Rayat Shikshan Sanstha's
Annasaheb Awate College, Manchar, Pune.

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Students Notes

Class : TYBCom (Sem. V) **Topic :-** Accounting Standards and Financial Reposting

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Advantages of Accounting Standards :

1) Reduction in variations
2) Disclosure beyond that required by law
3) Facilitates comparison
4) Benefits to the accounting and auditors

Brief review of Indian Accounting Standards :

AS – 3 Cash flow statement

AS – 12 Accounting for Government Grants

AS – 19 Leases

Objective in Topic

Accounting Standards (AS) are basic policy documents. Their main aim is to ensure transparency, reliability, consistency, and comparability of the financial statements. They do so by standardizing accounting policies and principles of a nation/economy. So the transactions of all companies will be recorded in a similar manner if they follow these accounting standards.

These Accounting Standards (AS) are issued by an accounting body or a regulatory board or sometimes by the government directly. In India, the Indian Accounting Standards are issued by the Institute of Chartered Accountants of India (ICAI).

Accounting Standards mainly deal with four major issues of accounting, namely

i. Recognition of financial events

ii. Measurement of financial transactions

iii. Presentation of financial statements in a fair manner

iv. Disclosure requirement of companies to ensure stakeholders are not misinformed

v.

The objective of financial reporting is to track, analyse and report your business income. The purpose of these reports is to examine resource usage, cash flow, business performance and the financial health of the business. This helps you and your investors make informed decisions about how to manage the business.

History of Accounting Standards and Purpose

The American Institute of Accountants, which is now known as the American Institute of Certified Public Accountants, and the New York Stock Exchange attempted to launch the first accounting standards in the 1930s. Following this attempt came the Securities Act of 1933 and the Securities Exchange Act of 1934, which created the Securities and Exchange Commission. Accounting standards have also been established by the

Governmental Accounting Standards Board for accounting principles for all state and local governments.

Accounting standards specify when and how economic events are to be recognized, measured and displayed. External entities, such as banks, investors and regulatory agencies, rely on accounting standards to ensure relevant and accurate information is provided about the entity. These technical pronouncements have ensured transparency in reporting and set the boundaries for financial reporting measures.

Meaning

An accounting standard is a common set of principles, standards and procedures that define the basis of financial accounting policies and practices. ... In the United States, the Generally Accepted Accounting Principles form the set of accounting standards widely accepted for preparing financial statements.

Financial statements prepared and presented by a company typically follow an external standard that specifically guides their preparation. ... Accounting standards prescribe in considerable detail what accruals must be made, how the financial statements are to be presented, and what additional disclosures are required.

Definition of Accounting Standard:

"An Accounting Standards is a common set of principles, standards and procedures that define the basis of financial accounting policies and practices. In the united states, the generally accepted accounting principles from set of accounting standards widely accepted for preparing financial statements."

The term 'Accounting Standard' may be defined as written statements issued from time to time by institutions of the accounting profession or institutions in which it has sufficient involvement and which are established expressly for this purpose.

Advantages of Accounting Standards

Accounting Standards are the ruling authority in the world of accounting. It makes sure that the information provided to potential investors is not misleading in any way. Let us take a look at the benefits of AS.

1] Attains Uniformity in Accounting

Accounting Standards provides rules for standard treatment and recording of transactions. They even have a standard format for financial statements. These are steps in achieving uniformity in accounting methods.

2] Improves Reliability of Financial Statements

There are many stakeholders of a company and they rely on the financial statements for their information. Many of these stakeholders base their decisions on the data provided by these financial statements. Then there are also potential investors who make their investment decisions based on such financial statements.

3] Prevents Frauds and Accounting Manipulations

Accounting Standards (AS) lay down the accounting principles and methodologies that all entities must follow. One outcome of this is that the management of an entity cannot manipulate with financial data. Following these standards is not optional, it is compulsory.

4] Assists Auditors

Now the accounting standards lay down all the accounting policies, rules, regulations, etc in a written format. These policies have to be followed. So if an auditor checks that the policies have been correctly followed he can be assured that the financial statements are true and fair.

5] Comparability

This is another major objective of accounting standards. Since all entities of the country follow the same set of standards their financial accounts become comparable to some extent. The users of the financial statements can analyse and compare the financial performances of various companies before taking any decisions.

