CHAPTER 1: THEORETICAL FRAMEWORK

UNIT 1: Meaning and Scope of Accounting

INTRODUCTION

In all activities (whether business or non-business activities) and in all organizations (whether business organizations like a manufacturing entity or trading entity or non-business organizations like schools, colleges, hospitals, libraries, clubs, temples, political parties) which require money and other economic resources, accounting is required to account for these resources. In other words, wherever money/economic resource is involved, accounting is required to account for it. Accounting is often called the language of business. The basic function of any language is to serve as a means of communication. Accounting also serves this function.

MEANING OF ACCOUNTING

TRADITIONAL DEFINITION

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

[American Institute of Certified Public Accountants (AICPA) (1941)]

MODERN DEFINITION

"Accounting is the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by users of information."

[American Accounting Association (AAA) (1966)]

ACTIVITIES COVERED UNDER ACCOUNTING

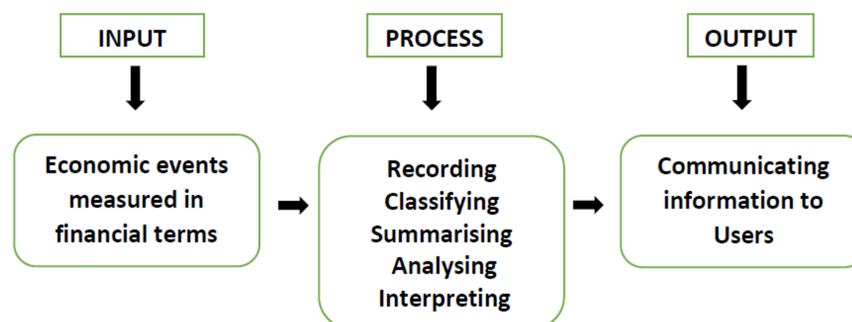
1. Identifying
2. Measuring
3. Recording
4. Classifying
5. Summarizing
6. Analysing
7. Interpreting
8. Communication

Let us discuss these activities one by one:

1. **Identifying the transactions and events** – Accounting identifies transactions and events of a specific entity. A transaction is an exchange in which each participant receives or sacrifices value (e.g. purchase of raw material). An event (whether internal or external) is a happening of consequence to an entity (e.g. use of raw material for production). An entity means an economic unit that performs economic activities (e.g. TATA Steels, Birla Industries Ltd, Reliance Industries Ltd., Infosys, Bharti Airtel).

2. **Measuring the Identified Transac**tions – Accounting measures the transactions in terms of a common measurement unit, (that is the ruling currency of a country)
3. **Recording** – It is concerned with the recording of identified and measured financial transactions in an orderly manner, soon after their occurrence in the proper books of account .
4. **Classifying** – It is concerned with the classification of the recorded transactions so as to group 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 brought to one place by posting. For example, all purchases of goods made for cash or on credit on different dates are brought to purchases account.
5. **Summarising** – It is concerned with the summarisation of the classified transactions in a manner useful to the users. This function involves the preparation of Financial Statements such as income statement, Balance Sheet, Cash Flow Statement.
6. **Analysing** – It is concerned with the establishment of relationship between the various items or group of items taken from Income Statement or Balance Sheet or both. Its purpose is to identify the financial strengths and weaknesses of the enterprise. It provides the basis for interpretation.
7. **Interpreting** – It is concerned with explaining the meaning and significance of the relationship so established by the analysis. Nowadays, the first six 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 the users, so as to enable the users to make reasoned decisions out of alternative courses of 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.
8. **Communicating** – It is concerned with the transmission of summarised, analysed and interpreted information to the users to enable them to make reasoned decisions.

Communication is preceded by an accounting cycle through which the identified and measured transactions and events pass. Accounting performs a basic function of a language, that is, to serve as a means of communication. It is an important system which communicates the accounting information to the users (whether internal or external) to enable them to make reasoned decisions. As an information system, accounting may be viewed as under:



Note: Economic Event refers to the occurrence of economic consequences of an activity related to an accounting entity.

MEANING OF ACCOUNTANCY

Accountancy refers to a systematic knowledge of accounting. It explains 'why to do' and 'how to do' of various aspects of accounting. It tells us why and how to prepare the Books of accounts and how to summarise the accounting information and communicate it to the interested parties.

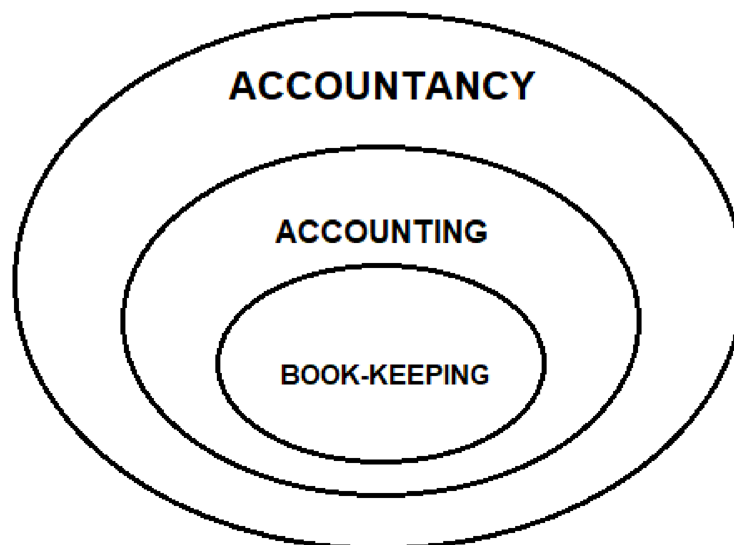
MEANING OF BOOK – KEEPING

Book – keeping is a part of accounting and is concerned with record keeping or maintenance of books of accounting which is often routine and clerical in nature. It only covers the following four activities:

1. Identifying the transactions and events
2. Measuring the Identified Transactions and events in a common measuring unit.
3. Recording the identified and measured transactions and events in Proper Books of Accounts.
4. Classifying the recorded transactions and events in the Ledger.

RELATIONSHIP BETWEEN ACCOUNTANCY, ACCOUNTING AND BOOK-KEEPING

Book – keeping is a part of Accounting. Accounting is a part of Accountancy. Diagrammatically, the relationship can be viewed as follows:



DISTINCTION BETWEEN BOOK-KEEPING AND ACCOUNTING

Basis of Distinction	Book – Keeping	Accounting
1. Scope	Book – keeping involves – **a)** Identifying the transactions, **b)** Measuring the identified transactions **c)** Recording the measured transactions and **d)** Classifying the recorded transactions	Accounting in addition to Book – keeping involves – summarising the classified transactions, analysing the summarised results, interpreting the analysed results and communicating the interpreted information to the interested plans.
2. Stage	Book – keeping is primary stage	Accounting is the secondary stage. It starts where book – keeping ends.
3. Basic objective	The basic objective of book – keeping is to maintain systematic records of financial transactions.	The basic objective of accounting is to ascertain Financial Performance and Financial position and to communicate information to the interested parties.
4. Who performs	Book – keeping work is performed by junior staff	Accounting work is performed by senior staff
5. Knowledge Level	The book – keeper is not required to have higher level of knowledge than that of an accountant	The accountant is required to have higher level of knowledge than that of book - keeper
6. Analytical Skill	The book keeper may or may not possess analytical skill	An accountant is required to possess analytical skill
7. Nature of job	The job of a book – keeper is often routine and clerical in nature	The job of an accountant is analytical in nature
8. Designing of Accounting System	It does not cover designing of accounts system.	It covers designing of accounting system
9. Supervision & Checking	The book – keeper does not supervise and check the work of an accountant	An accountant supervises and checks the work of a book – keeper.

MEANING OF ACCOUNTING CYCLE

After identifying and measuring the financial transactions, the accounting cycle begins. An accounting cycle is a complete sequence beginning with the recording of the transactions and ending with the preparation of the final accounts. The sequential steps involved in an accounting cycle are given below:

SEQUENTIAL STEPS INVOLVED IN AN ACCOUNTING CYCLE

STEP 1 **JOURNALISING**
Record the transactions in the Journal

STEP 2 **POSTING**
Transfer the transactions (recorded in the Journal), in the respective accounts opened in the Ledger

STEP 3 **BALANCING**
Ascertain the difference between the total of debit amount column and the total of credit amount column of a Ledger Account.

STEP 4 **TRIAL BALANCE**
Prepare a list showing the balances of each and every account to verify whether the sum of the debit balances is equal to the sum of the credit balances

STEP 5 **INCOME STATEMENT**
Prepare Trading and Profit & Loss Account to ascertain the Profit or loss for the accounting period.

STEP 6 **POSITION STATEMENT (i.e., balance sheet)**
Prepare the Balance sheet to ascertain the financial position As at the end of accounting period.

USERS OF ACCOUNTING INFORMATION AND THEIR NEEDS

The users of accounting information include present and potential investors, management, employees, lenders, suppliers, and other trade creditors, customers, government and their agencies and the public. These users use accounting information in order to satisfy some of their needs for information.
Some of the users and their needs for information are shown below:

USERS	NEED FOR INFORMATION
1. Short – term creditors [For example, Suppliers of Raw materials/Goods, Suppliers of Short – term Loans]	Short – term creditors need information to determine whether their dues will be paid when due and whether they should extend, maintain or restrict the flow of credit to an individual enterprise.
2. Long – term creditors [For Example, Suppliers of Long-term Loans]	Long – term creditors need information to determine whether their principals and the interest thereof will be paid when due and whether they should extend, maintain or restrict the flow of credit to an enterprise.
3. Present Investors [For Example, Shareholders]	Present investors need information to judge prospects for their investment and to determine whether they should buy, hold or sell the shares.
4. Potential Investors [For Example, those who want to invest]	Potential investors need information to judge prospects of an enterprise and to determine whether they should buy the shares

5. Management	Management need information to review the firm's (a) Short – term Solvency (b) Long – term Solvency (c) Activity (viz., Effective Utilisation of its Resources), (d) Profitability in relation to turnover (e) Profitability in relation to investments and to decide upon the course of action to be taken in future.
6. Employees	Employees and their representative groups are interested in information about the stability and profitability of the employees. They are also interested in information which enables them to assess the ability of the enterprise to pay remuneration, retirement benefits and to provide promotion opportunities
7. Tax Authorities	Tax authorities need information to assess the tax liabilities of enterprise
8. Customers	Customers have an interest in information about the continuation of an enterprise, especially when they have established a long term involvement with, or are dependent on, the enterprise.
9. Government and their Agencies	Government and their agencies are interested in the allocation of resources and, therefore, the activities of enterprise. They also require information in order to regulate the activities of enterprise, determine taxation policies and as the basis the national income and similar statistics.
10. 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 local suppliers. Financial Statements may assist the public by providing information about trends and recent developments in the prosperity of the enterprise and the range of its activities.

While all the information needs of these users cannot be met by financial statements, there are some needs which are common to all users. The information contents of the financial statements which met information needs of the investors or providers of risk capital will also meet most of the needs of other users.

PRIMARY OBJECTIVES OF ACCOUNTING

The main objectives of accounting are as follows:

1. **To maintain Systematic Accounting Records** – Written records are always better than oral records, since written records can be used by different persons for different decision-making purposes and serves as evidence of transactions. Nowadays, the volume of transactions is so large, a human memory cannot absorb each and every transaction. Accounting is done to keep a systematic record of (i) Financial Transactions, (ii) Assets and (iii) Liabilities.

2. **To ascertain the Financial Performance** – To measure the financial performance of an enterprise, the results of operations are ascertained by preparing an Income Statement (also called Profit & Loss Account) which shows the matching of current costs with current revenues during a particular accounting period. A systematic record of Income and Expenses facilitates the preparation of the Income Statement.
3. **To ascertain the Financial Position** – To evaluate the financial strengths and weakness of an enterprise, the financial position is ascertained by preparing the Position Statement (also called the Balance Sheet) which shows the resources (assets) owned by the enterprise and the sources of financing those resources. A businessman wants to know what the business owes to others and what it owns, and what happened to his capital whether the capital has increased, decreased or remained constant. A systematic record of various assets and liabilities facilitates the preparation of the Position Statement (also known as the Balance Sheet) which answers these questions.
4. **To communicate the information to the users** – Accounting communicates information to internal users and external users. The internal users include all the organizational participants at all levels of management (i.e., top, middle and lower). Top level management requires information for planning, middle level management requires information for controlling the operations. For internal use, the information is usually provided in the form of reports, for instance Cash Budget Reports, Production Reports, Idle Time Reports, Feedback Reports, Whether to Retain or Replace an Equipment Decision Reports, Project Appraisal Reports, and the like.
   Since the external users (e.g., Banks, Creditors) do not have direct access to all the records of an enterprise, they have to rely on financial statements as the source of information. External users are basically interested in the solvency and profitability of an enterprise.

OBJECTIVES OF ACCOUNTING

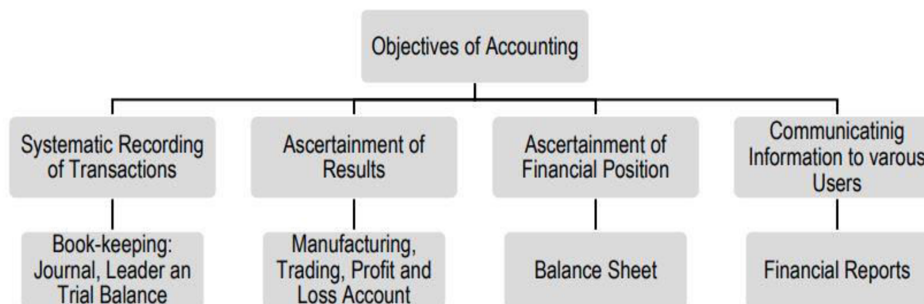
The objectives of accounting can be given as follows:

1. **Systematic recording of transactions** – Basic objective of accounting is to systematically record the financial aspects of business transactions i.e., book-keeping. These recorded transactions are later on classified and summarized logically for the preparation of financial statements and for their analysis and interpretation.
2. **Ascertainment of results of above recorded transactions** – Accountant prepares profit and loss account to know the results of business operations for a particular period of time. If revenue exceed expenses, then it is said that business is running profitably but if expenses exceed revenue then it can be said that business is running under loss. The profit and loss account helps the management and different stakeholders in taking rational decisions. For example, if business is not is not proved to be remunerative or profitable, the cause of such a state of affairs can be investigated by the management for taking remedial steps.
3. **Ascertainment of the financial position of the business** – Businessman is not only interested in knowing the results of the business in terms of profits or loss for a particular period but is also anxious to know that what he owes (liability) to the outsiders and what he owns (assets) on a certain date. To know this, accountant prepares a financial position statement known as Balance Sheet. The balance sheet is a statement of assets

and liabilities of the business at a particular point of time and helps in ascertaining the financial health of the business.

4. **Providing information to the users for rational decision-making** – Accounting as a 'language of business' communicates the financial results of an enterprise to various stakeholders by means of a financial statement. Accounting aims to meet the information needs of the decision-makers and helps them in rational decision-making.
5. **To know the solvency position** – By preparing the Balance Sheet, management not only reveals what is owned and owed by the enterprise, but also it gives the information regarding concern's ability to meet its liabilities in the short run (liquidity position) and also in the long run (solvency position) as and when they fall due.

An overview of objectives of Accounting is depicted in the chart given below:



ADVANTAGES OF ACCOUNTING

1. **Facilitates to Replace Memory** – Accounting facilitates to replace human memory by maintaining complete record of financial transactions. Human memory is limited by its very nature. Accounting helps to overcome this limitation.
2. **Facilitates to comply with Legal Requirements** – Accounting facilitates to comply with legal requirements which require an enterprise to maintain books of accounts. For example, Sec 209 of the Companies Act, 1956, requires a company to maintain proper books of accounts on accrual basis, Sec 44AA of the Income Tax Act, 1961 requires certain persons to maintain specified book of accounts.
3. **Facilitates to ascertain Financial Performance** – Accounting facilitates to ascertain financial performance by preparing the Income Statement.
4. **Facilitates to ascertain Financial Position** – Accounting facilitates to ascertain financial position by preparing Position Statement.
5. **Facilitates the user to take decisions** – Accounting facilitates the users (i.e., short-term creditors, long-term creditors, present investors, potential investors, employee groups, management, general public, tax authorities) to take decisions by communicating accounting information to them.
6. **Facilitates a Comparative Study** – Accounting facilitates a comparative study in the following four ways:
   (i) Comparison of actual figures with standard or budgeted figures for the same period and the same firm;
   (ii) Comparison of actual figures of one period with those of another period for the same firm (i.e., Intra-firm Comparison);

(iii) Comparison of actual figures of one firm with those of another standard firm belonging to the same industry (i.e., Inter-firm Comparison); and

(iv) Comparison of actual figures of one firm with those of industry to which the firm belongs (i.e., Pattern Comparison)

7. **Assists the Management** – Accounting assists the management in planning and controlling business activities and in taking decisions. For example, Projected Cash Flow Statement facilitates the management to know future receipts and payments and to take decisions regarding anticipated surplus and shortage of funds.
8. **Facilitates Control over Assets** – Accounting facilitates control over assets by providing information regarding Cash Balance, Bank Balance, Debtors, Fixed Assets, Stock etc.
9. **Facilitates the Settlement of Tax Liability** – Accounting facilitates the settlement of tax liability with the authorities by maintaining proper books of accounts in systematic manner.
10. **Facilitates the Ascertainment of Value of Business** – Accounting facilitate the ascertainment of value of business in case of transfer of business to another entity.
11. **Facilitates Raising Loans** – Accounting facilitates raising loans from lenders by providing them historical and projected financial statements.
12. **Acts as Legal Evidence** – Proper books of accounts maintained in systematic manner acts as legal evidence in case of disputes.

