1. THEORETICAL FRAMEWORK

UNIT 1 : MEANING AND SCOPE OF ACCOUNTING

CONCEPT 1 : INTRODUCTION

- Every individual performs some kind of economic activity.
- Not necessarily all the economic activities are run for any individual benefit; some economic activities may create social benefit i.e. benefit for the public, at large.

Economic Activity

- **Transaction**
  - A business, performance of an act, an agreement.
    - [1] An individual invests Rs.2,00,000
    - [2] Purchases goods for Rs.1,15,000.
    - [3] Sells for Rs.1,47,000.
    - [4] He pays shop rent for the month Rs.5,000.
- **Event**
  - A happening, as a *consequence of transaction*(s), a result.
    - [1] Earning of Rs.42,000surplus is an event.
    - [2] Inventories in hand.

- Here raising money through various sources can be termed as transaction and surplus or deficit at the end of the accounting year can be termed as an event.
- So, everybody wants to keep records of all transactions and events as an aid to decision-making.
- Accounting has universal application for recording transactions and events and presenting suitable information to aid decision-making.
- The growth of accounting discipline is closely associated with the development of the business world.
- The aim of accounting is to meet the information needs of the rational and sound decision-makers, and thus, called the language of business.

CONCEPT 2 : MEANING OF ACCOUNTING [T.Q. 1]

Definition :

- "Accounting is the art of recording, classifying, and summarising
  in terms of money, transactions and events
  of a financial character, and
  interpreting the result thereof."

Process :

[1] First identifying the events and transactions and then be recorded in the books of account. This recording is done in Journal or subsidiary books, also known as primary books.

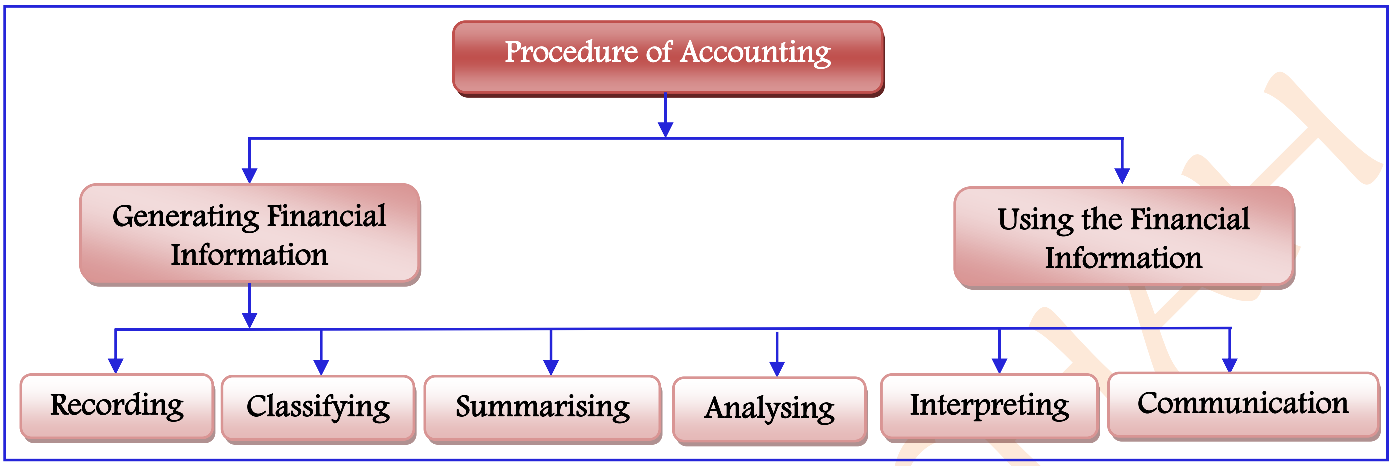
[2] After recording, they are transferred to secondary books i.e. Ledger. In ledger it is classified in terms of income, expense, assets and liabilities according to their characteristics and summarised in profit & loss account and balance sheet.

Measurement :

- Essentially the transactions and events are to be measured in terms of money.
- Measurement in terms of money means measuring at the ruling currency of a country, for example, rupee in India, dollar in U.S.A. and like.

PROCEDURAL ASPECTS OF ACCOUNTING

- On the basis of the above definitions, procedure of accounting can be basically divided into two parts:
  [i] Generating financial information and
  [ii] Using the financial information.
- The procedural aspects of accounting can be explained with the help of the following chart:



