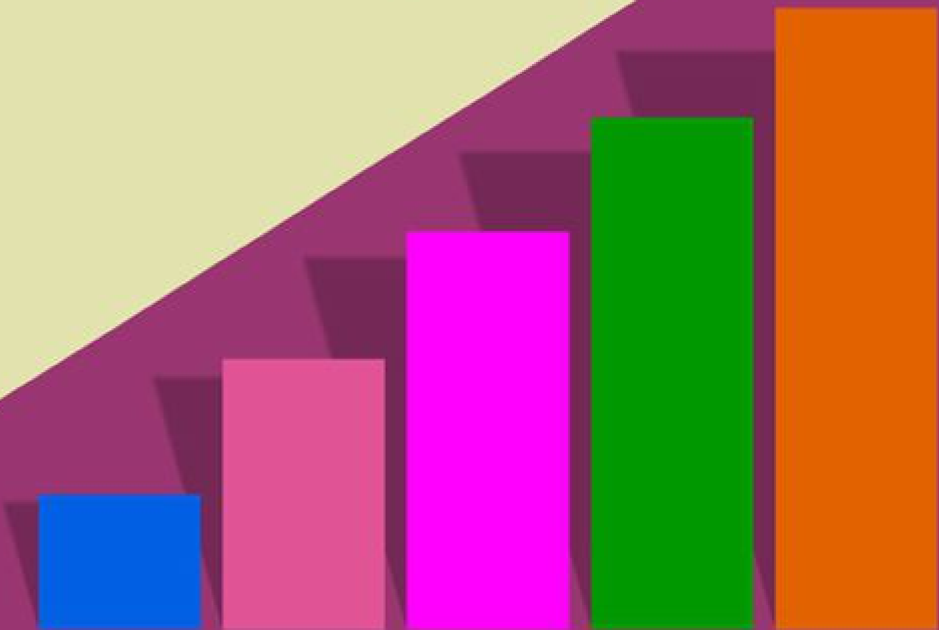
Accounting Standards For Students

Arjun Saini



Himalaya Publishing House
ISO 9001:2008 CERTIFIED

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FIRST EDITION : 2015

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First Edition : 2015

Published by	:	Mrs. Meena Pandey for **Himalaya Publishing House Pvt. Ltd.,** "Ramdoot", Dr. Bhalerao Marg, Girgaon, **Mumbai - 400 004.** Phone: 022-23860170/23863863, Fax: 022-23877178 **E-mail: himpub@vsnl.com; Website: www.himpub.com**
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DTP by	:	HPH, Editorial Office, Bhandup (Apte)
Printed at	:	M/s. Charita Impressions, Hyderabad. On behalf of HPH.

PREFACE

Accounting Standards is an authoritative pronouncement of code of practice of the regulatory accountancy body to be observed and applied in the preparation and presentation of financial statements. These standards are intended to apply only to material items.

This book on Indian Accounting Standards has been prepared for students preparing for the examinations of the Institute of Chartered Accountants of India (ICAI), Institute of Cost and Works Accountants of India (ICWA), Institute of Company Secretaries of India (ICS) and B.Com. and M.Com. courses of all Indian Universities. The book attempts to explain and illustrate in the simplest language all the Accounting Standards.

The views expressed in this book are of author's own.

I have taken help of the various Accounting Standards while explaining the comparative position; I have also taken a few quotes against which I have given proper reference.

I may also mention that while considerable care has been taken to ensure that contents are accurate, a few errors are inherent in work of this kind, therefore, with all humility I seek suggestions from the readers.

I am thankful to Shri K.N. Pandey, Director, Mr. S.K. Srivastav and all the editorial staff of M/s Himalaya Publishing House Pvt. Ltd. for bringing out this first edition of the book within a very short time.

I will be happy to welcome further suggestions from readers to improve this book. The readers may send their suggestions on arjunsaini@rediffmail.com.