LIMITATIONS OF ACCOUNTING

1. **Ignores the Qualitative Elements** – Since the accounting is confined to the monetary matters only, the qualitative elements like quality of management, quality of labour force, public relations are ignored.
2. **Not Free from Bias** – In many situations, the accountant has to make a choice out of various alternatives available e.g., choice in the method of depreciation (e.g., Straight Line or Written down Value), choice in the method of inventory valuation (e.g., FIFO, LIFO etc.). since the subjectivity is inherent in personal judgement, the financial statements are therefore not free from bias. As a result, the analysis of financial statements also cannot be said to be free from bias.
3. **Ignores the Price Level Changes in case of Financial Statements prepared on Historical Costs** – In case of financial statements prepared on historical costs, the Fixed Assets are shown in the Balance Sheet at historical costs less depreciation and not at the replacement value which is often far higher than the value stated in the Balance Sheet. The analysis of such financial statements will not yield strictly comparable results unless the price-level changes are taken into account.
4. **Estimated Position and not Real Position** – Since the financial statements are prepared on a going concern basis as against liquidation basis, they report only the estimated periodic results and not the true results since the true results can be ascertained only on liquidation of an enterprise.
5. **Danger of Window Dressing** – When the management decides to enter wrong figures to artificially inflate or deflate the figure of Profits, Assets and Liabilities, the Income Statement fails to provide true and fair view of the Financial Performance and Balance Sheet fails to provide true and fair view of the Financial Position of the enterprise.

BRANCHES / SUB-FIELDS OF ACCOUNTING

Financial Accounting	Financial Accounting is the process of identifying, measuring and communicating accounting information to permit informed judgements and decisions by the users of accounting
Cost Accounting	It is the process of accounting and controlling the cost of a product, operation or function
Management Accounting	It is the application of accounting techniques for providing information for the purpose of planning, controlling and decision-making
Social Responsibility Accounting	It is the process of identifying, measuring and communicating the social effects of business decisions to permit informed judgements and decisions by the users of information
Human Resource Accounting	It is the process of identifying, measuring and communicating the investments made in human resources of an enterprise to permit informed judgements and decisions by the users of accounting

QUALITATIVE CHARACTERISTICS

The qualitative characteristics are attribute that improve the usefulness of information provided in financial statements. The framework suggests that the financial statements should observe and maintain the following qualitative characteristics as far as possible within limits of reasonable cost/benefit.

1. Understandability	The financial statements should present information in a manner as to be readily understandable by the users with reasonable knowledge of business and economic activities. It is not right to think that more discloses better. A mass of irrelevant information creates confusion and can be even more harmful that non-disclosure. No relevant information can be however withheld on the grounds of complexity
2. Relevance	The financial statements should contain relevant information only. Information, which is likely to influence the economic decisions by the users is said to be relevant. Such information may help the users to evaluate past, present or future events or may help in confirming or correcting past evaluations. The relevance of a piece of information should be judged by its materiality. A piece of information is said to material if its omission or misstatement can influence economic decisions of a user
3. Reliability	To be useful, the information must be reliable; that is to say, they must be free from material errors and bias. The information provided are not likely to be reliable unless: a) Transactions and events reported are faithfully represented. b) Transactions and events are reported in terms of their substance and economic reality not merely on the basis of

	their legal form. The principle is called the principle of 'substance over form'. c) The reporting of transactions and events are neutral, i.e., free from bias. d) Prudence is exercised in reposting uncertain outcome of transactions or events.
4. Comparability	Comparison of financial statements in one of the most frequently used and most effective tools of financial analysis. The financial statements should permit both inter-firm and intra-firm comparison. One essential requirement of comparability is disclosure of financial effect of change in accounting policies.
5. True and Fair View	Financial statements are required to show a true and fair view of the performance, financial position and cash flows of an enterprise. The conceptual framework does not deal directly with this concept of true and fair view, yet the application of the principal qualitative characteristics and of appropriate accounting standards normally results in financial statements portraying true and fair view of information about an enterprise.

RELATIONSHIP OF ACCOUNTING WITH OTHER DISCIPLINES

Accounting is closely related with several other disciplines and thus to acquire a good knowledge in accounting one should be conversant with the relevant portions of such disciplines. In many cases they overlap accounting. The accountant should have a working knowledge of the related disciplines so that he can understand such other overlapping areas and apply the knowledge of other disciplines in his work wherever possible, or he can take the expert advice.

a) **Accounting and Economics:** Economics is viewed as a science of rational decision-making about the use of scarce resources. This may be viewed either from the perspective of a single firm or of the country as a whole.
Accounting is viewed as a system, which provides data to the users to permit informed judgement and decisions. Some non-accounting data are also relevant for decision-making.
Accounting overlaps economics in many aspects. It contributed a lot in improving the management decision-making process. But, economic theories influenced the development of the decision-making tools used in accounting.
However, there exists a wide gulf between economists' and accountants' concepts of income and capital. Accountants got the ideas of value, income and capital maintenance from economists, but brushed suitably to make them usable in practical circumstances. Accountants developed the valuation, measurement and decision-making techniques which may owe to the economic theorems for origin but these are moulded in the work environment and suitably tempered with reference to relevance, verifiability, freedom from bias, timeliness, comparability, reliability and understand ability.
An example may be given to explain the nexus between accounting and economics. Economists think that value of an asset is the present value of all future earnings which can be derived from such assets. Now think about a plant whose working life is more

than one hundred years. How can you estimate future stream of earnings? So accountants developed the workable valuation base – the acquisition cost i.e., the price paid to acquire the assets.

At the macro-level, accounting provides the database over which the economic decision models have been developed; micro-level data arranged by the accounting system is summed up to get macro-level database.

Non-overlapping zones of accounting are not negligible. Development of the systems of recording, classifying and summarising transactions and events, harmonising the systems by uniform rules and communicating the data is essentially a non-overlapping area of accounting.

b) **Accounting and Statistics:** The use of statistics in accounting can be appreciated better in the context of the nature of accounting records. Accounting information is very precise; it is exact to the last paisa. But, for decision-making purposes such precision is not necessary and hence, the statistical approximations are sought.

In accounts, all values are important individually because they relate to business transactions. As against this, statistics is concerned with the typical value, behaviour or trend over a period of time or the degree of variation over a series of observations. Therefore, wherever a need arises for only broad generalisations or the average of relationships, statistical methods have to be applied in accounting data.

Further, in accountancy, the classification of assets and liabilities as well as the heads of income and expenditure has been done as per the needs of financial recording to ascertain financial results of various operations. Other types of classification like the geographical and historical ones and ad hoc classification are done depending on the purpose to make such classification meaningful.

Accounting records generally take a short-term view of events and are confined to a year while statistical analysis is more useful if a longer view is taken for the purpose. For example, to fit the trend line a longer period will be required. However, statistical methods do use past accounting records maintained on a consistent basis.

The functional relations showing mathematical relations of one variable with one or more other variables are based on statistical work. These relations are used widely in making cost or price estimates for some estimated future values assigned to the given independent variables. For example, given the functional relation of total cost to the price of an input, the effect of changes in future prices on the cost of production can be calculated.

In accountancy, a number of financial and other ratios are based on statistical methods, which help in averaging them over a period of time. Several accounting and financial calculations are based on statistical formulae.

Statistical methods are helpful in developing accounting data and in their interpretation. For example, time series and cross-sectional comparison of accounting data is based on statistical techniques. Now-a-days multiple discriminate analysis is popularly used to identify symptoms of sickness of a business firm. Therefore, the study and application of statistical methods would add extra edge to the accounting data.

c) **Accounting and Mathematics:** Double Entry book-keeping can be converted in algebraic form; in fact, the first known book on this subject was part of a treatise on algebra. The fundamental accounting equation will be discussed in detail under 'Dual Aspect Concept' of this chapter.

Knowledge of arithmetic and algebra is a pre-requisite for accounting computations and measurements. Calculations of interest and annuity are the examples of such fundamental uses. While computing depreciation, finding out installments in hire-purchase and instalments payment transactions, calculating amount to be set aside for repayment of loan and replacement of assets and calculating lease rentals, mathematical techniques are frequently used. Accounting data are also presented in ratio form.

With the advent of the computer, mathematics is becoming a vital part of accounting. Instead of writing accounts in traditional fashion, the transactions and events can be recorded in the matrix form and the rules of matrix algebra can be applied for classifying and summarising data.

Now-a-days statistics and econometric models are largely used for developing decision models for the users of accounts. Also, Operations Research Techniques provide lot of decision models. Since accounting is meant for providing information to the users, to be effective, accounting data should feed the information requirements of such statistical, econometric and operations research models. Understanding mathematics has become a must to grasp the decision models framed by statisticians, econometricians and the O.R. experts.

Presently graphs and charts are being extensively used for communicating accounting information. In addition to statistical knowledge, knowledge in geometry and trigonometry seems to be essential to have a better understanding about the accounting communications system.

d) **Accounting and Law:** An economic entity operates within a legal environment. All transactions with suppliers and customers are governed by the Contract Act, the Sale of Goods Act, the Negotiable Instruments Act, etc. The entity itself is created and controlled by laws. For example, a company is created by the Companies Act and also controlled by Companies Act.

Similarly, every country has a set of economic, fiscal and labour laws. Transactions and events are always guided by laws of the land. Very often the accounting system to be followed has been prescribed by the law. For example, the Companies Act has prescribed the format of financial statements for companies.

Banking, insurance and electric supply undertakings may also have to produce financial statements as prescribed by the respective legislations controlling such entities.

However, legal prescription about the accounting system is the product of developments in accounting knowledge. That is to say, legislation about accounting system cannot be enacted unless there is a corresponding development in the accounting discipline. In that way accounting influences law and is also influenced by law.

e) **Accounting and Management:** Management is a broad occupational field, which comprises many functions and encompasses application of many disciplines including those mentioned above. Accountants are well placed in the management and play a key role in the management team. A large portion of accounting information is prepared for management decision-making. Although management relies on other data sources, accounting data are used as basic source documents. In the management team, an accountant is in a better position to understand and use such data. In other words, since an accountant plays an active role in management, he understands the data requirements. So the accounting system can be moulded to serve the management purpose.

ROLE OF ACCOUNTANT IN THE SOCIETY

There are only a few types of profession in the world which are held in high esteem in public eyes and there is no denying the fact that the accounting profession is one of them. Goethe had called the accountant's profession as 'the fairest invention of the human mind'. At the core of all types of learned profession, there is the desire of public good and of finding the best way to serve society. By the use of the science of accountancy and under the spell of its art, a dynamic pattern which assists business in planning its future is woven by accountants out of the inert mass of non-speaking silent figures. This is what makes their profession an instrument of socio-economic change and welfare of the society.

An accountant with his education, training, analytical mind and experience is best qualified to provide multiple need-based services to the ever growing society. The accountants of today can do full justice not only to matters relating to taxation, costing, management accounting, financial lay-out, company legislation and procedures but they can delve deep into the fields relating to financial policies, budgetary policies and even economic principles. The area of activities which can be undertaken by the accountants is not limited but it can also cover many additional facets.

Areas of Service

The practice of accountancy has crossed its usual domain of preparation of financial statements, interpretation of such statements and audit thereof. Accountants are presently taking active role in company laws and other corporate legislation matters, in taxation laws matters (both direct and indirect) and in general management problems. Some of the services rendered by accountants to the society are briefly mentioned hereunder:

i. **Maintenance of Books of Accounts:** An accountant is able to maintain a systematic record of financial transactions in order to establish the net result of the transactions entered into during a period and to state the financial position of the concern as at a particular date.
For the fulfillment of the twin objective of ascertaining the profit earned or loss suffered and the financial position, it is necessary that all transactions be recorded in a systematic manner, which can be done only by an accountant. Proper maintenance of books of accounts assists management in planning, decision- making, controlling functions.

ii. **Statutory Audit:** Every limited company is required to appoint a chartered accountant or a firm of chartered accountants as their auditor who are statutorily required to report each year whether in their opinion the balance sheet shows a true and fair view of the state of affairs on the balance sheet date, and the profit and loss account shows a true and fair view of the profit or loss for the year.
Auditing is not confined to the accounts of companies; other organizations may also have their accounts audited, either because the law so requires (for example, the Co-operative Societies Act, the Income-tax Act, etc.) or because the proprietors wisely decided so (for example, a partnership firm or an individual trader).

iii. **Internal Audit:** It is a management tool whereby an internal auditor thoroughly examines the accounting transactions and also the system, according to which these have been recorded with a view to ensure the management that the accounts are being properly maintained and the system contains adequate safeguards to check any leakage of revenue or misappropriation of property or assets and the operations have been carried out in conformity with the plans of management.
Now-a-days internal auditing has developed as a service to management. The internal auditor constructively contributes in improving the operational efficiency of the business through an independent review and appraisal of all business operations.

iv. **Taxation:** An accountant can handle taxation matters of a business or a person and he can represent that business or person before the tax authorities and settle the tax liability under the statute prevailing. He can also assist in avoiding or reducing tax burden by proper planning of tax affairs.
Accountants also have a social obligation to express their views on broad tax policy, on the effect of tax rate on business and the economy in general and on all other aspects of taxation in which they have knowledge superior to that of the general public.

v. **Management Accounting and Consultancy Services:** Management accountant performs an advisory function. He is largely responsible for internal reporting to the management for planning and controlling current operations, decision-making on special matters and for formulating long-range plans. His job is to collect, analyse, interpret and present all accounting information which is useful to the management. Accountant provides management consultancy services in the areas of management information system, expenditure control and evaluation of appraisal techniques for new investments and divestments, working capital management, corporate planning etc.

vi. **Financial Advice:** Many people need help and guidance in planning their personal financial affairs. An accountant who knows about finances, taxation and family problems is well placed to give such advice. Some of the areas in which an accountant can render financial advice are:
   a. **Investments:** An accountant can explain the significance of the formidable documents which shareholders receive from companies and help in making decisions relating to their investments.
   b. **Insurance:** An accountant can provide information to his clients on various insurance policies and helps in choosing appropriate policy.
   c. **Business Expansion:** As businesses grow in size and complexity and mergers are being considered, accountants are in the forefront in interpreting accounts, making suggestions as to the form of schemes and the fairness of proposals considering cost and financial consequences and generally advising their clients. They also advise on how to set about the problem of borrowing money or whether this is an appropriate method of finance. Accountants can render extremely useful service in connection of negotiations with foreign collaborators.
   d. **Investigations:** Financial investigations are required for a variety of purposes. Examples are:
      i. To ascertain the financial position of a business, for the information of interested parties in connection with an issue of capital, the purchase or sale of the business or a reconstruction or amalgamation.

ii. To help the management to decide whether it is cheaper to manufacture an article or to buy out.
iii. To ascertain why profits have fallen.
iv. To achieve greater efficiency in management.
v. To ascertain whether fraud has occurred and if so, its nature and extent and to make suggestions which will help to prevent a recurrence.
vi. To value businesses and shares in private companies for purposes such as purchase, sale, estate duty or wealth tax etc.

For such problems requiring financial investigation, you need an accountant. His task as an independent professional is to establish the facts fairly and clearly for the benefit of those who have to make decisions and to give advice in many areas in which he has competence and experience.

e. **Pension schemes:** Specialist advice from actuaries, insurance agents or insurance company is needed before launching or amending a provident fund or pension scheme in a business. But before making a final decision, an accountant has to be consulted. Later on, his help may be needed for managing the scheme or obtaining tax relief.

vii. Other Services

a. Secretarial Work: Companies, clubs, and associations indeed, virtually all organizations involve secretarial work. Accountants frequently do this work.

b. Share Registration Work: Accountants are often used by many companies to undertake the work involved in registering share transfers and new issues.

c. Company Formation: In conjunction with legal advisers, accountants help in the formation of a company or advise against doing so.

d. Receiverships, Liquidations, etc.: An accountant has to sometimes take on the onerous duties of liquidator when a company is being wound up or receiver when a debenture holder exercises a right to recover a loan on which the borrower has defaulted. Accountant is just the man for the job. He is also just the man to help you to keep insolvency away if you consult him in time.

e. Arbitrations: At times, accountants are invited by parties to act as arbitrators in a dispute or settle disputes of various kinds.

f. As regards the Cost Accounts: A cost accountant’s job is to continuously report cost data and related information at frequent intervals to the management.

g. Accountant and Information Services: An accountant will be effective in his role if he supplies the information promptly and in an unambiguous language. He should develop a system by which there is a regular flow of information both horizontally and vertically.

