	0.9091
31-3-2020	2,00,000	0.8265
31-3-2021	2,00,000	0.7513

The lease period of 3 years is equal to the life of the asset and it has Rs. 40,000 as residual value at the end of the 3rd year.

OR

- (b) (i) Explain AS 26 Accounting for Intangibles. (Unit-III, Q.No. 28, 29)

- (ii) A Pharmaceutical Company is engaged in research of a new process for its product. It has incurred an expenditure of Rs. 20,00,000 on research. The Development of the process has begun and Rs. 12,00,000 is spent on it, this will result in future economic benefits. Explain the accounting treatment of the above items as per AS 26. (Unit-III, Prob. 18)

13. (a) What is Convergence? Explain the significance of Ind AS. (Unit-I, Q.No. 29, 28)

OR

- (b) Briefly explain the Road map for implementation of Ind AS. (Out of Syllabus)

FACULTY OF COMMERCE
B.Com. - V Semester Examination
November / December - 2018
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.

PART - A (5 x 4 = 20 Marks)

Note : Answer any **FIVE** of the following questions.

1. State the limitations of Accounting standards. (Unit-I, SQA. 4)
2. Write short notes on the activities of Cash flows as per AS 3. (Unit-II, SQA. 2)
3. What do you mean by "Prior period items" ? (Unit-II, SQA. 10)
4. Write a short note on Government Grants. (Unit-III, SQA. 2)
5. State the general disclosures of AS 10 Property, Plant and Equipment. (Unit-III, SQA. 3)
6. ZEE Ltd. is a manufacturer of LED Bulbs. The company decided to change the design of the bulbs. So, it purchased a new plant and changed the production process. State with reason if you would, consider this as discounting operation as per AS 24. (Unit-II, Q.No. 29)
7. From the following particulars, calculate Deferred Tax asset / Liability. (Out of Syllabus)
Accounting Income Rs. 58,00,000 ; Taxable Income Rs. 62,00,000;
Rate of Tax (including surcharge) 20%.
8. List out any 4 Ind AS with their names and numbers. (Unit-I, SQA. 3)

PART - B (5 x 12 = 60 Marks)

Note : Answer **ALL** the questions.

9. (a) Define Accounting standards. List out any 10 accounting standards with Names and Numbers. (Unit-I, Q.No. 21, 27)
- OR
- (b) What is convergence? Explain the need and benefits of convergence with IFRS. (Unit-I, Q.No. 29, Out of Syllabus)
10. (a) (i) Explain AS 2 Valuation of Inventories. (Unit-III, Q.No. 1)
(ii) From the following information, calculate the Cost of inventories, (Unit-III, Prob. 6)
purchases Rs. 10,00,000; Direct Labour Rs. 6,40,000 ; Rent for storage of Finished goods Rs. 1,20,000; Selling and Distribution Cost Rs. 2,80,000; Direct expenses Rs. 3,20,000.

OR

- (b) (i) Explain the standard on Revenue recognition. **(Unit-III, Q.No. 20, 21, 22)**
- (ii) Perfect Ltd. received advance from a customer for sale of goods on 20th March 2016, however the goods were sent to the customer on 1st October 2016 and balance of payment was received on 2nd April 2017. State with reason when shall the revenue be recognized as per AS 9. **(Unit-III, Prob. 16)**
11. (a) (i) Explain an Amalgamation in the Nature of Merger and purchase as per AS 14. **(Out of Syllabus)**
- (ii) Following are the assets and liabilities of Week Ltd as on 31/3/2018. **(Out of Syllabus)**
Sundry Assets Rs. 25,00,000 (Market value Rs. 32,00,000) ;
Sundry Creditors Rs. 3,00,000; Share Capital Rs. 22,00,000 ;
Strong Ltd absorbs Weak Ltd. as on 1-4-2018 at a consideration of Rs. 30,00,000. Calculate the resultant Goodwill or Capital reserve.
- (b) (i) Explain AS 16 Accounting for Borrowing Costs. **(Unit-III, Q.No. 27)**
- (ii) Revised Ltd made an agreement for construction of Machinery which is not yet complete. They have taken a loan of Rs. 30,00,000 at 10% p.a. for the above purpose. Explain the accounting treatment of the borrowing cost as per AS 16. **(Unit-III, Prob. 17)**
12. (a) (i) Explain AS 18 Related Party disclosures. **(Unit-II, Q.No. 19)**
- (ii) P Ltd holds 80% voting rights of Q Ltd. and Q Ltd hold 52% voting power in R Ltd., P Ltd also hold 25% of voting interest in R Ltd. State with reason would P Ltd be a related party to R Ltd. **(Unit-II, Q.No. 20)**

OR

- (b) (i) Explain the standard of Earnings per share. **(Out of Syllabus)**
- (ii) Prosper Ltd has 7,200 equity shares as on 1-4-2016. On 31-8-2016 it issued another 2,400 equity shares for each, on 1-2-2017 it bought back 1200 equity shares. Profit available for equity shareholders is Rs. 18,90,000. Calculate the Basic EPS. **(Out of Syllabus)**
13. (a) Explain the Development and significance of Ind AS. **(Unit-I, Q.No. 28)**

OR

- (b) Explain the carve Ind's and Carve Out's in AS compared to Ind AS. **(Out of Syllabus)**

FACULTY OF COMMERCE
B.Com. III Year VI Semester (CBCS) Examination
Model Paper - I
ACCOUNTING STANDARDS

Time: 3 Hours

Max. Marks: 80

PART – A (5 × 4 = 20 Marks)

Note: Answer any five of the following questions not exceeding 20 lines each.