Dated 1st January, 2014

Dr. A.L. Saini

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Chapter 1

DISCLOSURE OF ACCOUNTING POLICIES (AS 1)

INTRODUCTION

Accounting policies refer to specific principles and the methods of applying those principles adopted by the enterprise in preparation and presentation of the financial statements. At the time of preparation of financial statements (i.e., Balance Sheet, Profit and Loss Account), there are many areas, which have more than one method of accounting treatment such as depreciation, valuation of inventories, valuation of investments, etc.

The purpose of this Standard is to promote better understanding of financial statements by establishing through an accounting standard the disclosure of significant accounting policies and the manner in which accounting policies are disclosed in the financial statements. Such disclosure would also facilitate a more meaningful comparison between financial statements of different enterprises.

This Standard deals with the disclosure of significant accounting policies followed in preparing and presenting financial statements. The view presented in the financial statements of an enterprise of its state of affairs and of the profit or loss can be significantly affected by the accounting policies followed in the preparation and presentation of the financial statements. The accounting policies followed vary from enterprise to enterprise. Disclosure of significant accounting policies followed is necessary if the view presented is to be properly appreciated.

The disclosure of some of the accounting policies followed in the preparation and presentation of the financial statements is required by law in some cases. The Institute of Chartered Accountants of India has, in Standard issued by it, recommended the disclosure of certain accounting policies, e.g., translation policies in respect of foreign currency items.

In recent years, a few enterprises in India have adopted the practice of including in their annual reports to shareholders a separate statement of accounting policies followed in preparing and presenting the financial statements. In general, however, accounting policies are not at present regularly and fully disclosed in all financial statements. Many enterprises include in the Notes on the Accounts, descriptions of some of the significant accounting policies. But the nature and degree of disclosure vary considerably between the corporate and the non-corporate sectors and between units in the same sector.

Even among the few enterprises that presently include in their annual reports a separate statement of accounting policies, considerable variation exists. The statement of accounting policies forms part of accounts in some cases while in others it is given as supplementary information.

Fundamental Accounting Assumptions

Certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed. The following have been generally accepted as fundamental accounting assumptions:

(a) **Going Concern:** The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.

(b) **Consistency:** It is assumed that accounting policies are consistent from one period to another.

(c) **Accrual:** Revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate. (The considerations affecting the process of matching costs with revenues under the accrual assumption are not dealt with in this Standard).

Nature of Accounting Policies

The accounting policies refer to the specific accounting principles and the methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements.

There is no single list of accounting policies which are applicable to all circumstances. The differing circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles acceptable. The choice of the appropriate accounting principles and the methods of applying those principles in the specific circumstances of each enterprise calls for considerable judgement by the management of the enterprise.

The various Standards of the Institute of Chartered Accountants of India combined with the efforts of government and other regulatory agencies and progressive managements have reduced in recent years the number of acceptable alternatives particularly in the case of corporate enterprises. While continuing efforts in this regard in future are likely to reduce the number still further, the availability of alternative accounting principles and methods of applying those principles is not likely to be eliminated altogether in view of the differing circumstances faced by the enterprises.

Areas in which Differing Accounting Policies are Encountered

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

(a) Methods of depreciation, depletion and amortisation

(b) Treatment of expenditure during construction

(c) Conversion or translation of foreign currency items

(d) Valuation of inventories

(e) Treatment of goodwill

(f) Valuation of investments

(g) Treatment of retirement benefits

(h) Recognition of profit on long-term contracts

(i) Valuation of fixed assets

(j) Treatment of contingent liabilities.

Considerations in the Selection of Accounting Policies

The primary consideration in the selection of accounting policies by an enterprise is that the financial statements prepared and presented on the basis of such accounting policies should represent a true and fair view of the state of affairs of the enterprise as at the balance sheet date and of the "profit and loss account".

