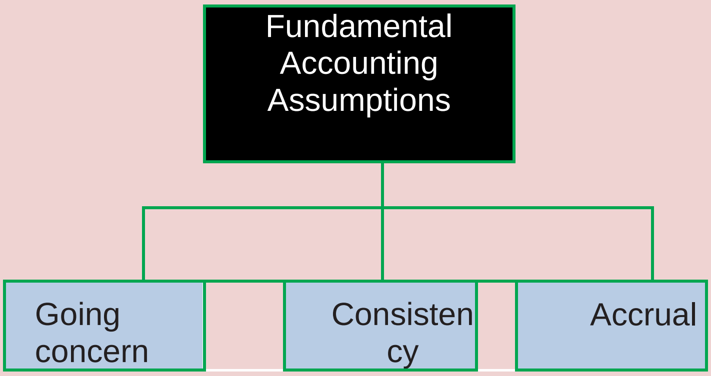
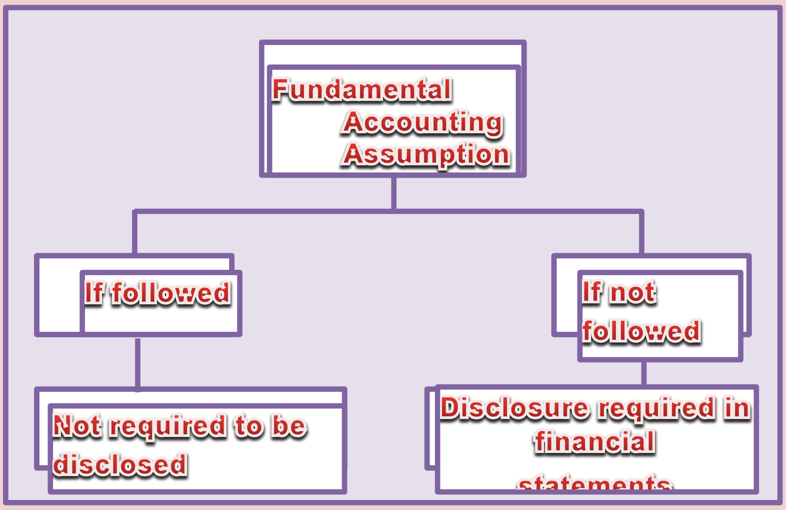
Chapter 3
Overview of Accounting Standards

Unit 1: Applicability of Accounting Standards

TOPIC	SUMMARY
APPLICABILITY OF AS	Accounting Standards apply in respect of any enterprise (whether organised in corporate, co-operative or other forms) engaged in commercial, industrial or business activities, whether or not profit oriented and even if established for charitable or religious purposes.
DO NOT APPLY ON	Accounting Standards however, do not apply to enterprises solely carrying on the activities, which are not of commercial, industrial or business nature, (e.g., an activity of collecting donations and giving them to flood affected people).
IMPLICATION OF MANDATORY STATUS	Where the statute governing the enterprise does not require compliance with the accounting standards, e.g. a partnership firm, the mandatory status of an accounting standard implies that, in discharging their attest functions, the members of the Institute are required to examine whether the financial statements are prepared in compliance with the applicable accounting standards. 
FINANCIAL ITEMS TO WHICH THE ACCOUNTING STANDARDS APPLY	The Accounting Standards are intended to apply only to items, which are material. An item is considered material, if its omission or misstatement is likely to affect economic decision of the user. Materiality is not necessarily a function of size; it is the information content i.e. the financial item which is important.
CRITERIA FOR CLASSIFICATION OF NON-CORPORATE	Level I Entities Level II Entities

ENTITIES	Level III Entities
LEVEL I ENTITIES	Entities whose equity or debt securities are listed or are in the process of listing on any stock exchange, whether in India or outside India. Banks (including co-operative banks), financial institutions or entities carrying on insurance business. All commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds rupees fifty crore in the immediately preceding accounting year All commercial, industrial and business reporting entities having borrowings(including public deposits) in excess of rupees ten crore at any time during the immediately preceding accounting year. Holding and subsidiary entities of any one of the above.
LEVEL II ENTITIES (SMES)	1.All commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds rupees one crore* but does not exceed rupees fifty crore in the immediately preceding accounting year. 2. All commercial, industrial and business reporting entities having borrowings (including public deposits) in excess of rupees one crore but not in excess of rupees ten crore at any time during the immediately preceding accounting year. 3. Holding and subsidiary entities of any one of the above.
Level III Entities (SMEs)	Non-corporate entities which are not covered under Level I and Level II are considered as Level III entities.