6] Determining Managerial Accountability

The accounting standards help measure the performance of the management of an entity. It can help measure the management's ability to increase profitability, maintain the solvency of the firm, and other such important financial duties of the management.

AS 3 - Cash Flow Statements

1. Applicability
2. Cash and Cash Equivalents
3. Presentation of Cash Flow
4. Cash flow from operating activities
5. Cash Flow from Investing and Financing Activities
6. Extraordinary Items, Dividends & Interests
7. Taxes on Income
8. Acquisitions and Disposal of Business Units including Subsidiaries
9. Non-cash Transactions
10. Disclosure

1. Applicability of AS 3 Cash Flow Statements

The applicability of Cash flow statement has been defined under the Companies Act, 2013. As per the definition in the act, a financial statement includes the following:

i. Balance sheet

ii. Profit and loss account / Income and expenditure account

iii. Cash flow statement

iv. Statement of changes in equity

v. Explanatory notes

Thus, cash flow statements are to be prepared by all companies but the act also specifies a certain category of companies which are exempted from preparing the same. Such companies are One Person Company (OPC), Small Company and Dormant Company.

♦ **OPC** means a company which has only one single person as its member.

♦ A **Small Company** is a private company with a maximum paid up capital of Rs. 50 lakhs and a maximum turnover of Rs. 2 crores.

♦ A **Dormant Company** is an inactive company which is formed for some future projects or only to hold an asset and has no significant transactions.

2. Cash and Cash Equivalents

Cash equivalents are held by an enterprise for meeting its short-term cash commitments instead of the purpose of investment or such other purposes. For investments to qualify as cash equivalents:

1. An investment must be easily convertible into cash and

2. Must be subject to a very low level of risk with respect to changes in its value

Hence, an investment would qualify to be a cash equivalent only when such an investment has a short maturity of three months or less from its acquisition date.

AS 3 Cash Flow Statements states that cash flows should exclude the movements between items which forms part of cash or cash equivalents as these are part of an enterprise's cash management rather than its operating, financing and investing activities.

Cash management consists of the investment of excess cash in the cash equivalents.

3. Presentation of Cash Flow

A cash flow statement must depict the cash flows within the period classifying them as

A. Operating activities

B. Investing

C. Financing activities

Companies must prepare and present cash flows from operating, financing as well as investing activities in such manner that is apt to their business.

Grouping the activities provide information which enables the users in assessing the impact of such activities on the overall financial position of an enterprise and also assess the value of the cash and cash equivalents.

A. Operating Activities

Cash flows from operating activities predominantly result from the main revenue-generating activities of an enterprise.

For example:

(i) Cash received from the sale of goods and services

(ii) Cash received in form of fees, royalties, commissions and various other revenue forms

(iii) Cash paid to a supplier of goods and services

B. Investing Activities

Cash flows from investing activities represent outflows are made for resources intended for generating cash flows and future income.

For instance:

(i) Cash paid for acquiring fixed assets

(ii) Cash received from disposal of fixed assets (including intangibles)

(iii) Cash paid for acquiring shares, warrants or debt instruments of other companies and interests in JVs

C. Financing Activities

Financing activities are those which brings changes in composition and size of owner's capital and borrowings of an enterprise.

For instance:

(i) Cash received from issuing shares or other similar securities

(ii) Cash received from issuing loans, debentures, bonds, notes, and other short-term or long-term borrowings

(iii) Cash repaid on borrowings

4. Cash flow from operating activities

A company must report its cash flows from operating activities using:

1. Direct method – Where all the major classes of cash receipts and cash payments are presented; or

2. Indirect method – Where the net profit or net loss is adjusted for:

a) Effects of transactions that are non-cash in nature such as depreciation, deferred taxes, provisions, etc.

b) Accruals or deferrals of future or past operating cash proceeds or payments

c) Any expense or income related to financing or investing cash flows

5. Cash Flow from Investing and Financing Activities

A company must separately record all the major classes of cash receipts and cash payments which arises from financing and investing activities, barring the ones which need to be reported on the net basis.

A. Cash flow on Net Basis

Cash flows which arise from below-mentioned operating, financing or investing activities might be reported on a net basis:

(i) Proceeds and payments in cash on behalf of a client where cash flows reflect the activities of such client rather than that of the company itself

(ii) Proceeds and payments in cash for items where the amounts are huge, turnover is quick, and maturities are short

Cash flows which arise from each of the below-mentioned activities of any financial enterprise might be reported on the net basis:

(i) Proceeds and payments in cash for acceptances and repayments of deposits having fixed maturities

(ii) Placement and withdrawal of deposits from other financial enterprises

(iii) Loans and cash advances are given to clients/customers and repayment of such loans and advances

B. Foreign Currency Cash Flows

Cash flows that arise from the transactions in the foreign currencies must be recorded in the company's reporting currency by using the below method:

Foreign currency amount * FX rates between the reporting and foreign currency at the date of cash flow.

A rate which approximates actual rate might be used in case the outcome is largely the same as it would have been if the rate at the date of cash flows was used.

The impact of changes in the exchange rate on cash and cash equivalents which is held in the foreign currencies must be reported as a distinct and separate part of the reconciliation of changes in the cash and cash equivalent during the relevant period.

6. Extraordinary Items, Dividends & Interests

The cash flows related to the extraordinary items must be categorized as arising from operating, financing or investing activities as apt and disclosed distinctly. Cash flows from dividends and interest received and paid must be separately disclosed. Cash flows which arise from dividends and interest received and paid in the case of financial enterprises must be categorized as cash flows from operating activities.

7. Taxes on Income

Cash flows which arise from taxes on income must be disclosed separately and must be reported as cash flows from the operating activities except if they could be explicitly related to investing and financing activities.

8. Acquisitions and Disposal of Business Units including Subsidiaries

The aggregate cash flows which arise from acquisition and from the disposal of business units including subsidiaries must be shown as investing activities and reported separately.

Enterprises must present, in total, with respect to both the acquisitions and disposals of other business units including subsidiaries within the period the followings:

(a) Aggregate purchase or disposal value

(b) The amount of purchase or disposal value which is discharged by way of cash and cash equivalents

9. Non-Cash Transactions

Financing and investing transactions which don't require cash or cash equivalents mustn't be included in the cash flow statement. Those transactions must be presented elsewhere in financial statements in a way which gives relevant information about such financing and investing activities.

10. Disclosure

Enterprises must disclose, along with management commentary, the amount of substantial cash and cash equivalents held by an enterprise which isn't available for use.

Commitments that may arise from discounted bills of exchange and other similar obligations that are undertaken by an enterprise are typically disclosed in financial statements by means of notes, even in case the probability of loss is remote.

AS 12 - Accounting for Government Grants

AS 12 explains how to account for government grants. It is a basic duty of any government to develop the industries and economy.

1. Introduction
2. Meaning of Government Grant
3. Methods of Accounting for Government Grants
4. Refund of Government Grants
5. Disclosure Requirements

1. Introduction

To help discharge this duty, the government undertakes promotional activities, provides incentives and grants to businesses. The grants received from the government are in various forms such as subsidy, incentives, duty drawbacks among others.

AS 12 deals with grants given by government but does not covers:

i) The accounting for grants which reflect the effect of price changes
ii) Assistance by the government other than grants like tax exemption, etc
iii) Participation of government in organisation's ownership

2. Meaning of Government Grant

The assistance was given by the government in cash or kind with certain specific conditions. These do not include such grants from the government which cannot be measured reasonably.

Also, the transactions with the government which cannot be separately identified from normal trading of the organization are not considered as a grant.

For eg:- Receipt of cash on the sale of packaged drinking water to railways by 'Bisleri'.

3. Methods of Accounting for Government Grants

There are two methods outlined by the AS to account for the government grants:

I. Capital approach
II. Income / Revenue approach

The method of accounting for any grant is always based on the nature of grant received. The grants are recognized only where a certainty exists for the fulfilment of conditions and ultimate collection of such grants.

3.I. Capital Approach

To state simply, these grants are treated as a part of capital or shareholder's funds. These are such grants which are given as a proportion of total investment in a business.

Ordinarily, the government does not expect a repayment of such grants. Due to this reason, such grants are credited to the capital or shareholder's funds.

These grants are divided primarily into three types:

A)Non-monetary grants
B) The proportion of capital in a business
C) For specific fixed assets

3.I.A. Accounting of grants as a Proportion of total capital in a business

The non-monetary grants are those which are given in form of resources such as land, building. These grants are usually given at a concessional rate or for free. These grants should be accounted for at the acquisition cost or nominal value (if given free of cost).

3.I.B. Accounting of grants as a Proportion of total capital in a business

Where grants are of such nature that they are treated as a proportion to total capital in a business, they are treated as Capital Reserves and shown as Capital Reserve in the Balance Sheet. This way the amount received will not have any effect on Income Statement or Fixed Assets carrying amount. This means that such amounts cannot be distributed as a dividend to shareholders. Also, they are not eligible to be considered as a deferred income.

3.I.C. Accounting of grants for Specific fixed assets

These are such grants which have a primary condition attached to them:

i. The organization receiving such grants must either Construct, Acquire or Purchase such specific fixed assets for which such grant is given.

ii. Other condition may also be imposed as the type of assets, location of assets, period of acquisition, etc.

4. Refund of Government Grants

There are scenarios where the government grants are to be refunded due to non-fulfilment of certain conditions.

Government Grants				
	Treated as revenue grant on receipt	Grant for Specific fixed assets		Grant for a Proportion of total Capital
		Method - 1	Method - 2	
Accounting on Receipt of Grant	Shown as deferred credit balance	Deducted from cost of fixed assets in books of accounts	Shown as deferred income and charged on the proportion and time basis of depreciation on asset	Amount charged and shown as capital reserve
Accounting on Refund of Grant	Deducted from deferred credit balance. Any balance after deduction is charged to P&L Account immediately as expenses.	Amount deducted inititally is increeased in the books of accounts	Deferred income balance is decreased in the books of accounts	Amount deducted from capital reserve

The accounting for such refund of grants is as under:

5. Disclosure Requirements

i. Accounting policy adopted inclusive of the method of presentation
ii. Nature and extent of government grant recognized in financial statements

AS 19 – Leases

AS-19 deals with the accounting policies applicable for all types of leases except certain listed below.

A lease is a transaction whereby an agreement is entered into by the lessor with the lessee for the right to use an asset by the lessee in return for a payment or series of payments for an agreed period of time.

What kind of leases are not covered under this standard?

This Standard is not applicable to:

(a) Lease agreements for exploring or using natural resource. Ex Oil, gas, timber, metals and other mineral rights

(b) Licensing agreements. Ex Motion picture films, video recordings, plays, manuscripts, patents and copyrights

(c) Lease agreements for use land

There are two types of leases:

1. Finance Lease

2. Operating Lease

Finance Lease: A lease in which all risks and rewards are transferred to the owner of assets. The title may or may not eventually be transferred.

Examples of Finance Lease are:

1. Lease in which Assets is transferred to lessee at the end of lease term

2. Lease term in which lessee has the option to purchase the assets form lessor at the price which is lower than fair price on the date when option become exercisable

3. Lease term Covers complete economic life of the asset even if title is not transferred

4. Lease term in which present value of the minimum lease payments is equal to or substantially covers the fair value of the leased asset

5. Leased asset is of a specialized nature. Ex Ambulance (the lessee can use it without major modifications being made)

Operating Lease: Any other lease other than finance lease is considered as an Operating Lease.

Accounting in the books of Lessee in case of Finance Lease

1. At the inception of lease, lessee will recognize the lease as assets or liability at an amount equal to the fair value of leased assets

2. Apportion the lease payments into finance charge and reduction in outstanding liability

3. Allocate finance charge to the periods during lease term

4. Pass journal entry for depreciation

Disclosure in case of Finance Lease

1. Assets acquired on Lease should be shown separately

2. For each leased assets, show net carrying amount at the balance sheet date

3. Provide reconciliation between Minimum Lease Payment at balance sheet date and their present value

4. Disclose total of minimum lease payment at balance sheet date and their present value for:

a)Not later than one year, b) Later than one year but not later than five year, c) Later than five years

5. Future minimum sublease payment expected to receive at balance sheet date

6. General description of lessee significant leasing arrangements

Accounting in the books of Lessee in case of Operating Lease

Lease payment is recognized as an expense in the profit and loss account.

Disclosure in case of Operating Lease

1. Future lease payment for the following period

a) Not later than one year, b) Later than one year but not later than five years, c) Later than five years

2. Total Expected future lease payment

3. Lease payment recognized in the statement of Profit and Loss for the period

4. General Description of Lessee significant leasing arrangements

Accounting in the books of Lessor in case of Finance Lease

1. Lessor to record assets in the books of account at an amount equal to net investment in Lease

2. Record finance income based on pattern reflecting constant periodic rate of return

3. Estimate unguaranteed residual value used in computing lessor gross investment in lease

4. If there is any reduction in estimated unguaranteed residual value then revise the income allocation over the remaining lease term. Reduction in respect to amount already recognized to be recognized immediately. Upward adjustment to be ignored

5. Initial direct cost associated with the lease to be recognized immediately in the profit and loss account or can be spread over the lease term

Disclosure in case of Finance Lease

1. Provide reconciliation between gross investment in lease at balance sheet date and present value of minimum lease payment. Also disclose the same as

a) Not later than one year

b) Later than one year, but not later than five year

c) Later than five year

2. Unearned finance income

3. Unguaranteed residual value

4. Accumulated provision for uncollectible minimum lease payment receivable

5. Contingent rent recognized in statement of profit and loss account

6. General description of leasing arrangement

7. Accounting policy adopted for in respect of initial direct cost

Accounting in the books of Lessor in case of Operating Lease

1. Lessor should record assets in balance sheet under fixed assets

2. Lease income to recognize in statement of profit and loss account

3. Cost incurred including depreciation to be recognized in statement of profit and loss account

4. Check for impairment and provide for in book as per GAAP

Disclosure in case of Operating Lease

1. For each class of assets accumulated depreciation, accumulated impairment and carrying amount at the balance sheet date.

2. Depreciation recognized in the statement of profit and loss account.

3. Impairment losses recognized in the statement of profit and loss account.

4. Impairment loss reversed in the statement of profit and loss account.

5. Future minimum lease payment under for each of the following periods:

a) Not later than one year

b) Later than one year but not later than five year

c) Later than five years

6. Total contingent recognized in the statement of profit and loss account.

7. General description of leasing arrangement

Sale and Leaseback Transaction

1. If sale and leaseback transaction results in finance lease: Any excess or deficiency over carrying amount should be deferred and amortized over the lease term in proportion to depreciation of the leased assets.

2. If sale and leaseback transaction results in operating lease: Any excess or deficiency over carrying amount should be recorded immediately in book of account:

a) If the sale price is below fair value, the loss is compensated by future lease payments at below market price, it should be deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used

b) If the sale price is above the fair value, the excess over fair value should be deferred and amortized over the period for which the asset is expected to be used

Financial Reporting

Financial reporting is the financial results of an organization that are released its stakeholders and the public. Financial statements, which include the income statement, balance sheet, and statement of cash flows.

IFRS

International Financial Reporting Standards (IFRS) are a set of accounting rules for the financial statements of public companies that are intended to make them consistent, transparent, and easily comparable around the world.

Requirement

1) Statement of Financial Position
2) Statement of Comprehensive Income
3) Statement of Changes in Equity
4) Statement of Cash Flow

IASB

The International Accounting Standards Board (IASB) is an independent, private-sector body that develops and approves International Financial Reporting Standards (IFRSs). The IASB operates under the oversight of the IFRS Foundation.

IAS

International Accounting Standards (IAS) are older accounting standards issued by the International Accounting Standards Board (IASB), an independent international standard-setting body based in London. The IAS were replaced in 2001 by International Financial Reporting Standards (IFRS).

IFRIC

IFRIC means the International Financial Reporting Interpretations Committee. IFRIC means the International Financial Reporting Interpretations Committee. "IFRS" means International Financial Reporting Standards, as issued by the IASB.

Fair Value Accounting

Fair Value

Fair value refers to the actual value of an asset – a product, stock, or security – that is agreed upon by both the seller and the buyer. Fair value is applicable to a product that is sold or traded in the market where it belongs or under normal conditions – and not to one that is being liquidated. It is determined in order to come up with an amount or value that is fair to the buyer without putting the seller on the losing end.

Fair value is a broad measure of an asset's worth and is not the same as market value, which refers to the price of an asset in the marketplace. In accounting, fair value is a reference to the estimated worth of a company's assets and liabilities that are listed on a company's financial statement.

Fair Value Accounting

Fair value accounting refers to the practice of measuring your business's liabilities and assets at their current market value. In other words, "fair value" is the amount that an asset could be sold for (or that a liability could be settled for) that's fair to both buyer and seller.

Fair Value Accounting Concepts

1) Current Market Conditions
2) Intention of Holder
3) Orderly Transaction
4) Third Party

Methods of Deriving Fair Value

1) Market Approach
2) Cost Approach
3) Discounted Cash Flow approach