For this purpose, the major considerations governing the selection and application of accounting policies are:

(a) Prudence: In view of the uncertainty attached to future events, profits are not anticipated but recognised only when realised though not necessarily in cash. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.

(b) Substance over Form: The accounting treatment and presentation in financial statements of transactions and events should be governed by their substance and not merely by the legal form.

(c) Materiality: Financial statements should disclose all "material" items, i.e., items the knowledge of which might influence the decisions of the user of the financial statements.

Disclosure of Accounting Policies

1. To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.
2. Such disclosure should form part of the financial statements.
3. It would be helpful to the reader of financial statements if they are all disclosed as such in one place instead of being scattered over several statements, schedules and notes.
4. Any change in an accounting policy which has a material effect should be disclosed. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. If a change is made in the accounting policies which has no material effect on the financial statements for the current period but which is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.
5. Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item in the accounts.

Question 1:

The Company has a branch office in India since 1997. As of March 2001, it has decided to close operations in India. Should 'Going Concern Assumption' be qualified? Will the assets and liabilities have to be restated/revalued? What if any and how are the disclosure requirements to be complied with? There is no disagreement on the going concern issue between management and the auditors. Since this is a branch office, with skeleton operations, there are no significant assets/liabilities. Besides, the branch operates out of rented premises.

Answer:

The company should prepare the accounts of the branch office on the basis of that it will be closed. Since the branch does not have significant assets and liabilities, the accounts prepared under the historical cost method itself may represent the accounts prepared on the assumption that the branch office will soon be closed. In addition to the liabilities disclosed in the accounts, further liabilities may have to be provided in respect of employee termination or premature termination of various contracts including the lease of the premises. Adequate disclosure and adjustments should be made in the financial statements about the impending closure and the fact that the accounts are prepared on that basis.

Question 2:

What are the principles to be followed when an enterprise is not a going concern? Are auditors required to qualify accounts of an enterprise that is not a going concern?

Answer:

The company should prepare the accounts on the basis that it is not a going concern or that it will be closed in the near future. All the assets of such a company should be valued at its net realizable value. All the liabilities should be valued at the expected settlement price. In addition, further liabilities may have to be provided in respect of employee termination or premature termination of various contracts including the lease of the premises. Adequate disclosures/adjustments should be made in the financial statements about the impending closure and the facts that the accounts are prepared on that basis. Since the accounts would be true and fair, there is no need for the auditor to make a qualification. The auditor should however, add a paragraph in his report detailing the going concern situation (matter of emphasis and not qualification). If the financial statements are not prepared on the above basis, the auditor will have to qualify the financial statements.

Question 3:

Comment on the following: The auditors need not review accounting policies unless there is a change in the basis of accounting?

Answer:

The auditor should review appropriateness of the accounting policies applied each year irrespective of whether there were changes in accounting policies or not because business and environment is not static and is constantly changing. Therefore, it would not be correct to state that the auditor need not review the accounting policies unless there is a change in the basis of accounting. Accounting policies also need revision when new accounting standards introduces new principles of accounting, for example, accounting for taxes on income (AS 22). A point to be noted is that the responsibility of choosing an accounting policy and applying it is that of the management. The auditor is required to express an opinion on the financial statements.

Question 4:

Can an enterprise apply different accounting policies for similar items?

Answer:

This is contrary to the fundamental accounting assumption of consistency, which requires use of consistent policies year after year and also in the same year for all similar items. In the case of depreciation, Expert Advisory Committee (EAC) of ICAI has given an opinion that different methods of depreciation for the same class of assets used in different plants of the company can be applied if the management considers it appropriate to do so after taking into account important factors such as the type of assets, the nature of the use of such assets and the circumstances prevailing in the business. Whilst such exceptions may in rare circumstances be justifiable it would be difficult to justifying valuing the same type of inventory at two different factories by applying two different accounting policies.