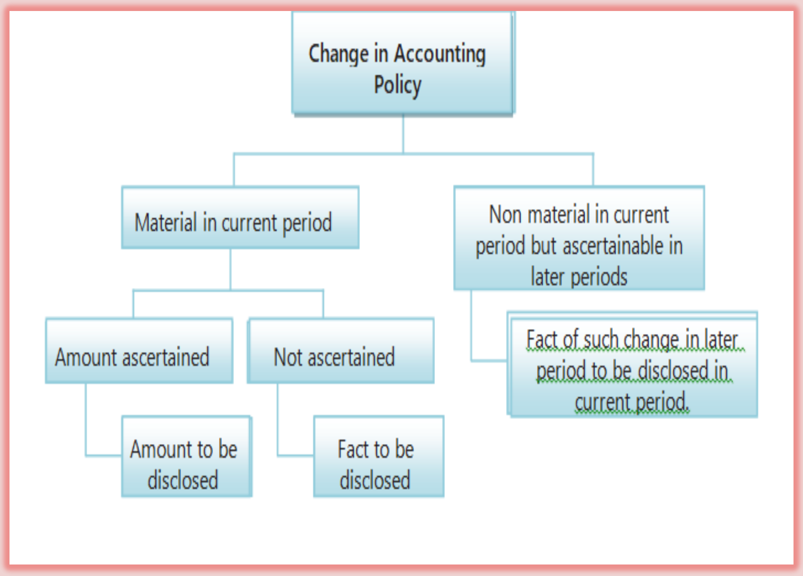
UNIT 2 : OVERVIEW OF ACCOUNTING STANDARDS

TOPIC	SUMMARY
PRACTICAL APPLICATION OF AS	
DISCLOSURE OF ACCOUNTING POLICIES (AS 1) ACCOUNTING STANDARD-1 DISCLOSURE OF ACCOUNTING POLICIES	**Disclosure of Accounting Policies. To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements must be disclosed. ... Any change in an accounting policy which has a significant effect should be disclosed.**  

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.

DISCLOSURE OF CHANGES IN ACCOUNTING POLICIES.

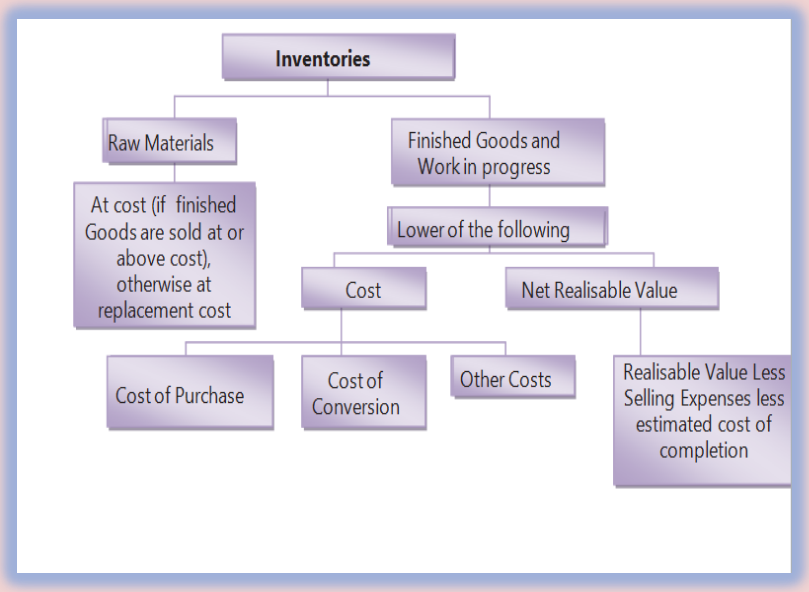


VALUATION OF INVENTORY [(AS 2 (REVISED)]

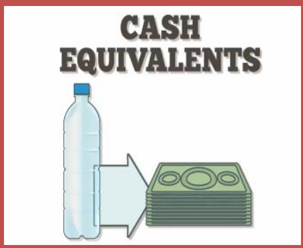
The accounting treatment for inventories is prescribed in AS 2 (Revised) 'Valuation of Inventories', which provides guidance for determining the value at which inventories, are carried in the financial statements until related revenues are recognised. It also provides guidance on the cost formulas that are used to assign costs to inventories and any write-down thereof to net realisable value.

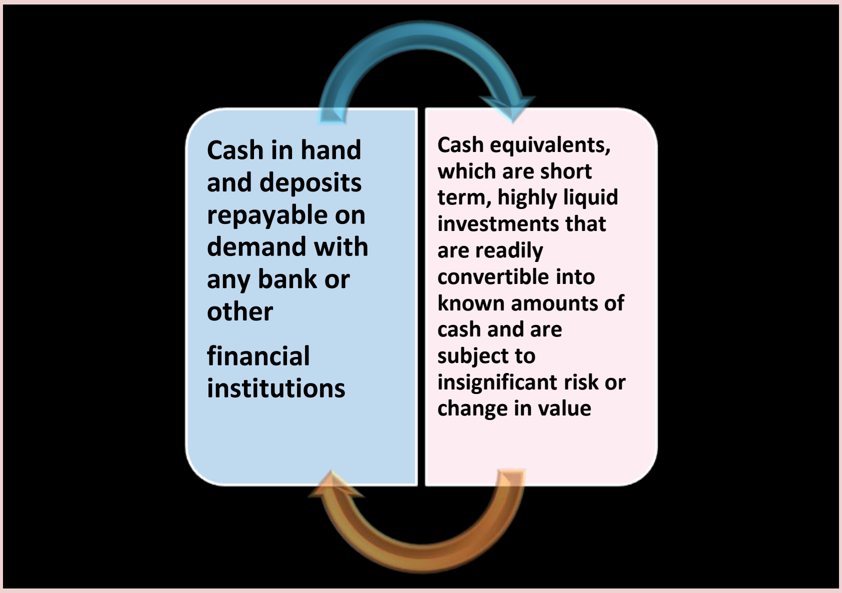
AS 2 (Revised) defines inventories as assets held

