# ACCOUNTING & FINANCIAL MANAGEMENT FOR BANKERS

INDIAN INSTITUTE OF BANKING & FINANCE

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# ACCOUNTING & FINANCIAL MANAGEMENT FOR BANKERS

# INDIAN INSTITUTE OF BANKING & FINANCE

Kohinoor City, Commercial-II, Tower-1, 2nd & 3rd Floor,
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**Established on 30th April 1928**

## VISION

- To be the premier Institute for developing and nurturing competent professionals in banking and finance field.

## MISSION

- To develop professionally qualified and competent bankers and finance professionals primarily through a process of education, training, examination, consultancy/counselling and continuing professional development programs.

## OBJECTIVES

- To facilitate study of theory and practice of banking and finance.
- To test and certify attainment of competence in the profession of banking and finance.
- To collect, analyse and provide information needed by professionals in banking and finance.
- To promote continuous professional development.
- To promote and undertake research relating to Operations, Products, Instruments, Processes, etc., in banking and finance and to encourage innovation and creativity among finance professionals so that they could face competition and succeed.

**COMMITTED TO PROFESSIONAL EXCELLENCE**

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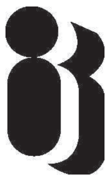
# ACCOUNTING & FINANCIAL MANAGEMENT FOR BANKERS

(For JAIIB/Diploma in Banking & Finance Examination)



Indian Institute of Banking & Finance

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## ACCOUNTING & FINANCIAL MANAGEMENT FOR BANKERS

**First Edition (2023)**

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# FOREWORD

*Formal education will make you a living; self-education will make you a fortune.*

*–Jim Rohn*

The banking sector, currently, is experiencing a transformation catalysed by digitalization and information explosion with the customer as the focal point. Besides, competition from NBFCs, FinTechs, changing business models, growing importance of risk and compliance have contributed to this radical shift. Such an ever-evolving ecosystem requires strategic agility and constant upgradation of skill levels on the part of the Banking & Finance professionals to chart a clear pathway for their professional development.

The mission of the Indian Institute of Banking & Finance is to develop professionally qualified and competent bankers and finance executives primarily through a process of education, training, examination, counseling and continuing professional development programs. In line with the Mission, the Institute has been offering a bouquet of courses and certifications for capacity building of the banking personnel.

The flagship courses/examinations offered by the Institute are the JAIIB, CAIIB and the Diploma in Banking & Finance (DB&F) which have gained wide recognition among banks and financial institutions. With banking witnessing tectonic shifts, there was an imperative need to revisit the existing syllabi for the flagship courses.

The pivotal point for revising the syllabi was to ensure that, in addition to acquiring basic knowledge, the candidates develop concept-based skills for keeping pace with the developments happening in the financial ecosystem and to ensure greater value addition to the flagship courses and to make them more practical and contemporary. This will culminate in creating a rich pool of knowledgeable and competent banking & finance professionals who are capable of contributing to the sustainable growth of their organizations.

Keeping in view the above objectives, the Institute had constituted a high-level Syllabi Revision Committee comprising of members from public sector banks, private sector banks, co-operative banks and academicians. On the basis of the feedback received from various banks and changes suggested by the Committee, the syllabi of JAIIB & CAIIB have since been finalized.

The revised JAIIB syllabi will now have four compulsory subjects as under:

1. Indian Economy & Indian Financial System
2. Principles & Practices of Banking
3. Accounting & Financial Management for Bankers
4. Retail Banking & Wealth Management

The new subject on Indian Economy & Indian Financial System will cover the basics of economics and financial system prevalent in India. This will familiarise the candidates with the evolving financial ecosystem of the country.

Insofar as the book on Accounting & Financial Management is concerned, two new modules viz Financial Management and Taxation & Fundamentals of Costing have been introduced. With bankers having to cater to the requirements of varied industries, it is imperative that they have an underlying understanding of the relationships between cost accounting, financial accounting, management accounting and financial management. Some of the other topics that have been covered are Cost of Capital, Equipment Leasing, GST, Standard Costing, Marginal Costing, Budgetary Control system etc.

The books on Principles & Practices of Banking and Retail Banking & Wealth Management have been thoroughly revised and updated.

As is the practice followed by the Institute, a dedicated courseware for every paper/subject is published. The present courseware on Accounting & Financial Management for Bankers has now been authored in line with the revised syllabus for the subject. The book follows the same modular approach adopted by the Institute in the earlier editions/publications.

While the Institute is committed to revise and update the courseware from time to time, the book should, however, not be considered as the only source of information / reading material while preparing for the examinations due to rapid changes witnessed in all the areas affecting banking & finance. The students have to keep themselves abreast with the current developments by referring to economic newspapers/journals, articles, books and Government / Regulators' publications / websites etc. Questions will be based on the recent developments related to the syllabus.

Considering that the courseware cannot be published frequently, the Institute will continue the practice of keeping candidates informed about the latest developments by placing important updates/Master Circulars/ Master Directions on its website and through publications like IIBF Vision, Bank Quest, etc.

The courseware has been updated with the help of Subject Matter Experts (SMEs) drawn from respective fields and vetted by practitioners to ensure accuracy and correctness. The Institute acknowledges with gratitude the valuable contributions rendered by the SMEs in updating/vetting the courseware.

We welcome suggestions for improvement of the courseware.

Mumbai
2023

**Biswa Ketan Das**
*Chief Executive Officer*

## RECOMMENDED READING

The Institute has prepared comprehensive courseware in the form of study kits to facilitate preparation for the examination without intervention of the teacher. An attempt has been made to cover fully the syllabus prescribed for each module/subject and the presentation of topics may not always be in the same sequence as given in the syllabus.

Candidates are also expected to take note of all the latest developments relating to the subject covered in the syllabus by referring to Financial Papers, Economic Journals, Latest Books and Publications in the subjects concerned.

# ACCOUNTING & FINANCIAL MANAGEMENT FOR BANKERS
## SYLLABUS

### MODULE A: ACCOUNTING PRINCIPLES AND PROCESSES

#### Definition, Scope and Accounting Standards including Ind AS

Nature and Purpose of Accounting, Historical Perspectives, New Accounting system / Value system accounting Origins of Accounting Principles, Accounting Standards in India and its Definition and Scope, Generally Accepted Accounting Principles of USA (US GAAP), Overview of IFRSs, Difference between GAAP and IFRS, Transfer Pricing

#### Basic Accountancy Procedures

Concepts of Accountancy, Going Concern Entity, Double Entry System, Principle of Conservatism, Revenue Recognition and Realisation, Accrual and Cash Basis

#### Maintenance of Cash/Subsidiary Books and Ledger

Record Keeping Basics, Account Categories, Debit and Credit Concepts, Accounting and Columnar Accounting Mechanics, Journalising

#### Bank Reconciliation Statement

Recording Transactions in Cash Book, Transactions Contained in the Pass Book/Bank Statement, Is Passbook a Mirror Image of Cash Book? Causes for Passbook and Cashbook being different, Understanding Reconciliation, Preparing Reconciliation Statement, Need for Bank Reconciliation, How to prepare a Bank Reconciliation Statement when extracts of Cash Book and Pass Book are given? Adjusting the Cash Book balance, Advantages of Bank Reconciliation Statement

#### Trial Balance, Rectification of Errors and Adjusting & Closing Entries

Meaning of a Trial Balance, Features and Purpose of a Trial Balance, Types of Trial Balance and Preparation of a Trial Balance, Disagreement of a Trial Balance, Classification of Errors, Location of Errors, Rectification of Errors, Suspense Account and Rectification, Rectification of Errors when Books are Closed, Adjusting and Closing Entries

#### Depreciation & its Accounting

Meaning of Depreciation, Causes of Depreciation, Need for Depreciation, Factors of Depreciation, Accounting Entries, Methods of Depreciation, Straight Line Method, Diminishing Balance or Written Down Value (WDV) Method, Advantages and Disadvantages of Straight Line Method, Advantages and Disadvantages of Written Down Value Method, Units of Production Method, Sum of the Years' Digits Method, Replacement of a Fixed Asset and Creation of Sinking Fund, Amortisation of intangible assets

#### Capital and Revenue Expenditure

Expenditure, Distinction between Capital and Revenue Expenditure, Receipts

#### Bills of Exchange

Types of Instruments of Credit, Term and Due Date of a Bill, Certain Important Terms, Accounting Entries to be Passed, Accommodation Bill, Bill Books

#### Operational Aspects of Accounting Entries

Peculiar Features of Accounting System in Banks, Accounting Systems of Different Banks, Illustration

### Back Office Functions/Handling Unreconciled Entries in Banks

Functions Performed by the Back Office, Reconciliation Function in Banks, Reconciliation of Inter Branch/ Office Entries

### Bank Audit & Inspection

Bank Audit, Emergence of Risk based Internal Audit, Types of Bank Audits Viz. Concurrent Audit, Internal Audit, Statutory Audit, Role of Audit and Inspection

## MODULE B: FINANCIAL STATEMENTS AND CORE BANKING SYSTEMS

### Balance Sheet Equation

Balance Sheet Equation, Computation of Balance Sheet Equation

### Preparation of Final Accounts

Preparation of Trial Balance, Adjustment Entries, Preparation of Financial Statements from Trial Balance

### Company Accounts – I

Definition and Types of Companies, Distinction between Partnership and Limited Liability Company, Classes of Share Capital, Issue of Shares, General Illustrations, Non-voting Shares

### Company Accounts – II

Form of Balance Sheet, Impact of Ind AS on Financial Statements

### Cash Flow & Funds Flow

Cash Flow, Funds Flow Statement, Cash Flow Statement, Fund Flow and Cash Flow Analysis

### Final Accounts of Banking Companies

Definition and Functions of a Bank, Requirements of Banking Companies as to Accounts and Audit, Significant Features of Accounting Systems of Banks, Principal Books of Account, Preparation and Presentation of Financial Statements of Banks, Accounting Treatment of Specific Items, Preparation of Profit and Loss Account, Comments on Profit and Loss Account Items, Important Items of Balance Sheet. Disclosure Requirements of Banks to be Added as Notes to Accounts, Disclosures Prescribed by RBI Under Basel-III, Banks Listed on a Stock Exchange, Implementation of Indian Accounting Standards (Ind AS)