Difference between AS 1 and IAS 1

1. **Number of standards, interpretations and literature available under IFRS and I-GAAP.**

Under IFRS

IAS 1 (2007) — Presentation of Financial Statements (effective 1 January, 2009).

Under I-GAAP

AS 1 — Disclosure of Accounting Policies/Schedule VI to Companies Act, 1956

AS 5 — Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

2. **Components of financial statements.**

Under IFRS

A complete set of financial statements under IFRS comprises

(a) a statement of financial position; (b) a statement of comprehensive income/a statement displaying components of profit or loss (separate income statement) and a second statement beginning with profit or loss and displaying components of other comprehensive income; (c) a statement of cash flows; (d) a statement of changes in equity; and (e) notes including summary of accounting policies and explanatory notes.

Comparative figures are presented for one year. When a change in accounting policy has been applied retrospectively or items of financial statements have been restated, a statement of financial position is required as at the beginning of the earliest period presented.

Under I-GAAP

The requirements for the presentation of financial statements are set out in Schedule VI to the Companies Act, 1956, Schedule III to the Banking Regulation Act, 1949 (for banks), the regulations issued by the Insurance Regulatory and Development Authority (for Insurance companies) and the SEBI guidelines for Mutual Funds together with the Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006.

The components of financial statements are (a) balance sheet; (b) statement of profit and loss; (c) cash flow statement (not mandatory; for Small and Medium Sized Companies); (d) explanatory notes including summary of accounting policies.

Single entity financial statements are required to be presented by all entities. Public listed companies are required to present consolidated financial statements in addition to separate financial statements of the parent in terms of the Listing Agreement with the Stock Exchanges and the SEBI Guidelines.

3. Definition of "material".

Under IFRS

Omissions or misstatements are material if individually or collectively they could influence the economic decisions that users take on the basis of financial statements.

Under I-GAAP

Financial statements should disclose all "material" items, i.e., items, the knowledge of which might influence the decisions of the user of the financial statements.

4. Fair presentation.

Under IFRS

Fair presentation requires faithful representation of the effects of the transactions, other events and conditions in accordance with the definitions of and recognition criteria for assets, liabilities, income and expenses set out in the Framework.

In extremely rare circumstances in which management concludes that compliance with requirements of a Standard or Interpretation is so misleading, it may depart from the Standard or the Interpretation. Reasons for departure and why application of the Standard or the Interpretation would have been misleading and the financial impact of applying the standard are required to be disclosed.

Under I-GAAP

Fair presentation requires compliance with the applicable requirements of the Companies Act, 1956 and the other regulatory requirements and the application of the qualitative characteristics of the Accounting Standards Framework.

Departures from Accounting Standards or Companies Act, 1956 are prohibited unless permitted by other regulatory framework for example, the Insurance Regulatory and Development Authority.

5. Classification of financial liabilities under refinancing arrangements.

Under IFRS

Non-current if the agreement to refinance or reschedule payments on a long-term basis is completed before the end of the reporting period.

Under I-GAAP

There is no guidance under Indian GAAP. Generally, not disclosed as payable within twelve months after the balance sheet date if the agreement to refinance or reschedule payments is completed after the balance sheet date and before the date of approval of financial statements.

6. Classification of financial liabilities upon violation of covenants.

Under IFRS

Non-current if the lender has agreed before the end of the reporting period to provide a period of grace of minimum twelve months after the reporting period within which the breach can be rectified and the lender cannot demand immediate repayment.

Under I-GAAP

There is no guidance under Indian GAAP. Generally, not disclosed as payable within twelve months of the balance sheet date if the lender has agreed after the balance sheet date and before the approval of the financial statements not to demand immediate repayment.

7. Presentation of income statement/statement of comprehensive income.

Under IFRS

An analysis of expenses is presented using a classification based on either the nature of expenses or their function whichever provides information that is reliable and more relevant. If presented by function, specific disclosures by nature are provided in the notes.