ANSWERS

1. What is Convergence? (Unit-I, SQA.17)
2. Explain the procedure for formulating accounting standards. (Unit-I, SQA. 1)
3. Explain the various activities of cash- flow statement. (Unit-II, SQA.2)
4. Calculate Cash from Operations.

Purchases	` 1,50,000
Sales	` 2,00,000
Expenses	` 20,000
Creditors at the Beginning of the year	` 30,000
Creditors at the end of the year	` 40,000

(Unit-II, Prob. 5)

5. Property, Plant and Equipment. (Unit-III, SQA.3)
6. Types of leases (Unit-III, SQA.8)
7. Business combination. (Unit-IV, SQA.2)
8. Define Financial Reporting. (Unit-V, SQA.1)

PART – B (5 × 12 = 60 Marks)

Note: Answer all the questions in not exceeding four pages each.

9. (a) Explain in detail about Deductive and Inductive Approach. (Unit-I, Q.No. 12)
(OR)
(b) Explain the concept of Accounting Standard. (Unit-I, Q.No.21)
10. (a) Explain the concept of Ind AS-101. (Unit-II, Q.No. 1)
(OR)
(b) (i) Explain the features of financial statements. (Unit-II, Q.No. 4)

(ii) Following is the balance sheet of Kuber Limited for the year ended 31st March, 2002

Particulars	2002	2001
ASSETS		
Non-current Assets		
Property, plant and equipment	13,000	12,500
Intangible assets	50	30
Other financial assets	145	170
Deferred tax asset (net)	855	750
Other non-current assets	800	770
Total non-current assets	14,850	14,220
Current assets Financial assets		
Investments	2,300	2,500
Cash and cash equivalents	220	460
Other current assets	195	85
Total current assets	2,715	3,045
Total Assets	17,565	17,265
EQUITY AND LIABILITIES		
Equity		
Equity share capital	300	300
Other equity	12,000	8,000
Total equity	12,300	8,300
Long-term borrowings	2,000	5,000
Other non-current liabilities	2,740	3,615
Total non-current liabilities	4,740	8,615
Current liabilities		
Financial liabilities		
Trade payables	150	90
Bank Overdraft	75	60
Other current liabilities	300	200
Total current liabilities	525	350
Total liabilities	5,265	8,965
Total Equity and Liabilities	17,565	17,265

Additional Information

1. Profit after tax for the year ended 31 st March, 2002- Rs. 4,450 lacs
2. Interim Dividend paid during the year - Rs. 450 lacs
3. Depreciation and amortisation charged in the statement of profit and loss during the current year are as under
 - a) Property, Plant and Equipment - Rs. 500 lacs
 - b) Intangible Assets - Rs. 20 lacs
4. During the year ended 31st March, 2002 two machineries were sold for Rs.10 lacs. The carrying amount of these machineries as on 31st March, 2002 is Rs.60 lacs.
5. Income taxes paid during the year Rs.105 lacs Using the above information of Kuber Limited, construct a statement of cash flows under indirect method. Other non-current / current assets and liabilities are related to operations of Kuber Ltd. and do not contain any element of financing and investing activities. **(Unit-II, Prob.4)**

11. (a) What is Income tax? Explain the need and scope of Ind As-12. **(Unit-III, Q.No. 8)**

(OR)

- (b) From the following details, calculate the amount to be recorded as an asset and liability in the books of lessee on 1-4-2018. Fair value of the asset at the inception of the lease ` 5,00,000.

Year	Lease Rent (`)	Discounting Factor at 10%
31-3-2019	2,00,000	0.9091
31 -3-2020	2,00,000	0.8265
31-3-2021	2,00,000	0.7513

The lease period of 3 years is equal to the life of the asset and it has ` 40,000 as residual value at the end of the 3rd year. **(Unit-III, Q.No.15)**

12. (a) Explain the computation and procedure of Equity method ? **(Unit-IV, Q.No. 2)**

(OR)

- (b) What information is required to be disclosed by an entity with regard to the interest in subsidiary?

(Unit-IV, Q.No. 17)

13. (a) Describe briefly the Developments on Financial Reporting Objective. **(Unit-V, Q.No. 3)**

(OR)

- (b) Bring out Recent Trends in Corporate Reporting in India. **(Unit-V, Q.No.11)**

FACULTY OF COMMERCE
B.Com. III Year VI Semester (CBCS) Examination
Model Paper - II
ACCOUNTING STANDARDS

Time: 3 Hours

Max. Marks: 80

PART – A (5 × 4 = 20 Marks)

Note: Answer any five of the following questions not exceeding 20 lines each.