The information system should be such that comparability of financial statement is possible both business-wise and year-wise so that it benefits both the management and the investors. Dependence on data from the computerised information system will put new responsibilities on an accountant but his product will command greater attention and respect.

Chartered Accountant in Industry

An accountant, though he is a part of the highest planning team is not a planner in an industry. He works with the functional departments and translates the organization's aims in terms of financial expectations. Therefore, he has to make a thorough study of the business and of individuals in the functional departments, whether they are engineers or salesmen. A qualified accountant will be able to play an important role in performing important functions of a business relating to accounting, costing and budgetary control, estimating and treasury.

Chartered Accountant in Public Sector Enterprises

Both in the developed and developing countries, public sector enterprises have become a special feature of the national economy. The system of financial and budgetary control and of accounting, auditing and reporting has, therefore, become a matter of interest and concern to the nation, and does not remain confined merely to a limited number of shareholders. The form of accounting followed by these corporations or companies is different from that of ordinary government accounting. It is the duty of the accountants to prepare the accounts and reports of these public corporations in such a way that they enable the general public to know how far the items appearing in the various types of records and financial statements justify their existence.

Chartered Accountant in Framing Fiscal Policies

Accountants have a positive role to play in the determination of proper fiscal policies and advancement of trade, commerce and industry. They should develop new techniques and prepare themselves for new fields of service towards their commitment to the concept of the public goods and services. A business enterprise can be successful in the commercial sense only if accounting and business knowledge are pooled together. It is a social obligation for both accountants in industry and in practice to disclose greater information regarding the corporate results. The state of affairs of the economy can be ascertained only when such consolidated corporate information is disclosed.

Chartered Accountant and Economic Growth

In the present times accountants should conceive their duties as broadly as the conditions might require and do not restrict them to only literal compliance of the law. Their aim should be not to allow any individual to gain at the cost of the nation. Accountants have to accept a positive role and do their best to encourage efficiency in individual business units and encourage those social objectives which form the main foundation of a welfare state.

UNIT 2: Accounting Concepts, Principles and Conventions

INTRODUCTION

Let us imagine a situation where you are a proprietor and you take copies of your books of account to five different accountants. You ask them to prepare the financial statements on the basis of the above records and to calculate the profits of the business for the year. After few days, they are ready with the financial statements and all the five accountants have calculated five different amounts of profits and that too with very wide variations among them. Guess in such a situation what impact would it leave on you about accounting profession. To avoid this, a generally accepted set of rules have been developed. This generally accepted set of rules provides unity of understanding and unity of approach in the practice of accounting and also in better preparation and presentation of the financial statements.
Accounting is a language of the business. Financial statements prepared by the accountant communicate financial information to the various stakeholders for decision-making purpose. Therefore, it is important that financial statements prepared by different organizations should be prepared on uniform basis. Also, there should be consistency over a period of time in the preparation of these financial statements. If every accountant starts following his own norms and notions for accounting of different items then there will be an utter confusion.
To avoid confusion and to achieve uniformity, accounting process is applied within the conceptual framework of 'Generally Accepted Accounting Principles'(GAAPs). The term GAAPs is used to describe rules developed for the preparation of the financial statements and are called concepts, conventions, postulates, principles etc. These GAAPs are the backbone of the accounting information system, without which the whole system cannot even stand erectly. These principles are the ground rules, which define the parameters and constraints within which accounting reports are generated. Accounting principles are basic norms and assumptions on which the whole accounting system has been developed and established. Accountant also adheres to various accounting standards issued by the regulatory authority for the standardization of accounting policies to be followed under specific circumstances. These conceptual frameworks, GAAPs and accounting standards are considered as the theory base of accounting.

ACCOUNTING CONCEPTS

Accounting concepts define the assumptions on the basis of which financial statements of a business entity are prepared. Certain concepts are perceived, assumed and accepted in accounting to provide a unifying structure and internal logic to accounting process. The word concept means idea or notion, which has universal application. Financial transactions are interpreted in the light of the concepts, which govern accounting methods. Concepts are those basic assumptions and conditions, which form the basis upon which the accountancy has been laid. Unlike physical science, accounting concepts are only result of broad consensus. These accounting concepts lay the foundation on the basis of which the accounting principles are formulated.

ACCOUNTING PRINCIPLES

"Accounting principles are a body of doctrines commonly associated 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."
Accounting principles must satisfy the following conditions:

1. They should be based on real assumptions;
2. They must be simple, understandable and explanatory;
3. They must be followed consistently;
4. They should be able to reflect future predictions;
5. They should be informational for the users.

ACCOUNTING CONVENTIONS

Accounting conventions emerge out of accounting practices, commonly known as accounting principles, adopted by various organizations over a period of time. These conventions are derived by usage and practice. The accountancy bodies of the world may change any of the convention to improve the quality of accounting information. Accounting conventions need not have universal application.
In the study material, the terms 'accounting concepts', 'accounting principles' and 'accounting conventions' have been used interchangeably to mean those basic points of agreement on which financial accounting theory and practice are founded.

ACCOUNTING PRINCIPLES

As per the Accounting Standard (AS-1) 'Disclosure of Accounting Policies' issued by the Institute of Chartered Accountants of India (ICAI), there are three Fundamental Accounting Assumptions:

- i. Going Concern
- ii. Consistency
- iii. Accrual

1. If the Fundamental Accounting Assumptions are followed in financial statements, specific disclosures are not required.
2. If any fundamental accounting assumption is not followed, the fact should be disclosed.

GOING CONCERN ASSUMPTION

MEANING OF GOING CONCERN ASSUMPTION

1. The enterprise is normally viewed as a going concern, i.e., as continuing operations for the foreseeable future.
2. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or curtailing materially its scale of operations.

3. If an enterprise is not going concern, valuation of its assets and liabilities on historical cost becomes irrelevant and as a consequence its profit/loss may not give reliable information.

IMPLICATIONS OF GOING CONCERN ASSUMPTION

1. It is because of the Going Concern Assumption:
2. That the assets are classified as current and Fixed Assets
3. That the liabilities are classified as Short-term and Long-term Liabilities
4. That the unused resources are shown as unutilised costs (or unexpired costs) as against the break-up values as in case of liquidating enterprise. Accordingly, the earning power and not the break-up values evaluates the continuing enterprise.

DISCLOSURE OF GOING CONCERN ASSUMPTION

According to Accounting Standard (1) issued by the Institute of Chartered Accountants of India, if this fundamental assumption is followed, this fact need not be disclosed in the financial statements since its acceptance and use are assumed. In case this concept is not followed, the fact should be disclosed in the financial statement together with reasons.

CONSISTENCY ASSUMPTION

MEANING OF CONSISTENCY ASSUMPTION

1. It is assumed that accounting policies are consistent from one period to another.
2. This adds the virtue of comparability of accounting data.
3. If comparability is lost, the relevance of accounting data for users' judgement and decision making is gone.
4. According to Consistency Assumption, whatever accounting practices (whether logical or not) are selected for a given category of transactions, they should be followed on a horizontal basis from one accounting period to another to achieve comparability.

NEED FOR CONSISTENCY ASSUMPTION

The consistency principle is applied when alternative methods of accounting are equally acceptable.

EXAMPLES OF CONSISTENCY ASSUMPTION

1. If the inventory is valued on LIFO basis, the basis should be followed year after year.
2. If a particular asset is depreciated according to WDV method, this method should be followed year after year.

EFFECT OF NOT OBSERVING CONSISTENCY

If Consistency Assumption is not followed, the intra-firm comparison (i.e., comparison of actual figures of one period with those of another period for the same firm), inter-firm comparison (i.e., comparison of actual figures of one firm with those of another firm belonging to the same industry) and Pattern comparison (i.e., comparison of actual figures of one firm with those of industry to which the firm belongs) cannot be made.

CONSISTENCY DIFFERS WITH UNIFORMITY

The consistency should not be confused with mere uniformity or inflexibility and should not be allowed to become an impediment to the introduction of improved accounting standards. It is not appropriate for an enterprise to leave the accounting policies unchanged when more relevant and reliable alternatives exist.

ACCRUAL ASSUMPTION

MEANING OF ACCRUAL ASSUMPTION

1. Revenues and cost accrued, that is recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate.
2. This assumption is the core of accrual accounting system.
3. For the companies it is mandatory to keep accounts on accrual basis under Companies Act, 2013.

MEANING OF REVENUE

Revenue is the gross inflow of cash, receivables or other considerations arising in the course of ordinary activities of an enterprise from the sale of goods, rendering of services and use of enterprise resources by other yielding interests, royalties and dividends. It excludes the amount collected on behalf of third parties such as certain taxes. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other considerations.

ACCOUNTING PRINCIPLES

1. Basic Principles of Accounting are essentially, the general decision rules which govern the development of accounting techniques. These principles guide how transactions should be recorded and reported.
2. Generally Accepted Accounting Principles may be defined as those rules of action or conduct which are derived from experience and practice and when they prove useful, they become accepted a principles of accounting.
3. According to the American Institute of Certified Public Accountants (AICPA), the principles which have substantial authoritative support become the part of Generally Accepted Accounting Principles (GAAP).

ACCOUNTING ENTITY (OR BUSINESS ENTITY PRINCIPLE)

MEANING OF ACCOUNTING ENTITY PRINCIPLE

According to Accounting entity Principle, a business as a separate entity that I distinct from its owner(s), and all other accounting entities and hence a distinction should be made between (i) personal transactions and business transactions, and (ii) transactions of one business entity and those of another business entity. For example, in case of a proprietary concern, though the legal entity of the business and its proprietor is the same, for the purpose of accounting, they are to be treated as separate from each other.

EFFECT OF ACCOUNTING ENTITY PRINCIPLE

If this principle is not followed, true financial position and true financial performance of a business entity cannot be ascertained. For example, if the household expenses (₹ 10,000) of a proprietor are shown as business expenses, the profits of a business will be understated to the extent of ₹ 10,000.

MONEY MEASUREMENT PRINCIPLE

MEANING OF MONEY MEASUREMENT PRINCIPLE

According to Money Measurement Principle, only those transactions which are capable of being expressed in terms of money are included in the accounting records.

WHAT IS NOT RECORDED?

The information which cannot be expressed in terms of money is not included in accounting records.
For example, if the Sales Director is not on speaking terms with the Production Director, the enterprise is bound to suffer. Since, monetary measurement of this information is not possible, this fact is not recorded in accounting records.

ADVANTAGES OF MONEY MEASUREMENT PRINCIPLE0

By expressing all transactions in terms of money, the different transactions expressed in different units are brought to a common unit of measurement (i.e., Money)

LIMITATIONS OF MENEY MEASUREMENT PRINCIPLE

Besides ignoring the non-monetary facts and attributes, this assumption also ignores the changes in the purchasing power of the monetary unit. In other words, this assumption treats all rupees alike, whether it is a rupee of 1950 or 2013. Hence, nowadays, it is considered to provide additional data showing the effect of price level changes on the reported Incomes, Assets and Liabilities of the business.

ACCOUNTING PERIOD PRINCIPLE (PERIODICITY PRINCIPLE)

MEANING OF ACCOUNTING PERIOD PRINCIPLE

It is also known as the Periodicity Principle or Time Period Principle. According to this principle, the economic life of an enterprise is artificially split into periodic intervals which are known as accounting periods, at the end of which an Income Statement and Position Statement are prepared to ascertain the Financial Performance and Position respectively.

IMPLICATION OF ACCOUNTING PERIOD PRINCIPLE

The use of this assumption further requires the allocation between capital and revenue. That portion of capital expenditure which is considered during the current period is charged as an expense to the Income Statement and the unconsumed portion is shown in the Balance Sheet as an asset for future consumption.

ESTIMATE AND NOT ACTUAL INCOME

Truly speaking, measuring the income following the concept of accounting period is more an estimate that factual since, actual income can be determined only on the liquidation of the enterprise.

REPORTING PERIOD

It may be noted that the custom of using twelve month period is applied only for external reporting. For internal reporting, accounts can be prepared even for shorter periods, say monthly, quarterly or half-yearly.

FULL DISCLOSURE PRINCIPLE

MEANING OF FULL DISCLOSURE PRINCIPLE

1. According to Full Disclosure Principle, the Financial Statements should act as a means of conveying and not concealing.
2. The financial statements must disclose all the relevant and reliable information which they purport to represent, so that the information may be useful for the users.
3. For this, it is necessary that the information is accounted for and presented in accordance with its substance and economic reality and not merely with its legal form.

EXAMPLES OF FULL DISCLOSURE PRINCIPLE

The practice of appending Notes to the financial statements has developed as a result of the Full Disclosure Principle.

QUALITY OF FULL DISCLOSURE PRINCIPLE

The disclosure should be full, fair and adequate so that the users of the financial statements can make correct assessment about the financial performance and position of the enterprise.

MATERIALITY PRINCIPLE

MEANING OF MATERIALITY PRINCIPLE

1. According to the Materiality Principle, all relatively relevant items, the knowledge of which might influence the decision of the users of the financial statements, should be disclosed in the financial statement.
2. Which information is more relevant than others is largely a matter of judgement. For instance, accounting and recording of a small calculator as an asset in the Balance Sheet may not be justified due to the excess of cost of recording over the benefits in terms of usefulness of recording and the accounting of calculators as assets.

WHAT IS MATERIALITY?

1. The materiality depends not only upon the amount of item but also upon the size of the business, level and nature of information, level of the person/department who makes the judgement about materiality, for instance a worker reporting to his foreman about the production in grams (e.g., part of kilogram), a foreman to his supervisor in kilograms, a

Abhimanyyu Agarrwal
Contact No: 9874311319 | Website: www.abhimanyyuagarrwal.com

supervisor to his production manager in quintals and the production manager to the top management that the production is 1,99,000.90 kilograms or simply 200 tonnes (nearly).

2. It is desirable to established and follow uniform policies governing material or non-material items so that while measuring incomes for an accounting period, the non-material items can be ignored on uniform basis.

EXCEPTION TO THE FULL DISCLOSURE PRINCIPLE

1. This principle is basically an exception to the Full Disclosure Principle.
2. The full disclosure principle requires that all facts necessary to ensure that the financial statements are not misleading, must be disclosed, whereas the materiality principle requires that the items or events having an insignificant economic effect or not being relevant to the user's need not be disclosed.

PRUDENCE PRINCIPLE (OR CONSERVATISM PRINCIPLE)

MEANING OF PRUDENCE PRINCIPLE

1. According to Prudence Principle, the principle of 'Anticipate no profit but provide for all probable losses' should be applied.
2. In other words, the Prudence Principle requires that in the situation of uncertainty and doubt, the business transactions should be recorded in such a manner that the Profits and Assets are not overstated and Losses and Liabilities are not understated.

Note: *Prudence Principle should be applied rationally only in circumstances in which great uncertainty and doubt exist as the over-conservatism may result in misrepresentation.*

EXAMPLES OF APPLICATION OF PRUDENCE PRINCIPLE

1. Valuation of Stock-in-trade at a lower of Cost or Net Realisable Value.
2. Making the Provisions of Doubtful Debts and Discount on Debtors.

CONFLICTS WITH CONSISTENCY

When the stock is valued at cost in one accounting period and at a lower of cost or NRV in another accounting period, this Principle conflicts with the Principle of Consistency.

CONFLICTS WITH FULL DISCLORURE

When excessive Provisions for doubtful debts and Depreciation are charged, it leads to the creation of Secret Reserves, and thus, this Principle conflicts with the Full Disclosure Principle.

CONFLICTS WITH OJBJECTIVITY

1. The estimation of probable losses is a subjective judgement and thus, this principle conflicts with the Principle of Objectivity.
2. The practice of making provisions for doubtful depts. And the like implies lesser charges in the following accounting periods.
3. It reduces the current income and raises the future income and thus it conflicts with the matching principle.

HISTORICAL COST PRINCIPLE

MEANING OF HISTORICAL COST PRINCIPLE

According to Historical Cost Principle, an asset is ordinarily recorded in the accounting records at the price to acquire it at the time of its acquisition and the cost becomes the basis for the accounts during the period of acquisition and subsequent accounting periods.
Accordingly, if nothing is paid to acquire an asset; the same will not be usually recorded as an asset, e.g., a favourable location and increasing reputation of the concern will remain unrecorded though these are valuable assets.

ADVANTAGES OF HISTORICAL COST PRINCIPLE

1. The justification for the use of the cost concept lies in the fact that it is objectively verifiable.
2. This does not mean that the asset will always be shown at cost.
3. The cost of an asset is systematically reduced from year to year by charging depreciation and the asset is shown in the Balance Sheet at book value (i.e., Cost less Depreciation).
4. It may be noted that the purpose of depreciation is to allocate the cost of an asset over its useful life and not to adjust its cost so as to bring it close to market value.