Profit or loss attributable to minority interest (non-controlling interest) and equity holders of the parent are disclosed in the statement of comprehensive income/income statement (if presented separately) as allocations of profit or loss for the period.

Under I-GAAP

Schedule VI requires an analysis of expense by nature.

Profit or loss attributable to minority interests is disclosed as deduction from the profit or loss for the period as an item of income or expense (as per AS 21).

8. Statement of comprehensive income.

Under IFRS

Includes all items of income and expense (non-owner changes in equity) including: (a) components of profit or loss and (b) other comprehensive income, for example, revaluation reserve.

Items are presented either:

(a) In a single statement of comprehensive income with a sub-total for profit or loss; or

(b) In a separate income statement displaying components of profit or loss and a separate statement of comprehensive income beginning with profit or loss and displaying components of other comprehensive income.

Under I-GAAP

A statement of comprehensive income is not required to be prepared. Statement of profit and loss is the Indian GAAP equivalent of separate income statement under IFRS. Some items such as revaluation surplus which are treated as ‘other comprehensive income’ under IFRS are recognised directly in equity under Indian GAAP.

9. Statement of changes in equity.

Under IFRS

A statement of changes in equity is presented showing (a) the total comprehensive income for the period; (b) effects of retrospective application or restatement on each component of equity (c) for each component of equity, a reconciliation between opening and closing balances, separately disclosing changes resulting from (i) profit or loss; (ii) each item of other comprehensive income and (iii) transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control.

Under I-GAAP

A statement of changes in equity is not required.

Movements in share capital, retained earnings and other reserves are presented in schedules to financial statements.

10. Extraordinary items.

Under IFRS

Presentation of any items of income or expense as extraordinary is prohibited.

Under I-GAAP

Extraordinary items are disclosed separately in the statement of profit and loss and are included in the determination of net profit or loss for the period.

Items of income or expense to be disclosed as extraordinary should be distinct from the ordinary activities and are determined by the nature of the event or transaction in relation to the business ordinarily carried out by an entity.

11. Reclassification.

Under IFRS

When comparative amounts are reclassified, nature, amount and reason for reclassification are disclosed.

Under I-GAAP

A disclosure is made in financial statements that comparative amounts have been reclassified to conform to presentation in the current period without additional disclosures for the nature, amount and reason for reclassification.

12. Critical Judgement.

Under IFRS

Requires disclosure of critical judgements made by management in applying accounting policies.

Under I-GAAP

No such requirement.

13. Estimation uncertainty.

Under IFRS

Requires disclosure of key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

The nature of the uncertainty and the carrying amounts of such assets and liabilities at the end of the reporting period are required to be disclosed.

Under I-GAAP

No such requirement.

14. Capital.

Under IFRS

IFRS requires disclosure of information to enable users of financial statements to evaluate the entity's objectives, policies and processes of managing capital.

Under I-GAAP

No such requirement.

Question 1:

Jagannath Ltd., had made a rights issue of shares in 1996. In the offer document to its members, it had projected a surplus of ` 40 crores during the accounting year to end on 31st March, 1998. The draft results for the year, prepared on the hitherto followed accounting policies and presented for perusal of the board of directors showed a deficit of ` 10 crores. The board in consultation with the managing director, decided on the following:

(i) Value year-end inventory at works cost (` 50 crores) instead of the hitherto method of valuation of inventory at prime cost (` 30 crores).

(ii) Provide depreciation for the year on straight line basis on account of substantial additions in gross block during the year, instead of on the reducing balance method, which was hitherto adopted. As a consequence, the charge for depreciation at ` 27 crores is lower than the amount of ` 45 crores which would have been provided had the old method been followed, by ` 18 crores.

(iii) Not to provide for "after sales expenses" during the warranty period. Till the last year, provision at 2% of sales used to be made under the concept of "matching of costs against revenue" and actual expenses used to be charged against the provision. The board now decided to account for expenses as and when actually incurred. Sales during the year total to ` 600 crores.