- **for sale in the ordinary course of business, or**
- **in the process of production for such sale, or**
- **for consumption in the production of goods or services for sale, including maintenance supplies and consumables other than machinery spares, servicing equipment and standby equipment meeting the definition of Property, plant and equipment.**

MEASUREMENT OF INVENTORIES	
COST OF INVENTORY	**Costs of inventories comprise** ➢ **all costs of purchase,** ➢ **costs of conversion and** ➢ **Other costs incurred in bringing the inventories to their present location and condition.**
NET REALISABLE VALUE	**Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.**
CASH FLOW STATEMENT (AS 3) 	**This Standard is mandatory for the enterprises, which fall in the category of level I, at the end of the relevant accounting period. For all other enterprises though it is not compulsory but it is encouraged to prepare such statements.**

MEANING OF THE TERM CASH AND CASH EQUIVALENTS FOR CASH FLOW STATEMENTS

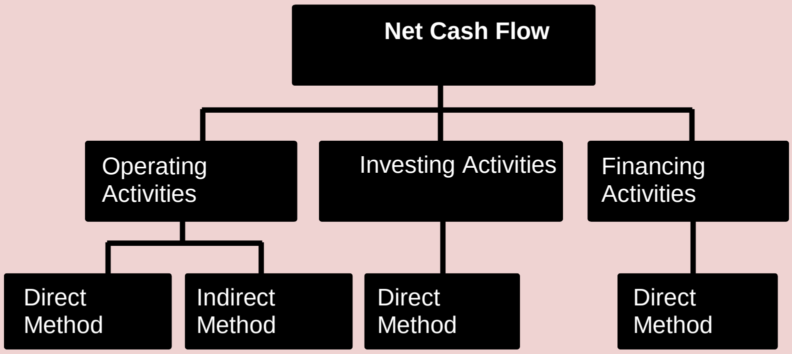




MEANING OF THE TERM CASH FLOW

Cash flows are inflows (i.e. receipts) and outflows (i.e. payments) of cash and cash equivalents. Any transaction, which does not result in cash flow, should not be reported in the cash flow statement.

CLASSIFICATION OF CASH FLOWS



NON-CASH TRANSACTIONS

Investing and financing transactions that do not require the use of cash or cash equivalents, e.g. issue of bonus shares, should be excluded from a cash flow statement.

DISCLOSURES

AS 3 requires an enterprise to disclose the amount of significant cash and cash equivalent balances held by it but not available for its use, together with a commentary by management.

AS 4 (REVISED): CONTINGENCIES AND EVENTS OCCURRING AFTER THE BALANCE SHEET DATE	**The present standard (AS 4 (Revised)) deals with the treatment and disclosure requirements in the financial statements of events occurring after the balance sheet.**
EVENTS OCCURRING AFTER THE BALANCE SHEET DATE	**Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and, by the corresponding approving authority in the case of any other entity.**
DISCLOSER	Evidence of such condition been existed at the Balance Sheet date → *Adjusting event* → *Adjustment to assets and liabilities is required* → *Disclosure in the financial statements is required* No Evidence of such condition been existed at the Balance Sheet date → *Non-adjusting event* → *liabilities is not required* → *Disclosure in the report of the approving authority is required*
AS 5: NET PROFIT OR LOSS FOR THE PERIOD,	The objective of AS 5 is to prescribe the classification and disclosure of certain items in the statement of profit and loss so that all enterprises prepare and present such a