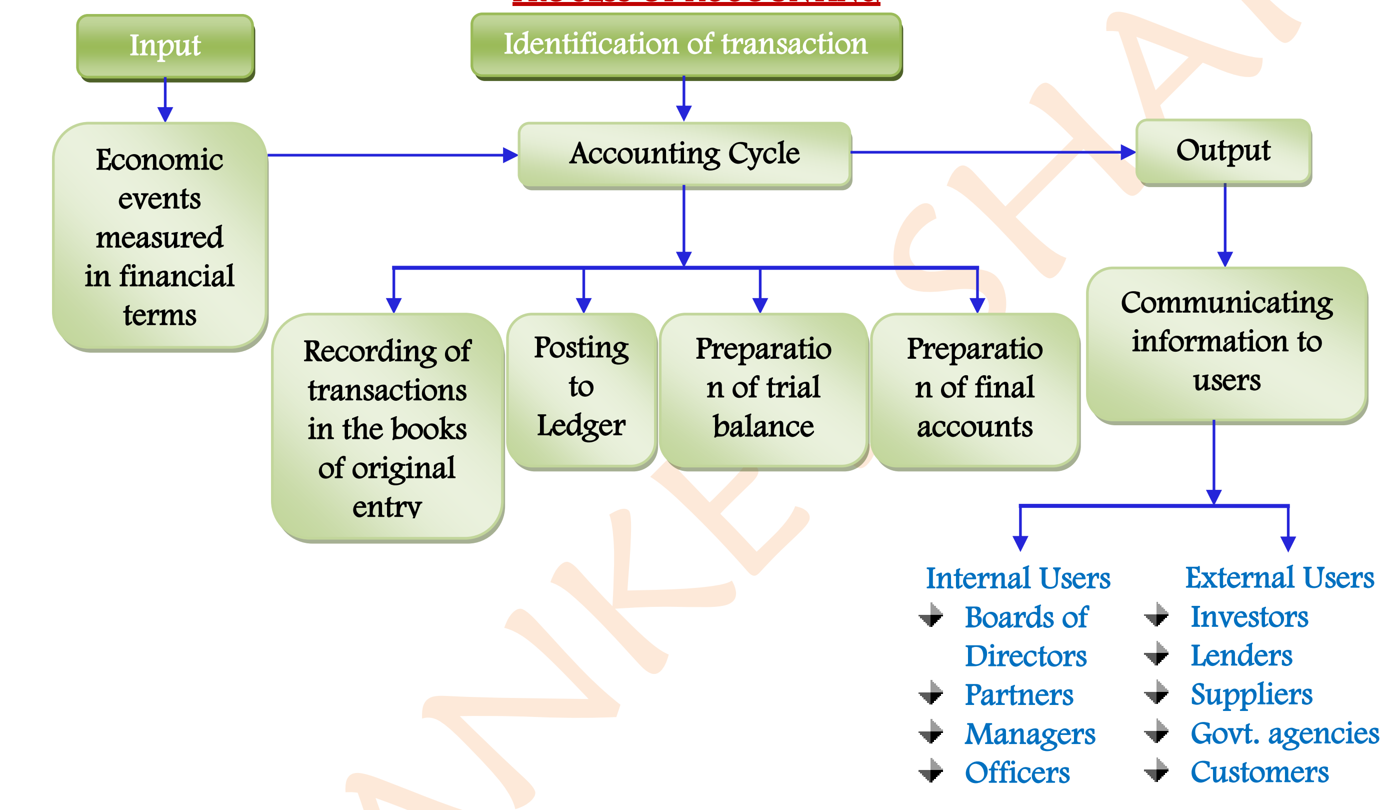
[i] Generating Financial Information

Sr No.	GFI	Explanation
[a]	Recording	¤ Basic function of accounting evidenced by sales bill, pass book, salary slip etc. are recorded in the books of account. ¤ Recording is done in a book called "Journal." ¤ This book may further be divided into several subsidiary books according to the nature and size of the business.
[b]	Classifying	¤ It is systematic analysis of the recorded data. ¤ The book containing classified information is called "Ledger". ¤ This will help in finding out the total expenditure incurred under each of the above heads.
[c]	Summarising	¤ It is concerned with the preparation and presentation of the classified data useful to the internal as well as the external users of financial statements. ¤ This process leads to the preparation of financial statements: [a] Trial Balance [b] Profit and Loss Account [c] Balance Sheet [d] Cash-flow Statement.
[d]	Analysing	¤ The term 'Analysis' means methodical classification of the data given in the financial statements. ¤ The figures given in the financial statements will not help anyone unless they are in a simplified form. ¤ For example, all items relating to fixed assets are put at one place while all items relating to current assets are put at another place.
[e]	Interpreting	¤ The recorded financial data is analysed and interpreted in a manner that will enable the end-users to make a meaningful judgement about the financial condition and profitability of the business operations.
[f]	Communicating	¤ It is concerned with the transmission of summarised, analysed & interpreted information to the end-users to enable them to make rational decisions. ¤ This is done through preparation and distribution of accounting reports.

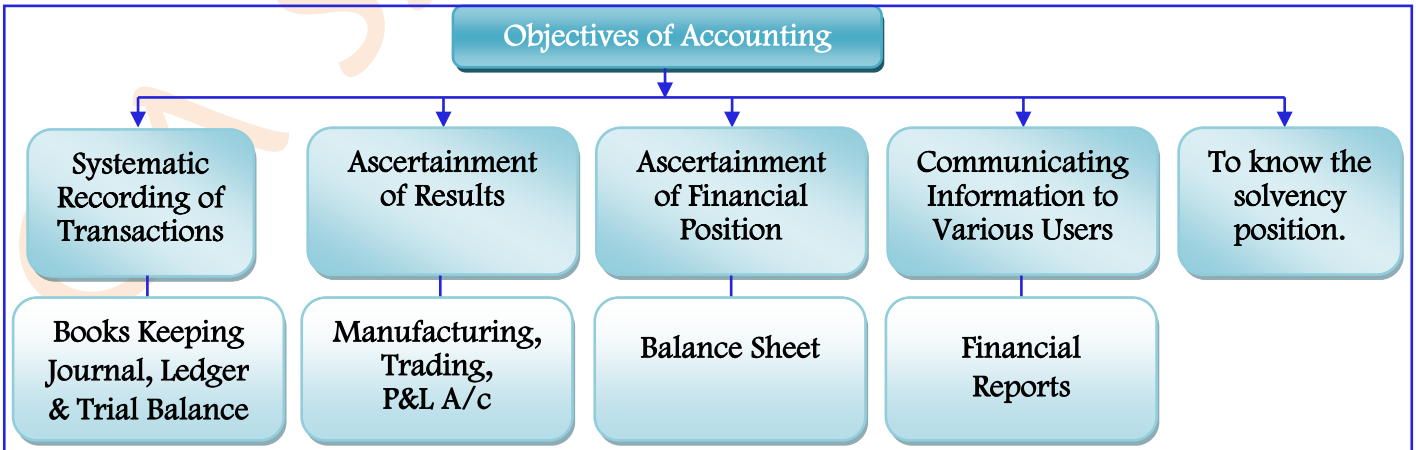
[ii] Using the Financial Information

- Earlier it was viewed that accounting is meant for the proprietor or owner of the business, but changing social relationships diluted the earlier thinking.
- Besides the owner include the investors, employees, lenders, suppliers, customers, government and other agencies and the public at large.
- Accounting provides the art of presenting information systematically to the users of accounts.
- Accounting data is more useful if it stresses economic substance rather than technical form.
- Information is useless and meaningless unless it is relevant and material to a user's decision.
- The information should also be free of any biases.

PROCESS OF ACCOUNTING



CONCEPT 3 : OBJECTIVES OF ACCOUNTING (SAAP To Know)



CONCEPT 4 : FUNCTIONS OF ACCOUNTING
(Memory technique : MF DC ko Control karta hai & Taxes pay karta hai)

Sr. no.	Functions	Explanation
[1]	Measurement :	¤ It measures past performance and depicts its current financial position.
[2]	Forecasting :	¤ It helps in forecasting future performance and financial position.
[3]	Decision-making :	¤ It provides relevant information to the users of accounts to aid rational decision-making.
[4]	Comparison & Evaluation :	¤ Accounting assesses performance achieved in relation to targets &discloses information regarding accounting policies & contingent liabilities which play role in predicting, comparing & evaluating the financial results.
[5]	Control :	¤ Accounting identifies weaknesses of the operational system and provides feedbacks to check weaknesses.
[6]	Government Regulation & Taxation :	¤ Accounting provides necessary information to the government to exercise control on the entity as well as in collection of tax revenues.

CONCEPT 5 : BOOK – KEEPING& ITS OBJECTIVES

➥ Book-keeping is an activity concerned with the recording of financial data relating to business operations in a significant and orderly manner.

❈ OBJECTIVES OF BOOK-KEEPING

[a] Complete Recording of Transactions :

➥ It is concerned with complete and permanent record of all transactions in a systematic and logical manner to show its financial effect on the business.

[b] Ascertainment of Financial Effect on the Business :

➥ It is concerned with the combined effect of all the transactions made during the accounting period upon the financial position of the business as a whole.