(iv) Provide for permanent fall in the value of investments — which fall had taken place over the past five years — the provision being ` 10 crores.

As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 1997-1998.

Answer:

As per AS 1 "Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Accordingly, the notes on accounts should properly disclose the change and its effect."

Notes on Accounts:

(i) During the year inventory has been valued at factory cost, against the practice of valuing it at prime cost as was the practice till last year. This has been done to take cognisance of the more capital intensive method of production on account of heavy capital expenditure during the year. As a result of this change, the year-end inventory has been valued at ` 50 crores and the profit for the year is increased by ` 20 crores.

(ii) In view of the heavy capital intensive method of production introduced during the year, the company has decided to change the method of providing depreciation from reducing balance method to straight line method. As a result of this change, depreciation has been provided at ` 27 crores which is lower than the charge which would have been made had the old method and the old rates been applied, by ` 18 crores. To that extent, the profit for the year is increased.

(iii) So far, the company has been providing 2% of sales for meeting after sales expenses during the warranty period. With the improved method of production, the probability of defects occurring in the products has reduced considerably. Hence, the company has decided not to make provision for such expenses but to account for the same as and when expenses are incurred. Due to this change, the profit for the year is increased by ` 12 crores than would have been the case if the old policy were to continue.

(iv) The company has decided to provide ` 10 crores for the permanent fall in the value of investments which has taken place over the period of past five years. the provision so made has reduced the profit disclosed in the accounts by ` 10 crores.

Question 2:

Write short notes on the advantages and disadvantages of setting of Accounting Standards.

Answer:

The Accounting Standards seek to describe the accounting principles, the valuation techniques and the methods of applying the accounting principles in the preparation and presentation of financial statements so that they may give a true and fair view. The ostensible purpose of the standard setting bodies is to promote the dissemination of timely and useful financial information to investors and certain other parties having an interest in companies' economic performance. The setting of accounting standards has the following advantages:

(i) Standards reduce to a reasonable extent or eliminate altogether confusing variations in the accounting treatments used to prepare financial statements.

(ii) There are certain areas where important information are not statutorily required to be disclosed. Standards may call for disclosure beyond that required by law.

(iii) The application of accounting standards would, to a limited extent, facilitate comparison of financial statements of companies situated in different parts of the world and also of different companies situated in the same country. However, it should be noted in this respect that differences in the institutions, traditions and legal systems from one country to another give rise to differences in accounting standards practised in different countries.

However, there are some disadvantages of setting of accounting standards:

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

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

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

Question 3:

ABC Ltd. was making provision for non-moving stocks based on no issues for the last 12 months upto 31.3.2002.

The company wants to provide during the year ending 31.3.2003 based on technical evaluation:

Total value of stock	` 100 lakhs
Provision required based on 12 months issue	` 3.5 lakhs
Provision required based on technical evaluation	` 2.5 lakhs

Does this amount to change in Accounting Policy? Can the company change the method of provision?

Answer:

The decision of making provision for non-moving stocks on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving stocks should be made. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

In the given case, considering the total value of stock, the change in the amount of required provision of non-moving stock from ` 3.5 lakhs to ` 2.5 lakhs is also not material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of ABC Ltd., for the year 2002-03:

"The company has provided for non-moving stocks on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the corresponding effect on the year end net assets would have been higher by ` 1 lakh".

Question 4:

Write short note on *"Concept of Materiality."*

Answer:

Para 17 of AS 1 'Disclosure of Accounting Policies', states that financial statements should disclose all material items, i.e., items the knowledge of which might influence the decisions of the user of the financial statements. Materiality depends on the size of item or error judged in the particular circumstances of its omission or misstatement. From a positive perspective, materiality has to do with the significance of an item or event to warrant attention in the accounting process. From a negative viewpoint, materiality is critical because otherwise a great deal of time might be spent on trivial matters in the accounting process. Individual judgements are required to assess materiality, or to decide what the appropriate minimum quantitative criteria are to be set for given situations. What is material to one organisation, may not be material for another organisation.