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<td>PRIOR PERIOD ITEMS AND CHANGES IN ACCOUNTING POLICIES.</td>
<td>statement on a uniform basis. This enhances the comparability of the financial statements of an enterprise over time and with the financial statements of other enterprises.</td>
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<td>NET PROFIT OR LOSS FOR THE PERIOD</td>
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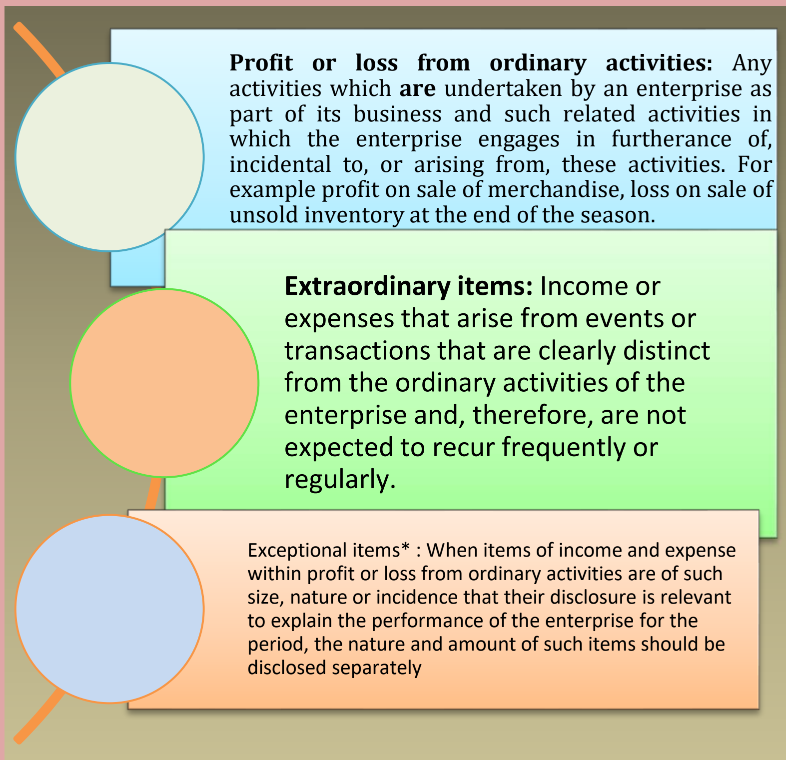
All items of income and expense which are recognised in a period should be included in the determination of net profit or loss for the period unless an Accounting Standard requires or permits otherwise.

The net profit or loss for the period comprises the following components, each of which should be disclosed on the face of the statement of profit and loss:



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<td>PRIOR PERIOD ITEMS</td>
<td>Prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods.</td>
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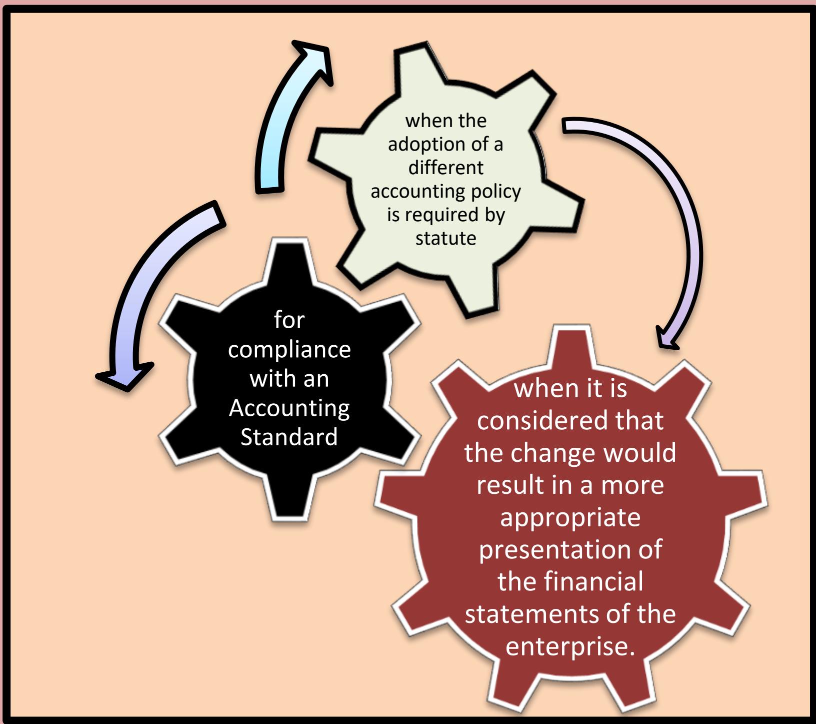
CHANGES IN ACCOUNTING POLICIES

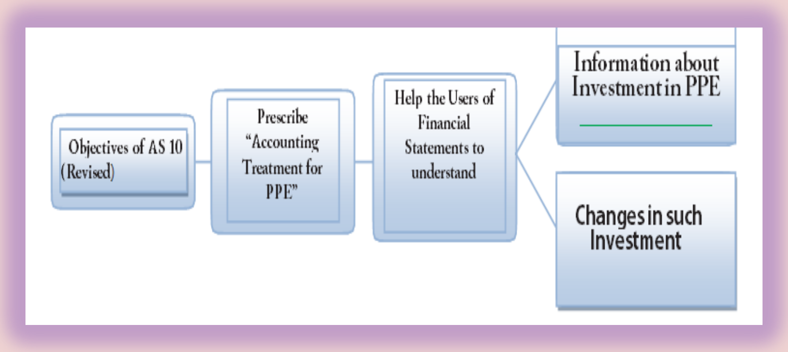
Accounting policies are the specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements.