MATCHING PRINCIPLE

MEANING OF MATCHING PRINCIPLE

1. According to Matching Principle, the expenses incurred in an accounting period should be matched with the revenues recognized in that period. It means that, if revenue is recognized on all goods sold during a period, cost of those goods sold should also be charged to that period. It is wrong to recognize revenue on all sales, but charge expenses only o such sales as are collected in cash till that period.
2. This concept is basically an accrual concept since, it disregards the timing and the amount of actual cash inflows or cash outflows and concentrates on the occurrence (i.e., accrual) of revenue and expenses. This concept calls for adjustments to be made in respect of Prepaid Expenses, Outstanding Expenses, Accrued Revenue and Un-accrued Revenues.
3. Matching does not mean that expenses must be identifiable with revenues. Expenses charged to a period may or may not be related to the revenue recognized in that period, for example, cost of goods sold and commission to the salesmen are directly related to sales whereas rent, interest, depreciation accruing with the passage of time and stock lost by fire are not directly related with sales revenue, yet they are charged to the accounting period to which they relate. Thus, appropriate costs have to be matched against appropriate revenues for the accounting period.

DUALITY PRINCIPLE

MEANING OF DUALITY PRINCIPLE

To fold aspect of a transaction is called dual aspect of duality of a transaction. This duality is the basis of double entry records.

As the name implies, the entry made for each transaction is composed of two parts – one for the debit and another for the credit.

The double entry system may be compared with the Newton's law of motion, viz, to every action there is always an equal and contrary reaction. Every debit has equal amount of credit. So the total of all debits must be equal to the total of all credits.

EXAMPLES OF DUALITY PRINCIPLE

Mr. X sold goods for cash ₹ 1,000 to Mr. Y in this case the dual aspect of the transaction for Mr. X and Mr. Y are as follows:

Dual Aspects for Mr. X	Dual Aspects for Mr. Y
1. Receipt of cash ₹ 1,000 2. Forgoing of goods of ₹ 1,000	1. Payment of cash ₹ 1,000 2. Receipt of goods of ₹ 1,000

Mr. X sold goods for ₹ 1,000 to Mr. Y on credit. In this case the dual aspects of this transaction for Mr. X and Mr. Y are as follows:

Dual Aspects for Mr. X	Dual Aspects for Mr. Y
1. Acquisition of rights to recover ₹ 1,000 2. Forging goods of ₹ 1,000	1. Assumption of obligation to pay ₹ 1,000 2. Receipt of goods of ₹ 1,000

DOUBLE ENTRY SYSTEM OF BOOK-KEEPING

MEANING OF DOUBLE ENTRY SYSTEM OF BOOK-KEEPING

1. Double Entry System of book-keeping refers to a system of accounting under which both the aspects (i.e., Debit or Credit) of every transaction are recorded in the accounts involved.
2. **Dual Aspect** – Two-fold aspect of a transaction is called dual aspect or duality of a transaction. This duality is the basis of double entry records.
3. **As the name implies, the entry made for each transaction is composed of two parts** – one for debit and another for credit. The double entry system may be compared with the Newton's law of motion, viz to every action there is always an equal and contrary reaction.
4. Every debit has equal amount of credit. So the total of all debits must be equal to the total of all credits.
5. **The terms debit and credit used today have their origin from the terms** – Debito and Credito as used by Luca fra Pacioli in his book.
6. **Account** – The individual record of a person or thing or an item of income or an expense is called an account.

ADVANTAGES OF DOUBLE ENTRY SYSTEM

1. It facilitates the accuracy of ledger accounts through the device of Trial Balance.
2. It facilitates the ascertainment of Financial Performance.
3. It facilitates the ascertainment of Financial Position.
4. It facilitates the comparability of Financial Statements.

UNIT 3: Accounting Terminology Glossary

ENTITY

An entity means an economic unit that performs economic activities (For Example, TATA Steel, Birla Industries, Reliance Industries, Infosys, Bharti Airtel).

EVENT

An event is a happening of consequences to an entity (For Example, Use of Raw Materials for Production)

BUSINESS TRANSACTION

A Business transaction is an exchange in which each participant receives or sacrifices value (For Example, Purchase of Raw Material for cash or on credit). It involves exchange of goods or services on cash or credit basis. It is an economic event that relates to a business entity involving transfer of money or money's worth.

ACCOUNT

An account is a summary of relevant transactions at one place relating to a particular head. It records not only the amount of transactions but also their effect and direction.

ASSETS

Assets refer to tangible or intangible rights of an enterprise which carry probable future benefits, in other words, an asset is a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise. These assets may broadly be classified as follows:

1. **Current Assets** – Current assets are those assets which are held –
    a. In the form of cash,
    b. For their conversion into cash, normally within 12 months from the date of Balance Sheet and
    c. For their consumption in the production of goods or rendering of services in the normal course of business.

    For Example, Cash in Hand, Cash at Bank, Stock of Finished Goods, Debtors, Bills Receivables, Stock of Raw Materials, Stock of Work – in – Progress.

    Liquid Assets (or Quick Assets) – Liquid Assets represent the Current Assets other than Stock and Prepaid Expenses.

    Liquid Assets = Current Assets – Stock & Prepaid Expenses
2. **Non-Current Assets** – Non-Current assets refer to those assets which are held for the purposes of producing or providing goods or services and those that are not held for resale in the normal course of business. For Example, 1. Fixed Assets, 2. Non-Current Investments, 3. Long-Term Loans and Advances, 4. Other Non-Current Assets

Tangible Fixed Assets – Refer to those fixed assets which have physical existence. For Example, Land and Building, Plant and Machinery and Furniture and Fixtures.
Intangible Fixed Assets – Refer to those fixed assets which do not have physical existence. For example, Goodwill, Patent, Trademarks, Copyrights and the like.

3. **Fictitious Assets** – Fictitious Assets either represent Accumulated Losses or Deferred Revenue Expenses not yet written off till the date of Balance Sheet.

HOW TO DETERMINE WHETHER AN ASSET IS A CURRENT ASSET OR FIXED ASSET?

An asset is classified either as a Current Asset or as a Fixed Asset on the basis of the purpose for which an asset is held in the hands of the user.

EXAMPLE

The following table summarises the circumstances when a particular asset is treated as Current in one case and Fixed in another case:

Asset	When treated as Current Asset	When treated as Non-Current Asset
1. Land	In case of Land Developers & Property Dealers	In case of other persons.
2. Buildings	In case of Builders & Property Dealers	In case of other persons.
3. Furniture	In case of furniture manufacturers and furniture dealers	In case of other persons.
4. Motor - Vehicles	In case of motor vehicles manufacturers and dealers	In case of other persons.
5. Shares & Debentures	In case of dealer in securities	In case of other persons.
6. Plant & Machinery	In case of plant & Machinery manufacturers and dealers	In case of other persons.

LIABILITIES

Liabilities refer to the financial obligations of an enterprise other than owner's funds. Liabilities may be broadly classified as follows:

I. LIABILITIES ON THE BASIS OF PERIOD

1. **Current liabilities** – Current Liabilities refer to those liabilities which are expected to be settled normally within 12 months from the date of the balance sheet.
2. **For example:** Bills payable, Trade creditors, Outstanding expenses, Bank overdraft and so on
3. **Non-Current liabilities** – Non-Current Liabilities refer to those liabilities which are expected to be settled after 12 months from the date of Balance Sheet. For example, long – term Loans, Debentures and the like.

II. LIABLITIES ON THE BASIS OF SOURCE

1. **Internal Liabilities** – Internal Liabilities refers to the financial obligations of an enterprise towards owners.
2. **External Liabilities** – External Liabilities refer to the financial obligations of an enterprise towards outsiders.

CAPITAL

Capital refers to the amount invested in an enterprise by the proprietor (in case of proprietorship) or partners (in case of a partnership concern), This amount is increased by the amount of profits earned and amount of additional capital introduced and is decreased by the amount of losses incurred and the amount withdrawn (whether in the form of cash or kind). It represents the owner's claim on the assets of the enterprise. It is also known as Owner's Equity or Net Assets or Net Worth.
Since, the liability holders have a definite and prior claim against the assets; the capital is also called a residual of assets over liabilities and may be expressed as follows:

Capital = Assets – Liabilities

Thus, Capital is the excess of Assets over External Liabilities

DRAWINGS

The term 'drawings' refer to the total amount of cash or goods or any other asset withdrawn by the proprietor (in case of a proprietorship enterprise) or partner (in case of a partnership enterprise) for personal use. For example, if cash of ₹ 10,000 and Goods costing ₹ 5,000 are withdrawn by a proprietor, ₹ 15,000 is called as the amount of drawings.

GOODS

Goods refer to the items in which the enterprise deals in. For Example, Cars purchased by a Car Dealer, Tables & Chairs purchased by a Furniture Dealer.

PURCHASES

The term 'Purchases' refers to the total amount of goods obtained by an enterprise for resale or for use in the production of goods or rendering of services in the normal course of business. The purchases may be for cash or on credit.
For example, in case 100 units are purchased @ ₹ 2 per unit for cash, ₹ 200 is called as the amount of cash purchase. In case 200 units are purchased @ ₹ 3 per unit from Ram on credit, ₹ 600 is called as the amount of credit purchase.

PURCHASE RETURNS

The term 'Purchase Returns' refers to the total amount of goods returned by an enterprise to the Supplier. For example, in case 50 units (purchased @ ₹ 3 per unit) are returned to Ram, ₹ 150 is called as the amount of purchase returns.

SALES

The term 'Sales' refer to the amount for which the goods are sold or services are rendered. The sales may be for cash or on credit. For Example, in case 60 units are sold @ ₹ 5 per unit for cash, ₹ 300 is called as the amount of in case 120 units are sold @ ₹ 6 per unit to Shyam on credit, ₹ 720 I called as the amount of credit sales.

SALES RETURNS

The term 'Sales Returns' refers to the total amount of goods returned by a customer to the enterprise.
For example, in case 50 units (sold @ ₹ 6 per unit) are returned by Shyam (customer), ₹ 300 is called as the amount of sales returns.

STOCK (OR INVENTORY OR MERCHANDISE)

The term 'Stock' refers to tangible property held for sale in the ordinary course of business or for consumption in the production of goods or services for sale. It includes Stock of Raw materials, Semi-Finished goods and Finished Goods. For example, in case 40 units out of 100 units (purchased @ ₹ 2 per unit) remained unsold, ₹ 80 is called as the Cost of stock. The stock may be Opening Stock or Closing Stock. Opening Stock means the unsold goods at the beginning of the Current Accounting Period. Closing Stock means the unsold goods at the end of the Current Accounting Period.

TRADE RECEIVABLES

The term 'Trade Receivables' include Trade Debtors and Bills Receivables.

TRADE DEBTORS

The term 'Trade Debtor' refers to the person from whom the accounts are due for goods sold or services rendered on credit basis. For example, in case 60 units are sold to Mr. X @ ₹5 per unit on credit, Mr. X is a Trade Debtor of the business.

BILLS RECEIVABLES

A bill of exchange is an unconditional order in writing given by the creditor to the debtor to pay on demand or at a fixed or determinable future time, a certain sum of money to or to the order of a specified person or to the bearer. This bill of exchange is known as Bills Receivable for the creditor.

TRADE PAYABLES

The term ‘Trade Payables’ include Trade Creditors and Bills Payables.

TRADE CREDITORS

The term ‘Trade Creditor’ refers to the person to whom the amounts are due for goods purchased or services rendered on credit basis. For example, in case 100 units are purchased @ ₹ 2 per unit from Mr. Y on credit, Mr. Y is a Trade Creditor of the business.

BILLS PAYABLES

The bill of exchange is known as Bills Payable for the Debtors.

CAPITAL EXPENDITURE

1. Meaning	It is an expenditure which is incurred: a. To acquire or bring into existence an asset, or b. To acquire or bring into existence an advantage or benefit of an enduring nature, or c. To increase the productivity or earning capacity
2. Benefits	It normally yields benefits beyond current accounting period
3. Accounting Treatment	It is debited to the Respective Asset Account which appears on the Assets side of the Balance Sheet
4. Examples	a. Cost of Land & Building b. Cost of Plant & Machinery c. Cost of Furniture & Fixture

REVENUE EXPENDITURE

1. Meaning	It is an expenditure which is incurred: a. To maintain the productivity or earning capacity of a business b. To carry out operating activities in the normal course of business
2. Benefits	It normally does not yield benefits beyond the current accounting period
3. Accounting Treatment	It is debited to Respective Expenses Account which appears on the debit side of Trading A/c (if Direct Expense) or P&L A/c (if Indirect Expense)
4. Examples	a. Depreciation on Land & Building b. Rent on Machines c. Repairs of Building d. Insurance of Building

DEFERRED REVENUE EXPENDITURE

1. Meaning	According to the Guidance Note on 'Terms used in Financial Statements', issued by ICAI 'Deferred revenue expenditure is the expenditure for which payments has been made or liability has been incurred but which is carried forward on the presumption that it will be of benefit over a subsequent period or periods'. In short, it refers to that expenditure which is, for the time being, deferred from being charged to income. Such suspension of 'charging off' operation may be due to the nature of expenses and the benefit expected therefrom.
2. Example	Heavy advertising to launch a new product is a deferred revenue expenditure since the benefit from it will be availed over the next 3 to 5 years.
3. Accounting Treatment	Normally such expenditure should be written off over a period of 3 to 5 years. The written off portion is debited to the P&L A/c and unwritten off portion is shown on the Assets side of the Balance Sheet.

CAPITAL RECEIPTS

1. Meaning	Capital receipts refer to those receipts which are not revenue in nature
2. Accounting Treatment	These are credited to the respective account of capital nature.
3. Example	a. Sales of Land & Building by a person other than a dealer in real estate b. Raising of Loan by a person other than one engaged in the business of finance/banking c. Raising of Capital

EXPENSES

Expenses are decrease in economic benefits during an accounting period in the form of (a) Outflow or Depletion of Assets or (b) Incurrence of liabilities that result in decrease in internal equity other than those relating to distribution to Equity Participants.
EXAMPLE I: Purchase of goods for cash involves outflow of cash
EXAMPLE II: Purchase of goods on Credit involves decrease in Creditors
EXAMPLE III: Discount Allowed to Customers involves decreases in assets.

INCOME

Income is increase in economic benefits during an accounting period in the form of (a) inflow of Assets, or (b) Decrease of Liabilities, that result in increase in internal equity other than those relating to Investment by Equity Participants.
Note: Equity Participants means –

a) Proprietor in case of sole proprietorship
b) Partners in case of a partnership firm
c) Shareholders in case of a company

EXAMPLE I: Trading Commission received involves inflow of Cash.
EXMAPLE II: Discount received from creditors involves decrease in Creditors.

NET PROFIT

Net Profit means the excess of Revenue & gains over its related Expenses & Losses during an accounting period. It increases Owners' Equity

Net Profit = (Revenue & Gain) – (Expenses & Loss)

GAINS

Gains are increases in equity (i.e. Net Assets) from incidental transaction of an entity and from all other transactions and other events and circumstances affecting the entity during the accounting period except those that result from revenues or investment by equity participants. These gains may be operating or non – operating.
EXAMPLE I: Profit on sale of marketable securities is usually considered as operating gain.
EXAMPLE II: Profit on sale of a fixed asset is usually considered as non – operating gain
EXAMPLE III: Increase in Equity due to Profit on sale of goods is not considered as Gain because it is due to revenue.
EXAMPLE IV: Increase in Equity due to increase in Capital is not gain because it is due to increase in Capital

LOSSES

Losses are decreases in equity (i.e. Net Assets) from incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity during the accounting period except that result from expense or distribution to equity participants. These losses may be operating or non-operating.
EXAMPLE I: Loss or sale of marketable securities, losses on writing down inventory from Cost to Market Value, writing off Bad Debts are considered as operating losses.
EXAMPLE II: Loss on sale of a Non – Current Asset, Losses from disposal of segments of Enterprises, Losses on Foreign Currency Devaluations are usually considered as Non – Operating Losses.

DISCOUNT

Discount is an incentive to promote Sales (i.e., Trade Discount) or prompt payment by the debtors (i.e., Cash Discount).

TRADE DISCOUNT

Trade Discount is a reduction granted by a supplier from the list price of goods or services on business considerations (such as quantity bought, trade practices, etc.,) other than for prompt payment.

Example – If 10 Gold Rings are sold at the list price of ₹ 50,000 each subject to trade discount of 10%. In this case trade discount will be calculated as given on below:

10 Gold Rings @ ₹ 50,000	₹ 5,00,000
Less: Trade Discount @ 10%	₹ 50,000
Amount payable as per Invoice	₹ 4,50,000

CASH DISCOUNT

Cash Discount is a reduction granted by a supplier from the invoice price in consideration of immediate payment or payment within a stipulated period.

Example – if in the above example, terms of payable are 2%, 30 days, it means buyer will get 2% cash discount if he makes payment within 30 days. In case the purchaser makes the payment within 30 days, the cash discount will be calculated as under:

Amount payable as per invoice	₹ 4,50,000
Cash discount @ 2%	₹ 9,000
Cash paid within 30 days	₹ 4,41,000

COST

The term 'Cost' may be defined as a noun or as a verb as follows:

a. **As a noun** – The amount of expenditure (actual or notional) incurred on a specified thing or activity.
b. **As a verb** – To ascertain the cost of specified thing or activity.

ICA, India defines Cost as "measurement, in monetary terms, of the amount of resource used for the purpose of production of goods or rendering services"
The word 'cost' can rarely stand on its own and should be qualified as to its limitations (e.g., historical, variable, fixed, etc.) and should be related to a particular thing or activity (e.g., a given quantity or unit of produced or services performed).