### Core Banking Systems & Accounting in Computerised Environment

Meaning of Computerised Accounting, Features of Computerised Accounting, Terms Used in Computerised Accounting, Difference between Computerised and Manual Accounting, Advantages and Disadvantages of Computerised Accounting, Functions Performed by Computerised Accounting Softwares Available in the Market, Computerisation – Scope and Experiences in Banking, The Core Banking Components, Information Security, Internet and World Wide Web – Influences on Banking

## MODULE C: FINANCIAL MANAGEMENT

### An Overview of Financial Management

Forms of Business Organisation, Financial Decision making in a Firm, Objectives of Financial Management, The Fundamental Principles of Finance, Building Blocks of Modern Finance, Risk-Return Trade off, Agency Problem in Financial Management, Business Ethics & Social Responsibility, Organisation of the Finance Function, Relationship of Finance to Economics and Accounting, Emerging Role of the Financial Manager in India

### Ratio Analysis

Meaning of Accounting Ratios, Classification of Ratios, Uses of Accounting Ratios, Limitations of Accounting Ratios, Calculation and Interpretation of Various Ratios, Different Users and Their Use of Ratios

### Financial Mathematics - Calculation of Interest & Annuities

What is Simple Interest? What is Compound Interest? Fixed and Floating Interest Rates, Front-end and Back-end Interest Rates, Calculation of Interest Using Products/Balances, What are Annuities? Calculating the Future Value of an Ordinary Annuity, Calculating the Present Value of an Ordinary Annuity, Calculating the Future Value of an Annuity Due, Calculating the Present Value of an Annuity Due, Repayment of a Debt

### Financial Mathematics - Calculation of YTM

Meaning of Debt, Introduction to Bonds, Terms Associated with Bonds, Types of Bonds, Optionality in Bonds, Valuation of Bonds, Bond Value with Semi-annual Interest, Current Yield on Bond, Yield-to-Maturity of Bond, Theorems for Bond Value, Illustrations, Duration of Bond, Properties of Duration, Bond Price Volatility, Problems and Solutions

### Financial Mathematics - Forex Arithmetic

Fundamentals of Foreign Exchange, Indian Forex Market, Direct and Indirect Quote, Some Basic Exchange Rate Arithmetic, Forward Exchange Rates

### Capital Structure and Cost of Capital

Meaning of Capital Structuring, Leverage/Gearing, Factors Influencing Decision on Capital Structuring, Theories/Approaches on Capital Structuring, Net Income Approach, Net Operating Income Approach, Traditional Position, Assumptions in the Approaches on Capital Structuring, Taxation & Capital Structure, Cost of Debt, Preference, Equity, Determining the Proportions, Weighted Average Cost of Capital (WACC), Factors Affecting the WACC, Weighted Marginal Cost of Capital, Determining the Optimal Capital Budget, Divisional and Project Cost of Capital, Floatation Cost and the Cost of Capital, Misconceptions surrounding the Cost of Capital

### Capital Investment Decisions/Term Loans

Discounted and Non-Discounted Cash Flow Methods for Investment Appraisal, Basic concepts of term loans, Deffered payment Guarantees, Project financing, Difference between term loan appraisal and project appraisal

### Equipment Leasing/Lease Financing

Meaning of a Lease, Features of a Lease, Types of Leases, Rationale for Leasing, Contents of a Lease Agreement, Legal Aspects of Leasing, Finance Leases, Operating Leases, Accounting of Lease Transaction in the books of Lessor and Lessee, Leasing as a Financing Decision

### Working Capital Management

Working Capital Cycle, Cash and Marketable Securities, Accruals, Trade Credit, Working Capital Advance by Commercial Banks, Cash Budget Method of Lending, Regulation of Bank Finance, Public Deposits, Inter-Corporate Deposits, Short-term loans from, Financial Institutions, Rights Debentures for Working Capital, Commercial Paper, Factoring & Forfaiting

### Derivatives

Characteristics & Functions of Derivatives, Users of derivatives, Salient points, Futures, Forward Rate Agreement (FRA), Swaps, Options

## MODULE D: TAXATION AND FUNDAMENTALS OF COSTING

### Taxation: Income Tax/TDS/Deferred Tax

Overview of Income Tax Act, Basic Overview of Deductions in Respect of Certain Incomes & Deduction 80QQB, 80RRB, 80TTA & 80U, TDS/TCS, Returns, Refund & Recovery

### Goods & Services Tax

Meaning of Direct & Indirect Tax, Introduction to GST

### An Overview of Cost & Management Accounting

Cost Accounting: Evolution, Meaning, Objectives and Scope, Concepts of Costs, Classifications and Elements of Cost, Cost Centre and Cost Unit, Methods and Techniques of Costing, Cost Accounting Standards, Management Accounting: Evolution, Meaning, Objectives and Scope. Tools and Techniques of Management Accounting, Relationship of Cost Accounting, Financial Accounting, Management Accounting and Financial Management

### Costing Methods

Unit and Output Costing, Job Costing: Job Cost Cards, Collecting Direct Costs, Allocation of Overheads and its Applications, Batch Costing: Features and Applications, Contract Costing: Features, Distinction between Job and Contract Costing, Progress Payments, Retention Money, Escalation Clause, Contract Accounts, Accounting for Material, Accounting for Plant Used in a Contract, Contract Profit and Accounting Entries, Process Costing: Features, Applications and Types of Process Costing, Process Loss, Abnormal Gains and Losses, Equivalent Units, Inter-Process Profit, Joint Products, By-Products and Accounting, Service Costing: Features and Applications, Unit Costing and Multiple Costing, Application, Identification of Cost Unit and Cost Determination and Control

### Standard Costing

Definition, Significance and Applications, Various Types of Standards, Installation of Standard Costing System—for Material, Labour, and Overhead, Variance Analysis for Materials, Labour and Overheads and Accounting Treatment of Variances, Benchmarking for Setting of Standards, Variance Reporting to Management

### Marginal Costing

Meaning, Advantages, Limitations and Applications, Breakeven Analysis, Cost-Volume Profit Analysis, P/V Ratio and its Significance, Margin of Safety, Absorption Costing: System of Profit Reporting and Stock Valuation, Difference between Marginal Costing and Absorption Costing, Income Measurement under Marginal Costing and Absorption Costing

### Budgets and Budgetary Control

Budget Concept, Manual, Fixed and Flexible Budgets, Preparation and Monitoring of Various Types of Budgets, Budgetary Control System: Advantages, Limitations and Installation, Zero Base Budgeting, Programme and Performance Budgeting

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# MODULE – A

# ACCOUNTING PRINCIPLES AND PROCESSES


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**Unit 2.** Basic Accountancy Procedures
**Unit 3.** Maintenance of Cash/Subsidiary Books and Ledger
**Unit 4.** Bank Reconciliation Statement
**Unit 5.** Trial Balance, Rectification of Errors and Adjusting & Closing Entries
**Unit 6.** Depreciation and its Accounting
**Unit 7.** Capital and Revenue Expenditure
**Unit 8.** Bills of Exchange
**Unit 9.** Operational Aspects of Accounting Entries
**Unit 10.** Back Office Functions/Handling Unreconciled Entries in Banks
**Unit 11.** Bank Audit & Inspection

# UNIT 1

# DEFINITION, SCOPE & ACCOUNTING STANDARDS INCLUDING Ind AS

## STRUCTURE


1.0 Objectives
1.1 Introduction
1.2 Nature and Purpose of Accounting
1.3 Historical Perspectives
1.4 New Accounting Systems
1.5 Origins of Accounting Principles
1.6 Accounting Standards in India and its Definition and Scope
1.7 Indian Accounting Standards (Ind AS)
1.8 Generally Accepted Accounting Principles of USA (US GAAP)
1.9 Overview of IFRS
1.10 Difference between US GAAP and IFRS
1.11 Transfer Pricing
Let Us Sum Up
Keywords
Check Your Progress
Answers to Check Your Progress

## 1.0 OBJECTIVES

After studying this unit, you should be able to appreciate the:

- Historical perspectives on accountancy
- Definition, meaning and features of accountancy
- Accounting concepts, accounting conventions and accounting systems
- Purpose of accounting
- Meaning of financial statements, accounting standards and their relations
- Users of financial statements and their needs
- Background and status of Indian accounting standards
- Nature and contents of accounting standards
- Importance of accounting standards

## 1.1 INTRODUCTION

Accounting often is called the language of business. The basic function of any language is to serve as a means of communication. In this context, the purpose of accounting is to communicate or report the results of business operations and the financial health of the organisation.

The most apt definition of Accounting is given by the 'American Institute of Certified Public Accountants', which is as under:

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

On the basis of the definition given by AICPA and APB, Keiso and Weyhandt observed that accounting is – i) a service activity which provides quantitative financial information to help make decisions regarding deployment and use of resources, ii) an analytical discipline which defines, measures, classifies and summarises data relating to economic transactions. iii) An information system which collects and communicates economics information about an economic activity to a variety of concerned people.

Many people take bookkeeping and accountancy to mean one and the same, but the two are different. Accountancy is a wider concept and includes bookkeeping. Bookkeeping means recording the business transactions in the books of original entry and in the ledgers. On the other hand, accountancy means the compilation of accounts in such a way that one is in a position to know the state of affairs of the business.

Financial statements, normally, mean the balance sheet, profit and loss account, statement of changes in the financial position (which may be either a fund flow statement or a cash flow statement), explanatory statements, notes and schedules forming part of the financial statement. The objective of financial statements is to provide information about the financial position, performance and changes in the financial position of an enterprise. The users of financial statements include government authorities, e.g. income tax department, sales tax department, etc., shareholders, investors, business associates, directors, banks and financial institutions, etc.

Accounting is the language of business, communicating through the financial statements, the financial results and performance of an enterprise, to various users of such financial statements. It is in the interest of all that the financial statements exhibit a 'true and fair' view of the state of affairs of an entity.

Any language has a set of rules called grammar. Recording of events in accounts also has its own set of rules and criteria. Such rules, are called the 'Accounting Standards' (AS).

## 1.2 NATURE AND PURPOSE OF ACCOUNTING

A business entity, operating for profit, must keep a systematic record of the day-to-day events so that it can know about its profits, assets and liabilities. Even institutions, which do not have profit earning as an objective, must keep a record of their incomes, expenditures and financial status. This purpose is achieved by keeping systematic books of account based on sound accounting principles.