Accounting Policies can be changed only:



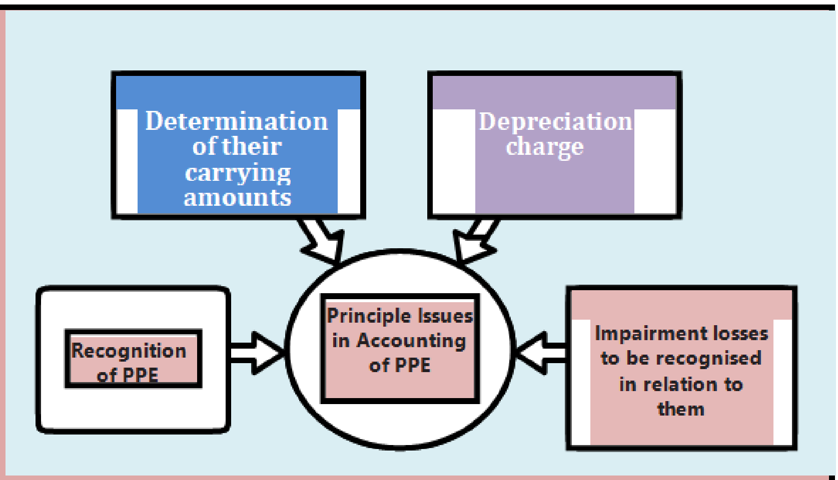
AS 10 (REVISED): PROPERTY, PLANT AND EQUIPMENT

The objective of this Standard is to prescribe accounting treatment for Property, Plant and Equipment (PPE).

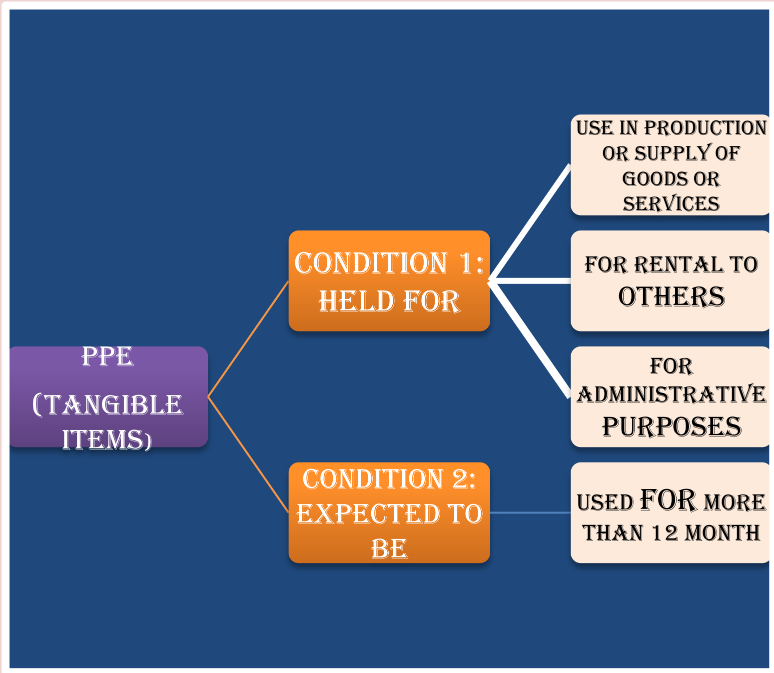


THE PRINCIPAL ISSUES IN ACCOUNTING FOR

PPE ARE:



DEFINITION OF PROPERTY, PLANT AND EQUIPMENT (PPE)



COST OF AN ITEM OF PPE

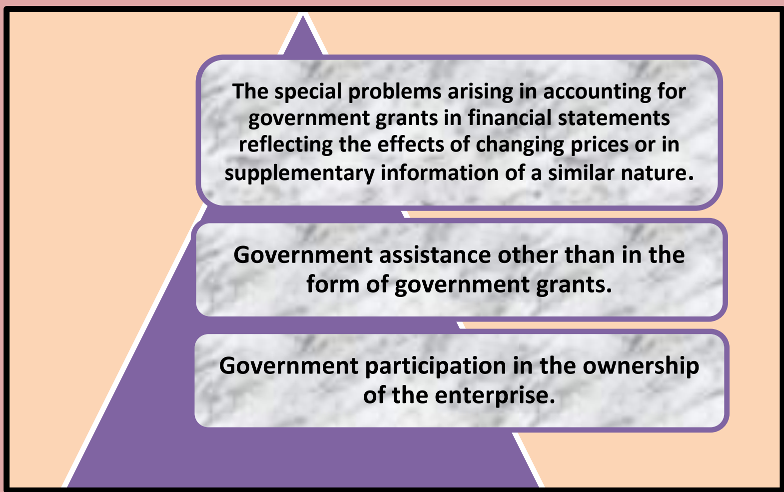
Includes-

- **Purchase Price**
- **Directly Attributable Costs**
- **Decommissioning, Restoration and similar Liabilities**