CONCEPT 6 : DISTINCTION BETWEEN BOOK – KEEPING AND ACCOUNTING

✷ Accounting is a broad subject. It calls for a greater understanding of records obtained from book-keeping and an ability to analyse and interpret the information provided by book-keeping records.

Sr. no.	Point of Distinction	Book – Keeping	Accounting
1]	Meaning	It is a process concerned with recording of transactions.	Process concerned with summarising of the recorded transactions.
2]	Constitutes	It constitutes as a base for accounting	It is considered as a language of the business.
3]	Financial Statements	It does not form part of this process.	It is prepared in this process.
4]	Managerial Decisions	Cannot be taken.	Taken.
5]	Subfield	No sub-field.	Several sub-fields like financial accounting, management accounting.
6]	Financial Position	Cannot be ascertained through book-keeping records.	Ascertained on the basis of the accounting reports.

CONCEPT 7 : SUB – FIELDS OF ACCOUNITNG [T.Q. 1]

Sr. no.	Functions	Explanation
[1]	Financial Accounting	➥ It covers the preparation and interpretation of financial statements and communication to the users of accounts. ➥ It is historical in nature as it records transactions which had already been occurred. ➥ The final step of financial accounting is the preparation of Profit and Loss Account and the Balance Sheet.
[2]	Management Accounting :	➥ It is concerned with internal reporting to the managers of a business unit. ➥ To discharge the functions of stewardship, planning, control and decision making, the management needs variety of information. ➥ The different ways of grouping information and preparing reports as desired by managers for discharging their functions are referred to as management accounting.
[3]	Cost Accounting :	➥ "The process of accounting for cost which begins with the recording of income and expenditure or the bases on which they are calculated and ends with the preparation of periodical statements and reports for ascertaining and controlling costs."
[4]	Social Responsibility Accounting :	➥ Social responsibility accounting is concerned with accounting for social costs incurred by the enterprise and social benefits created.
[5]	Human Resource Accounting :	➥ Human resource accounting is an attempt to identify, quantify and report investments made in human resources of an organisation that are not presently accounted under conventional accounting practice.

CONCEPT 8 : USERS OF ACCOUNTING INFORMATION [T.Q. 2]

☛ Generally users of accounts are classified into two categories,

[a] Internal management and owners; and

[b] External users or outsiders.

Sr. no.	Users	Explanation
[1]	Investors :	▶ They provide risk capital to the business. ▶ They need information to assess whether to buy, hold or sell their investment. ▶ Also they are interested to know the ability of the business to survive, prosper and to pay dividend.
[2]	Employees :	▶ Growth of the employees is directly related to the growth of the organisation and therefore, they are interested to know the stability, continuity and growth of the enterprise.
[3]	Lenders :	▶ They are interested to know whether their loan-principal and interest will be paid when due.
[4]	Suppliers and Creditors :	▶ They are also interested to know the ability of the enterprise to pay the dues, that helps them to decide the credit policy for the relevant concern, rates to be charged and so on.
[5]	Customers :	▶ Customers are also concerned with the stability and profitability of the enterprise because their functioning is more or less dependent on the supply of goods.

[6]	Government & their agencies :	▸ They regulate the functioning of business enterprises for public good, allocate scarce resources among competing enterprises, control prices, charge excise duties and taxes, and so they have continued interest in the business enterprise.
[7]	Public :	▸ The public at large is interested in the functioning of the enterprise because it may make a substantial contribution to the local economy in many ways including the number of people employed.

CONCEPT 9 : RELATIONSHIP OF ACCOUNTING WITH OTHER DISCIPLINES [T.Q. 3]

¤ Accounting is closely related with several other disciplines and the Accountant should have a working knowledge of the related disciplines so that he can understand such overlapping areas.

[a] Accounting and Economics :

Similarities	Difference	Nexus
❋ Economics : ▸ It is 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 ▸ It provides data to the users to permit informed judgement and decisions.	▸ In concepts of income and capital.	▸ Accountants got the ideas of value, income and capital maintenance from economists. ▸ Economists think that value of an asset is the present value of all future earnings which can be derived from such assets. ▸ 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.

[b] Accounting and Statistics :

▸ In accountancy, a number of financial and outer ratios are based on statistical methods, which help in averaging them over a period of time. ▸ Statistical methods are helpful in developing accounting data and in their interpretation.	[1] In accounts, all values are important individually because they relate to business transactions. [2] Statistics is concerned with typical value over a period of time or degree of variation over a series of observations. [3] Accounting records generally take a short-term view of events (a year) while statistical analysis is more useful if a longer view is taken for the purpose.	▸ Accounting records are based on historical costs of fixed assets, while the current assets are valued at the current values. The new methods of inflation accounting are an attempt to correct this situation. ▸ The correction of values is made on the basis of the current purchasing power of money. ▸ All this would require the use of price indices or the price deflators based on statistical data.

[c] Accounting and Mathematics :

- Double Entry book-keeping can be converted in algebraic form.
- 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.
- 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 for classifying and summarising data.
- Presently graphs and charts are being extensively used for communicating accounting information.

[d] Accounting and Law :

- 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. Every country has a set of economic, fiscal and labour laws.
- Transactions and events are always guided by laws.
- 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. Banking, insurance and electric supply undertakings also have to produce financial statements as prescribed by the respective legislations.

[e] Accounting and Management :

- Management is a broad occupational field.
- 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.
- So the accounting system can be moulded to serve the management purpose.

CONCEPT 10 : LIMITATIONS OF ACCOUNTING [T.Q. 4]

➥ The assumptions and conventions, on which the accounting is based, become the limitations of accounting.

[a] The Balance sheet cannot reflect the value of certain factors like loyalty and skill of the personnel.

[b] Balance Sheet shows the position on the day of its preparation and not on the future date. Users are interested in knowing the position in the near future and not for the past date.

[c] Accounting ignores changes in some money factors like inflation etc.

[d] There are occasions when accounting principles conflict with each other.

[e] Certain accounting estimates depend on the personal judgement of the accountant, e.g., provision for doubtful debts, method of depreciation adopted.

[f] Financial statements only consider those assets which can be expressed in monetary terms. Human resources although very important are not shown in the balance sheet.

[g] Different accounting policies for the treatment of same item add to the probability of manipulations.

☞ It can be said that the language of accounting has certain practical limitations and, therefore, the financial statements should be interpreted carefully keeping in mind all various factors influencing the true picture.