The relevance of information is affected by its materiality. Information is material if its misstatements (i.e., omission or erroneous statement) could influence the economic decisions of users taken on the basis of the financial information. Materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which the information must have if it is to be useful.

Question 5:

Discuss the concept of Cost vs. Fair value with reference to Indian Accounting Standards.

Answer:

Cost vs. Fair value

Cost basis: The term cost refers to cost of purchase, costs of conversion on other costs incurred in bringing the goods to its present condition and location. Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

Fair value: Fair value of an asset is the amount at which an enterprise expects to exchange an asset between knowledgeable and willing parties in an arm’s length transaction.

Indian Accounting Standards are generally based on historical cost with a very few exceptions:

AS 2 “Valuation of Inventories” – Inventories are valued at net realizable value (NRV) if cost of inventories is more than NRV.

AS 10 “Accounting for Fixed Assets” – Items of fixed assets that have been retired from active use and are held for disposal are stated at net realizable value if their net book value is more than NRV.

AS 13 “Accounting for Investments” – Current investments are carried at lower of cost and fair value. The carrying amount of long-term investments is reduced to recognise the permanent decline in value.

AS 15 “Employee Benefits” – The provision for defined benefits is made at fair value of the obligations.

AS 26 “Intangible Assets” – If an intangible asset is acquired in exchange for shares or other securities of the reporting enterprise, the asset is recorded at its fair value, or the fair value of the securities issued, whichever is more clearly evident.

AS 28 “Impairment of Assets”– Provision is made for impairment of assets.

On the other hand IFRS and US GAAPs are more towards fair value. Fair value concept requires a lot of estimation and to the extent, it is subjective in nature.

Question 6:

(a) XYZ Ltd., with a turnover of ` 35 lakhs and borrowings of ` 10 lakhs during any time in the previous year, wants to avail the exemptions available in adoption of Accounting Standards applicable to companies for the year ended 31.3.2008. Advise the management the exemptions that are available as per Companies (AS) Rules, 2006. If XYZ is a partnership firm is there any other exemptions additionally available.

(b) Write short note on NACAS.

Answer:

(a) XYZ Ltd. is a small and medium sized enterprise (SME) company as per Companies (AS) Rules, 2006. The following relaxations and exemptions are available.

1. AS 3 “Cash Flow Statements” is not mandatory.
2. AS 17 “Segment Reporting” is not mandatory.
3. SMEs are exempt from some paragraphs of AS 19 “Leases”.
4. SMEs are exempt from disclosures of diluted EPS (both including and excluding extraordinary items).
5. SMEs are allowed to measure the ‘value in use’ on the basis of reasonable estimate thereof instead of computing the value in use by present value technique under AS 28 “Impairment of Assets”.
6. SMEs are exempt from disclosure requirements of paragraphs 66 and 67 of AS 29 “Provisions, Contingent Liabilities and Contingent Assets”.
7. SMEs are exempt from certain requirements of AS 15 “Employee Benefits”.

8. Accounting Standards 21, 23, 27 are not applicable to SMEs.

If XYZ is not a company, it will be treated as a level III enterprise instead of level II enterprise; XYZ Ltd., will be exempt from requirements of AS 18 “Related Party Disclosures” and AS 24 “Discontinuing Operations”.

(**b) NACAS:** Under Section 210 A of the Companies Act 1956, the Central Government, by notification, has constituted a committee to advise the Central Government on the formulation of accounting policies and accounting standards for adoption by companies or class of companies specified under the Act. Based on the recommendations of NACAS, the Central Government has notified AS 1 to AS 7 and AS 9 to AS 29 in Dec. 2006 in the form of Companies (Accounting Standards) Rules, 2006.