EXCLUDES

- ✓ 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) ✓ Administration and other general overhead costs
AS 11: THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES.	**The standard deals with the issues involved in accounting for foreign currency transactions and foreign operations i.e., to decide which exchange rate to use and how to recognise the financial effects of changes in exchange rates in the financial statements.**
SCOPE	**This Standard should be applied:** • In accounting for transactions in foreign currencies. • In translating the financial statements of foreign operations. • This Statement also deals with accounting for foreign currency transactions in the nature of forward exchange contracts.
DEFINITIONS OF THE TERMS USED IN THE STANDARD	**A foreign currency transaction is a transaction which is denominated in or requires settlement in a foreign currency, including transactions arising when an enterprise either:** o **Buys or sells goods or services whose price is denominated in a foreign currency.** o **Borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency.** o **Becomes a party to an unperformed forward exchange contract or** o **Otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.**
MONETARY ITEMS/ NON-MONETARY ITEMS	**Monetary items - are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money. For example, cash,**

	receivables and payables. Non-monetary items - are assets and liabilities other than monetary items. For example, fixed assets, inventories and investments in equity shares
AS 12 : ACCOUNTING FOR GOVERNMENT GRANTS  	AS 12 deals with accounting for government grants such as subsidies, cash incentives, duty drawbacks, etc. and specifies that the government grants should not be recognised until there is reasonable assurance that the enterprise will comply with the conditions attached to them, and the grant will be received.
THIS STANDARD DOES NOT DEAL WITH :	
GOVERNMENT GRANTS	Government grants are assistance by government in cash or kind to an enterprise for past or future compliance with certain conditions. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the enterprise.

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<td>ACCOUNTING TREATMENT OF GOVERNMENT GRANTS</td>
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- The ‘capital approach’, under which a grant is treated as part of shareholders’ funds, and
- The ‘income approach’, under which a grant is taken to income over one or more periods.

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<td>RECOGNITION OF GOVERNMENT GRANTS</td>
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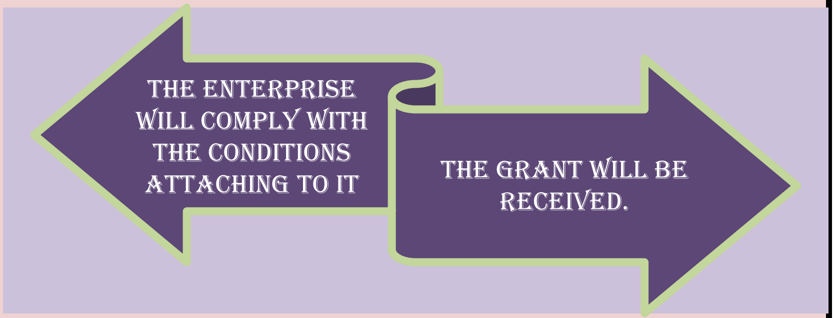
A government grant is not recognised until there is reasonable assurance that:



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<td>ACCOUNTING FOR INVESTMENTS (AS 13(REVISED))

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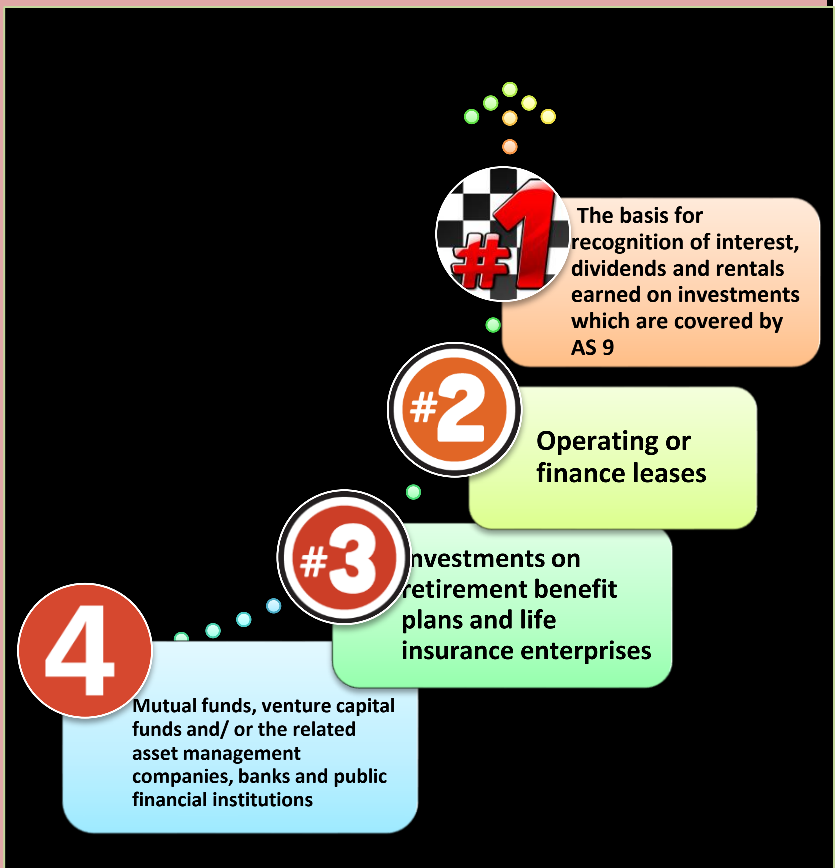
The standard deals with accounting for investments in the financial statements of enterprises and related disclosure requirements.