VOUCHER

Voucher is documentary evidence in support of a business transaction. For Example, in case of Cash Purchases, Cash memos and in case of Credit Purchases, Purchase Invoices are Vouchers. The vouchers act as source documents on the basis of which transactions are recorded in the books of accounts.

REVENUE

The term 'Revenue' refers to the amount charged for the goods sold or services rendered, or permitting others to use enterprise's resources yielding interest, Royalty, and Dividend. For example, sales, Commission earned, interest earned, Royalty Earned, Dividend Earned.

ACCRUAL BASIS OF ACCOUNTING

1. Accrual Basis of Accounting is a method of recording of transactions by which revenue, costs, assets and liabilities are recognized during the accounting period in which they accrue.
2. This basis includes consideration relating to deferrals, allocations, depreciation and amortization.
3. This basis is also known as the Mercantile Basis of Accounting.
4. Under the Companies Act, 2013 all companies are required to maintain the books of accounts according to accrual basis of accounting.

CASH BASIS OF ACCOUNTING

Cash Basis of Accounting is a method of recording the transactions by which revenues, costs, assets, and liabilities are recognized during the accounting period in which Actual Receipts or Payments take place.

HYBRID BASIS OF ACCOUNTING

It is a combination of both Cash Basis and Accrual Basis of Accounting. Under the hybrid basis of accounting, incomes are recorded on Cash basis (i.e., during the accounting period in which they are received irrespective of when they accrue) and expenses are recorded on Accrual basis (i.e., during the accounting period in which they arise irrespective of when they are paid).

DISTINCTION BETWEEN ACCRUAL BASIS OF ACCOUNTING AND CASH BASIS OF ACCOUNTING

Basis of Distinction	Accrual Basis of Accounting	Cash Basis of Accounting
1. Prepaid/Outstanding Expenses accrued/unaccrued Income in Balance Sheet	Under this, there may be Prepaid/Outstanding Expenses and Accrued/Unaccrued Incomes in Balance Sheet	Under this, there is no Prepaid/Outstanding Expenses and Accrued/Unaccrued Incomes
2. Higher/Lower Income in case of Prepaid Expenses and Accrued Income	Income Statement will show a relatively higher income	Income Statement will show lower income
3. Higher/Lower income in case of outstanding	Income Statement will show a relatively lower income	Income Statement will show higher income

expenses and unaccrued income		
4. Recognition under the Companies Act, 2013	This basis is recognized under the Companies Act, 2013	This basis is not recognized under the Companies Act, 2013
5. Availability of options to an accountant to manipulate the accounts by way of choosing the most suitable method out of several alternative methods of accounting e.g., FIFO/LIFO/SLM/WDV	Under this, an accountant has options	Under this an accountant has no options to make a choice as such

ILLUSTRATION 1

PRARTHANA PESTICIDES supplies you the following information about his incomes and expenses for the financial year 2017-18:

Particulars	₹	Particulars	₹
Expenses paid	75,000	Income received	2,03,000
Expenses paid in advance	38,000	Income received in advance	25,000
Expenses not yet paid	23,000	Income earned but not received	22,000
Loans taken	1,00,000	Loans given	20,000

Compute the Net Income on: (i) Cash Basis (ii) Accrual Basis (iii) Hybrid Basis

SOLUTION

COMPUTATION OF INCOME

Particulars	On Cash Basis	On Accrual Basis	On Hybrid Basis
A. Total Revenue:			
a) Income receives	2,03,000	2,03,000	2,03,000
b) Income received in advance	-	(25,000)	-
c) Income not yet received	-	22,000	-
	2,03,000	2,00,000	2,03,000
B. Total Expenditure:			
a) Expenses paid	75,000	75,000	75,000
b) Expenses paid in advance	-	(38,000)	(38,000)
c) Expenses not yet paid	-	23,000	23,000
	75,000	60,000	60,000
C. Income for the Year	1,28,000	1,40,000	1,43,000

Note: Loans taken and Loans given are not considered while calculating Income because these represent Capital Receipts and Capital Payments respectively.

ILLUSTRATION 2

TULSIAN Cloth Agency provides the following information for the year 2017-18:

Cash sales	₹ 1,00,000	
Credit sales	₹ 9,00,000	(out of which ₹ 8,00,000 collected)
Cash purchases	₹ 80,000	
Credit purchases	₹ 6,50,000	(out of which ₹ 6,00,000 paid)
Expenses paid	₹ 75,000	
Expenses paid in advance	₹ 38,000	
Outstanding expenses	₹ 23,000	
Closing stock in trade	Nil	

Compute the Net Income on: (i) Cash Basis (ii) Accrual Basis (iii) Hybrid Basis

SOLUTION

COMPUTATION OF INCOME

Particulars	On Cash Basis	On Accrual Basis	On Hybrid Basis
A. Total Revenue:			
a) Cash sales	1,00,000	1,00,000	1,00,000
b) Credit sales			
1. Collected	8,00,000	8,00,000	8,00,000
2. Outstanding	-	1,00,000	-
Total Revenue	9,00,000	10,00,000	9,00,000
B. Total Expenditure			
a) Cash purchase	80,000	80,000	80,000
b) Credit purchase			
1. Paid	6,00,000	6,00,000	6,00,000
2. Outstanding	-	50,000	50,000
c) Expenses			
1. Paid	75,000	75,000	75,000
2. Paid in advance	-	(38,000)	(38,000)
3. Outstanding	-	23,000	23,000
	7,55,000	7,90,000	7,90,000
C. Income	1,45,000	2,10,000	1,10,000

UNIT 4: Capital and Revenue Expenditures and Receipts

CLASSIFICATION OF CAPITAL AND REVENUE

The Going Concern Assumption allows the accountant to classify the expenditure and receipts as capital expenditure, Revenue expenditure, Deferred Revenue expenditure, Capital Receipts, Revenue Receipts.

CLASSIFICATION OF EXPENDITURE

As expenditure may be classified as follows:

CAPITAL EXPENDITURE

1. Meaning	It is an expenditure which is incurred: a) To acquire or bring into existence an asset, or b) To acquire or bring into existence an advantage or benefit of an enduring nature, or c) To increase the productivity or earning capacity
2. Benefits	It normally yields benefits beyond current accounting period
3. Accounting Treatment	It is debited to the respective Asset Account which appears on the Asset side of the Balance Sheet
4. Examples	a) Cost of Land & Building b) Cost of Plant & Machinery c) Cost of Furniture & Fixtures
5. Disclosure in Financial Statements	**BALANCE SHEET AS AT ….**

BALANCE SHEET AS AT ….

Liabilities	₹	Assets	₹
		Capital Expenditure	….

REVENUE EXPENDITURE

1. Meaning	It is an expenditure which is incurred: a) To maintain the productivity or earning capacity of a business b) To carry out operating activities in the normal course of business
2. Benefits	It normally does not yield benefits beyond the current accounting period
3. Accounting Treatment	It is debited to Respective Expenses Account which appears on the debit side of Trading A/c (if Direct Expense) or P&L A/c (if Indirect Expense)
4. Examples	a) Depreciation on Land & Building b) Rent on Machines c) Repairs of Building d) Insurance of Building
5. Disclosure in Financial Statements	**INCOME STATEMENT FOR THE PERIOD ENDED ON ….**

INCOME STATEMENT FOR THE PERIOD ENDED ON ….

Particulars	₹	Particulars	₹
To Revenue Expenditure	….		

DISTINCTION BTWEEN CAPITAL EXPENDITURE AND REVENUE EXPENDITURE

Basis of Distinction	Capital Expenditure	Revenue Expenditure
1. Meaning	It is an expenditure which is incurred: a) To acquire or bring into existence an asset, or b) To acquire or bring into existence an advantage or benefit of an enduring nature, or c) To increase the productivity or earning capacity	It is an expenditure which is incurred: a) To maintain the productivity or earning capacity of a business b) To carry out operating activities in the normal course of business
2. Benefits	It normally yields benefits beyond current accounting period	It normally does not yield benefits beyond the current accounting period
3. Accounting Treatment	It is debited to the respective Asset Account	It is debited to Respective Expenses Account
4. Examples	a) Cost of Land & Building b) Cost of Plant & Machinery c) Cost of Furniture & Fixtures	a) Depreciation on Land & Building b) Rent on Machines c) Repairs of Building d) Insurance of Building

DEFERRED REVENUE EXPENDITURE

1. Meaning	According to the Guidance Note on 'Terms used in Financial Statements', issued by ICAI 'Deferred revenue expenditure is the expenditure for which payments has been made or liability has been incurred but which is carried forward on the presumption that it will be of benefit over a subsequent period or periods'. In short, it refers to that expenditure which is, for the time being, deferred from being charged to income. Such suspension of 'charging off' operation may be due to the nature of expenses and the benefit expected therefrom.
2. Example	Heavy advertising to launch a new product is a deferred revenue expenditure since the benefit from it will be availed over the next 3 to 5 years.
3. Accounting Treatment	Normally such expenditure should be written off over a period of 3 to 5 years. The written off portion is debited to the P&L A/c and unwritten off portion is shown on the Assets side of the Balance Sheet.

4. Disclosure in Financial Statement			
INCOME STATEMENT FOR THE PERIOD ENDED ON …			
Particulars	**₹**	**Particulars**	**₹**
To Deferred Revenue Expenditure w/o	….		
BALANCE SHEET AS AT ….			
Liabilities	**₹**	**Assets**	**₹**
		Deferred Revenue Expenditure (Unwritten off portion)	…

CLASSIFICATION OF SOME EXPENDITURES WITH REASONS

Sl. No.	Items of Expenditure	Nature of Expenditure	Reason for Classification
1.	Expenses on a Foreign Tour to purchase a machinery	Capital	These are incurred to acquire a capital asset
2.	Cost of Machinery Purchased	Capital	These are incurred to acquire a capital asset
3.	Insurance & Freight on Machinery purchased	Capital	These are incurred to acquire a capital asset
4.	Custom Duty on Imported Machinery	Capital	These are incurred to acquire a capital asset
5.	Wages for erection of Machinery	Capital	These are incurred to acquire a capital asset to use
6.	Installation charges of a Machinery Purchased	Capital	These are incurred to acquire a capital asset to use
7.	Expenses incurred on Trial Run before the asset is put to use	Capital	These are incurred before the commencement of commercial production
8.	Cost of a Second hand Machinery Purchased	Capital	These are incurred to acquire a capital asset
9.	Repair of a second hand machinery before put to use	Capital	These are incurred to acquire a capital asset to use
10.	Interest on a term loan for the purchase of machinery. The commercial production has not begun till the last day of the accounting year	Capital	These are incurred to acquire capital assets and the commercial production has not yet begun
11.	Interest on a term loan for the purchase of machinery. The commercial production has already begun	Revenue	The commercial production has already begun
12.	Repairs of Machine after the machine is put to use	Revenue	These are incurred to maintain the capital asset
13.	Amount spent for replacement of worn out part of machine	Revenue	These are incurred to maintain the capital asset

14.	Annual Maintenance fee of a machine	Revenue	These are incurred to maintain the capital asset
15.	Money spent to reduce working expenses	Capital	These are incurred to acquire long term benefits
16.	Amount spent for replacement of a petrol driven engine by CNG kits	Capital	These are incurred to reduce the operating costs and thereby increasing the profit
17.	Cost of Rings & Pistons of an engine changed to get fuel efficiency	Capital	These are incurred to reduce the operating costs and thereby increasing the profit
18.	Overhauling expenses for the engine of a motor car to get better fuel efficiency	Capital	These are incurred to reduce the operating costs and thereby increasing the profit
19.	Legal expenses to acquire a Building	Capital	These are incurred to acquire ownership right of the capital asset.
20.	Legal expenses to defend a suit claiming that firm's factory site belongs to plaintiff	Revenue	These are incurred to maintain the capital asset
21.	Amount spent on repainting an old building for the first time on purchase	Capital	These are incurred to put the capital asset to use
22.	Amount spent on annual repainting of building	Revenue	These are incurred to maintain the capital asset
23.	Expenses to obtain a license for starting a factory	Capital	These are incurred to acquire the right to carry on business
24.	Annual renewal fee of license for next year	Revenue Prepaid Expenses	These are incurred to maintain the capital asset (i.e., right to carry on business)
25.	Amount spent for the construction of temporary huts for storing building material while constructing a building	Capital	These are incurred for the construction of building and hence to be capitalized with the cost of building
26.	Deposit with Mahanagar Telephone Nigam Ltd. for installing telephone	Capital	The amount is adjusted over a period of time against telephone bills
27.	Expenses for removal of stock to a new site	Revenue	Such expenditure is neither bringing enduring benefit nor enhancing the value of capital asset
28.	Fines imposed	Revenue	Such expenditure is neither bringing enduring benefit nor enhancing the value of capital asset
29.	Annual Fire Insurance ₹ 12,000 paid on 1st January 2006 during accounting year ended 31.03.2006	Revenue	₹ 3,000 as current year's revenue expenses ₹ 9,000 as prepaid expenses for next year
30.	Inauguration expenses on opening of a new branch of an	Revenue	Such expenditure is not enhancing value of capital asset. Since it has an

	existing business. Free gifts to customers or Tournament Sponsoring expenses or Advertisement Campaign to launch a new product		enduring effect on the future revenue generating capability of business, it may be treated as deferred revenue expenses
31.	Compensation for breach of contract	Revenue	Such expenditure is neither bringing enduring benefit nor enhancing the value of capital asset
32.	Compensation paid to workers under Voluntary Retirement Scheme (VRS)	Revenue	Such expenditure is not enhancing value of capital asset. Having regard to the large amount , it may be better to treat it as deferred revenue expenditure which may be w/o over future years
33.	Amount spent on demolition of Building to construct a bigger building on the same site	Capital	These are incurred for the construction of a new building
34.	Loss on Sale of Machine	Revenue Loss	Such expenditure is neither bringing enduring benefit nor enhancing the value of capital asset
35.	Legal expenses to recover dues from customers	Revenue	These are incurred to maintain present revenue generating capability
36.	Festival advance to employees	Not an expense	It is an item of Loans & Advances
37.	Advances to suppliers of Goods	Not an expense	It is an item of Loans & Advances
38.	Cost of improvement in Electric Wiring System	Capital	This is incurred to acquire capital asset
39.	Purchase of Patent Rights	Capital	This is incurred to acquire capital asset
40.	Purchase of Goodwill	Capital	This is incurred to acquire capital asset
41.	Purchase of a Technical-know-how	Capital	This is incurred to acquire capital asset
42.	Purchase of a live stock by a farmer	Capital	This is incurred to acquire capital asset
43.	Amount spent on Neon Sign Board at Airport	Capital	This is incurred to acquire capital asset
44.	Import Duty on purchase of Materials	Revenue	This is incurred on operating activities in the normal course of business
45.	Compensation paid to the employees who were retrenched	Revenue	Such expenditure is neither bringing enduring benefit nor enhancing the value of capital asset
46.	Imported Goods confiscated by custom authorities	Revenue Loss	Such expenditure is neither bringing enduring benefit nor enhancing the value of capital asset

ILLUSTRATION

State with reasons whether the following are Capital or Revenue Expenditure:

- **a)** Expenses on a foreign tour for purchasing a new machinery
- **b)** Freight & Insurance on the new machinery
- **c)** Custom duty paid on import of a machinery
- **d)** Cartage paid to bring the new machines to factory
- **e)** Wages paid in connection with the erection of new machinery
- **f)** ₹ 1,000 spent on repairing a second hand machine before put to use
- **g)** ₹ 2,000 spent to remove a worn out part and replace it with a new engine
- **h)** A petrol driven engine of a passenger bus was replaced by a diesel engine
- **i)** ₹ 8,00,000 spent on advertising the introduction of a new product in the market, the benefit of which will be effective for 3 to 5 years
- **j)** ₹ 5,000 spent on repainting the factory
- **k)** Heavy amount spent on research for a particular product which ultimately did not result in success
- **l)** Repair ₹ 2,000 necessitated by negligence of an operator of machine
- **m)** ₹ 10,000 paid as compensation to employees who were retrenched
- **n)** Interest on a term loan for the purchase of machinery. The commercial production has not begun till the last day of the accounting year
- **o)** Interest on a term loan for the purchase of machinery. The commercial production has already begun
- **p)** Compensation paid for breach of contract to acquire stock-in-trade
- **q)** ₹ 30,000 spent as layer's fee to defend a suit that firm's factory belonged to the plaintiff. The suit was not successful

SOLUTION

- **a)** Items referred to in **(a) to (f)** represent capital expenditure since these expenditures are incurred up to the point the machine is ready for use.
- **g)** It should be treated as revenue expenditure since it is incurred to keep the asset in working order. Such expenditure has neither resulted in increasing the life or efficiency of an existing asset nor in bringing into existence a new asset and such cannot be treated as capital expenditure.
- **h)** Such expenditure should be treated as capital expenditure since it will increase the profit capacity of the business through lowering of costs.
- **i)** Such expenses should be treated as a deferred revenue expenditure and should be written-off each year over a period of 3 to 5 years.
- **j)** Such expenses should be treated as a revenue expenditure since it is incurred to maintain the factory in good condition.
- **k)** Such expenses should be treated as revenue expenditure as per AS 26.
- **l)** Such expenses should be treated as revenue expenditure since it is incurred to keep the asset in working condition.
- **m)** Such expenditure should be treated as revenue expenditure since it is incurred to keep the asset in working order.
- **n)** Such expenses should be treated as revenue expenditure since it is neither bringing the benefit of enduring nature nor enhancing the value of any asset.
- **o)** Such expenditure should be treated as capital expenditure since the commercial production has already begun.

p) Such expenditure should be treated as revenue since it is neither bringing the benefit of enduring nature nor enhancing the value of any asset.

q) Such expenditure should be treated as revenue expenditure since it is incurred for the upkeep of fixed asset.