CONCEPT 11 : ROLE OF CHARTERED ACCOUNTANT IN THE SOCIETY [T.Q. 5]

[A] AREAS OF SERVICE

[1] Maintenance of Books of Accounts

[2] Statutory Audit

[3] Internal Audit

[4] Taxation

[5] Management Accounting and Consultancy Services

[6] Financial Advice
- [a] Investments
- [b] Insurance
- [c] Business Expansion
- [d] Investigations
- [e] Pension schemes

[7] Other Services
- [a] Secretarial Work
- [b] Share Registration Work
- [c] Company Formation
- [d] Receiverships, Liquidations, etc.
- [e] Arbitrations
- [f] As Regards the Cost Accounts
- [g] Accountant and Information Services

[B] CHARTERED ACCOUNTANT IN INDUSTRY

[C] CHARTERED ACCOUNTANT IN PUBLIC SECTOR ENTERPRISES

[D] CHARTERED ACCOUNTANT IN FRAMING FISCAL POLICIES

[E] CHARTERED ACCOUNTANT AND ECONOMIC GROWTH

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UNIT 2 : ACCOUNTING CONCEPTS, PRINCIPLES AND CONVENTIONS

CONCEPT 1 : INTRODUCTION

- A situation where you are a proprietor and you take copies of your books of account to five different accountants. After few days, financial statements of five accountants have different amounts of profits and with very wide variations. To avoid this, a generally accepted set of rules have been developed.
- Accounting is a language of the business. Financial statements communicate financial information to the various stakeholders for decision-making purpose.
- Financial statements prepared by different organizations should be prepared on uniform basis. There should be consistency over a period of time in the preparation.
- 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,
- 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.

CONCEPT 2 : ACCOUNTING CONCEPTS

- Accounting concepts define the assumptions on the basis of which financial statements of a business entity are prepared.
- The word concept means idea or notion, which has universal application.

CONCEPT 3 : ACCOUNTING PRINCIPLES

- "Accounting principles are associated with the guide for selection of conventions or procedures where alternatives exist."
- Accounting principles must satisfy the following conditions: They must be
  [a] based on real assumptions;
  [b] Simple, understandable and explanatory;
  [c] Followed consistently;
  [d] Able to reflect future predictions;
  [e] Informational for the users.

CONCEPT 4 : ACCOUNTING CONVENTIONS [T.Q. 1(iii)]

- Accounting conventions emerge out of accounting practices, adopted by various organizations over a period of time.
- They derived by usage & practice.
- The accountancy bodies may change convention to improve the quality of accounting information.
- They need not have universal application.

CONCEPT 5 : CONCEPTS, PRINCIPLES AND CONVENTIONS – AN OVER VIEW

	Concept	Explanation
[1]	Entity concept	• Business enterprise is a separate identity apart from its owner. • Business transactions are recorded in the business books of accounts. This concept helps in keeping business affairs free from influence of personal affairs of owner. • Since the owner invested capital, which is also risk capital he has claim on the profit of the enterprise.

[2]	Money measurement concept [T.Q. 2 (i)]	☞ Since money is the medium of exchange, only those transactions which can be measured in terms of money are recorded. ☞ E.g. Employees are assets of the organizations but their measurement in monetary terms is not possible so not included in the books. ☞ Measuring unit for money is taken as currency of the ruling country. Ruling currency of a country provides common denomination for the value of material objects.
[3]	Periodicity concept [T.Q. 1(ii)]	☞ This is also called the concept of definite accounting period. As per 'going concern' concept an indefinite life of the entity is assumed. ☞ Eg. : If a textile mill lasts for 100 years, it is not desirable to measure its performance as well as financial position only at the end of its life. ☞ Generally one year period is taken up for performance measurement and appraisal of financial position. ☞ However, it may also be 6 months or 9 months or 15 months. ☞ According to this concept accounts should be prepared after every period & not at the end of the life of the entity. Usually this period is one calendar year. ☞ In India we follow from 1st April of a year to31st March. ☞ This concept makes the accounting system workable& term 'accrual' meaningful. ☞ Accrued expenses or accrued revenue is only with reference to a finite time-frame which is called accounting period. ☞ Thus, the periodicity concept facilitates in : (i) Comparing financial statements of different periods. (ii) Uniform and consistent accounting treatment. (iii) Matching periodic revenues with expenses.
[4]	Accrual concept	☞ The effects of transactions and other events are recognised on mercantile basis i.e., and they are recorded in the accounting records periods to which they relate. ☞ Expense is a cost relating to the operations of an accounting period or to the revenue earned during the period or the benefits of which do not extend beyond that period. ☞ Accrual means recognition of revenue and costs as they are earned or incurred and not as money is received or paid.
[5]	Matching concept [T.Q. 2 (ii)]	☞ All expenses matched with the revenue of that period should be taken into consideration, ☞ This concept is based on accrual concept do not concentrate on actual inflow or outflow of cash. ☞ This leads to adjustment of certain items like prepaid and outstanding expenses, unearned or accrued incomes. ☞ It is not necessary that every expense identify every income. Some expenses are directly related to the revenue and some are time bound. For example : selling expenses are directly related to sales but rent, salaries etc are recorded on accrual basis for a particular accounting period, periodicity concept has also been followed while applying matching concept.
[6]	Going Concern concept [T.Q. 3 (i)]	☞ The financial statements are normally prepared on the assumption that an enterprise is a going concern and will continue in operation for the foreseeable future. ☞ The valuation of assets of a business entity is dependent on this assumption. Traditionally, accountants follow historical cost in majority of the cases.

		☞ If going concern concept is taken, increase/ decrease in the value of assets in the short-run is ignored. The concept indicates that assets are kept for generating benefit in future, not for immediate sale; current change in the asset value is not realisable and so it should not be considered.
[7]	Cost concept [T.Q. 3 (ii)]	☞ By this concept, the value of an asset is to be determined on the basis of historical cost, in other words, acquisition cost. ☞ Other measurement bases (Current, Replacement, Realisable) are not so proper. ☞ Limitation : [a] In an inflationary situation when prices of all commodities go up on an average, acquisition cost loses its relevance. [b] Historical cost-based accounts may lose comparability. [c] Many assets do not have acquisition costs. Human assets of an enterprise are an example. The cost concept fails to recognise such asset although it is a very important asset of any organization.
[8]	Realisation concept	☞ It closely follows the cost concept. ☞ Any change in value of an asset is to be recorded only when business realises it. ☞ When an asset is recorded at its historical cost of Rs.5,00,000 and even if its current cost is Rs.15,00,000 such change is not counted unless there is certainty that such amount will realised. ☞ If accountants anticipate decrease in value they count it, but if there is increase in value they ignore it until it is realised. ☞ Economists are highly critical about the realisation concept. ☞ Now-a-days the revaluation of assets has become a widely accepted practice when the change in value is of permanent nature. Accountants adjust such value change through creation of revaluation (capital) reserve. ☞ Thus the going concern, cost concept and realization concept gives the valuation criteria.
[9]	Dual aspect concept	☞ This concept is the core of double entry book-keeping. Every transaction or event has two aspects: ❊ Transactions [a] New machine is purchased paying Rs.50,000 in cash [A↑A↓] [b] New machine purchased for 50,000 on credit, cash is to be paid later on[A↑ L↑] [c] Cash paid to repay bank loan to the extent of Rs.50,000 [A↓ L↓] [d] Raised bank loan of Rs.50,000 to pay off other loan [L↑L↓]
[10]	Conservatism	☞ Accountant should not anticipate income & should provide for all possible losses. ☞ When there are many alternative values of an asset, an accountant should choose the method which leads to the lesser value. ☞ Current assets valuation - 'cost or market price' whichever is lower originated from this concept. ☞ The realisation Concept also states that no change should be counted unless it has materialised. ☞ For this concept three qualitative characteristics namely, [a] Prudence, [b] Neutrality, unbiased outlook possible losses, as well as to uncertain gains, [c] Faithful representation of alternative values. ☞ Conservatism essentially leads to understatement of income and wealth and it should not be the basis.