<u>This Standard does not deal with :</u>



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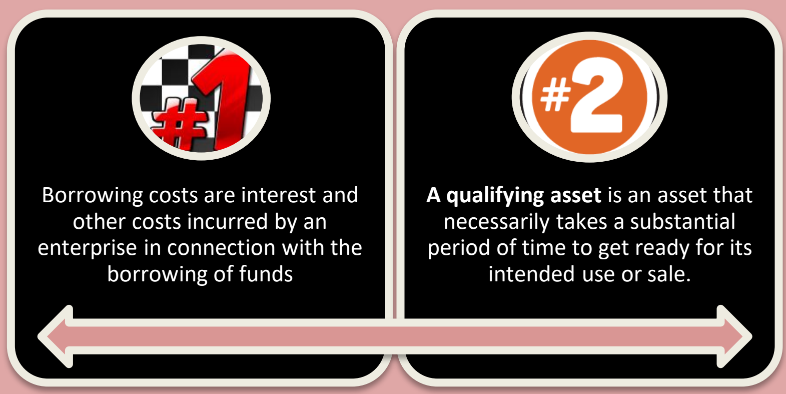
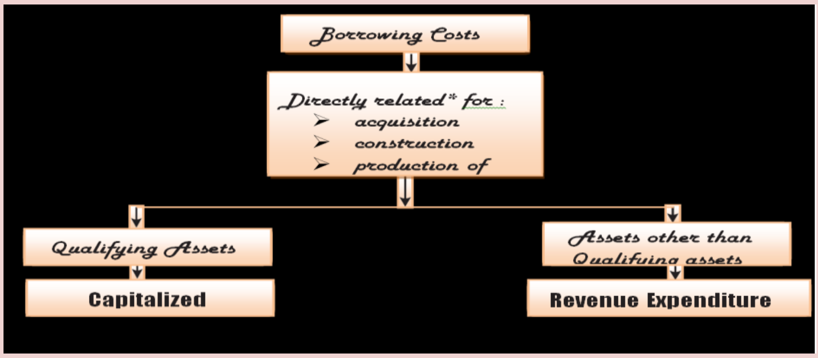
INVESTMENTS DEFINITION	**Investments are assets held by an enterprise for earning income by way of dividends, interest, and rentals, for capital appreciation, or for other benefits to the investing enterprise. Assets held as stock-in-trade (inventory) are not 'investments'**
FAIR VALUE	**Is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction. Under appropriate circumstances, market value or net realisable value provides an evidence of fair value.**
MARKET VALUE	**Market value is the amount obtainable from the sale of an investment in an open market, net of expenses necessarily to be incurred on or before disposal.**
CLASSIFICATION OF INVESTMENTS	**Classification of Investments-** • **Current Investments** • **Long Term Investments**
A CURRENT INVESTMENT	**A current investment is an investment that is by its nature readily realisable and is intended to be held for not more than one year from the date on which such investment is made. The intention to hold for not more than one year is to be judged at the time of purchase of investment.**
A LONG TERM INVESTMENT	**A long term investment** is an investment other than a current investment
COST OF INVESTMENTS	**The cost of an investment includes acquisition charges such as brokerage, fees and duties etc.**
CARRYING AMOUNT OF INVESTMENTS	**Cost** **OR** **NRV**

	Whichever is Lower
DISPOSAL OF INVESTMENTS	**On disposal of an investment, the difference between the carrying amount and the disposal proceeds, net of expenses, is recognised in the profit and loss statement.**
RECLASSIFICATION OF INVESTMENTS	**Where long-term investments are reclassified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.** **Where investments are reclassified from current to long-term, transfers are made at the lower of cost and fair value at the date of transfer.**
AS 16: BORROWING COSTS	**The objective of AS 16 is accounting for borrowing costs. It does not deal with the actual or imputed cost of owners' equity, including preference share capital not classified as a liability**

DEFINITIONS



TRETMENT OF BORROWING COST



SPECIFIC BORROWINGS

When an enterprise borrows funds specifically for the purpose of obtaining a particular qualifying asset, the borrowing costs that directly relate to that qualifying asset can be readily identified.

GENERAL BORROWINGS

To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation should be determined by applying a capitalisation rate to the expenditure on that asset.

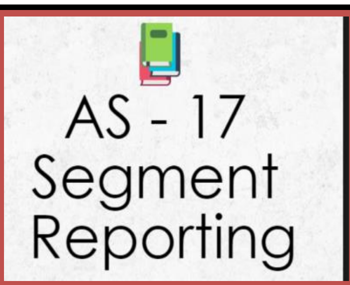
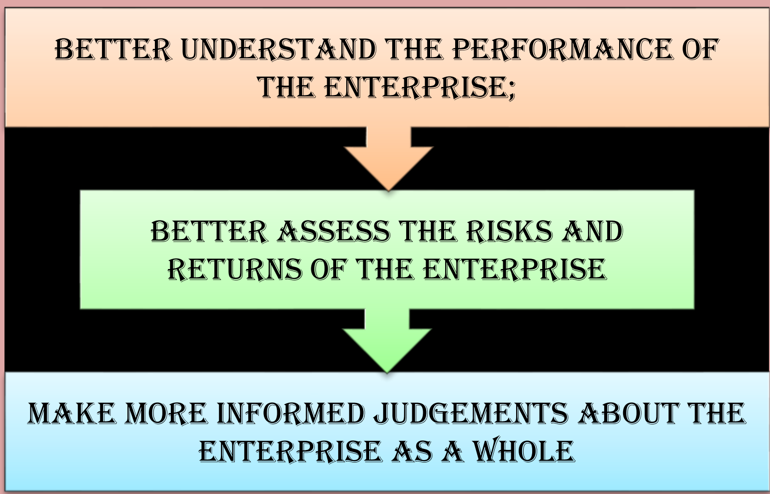
DISCLOSURE