CLASSIFICATION OF RECEIPTS

The receipts may be classified as follows:

CAPITAL RECEIPTS

1. Meaning	Capital receipts refer to those receipts which are not revenue in nature
2. Accounting Treatment	These are credited to the respective account of capital nature.
3. Example	a. Sales of Land & Building by a person other than a dealer in real estate b. Raising of Loan by a person other than one engaged in the business of finance/banking c. Raising of Capital

REVENUE RECEIPTS

1. Meaning	Revenue receipts refer to those receipts which arise in the normal course of business
2. Accounting Treatment	These are credited to Respective Revenue Account which appears in the Income Statement
3. Example	a. Sale of Land and Building by a dealer in real estate b. Sale of Securities by a dealer in securities

DISTINCTION BETWEEN CAPITAL RECEIPTS AND REVENUE RECEIPTS

Basis of Distinction	Capital Receipts	Revenue Receipts
1. Meaning	Capital receipts refer to those receipts which are not revenue in nature	Revenue receipts refer to hose receipts which arise in the normal course of business
2. Accounting Treatment	These are credited to the respective account of capital nature	These are credited to Respective Revenue Account which appears in the Income Statement
3. Examples	**a)** Sales of Land and Building by a person other than a dealer in real estate **b)** Raising of Loan by a person other than one engaged in the business of finance/banking **c)** Raising of Capital	**a)** Sales of Land and Building by a dealer in real estate **b)** Sale of Securities by a dealer in securities

CLASSIFICATION OF SOME RECEIPTS WITH REASONS

Sl. No.	Items of Receipt	Nature of Receipt	Reason for Classification
1.	Sale of Plant & Machinery	Capital	It is arising from investing activities and not from operating activities in the normal course of business
2.	Sales of Investment	Capital	It is arising from investing activities and not from operating activities in the normal course of business
3.	Capital Introduction	Capital	It is arising from financing activities and not from operating activities in the normal course of business
4.	Loans Raised	Capital	It is arising from financing activities and not from operating activities in the normal course of business
5.	Interest received on Investment	Revenue	It is arising from operating activities in the normal course of business
6.	Interest accrued on investment	Revenue	It is arising from operating activities in the normal course of business
7.	Cash received from Debtors	Revenue	It is arising from operating activities in the normal course of business
8.	B/R collected	Revenue	It is arising from operating activities in the normal course of business
9.	Sale of Goods for cash	Revenue	It is arising from operating activities in the normal course of business
10.	Sale of Goods on credit	Revenue	It is arising from operating activities in the normal course of business
11.	Insurance claim for stock damaged by fire	Revenue	It is arising from operating activities in the normal course of business
12.	Insurance claim for machinery damaged by fire	Capital	It is arising from investing activities and not from operating activities in the normal course of business
13.	Subsidy received from Govt. for plot of land	Capital	It is arising from investing activities and not from operating activities in the normal course of business
14.	General subsidy received	Revenue	It is not for the purchase of any capital asset
15.	Bad debt recovered	Revenue	It is arising from operating activities in the normal course of business
16.	Sale value of Machinery	Capital	It is arising from investing activities and not from operating activities in the normal course of business
17.	Premium received on issue of Shares	Capital	It is arising from financing activities and not from operating activities in the normal course of business

UNIT 5: Contingent Assets and Contingent Liabilities

CONTINGENT ASSET

MEANING OF CONTINGENT ASSET

According to Accounting Standard 29, "a contingent asset is a possible asset that arises from past events to existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of enterprise. It usually arises from unplanned or unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise."

EXAMPLE OF CONTINGENT LIABILITY

A claim that an enterprise is pursuing through legal process, where the outcome is uncertain, is a contingent asset.

NO RECOGNITION IN FINANCIAL STATEMENTS

As per the concept of prudence as well as the present accounting standards, an enterprise should not recognise a contingent asset. it is possible that recognition of contingent assets may result in recognition of income that may never be realised. However, when the realisation of income is virtually certain, then the related asset no longer remains as contingent asset.

NO DISCLOSURE OF CONTINGENT ASSET

A contingent asset need not be disclosed in the financial statements. A contingent asset is usually disclosed in the report of approving authority (i.e., Board of Directors in the case of a company, and the corresponding approving authority in the case if any other enterprise), if an inflow of economic benefits is probable.

WHEN RECOGNISED

Contingent assets are assessed continually and if it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.

CONTINGENT LIABILITIES

MEANING OF CONTINGENT LIABILITIES

According to Accounting Standard 29, 'Contingent Liability' is

a) A possible obligation that arises from past events the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or
b) A present obligation that arises from past events but is not recognised because:
   (i) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
   (ii) A reliable estimate of the amount of the obligation cannot be made.

Where

- **Possible Obligation** – an obligation is a possible obligation if, based on the evidence available, its existence at the balance sheet date is considered not probable.
- **Present Obligation** – an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.

NO RECOGNITION OF CONTINGENT LIABILITY

An enterprise should not recognise a contingent liability.

DISCLOSURE OF CONTINGENT LIABILITY BY WAY OF NOTE TO THE BALANCE SHEET

A contingent liability is required to be disclosed by way of Notes to the Balance Sheet unless possibility of outflow of a resource embodying economic benefits is remote

WHEN RECOGNISED

Contingent liabilities are assessed continually to determine whether an outflow of resources embodying economic benefits has become probable. If it becomes probable that an outflow or future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in financial statements of the period in which the change in probability occurs except in the extremely rare circumstances where no reliable estimate can be made.

DISTINCTION BETWEEN CONTINGENT LIABILITY AND OTHER LIABILITIES

Basis of Distinction	Contingent Liability	Other Liabilities
1. Meaning	It is an obligation which may or may not arise depending on the happening or non-happening of an uncertain future event	These are financial obligations of an enterprise other than owners' equity
2. Disclosure	It is disclosed by way of foot note to the Balance Sheet	These are disclosed on the liabilities side of the Balance Sheet
3. Examples	a) Bills discounted but not yet matured b) Arrears of dividend on Cum-Pref-Shares	a) Creditors of Goods b) Outstanding Expenses

PROVISION

MEANING OF PROVISION

Provision means “any amount written off or retained by way of providing for depreciation, renewal or diminution in the value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy.”
As per AS 29, a provision is a liability which can be measured only by using a substantial degree of estimation.

CONDITIONS FOR RECOGNITION OF PROVISION

A provision should be recognised when:

a) An enterprise has a present obligation as a result of a past event.
b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and
c) A reliable estimate can be made of the amount of the obligation.

DISTINCTION BETWEEN PROVISION AND CONTINGENT LIABILITY

Basis of Distinction	Provisions	Contingent Liability
1. Meaning	Provision is a present liability of uncertain amount, which can be measured reliably by using a substantial degree of estimation	It is an obligation which may or may not arise depending on the happening or non-happening of an uncertain future event
2. Recognition criteria	A provision meets the recognition criteria	A contingent liability fails to meet the same
3. Conditions for recognition	Provision is recognised when (a) an enterprise has a present obligation arising from past events; an outflow of resources embodying economic benefits is probable and (b) a reliable estimate can be made of the amount of the obligation	Contingent liability include present obligations that do not meet the recognition criteria because either it is not probable that settlement of those obligations will require outflow of economic benefits, or the amount cannot be reliably estimated

EXAMPLES TO UNDERSTAND THE DISTINCTION BETWEEN PROVISIONS AND CONTINGENT LIABILITIES

The GST officer imposes a penalty on X Ltd. For the violation of a provision in the GST Act. The company files an appeal. If the management of the company estimates that it is probable that the company will have to pay the penalty, it recognises a provision for the liability. On the other hand, if the management anticipates that the judgement of the appellate authority will be in its favour and it is less likely that the company will have to pay the penalty, it will disclose the obligation as a contingent liability instead of recognising a provision for the same.

TABLE SHOWING THE TREATMENT OF PRESENT/POSSIBLE OBLIGATION UNDER VAIOUS SITUATIONS

Situation	Present Obligation	Possible Obligation
1. Probable outflow and Reliable estimate	Recognise as 'Provision'	Disclose as 'Contingent Liability'
2. Probable outflow and no Reliable estimate	Disclose as 'Contingent Liability'	Disclose as 'Contingent Liability'
3. No Probable outflow and no Reliable estimate	Disclose as 'Contingent Liability'	Do Nothing

UNIT 6: Accounting Policies

MEANING OF ACCOUNTING POLICIES

Accounting policies refer to the specific accounting principles and methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements. There is no single list of accounting policies which are applicable to all enterprises in all circumstances. The management of each enterprise has to select appropriate accounting policies having regard to the nature and circumstances of the enterprise.

EXAMPLES OF ACCOUNTING POLICIES

Following re the examples of some of the areas in which different accounting policies may be adopted by different enterprises:

(i) Methods of depreciation, depletion and amortisations;
(ii) Treatment of expenditure during construction;
(iii) Conversion or translation of foreign currency items;
(iv) Valuation of inventories;
(v) Valuation of goodwill;
(vi) Valuation of investments;
(vii) Treatment of retirement benefits;
(viii) Recognition of profit on long-term contracts;
(ix) Valuation of fixed assets;
(x) Treatment of contingent liabilities.

This list should not be taken as exhaustive; it is only illustrative.

MAJOR CONSIDERATIONS IN THE SELECTION OF ACCOUNTING POLICIES

The primary considerations in the selection of accounting policies should be to prepare and present financial statements in a way that they represent a true and fair view of the state of affairs of the enterprise as at the Balance Sheet date and of the Profit & Loss Account for the period ended on that date. The major consideration governing the selection and application of accounting policies are as under:

1. Prudence: Uncertainties inevitably surround many transactions. This should be recognised by exercising prudence in preparing financial statements. Prudence does not, however, justify the creation of secret or hidden reserves.
2. Substance over form: Transactions and other events should be accounted for and presented in accordance with their substance and financial reality and not merely with their legal form.
3. Materiality: Financial Statements should disclose all material items, that is, items, the knowledge of which might influence the decision of the users of the financial statements.

DISCLOSURE OF ACCOUNTING POLICIES

According to AS – 1 issued by the Institute of Chartered Accountants of India –

1. All significant according policies adopted in the preparation and presentation of financial statements should be disclosed.
2. The disclosure of the significant accounting policies as such should form a part of the financial statements and the significant accounting policies should normally be disclosed in one place.

CHANGE IN ACCOUNTING POLICY

WHEN THE CHANGE IN ACCOUNTING POLICY IS RECOMMENDED

The change in Accounting Policy is recommended only in the following circumstances:
If it is required by statute for compliance with an accounting standard.
If it is considered that the change would result in a more appropriate presentation of the financial statements of an enterprise.

DISCLOSURE REQUIREMENTS IN CASE OF CHANGE IN ACCOUNTING POLICY

The disclosure requirements are as follows:

Case	Disclosure Requirements
1. If change has a material effect in current period and the effect of change is ascertainable	The amount of change should be disclosed
2. If change has a material effect in current period and the effect of change is not ascertainable, wholly or in part	The fact should be disclosed
3. If change has no material effect in current period but which is reasonably expected to have a material effect in later periods	The fact of such change should be appropriately disclosed

EXAMPLES OF CHANGE IN ACCOUNTING POLICY

X Ltd. Changed the method of depreciation from WDV to SLM, with effect from 1.4.2017. The depreciation has been recomputed from the date of commissioning of these assets at SLM rates applicable to those years. Consequent to this there has been an additional charge for depreciation during the year of ₹ 100 crore due to said change which relates to the previous years and an equal amount has been withdrawn from General Reserve and credited to the Profit & Loss Account. Had there been no change in the method of depreciation, the charge for the year would have been lower by ₹ 10 crore excluding the charge relating to the previous years. Consequently, the Net Block of Fixed Assets and Reserves & Surplus are lower by ₹ 110 crore.

DISTINCTION BETWEEN FUNDAMENTAL ACCOUNTING ASSUMPTIONS AND ACCOUNTING POLICIES

The Fundamental Accounting Assumptions differ from Accounting Policies in the following respects:

Basis of Distinction	Fundamental Accounting Assumptions	Accounting Policies
1. Number	There are only three fundamental accounting assumptions viz. Going Concern, Consistency and Accrual	There is no single list of accounting policies which are applied in all circumstances. As a result, there may be different accounting policies adopted by different enterprises
2. Disclosure if followed	No disclosure is required if all the fundamental assumptions have been followed	Disclosure is requires if a particular accounting policy has been followed
3. Disclosure if not followed	In case the fundamental assumptions are not followed; the fact has to be disclosed in the financial statements together with the reasons	In case the policy is changed in subsequent year, the reasons for such change and the resulting financial consequences have to be disclosed
4. Choice	There is no choice	The firm has a choice to select a particular policy

UNIT 7: Accounting as a Measurement Discipline – Valuation Principles & Accounting Estimates

MEANING OF MEASUREMENT

Prof. R. J. Chambers defined measurement as "assignment of number to objects and events according to rules specifying the property to be measured, the scales to be used and the dimension of the unit".

Thus, the three elements of measurements are:

1. Identification of objects and events to be measured
2. Selection of standard or scale to be used
3. Evaluation of dimension of measurement standard or scale

OBJECTS OR EVENTS TO BE MEASURED

1. Past and present objects or events can be measures with some degree of accuracy.
2. Future objects or events are only predicted but not measured.
3. Although decision makers need past, present and future information but generally the past information is communicated to the external users.

STANDARD OR SCALE OF MEASUREMENT

1. In accounting, money is the scale of measurement.
2. Money as a measurement scale has no universal application because it takes the shape of currency ruling in a country which differs from one reporting country to another reporting country. For example, the scale of measurement in India is Rupee, in the UK Pound Sterling, in USA Dollar.

DIMENSION OF MEASUREMENT SCALE

1. An ideal measurement scale should be stable overtime.
2. Money as a scale of measurement is not stable in the dimension for comparison over time because the same quantity of money may not have the ability to buy same quantity of identical goods at different dates.

ACCOUNTING AS A MEASUREMENT DISCIPLINE

1. Accounting is not an exact measurement discipline because accounting measures information mostly in money terms which is –
   a) Not a stable scale
   b) Not having universal applicability
   c) Not stable in dimension for comparison over the time
2. Though measurement is an important accounting discipline but a set of theorems which govern the measurement system (such as Going Concern, Consistency and Accrual) should be carefully understood to know how the cogs of the accounting wheel work.
3. Although the quantitative information is also required in many cases but such information is only supplementary to monetary information.

VALUATION PRINCIPLES OR MEASUREMENT BASES

There are four generally accepted valuation principles or measurement bases

HISTORICAL COST BASE

As per the Historical Cost base –

1. The assets are recorded at the amount of cash or cash equivalent paid or incurred of fair value of the asset at the time of acquisition.
2. Liabilities are recorded at the amount of proceeds received in exchange for the obligation.

CURRENT COST BASE

As per the Current Cost base –

1. The assets are recorded at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently.
2. Liabilities are recorded at the undiscounted amount of cash or cash equivalent that would be required to settle the obligation currently.

REALIZABLE VALUE BASE

As per the Realizable Value base –

1. The assets are recorded at the amount of cash or cash equivalent that could currently be obtained by selling the assets in an orderly disposal.
2. Liabilities are recorded at the undiscounted amount of cash or cash equivalent expressed to be paid to satisfy the liabilities in the normal course of business.

PRESENT VALUE BASE

1. As per the Present Value base –
2. The assets are recorded at the present undiscounted value of the future net cash inflows that the item is expected to generate in the normal course of business.
3. Liabilities are recorded at the present discounted value of future net cash outflows that are expected to be required to settle the liabilities in the normal course of the business.

ILLUSTRATION

X Ltd. purchased a machine for ₹ 1,00,000 on 1.4.2014, on 31st March 2018 –

a) A similar machine could be purchased for ₹ 1,20,000
b) The same machine could be disposed for ₹ 80,000
c) The present discounted value of the future net cash inflows that the machinery was expected to generate in the normal course of business is calculated at ₹ 1,50,000

In the above case –

a) Historical cost is ₹1,00,000
b) Current cost is ₹ 1,20,000
c) Realization cost is ₹ 80,000
d) Present value is ₹ 1,50,000

MEASUREMENT AND VALUATION

1. In economics, the value of an object, ability or idea is the utility (i.e., satisfaction) of an economic resource to the person contemplating or enjoying its use. Economists use ordial scale to indicate the level of satisfaction.
2. In accounting, the value of an object, ability or idea is always measured in terms of money. Accountants use only cardinal scales.