[11]	Consistency	☞ In order to achieve comparability the accounting policies are followed consistently from one period to another; change in an accounting policy is made only in certain exceptional circumstances. ☞ An enterprise should change its accounting policy in any of the following circumstances only : (i) To bring the books of accounts in accordance with issued Accounting Standards. (ii) To compliance with the provision of law. (iii) When under changed circumstances it is felt that new method will reflect more true and fair picture in the financial statement.
[12]	Materiality	☞ Materiality principle permits other concepts to be ignored, if the effect is not considered material. ☞ This principle is an exception of full disclosure principle. ☞ All the items having significant economic effect on the business of the enterprise should be disclosed in the financial statements and any insignificant item which will only increase the work need should not be disclosed ☞ The term materiality is the subjective term. It is on the judgement, common sense and discretion of the accountant. ☞ Depreciation on small items like books, calculators etc. is taken as 100% in the year of purchase though used by the entity for more than a year. This is because the amount of books or calculator is very small to be shown in the balance sheet ☞ The materiality depends upon the size of the business, nature and level of information, level of the person making the decision etc. ☞ Item material to one person may be immaterial to another person.

CONCEPT 6 : FUNDAMENTAL ACCOUNTING ASSUMPTIONS [T.Q. 1(i)]

[a] Going Concern
[b] Consistency
[c] Accrual

- If nothing has been written about the fundamental accounting assumption in the financial statements then it is assumed that they have already been followed in their preparation of financial statements.
- However, if any assumption is not followed then this fact should be specifically disclosed.

CONCEPT 7 : FINANCIAL STATEMENTS

- The financial statements are basic means through which the management of an entity makes public communication of the financial information along with selected quantitative details.

QUALITATIVE CHARACTERISTICS OF FINANCIAL STATEMENTS [T.Q. 3]

☞ Qualitative characteristics are the attributes that make the information provided in financial statements useful to users.

☞ The four principal qualitative characteristics are understandability, relevance, reliability and comparability.

Sr. no.	Concept	Explanation
[1]	Understandability	☞ An essential quality of financial statement is that it must be readily understandable by users. ☞ It is assumed that users have a reasonable knowledge of business and economic activities and accounting.

[2]	Relevance	☞ Information must be relevant to the decision-making needs of users. ☞ Information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events. ☺ For example, information about the current level and structure of asset holdings has value to users when they endeavour to predict the ability of the enterprise to take advantage of opportunities.
[3]	Reliability	☞ Information has the quality of reliability when it is free from material error.
[4]	Comparability	☞ Users must be able to compare the financial statements of an enterprise through time in order to identify trends in its financial position, performance and cash flows.
[5]	Materiality	☞ Information is material if its misstatement (i.e., omission or erroneous statement) could influence the economic decisions of users taken on the basis of the financial information.
[6]	Faithful Representation	☞ A balance sheet should represent faithfully the transactions and other events that result in assets, liabilities and equity of the enterprise at the reporting date which meet the recognition criteria. ☞ In certain cases, the measurement of the financial effects of items could be so uncertain that enterprises generally would not recognise them in the financial statements; for example, although most enterprises generate goodwill internally over time, it is usually difficult to identify or measure that goodwill reliably.
[7]	Substance Over Form	☞ Where rights and beneficial interest in an immovable property are transferred but the documentations and legal formalities are pending, the recording of acquisition/disposal (by the transferee and transferor respectively) would in substance represent the transaction entered into.
[8]	Neutrality	☞ Financial statements are not neutral if, by the selection or presentation of information, they influence the making of a decision or judgement in order to achieve a predetermined result or outcome.
[9]	Prudence	☞ Prudence is the inclusion of a degree of caution in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated.
[10]	Full, fair & adequate disclosure	☞ The principle of full disclosure implies that nothing should be omitted ☞ The principle of fair disclosure implies that financial statement should show true and fair view of the results of the business. ☞ The disclosures of all the major accounting policies and other information are to be provided in the form of footnotes, annexures etc.
[11]	Completeness	☞ To be reliable, the information in financial statements must be complete within the bounds of materiality and cost. ☞ An omission can cause information to be false or misleading and thus unreliable.

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UNIT 4 : CAPITAL AND REVENUE EXPENDITURES AND RECEIPTS

CONCEPT 1 : INTRODUCTION

- For ascertaining the periodical business results, the nature of transactions should be analysed whether they are of capital or revenue nature.
- The Revenue Expense relates to the operations of the business of an accounting period, benefits of which do not extend beyond that period.
- Capital Expenditure, generates enduring benefits and helps in revenue generation over more than one accounting period.
- The distinction of transaction into revenue and capital is done for the purpose of placing them in Profit and Loss account or in the Balance Sheet.

CONCEPT 2 : CONSIDERATIONS IN DETERMINING CAPITAL & REVENUE EXPENDITURES

[T.Q. 1]

Sr. no.	Considerations	Explanation
[1]	Nature of business :	➥ For a trader dealing in furniture, purchase of furniture is revenue expenditure but for any other trade, it should be treated as capital expenditure.
[2]	Recurring nature of expenditure :	➥ If the frequency of an expense is recurring then it is said to be revenue nature. ☺ E.g.: Monthly salary or rent -revenue expenditure. ☺ E.g.: Purchase of assets not done regularly - capital expenditure.
[3]	Purpose of expenses :	➥ Expenses for repairs incurred in course of normal maintenance of the asset. Such expenses are revenue in nature. ➥ Expenditure incurred for major repair of the asset so as to increase its productive capacity is capital in nature.
[4]	Effect on revenue generating capacity of business :	➥ The expenses which help to generate income/revenue in the current period are revenue in nature. ➥ On the other hand, if expenditure helps to generate revenue over more than one accounting period, it is capital expenditure.
[5]	Materiality of the amount involved :	➥ Relative proportion of the amount involved is another important consideration distinction between revenue and capital.

CONCEPT 3 : DEFERRED REVENUE EXPENDITURES

- Deferred revenue expenditure is that expenditure for which payment has been made or a liability incurred but which is C/f on the presumption that it will be of benefit over a subsequent periods.
- As per AS 26 "Intangible Assets", in some cases expenditure is incurred to provide future economic benefits(more than one accounting period) which does not create an asset to be recognized in the books of an entity.
- Such expenses, should be charged to profit and loss account in the year the amount is incurred.
- Share issue expenses & discount allowed on issue of shares maybe deferred for more than 1 accounting period.