ANSWERS

- | | |
|-------------------------------------------------|--------------------|
| 1. What are Indian Accounting Standards? | (Unit-I, SQA. 16) |
| 2. Limitations of Accounting Standards | (Unit-I, SQA. 4) |
| 3. What are Financial Statements? | (Unit-II, SQA.3) |
| 4. What are accounting estimates. | (Unit-II, SQA.7) |
| 5. What is Income tax. | (Unit-III, SQA. 6) |
| 6. Explain the objective and scope of Ind AS-2. | (Unit-III, SQA.4) |
| 7. What is measurement period? | (Unit-IV, SQA.6) |
| 8. Accounting Principles Board | (Unit-V, SQA.3) |

PART – B (5 × 12 = 60 Marks)

Note: Answer all the questions in not exceeding four pages each.

- | | |
|--------------------------------------------------------------------------------------------------------------------------|----------------------|
| 9. (a) Explain in detail the various accounting concepts. | (Unit-I, Q.No.17) |
| (OR) | |
| (b) Explain the objectives of Accounting Standards. | (Unit-I, Q.No.24) |
| 10. (a) What are accounting policies? Explain briefly about changes in accounting policies. | (Unit-II, Q.No. 12) |
| (OR) | |
| (b) What are various disclosures to be made as per Ind AS-108? | (Unit-II, Q.No.32) |
| 11. (a) Explain the objective and scope of Ind AS-18. | (Unit-III, Q.No. 20) |
| (OR) | |
| (b) Explain briefly about Ind AS-23. | (Unit-III, Q.No.27) |
| 12. (a) What is measurement principle? Explain the exceptions to the recognition and measurement principle under AS-103. | (Unit-IV, Q.No. 6) |
| (OR) | |
| (b) Explain accounting treatment of joint venture. | (Unit-IV, Q.No.14) |
| 13. (a) Describe the recommendations made in true blood report. | (Unit-V, Q.No.4) |
| (OR) | |
| (b) Explain the various qualities of financial reporting information. | (Unit-V, Q.No.10) |

FACULTY OF COMMERCE
B.Com. III Year VI Semester (CBCS) Examination
Model Paper - III
ACCOUNTING STANDARDS

Time: 3 Hours

Max. Marks: 80

PART – A (5 × 4 = 20 Marks)

Note: Answer any five of the following questions not exceeding 20 lines each.

ANSWERS

1. Separate Entity Concept (Unit-I, SQA. 12)
2. Advantages of Accounting (Unit-I, SQA.6)
3. What are prior period errors? (Unit-II, SQA.8)
4. Golden Ltd acquired Fixed Assets viz. Plant and Machinery for ₹ 60 Lakhs. During the same year, it also sold Furniture and Fixtures for ₹ 15 Lakhs. Can the Company disclose, Net Cash Outflow towards Purchase of Fixed Assets in the Statement of Cash Flows? (Unit-II, Prob. 2)
5. What is a construction contract? (Unit-III, SQA.5)
6. Define lease. (Unit-III, SQA.7)
7. What is joint arrangement. (Unit-IV, SQA.8)
8. True blood report. (Unit-V, SQA.5)

PART – B (5 × 12 = 60 Marks)

Note: Answer all the questions in not exceeding four pages each.

9. (a) Explain in detail the various accounting conventions. (Unit-I, Q.No.18)

(OR)

 (b) What are Indian Accounting Standards? Explain the significance of IndAS. (Unit-I, Q.No.28)
10. (a) Explain briefly about related party disclosures. (Unit-II, Q.No.19)

(OR)

 (b) (i) Explain basis and reconciliation of operating segment. (Unit-II, Q.No. 33)
 (ii) Bharath Ltd. provides the following information.

(₹ in lakhs)

Segment	Revenue	Net Profit	Assets
A	2,000	800	5,000
B	200	50	400
Total	2,200	850	5,400

You are required to identify the reportable segments.

(Unit-II, Prob.6)

11. (a) Explain briefly about Ind As 20 ? **(Unit-III, Q.No. 24)**

(OR)

- (b) MGR Construction Company commenced a contract on 1-4-2016. The fixed price agreed for the contract was ` 50,00,000. The company incurred ` 18,50,000 in the year 2016-2017 for completing 45% work and have received ` 15,00,000 as progress payment from the customer. Calculate the amount of profit to be transferred by MGR Construction Company to their profit and Loss A/c as per the % of completion method for the year ended 2016-2017.

[Note: As per New Accounting Standards of India, AS-7 is converted or modified as AS-11]

(Unit-III, Prob.7)

12. (a) Explain the objective and scope of Ind AS-110. **(Unit-IV, Q.No. 9)**

(OR)

- (b) Explain the objective and scope of Ind AS-112. **(Unit-IV, Q.No. 15)**

13. (a) State the objectives of Financial Reporting? **(Unit-V, Q.No.7)**

(OR)

- (b) Write about Canadian Stamp Report. **(Unit-V, Q.No.6)**