Accountancy, thus, involves the following:

1. Systematic classification of business transactions, for recording them in the books of account.
2. Recording of events and transactions in the books of account, called bookkeeping.
3. Summarising of the recorded events, i.e. preparation of a trial balance from a ledger and, subsequently, the preparation of balance sheet and the profit and loss account, from the trial balance.
4. Interpreting the financial transactions from the recorded data and the financial statements.

The features of accounting are:

1. Accounting is the art of recording, classifying and summarising business transactions: It not only records the business transactions but also records them in an orderly manner. It also classifies business transactions according to their nature, before recording them in the books of account, e.g. all purchase transactions are first entered in the purchase register. This also helps to find the total purchases during a given period. Accounting also summarises the data, recorded in books of account, and presents them in a systematic way, in the form of:
   (a) Trial Balance
   (b) Profit and Loss account and
   (c) Balance Sheet
   (d) Cash Flow Statement
2. Accounting records the transactions in terms of money: Accounting records business transactions by expressing them in terms of money. This makes the recorded data more meaningful. Events that cannot be expressed in money terms, are not recorded in the books of account. Events such as, a quarrel between the management and workers of a company, are not recorded in its books of account, though loss or monetary outflow from it, is recorded in its books of account.
3. Accounting records only the transactions of a financial character: Accounting records only those events and transactions that are financial in nature. Let us say that a very high-speed computer is bought by a business entity for ₹ 1 lakh, but the entries in the books of account will not record the computer's efficiency or the brand name as such but record only the cost price.
4. Accounting also interprets the financial data: The business transactions/events, recorded in the books of account, are also interpreted by accounting. The interpretation helps in making meaningful decisions in the future. For example, a bank may study the balance sheet of an entity, before taking a credit decision.

The purposes and the objectives of accountancy can be briefly listed out as under:

1. *To keep a systematic record*

It is very difficult to remember all the business transactions that take place. Accounting serves this purpose of record keeping, by promptly recording all the business transactions in the books of account. Accounting also records the assets (properties and possessions) and liabilities (loans and debts) of the business.

2. *To ascertain the results of the operations*

Accounting helps in ascertaining the result, i.e. profit earned or loss suffered in a business during a particular period. For this purpose, a business entity prepares either a trading and profit and loss account or an income and expenditure account that shows the profit or loss of the business, by matching the items of revenue and expenditure for the same period.

3. *To ascertain the financial position of the business*

In addition to profits, a businessperson must know his financial position, i.e. the availability of cash, the position of assets and liabilities, etc. This helps the businessperson to know his financial strength. Financial statements are the barometers of health of a business entity. Just as a doctor knows the health of a person by feeling his pulse, in the same way a look at the balance sheet of an organisation reveals its financial health. It also helps to ascertain the assets and liabilities, i.e. the amounts receivable from debtors and payable to creditors.

4. *To facilitate rational decision-making*

Accounting records and the financial statements provide the financial information that helps in making rational decisions about the steps to be taken with respect to the various aspects of business. Such decisions may be in respect of:

(a) Should a part or product be made in the factory or, purchased from outside?
(b) What should be reasonable selling price of a product or a service?
(c) What should be the maximum discount offered to a special customer?

5. *To satisfy the requirements of law*

Entities such as companies, societies, public trusts, etc., are compulsorily required to maintain accounts as per the law governing their operations, such as the Companies Act, Societies Act, Public Trust Act, etc., the maintenance of accounts is also compulsory under the Sales Tax Act and Income Tax Act.

## Advantages of financial accounting

(i) to provide information, useful for making economic decisions.
(ii) to serve primarily those users who have limited authority, ability or resources to obtain information and who rely on financial statements as their principal source of information about the economic activities of an enterprise.
(iii) to provide information useful to investors and creditors, for predicting, comparing and evaluating cash flows in terms of amount, timing and related uncertainty.
(iv) to provide users with information for predicting, comparing and evaluating the earning power of an enterprise.
(v) to supply information useful in judging the management's ability to utilise enterprise resources effectively for achieving the primary enterprise goals.
(vi) to provide factual and interpretive information about the transactions and other events, that are useful for predicting, comparing and evaluating the earning power of an enterprise. Basic underlying assumptions with respect to matters subject to the interpretation, evaluation, prediction or the estimation, should be disclosed.

## 1.3 HISTORICAL PERSPECTIVES

The origin of accounting as a social study can be traced back to very ancient days. It is old as the beginning of the use of money. Even under the barter system. The Arthashastra also discussed the critical role of accounting in the society.

The history of accounting indicates the evolutionary pattern which reflects the changing socio-economic conditions and the enlarged purposes to which accounting is applied. In the present context, there are four phases in the evolution of accounting that are distinguishable.

### Stewardship Accounting

In the earlier times in history, wealthy people employed 'stewards' to manage their property. These stewards rendered an account of their stewardship to their owners, periodically. This notion lies at the root of financial reporting even today, which essentially involves the orderly recording of business transactions, commonly known as 'bookkeeping'. Indeed, the accounting concepts and procedures in use today, for a systematic recording of business transactions, have their origins in the practices employed by the merchants in Italy during the fifteenth century. The Italian method, which specifically began to be known as 'double entry bookkeeping', was adopted by other European countries, during the nineteenth century. Stewardship accounting, in a sense, is associated with the need of business owners to keep records of their transactions, the property and tools they own, debts they owe, and the debts others owe them.

### Financial Accounting

Financial accounting dates from the development of large-scale business and the advent of the 'Joint Stock Companies' (a form of business which enables the public to participate by providing capital in return for 'shares' in the assets and the profits of the company). This form of a business organisation permits a limit to the liability of their members to the nominal value of their shares. This means that the liability of a shareholder, for the financial debts of the company, is limited to the amount he had agreed to pay on the shares he bought. He is not liable to make any further contribution in the event of the company's failure or liquidation. As a matter of fact, the law governing the operations (or functioning) of a company in any country (for instance the Companies Act in India) gives a legal form to the doctrine of stewardship which requires that information be disclosed to the shareholders in the form of annual income statement and balance sheet.

Briefly speaking, the income statement is a statement of profit and loss made during the year of the report; and the balance sheet indicates the assets held by the firm and the monetary claims against the firm. The general unwillingness of the company directors to disclose more than the minimum information required by law, and the growing public awareness, have forced the governments in various countries of the world to extend the disclosure (of information) requirements.

The importance attached to financial accounting statements can be traced to the need of the society to mobilise the savings and channel them into profitable investments. Investors, whether they are large or small, must be provided with reliable and sufficient information in order to be able to make efficient investment decisions. This is the most significant social purpose of financial accounting.

### Cost Accounting

The industrial revolution in England presented a challenge to the development of accounting as a tool of industrial management. Costing techniques developed as guides to management actions. The increasing awareness on the part of entrepreneurs and industrial managers for using scientific principles

of management, in the wake of the scientific management movement, led to the development of cost accounting. Cost Accounting is concerned with the application of costing principles, methods and techniques for ascertaining the costs, with a view to controlling them, and assessing the profitability and efficiency of the enterprise. Cost accounting is concerned with the accumulation and assignment of historical cost to unit of product and departments, primarily for the purpose of valuation of stock and measurement of profits. Cost accounting seeks to ascertain the cost of units produced and sold or the services rendered by business units with a view to exercising control over these cost to access the profitability and efficiency of the enterprise.

### Management Accounting

The advent of management accounting was the next logical step in the developmental process. The practice of using accounting information as a direct aid to management, is a phenomenon of the twentieth century, particularly of the last thirty–forty years. The genesis of modern management, with its emphasis on detailed information for decision-making, provides a tremendous impetus to the development of management accounting.

Management accounting is forward looking and generally includes cost accounting and budgeting. The preparation of management accounting is not based on generally accepted accounting principles and its relatively free of constraints imposed by legal regulation and accounting standards.

Management accounting is concerned with the preparation and presentation of accounting, and controlling information, in a form that assists management in the formulation of policies and in decision-making on the various matters connected with routine or the non-routine operations of a business enterprise. It is through the techniques of management accounting that the managers are supplied with information, that they need for achieving objectives for which they are accountable. Management accounting has, thus, shifted the focus of accounting from recording and analysing financial transactions to using the information for decisions affecting the future. In this sense, management accounting has a vital role to play in extending the horizons of modern business. While the reports emanating from financial accounting are subject to the conceptual framework of accounting, internal reports, routine or non-routine, are free from such constraints.

### Social Responsibility Accounting

Social responsibility accounting is a new phase in the development of accounting, and owes its birth to increasing social awareness that has been particularly noticeable over the last two decades or so. Social responsibility accounting widens the scope of accounting by considering the social effects of business decisions, in addition to the economic effects. Several social scientists and social workers, all over the world, have been drawing the attention of their governments and the people in their countries, to the dangers posed to the environment and ecology by the unbridled industrial growth. The role of business in society is increasingly coming under greater scrutiny. The managements are being held responsible for not only efficient conduct of business, as expressed in profitability, but also for what it contributes to the social well-being and progress. There is a growing feeling that the concepts of growth and profit, as measured in traditional balance sheets and income statements, are too narrow to reflect the social responsibility aspects of a business.

### Human Resource Accounting

Back in 1964, the first attempt to include figures on human capital, in the balance sheet, was made by Hermansson, that later came to be known as 'Human Resource Accounting' (HRA). However, there

had been a great socio-economic shift in the 1990s with the emergence of 'Knowledge Economy', a distinctive shift towards the recognition of human and intellectual capital in contrast to the physical capital. 'Human Resource Accounting' is a branch of accounting that seeks to report and emphasise the importance of the human resources (knowledgeable, trained, loyal and committed employees) in a company's earning process and total assets. It is 'the process of identifying and measuring data about human resources and communicating this information to interested parties. In simple words, it involves accounting for the investment in people and the replacement costs as well as accounting for the economic values of people to an organisation. Generally, the methods used for valuing and accounting of human resources are based either on costs or on economic value of the human resources. However, providing adequate and valid information on human assets (capital), which are outside the concept of ownership, in figures, is very difficult. Nevertheless, HRA is a managerial tool that provides valuable information to the top management to take decisions regarding the adequacy of human resources and thus encouraging managers to consider the investment in the workforce in a more positive way.

### Inflation Accounting

Inflation accounting is concerned with the adjustment in the value of assets (current and fixed) and of profits, in the light of changes in the price level. In a way, it is concerned with the overcoming of limitations that arise in financial statements because of the cost assumption (that is, recording of the assets at their historical or original cost) and the assumption of a stable monetary unit. It, thus, aims at correcting the distortions in the reported results caused by price level changes. Generally, rising prices during inflation have the distorting influence of overstating the profit. Various approaches have been suggested to deal with this problem.

## 1.4 NEW ACCOUNTING SYSTEMS

### Value Accounting

A product is a result of various individual contributions. Value accounting is used to evaluate and capture these individual contributions, whether this contribution is tangible or intangible and is normally mentioned as a % for each contributor. Value accounting helps in ensuring that every contributor gets his due share in the future revenue generated through the product. Example: If 5 workers are picking tea leaves and putting these in the same basket, the contribution of each is tracked through the value accounting system. This is helpful in deciding the share of revenue of each individual on selling the leaves in the market. Various value evaluation processes can be used in value accounting.

### Fair Value Accounting

Fair value accounting takes into account the current market value of certain assets and liabilities. Fair value of an asset is the estimated price at which an asset can be sold under current market conditions. Similarly, the fair market value of a liability is the estimated amount at which a liability can be settled under current market condition. The measurement of fair value under this accounting method is not concerned with the intention of the holder of the asset or liability to hold it or not. Under this method of accounting, various approaches can be used for deriving the fair value. Some of these are; Market approach, Income approach, Cost approach. Fair value accounting is also known as current value accounting. Presently, this method of accounting does not enjoy wide degree of acceptance due to the issues like increased cost and delays, non-availability of reliable information and doubts about the accuracy of available information.

## 1.5 ORIGINS OF ACCOUNTING PRINCIPLES

Accountancy and bookkeeping are as old as money itself. The Greeks, Romans, Egyptians and Babylonians had well-developed records and maintained a good system of record keeping and control. In the thirteenth and fourteenth centuries, there was a tremendous development of commerce in Italy where the modern system of bookkeeping took birth. In 1494, at Venice, Luca De Bargo Pacioli, an Italian monk, published his book called Summa that contained a section on the 'Double Entry' bookkeeping. In the latter part of the fifteenth century, there was an increase in use of Pacioli's work on accounting because of increased trade, and the necessity of merchants to record transactions.

Later, in the sixteenth and seventeenth centuries, there were attempts in England and Holland to design the rules for double entry and the preparation of financial statements/reports and independent ledger accounts. In the nineteenth century the industrial revolution, and in the twentieth century the two world wars, revised the form of accounting and reporting to the forms still in use till date.

In India also, accountancy and bookkeeping were practised in a scientific form twenty centuries ago. During the regime of King Chandragupta, Kautilya, one of his ministers, wrote a book on accountancy, named the 'Arthashastra'. In India, the old method of accounting, called the 'Nama' method, is still in use. It is also called the 'Mahajani', 'Marwari' or the 'Deshi' method.

## 1.6 ACCOUNTING STANDARDS IN INDIA AND ITS DEFINITION AND SCOPE

The Institute of Chartered Accountants of India (ICAI), recognising the need to harmonise the diverse accounting policies and practices, constituted an 'Accounting Standards Board' (ASB) on 21st April, 1977. The main function of the ASB is to formulate accounting standards so that the council of ICAI may mandate such standards.

### Procedure adopted for formulating accounting standards

1. ASB shall determine the broad areas in which accounting standards need to be formulated and the priority about the selection thereof.
2. In the preparation of the accounting standards, the ASB will be assisted by study groups constituted to consider specific subjects. It will also hold a dialogue with the representatives of the government, public and private sector industries and other organisations, for ascertaining their views.
3. Based on the above, an exposure draft of the proposed standard will be prepared and issued to its members for comments, and the public at large.
4. After taking into consideration the comments received, the exposure draft will be finalised by the ASB for submission to the council of ICAI.
5. The council of ICAI will consider the final draft 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.

A mandatory accounting standard, if not followed, requires the auditors, who are members of ICAI, to qualify their audit reports, failing which they will be guilty of professional misconduct. Both the SEBI and Companies Act 2013 require auditors to qualify the audit reports that do not conform to mandatory accounting standards. Section 134 (5) of the Companies Act 2013 also casts a responsibility on the Board of Directors to comply with mandatory accounting standards.

Under the Section 129(5) of the Companies Act 2013, where the financial statements do not comply with the accounting standards, such companies shall disclose the following:

(a) the deviation from the accounting standards;
(b) the reasons for such a deviation; and
(c) the financial effects, if any, arising out of such a deviation.

The 'National Advisory Committee on Accounting Standards' was set up on 15th June, 2001 to advise the Central Government on the formulation and laying down of accounting policies and accounting standards for adoption by the corporate sector. This committee has now been replaced by The National Financial Reporting Authority (NFRA). NFRA is a body constituted under the provisions of Section 132 of the Companies Act, 2013. The constitution of this authority is effective from 1st October 2018. It is a separate and independent regulatory body to assist in the framing and enforcement of legislation relating to accounting & auditing. The ICAI is now required to consult with the NFRA and examine its recommendations on Accounting Standards. The ICAI is a self-regulatory professional accountants' body whereas NFRA is an independent audit regulator. Setting up of NFRA may result in curtailment of some of the powers of ICAI.

**TABLE: 1.1:** Accountancy Standards

| *Number of the Accounting Standard (AS)* | *Title of the Accounting Standard* | *Date from which Mandatory (accounting periods commencing on or after)* |
|---|---|---|
| AS 1 | Disclosure of Accounting Policies | 1-4-1991/1-4-1993 |
| AS 2 (Revised) | Valuation of Inventories | 1-4-1999 |
| AS 3 (Revised) | Cash Flow Statements | 1-4-2001 * |
| AS 4 (Revised) | Contingencies and Events Occurring after the Balance Sheet Date | 1-4-1995 |
| AS 5 (Revised) | Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies | 1-4-1996 |
| AS 7 (Revised) | Construction Contracts | 1-4-2003 |
| AS 9 | Revenue Recognition | 1-4-1991/1-4-1993 |
| AS 10 (Revised) | Property, Plant and Equipment | 1-4-1991/1-4-1993 |
| AS 11 (Revised) | The Effects of Changes in Foreign Exchange Rates | 1-4-2004 |
| AS 12 | Accounting for Government Grants | 1-4-1994 |
| AS 13 | Accounting for Investments | 1-4-1995 |
| AS 14 | Accounting for Amalgamations | 1-4-1995 |
| AS 15 | Employee Benefits | 1-4-1995 |
| AS 16 | Borrowing Costs | 1-4-2000 |
| AS 17 | Segment Reporting | 1-4-2001 * |
| AS 18 | Related Party Disclosures | 1-4-2001 |

*(Contd.)*

| Number of the Accounting Standard (AS) | Title of the Accounting Standard | Date from which Mandatory (accounting periods commencing on or after) |
|---|---|---|
| AS 19 | Leases | 1-4-2001 |
| AS 20 | Earnings Per Share | 1-4-2001 |
| AS 21 | Consolidated Financial Statements | 1-4-2001 |
| AS 22 | Accounting for Taxes on Income | 1-4-2001*<br>1-4-2002 for companies<br>1-4-2003 for all |
| AS 23 | Accounting for Investments in Associates in Consolidated Financial Statements | 1-4-2002 |
| AS 24 | Discontinuing Operations | 1- 4-2004/1- 4-2005 |
| AS 25 | Interim Financial Reporting | 1-4-2002 |
| AS 26 | Intangible Assets | 1-4-2003/1-4-2004 |
| AS 27 | Financial Reporting of Interests in Joint Ventures | 1-4-2002 |
| AS 28 | Impairment of Assets | 1-4-2004*/1-4-2006/1- 4-2008 |
| AS 29 | Provisions, Contingent Liabilities and Contingent Assets | 1-4-2004 |

A brief summary of the contents and purposes of the accounting standards, issued by the Institute of Chartered Accountants of India, is given below. For further details and knowing about revisions, if any, it is suggested to go to the website of ICAI.

## 1. Accounting Standard – 1

It deals with the disclosure in the financial statements of significant accounting policies followed in the preparation and presentation of such statements. The purpose of this standard is to promote a better understanding of the financial statements by such a disclosure. Compliance of this standard helps in facilitating a more meaningful comparison between the financial statements of two different enterprises.

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

(i) Treatment of goodwill
(ii) Valuation of inventories
(iii) Valuation of investments
(iv) Valuation of fixed assets
(v) Methods of depreciation
(vi) Treatment of retirement benefits
(vii) Treatment of contingent liabilities
(viii) Treatment of expenditure during construction

(ix) Conversion or translation of foreign currency items
(x) Recognition of profit on long-term contracts

### *Disclosures of accounting policies*

1. All significant accounting policies adopted in the preparation 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.
3. Any change in the accounting policies that has a material effect in the current period or that which is reasonably expected to have a material effect in a later period should be disclosed. In the case of a change in accounting policies that has a material effect in the current period, the amount by which any item in the financial statement is affected by such a change should also be disclosed to the extent ascertainable. Where such an amount is not ascertainable wholly or in part, the fact should be indicated.
4. If the fundamental accounting assumptions, viz., going concern, consistency and accrual, are followed in the financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

## 2. Accounting Standard – 2 (Revised)

The Standard was originally issued in June 1981. The Standard has been revised by the Ministry of Corporate Affairs, Government of India, vide Notification dated 30th March, 2016, which is relevant for companies following Companies (Accounting Standards) Rules, 2006 and which should be used for preparation of accounts for accounting periods commencing on or after the date of notification. The Standard has been revised for entities other than companies in 2016 by the Council of the ICAI and is mandatory for accounting periods commencing on or after April 1, 2017.

The standard deals with the determination of the values at which inventories are carried in the financial statements until the related revenues are recognised. The standard also deals with determination of such value, including the ascertainment of cost of inventories and any write-down thereof to net realisable value. It states that inventories are to be valued at a lower of cost or net realisable value. Weighted average cost or first in first out (FIFO) methods is permitted in cases where goods are ordinarily interchangeable. Specific identification method is permitted only when goods are not ordinarily interchangeable. Techniques for measurement of the cost of inventories, such as the standard cost method or the retail method, are permitted to be used for convenience if the results approximate the actual cost.