ACCOUNTING ESTIMATES

WHEN REQUIRED

Accounting estimates are required hen many items of financial statements can not be measured with precision due to uncertainties inherent in business activities. The estimation process involves judgement based on the latest information available.

EXAMPLES OF ACCOUNTING ESTIMATES

a) Accounting estimates are required in respect of:
b) Doubtful debts
c) Useful life of Depreciable Assets
d) Residual value
e) Inventory Obsolescence
f) Employees Retirement Benefit obligations
g) Provision for unseen contingencies while using percentage of Completion Method is long term contract.

MEANING OF CHANGE IN ACCOUNTING ESIMATES

Change in Accounting Estimates means difference arising between certain parameters estimated earlier and

a) Re-estimated during the current period, or
b) Actual results achieved during the current period

WHEN AN ACCOUNTING ESTIMATE REQUIRES REVISION

An accounting estimate may require revision –

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

EXAMPLES OF CHANGE IN ACCOUNTING ESTIMATE INCLUDE

a) Change in the amount of doubtful debts
b) Change in the estimated useful life of the depreciable asset
c) Change in the estimated residual value of the depreciable asset

NO RETROSPECTIVE EFFECR

Change in Accounting Estimates cannot be given a retrospective effect.

REQUIREMENTS OF AS-5

1. The effect of change in an accounting estimate should be included in the determination of net profit or loss –
    a) In the period of the change if the change affects the period only (e.g., change in the estimated amount of doubtful debts)
    b) In the period of change and future periods if the change affects both (e.g., change in the estimated useful life of depreciable asset)
2. The effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate. (For example, previously included as an extraordinary item should be reported as an extraordinary item).
3. The nature and the amount of change in an accounting estimate which has a material effect in the current period, or which is expected to have a material effect in subsequent periods should be disclosed. If it is impracticable to quantify the amount, this fact should be disclosed.

UNIT 8: Accounting Standards

MEANING OF ACCOUNTING STANDARD

An accounting standard is a selected set of accounting policies or board guidelines regarding the principles and methods to be chosen out of several alternatives. Standards conform to the applicable laws, customs, usage and business environment. So there is no universally accepted set of standards.

OBJECTIVE OF ACCOUNTING STANDARD

The main objective of accounting standards is to harmonise the diverse accounting policies and practices at present in use in India. However, harmonization does not mean that accounting standards should become very rigid. In fact, harmonization of accounting standards does permit flexibility to make the necessary adjustments to suit their purpose.

SIGNIFICANCE OF ACCOUNTING STANDARDS

1. The adoption and application of accounting standards ensures uniformity, comparability and qualitative improvement in the preparation and presentation of financial statements.
2. The accounting standards seek to describe the accounting principles, the valuation techniques and the method of applying the accounting principles in the preparation and presentation of financial statements so that they may give a true and fair view.
3. The ostensible purpose of the standard setting bodies is to promote the dissemination of timely and useful financial information to investors and certain other parties having an interest in companies' economic performance.

ADVANTAGES OF SETTING ACCOUNTING STANDARDS

1. Reduction in variation	Standards reduce to a reasonable extent or eliminate altogether confusing variations in the accounting treatments used to prepare financial statements.
2. Disclosure beyond that required by Law	There are certain areas where important information is not statutorily required to be disclosed. Standards may call for disclosure beyond that required by law.
3. Facilitates comparison	The application of accounting standards would, to a limited extent, facilitate comparison of financial statements of companies situated in different parts of the world and also of different companies situated in the same country. However, it should be noted in this respect that difference in the institution, tradition and legal systems from one country to another gives rise to differences in accounting standards practiced in different countries.

ARGUMENTS AGAINST SETTING ACCOUNTING STANDARDS

1. Restriction on choice of Alternative Treatments	Alternative solutions to certain accounting problems may each have arguments to recommend them. A standard which insists on one particular solution may be unduly restrictive. This can sometimes be avoided either by allowing a permitted choice between different accounting treatments, or by defining closely the circumstances where different treatments may be appropriate.
2. Rigidity	There may be trend towards rigidity in applying the accounting standards. Michael Alexander, Director of Research and Technical Activities at the Financial Accounting Standards Board (FASB) said, "the demand for standards comes largely from an insatiable appetite for rules. The reliance on judgement in technical accounting matters seems to have gone".
3. Cannot override the Statute	Accounting standards cannot override the statute. The standards are required to be framed within the ambit of statute.

DEVELOPMENT OF ACCOUNTING STANDARDS

1. Prior to the 1970s few academics paid much attention to the standard setting process in accounting beginning in 1970s, however, it became clear that standard setting was a fascinating process that had become intertwined with the economic self-interest of affected parties. Currently standard setting board or committee are active in number of countries, including the United States, United Kingdom, Australia, Canada, New Zealand, the Netherlands, Japan and India.
2. **At international** – level in 1972 International Accounting Standards Committee (IASC), was formed for developing International Accounting Standards (IASs). The ISC comprises the professional accountancy bodies of over 75 countries (including the institute of Chartered Accountants of India). During these 3 decades the IASC has issued 40 IASs through a due process involving the worldwide accountancy profession, the preparers and users of financial statement and national standard-setting bodies. However, the IASs are not accepted worldwide.
3. In 1978, another professional body, International Federation of Accountants (IFAC) was established.

ACCOUNTING STANDARDS BOARD OF INDIA (ASB)

1. **Formation of Accounting Standards Board** – Institute of Chartered Accountants of India, recognizing the needs of to harmonise the diverse accounting policies and practices at present in use in India constituted and accounting standard board on April 21, 1977.
2. **Scope and function of accounting Standards Board**
   a) The main function of ASB is to formulate accounting standards so that such standards may be established by the council of the institute of India.

b) While formulating the accounting standards ESB will take into consideration the applicable laws, customs, usages and business environment.
c) The institute is one of the members of the International Accounting Standards Committee and has agreed to support the objectives of IASC.
d) While formulating the accounting standards IASB will give due consideration to International Accounting Standard issued by ASC and try to integrate them, to the extent possible, in the light of the conditions and practices prevailing in India.
e) The accounting standards will be issued under the authority of the council. IAS has also been entrusted with the responsibility of propagating the accounting standards and of persuading the concerned parties to adopt them in preparation and presentation of financial statements.
f) ASB when issue guidance notes on accounting standards and give clarification on issues arising therefrom.
g) ASB will also review the accounting standards at periodical intervals.

3. **Procedure for issuing accounting standards**

Broadly the following procedure will be adopted for formulating accounting standards:

Step 1: Determine the broad areas in which accounting standards need to be formulated and the priority in regards to the selection thereof.

Step 2: To hold a dialogue with the representatives of the government, public sector undertakings, industry and other organizations for a certain in their views.

Step 3: On the basis of the work of the study groups and the dialogue with the representatives to prepare and issue the exposure of draft of the proposed standard for comment by members of the institute and the public at large.

Step 4: To finalize the draft of the proposed standard after taking into consideration comments received.

Step 5: To submit the final draft of the proposed standard to the council of the institute.

The council of the institute will consider the final draft of the proposed standard and if found necessary modify the same in consultation with ASB. The accounting standard on the relevant subject will then be issued under the authority of the council.

4. **Accounting standards issued so far**

a) In India the council of the institute of Chartered Accountants of India has so far issued 32 accounting standards but effectively there are 31 as at present since AS-8 has been withdrawn consequent to the issuance of AS-26 on 'Intangible Assets'.
b) Some of the standards are mandatory.
c) These accounting standards are mandatory in the sense that these are binding on the members of the institute.
d) These standards are as follows:

SI. No.	Title	Recommendatory or mandatory	Mandatory from accounting. Beginning on or after
AS – 1	Disclosure of accounting policies	Mandatory	1.4.93
AS – 2	Valuation of inventories (Revised)	Mandatory	1.4.99
AS – 3	Cash flow statement (Revised)	Mandatory	1.4.2001
AS – 4	Contingencies and events	Mandatory	1.4.95

	occurring after the balance sheet date (Revised)		
AS – 5	Net profit or loss for the period, prior Extraordinary items and changes in accounting policies (Revised)	Mandatory	1.4.96
AS – 6	Depreciation accounting revised	Mandatory	1.4.95
AS – 7	Accounting for construction contracts (Revised)	Mandatory	1.4.03
AS – 8	Accounting for research and development (Withdrawn)	Withdrawn and included in AS-26	
AS – 9	Revenue recognition	Mandatory	1.4.93
AS – 10	Property plant and equipment	Mandatory	1.4.16
AS – 11	Accounting for effects of foreign changes in exchange rates (Revised)	Mandatory	1.4.04
AS – 12	Accounting for government grants	Mandatory	1.4.94
AS – 13	Accounting for investments	Mandatory	1.4.95
AS – 14	Accounting for amalgamations	Mandatory	1.4.95
AS – 15	Accounting for retirement benefits in financial statements of employers	Mandatory	1.4.95
AS – 16	Borrowing costs	Mandatory	1.4.2000
AS – 17	Segment reporting	Mandatory	1.4.2001
AS – 18	Related parties disclosures	Mandatory	1.4.2001
AS – 19	Leases	Mandatory	1.4.2001
AS – 20	Earnings per share	Mandatory	1.4.2001
AS – 21	Consolidated financial statements	Mandatory	1.4.2001
AS – 22	Accounting for taxes on income	Mandatory	1.4.2001
AS – 23	For investments in associates with consolidated financial statements	Mandatory	1.4.2002
AS – 24	Discontinuing operations	Mandatory	1.4.2004
AS – 25	Interim financial reporting	Mandatory	1.4.2002
AS – 26	Intangible assets	Mandatory	1.4.2003
AS – 27	Financial reporting of interest in joint venture	Mandatory	1.4.2004
AS – 28	Impairment of assets	Mandatory	1.4.2004
AS – 29	Provision, contingent liabilities and contingent assets	Mandatory	1.4.2004
AS – 30	Financial instrument: Recognition and measurement	Recommendation 1.4.2009 to 31.3.2011	1.4.2011

AS – 31	Financial instrument: Presentation	Recommendation 1.4.2009 to 31.3.2011	1.4.2011
AS – 32	Financial instrument: Disclosure	Recommendation 1.4.2009 to 31.3.2011	1.4.2011

5. **Compliance with accounting standards**
   a) During the period and accounting standard is recommendatory in nature, the members of the institute should, while discharging there a test function, examine whether the standard has been followed on not. If the same has not been followed, the member should consider whether, keeping in view the circumstances of the case, a disclosure in their audit reports is necessary.
   b) When's the standard becomes mandatory, it will be the duty of the members of the institute to examine, while discharging there a test functions, whether this accounting standard is compliant with in the presentation of financial statements covered by their audit. In the event of any deviation from the accounting standard, it will be their duty to make adequate disclosures in their audit report so that the users of financial statement may be aware of such deviations.

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

WHY THERE IS NEED OF HARMONIZATION?

Harmonization implies having conformity in accounting and reporting practices. Variations should be minimized. It should be at minimum level.
When originally accounting evolved, there is greater variation in accounting principles and practices. Many bodies like FASB, OECD took many steps to reduce these variations.
Now many countries try to achieve harmonization but since all the countries were following their own accounting standards so harmonization was never achieved. Hence harmonization was retaliated again and again but never achieved.

WHAT IS CONVERGENCE?

Convergence implies that all accounting standard setters around the world should agree on a single, high quality accounting standard.
Convergence can be achieved in 2 ways:

I. Either adopting International Financial Reporting Standards (IFRS) or
II. Adopt IFRS to formulate the country zone accounting standard

HISTORICAL BACKGROUND OF IFRS

INTERNATIONAL ACCOUNTING STANDARD COMMITTEE (IASC)

Few years back in 1973, body was established i.e., International Accounting Standard Committee (IASC) to push up harmonization. It composed of members of the developed nations. Its main objectives were:

1. To formulate and publish in the public interest accounting standards to be observed in the presentation of the financial statements and to promote their worldwide acceptance and observance.
2. To work generally for the improvement and harmonization of the accounting standard.

INTERNATIONAL FINANCIAL REPORTING STANDARD FOUNDATION

However, nothing happened from 1973-2000. As a consequence IASC itself approved constitutional changes necessary for its own restructuring.
A new IFRS foundation was incorporated and its trustees were appointed.
The IFRS Foundation is an independent, not-for-profit private sector organization working in the public interest. Its principal objectives are:

1. To develop a single set of high quality, understandable, enforceable and globally accepted International Financial Reporting Standards (IFRSs) through its standard setting body, the IASB;
2. To promote the use and rigorous application of those standards;
3. To take account of the financial reporting needs of emerging economics and small and medium sized entities (MSMEs) and;
4. To bring about convergence of national accounting standards and IFRSs to high quality solutions.

The governance and over-sight of the activities undertaken by the IFRS Foundation and its standard-setting body rests with its Trustees, who are also responsible for safeguarding the independence of the IASB and ensuring the financing of the organization. The Trustees are publicly accountable to Monitoring Board of Public Authorities.

INTERNATIONAL ACCOUNTING STANDARD BOARD (IASB)

WHAT IS IASB?

The IASB is the independent standard-setting body of the IFRS Foundation. Its members are responsible for the development and publication of IFRSs, including IFRS for SMEs and for approving interpretations of IFRSs as developed by the IFRS Interpretations Committee (formerly called IFRIC). All meetings of the IASB are held in public and webcast. In fulfilling its standard-setting duties the IASB follows a through, open and transparent due process of which the publication of consultative documents, such as discussion papers and exposure drafts, for public comment is an important component. The IASB engages closely with stakeholders around the world, including investors, analysts, regulators, business leaders, accounting standard-setters and the accountancy profession.
Formulation of IASB is necessary since:

1. There is recognized and growing need for common international accounting standards.
2. No individual setter has a monopoly over a best solution to accounting problem.
3. No national standard setter is in position to set accounting standard that can gain acceptance around the world.

WHAT ARE THE OBJCTIVES OF IASB?

1. To develop in the public interest, a single set of high quality, understandable and enforceable accounting standards that requires high quality, transparent and comparable financial information.
2. To promote the use and rigorous application of these accounting standards.
3. To bring about convergence.

STEPS TAKEN BY IASB FOR GOLBAL CONCERGENCE

1. **Insured a Conceptual Framework:** It had adopted the framework issues by the IASB in 1989. This framework, serves as guide to IASB for developing Accounting Standards.
2. **Issue of IAS:** Till now IASC had issued 41 International Accounting Standards:

IAS 1	Presentation of Financial Statements
IAS 2	Inventories
IAS 7	Statement of Cash Flow
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10	Events after the Balance Sheet date
IAS 11	Construction Contracts
IAS 12	Income Taxes
IAS 16	Property, Plant and Equipment
IAS 17	Leases
IAS 18	Revenue
IAS 19	Employee Benefits
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance
IAS 21	The Effects of Changes in Foreign Exchange Rates
IAS 23	Borrowing Costs
IAS 24	Related Party Disclosures
IAS 26	Accounting and Reporting by Retirement Benefit Plans
IAS 27	Consolidated and Separate Financial Statements
IAS 28	Investments in Associates
IAS 29	Financial Reporting in Hyperinflationary Economies
IAS 31	Interests in Joint Ventures
IAS 32	Financial Instruments: Presentation
IAS 33	Earnings per Share
IAS 34	Interim Financial Reporting
IAS 36	Impairment of Assets
IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 38	Intangible Assets
IAS 39	Financial Instruments: Recognition and Measurement
IAS 40	Investment Property
IAS 41	Agriculture

3. **Issue of International Financial Reporting Standards (IFRS):** till now IASB has issued 9 IFRS. The difference between IFRS and IAS is that IAS was issued by IASC up to year 2000. Thereafter standards are issued by IASB by the name IFRS. However, IASB adopted all IAS issued previously by the IASC and which will remain there till replaced or covered by new IFRS. Till now 9 IFRS has been issued. These are as follows:

IFRS 1	First-time adoption of International Financial Reporting Standards
IFRS 2	Share-based Payment
IFRS 3	Business Combinations
IFRS 4	Insurance Contracts
IFRS 5	Non-current Asset held for Sale and Discontinued Operations
IFRS 6	Exploration for and Evaluation of Mineral Resources
IFRS 7	Financial Instruments: Disclosures
IFRS 8	Operating Segments
IFRS 9	Financial Instruments

4. **Setting up the IFRS Interpretation Committee:** The IFRS Interpretation Committee (formerly called the IFRIC) is the interpretative body of the IASB. The role of this committee is to review on timely basis the context of IAS, IFRS and Framework, accounting issues that are debatable and issue clarification on that.

5. **Working closely with Intergovernmental Organisations** such as OECD, EU, ISAR, etc. so as to enforce member bodies to converge with the standards.

6. **Acceptance of IFRS by the International Organisation of Securities Commissions (IOSCO):** IOSCO is an association of organizations that regulate the world's securities and futures markets. Members are typically the Securities Commission or the main financial regulator from each country. IOSCO has members from over 100 different countries, who regulate more than 90 per cent of the world's securities markets. The organizations role is to assist its members to promote high standards of regulation and act as a forum for national regulators to cooperate with each other and other international organizations. Therefore, the acceptance of IFRS by IOSCO is major landmark since IOSCO can enforce its members to converge with such IFRS.

7. **First time adoption of IFRS (i.e., IFRS 1):** It prescribes the accounting and disclosure required by the first time adopters of IFRS.

8. Issued a draft of Memorandum of Undertaking (MOU) on the role of National Accounting Standard Setter and IASB. This document is intended to set out the shared vision. Through this 'MOU' has become important for National Accounting Standard Setters to converge with IFRS. The draft 'MOU' lays out the large number of responsibilities on national accounting standard setters.

9. Convergence with US GAAP.

MEANING OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRSs)

IFRSs refers to the entire body of IASB pronouncements, including standards and interpretations approved by the International Accounting Standard Board (IASB) & IASs and SIC interpretations approved by the predecessor International Accounting Standards Committee (IASC).
Broadly, IFRS consist of:

1. International Financial Reporting Standard (IFRS)
2. International Accounting Standard (IAS)
3. International Financial Reporting Interpretation Committee (IFRIC) Interpretations
4. Standard Interpretation Committee (SIC) Interpretation

Simply be put, IFRS are AS of the World.

DIFFERENCE BETWEEN IFRS AND AS

The Accounting Standards (AS) issued by ICAI are prepared on the basis of the Indian environment, while International Financial Reporting Standards (IFRS) are prepared by considering the global environment as a whole.

NEED FOR IND AS

The Indian environment and Global environment are different which leads to a huge gap between AS issued by ICAI and IFRS issued by IASB. So as to bridge the gap between AS and IFRS, ICAI issued Indian Accounting Standard converged with IFRS (formally known as Ind AS).

MEANING OF INDIAN ACCOUNTING SANDARDS CONVERGED WITH IFRS (IND AS)

Convergence means alignment of the standards with different standard setters with a certain rate of promise, by adopting he requirement of the standards either fully or partially.
Ind AS are set of accounting standards notified by Ministry of Corporate Affairs (MCA), converged with International Financial Reporting Standard (IFRS), these accounting standards are formulated by Accounting Standard Board (ASB) of Institute of Chartered Accountants of India (ICAI).
In a nut shell, Ind AS can be referred as "International Dish with Indian Flavour" or "Desi version of IFRS".

NEED FOR CHANGE

The Need for Change is to have common set of accounting standards. The benefits of having the common standards for financial reporting are the reasons which attract such change.

1. **Better Comparability: By** following a common set of standards, will help the stakeholders to compare the organizations globally, i.e., to create an apple to apple comparision.
2. **Better Transparency:** The users of accounts will be benefitted by this as, same accounting standards will help to them understand the fundamentals of the organization which will generate better transparency.
3. **Saving time & cost on the financial department:** Many companies having subsidiary or holding company is different countries are required to follow dual set of accounting standards, local standards on one hand and global standards on the other hand. The transition will be helpful in saving time and cost on the finance department. For example, Swiss Pharmaceutical giant ROCHE group, which operates in more than 100 countries, likely to save more than ₹100 million through convergence.
4. **Attract Foreign Investment:** Since the investors can compare with other organizations globally, it will help them to take investment decision, at the same time it will help the organization to prevent their financial position in more efficient way to the world, in a language that all can understand.

ARGUMENTS IN FAVOUR OF IFRS

1. **Growth in International Business:** As international business and investment multiplies, accounting international dimension broadens and it becomes more important as the tool of communication among businessman, entrepreneurs, financers and investors. If accounting wants to serve as universal means of communication, then there must be uniformity in accounting practices and that can be achieve through IFRS.
2. **Globalization of Capital Markets:** Today companies are going globally to acquire the funds. Like companies acquiring funds through ADRs, GDRs, etc. Now if there is accounting difference then the investor could not analyses the accounts of other countries. So IFRS helps in reducing these accounting differences.
3. **Investors:** Nowadays investors want to invest outside their country. Investors include both type of investors i.e., international company investing directly into other country or individual investors. Now if accounts are comparable then they can make sound decision. If accounts are different then they cannot make sound decision. Now if there is no harmonization then it is difficult to assess the relative merit of investment opportunities.
4. **Multinational Companies:** A major force in the movement towards adoption of IFRS has been the economic self interest of multinational companies. With diversity in Accounting Standards from country to country, these firm faces lot of accounting requirements from the countries in which they operate. Now due to adoption of IFRS there would be fewer burdens on their financial reporting structure. Due to IFRS they can easily consolidate their subsidiaries as they are taking funds from many countries so investors across different countries can understand their financial statements.

5. **International Auditing Firms:** Another major force in the movement towards IFRS was the economic self interest of international auditing firms like PWC, Deloitte, KPMG, Ernst & Young, etc., so they can sell their service as expert in different countries.
6. **Developing Countries:** Countries that do not have and domestic Accounting Standards would benefit from international standards since it will enable them to adopt readymade system.
7. **Other interest Group:** Such as tax authorities or government will find it easier to tax foreign concern if their accounts are prepared by following IFRS.

ARGUMENTS AGAINST IFRS

DIFFICULTIES IN FORMULATION OF IFRS

1. Nationalism: Many countries believe that their views are superior to those of theirs. Due to this behavior there is great difficulty in achieving a common solution.
2. Difference in Economic and Social Environment: Standard setting on international level is adversely affected by the difference in economic and social environment in which accounting has the role to play. In some countries information need of government may dominate accounting structure and in some countries need of investor may dominate accounting structure.
3. Diverse Accounting Practice: The is wide divergence in worldwide accounting practices. Each practice has its own justification. But this creates difficulty in arriving at commonality.
4. Gaps between Developed and Developing Countries: in many areas, developing countries differ from those of developed. In fact, most developing countries have little chance to evolve accounting systems which truly reflect the needs and circumstances of their countries. Now copying the model of developed countries will not fill their needs.

DIFFICULTIES IN ENFORCEMENT OF IFRS

1. Difference in Tax Laws of Nations.
2. Difference in Corporate Laws.
3. Disclosure requirements under any other statute.
4. Existence of Local Standards.
5. Competition among International Standards Setting agencies like OECD.
6. Unethical conduct by Corporate houses like Satyam, Enron, etc.

SUGGESTION FOR MORE EFFECTIVE ADOPTION OF IFRS

1. Enlarge representation on IASB.
2. Avoid political pressure.
3. IASB should publicise its standard world widely and try to get support of accounting profession, member countries and countries and corporate all over the world and investors all over the world.
4. Every country should pass legislation to enforce IFRS.
5. UN should recognize IASB as the body qualified to set up international standard give it authority to force universal acceptance of IFRS.
6. In each country, securities exchange should take an appropriate action that company registering with them is required to comply with IFRS.
7. Continuous research is needed.

UNIT 9: Indian Accounting Standards

NEED FOR CONVERGENCE TOWARDS GLOBAL STANDARDS

The last decade has witnessed a sea change in the global economic scenario. The emergence of transnational corporations in search of money, not only for fueling growth, but to sustain on going activities has necessitated raising of capital from all parts of the world, cutting across frontiers.

Each country has its own set of rules and regulations for accounting and financial reporting. Therefore, when an enterprise decides to raise capital from the markets other than the country in which it is located, the rules and regulations of that other country will apply and this in turn will require that the enterprise is in a position to understand the differences between the rules governing financial reporting in the foreign country as compared to its own country of origin. Therefore, translation and re-instatements are of utmost importance in a world that is rapidly globalising in all ways. In themselves also, the accounting standards and principle need to be robust so that the larger society develops degree of confidence in the financial statements, which are put forward by organizations.

International analysts and investors would like to compare financial statements based on similar accounting standards, and this has led to the growing support for an internationally accepted set of accounting standards for cross-border filings. The harmonization of financial reporting around the world will help to raise confidence of investors generally in the information they are using to make their decisions and assess their risks.

Also a strong need was felt by legislation to bring about uniformity, rationalization, comparability, transparency and adaptability in financial statements. Having a multiplicity of accounting standards around the world is against the public interest. If accounting for the same events and information produces different reported numbers, depending on the system of standards that are being used, then it is self-evident that accounting will be increasingly discredited in the eyes of those using the numbers. It creates confusion, encourages error and facilitates fraud. The cure for these ills is to have a single set of global standards, of the highest quality, set in the interest of public. Global Standards facilitate cross border flow of money, global listing in different bourses and comparability of financial statements.

The convergence of financial reporting and accounting standards is a valuable process that contributes to the free flow of global investment and achieves substantial benefits for all capital market stakeholders. It improves the ability of investors to compare investments on a global basis and thus lowers their risk of errors of judgment. It facilitates accounting and reporting for companies with global operations and eliminates some costly requirements say reinstatement of financial statements. It has the potential to create a new standard of accountability and greater transparency, which are values of great significance to all market participants including regulators. It reduces operational challenges for accounting firms and focuses their value and expertise around an increasingly unified set of standards. It creates an unprecedented opportunity for standard setters and other stakeholders to improve the reporting model. For the companies with joint listings in both domestic and foreign country, the convergence is very much significant.

INTERNATIONAL FINANCIAL REPORTING STANDARDS AS GLOBAL STANDARDS

With a view of achieving convergence towards global reporting, the London based group namely the International Accounting Standards Committee (IASC), responsible for developing International Accounting Standards, was established in June, 1973. It is presently known as International Accounting Standards Board (IASB), The IASC comprises the professional accountancy bodies of over 75 countries (including the Institute of Chartered Accountants of India). Primarily, the IASC was established, in the public interest, to formulate and publish, International Accounting Standards to be followed in the presentation of audited financial statements. International Accounting Standards were issued to promote acceptance and observance of International Accounting Standards worldwide. The members of IASC have undertaken a responsibility to support the standards promulgated by IASC and to propagate those standards in their respective countries.

Between 1973 and 2001, the International Accounting Standards Committee (IASC) released International Accounting Standards. Between 1997 and 1999, the IASC restructured their organization, which resulted in formation of International Accounting Standards Board (IASB). These changes came into effect on 1st April, 2001. Subsequently, IASB issued statements about current and future standards: IASB publishes its Standards in a series of pronouncements called International Financial Reporting Standards (IFRS). However, IASB has not rejected the standards issued by the ISAC. Those pronouncements continue to be designated as “International Accounting Standards”(IAS).

The term IFRS comprises IFRS issued by IASB; IAS issued by International Accounting Standards Committee (IASC); Interpretations issued by the Standard Interpretations Committee (SIC) and the IFRS Interpretations Committee of the IASB.

International Financial Reporting Standards (IFRSs) are considered a "principles-based" set of standards. In fact, they establish broad rules rather than dictating specific treatments. Every major nation is moving toward adopting them to some extent. Large number of authorities requires public companies to use IFRS for stock- exchange listing purposes, and in addition, banks, insurance companies and stock exchanges may use them for their statutorily required reports. So over the next few years, thousands of companies will adopt the international standards. This requirement will affect about 7,000 enterprises, including their subsidiaries, equity investors and joint venture partners. The increased use of IFRS is not limited to public-company listing requirements or statutory reporting. Many lenders and regulatory and government bodies are looking to IFRS to fulfil local financial reporting obligations related to financing or licensing.

BENEFITS OF CONVERGENCE WITH IFRSs

There are many beneficiaries of convergence with IFRSs such as the economy, investors, industry etc.
The Economy: When the markets expand globally the need for convergence increases since the convergence benefits the economy by increasing growth of its international business. It facilitates maintenance of orderly and efficient capital markets and also helps to increase the capital formation and thereby economic growth. It encourages international investing and thereby leads to more foreign capital flows to the country.
Investors: A strong case for convergence can be made from the viewpoint of the investors who wish to invest outside their own country. Investors want the information that is more relevant, reliable, timely and comparable across the jurisdictions. Financial statements prepared using a common set of accounting standards help investors better understand investment opportunities as opposed to financial statements prepared using a different set of national accounting standards. Investors' confidence is strong when accounting standards used are globally accepted. Convergence with IFRS contributes to investors' understanding and confidence in high quality financial statements.
The Industry: A major force in the movement towards convergence has been the interest of the industry. The industry is able to raise capital from foreign markets at lower cost if it can create confidence in the minds of foreign investors that their financial statements comply with globally accepted accounting standards. With the diversity in accounting standards from country to country, enterprises which operate in different countries face a multitude of accounting requirements prevailing in the countries. The burden of financial reporting is lessened with convergence of accounting standards because it simplifies the process of preparing the individual and group financial statements and thereby reduces the costs of preparing the financial statements using different sets of accounting standards.

DEVELOPMENT IN INDIAN ACCOUNTING STANDARDS (IND AS)

The Institute of Chartered Accountants of India (ICAI) being the accounting standards-setting body in India, way back in 2006, initiated the process of moving towards the International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB) with a view to enhance acceptability and transparency of the financial information communicated by the Indian corporates through their financial statements. This move towards IFRS was subsequently accepted by the Government of India.

The Government of India in consultation with the ICAI decided to converge and not to adopt IFRSs issued by the IASB. The decision of convergence rather than adoption was taken after the detailed analysis of IFRS requirements and extensive discussion with various stakeholders. Accordingly, while formulating IFRS- converged Indian Accounting Standards (Ind AS), efforts have been made to keep these Standards, as far as possible, in line with the corresponding IFRS and departures have been made where considered absolutely essential. These changes have been made considering various factors, such as, various terminology related changes have been made to make it consistent with the terminology used in law. Certain changes have been made considering the economic environment of the country, which is different as compared to the economic environment presumed to be in existence by IFRS.

What are Indian Accounting Standards (Ind AS)?

Indian Accounting Standards (Ind-AS) are the International Financial Reporting Standards (IFRS) converged standards issued by the Central Government of India under the supervision and control of Accounting Standards Board (ASB) of ICAI and in consultation with National Advisory Committee on Accounting Standards (NACAS).

National Advisory Committee on Accounting Standards (NACAS) recommend these standards to the Ministry of Corporate Affairs (MCA). MCA has to spell out the accounting standards applicable for companies in India.

Government of India - Commitment to IFRS Converged Ind AS

Initially Ind AS were expected to be implemented from the year 2011. However, keeping in view the fact that certain issues including tax issues were still to be addressed, the Ministry of Corporate Affairs decided to postpone the date of implementation of Ind AS.

In July 2014, the Finance Minister of India at that time, Shri Arun Jaitely ji, in his Budget Speech, announced an urgency to converge the existing accounting standards with the International Financial Reporting Standards (IFRS) through adoption of the new Indian Accounting Standards (Ind AS) by the Indian companies.

Pursuant to the above announcement, various steps have been taken to facilitate the implementation of IFRS- converged Indian Accounting Standards (Ind AS). Moving in this direction, the Ministry of Corporate Affairs (MCA) has issued the Companies (Indian Accounting Standards) Rules, 2015 vide Notification dated February 16, 2015 covering the revised roadmap of implementation of Ind AS for companies other than Banking companies, Insurance Companies and NBFCs and Indian Accounting Standards (Ind AS). As per the Notification, Indian Accounting Standards (Ind AS) converged with International Financial Reporting Standards (IFRS) shall be implemented on voluntary basis from 1st April, 2015 and mandatory from 1st April, 2016. Later on, in 2016 MCA notified roadmap for NBFC announcing implementation date for Ind AS. Similarly, Banking and Insurance regulatory authority have issued separate roadmaps for implementation of Ind AS for Banking and Insurance companies respectively.

LIST OF IND AS

Ind AS	Title of Ind AS
101	First -Time Adoption of Indian Accounting Standards
102	Share- Based Payment
103	Business Combinations
104*	Insurance Contracts
105	Non-current Assets Held for Sale and Discontinued Operations
106	Exploration for and Evaluation of Mineral Resources
107	Financial Instruments: Disclosures
108	Operating Segments
109	Financial Instruments
110	Consolidated Financial Statements
111	Joint Arrangements
112	Disclosure of Interests in Other Entities
113	Fair Value Measurement
114	Regulatory Deferral Accounts
115	Revenue from Contracts with Customers
116	Leases
1	Presentation of Financial Statements
2	Inventories
7	Statement of Cash Flows
8	Accounting Policies, Changes in Accounting Estimates and Errors
10	Events after the Reporting Period
12	Income Taxes
16	Property, Plant and Equipment
19	Employee Benefits
20	Accounting for Government Grants and Disclosure of Government Assistance
21	The Effects of Changes in Foreign Exchange Rates
23	Borrowing Costs
24	Related Party Disclosures
27	Separate Financial Statements
28	Investment in Associates and Joint Ventures
29	Financial Reporting in Hyperinflationary Economies
32	Financial Instruments: Presentation
33	Earnings per Share
34	Interim Financial Reporting
36	Impairment of Assets
37	Provisions, Contingent Liabilities and Contingent Assets
38	Intangible Assets
40	Investment Property
41	Agriculture

Ind AS 117 Insurance Contracts is under formulation and it will replace this.

Note: *The list of Ind AS given above does not form part of syllabus. It has been given here for the knowledge of students only.*