CONCEPT 4 : CAPITAL RECEIPTS AND REVENUE RECEIPTS [T.Q. 2]

- ➥ Receipts which are obtained in course of normal business activities are revenue receipts (e.g. receipts from sale of goods or services, interest income etc.).
- ➥ Receipts which are not revenue in nature are capital receipts (e.g. receipts from sale of fixed assets or investments, secured or unsecured loans, owners' contributions etc.).
- ➥ Revenue receipts are credited to the Profit and Loss Account.

UNIT 5 : CONTINGENT ASSETS AND CONTINGENT LIABILITIES

CONCEPT 1 : CONTINGENT ASSETS

- A possible asset that arises from past events and Whose existence will be confirmed Only after occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.
- ☺ For example, a claim that an enterprise is pursuing through legal process, where the outcome is uncertain, is a contingent asset.
- As per the concept of prudence, an enterprise should not recognise a contingent asset.
- There is uncertainty in realisation of claim. It is possible that recognition of contingent assets may result in unrealised income.
- A contingent asset need not be disclosed in the financial statements.
- A contingent asset is usually disclosed in the report of the approving authority, if an inflow of economic benefits is probable.

CONCEPT 2 : CONTINGENT LIABILITIES

Possible Obligation

[a] Arises from past events
[b] The existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events
[c] Not wholly within the control of the enterprise

Present Obligation

Arises from past events but is not recognised because:

- No probable outflow of resources embodying economic benefits required to settle the obligation.
- A reliable estimate of the amount of the obligation cannot be made

- ✷ An enterprise should not recognise a contingent liability, if all the conditions are not satisfied.
- ✷ A Contingent liability is required to be disclosed unless possibility of outflow of a resource embodying economic benefits is remote.

CONCEPT 3 : DISTINCTION BETWEEN CONTINGENT LIABILITIES AND LIABILITIES [T.Q. 1(ii)]

- The distinction is generally based on the judgement of the management.
- A liability is defined as the present financial obligation of an enterprise, which arises from past events.
- Examples of contingent liabilities are claims against the enterprise not acknowledged as debts, guarantees given in respect of third parties, liability in respect of bills discounted and statutory liabilities under dispute etc.
- Enterprises are required to disclose contingent liability in their balance sheets by way of notes.

CONCEPT 4 : DISTINCTION BETWEEN CONTINGENT LIABILITIES AND PROVISIONS [T.Q. 1(i)]

Sr. no.	Points	Provision	Contingent liability
[1]	Meaning	It is a present liability of uncertain amount, which can be measured reliably by using a substantial degree of estimation.	It is a possible obligation that may or may not crystallise depending on the occurrence or nonoccurrence of one or more uncertain future events.
[2]	Recognition	It meets the recognition criteria.	It fails to meet the same.
[3]	Outflow of resources	It will result in outflow of economic benefits.	It is less likely that any economic benefit will outflow firm to settle the obligation.
[4]	Disclosure	It is recognised in the balance sheet.	It is disclosed as liability by way of notes.

UNIT 6 : ACCOUNTING POLICIES

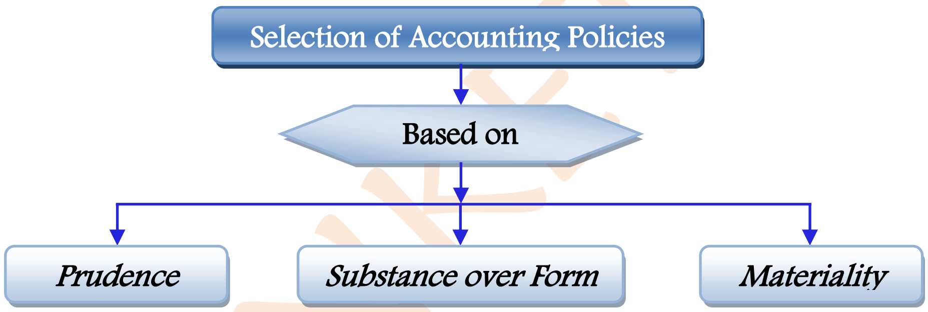
CONCEPT 1 : MEANING [T.Q. 1]

- Accounting Policies refer to specific accounting principles and methods of applying these principles adopted by the enterprise in the preparation and presentation of financial statements.
- Policies are based on various accounting concepts, principles and conventions.
- There is no single list of accounting policies, which are applicable to all enterprises in all circumstances.
- The choice of specific accounting policy is appropriate judgement by the management.
- ICAI has been trying to reduce the number of acceptable accounting policies through Guidance Notes and Accounting Standards.
- The areas wherein different accounting policies are adopted :
  [a] Methods of depreciation, depletion and amortisation;
  [b] Valuation of inventories;
  [c] Valuation of investments.

CONCEPT 2 : SELECTION OF ACCOUNTING POLICIES

- Accounting policy should be selected with due care after considering its effect on the financial performance of the business enterprise from the angle of various users of accounts.

The basis for selecting accounting policies can be shown in the following chart as :



☺ Examples :

[a] Inventories are valued at cost except for finished goods and by-products. Finished goods are valued at lower of cost or market value and by-products are valued at net realisable value.

[b] Investments (long term) are valued at their acquisition cost. Provision for permanent diminution in value has been made wherever necessary.

CONCEPT 3 : CHANGE IN ACCOUNTING POLICIES [T.Q. 2]

[a] It is required by some statute.
[b] For compliance with an Accounting Standard.
[c] Change would result in more appropriate presentation of financial statement.

- Unless the effect of such change in accounting policy is quantified, the financial statements may not help the users of accounts. Therefore, it is necessary to quantify the effect of change on financial statement items like assets, liabilities, profit/loss.

☺ Examples:

[a] Omega Enterprises revised its accounting policy relating to include applicable production overheads.

[b] Alpha Enterprises changed the method depreciation from straight-line method to written-down value method.

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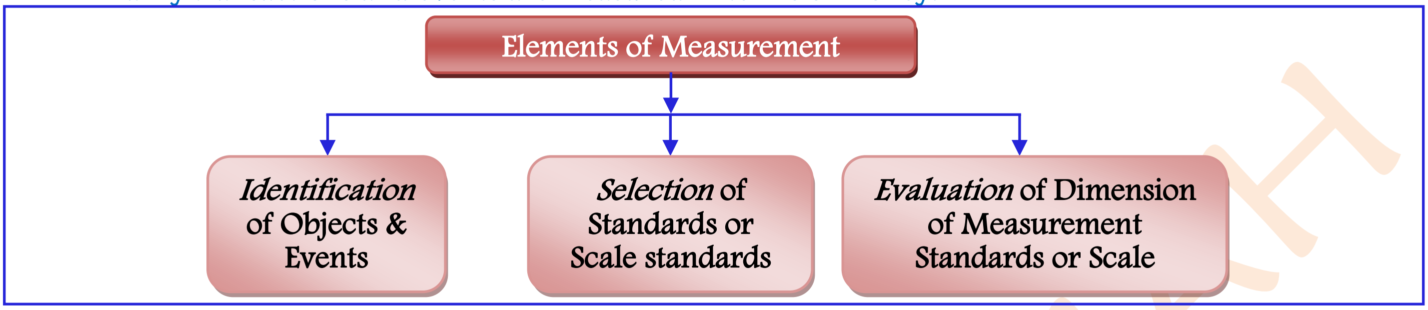
UNIT 7 : ACCOUNTING AS A MEASUREMENT DISCIPLINE - VALUATION PRINCIPLES, ACCOUNTING ESTIMATES

CONCEPT 1 : MEANING OF MEASUREMENT [T.Q. 1]

- Primarily transactions and events are measured in terms of money.



CONCEPT 2 : OBJECTS OR EVENTS TO BE MEASURED [T.Q. 1]

- Accounting essentially includes measurement of Information.
- Decision makers need past, present and future information.
- For external users, the past information is communicated.
  For example, in cash management, decision makers need past cash receipts and expenses along with projected receipts and expenses. For giving loan to a business needs information regarding the repayment ability. This also includes past information, current state of affairs as well as future projections.
- Past and present objects can be measured with some degree of accuracy but future events and objects are only predicted, not measured.
- Prediction is an essential part of accounting information.

CONCEPT 3 : STANDARD OR SCALE OF MEASUREMENT

- In accounting, money is the scale of measurement although now-a-days quantitative information is also communicated along with monetary information.
- Money as a measurement scale has no universal denomination. It takes the shape of currency ruling in a country. For example, in India the scale of measurement is Rupee (Rs.), in the U.K. Pound-Sterling (£), in Germany Deutschmark (DM), United States Dollar ($) and so on.
- There is no constant exchange relationship among currencies. For example, at the time of loan agreement exchange rate was US $ = Rs.50. Afterwards exchange rate changed to $ 1 = Rs.55.
- So money as a unit of measurement lacks universal applicability across the boundary of a country
- Since the rate of exchange fluctuates, money as a measurement scale also becomes volatile.

CONCEPT 4 : DIMENSION OF MEASUREMENT SCALE

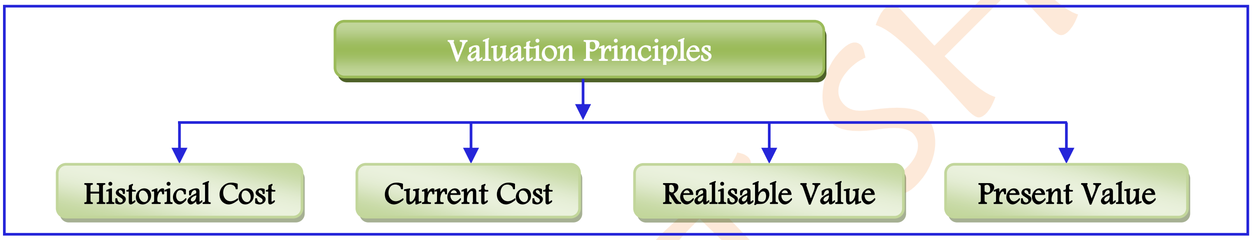
- An ideal measurement scale should be stable over time. For example, one buys 1 kg. cabbage today, quantity he receives will be the same one year later.
- Money as a scale of measurement is not stable. The same quantity of money may not have the ability to buy same quantity of identical goods at different dates.
- Thus Accounting measures information mostly in money terms which is not a stable scale having universal applicability. So it is not an exact measurement discipline

CONCEPT 5 : ACCOUNTING AS A MEASUREMENT DISCIPLINE

- How do you measure a transaction or an event?
- Accounting is meant for generating information for decisions.
- It measures performance by way of profit or loss and shows its financial position.
- Now-a-days accounting profession earmarked three theorems namely going concern, consistency and accrual. While measuring, classifying, summarising various policies are adopted which do not fall within the purview of measurement discipline.
- We cannot simply say that accounting is a measurement discipline. But in accounting money is the unit of measurement.
- All transactions and events are to be recorded in terms of money only.
- Quantitative information is also required but is only supplementary to monetary information.

CONCEPT 6 : VALUATION PRINCIPLES [T.Q. 2]

- There are four generally accepted measurement bases or valuation principles.



[a] Historical Cost

- It means acquisition price.
- According to this base, assets are recorded at an amount of cash or cash equivalent paid or the fair value of the asset at the time of acquisition.
- Liabilities are recorded at the amount of proceeds received in exchange for the obligation.

[b] Current Cost

- Current cost gives an alternative measurement base.
- Assets are carried out at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently.
- Liabilities are carried at the undiscounted amount that would be required to settle the obligation currently.

[c] Realisable Value

- As per realisable value, assets are carried at the amount of cash or cash equivalents that could currently obtained by selling the assets.
- Liabilities are carried at their settlement values.

[d] Present Value

- As per present value, an asset is carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business.
- Liabilities are carried 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 business.

CONCEPT 7 : MEASUREMENT AND VALUATION

- Value relates to the benefits to be derived from objects, abilities or ideas.
- Suppose, an individual purchased a car paying Rs.2,50,000. Its value lies in the satisfaction to be derived by that individual using the car in future.
- If the value of car is taken as Rs.2,50,000 it is only one type of value called acquisition cost or historical cost.
- In accounting the value is always measured in terms of money.

CONCEPT 8 : ACCOUNTING ESTIMATES

- There are certain items, which are not occurred therefore cannot be measured using valuation principles still they are necessary to record in the books of account. For example, provision for doubtful debts.
- In such a situation reasonable estimates based on the existing situation and past experiences are made.
- As a result of the uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated.
- The process of estimation involves judgements based on the latest information available.
- An estimate may require revision. Change in accounting estimate means difference arises between certain parameters estimated earlier and re-estimated.

☺ Example:

A company incurs expenditure of Rs.10,00,000 on development of patent. Now the company has to estimate that for how many years the patent would benefit the company. This estimation should be based on the latest information and logical judgment.

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UNIT 8 : ACCOUNTING STANDARDS – CONCEPTS OBJECTIVES, BENEFITS

CONCEPT 1 : INTRODUCTION

- Accounting as a 'language of business' communicates the financial results of an enterprise to various stakeholders by means of financial statements.
- If the financial accounting process is not properly regulated, there is possibility of financial statements being misleading, tendentious and providing a distorted picture of the business, rather than the true state of affairs, in order to ensure transparency, consistency, comparability, adequacy and reliability of financial reporting, it is essential to standardise the accounting principles and policies.
- Accounting Standards (ASs) provide framework and standard accounting policies so that the financial statements of different enterprises become comparable.

CONCEPT 2 : CONCEPTS

- Accounting standards are written policy documents issued by expert accounting body or by government or other regulatory body covering the aspects of recognition, treatment, measurement, presentation and disclosure of accounting transactions and events in the financial statements.
- 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 the company's economic performance.
- The accounting standards deal with the issues of :

[a] recognition of events and transactions in the financial statements;
[b] measurement of these transactions and events;
[c] presentation of these transactions and events in the financial statements in a manner that is meaningful and understandable to the reader; and
[d] the disclosure requirements which should be there to enable the public at large and the stakeholders and the potential investors in particular, to get an insight into what these financial statements are trying to reflect and thereby facilitating them to take prudent and informed business decisions.

CONCEPT 3 : OBJECTIVES [T.Q. 1]

- The whole idea of accounting standards is centered around harmonisation of accounting policies and practices followed by different business entities so that the diverse accounting practices adopted for various aspects of accounting can be standardised.
- Accounting Standards standardise diverse accounting policies with a view to:

[a] Eliminate the non-comparability of financial statements and thereby improving the reliability of financial statements; and
[b] provide a set of standard accounting policies, valuation norms and disclosure requirements.

AS reduce the accounting alternatives in the preparation of financial statements within the bounds of rationality, thereby ensuring comparability of financial statements of different enterprises.

CONCEPT 4 : BENEFITS AND LIMITATIONS

BENEFITS : (T.Q. 2)

[i] Standards reduce to a reasonable extent or eliminate altogether confusing variations in the accounting treatments used to prepare financial statements.
[ii] There are certain areas where important information are not statutorily required to be disclosed. Standards may call for disclosure beyond that required by law.

[iii] 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 differences in the institutions, traditions and legal systems from one country to another give rise to differences in accounting standards adopted in different countries.

❅ **LIMITATIONS :**

[i] Alternative solutions to certain accounting problems may each have arguments to recommend them. Therefore, the choice between different alternative accounting treatments may become difficult.

[ii] There may be a trend towards rigidity and away from flexibility in applying the accounting standards.

[iii] Accounting standards cannot override the statute. The standards are required to be framed within the ambit of prevailing statutes.

CONCEPT 5 : OVERVIWS OF ACCUNTING STANDARDS IN INDIA

- In India, the Institute of Chartered Accountants of India (ICAI), being a premier accounting body in the country, took upon itself the leadership role by constituting the Accounting Standards Board (ASB) on 21st April, 1977.
- The main function of ASB is to formulate accounting standards so that such standards may be established in India by the council of the ICAI.
- The council of the Institute of Chartered Accountants of India has, so far, issued thirty two Accounting Standards.
- However, AS 8 on 'Accounting for Research and Development' has been withdrawn consequent to the issuance of AS 26 on 'Intangible Assets'.
- Thus effectively, there are 31 Accounting Standards at present.
- The 'Accounting Standards' issued by the Accounting Standards Board establish standards which have to be complied by the business entities so that the financial statements are prepared in accordance with generally accepted accounting principles.

➥ For capitalisation of interest, determination of the period for which interest can be capitalized and determination of the amount that can be capitalised.

➥ The amount of borrowing costs eligible for capitalisation should be determined in accordance with provisions of AS 16 and other borrowing costs (not eligible for capitalisation) should be recognised as expenses in the period in which they are incurred.

List of Accounting Standards

Sr. No.	Number of the Accounting Standard (AS)	TITLE OF THE ACCOUNTING STANDARD
1	AS 1	Disclosure of Accounting Policies
2	AS 2 (Revised)	Valuation of Inventories
3	AS 3 (Revised)	Cash flow Statements
4	AS 4 (Revised)	Contingencies and Events Occurring after the Balance Sheet Date
5	AS 5 (Revised)	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
7	AS 7 (Revised)	Accounting for Construction Contracts
8	AS 8 (withdrawn pursuant to AS 26 becoming mandatory)	Accounting for Research and Development
9	AS 9	Revenue Recognition
10	AS 10	Accounting for Fixed Assets
11	AS 11 (Revised)	The Effects of Changes in Foreign Exchange Rates
12	AS 12	Accounting for Government Grants
13	AS 13	Accounting for Investments
14	AS 14	Accounting for Amalgamations
15	AS 15 (Revised)	Employee Benefits
16	AS 16	Borrowing Costs
17	AS 17	Segment Reporting
18	AS 18	Related Party Disclosures
19	AS 19	Leases
20	AS 20	Earnings Per Share
21	AS 21	Consolidated Financial Statements
22	AS 22	Accounting for Taxes on Income
23	AS 23	Accounting for Investments in Associates in Consolidated Financial Statements
24	AS 24	Discontinuing Operations
25	AS 25	Interim Financial Reporting
26	AS 26	Intangible Assets
27	AS 27	Financial Reporting of Interests in Joint Ventures
28	AS 28	Impairment of Assets
29	AS 29	Provisions, Contingent Liabilities & Contingent Assets
30	AS 30	Financial Instruments: Recognition & Measurement
31	AS 31	Financial Instruments: Presentation
32	AS 32	Financial Instruments: Disclosures

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UNIT 9 : INTRODUCTION TO IND AS

CONCEPT 1 : WHY IND AS ?

- The last decade has witnessed a sea change in the global economic scenario.
- Each country has its own set of rules and regulations for accounting and financial reporting. Therefore, when an enterprise decides to raise capital from other markets, it should be in a position to understand the differences between rules & principles of both the countries.
- 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.
- Global Standards facilitate cross border flow of money, global listing, greater transparency, uniform standard of accountability, comparability of financial statements and also reduces operational challenges.

CONCEPT 2 : IFRS AS GLOBAL STANDARDS

- With a view of achieving convergence towards global reporting, International Accounting Standards Committee (IASC) [Currently known as International Accounting Standards Board (IASB)] was established to formulate and publish, International Accounting Standards to be followed in the presentation of audited financial statements.
- IASB publishes its Standards in a series of pronouncements called International Financial Reporting Standards (IFRS). 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.

CONCEPT 3 : BENEFITS OF CONVERGENCE WITH IFRS [T.Q. 2]

There are many beneficiaries of convergence with IFRSs such as the economy, investors, industry etc.

- The Economy : When markets expand globally the need for convergence increases since 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 : 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.
- The Industry : It 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.

CONCEPT 4 : INDIAN ACCOUNTING STANDARDS (IND AS)

- 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. [T.Q. 1]
- Ind-AS are 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).
- The Ind AS are named and numbered in the same way as the corresponding International Financial Reporting Standards (IFRS).
- Ind AS converged with IFRS shall be implemented on voluntary basis from 1st April, 2015 and mandatory from 1st April, 2016.

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