This standard is not applied to:

(a) Work in progress arising under construction contracts
(b) Work in progress of service providers
(c) Shares, debentures, etc., held as stock-in-trade
(d) Inventories of livestock, agricultural and forest products, and mineral oils, ores and gases

## 3. Accounting Standard – 3

The standard deals with the preparation of a cash flow statement and its presentation along with the financial statements. It states that the cash flow statement should report the cash flows during the period of financial statements classified by the operating, investing and financing activities. It prescribes a direct

and indirect method of reporting cash flows. It states that a cash flow statement should disclose the components of cash and cash equivalents and simultaneously present a reconciliation of the amounts in the cash flow statement with the equivalent items reported in the balance sheet.

Cash comprises of cash in hand and demand deposits with the banks.

Cash equivalents are short-term high liquid investments that are readily convertible into a known amount of cash and are subject to an insignificant risk of change in value.

An investment normally qualifies as a cash equivalent only when it has a short maturity of, say, 3 months or less from the date of acquisition.

An enterprise presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business.

The Accounting Standard 3 requires the cash flows to be classified into three heads:

(a) Operating activities

(b) Investing activities

(c) Financing activities

The cash flows associated with extraordinary items should be classified as arising from operating, investing or financing activities as appropriate and separately disclosed.

### 4. Accounting Standard – 4 (Revised)

This accounting standard is mandatory. It deals with the treatment in financial statements of contingencies and events occurring after the balance sheet date. Contingencies are events whose outcomes will be known only on their occurrence, e.g. a case in the High Court, penalty proceedings under law, etc., are events whose outcome will be known only on their occurrence. Events occurring after the balance sheet date are those that occur between the balance sheet date and the date on which the financial statements are approved later by the Board of Directors of the company. Let us say, insolvency of a debtor, recovery from whom was considered as doubtful as on the date of balance sheet. The standard sets down, that contingencies must be provided if the loss due to these can be reasonably estimated. The standard also states that assets and liabilities should be adjusted for events occurring after the balance sheet date if they establish the conditions existing on the balance sheet date.

#### *Accounting treatment of contingent losses*

(a) If it is likely that a contingency will result in a loss to the enterprise, then it is prudent to make a provision for that loss.

(b) If there is insufficient evidence, then disclosure is made of the existence and nature of the contingency.

(c) A potential loss to an enterprise may be reduced by a related counterclaim. In such cases, the amount of the provision is determined after taking into account the probable recovery under the claim, if no significant uncertainty as to measurability exists.

#### *Accounting treatment of contingent gains*

Contingent gains are not recognised. However, when the realisation of a gain is virtually certain, then this gain is not a contingency and hence, accounting for the gain is appropriate.

### *Events occurring after the balance sheet date*

Events occurring after the balance sheet date are those significant events that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors.

(a) Adjustments to the assets and liabilities are required for events occurring after the balance sheet date that provide additional information relating to the conditions existing at the balance sheet date.

(b) Adjustments are not appropriate if such events do not relate to conditions existing at the balance sheet date.

(c) Events occurring after the balance sheet date, that do not affect the figures, would not normally require disclosure.

(d) There are events that take place after the balance sheet date, which are reflected in the financial statements because of a statutory requirement, e.g. dividend proposed.

(e) Events may indicate that the enterprise ceases to be a going concern, e.g. the destruction of a major production plant by a fire may indicate a need to consider whether it is proper to use the fundamental accounting assumption of a going concern.

### 5. Accounting Standard – 5 (Revised)

This accounting standard is mandatory. It deals with the treatment in the financial statements of a prior period and extraordinary items and changes in accounting policies. Prior period items are incomes or expenses that arise in the accounts of current year because of a mistake or omission in the preparation of the financial statement of one or more prior periods. Extraordinary items are unusual items distinct from the day-to-day activities of an entity. The nature and significant amount of such items need to be provided for in the financial statements. A change in the accounting policy shall be made only if the change is required by statute or standard or for appropriate presentation and any such change should be reported and quantified with respect to its impact on the profit or loss of the entity for the period of change/future period.

Ordinary activities are any activities that are undertaken by an enterprise as a part of its business. When the items of income and expense arising from the profit or loss from the ordinary activities are of such size, nature, or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

Circumstances, which may give rise to a separate disclosure of items of income and expense, include:

- the writing-off of inventories to net releasable value
- a restructuring of the activities of an enterprise
- disposals of items of fixed assets
- disposals of long-term investments
- legislative changes having retrospective application
- litigation settlements
- other reversals of provisions

**Extraordinary items:** They are incomes or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and therefore, are not expected to recur frequently or regularly.

### *Changes in accounting estimates*

- Changes in accounting estimates are uncertainties inherent in business activities. The estimation process involves judgements based on the latest information available. The use of reasonable estimates is an essential part of the preparation of a financial statement and does not undermine their reliability.
- An estimate may have to be revised, if changes occur regarding the circumstances. The revision does not bring the adjustment within the definitions of an extraordinary item or a prior period item.

Change in an accounting policy should be made only if the adoption of a different accounting policy 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 the enterprise.

## 6. Accounting Standard – 7 (Revised)

It deals with the accounting for construction contracts. Contract accounting is complicated because the contract period exceeds a single year in most cases. This poses serious accounting problems relating to revenue, treatment of advances received, work-in-progress, etc., in the financial statements. The standard recognises two methods of accounting for the construction contract, namely, the percentage of completion method and the completed contract method. The standard explains the relevance of both the methods of accounting and the method that is more appropriate under a given set of circumstances. It states the essential ingredients of these two methods and deals with the disclosures to be made in this regard.

This standard should be applied in accounting for construction contracts in the financial statements of contractors.

### *Construction contract*

A construction contract is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.

### *Construction contracts include*

(a) contracts for the rendering of services, which are directly related to the construction of the asset.
(b) contracts for destruction or restoration of assets.

### *Types of contracts*

A fixed price contract is a construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, that in some cases is subject to cost escalation clauses.

A cost plus contract is a construction contract in which the contractor is reimbursed for allowable or otherwise defined costs, plus a percentage of these costs or a fixed fee.

### *Disclosures*

An enterprise should disclose:

1. the amount of contract revenue recognised
2. the methods used to determine the contract revenue recognised

3. the method used to determine the stage of completion of contracts in progress
4. the aggregate amount of costs incurred and profits recognised (less recognised losses) up to the reporting date
5. the amount of advances received
6. the amount of retentions an enterprise should present:
   (i) the gross amount due from customers for contract work as an asset
   (ii) the gross amount due to customers for contract work as a liability

### 7. Accounting Standard – 9

It deals with the basis for the recognition of revenue, i.e. income and the time when the income can be said to have arisen. It also states the quantum of income to be credited to the profit and loss account. The statement shows how revenue is to be recognised from the various activities carried on by the enterprise. Let us say, from sale of goods, rendering of services and use by others of enterprise resources yielding interest, royalties, and dividends, etc.

This standard does not deal with:

(a) Revenue arising from construction contracts
(b) Revenue arising from hire purchase, lease agreements
(c) Revenue arising from government grants and other similar subsidies
(d) Revenue of insurance companies arising from insurance contracts.

#### *Disclosure*

When revenue recognition is postponed, the disclosure of the circumstances necessitating the postponement should be made.

### 8. Accounting Standard – 10 (Revised 2016)

#### *Accounting Standard AS-10 Property, Plant and Equipment*

The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment (PPE).

PPE are tangible items that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and are expected to be used during more than a period of twelve months.

#### *Recognition*

The cost of an item of PPE should be recognised as an asset if, and only if:

(a) it is probable that future economic benefits associated with the item will flow to the enterprise; and
(b) the cost of the item can be measured reliably.

#### *Measurement at recognition*

At the time of recognition, an item of PPE that qualifies for recognition as an asset should be measured at its cost which includes (a) purchase costs including import duties and non-refundable taxes, after adjusting trade discounts/rebates; (b) directly attributable and necessary costs and (c) costs of dismantling and restoration.

### *Examples of Directly Attributable Costs*

- Costs of employee benefits arising directly from the construction or acquisition of the item of PPE
- Costs of site preparation
- Initial delivery and handling costs
- Installation and assembly costs
- Professional fees
- Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment)

### *Exclusions*

- Administration and other general overhead costs
- Costs of opening a new facility or business, such as, inauguration costs
- Costs of introducing a new product or service (including costs of advertising and promotional activities)
- Costs of conducting business in a new location or with a new class of customer (including costs of staff training)

PPE acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets.

The cost of such an item of PPE is measured at fair value unless:

(a) the exchange transaction lacks commercial substance; or
(b) the fair value of neither the asset(s) received nor the asset(s) given up is reliably measurable.

The acquired item(s) is/are measured in this manner even if an enterprise cannot immediately derecognise the asset given up. If the acquired item(s) is/are not measured at fair value, its/their cost is measured at the carrying amount of the asset(s) given up.

### *Subsequent costs*

Subsequent costs on day-to-day servicing are not recognised as PPE. However, the replacement and regular major inspection costs are recognised in the carrying amount of PPE, if the recognition criteria is met.

### *Deferred Payment Plan*

If an item of PPE is acquired under deferred payment plan, the difference of cash price equivalent and total payment is recognised as interest over the period of credit unless such interest is capitalised as per AS 16, *Borrowing Costs.*

### *Measurement after recognition*

An enterprise should choose either the cost model or the revaluation model as its accounting policy and apply that policy to an entire class of PPE.

### *Cost Model*

Cost less any accumulated depreciation and any accumulated impairment losses.

### *Revaluation Model*

- Whose fair value can be measured reliably should be carried at a revalued amount less any subsequent accumulated depreciation and subsequent accumulated impairment losses.
- With sufficient regularity for entire class of PPE to which an asset which is revalued belongs.

### *Accounting for Revaluations*

Increase in an asset's carrying amount as a result of a revaluation is credited directly to owners' interests under the heading of revaluation surplus. However, the increase should be recognised in the Statement of Profit and Loss to the extent it reverses a revaluation decrease of the same asset previously recognised in the Statement of Profit and Loss.

Decrease in an asset's carrying amount as a result of a revaluation is recognised in the Statement of Profit and Loss. However, the decrease should be debited directly to owners' interests under the heading of revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that asset.

### *Depreciation*

Each part of an item of PPE with a cost that is significant in relation to the total cost of the item should be depreciated separately.

The depreciable amount should be allocated on a systematic basis over its useful life.

Depreciation charge for each period should be recognised in the Statement of Profit and Loss unless it is included in the carrying amount of another asset.

Residual value & useful life to be reviewed at each balance sheet date.

Any change is accounted for as change in an accounting estimate as per AS 5.

Depreciation method used should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the enterprise.

Depreciation method to be reviewed at least at each financial year end.

Any change is accounted for as change in an accounting estimate as per AS 5.

Depreciation methods include SLM, WDV & Units of Production method.

### *Retirements*

Items of PPE retired from active use and held for disposal should be stated at the lower of their carrying amount and net realisable value. Any write-down should be recognised immediately in the Statement of Profit and Loss.

### *Derecognition*

The carrying amount of an item of PPE should be derecognised on disposal or when no future economic benefits are expected from its use or disposal.

Gain/loss on derecognition should be recognised in Statement of Profit and Loss (unless AS 19 requires otherwise in a sale and leaseback) and should not be classified as revenue.

Gain/loss on derecognition is the difference between net disposal proceeds, if any, and the carrying amount of the derecognised item of PPE.

### 9. Accounting Standard – 11 (Revised 2018)

This comes in effect on or after 1st April, 2004 and is mandatory in nature. It deals with the accounting for transactions in foreign currencies in the financial statements prepared by an enterprise and with the translation of the financial statements of foreign branches prepared in foreign currency, into Indian rupees for including them in the financial statements of the head office in India. The standard also deals with the rules with respect to foreign currency translation (conversion) and the difference arising, if any, from the conversion of foreign currency into Indian rupees.

#### *Applied to*

(a) accounting for transactions in foreign currencies

(b) translating the financial statements of foreign operations

(c) foreign currency transactions in the nature of forward exchange contracts

#### *Does not deal with*

1. Restatement of an enterprise's financial statements from its reporting currency into another currency for the convenience of users.
2. The presentation in a cash flow statement of cash flows arising from transactions in a foreign currency and the translation of cash flows of a foreign operation.
3. Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

#### *Definitions*

- Exchange rate is the ratio for exchange of two currencies.
- Reporting currency is the currency used in presenting the financial statements.
- Foreign currency is a currency other than the reporting currency of an enterprise.
- Forward exchange contract means an agreement to exchange different currencies at a forward rate.

#### *Disclosures*

1. The amount of exchange differences included in the net profit or loss for the period.
2. Net exchange differences accumulated in the foreign currency translation reserve as a separate component of shareholders' funds.
3. Reconciliation of the amount of such exchange differences at the beginning and end of the period.
4. When the reporting currency is different from the currency of the country in which the enterprise is domiciled, the reason for using a different currency should be disclosed.
5. When there is a change in the classification of a significant foreign operation, an enterprise should disclose the:

   (i) nature of the change in classification;

   (ii) reason for the change;

   (iii) impact of the change in classification on shareholders' funds; and

   (iv) impact on net profit or loss for each prior period presented had the change in classification occurred at the beginning of the earliest period presented.

### 10. Accounting Standard – 12

It deals with the accounting for government grants received by an entity and how should such grants be presented in the financial statement. Such grants may be in the form of subsidies, cash incentives or duty drawbacks, etc. The various approaches to the grant as suggested by the standard would depend upon the purpose for which the grant is received and conditions that have to be fulfilled to obtain and enjoy the grant. Treatment of withdrawal of grants is also laid down in the standard.

#### *This standard does not deal with*

1. Government assistance – in the form of the government grants, i.e. tax holiday in backward areas, tax exemption in notified areas.
2. Government participation – in the ownership of the enterprise, i.e. investment by the government as equity.

Recognition of Government grants:

Government grants available to an enterprise are considered for inclusion:

(a) Where there is reasonable assurance.

(b) Where such benefits have been earned and it is reasonably certain that the ultimate collection will be made.

   (i) Government grants are rarely gratuitous. The enterprise earns them through compliance with their conditions and meeting the envisaged obligation.

   (ii) Government grants should be recognised in the profit and loss statement on a systematic and rational basis over the periods necessary to match them with the related costs.

#### *Disclosures*

The following disclosures are required to be made:

1. The accounting policy adopted for government grants, including the methods of presentation in the financial statements.
2. The nature and extent of government grants recognised in the financial statements, including grants of the non-monetary assets given at a concessional rate or free of cost.

### 11. Accounting Standard – 13 (Revised 2016)

It deals with accounting for investments made by an entity and its presentation in the financial statements. The standard defines the current and long-term investments and their basis of classification. To the extent the standard relates to current investments, it is also applicable to shares, debentures and other securities held as stock-in-trade, with suitable modification as specified in the standard itself. It lays down the criteria for bifurcation between the current and long-term investments and how they are to be classified as such.

This standard does not deal with:

1. Interest, dividends and rentals earned on investments.
2. Operating or finance leases.
3. Investments of retirement benefit plans and life insurance enterprises.
4. Mutual funds and venture capital funds and/or the related asset management companies, banks and public financial institutions.

Forms of Investments:

1. Investments having no physical existence and are represented merely by certificates, e.g. shares.
2. In physical form, e.g. buildings.
3. Investment may be in the nature of debt or equity shares.
4. Investments representing financial rights.

Classification of Investments:

Investments are classified as long-term investments and current investments.

### *Disclosures*

1. The accounting policies;
2. The amounts included in profit and loss statement for:
   (i) interest, dividends, and rentals on investments showing separately such income from long term and current investments. Gross income should be stated, the amount of income tax deducted at source being included under advance taxes paid.
   (ii) Profit and loss on the disposal of current investments and changes in carrying amount.
   (iii) Profit and loss on the disposal of long-term investments and changes in carrying amount.
3. Significance restrictions on the right of ownership realisability of investments or the remittance of income or proceeds of disposal.
4. The aggregate amount of the quoted and unquoted investments, giving the aggregate market value of quoted investments.
5. Other disclosures required by the relevant statute governing the enterprise.

## 12. Accounting Standard – 14 (Revised 2016)

It deals with the accounting for amalgamation and the treatment of any resultant goodwill or reserves. Amalgamation means an amalgamation pursuant to the provisions of the Companies Act, 2013 or any other statute which may be applicable to companies and includes ‘merger’. The standard does not deal with cases of acquisitions, which arise when there is a purchase by one company of the whole or part of the shares, or the whole or part of the assets, of another company. The distinguishing feature of an acquisition is that the acquired company is not dissolved and its separate entity continues to exist. The standard lays down the methods of amalgamation and the accounting adjustment under each method.

This accounting standard deals with accounting to be made in the books of Transferee Company in case of amalgamation.

An amalgamation may be either –

(a) an amalgamation in the nature of merger, or
(b) an amalgamation in the nature of purchase

The company which is amalgamated into another company is called the transferor company. The company into which a transferor company is amalgamated, is called the transferee company.

### *Disclosures*

In the first financial statement of the transferee company, the following disclosures for all amalgamations should be made:

- Names and general nature of business of amalgamating companies.
- Effective date of amalgamation.

- Method of accounting used.
- Particulars of scheme sanctioned under a statute. Amalgamation accounted under the pooling interest method.
- Description and number of shares issued.
- Difference between consideration and the value of net identifiable assets acquired and the treatment thereof.

Amalgamation accounted under the purchase method:

- Consideration for the amalgamation.
- Difference between the consideration and net identifiable assets acquired and the treatment thereof, including period of amortisation of the goodwill.

### 13. Accounting Standard – 15 (Revised 2005)

It deals with accounting and disclosure for benefits provided to employees in the financial statements of employers. Employee benefits include short-term employee benefits-both monetary and non-monetary, post-employment benefits, other long-term employee benefits and termination benefits. Retirement benefits would include provident fund, superannuation/pension and gratuity; leave encashment, post-retirement health and welfare schemes. This statement does not apply to those retirement benefits for which the employer's obligations cannot be reasonably estimated.

#### *Disclosures*

1. The financial statements should disclose the method by which the retirement benefit costs for the period have been determined.
2. In case the costs related to gratuity and other defined benefit schemes are based on an actuarial valuation, the financial statements should also disclose whether the actuarial valuation was made at, the end of the period or at an earlier date and the date of the actuarial valuation should be specified.
3. The method by which the accrual for the period has been determined should also be briefly described if the same is not based on the report of the actuary.

### 14. Accounting Standard – 16

The standard is mandatory for accounting periods commencing from 1st April, 2000. It deals with the accounting for the borrowing cost and not with the actual cost of owner's equity/preference capital. It states that the borrowing costs like interest and other costs that are directly attributable to the acquisition, construction or production of any qualifying asset (assets that take a substantial period to get ready for its intended use or sale) should be capitalised. It states that the income on the temporary investment of the borrowed funds be deducted from the borrowing costs. It states that the capitalisation of the borrowing cost be suspended during extended periods in which the development is interrupted. Capitalisations should cease when the asset is completed substantially or if completed in parts, in respect of that part, all the activities for its intended use or sale are complete. Policy with regard to borrowing cost needs to be disclosed in the financial statements.

Borrowing costs include:

(a) Interest and commitment charges
(b) Amortisation of discounts or premiums
(c) Amortisation of ancillary costs for the arrangement of borrowings

(d) Finance charges in respect of assets acquired under finance leases

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

### *Disclosures*

The financial statements should disclose:

1. The accounting policy adopted for the borrowing costs
2. The amount of borrowing costs capitalised during the period

## 15. Accounting Standard – 17

The standard is mandatory for accounting periods commencing from 1st April, 2001. It deals with the reporting of information about the different types of products and services of an enterprise and its operations in different geographical areas for assessing the risk and returns of a diversified or multi-location enterprise that is not determinable from the aggregated data. The statement is applicable to general purpose financial statements and consolidated financial statements (a separate accounting standard is presently being formulated on the consolidated financial statements). It lays down the criteria for identifying a 'business segment' and 'geographical segment' and requires reporting of the segments subject to fulfilment of certain criteria specified in the statement. It states that the segment information should be prepared in conformity with the accounting policies adopted for preparing and presenting financial statements of an enterprise as a whole.

This should help the user of financial statements to:

- Better understand the enterprise's performance.
- Better assess the risks and returns of the enterprise.
- Make more informed judgements about the enterprise as a whole.

### *Scope*

1. To be applied in presenting general purpose financial statements.
2. Also applicable in case of consolidated financial statements.
3. Segment information should be prepared in conformity with the accounting policies adopted for preparing and presenting the financial statements of the enterprise as a whole.
4. To be compiled with in full and not selectively.

A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments.

A geographical segment is a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic environments.

A reportable segment is a business segment or a geographical segment identified on the basis of definitions of business segment and geographical segment for which segment information is required to be disclosed by this Standard.

### *Disclosures*

The following disclosures are required for each reportable segment identified as primary segment:

(a) segment revenue, classified into segment revenue from sales to external customers and segment revenue from transactions with other segments;
(b) segment result;
(c) total carrying amount of segment assets;
(d) total amount of segment liabilities;
(e) total cost incurred during the period to acquire segment tangible and intangible fixed assets;
(f) total amount of depreciation and amortisation included in segment expenses; and
(g) total amount of significant non-cash expenses included in segment expenses.

## 16. Accounting Standard – 18

The standard is mandatory for accounting periods commencing from 1st April, 2001. It deals with the reporting of related party relationships and transactions between a reporting enterprise and its related parties. The statement is applicable to general-purpose financial statements and consolidated financial statements. The statement applies to the related party relationship as described in the statement. It states that the requirement of the statement shall not apply in circumstances where the providing such disclosures would conflict with the reporting enterprise's duties of confidentiality as specifically required in terms of a statute or by any regulatory or similar competent authority. It states that name of the related party and nature of the related party relationship where control exists should be disclosed irrespective of whether or not there have been transactions between the related parties.

### *Disclosure requirements*

If there is no transaction but control exists:

1. Name of the related party and
2. Nature of relationship

If there are transactions:

1. Name of the related party
2. Nature of relationship
3. Description of nature or transactions
4. Volume of the transactions
5. Amounts outstanding at the balance sheet date
6. Amounts provided, written off, written back during the year

## 17. Accounting Standard – 19

The objective of this standard is to prescribe, for lessors and lessees, the appropriate accounting policies and disclosure in financial statements in relation to finance lease and operating leases. It lays down the guidelines for classification of a lease between finance and operating lease. It lays down the treatments to be given to the finance and operating leases in the financial statements of the lessor and lessee. It also states that the disclosure requirements apply equally to sale and leaseback transaction.

This accounting standard comes into effect in respect of all assets leased on or after 1st April, 2001 and is mandatory.

### *Does not apply to:*

1. Lease agreements to explore for or use natural resources.
2. Licensing agreements for films, patents and copyrights, etc.
3. Lease agreement to use land.
4. Does not apply to agreements that are contracts for services that do not transfer the right to use the assets from one contracting party to the other.

Lease: A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or a series of payments the right to use an asset for an agreed period.

## 18. Accounting Standard – 20

The objective of this statement is to prescribe principles for the determination and presentation of earnings per share, which will improve the comparison of performance among different enterprises. This statement applies to enterprises whose equity or potential equity shares are listed on a recognised stock exchange in India. This statement requires the presentation of earnings per share information based on the consolidated financial statements as well as stand-alone financial statements of an entity.

A financial instrument is any contract that gives rise to both a financial asset of one enterprise and a financial or equity share of another enterprise. Share warrants or options are financial instruments that give the holder the right to acquire equity shares. For this purpose, a financial asset is any asset that is:

(a) Cash;
(b) A contractual right to receive cash or another financial asset from another enterprise;
(c) A contractual right to exchange financial instruments with another enterprise under conditions that are potentially favourable; or
(d) An equity share of another enterprise.

Potential equity share includes:

(a) Debt instruments or preference shares, that are convertible into equity shares
(b) Share warrants
(c) Options
(d) Shares which would be issued upon the satisfaction of certain conditions resulting from contractual arrangements

### *Presentation*

1. An enterprise should present basic and diluted earnings per share on the face of the statement of profit and loss for each class with equal prominence for all periods presented.
2. This statement requires an enterprise to present basic and diluted earnings per share, even if the amounts disclosed are negative.

### *Disclosures*

1. The amounts used as the numerators in calculating basic and diluted earnings per share, and a reconciliation of these amounts to the net profit or loss for the period;
2. The weighted average number of equity shares used as the denominator in calculating basic and diluted earnings per share, and a reconciliation of these denominators to each other; and
3. The nominal value of shares along with the earnings per share figures.

## 19. Accounting Standard – 21 (Revised 2016)

A parent which presents consolidated financial statements should present these statements in addition to its separate financial statements. A subsidiary is excluded from consolidation when control is intended to be temporary or when it operates under severe long-term restrictions on transferring funds to the parent.

Financial statements of the parent and its subsidiaries should be combined on a line-by-line basis, by adding together like items of assets, liabilities, incomes and expenses. The following steps should be taken:

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

(b) Any excess described as goodwill to be recognised as an asset in the consolidated financial statements and the deficit should be taken to capital reserve

(c) Minority interests in the net income of consolidated subsidiaries should be identified and adjusted

(d) Minority interest in the net assets of consolidated subsidiaries should be identified and presented separately from the liabilities and the equity, of the parent's shareholders.

### *Disclosures*

1. A list of all subsidiaries including the name, country, proportion of ownership and proportion of voting power held.
2. The nature of the relationship, between the parent and a subsidiary, if the parent does not own more than one-half of the voting power of the subsidiary.
3. The effect of the acquisition and disposal of subsidiaries on the financial position at the reporting date, the results for the reporting period and on the corresponding amounts for the preceding period.
4. The names of the subsidiary(ies) of which reporting date(s) is/are different from that of the parent and the difference in reporting dates.

## 20. Accounting Standard – 22

Taxes on income accrue in the same period as the revenues and the expenses to which they relate. Problems arise when the taxable income is different from the accounting income due to certain revenues or expenses not considered in computation of taxable income or their amounts differ.

### *Scope*

This statement prescribes the method of determination of the amount of expense or saving relating to taxes on income in respect of an accounting period.

This statement prescribes the disclosure of such an amount in the financial statements. Does not deal with taxes payable on the distribution of dividends.

### *Definitions*

*Accounting income* (*loss*) is the net profit or loss for a period, as reported in the statement of profit and loss, before deducting the income tax expenses or adding the income tax savings.

*Taxable income* (*loss*) is the amount of the income (loss) for a period, determined in accordance with the tax laws, based upon which income tax payable (recoverable) is determined.

*Tax expense* (*tax saving*) is the aggregate of current tax and deferred tax charged or credited to the statement of profit and loss for the period.

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

*Deferred tax* is the tax effect of timing differences.

*Timing differences* are the differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods.

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

### *Disclosures*

1. An enterprise should offset assets and liabilities representing current tax subject to fulfilment of the prescribed conditions.
2. An enterprise should offset deferred tax assets and deferred tax liabilities subject to fulfilment of the prescribed conditions.
3. Deferred tax assets and liabilities should be distinguished from current tax assets and liabilities.
4. Deferred tax assets and liabilities should be disclosed under a separate heading in balance sheet separately from the current assets and liabilities.
5. Break-up of deferred tax assets and liabilities into major components should be disclosed in the notes to account.
6. If the enterprise has unabsorbed depreciation or carry forward losses, the nature of evidence supporting the recognition of deferred tax assets is to be disclosed.

## 21. Accounting Standard – 23

This statement should be applied in accounting for investments in associates in the preparation and presentation of consolidated financial statements by an investor (and not for separate financial statement).

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

Significant influence is the power to participate in the financial and/or operating policy decisions of the investee but not the control over their policies. Significant influence may be gained by share ownership, statute or agreement. Share ownership means if an investor holds, directly or indirectly through a subsidiary, twenty per cent more of the voting power of the investee.

### Significant influence includes

(a) Representation on the Board of Directors or corresponding governing body of the investee
(b) Participation in the policymaking processes
(c) Material transactions between the investor and the investee
(d) Interchange of managerial personnel
(e) Provision of essential technical information.

Disclosures are required for proportion of ownership interest and, if different, the proportion of voting power held should be disclosed in the consolidated financial statements.

1. Investments in associates accounted for using the equity method should be classified as long-term investments.
2. The investor's share of any extraordinary or prior period items should also be separately disclosed.

3. The name(s) of the associate(s) of which reporting date(s) is/are different.
4. Brief description of the differences in the accounting policies of associates.

### 22. Accounting Standard – 24

If an enterprise has plans, to discontinue the operation of a particular segment, then the user has to understand the information about the discontinuing operation distinctly from that of the continuing operation, so that the user can make the projections of cash flows of the enterprise, the earning generating capacity and the financial position by segregating the information about the discontinuing operation from the information about the continuing operation.

A discontinuing operation:

(a) that the enterprise, pursuant to a single plan, is:
- disposing of substantially in its entirety, such as by selling the component in a single transaction or by a de merger or a spin-off of ownership of the component to the enterprise's shareholders; or
- disposing in piecemeal, such as by selling off the component's assets and settling its liabilities individually; or
- terminating through abandonment;

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

(c) that can be distinguished operationally and for financial reporting purposes
- if an enterprise sells a component substantially in entirety, a binding sale agreement is entered into on a specific date.
- the enterprise may discontinue and dispose of the components on a piecemeal basis and the disposal of a component may be in progress at the end of a financial reporting period. To qualify as a discontinuing operation, the disposal must be pursuant to a single coordinate plan.
- an enterprise may terminate an operation by abandonment without a substantial sale of assets.

#### *Procedure of disclosure*

The disclosures should be presented in the notes to the financial statements except the following, which should be shown on the face of the profit and loss statement:

1. The amount of pre-tax profit or loss from the ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related; and
2. The amount of the pretax gain or loss recognised, on the disposal of assets or settlement of liabilities.

### 23. Accounting Standard – 25

Interim reporting period is a period, which is not a complete financial period. Interim reporting is the financial reports of a period, which is less than a complete financial period.

A complete set of financial statements normally includes:

(a) balance sheet

(b) statement of profit and loss

(c) cash flow statement

(d) notes including those relating to accounting policies.

Components of an interim financial report are:

- condensed balance sheet;
- condensed statement of profit and loss;
- condensed cash flow statement; and
- selected explanatory notes.

Interim reporting and annual reporting:

(a) An enterprise should apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements. However, the frequency of an enterprise's reporting (annual, half-yearly, or quarterly) should not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes should be made on a year-to-date basis.

(b) Revenues that are received seasonally or occasionally within a financial year should not be anticipated or deferred as of an interim date if anticipation or deferral would not be appropriate at the end of the enterprise's financial year.

(c) Some enterprises consistently earn more revenues in certain interim periods of a financial year than in other interim periods; such revenues are recognised when they occur.

(d) A change in the accounting policy, other than the one for which the transition is specified by an accounting standard, should be reflected by restating the financial statements of prior interim period of the current financial year.

### 24. Accounting Standard – 26

This statement is mandatory for all accounting periods commencing from 1st April, 2003. Intangible assets do not include:

(a) Intangible assets that are covered by another AS, e.g. lease tax assets
(b) Financial assets
(c) Mineral rights and the expenditure on the exploration for, or development and extraction of minerals, oil, natural gas and similar non-regenerative resources; and
(d) Intangible assets arising in insurance enterprises from contracts with policyholders.

This statement applies to:

- Expenditure on advertising, training and start-up cost.
- Research and development activities.
- Rights under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts.
- Patents, copyrights and trademarks.
- Goodwill.

An intangible asset is:

- Identifiable
- A non-monetary asset
- Without physical substance

– Held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

The definition of an intangible asset requires that an intangible asset be identifiable. To be identifiable, it is necessary that the intangible asset is clearly distinguished from goodwill.

An asset is separable if the enterprise could rent, sell, exchange or distribute the specific future economic benefits attributable to the asset without also disposing of future economic benefits that flow from other assets used in the same revenue earning activity.

Some intangible assets may be contained in or on a physical substance such as a compact disk (in the case of computer software), legal documentation (in the case of licence or patent). The cost of the physical substance containing the intangible asset is usually not significant and hence, it is treated as a part of the intangible asset.

If the physical substance is significant, then it is treated under the AS 10.

### *Disclosures*

The financial statements should disclose the following for each class of intangible assets:

(a) the useful lives or the amortisation rates used;
(b) the amortisation methods used;
(c) the gross carrying amount and the accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period;
(d) a reconciliation of the carrying amount at the beginning and end of the period. The financial statements should also disclose:
    (i) If an intangible asset is amortised over more than ten years, the reasons why it is presumed that the useful life of an intangible asset will exceed ten years. In giving these reasons, the enterprise should describe the factor(s) that played a significant role in determining the useful life of the asset.
    (ii) A description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the financial statements of the enterprise as a whole.
    (iii) The existence and carrying amounts of intangible assets whose title is restricted and the carrying amounts of intangible assets pledged as security for liabilities.
    (iv) The amount of commitments for the acquisition of intangible assets.

## 25. Accounting Standard – 27

A joint venture is an economic activity that is controlled jointly by the parent enterprise and another party outside the group. This statement should be applied in accounting for interests in joint ventures and reporting the joint venture assets, liabilities, incomes and expenses in the financial statements of the venturers and investors. The requirement relating to accounting for joint ventures in consolidated financial statements are applicable only where consolidated financial statements are prepared and presented by the venturer.

### *Definitions*

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control.

Joint control is the contractually agreed sharing of control over an economic activity.

Control is the power to govern the financial and operating policies of an economic activity to obtain benefits from it.

A venturer is a party to a joint venture and has joint control over that joint venture.

An investor in a joint venture is a party to a joint venture and does not have joint control over that joint venture.

Proportionate consolidation is a method of accounting and reporting whereby a venturer's share of each of the assets, liabilities, incomes and expenses of a jointly controlled entity is reported as separate line items in the venturer's financial statements.

### *Disclosures*

A venturer should disclose the aggregate amount of the following contingent liabilities:

1. Any contingent liabilities that the venturer has incurred in relation to its interests in the joint ventures and its share in each of the contingent liabilities which have been incurred jointly with other venturers.
2. Its share of the contingent liabilities of the joint ventures themselves for which it is contingently liable.
3. Those contingent liabilities that arise because the venturer is contingently liable for the liabilities of the other venturers of a joint venture.
4. Any capital commitments of the venturer in relation to its interest in the joint ventures and its share in the capital commitments.
5. Its share of the capital commitments of the joint ventures themselves.
6. A venturer should disclose a list of all joint ventures and descriptions of interest in significant joint ventures.
7. A venturer should disclose, in its separate financial statements, the aggregate amounts of each of the assets, liabilities, incomes and expenses related to its interests in the jointly controlled entities.

### 26. Accounting Standard – 28

It is mandatory in nature and came into effect from 1st April, 2004 for enterprises whose equity or debt securities are listed on a recognised stock exchange and all other commercial, industrial and business reporting enterprises, whose turnover for the accounting period exceeds ₹ 50 crores. In respect of all other enterprises, the accounting standard comes into effect after 1st April, 2005. The standard is not applied to:

(a) inventories (AS 2)

(b) assets arising from construction contracts (AS 7)

(c) financial assets, including investments (AS 13)

(d) deferred tax assets (AS 22).

The objective of this AS is to prescribe the procedure applied to ensure that the carrying amount of an asset is not more than the recoverable amount of the asset. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset.

An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount. Recoverable amount is the higher of:

- an asset's net selling price, and
- its value in use.

Value in use is the present value of the estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

Costs of disposal are the incremental costs directly attributable to the disposal of an asset, excluding the finance costs and income tax expense.

An enterprise should assess at each balance sheet date whether there is any indication that an asset may be impaired. If any such indication exists, the enterprise should estimate the recoverable amount of the asset. The concept of materiality applies in identifying whether the recoverable amount of an asset needs estimation.

### *Disclosures*

Disclosure requirements can be categorised into the following four major categories:

- Basic requirements for each class of assets.
- Requirement for segment reporting.
- Requirement for cash generating unit.
- Requirement for reversal of impairment loss.

## 27. Accounting Standard – 29 (Revised 2016)

The Standard was originally issued in 2003. The Standard has been revised by the Ministry of Corporate Affairs, Government of India, vide Notification dated 30th March, 2016, which is relevant for companies following Companies (Accounting Standards) Rules, 2006 and which should be used for preparation of accounts for accounting periods commencing on or after the date of notification. The Standard has been revised for entities other than companies in 2016 by the council of the ICAI and is mandatory for accounting periods commencing on or after April 1, 2017.

### *Objective*

The objective of this Standard is to ensure that appropriate recognition criteria and measurement bases are applied to the provisions and contingent liabilities and that sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount. The objective of this Standard is also to lay down the appropriate accounting for contingent assets.

### *Scope*

This Standard should be applied in accounting for provisions and contingent liabilities and in dealing with contingent assets, except:

(a) those resulting from financial instruments that are carried at fair value;
(b) those resulting from executory contracts, except where the contract is onerous;
(c) those arising in insurance enterprises from contracts with policy-holders; and
(d) those covered by another Accounting Standard.

A provision should be recognised when:

- an enterprise has a present obligation because of a past event
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation
- a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognised.

### Reliable Estimate of the Obligation

Except in extremely rare cases, an enterprise will be able to determine a range of possible outcomes and can therefore, make an estimate of the obligation that is reliable to use in recognising a provision.

### Contingent Liability

An enterprise should not recognise a contingent liability.

### Contingent Asset

An enterprise should not recognise a contingent asset.

### Measurement

The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date. The amount of a provision should not be discounted to its present value except in case of decommissioning, restoration and similar liabilities that are recognised as cost of Property, Plant and Equipment.

### Changes in Provisions

Provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed.

### Use of Provisions

A provision should be used only for expenditures for which the provision was originally recognised.

### *Disclosure*

1. For each class of provision, an enterprise should disclose
   (a) the carrying amount at the beginning and end of the period
   (b) additional provisions made in the period, including increases to existing provisions
   (c) amounts used (i.e. incurred and charged against the provision) during the period
   (d) unused amounts reversed during the period
   (e) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits
   (f) an indication of the uncertainties about those outflows. Where necessary, to provide adequate information, an enterprise should disclose the major assumptions made concerning the future events

(g) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

2. Unless, the possibility of any outflow in settlement is remote, an enterprise should disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, where practicable
   (a) an estimate of its financial effect
   (b) an indication of the uncertainties relating to any outflow
   (c) the possibility of any reimbursement.

   Where any of this information is not disclosed because it is not practicable to do so, that fact should be stated.
3. In extremely rare cases, disclosure of some or all of the information required by the above paragraphs can be expected to prejudice seriously the position of the enterprise in a dispute with other parties on the subject matter of the provision or contingent liability. In such cases, an enterprise need not disclose the information, but should disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed. A Small and Medium-sized Company and a Small and Medium-sized Enterprise (Level II and Level III non-corporate entities), may not comply with the disclosure requirements.

## 1.7 INDIAN ACCOUNTING STANDARDS (Ind AS)

The accounting standards discussed above are not in line with the standards and principles applicable globally (IFRS). With a view to making the financial statements uniform and to enable the investors to assess and compare the financial position of Indian companies with other global companies, Ind AS have been introduced. These are converged form of **IFRSs (International Financial Reporting Standards)**. The Ind AS are named and numbered in the same way as the IFRSs. However, Ind AS differ from the IFRS Standards as they contain certain additions and deletions for making them contextually relevant to the Indian economic and legal environment. The Institute of Chartered Accountants of India (ICAI) recommends Accounting Standards to National Financial Reporting Authority (NFRA) and the Standards are notified by the Ministry of Corporate Affairs, Government of India after considering the recommendation of the NFRA . A total of 41 standards have been notified till now, of which two standards have been superseded and withdrawn. In case of any conflict between provisions of any applicable Act and Ind AS, the provisions of the Act will prevail to that extent.

### Which set of Accounting Standards should be followed?

Presently, two sets of Accounting Standards are being used in India. These are:

1. Accounting Standards issued by The Institute of Chartered Accountants of India (ICAI)
2. Indian Accounting Standards (Ind AS) notified by the Ministry of Corporate Affairs (MCA)

Government of India Ministry of Corporate Affairs, has issued 2 notifications specifying which companies have to follow which set of Accounting Standards. The notification dated February 16, 2015, called Companies (Indian Accounting Standards) Rules, 2015, specifies the companies which are required to follow Ind AS. These are: (a) companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India (b) Unlisted companies having net worth of rupees two hundred and fifty crore or more (c) holding, subsidiary, joint venture or associate companies