The financial statements should disclose:

a. **The accounting policy adopted for borrowing costs; and**
b. **The amount of borrowing costs capitalised during the period.**

AS 17: SEGMENT REPORTING

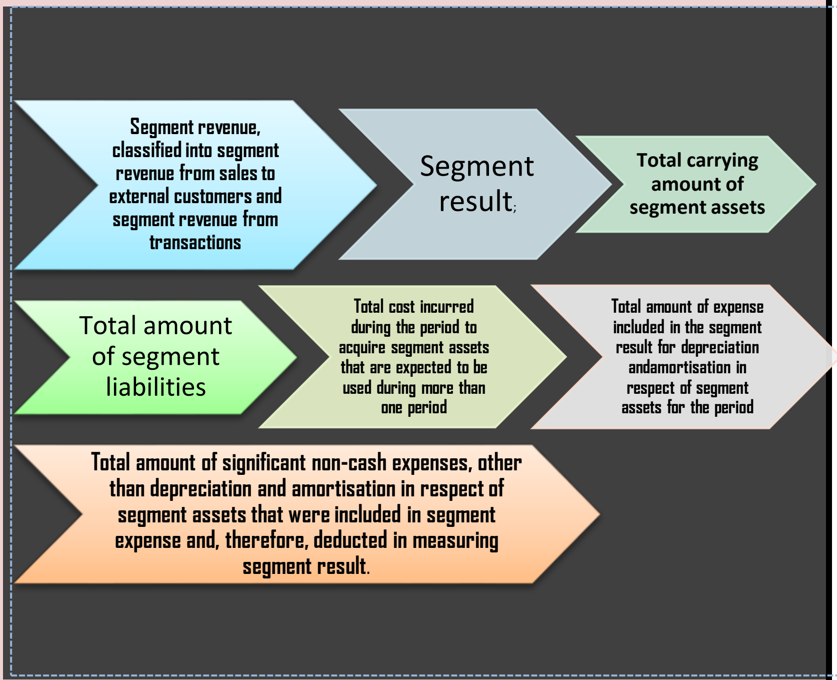
AS 17 is mandatory in respect of non-SMCs (and level I

	**entities in case of non- corporates). Other entities are encouraged to comply with AS 17.** **This standard establishes principles for reporting financial information about different types of products and services an enterprise produces and different geographical areas in which it operates. The standard is more relevant for assessing risks and returns of a diversified or multi-locational enterprise which may not be determinable from the aggregated data.**
OBJECTIVE	
A REPORTABLE SEGMENT	**A reportable segment is a business segment or a geographical segment identified on the basis of foregoing definitions for which segment information is required to be disclosed by AS 17.**
SEGMENT REVENUE	**Segment revenue is the aggregate of** ➢ **The portion of enterprise revenue that is directly attributable to a segment,** ➢ **The relevant portion of enterprise revenue that can be allocated on a reasonable basis to a segment, and** ➢ **Revenue from transactions with other segments of the enterprise**
SEGMENT EXPENSE	**Segment expense is the aggregate of** ❖ The expense resulting from the operating activities of a

	segment that is directly ❖ attributable to the segment, and ❖ The relevant portion of enterprise expense that can be allocated on a reasonable ❖ basis to the segment, ❖ Including expense relating to transactions with other segments of the enterprise.
SEGMENT RESULT	**Segment result is segment revenue less segment expense.** **Segment assets are those operating assets that are employed by a segment in its operating activities and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.**
SEGMENT LIABILITIES	**Segment liabilities are those operating liabilities that result from the operating activities of a segment and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.**
TREATMENT OF INTEREST FOR DETERMINING SEGMENT EXPENSE	**The interest expense relating to overdrafts and other operating liabilities identified to a particular segment should not be included as a part of the segment expense unless the operations of the segment are primarily of a financial nature or unless the interest is included as a part of the cost of inventories.**
MATRIX PRESENTATION	**A 'matrix presentation' both business segments and geographical segments as primary segment reporting formats with full segment disclosures on each basis will often provide useful information if risks and returns of an enterprise are strongly affected both by differences in the products and services it produces and by differences in the geographical areas in which it operates. AS 17 does not require, but does not prohibit, a 'matrix presentation'.**
SEGMENT ACCOUNTING POLICIES	**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. AS 17 does not prohibit the disclosure of additional segment information that is prepared on a basis other than the accounting policies adopted for the enterprise**

PRIMARY REPORTING FORMAT

An enterprise should disclose the following for each reportable segment:



DISCLOSURES

In measuring and reporting segment revenue from transactions with other segments, inter-segment transfers should be measured on the basis that the enterprise actually used to price those transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements.