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Financial Reporting and Analysis

SEMESTER 2

MASTER OF COMMERCE

BLOCK 1



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MASTER OF COMMERCE

FINANCIAL REPORTING AND ANALYSIS

Block 1

DETAILED SYLLABUS

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COURSE INTRODUCTION

This is the second course in M.Com. 2nd semester. This course introduces you to the subject– ***Financial Reporting and Analysis***. This course focuses on the aspects ranging from accounting principles, accounting standards, consolidated financial statements, ratio analysis, environmental accounting, human resource accounting etc. The main objective of this course is to enable a learner to prepare and study the different financial statements. The financial statements are prepared under the broad perspective of different accounting principles and standards. Therefore, a learner must have knowledge about these aspects. The units like Corporate Financial Reporting, Environmental Accounting, Human Resource Accounting will provide an understanding about the recent changes in the accounting parlance.The course has 13 units and is divided into two blocks; Block 1 and Block 2.

Each unit of these blocks includes some along-side boxes to help you know some of the difficult, unseen terms. Some “EXERCISES” have been included to help you apply your own thoughts. You may find some boxes marked with: “LET US KNOW”. These boxes will provide you with some additional interesting and relevant information. Again, you will get “CHECK YOUR PROGRESS” questions. These have been designed to self-check your progress of study. It will be helpful for you if you solve the problems put in these boxes immediately after you go through the sections of the units and then match your answers with “ANSWERS TO CHECK YOUR PROGRESS” given at the end of each unit. you in making your learning more active and efficient. And, at the end of each section, you will get “CHECK YOUR PROGRESS” questions. These have been designed to self-check your learning.

BLOCK INTRODUCTION

The first block of the course ***Financial Reporting and Analysis*** consists of 7 units. After completing this block, you will be able to get a fair idea on the different concepts on Accounting Principles, GAAP, IFRS, Accounting Standards, Financial Reporting practices, Conceptual Framework of Accounting and Cash Flow Statement. You will also learn about regulatory frameworks for the preparation and presentaion of financial statements. The structure of Block 1 is as follows:

UNIT 1: Accounting Concepts and Principles

UNIT 2: Accounting Standards

UNIT 3: International Financial Reporting Standards and their Scope and Objectives

UNIT 4: The Conceptual Framework for the Preparation and Presentation of Financial Statements

UNIT 5: Regulatory Framework and National Differences

UNIT 6: Consolidated Fiancial Statements

UNIT 7: Cash Flow Statement

UNIT 1: ACCOUNTING CONCEPTS AND PRINCIPLES

UNIT STRUCTURE

1.1 Learning Objectives

1.2 Introduction

1.3 Meaning of Accounting Principles, Concepts, Conventions and Postulates

1.4 Meaning and Features of Generally Accepted Accounting Principles (GAAP)

1.5 Structure of GAAP

1.6 Role of GAAP in the Preparation of Financial Statements

1.7 Application of GAAP in Recording and Preparing Financial Statements

1.8 International Financial Reporting Standards

1.9 IFRS in India

1.10 Benefits of IFRS

1.11 Indian GAAP Vs. IFRS

1.12 Let Us Sum Up

1.13 Further Reading

1.14 Answers To Check Your Progress

1.15 Model Questions

1.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- Define the accounting principles, concepts, conventions and postulates
- Discuss the different accounting principles, concepts and conventions
- Explain the meaning and features of Generally Accepted Accounting Principles
- Discuss the structure of Generally Accepted Accounting Principles
- Discuss the role of Generally Accepted Accounting Principles in recording and presentation of accounting information

- Show the application of GAAP in recording and preparing financial statements.

1.2 INTRODUCTION

'Accounting' in business is considered as a system that provides information about the transactions that have taken place and the financial condition of the business. This system starts with recording of business transactions and ends with interpreting the results thereof. Hence accounting is defined by the Committee on Terminology of the American Institute of Accountants (later on known as American Institute of Certified Public Accountants, AICPA) as, *"Accounting is the art of recording, classifying and summarizing 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." (Accounting Terminology Bulletin No. 1).*

Recording, classifying and summarizing are done on some basic premise which are called accounting principles. In this unit, we will discuss the meaning of accounting principles, concepts, conventions as well as the different accounting principles, like business entity concept, going concern concept etc. We will also deal with the Generally Accepted Accounting Principles, its structure and the use of these principles in recording and presenting accounting statements.

1.3 MEANING OF ACCOUNTING PRINCIPLES, CONCEPTS, CONVENTIONS AND POSTULATES

- **Accounting Principles:** Accounting principles are the principles applied in the preparation of the accounts. These are general decision rules, derived from both the objectives and the theoretical concept of accounting. These principles are the bases which govern the development of accounting technique. Accounting technique means the specific rules derived from accounting principles which are applied while recording transactions.
- **Accounting Concepts:** Accounting Concepts are the accepted notion applied in the field of accounting. A concept finds its place in

a belief about the desirability of a method or procedure. Such methods or procedures are the general norms applied by the business entities while recording the transactions and preparing the financial statements.

- **Accounting Convention:** Accounting Convention is an established usage or custom followed in recording and presenting financial data.
- **Postulates:** Postulates are derived from the economic and political environment and from the modes of thought and customs of all segments of business community.



CHECK YOUR PROGRESS

Q.1: Define accounting principles. (In three lines)

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1.4 MEANING AND FEATURES OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)

GAAP are the buildings blocks of the accounting language. Whole accounting framework is built on GAAP. To understand and use accounting information, the users should know this conceptual framework beforehand. Generally Accepted Accounting Principles (GAAP) are guides to the accounting profession in the choice of accounting techniques and the preparation of financial statements. These principles have been developed gradually through practice. Experience, reason, custom, usage and practical necessity have contributed significantly in the evolution of GAAP.

GAAP incorporate the consensus at a particular time as to which economic resources and obligations should be recorded as assets and liabilities in financial accounting, which changes in assets and liabilities should be recorded, when these changes should be recorded, how the assets and liabilities and changes in them should be measured, what information should

be disclosed and how it should be disclosed, and which financial statement should be prepared. GAAP thus help to bring about uniformity in the reporting of financial events of the entities across the industry.

As of now, we have discussed the meaning of Generally Accepted Accounting Principles. Now, we will discuss the basic features of these accounting principles–

a) Accounting principles are not rigid. A considerable amount of flexibility is expected in the application of these principles.
b) Such principles are man-made and are the result of evolutionary process in accounting.
c) Like the principles of natural sciences, accounting principles may not be universally true and cannot be verified by observation.
d) The acceptance of accounting principles may vary from time to time and from country to country.
e) Accounting principles are influenced by the social environment, political environment, economic environment etc. These are the main reasons behind variation in the application of accounting principles from country to country and even in the same country.



LET US KNOW

Accounting information means the financial information provided in the Trading Account, Profit & loss Account, Balance Sheet and other reports of a business organization. Trading Account, Profit & loss Account, Balance Sheet are the basic financial statements. Trading Account and Profit & Loss Account are together called Revenue Statement or Income Statement and the Balance Sheet is known as Position Statement. Reports include directors' report and auditor's report (in case of limited companies). These statements and reports are published in the form of Annual Reports of companies. The basic financial statements provide accounting information on five elements. These five elements are (a) assets, (b) liabilities, (c) equities (capital), (d) incomes and gains and (e) expenses and losses. Assets,

liabilities and capital are elements of Balance Sheet and incomes & gains and expenses & losses are elements of revenue statement. Information regarding these elements of financial statements is called Accounting Information.

The information disclosed in financial statements is very useful to a number of parties. These are: (a) Owners, (b) Managers, (c) Creditors, (d) Bankers and lenders, (e) Government and regulatory agency, (f) Employees, (g) Prospective and existing investors, (h) Consumers, (i) Researchers, (j) Trade association and chambers of commerce.

1.5 STRUCTURE OF GAAP

The structure of GAAP refers to the forms of elements of GAAP. Traditionally, these are known by various names, viz., assumptions, principles, concepts, conventions, etc. Based on the recent development in the theory base of accounting, the traditional structure of GAAP has been modified as under:

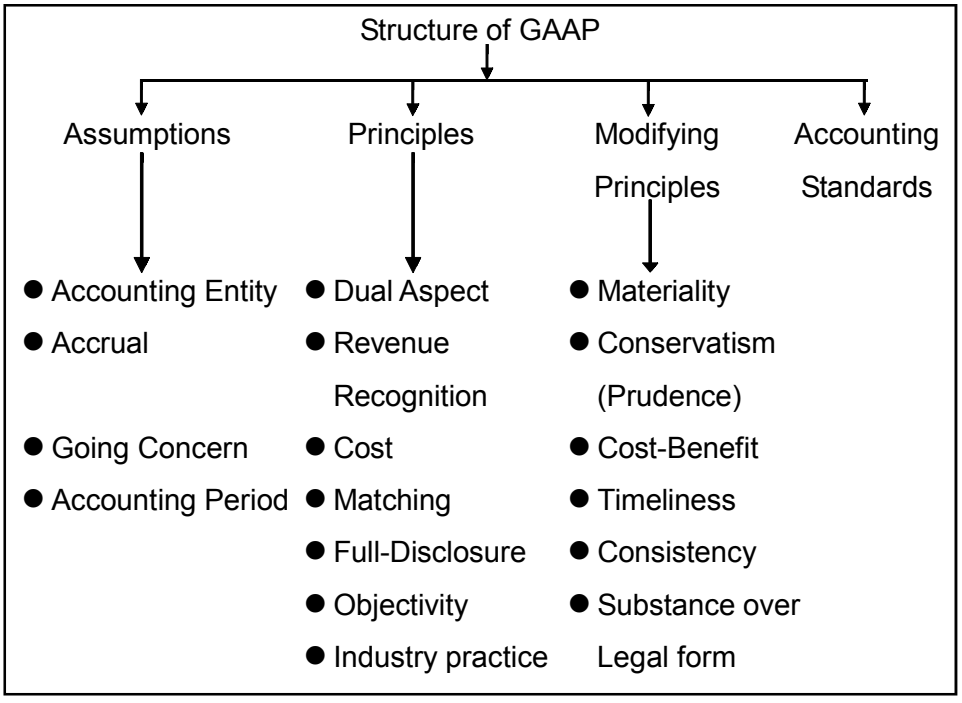


Fig. 1.1: Structure of GAAP

- **Modifying Principles:** Due to difficulties faced in the application of certain accounting principles in certain situations these are modified in the application stage. These are referred to as modifying principles which are given below:
  - **Accounting Standards:** Accounting Standards are the established and accepted models which aim at providing excellent, adequate and unbiased treatment of accounting transaction/ information and reporting the same in the financial statements to facilitate their users in forming rational and judicious decision.

    Accounting assumptions and accounting principles are traditionally termed as accounting concepts and the modifying principles are considered as accounting conventions.

    There has been an effort to distinguish between accounting concepts and accounting conventions. Although theoretically concepts and conventions are different terms, but when applied to accounting practice, no distinguishing features between these two are found. They are interdependent and the demarcation line between the two is very narrow.

    It should be keep in mind that principles, concepts, conventions, postulates etc. are all included in Generally Accepted Accounting Principles (GAAP) that are followed in recording business transactions, preparing accounts and presenting them before the users of accounting information.

    Now, we will discuss the various assumptions and principles of GAAP.
- **Business Entity or Accounting Entity:** This assumes that the business is separate from its owners or other businesses. Revenues and expenses should be kept separately from personal expenses of the owner.

  The term 'entity' means 'something that exists independently'. Hence 'business entity' means existence of a business unit independently. When a customer purchases goods, he purchases them from a business firm and not from an individual, family or household. This means a business firm has its separate entity.

The use of the word 'Separate' is used to separate the business unit from owner. A business firm is formed by the owner who invests money (Capital) to earn profit. His objective is to earn profit from the business. So, he must keep accounts of the business separately, to enable himself to ascertain profit. He must not mix the transactions of household affairs to that of business affairs. To calculate the profit of the business, accounts of the business must be kept distinctly separate from the household or other personal transactions of the owner. Every transaction is analysed from the point of view of the business and not from the point of view of the persons who own them. This is called Separate Business Entity or Accounting Entity Concept.

- **Accrual Assumption:** In business, all transactions are not cash transactions. Accrual is the accounting process of recognising non-cash events and circumstances as they occur. Accrual assumption is used to facilitate measurement of cash and non-cash incomes and expenses of a period. Income and expenses are accounted in the period to which these are related. In accrual system of accounting, revenue is recognised as follows:

  In case of sale:

  i) When cash is received, or
  ii) When an obligation is received from the buyer for the payment within a certain future period, or
  iii) When the consideration is received in settlement in any form other than cash, which can be expressed in definite money value.

  In case of purchase:

  i) When cash is paid, or
  ii) When an obligation is given to the seller to pay the amount within a certain future period, or
  iii) When a consideration other than cash is given in settlement of the due.

  Thus, in accrual system, income or expenses of a period are accounted in the period to which the income or expense is related applying the Matching Principle irrespective of the fact that whether

cash is received or paid or the payment is deferred. The objective of accrual system is to determine the operating result (profit/Loss) in an accurate manner. As a result of this assumption, outstanding items of expenses and incomes are taken into consideration while preparing financial statements. Expenditure incurred in the year 2007-2008 is accounted in that year if the full benefit of this expenditure is received in the year 2007-08. Salary of March 2008 paid in April 2008 is accounted in the year 2007-08 under accrual system. This is because the service of the employee was received and used in the month of March to the tune of the amount of salary.

- **Going Concern Assumption:** This assumption assumes that the business will be in operation indefinitely. This validates the methods of asset capitalization, depreciation, and amortization. This assumption is not applicable only when liquidation is certain.

  An existing and running business firm is called going-concern. This assumption is an important assumption on the basis of which transactions are recorded in the books of accounts. While recording business transactions in the books of accounts of an existing and running business firm, it is not assumed that the business will be closed down shortly. Rather it is assumed that the business will be carried on indefinitely. A business entity possesses assets and owes liabilities which are shown in the balance sheet. These assets and liabilities are carried to the next financial (or accounting) year. If it is assumed that the business will be closed down the next day or in the near future, than the assets would not have been shown at the cost price, but at saleable or realisable market value. But since the 'going concern' assumption is applied in recording transactions and preparing financial statements, so the accountant does not take into account the market price or realisable price.

  'Going concern' assumption simply states that in the foreseeable future the business will not be liquidated or closed down. This assumption is not applied for the firm which goes into liquidation or is put to sale. Accounts are carried forward to the following year on

the presumption that the business will be carried out in the years to come. This is called *'Going Concern'* assumption. For this reason there is no justification to value the assets to be carried forward in realisable value or market value.

- **Money Measurement:** It is assumed that a stable currency is going to be the unit of record. The FASB accepts the nominal value of the US Dollar as the monetary unit of record unadjusted for inflation. In India, Rupee is accepted as the monetary unit of record without adjusting for inflation. Purchases, sales, plant, furniture, capital, bank loan, salaries, expenses all are recorded in the books of account in money value. Recording of transactions does not mean recording of qualitative or quantitative feature of these elements. Monetary value of purchases and sales are recorded and not the quantities. Assets and liabilities are shown at their respective money values. This is known as *'*money measurement' concept.
- **Accounting Period:** It implies that the economic activities of an enterprise can be divided into artificial time periods. Accounting period means the period for which the accounts are prepared. This refers to the period of time at the end of which books of accounts of business entity are to be closed and financial statements are to be prepared. The going concern assumption tells that a business firm has an indefinite life or very long life. If this is the case then the result of business operation can be known only after the end of the life of business, i.e., when the business is liquidated. But to take decisions on various aspect concerning the business operation and its financial matter, information on periodic basis is required. To facilitate supply of accounting information, the life span of the entity is divided into shorter and convenient period known as accounting period. This assumption has also received legal sanction from the Indian income tax laws under which the books of accounts are required to be closed by a business entity on 31st March, every year.
- **Dual-Aspect:** Dual Aspect is another important concept applied in recording and presenting accounting information. This concept is

the very foundation of present accounting mechanism – double-entry system of book-keeping. According to this concept, every business transaction has a double effect, i.e., it has two sides– Debit and Credit.

This relationship between the elements of financial statements: assets, capital, liabilities, income and expenses is called Accounting Equation which is a result of ''Dual 'Aspect''' of all business transactions. Thus dual aspect of transaction means, if one side of the equation is affected by a transaction, the other side of the equation is also equally affected. For example, if a loan of Rs. 2,00,000 is taken, then liability and cash (asset) will increase by Rs. 2,00,000 each.

- **The Revenue Recognition Principle:** This principle requires business firms to record when revenue is: (1) realized or realizable and (2) earned, not when cash is received. This way of accounting is called accrual basis of accounting as described above. The revenue recognition principle helps in ascertaining the amount and time of recognising the revenues from the ordinary business activities. This principle is also known as **Revenue Realisation Principle**. In simple words, revenue recognition principle tells us the procedure of determining the income and expense for incorporation in profit and loss account (Revenue statement).
- **Matching Principle:** Expenses have to be matched with Revenues as long as it is reasonable to do so. Expenses are recognized not when the work is performed, or when a product is produced, but when the work or the product actually makes its contribution to revenue. Only if no connection with revenue can be established, may cost be charged as expenses to the current period (e.g. office salaries and other administrative expenses). This principle allows greater evaluation of actual profitability and performance (shows how much was spent to earn revenue). Depreciation and Cost of Goods Sold are good examples of application of this principle.
- **The Cost Principle:** The Cost principle provides a relatively objective foundation for accounting. Cost principle in accounting states that all accounting entries shall be made at cost as and when the

transaction takes place. Cost is the amount of money paid or payable for goods and assets acquired or services received.

- **The Objectivity Principle:** The Objectivity Principle states that accounting should be definite, verifiable, reliable and free from manipulation and personal bias of the persons engaged in the process of recording and presenting accounting data. For this reason, accounting must be carried out on an objective and factual basis. Every entry in the books of account must be based on documentary evidence i.e. source documents viz., vouchers and receipts. Historical cost recorded in the books is on the basis of original documents, which contain the information, which is not affected by the personal bias. Where no voucher/receipt is available as in the case of provision for doubtful debt, a certificate from the competent authority of the business firm must be obtained.
- **The Principle of full Disclosure:** Amount and kinds of information disclosed should be decided based on trade-off analysis as a larger amount of information costs more to prepare and use. Information disclosed should be enough to make a judgment while keeping costs reasonable. Information is presented in the main body of financial statements, in the notes or as supplementary information. Accounting information is required for decision making purpose by various users. Therefore, to be useful as the basis of decision-making process, there should be full disclosure in the financial statements of all significant information. Full Disclosure Principle specifies that there should be complete and understandable reporting relating to the economic affairs of the entity.
- **Cost-benefit:** The benefit of providing the financial information should also be weighed against the cost of providing it. This modifying principle states that the cost of applying a particular principle should not exceed the benefits derived from it. This does not mean that effort should be taken to save cost by providing lesser information. It stresses that undue heavy expenses must not be incurred in supplying information which are not relevant. Cost benefit principle

is generally applied to the supply of supplementary information, viz., human resource, value added statement, inflation adjusted account etc. Because of the application of this principle, companies are allowed to provide abridged financial statements to the shareholders instead of detailed statements.

- **Materiality:** The significance of an item should be considered when it is reported. An item is considered significant when it would affect the decision of a reasonable individual. The term materiality refers to the relative importance of an item. What is material for one firm may be immaterial for another firm. Again, material in one context may be immaterial in another context. Purchase of a calculator for office use may be accounted for as an asset by a small retail business and as an office expense by a large business. A difference of Rs. 1,000 in provision for doubtful debts is not material but the difference of Rs.1, 000 in cash is a serious one.

  Accounting Standard 1, states that financial statements should disclose all "material" items, i.e., the items, the knowledge of which might influence the decisions of the users of the financial statements. Thus materiality is an important guide for the accountants in deciding what should be disclosed in financial statements. It is essentially a matter of personal judgement and can be modified to the best interest of the firm and the users of financial statements.

- **Consistency:** The principle of 'consistency' requires that the accounting policies, which are followed from period to period, should not be changed. If it is assumed that the entity is a 'going concern', the accounting principles, methods, etc., must be consistently followed while recording and preparing financial statements. Users of accounting information draw their conclusions by comparing the financial statements of the current year with that of the previous year. If the accounting policies, techniques and methods applied are changed from year to year, the operating and financial results disclosed through financial statements, will suffer from lack of consistency.

- **Conservatism (Prudence):** When choosing between two solutions, the one that will be least likely to overstate assets and income should

be picked up. The term conservatism implies that all probable or anticipated losses should be provided for and all anticipated or unrealized gains should be ignored and the profit should not be overstated. In other words, accountants should preferably report the highest values of liabilities and expenses, and the lowest values of assets and revenues.

- **Timeliness:** Information is useful for a decision maker if it is relevant and reliable. Information becomes useful, relevant and reliable if it is made available in time. The principle of timeliness states that information should be disclosed timely.
- **Substance over Legal Form:** According to this modifying principle, the transactions and events recorded in the books of accounts and presented in the financial statements should be governed by the 'substance of such transactions and not by the legality of such transactions'. In certain cases, the transactions recorded may not represent the true legal position. Therefore, under 'substance over legal form' principle, substance of the transaction gets preference over legal position.
- **Industry Practice:** Accounting procedures should follow industry practices. Industries have to work under various situations. Some situation may be unique to only one industry. Therefore, sometimes practice prevailing in a particular industry is given precedence over generally accepted accounting principles.



CHECK YOUR PROGRESS

Q.2: Explain the meaning of Generally Accepted Accounting Principles. (In three lines)

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Q.3: State whether following statements are true or false.

I) According to going concern concept, the business will be in operation indefinitely.

II) According to business entity concept business is not separate from its owners or other businesses.

III) Accounting period is the period for which the accounts are prepared

IV) Cost principle states that all accounting entries shall be made at cost as and when the transaction takes place.

1.6 ROLE OF GAAP IN THE PREPARATION OF FINANCIAL STATEMENTS

Preparation of financial statements means preparing trading account; profit & loss account and balance sheet after recording and balancing of accounts in ledgers are over. While performing these accounting function, accounting principles and conventions are continuously applied. Hence, these have an important role to play in preparation of financial statements. Such role of GAAP may be outlined in the following paragraphs.

- GAAP helps in reducing alternative accounting procedures/methods.
- Application of GAAP helps in measuring the accounting values of various elements of financial statements in the best possible manner.
- GAAP helps in maintaining consistency in the measurement of accounting values, in preparing and presenting the accounting information.
- Accountants are relieved to a great extent from the problem of choosing the right value of an item for recording purpose.
- GAAP also assists an accountant to decide on what to disclose, how to disclose and when to disclose accounting information.
- GAAP plays the important role in defining the time frame for which the accounts are being prepared. This also helps in keeping aside the unmatched expenses and incomes from the purview of trading account and profit & loss account.

- GAAP also assists an accountant in the process of recognising non-cash events and circumstances. This helps in measuring the operating and financial result of the firm in a true and fair manner.

1.7 APPLICATION OF GAAP IN RECORDING AND PREPARING FINANCIAL STATEMENTS

Now, we will discuss the application of GAAP in recording transactions with the help of some examples.

Example 1: Whether Cash Sales Rs. 70,000 and Credit sales Rs, 5,000 are recognised as revenue.

Both the sales are recognised as revenue, since a 'Sale' implies transfer of title to the goods is complete.

Example 2: M/s. Shastri received an order on 20.3.08 from a customer to supply goods of Rs. 40,000 which was executed on 30th March 2008. Books of accounts are closed on 31st March each year. M/s Shastri got the payment for the goods as follows :

Rs. 25,000 by an account payee cheque dated 30.3.08

Rs. 10,000 cash on 31.3.08

Rs. 5,000 cash on 10.4.08

How are these treated in accounts?

These are treated applying Revenue Recognition principle**.** During the accounting year 2007-08, revenue will be for Rs. 40,000.

Example 3: Tata Ltd. purchased an old machine from Bajaj Ltd. for Rs. 2,50,000. The market value of the machine was estimated at Rs. 3,75,000. Which principle is applied in recording the transaction and which value will be recorded?

Cost principle is applied in recording the transaction in the books of Tata Ltd. And it will be recorded at Rs. 2,50,000.

Example 4: On 1.1.2008 House Rent of Rs. 12,000 was paid for one year from 1.1.08. to 31.12.08. Books of accounts are closed on 31st March each year. Explain the basis of recording.

Matching principle is applied in recording the transaction. House Rent paid for 12 months from 1.1.08 to 31.12.08. House Rent paid for three

months, January, February and March 2008 Rs. 3,000 is related to the accounting the year 2007-08, so it is to be matched for the year 2007-08 and debited in the P/l Account of that year. The unmatched expense of Rs. 9000 in the year 2007-08 will be shown in the Balance Sheet of 31.3.2008 as "Insurance Prepaid". House Rent paid for nine months from April to December Rs. 9000 will be matched with revenue of the year 2008-09 so it is to be matched for the year 2008-09 and debited in the P/l Account of that year.



CHECK YOUR PROGRESS

Q.4: In the year 2007-08 there is prepaid insurance of Rs. 500. Mention the accounting principle or principles applied in accounting treatment of this expenditure.

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1.8 INTERNATIONAL FINANCIAL REPORTING STANDARDS

The need to speak a uniform accounting language over the world has resulted in the development of a new concept in accounting known as IFRS. International Financial Reporting Standards (IFRS) are set of high quality, transparent and enforceable global accounting standards which have attracted attention of the accountants all over the world in the recent time. This is due to its growing popularity and application as a result of globalisation of business and internationalisation of accounting practices which compelled the countries to adopt the same as a means to harmonise the whole concept of accounting. Earlier to the evolution of this concept, every country used to follow their local GAAPs and accounting standards while preparing and presenting their financial statements. As business started spreading beyond the national boundary of countries, it forced the accounting world to develop a uniform accounting language which is understood by all the stakeholders across borders and as a consequence IFRS evolved. These are designed as a common global language for business affairs so that company accounts

are comparable and understandable across international borders. The term IFRS has both a narrow and a broader meaning. Narrowly, IFRS refers to the new numbered series of pronouncements that the International Accounting Standards Board (IASB) has been issuing, as distinct from the International Accounting Standards(IASs) issued by its predecessor. More broadly, IFRS refers to the entire body of IFRS pronouncements including standards and interpretations approved by IASB and IASs and SIC interpretations approved by the predecessor International Accounting Standards Committee (IASC).Thus IFRS comprises–

- International Financial Reporting Standards(IFRSs) issued by IASB
- International Accounting Standards(IASs) issued by IASC
- Interpretations developed by the IFRS Interpretations Committee (IFRICs) and
- Former IASC Standing Interpretations Committee(SICs).

In the recent years, IFRS has been a widely debated issue all over the world. The major breakthrough came in the year 2002 when the European Union passed legislation for adoption of the same. The legislation came to effect in 2005 which resulted in mandatory adoption of IFRS by more than 8000 firms in 30 countries belonging to EU including France, Germany, United Kingdom, Italy, Spain and so on. Thereafter, the world is moving rapidly towards the adoption of IFRS in preparation and presentation of financial statements. At present, almost 123 countries have joined the process; some fully adopting the original IFRS and others converging their local GAAPs to IFRS.

1.9 IFRS IN INDIA

Accounting standards in India are issued by the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) and these are largely based on IFRS. However, because of its sensitive local conditions including conflicting legal and economic environment, India has not been able to keep pace with the developments and amendments made in IFRS. However, India made a commitment towards the convergence of Indian accounting standards with International Financial Reporting Standards

(Called Ind AS) at the G-20 summit held at Pittsburgh, USA. Following this, the Ministry of Corporate Affairs came out with a road map for the implementation of Indian Accounting Standards (Ind AS) converged with IFRS. Till now, the MCA has notified 39 Ind AS which are applicable in India.

1.10 Benefits of IFRS

The adoption of IFRS is expected to result in better quality of financial reporting due to consistent application of accounting principles and improvement in reliability of financial statements. This, in turn, will lead to increased trust and reliance placed by investors, analysts and other stakeholders in a company's financial statements. The shift towards IFRS is expected to yield benefits in different ways-

1) **For Companies:** Better access to and reduction in the cost of capital raised from global capital markets since IFRS are now accepted as a financial reporting framework for companies seeking to raise funds from most capital markets across the globe.
2) **For Investors:** Better information for decision making, leading to broader investment opportunities. The investor will be benefited in as the way accounting information made available to them will be more reliable, relevant, timely and most importantly the information will be comparable across different legal framework. It will develop better understanding and confidence among the investors.
3) **Easy Cross Border Listing:** Companies require funds for their expansion plans which are not limited to the economic and political boundaries of a nation. Indian Firms are acquiring firms outside India also. They are also getting listed in European and American Capital Markets through raising funds from these markets. One of the major pre-requisites of getting listed on European Markets is preparation of Accounts as per IFRS requirements. A few Indian Companies which have raised funds through the European Capital Markets have started preparing their Financial Statements as per IFRS.
4) **Better Quality of Financial Reporting:** Adoption of IFRS is expected to result in better quality of financial reporting due to consistent

application of Accounting Principles and improvement in reliability of financial statements. Among various latest trends-based concepts, IFRS follows a concept of fair value which can help Indian firms to reflect their true worth of Assets held in the financial statements. Since a single body (IASB, London) is preparing IFRS, these are very consistent, reliable and easy to adopt ensuring better quality of financial reporting.

5) **Elimination of Multiple Reporting:** Adoption of IFRS ensures the elimination of multiple financial reporting standards by these firms as they are following single set of Financial Reporting.

6) **For National Regulatory Bodies:** Indian Accounting standard Board will be alert to the best international accounting practice (IFRS) to guide them in the establishment of highly improved reporting practices in India**.** It brings about a higher and improved standard of financial disclosure. Moreover, it also brings about better ability to attract and monitor listings by foreign companies.

1.11 INDIAN GAAP Vs. IFRS

BASIS FOR COMPARISON		INDIAN GAAP	IFRS
1)	**Acronym**	The Indian version of Generally Accepted Accounting Principles	International Financial Reporting Standard.
2)	**Meaning**	A set of accounting guidelines and procedures, used by the companies to prepare their financial statements is known as GAAP.	IFRS is the universal business language followed by the companies while reporting financial statements.
3)	**Developed by**	Ministry of Corporate Affairs(MCA).	International Accounting Standards Board(IASB).

4)	**Based on**	GAAP focuses on research and is rule-based.	IFRS looks at the overall patterns and is based on principle.
5)	**Adopted by**	Indian GAAP is only adopted by Indian companies.	Companies in 110+ countries have adopted IFRS. More and more countries are making the shift as well.
6)	**First Time Adoption**	Indian GAAP doesn't give any clear instruction on the first time adoption.	IFRS 1 provides clear instruction on how to adopt IFRS for the first time.
7)	**Disclosure of Revenue**	The money charged for the products/services to the customers and the rewards received by using the resources come under revenue as per Indian GAAP.	As per IFRS, the revenue is shown at the fair value of the money received or receivable.
8)	**Extraordinary Items**	Defined as events or transactions clearly distinct from the ordinary activities of the entity and are not expected to recur frequently and regularly.	Prohibited.



1.12 LET US SUM UP

In this unit we have discussed the following-

- Accounting principles govern the development of accounting techniques.

- Accounting principles, concepts, conventions and postulates are applied in the preparation of accounts.
- Generally Accepted Accounting Principles (GAAP) provides guidelines to the in the choice of accounting techniques and the preparation of financial statements.
- These principles have been developed gradually through practice. Experience, reason, custom, usage and practical necessity have contributed significantly in the evolution of GAAP.
- GAAP consists of various assumptions, principles, modifying principles and accounting standards.
- GAAP plays an important role in the preparation of financial statements, like trading account, profit and loss account and balance sheet.
- GAAP helps in reducing alternative accounting procedures/methods.
- GAAP helps in disclosing accounting information.
- International Financial Reporting Standards (IFRS) are set of high quality, transparent and enforceable global accounting standards which have attracted attention of the accountants all over the world in the recent time.
- Accounting standards in India are issued by the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) and these are largely based on IFRS.



1.13 FURTHER READING

1) Bhattacharya, Ashis. *Financial Accounting*. New Delhi: Prentice hall of India Pvt. Ltd.
2) Dam, B. B. and Gautam, H. C. *Theory and Practice of Financial Accounting*. Guwahati: Capital Publishing Company.
3) Gupta, R. L. and Radhaswamy, M. Accountancy. New Delhi: Sultan Chand & Sons.
4) Maheshwari, S. N. *Financial Accounting*. New Delhi: Vikash Publishing House Pvt. Ltd.

1.14 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: Accounting principles are the principles applied in the preparation of the accounts. They help in the development of accounting technique. They are derived from the objectives and the theoretical concept of accounting.

Ans. to Q. No. 2: Generally Accepted Accounting Principles are the guide to the accounting profession in the choice of accounting techniques and the preparation of financial statements. GAAP brings uniformity in the reporting of financial events of the entities across the industry. The main elements of GAAP are as under:

a) Assumptions b) Principles

c) Modifying Principles, and d) Accounting Standards.

Ans. to Q. No. 3: i) True, ii) False, iii) True, iv) True

Ans. to Q. No. 4: Accrual and Matching principles are applied.

1.15 MODEL QUESTIONS

A) Objective Type:

Q.1: State the accounting principle involved in each of the following situation:

a) Cash Sale Rs. 400 and credit sale Rs. 5000

b) Inventory valued at cost.

c) Bad debt provided Rs. 600.

d) It is assumed that the business will last for unforeseeable future.

e) The assets are recorded in books at the acquisition cost.

f) Total insurance paid is Rs. 1200 out of which Rs. 500 is prepaid.

g) The cash withdrawn by the owner to meet personal expenses.

Q.2: State whether each of the following statement is True or False.

i) Accounting principles are generally theoretically based.

ii) Basic accounting principles can not bring uniformity in Accounting practice.

iii) Bad debt provision is based on Concept of conservatism.

iv) Going concern concept states that assets are valued at.

Q.3: Fill in the blanks with appropriate word/term/phrase:

i) ..... Principle states that income should be measured in the period in which it is *earned*.

ii) Inventory valuation at cost is based on ..... concept.

iii) Normally, method of valuing assets should not be changed. This principle is known as principle of .....

iv) Machineries of a factory are valued at cost less depreciation in pursuant to .....

B) Long Answer Type:

Q.1: Explain the purposes of Accounting information.

Q.2: "Accounting is an information system". Explain

Q.3: Name the different parties interested in accounting information .

Q.4: Give a short explanation of the features of Accounting Principles. Explain the term 'Accounting Concept'. Name eight accounting concepts and explain any one of them with a suitable example.

Q.5: What is meant by Generally Accepted Accounting Principles? Explain its needs and importance.

Q.6: Write short notes on the following:

i) Business Entity Concept.

ii) Going-Concern Concept.

iii) Matching Concept.

Q.7: Discuss the role of accounting principles in the preparation of financial statements.

Q.8: Explain "Anticipate no profit, provide for all possible losses."

Q.9: Briefly explain the concept of matching cost with revenue. When is revenue said to be realised for accounting purpose?

Q.10: Briefly discuss the differences between IFRS and Indian GAAP.

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UNIT 2: ACCOUNTING STANDARDS

UNIT STRUCTURE

2.1 Learning Objectives

2.2 Introduction

2.3 Meaning and Needs of Accounting Standards

2.4 Objectives of Accounting Standards

2.5 Advantages of Accounting Standards

2.6 Authorities for Setting Accounting Standards in India

2.7 Procedure Adopted for Formulating Accounting Standards in India

2.8 Indian Accounting Standards Issued By ICAI

2.9 Enforcement of Accounting Standards (Compliance with Accounting Standards)

2.10 Let Us Sum Up

2.11 Further Reading

2.12 Answers To Check Your Progress

2.13 Model Questions

2.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- define the meaning and importance of Accounting Standards.
- explain the objectives and advantages of Accounting Standards.
- describe the Accounting Standards setting procedure in India
- explain a few accounting standards issued by the ICAI
- explain the enforcement of Accounting Standards in India.

2.2 INTRODUCTION

In the preceding unit (Unit-1), we have discussed the accounting principles applied in the framing of accounting information. These principles are generally applied in accounting. Some accountants may not follow these when most of the accounting professionals in general do not welcome variations in the application of accounting principles. This is because such

a situation creates confusion in preparing the accounts. In the same way, the users of financial statements do not like variation in the application of accounting principles by the preparers of financial statements because it creates problem in their decision making process. Hence, there is always an effort from both sides to minimise these variations in the application of accounting principles. The accounting bodies and associations world over are continuously engaged in the effort to provide the best acceptable accounting principles. They have conducted research studies, made pronouncements from time to time on the basis of the findings of such research to evolve and improve the principles of accounting, known as 'Accounting Standards'. In the practical application these are generally accepted by all the accounting professionals, and that is why these are included in 'Generally Accepted Accounting Principles'

2.3 MEANING AND NEEDS OF ACCOUNTING STANDARDS

Accounting Standards are the established and accepted models which aim at providing excellent, adequate and unbiased treatment of accounting transaction/information and reporting the same in the financial statements to facilitate their users in forming rational and judicious decision.

According to T. P. Ghosh *"*Accounting standards are the policy document issued by the recognised expert accountancy body relating to various aspects of measurement, treatment and disclosure of accounting transactions and events.'' Accounting standards provide the prescription for treating accounting events and disclosing the same in an all-accepted, unbiased and fair manner. These relate to accounting rules and procedures applied in measurement, valuation, reporting and disclosure of financial information.

The accounting standard is a standardised practice of accounting which aims to reduce the several alternative practices. 'Accounting standards relate to the codification of generally accepted accounting principles. These are stated to be the norms of accounting policies and practices by way of codes and guidelines to direct as to how the items which go to make the

financial statements should be dealt with in accounts and presented in the annual reports'. (ICSI)

Accounting standards must be developed for the development of accounting as a business language. The central idea of accounting standards is to harmonise the diverse accounting policies and practices followed by business enterprises. Endeavour in this regard is needed at national as well as international level. Thought on standardization of accounting events and disclosure of the same in the financial statements was developed when the limitations of conventional GAAP were felt. Availability of alternative treatment of the event/transaction and reporting the same in any manner the accountant or the manager likes, have made the financial statements less useful to the decision makers since they can not make inter-firm comparison. This has reduced the investors' confidence on the audited accounts and thus has damaged the dignity of accounting profession.

Needs of Accounting Standards: Accounting Standards are primarily required for harmonizing the accounting practices. In this connection the statement provided by David Solomons (1983) is mentionable. He has identified the following reasons for setting accounting standards:

- The corporations cannot be granted absolute freedom of choice regarding what to report and how to report on market principles. For, this might cause damage to the interest of the investors and creditors.
- Comparability of financial information generated and disclosed by several enterprises will become easier through the adoption of a uniform accounting standard. The value of information would be enhanced if this can be compared from entity to entity.
- The third argument says that an accounting standard appeals to the limited capacity of receivers of information to interpret and use it for their economic decision making purpose. The accounting standards recognise the principle of equity in information dissemination.
- Moreover, in view of the globalization and internationalization of business, it has become a necessity to adopt globally acceptable treatment of accounting issues and their reporting methods.



CHECK YOUR PROGRESS

Q.1: Define the concept of Accounting Standard.

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Q.2: Mention any three needs of Accounting Standards.

i) .....

ii) .....

iii) .....

2.4 OBJECTIVES OF ACCOUNTING STANDARDS

Objectives of Accounting Standards are given below:

- The most important objective of Accounting Standards is to bring uniformity in financial reporting and to ensure consistency and comparability of data contained in the financial statements.
- Another objective of Accounting Standards is to use accounting standards as a tool to enhance corporate governance and responsibility.
- Accounting standards have been formulated to ensure fairness, probity, consistency and transparency in business operation and accounting practices.
- Another objective of Accounting Standards is to develop accounting as a language of business.

2.5 ADVANTAGES OF ACCOUNTING STANDARDS

Accounting Standards provide the accountants those accounting policies which are most suitable in a given situation. The utility of accounting standards may be stated as follows:

- Accounting Standards improve the reliability and credibility of financial statements.

- Accounting Standards ensure the consistency and comparability of Financial Statements.
- Accounting Standards help in resolving conflict of financial interests among various groups.
- Accounting Standards reduce the chances of manipulations and frauds.
- Accounting Standards are aid to Auditors. In case of companies, it is the duty of the auditors to ensure that the accounting standards have been followed in the preparation of financial statements. In case of deviations, it is also their duty to make adequate disclosure in their reports so that the users of such statements may be aware of such deviations. Such disclosure by the auditors helps them to avoid penal actions which may be taken against them under the company law.



CHECK YOUR PROGRESS

Q.3: Mention two objectives of Accounting Standards.

i) .....

.....

ii) .....

.....

Q.4: Mention two advantages of Accounting Standards.

i) .....

.....

ii) .....

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2.6 AUTHORITIES FOR SETTING ACCOUNTING STANDARDS IN INDIA

In India there are three authorities that can set and issue Accounting Standards under their respective legislative powers. These authorities are:

- The Council of the Institute of Chartered Accountants of India,
- The Central Government under the Income Tax Act, 1961; and
- The Central Government under the Companies Act, 1956.

The Central Government, under Section 145(2) of the Income Tax Act, 1961, is authorised to notify, from time to time, the accounting standards to be followed by any class of assessees or any class of income.

The Central Government has constituted a 12-member NATIONAL ADVISORY COMMITTEE ON ACCOUNTING STANDARDS under Section 210A (1) of the Companies Act, 1956. Though no accounting standard has been laid down till now under this Act, but it is provided in section 210 of the Act, that the standard of accounting specified by the ICAI shall be deemed to be the Accounting Standards prescribed by the Central Government under this section.

Since the financial audit is performed by qualified chartered accountants in India, therefore, practically the task of setting, issuing and enforcing the implementation of accounting standards have been performed by the ICAI. Therefore the procedure followed by the ICAI in this regard is described hereunder.

The Institute of Chartered Accountants of India (ICAI) was established in the year 1949 under an Act of Parliament mainly to perform the following two basic activities: (a) Conducting Chartered Accountancy examination and preparing CAs to perform accounting and auditing function; and (b) Formulating accounting standards as well as auditing standards and guidelines. The ICAI is a full-fledged member of the International Federation of Accountants (IFAC) and is an associate member of the International Accounting Standard Committee since April 1974. Recognizing the need to harmonize the diverse accounting practices prevalent in India and also to integrate them with the international accounting practices, the Accounting Standards Board (ASB) was constituted on 21st April 1977 by the ICAI. The Accounting Standards Board gives adequate representation to the related and interested groups of bodies, viz., Industry and Commerce, Company Law, Central Board of Direct Taxes, Comptroller and Auditor General of India, Banks, Public Enterprises and practising auditors.

The main function of the ASB is to formulate Accounting Standards so that such standards may be established by the ICAI in India. While formulating the Accounting Standards, the ASB takes into consideration the applicable laws, customs, usages and business environment prevailing in India. Accordingly, while formulating the Accounting Standards, the ASB gives due consideration to International Accounting Standards (IASs) issued by the International Accounting Standards Committee Foundation and try to integrate them, to the extent possible, in the light of the conditions and practices prevailing in India.

2.7 PROCEDURE ADOPTED FOR FORMULATING ACCOUNTING STANDARDS IN INDIA

The procedure adopted for formulating Accounting Standards is described below:

First, the ASB determines the broad areas in which Accounting Standards need to be formulated and the priority in regard to the selection thereof. Then Study Group is constituted to consider the specific subject of the proposed standard. In the formation of Study Groups, proper care is taken for wide participation by the members of the Institute and others. The Study Group prepares the preliminary draft on the proposed standard.

The draft of the proposed standard normally includes the following:

- Objective of the Standard,
- Scope of the Standard,
- Definitions of the terms used in the Standard,
- Recognition and measurement principles, wherever applicable,
- Presentation and disclosure requirements.

The ASB considers the preliminary draft prepared by the Study Group and if any revision of the draft is required on the basis of deliberations, the ASB makes the same or refer the same to the Study Group.

In the next step the ASB circulates the draft of the Accounting Standard, called **'Exposure Draft'**, to the Council members of the ICAI and to the specified bodies who are the representatives of the various interested groups. Normally the ASB holds a meeting with the representatives of specified

bodies to ascertain their views on the draft of the proposed Accounting Standard. On the basis of comments received and discussion with the representatives of specified bodies, the ASB finalises the Exposure Draft of the proposed Accounting Standard.

The Exposure Draft of the proposed Standard then is issued for comments by the members of the Institute and the public. The Exposure Draft is specifically sent to specified bodies, stock exchanges, and other interest groups.

After taking into consideration the comments received, the draft of the proposed Standard is finalised by the ASB and submitted to the Council of the ICAI.

The Council of the ICAI considers the final draft of the proposed Standard, and if found necessary, modify the same in consultation with the ASB. Then, finally the Accounting Standard on the relevant subject is issued under the authority of the Council of the ICAI. Accounting Standards issued under by Council of the ICAI are serially numbered as AS 1, AS 2, AS 3, and so on.

The same procedure as described above is followed by the ICAI for substantive revision of an Accounting Standard in subsequent period.

2.8 INDIAN ACCOUNTING STANDARDS ISSUED BY ICAI

The following are the Accounting Standards issued by The Institute of Chartered Accountants of India (ICAI) till date.

No.	Title	Period commencing on or after
AS-1	Disclosure of Accounting policies	1.4.1991
AS-2	Valuation of inventories (Revised)	1.4.1999
AS-3	Cash flow statements (Revised)	1.4.1997
AS-4	Contingencies & events occurring after the Balance Sheet	1.4.1995
AS-5	Net profit or loss for the period	1.4.1996

AS-6	Depreciation Accounting (Revised)	1.4.1995
AS-7	Construction Contracts (Revised)	1.4.2003
AS-8	Accounting for Research & Development *(Withdrawn pursuant to AS 26 becoming mandatory)*	1.4.1991
AS-9	Revenue Recognition	1.4.1991
AS-10	Accounting for Fixed Assets	1.4.1991
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 Amalgamation	1.4.1995
AS-15	Employee Benefits	1.4.2005
AS-16	Borrowing costs	1.4.2000
AS-17	Segment Reporting	1.4.2001
AS-18	Related party disclosures	
AS-19	Leases	
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
AS-23	Accounting for Investments in Associates in Consolidated Financial Statements	1.4.2002
AS-24	Discontinuing Operations	
AS-25	Interim Financial Reporting	1.4.2002
AS-26	Intangible Assets	1.4.2003
AS-27	Financial Reporting of Interests in Joint Ventures	1.4.2002
AS-28	Impairment of Assets	1.4.2004
AS 29	Provisions, Contingent Liabilities and Contingent Assets	1.4.2004.

AS 30	Financial Instruments Recognition and Measurement and Limited Revisions to AS 2, AS 11 (revised 2003), AS 21, AS 23, AS 26, AS 27, AS 28	
AS 31	Financial Instruments: Presentation	



CHECK YOUR PROGRESS

Q.5: Mention the authorities empowered to set Accounting Standards in India.

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Q.6: State whether the following statements are *true* or *false*.

i) Accounting Standard 1 deals with the valuation of inventories.

ii) ICAI formulates accounting and auditing standards and guidelines.

iii) Accounting Standard 6 relates to depreciation accounting.

2.9 ENFORCEMENT OF ACCOUNTING STANDARDS (COMPLIANCE WITH ACCOUNTING STANDARDS)

The legal and authoritative support has recently been given to the Accounting Standards in India. This support to the accounting standards is given by three agencies:

- The Institute of Chartered Accountants of India (ICAI),
- The Central Government : Through Income Tax Act and Companies Act;
- The SEBI.

The manner of exercising authority for enforcement and compliance by the above agencies is discussed below:

- **The ICAI:** Earlier the ICAI was the only authority to issue and implement the compliance of accounting standards through its member auditors. The auditors' duties in relation to mandatory accounting standards clearly state that it is the duty of the auditor to ensure that the accounting standards are followed in the preparation and presentation of financial statements. If the mandatory accounting standards have not been complied with, the auditor should make adequate disclosure to this effect in his report so that the users of financial statements are aware of the non-compliance of accounting standards by the enterprise.
- **The Central Government:**
  - **Income Tax Act:** The Central Government, under Section 145(2) of the Income Tax Act, 1961 is authorised to notify, from time to time, the accounting standards to be followed by any class of assessees or any class of income. Till now two standards have been issued under the Income Tax Act. These two standards were notified on January 25, 1996 which are to be followed by all assessees following the mercantile system of accounting. They are:
    - Disclosure of Accounting Policies.
    - Disclosure of the Prior Period and Extra-ordinary Items and changes in Accounting Policies.
  - **Companies Act:** The real legislative support to the accounting standards in true sense has been completed only in the year 1999, when the Companies Act 1956 was amended. The amended Act came into force w.e.f. 31.10.1998, which has made the compliance of accounting standards mandatory. Three new sub-sections 3A, 3B and 3C have been added to Section 211.

    Now, the auditors are also made responsible to see whether the companies have complied with the accounting standards or not. In this regard a new clause (d) in sub-section (3) of Section 229 is

inserted which requires the auditor to report "whether in his opinion, the profit and loss account and the balance sheet comply with the accounting standards mentioned in sub-section 3(c) of Section 229".

Under Section 217 (2AA) (i) the directors of a company are responsible to make a disclosure on compliance of accounting standards.

- **SEBI:** The enforcement of accounting standards has further been strengthened by the initiatives of the Securities and Exchange Board of India. The SEBI has formed a committee to ensure the implementation of accounting standards, statements, guidance notes and studies, evolved by the ICAI, and to provide inputs and make reference to the Accounting Standards Board.



2.10 LET US KNOW

In this unit we have discussed the following aspects–

- Accounting standards are the established rules which are used in the preparation of financial statements.
- Accounting standards brings uniformity in financial reporting
- Accounting standards makes the comparison of financial statements easy
- Accounting standards are the aids to the auditors.
- The Institute of Chartered Accountants of India (ICAI) was established to conduct Chartered Accountancy examination and preparing CAs to perform accounting and auditing function; and to formulating accounting as well as auditing standards and guidelines.
- The various Accounting Standards issued by icai, like Accounting Standard 1: Disclosure of accounting Policies, Accounting Standard 6: Depreciation accounting etc.
- The legal and authoritative support to Accounting Standards ig given by ICAI, Central Government and SEBI.



2.11 FURTHER READING

1) Bhattacharya, Ashis. *Financial Accounting*. New Delhi: Prentice hall of India Pvt. Ltd.

2) Dam, B. B. and Gautam, H. C. *Theory and Practice of Financial Accounting*. Guwahati: Capital Publishing Company.

3) Gupta, R. L. and Radhaswamy, M. Accountancy. New Delhi: Sultan Chand & Sons.

4) Maheshwari, S. N. *Financial Accounting*. New Delhi: Vikash Publishing House Pvt. Ltd.



2.12 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: "Accounting standards are the policy document issued by the recognised expert accountancy body relating to various aspects of measurement, treatment and disclosure of accounting transactions and events."

Ans. to Q. No. 2: i) Precise and prudent information
ii) Comparability
iii) Global acceptability of accounting information.

Ans. to Q. No. 3: i) To bring uniformity in financial reporting and to ensure consistency and comparability of data contained in the financial statements.
ii) To use accounting standards as a tool to enhance corporate governance and responsibility.

Ans. to Q. No. 4: i) Accounting Standards improve the reliability and credibility of financial statements.
ii) Accounting Standards help in resolving conflict of financial interests among various groups.

Ans. to Q. No. 5: In India there are three authorities that can set and issue Accounting Standards under their respective legislative powers.

These authorities are:

1) The Council of the Institute of Chartered Accountants of India,
2) The Central Government under the Income Tax Act, 1961; and
3) The Central Government under the Companies Act, 1956.

Ans. to Q. No. 6: i) False, ii) True, iii) True



2.13 MODEL QUESTIONS

Q.1: What is accounting standard?

Q.2: What are the needs of accounting standard?

Q.3: What are its benefits of accounting standard?

Q.4: Discuss in brief the accounting standard setting procedure in India.

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UNIT 3: INTERNATIONAL FINANCIAL REPORTING STANDARDS AND THEIR SCOPE AND OBJECTIVES

UNIT STRUCTURE

3.1 Learning Objectives

3.2 Introduction

3.3 International Accounting Standards Committee Foundation (IASCF)

3.4 International Accounting Standard Board (IASB)

3.5 International Financial Reporting Interpretations Committee (IFRIC)

3.6 Let Us Sum Up

3.7 Further Reading

3.8 Answers To Check Your Progress

3.9 Model Questions

3.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- describe the objectives and responsibilities of IASCF
- describe objectives, functions and responsibilities of IASB
- describe the objectives, scope and process of issuing IFRS.

3.2 INTRODUCTION

As per Chambers Twentieth Century Dictionary 'Standard' means an established or accepted model, a definite level of excellence or adequacy required or aimed at. Accounting Standards are the laws, rules, procedures, methods and system issued by appropriate authority to apply in the preparation and presentation of financial statements. These are the established and accepted models, which aim at providing excellent, adequate and unbiased treatment of accounting transaction/information and reporting the same in the financial statements to facilitate their users in forming rational and judicious

decision. According to T. P. Ghosh "Accounting Standards are the policy document issued by the recognised expert accountancy body relating to various aspects of measurement, treatment and disclosure of accounting transactions and events". Accounting Standards provide the prescription for treating accounting activities and disclosing the results in al accepted, unbiased, true and fair manner. These accounting standards are standardised practices of accounting which purpose to minimise the several alternative practices. ''Accounting Standards relate to the codification of generally accepted accounting principles. These are stated to be the norms of accounting policies and practices by way of codes and guidelines to direct as to how the items, which go to make the financial statements, should be dealt with in accounts and presented in the annual reports.'' (ICSI)

As per Section 2(2) of the Companies Act 2013, "Accounting Standards" means the standards of accounting or any addendum thereto for companies or class of companies referred to in section 133; section 133 of the Act states that the Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.

3.3 INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE FOUNDATION (IASCF)

In the year 2000, the IASC was restructured in order to strengthen its working. After that, the International Accounting Standards Committee (IASC) has been converted to the International Accounting Standards Committee Foundation (IASCF). In December, 1999, the IASC Board had appointed a nominating committee to select the first Trustees of IASCF. The nominating committee nominated 19 trustees on 22nd May 2000 who took office on 24th May 2000 as a result of the approval of the constitution. For the purpose of execution of their duties under the constitution, the Trustees formed the International Accounting Standards Committee Foundation on 6th February 2000. It has three organs viz.

1) Standard Advisory Council (SAC);
2) International Accounting Standard Board (IASB); and
3) International Financial Reporting Interpretations Committee (IFRIC).

On 1st July, 2010, IASCF is renamed as The International Financial Reporting Standards Foundation, or IFRS Foundation. It is a non-profit accounting organisation. Their principal objective is development and promotion of the IFRS through the International Accounting Standards Board (IASB). It is governed by a board of 22 trustees. There shall be:

a) Six trustees appointed from the Asia/Oceania region;
b) Six trustees appointed from Europe;
c) Six Trustees appointed from North America;
d) One Trustee appointed from Africa;
e) One Trustee appointed from South America; and
f) Two Trustees appointed from any area, subject to maintaining overall geographical balance.

Objectives of IASCF / IFRS Foundation: The objectives of IASCF / IFRS foundation are:

I) To develop in the public interest, a single set of high – quality, understandable and enforceable global accounting standards;
II) To promote the use and rigorous application of those standards;
III) To bring about convergence of National Accounting Standards and International Accounting Standards to high quality solutions; and
IV) To promote and facilitate adoption of IFRSs, being the standards and interpretations issued by the IASB, through the convergence of national accounting standards and IFRSs.

Responsibilities and Functions of the trustees of IFRS Foundation: The responsibilities and functions of the trustees of IFRS Foundation are:

1) Appointing members of the IASB, the IFRS Interpretation Committee and the IFRS Advisory Council;
2) Establishing and amending the operating procedures, consultative arrangements and with due process for the IASB, the Interpretation Committee and the Advisory Council;

3) Reviewing annually the strategy of the IASB and assessing its effectiveness;
4) Ensure the financing of the IFRS foundation and approve annually its budget; and
5) Publish an annual report on the IFRS foundation's activities, including audited financial statements and priorities for the upcoming year.

In exercising their governance responsibilities, the Trustees may reconsider or amend the IASB's due process or recommend, for example, improvements to the IASB's outreach activities. In addition, the constitution requires the Trustees to undertake a formal, public review of the structure of the IFRS Foundation, its governance arrangements and its effectiveness in fulfilling the organisation's objectives for five years.



CHECK YOUR PROGRESS

Q.1: Define Accounting Standards.

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Q.2: State two objectives of IASCF.

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3.4 INTERNATIONAL ACCOUNTING STANDARD BOARD (IASB)

The International Accounting Standard Board (IASB) is an independent, privately funded standard setter based in London, England. IASB is the vital important organ of the IFRS Foundation. The IASB was founded on April 1, 2001 as the successor to the IASC. On March1, 2001, the IASB assumed accounting standard setting responsibilities from its

predecessor body, the IASC. It is responsible for developing International Financial Reporting Standards (the new name of IAS issued after 2001), and promoting the use and application of these standards. The IFRS Foundation, incorporated on February 6, 2001 is the parent entity of IASB. IASB has 16 Board members with an appropriate mix of recent practical experience in setting accounting standards, in preparing auditing or using annual reports, and in academic work (12 of who are full time) each with one vote.

Objectives of IASB: The objectives of the IASBs are:

1) To formulate global standards that are transparent, enforceable, understandable and of high quality;
2) To keep or develop under review International Accounting Standard on all major financial reporting issues;
3) To promote the convergence of accounting standards around the world;
4) To lead on certain issues on its agenda and devote recourses to them;
5) To consider fully the views of the national standard setters in its own debates of the same issues.

Functions and responsibilities of IASB: Under the IFRS Foundation Constitution, the IASB has complete responsibility for all technical matters of the foundation. The main functions and responsibilities of the IASB, as laid down in IFRS Foundation Constitution, are mentioned below:

1) They are entrusted with all technical matters which include the following:
   a) To prepare and issue International Accounting Standards;
   b) To prepare and issue International Reporting Standards;
   c) To prepare and issue Exposure Drafts should contain comments including dissenting notes;
   d) To publish the Final Approval of Interpretations given by International Reporting Interpretations Committee.
2) To publish an Exposure Draft on all projects and a Draft Statement Of Principles or other discussion documents. These drafts are published for eliciting public comments on major projects.

3) a) To exercise discretion over the technical agenda on project assignment on technical matters;
   b) To organise the conduct of its work; and
   c) To outsource research work or other work to the other organisations such as National Standard Setters, etc.
4) a) To establish procedure for reviewing comments on published documents;
   b) To form Steering Committee or other Specialist Advisory Groups to give advice On major project; and
   c) To consult the Standards Advisory Council on major projects, agenda decisions and work priorities.

3.5 INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE (IFRIC)

The IFRS Interpretations Committee is the interpretative body of the IFRS foundation which came in to force from April, 2010.

Its mandate is to review on a timely basis various accounting issues that have arisen within the context of current International Financial Reporting Standards (IFRSs). The work of the Interpretation Committee is aimed at reaching consensus on the appropriate accounting treatment (IFRIC Interpretations) and providing authoritative guidance on those related issues.

In developing new interpretation, the interpretations committee works closely with other similar committees. These interpretations cover newly identified financial reporting issues not specially dealt with in IFRSs and issues where unsatisfactory or conflicting interpretations have developed or likely to develop in the absence of guidance. The IFRS Interpretation Committee is comprised of 14 voting members appointed by trustees of IFRS Foundation from a various countries and having variety professional backgrounds. They are selected for their ability to maintain an awareness of current issues as per their technical ability to resolve them.

Till January, 2011 there are 16 Interpretations issued by IFRS Interpretations Committee. These are numbered as IFRIC 1, IFRIC 2, IFRIC

3, IFRIC 4, IFRIC 5, IFRIC 6, IFRIC 7, IFRIC 8, IFRIC 9, IFRIC 10, IFRIC 11, IFRIC 12, IFRIC 13, IFRIC 14, IFRIC 15, IFRIC 16, IFRIC 17, IFRIC 18 and IFRIC 19. An IFRIC interpretation requires IASB approval and has the same authority as a standard issued by IASB.

International Financial Reporting Standards (IFRS): International Financial Reporting Standards (IFRS) is a set of accounting standards developed by an independent non-profit organisation called the International Accounting Standards Board (IASB).

The objective of IFRS is to provide a global framework for how public companies prepare and present their financial statements. Usually IFRS provides general guidance for the preparation of financial statements, rather than setting rules for industry-specific reporting. This International Standard is especially important for large companies that have their subsidiaries in different countries. Only adopting a single set of world – wide standards will simplify accounting principles by allowing an entity to use one reporting language throughout. A single set of standards will also provide investors and auditors with a cohesive view of finances.

By 2015, over 100 countries allow or require IFRS for public companies, with more countries expected to transit to IFRS. By adopting IFRS, an entity can present its financial statements on the same basis as its foreign competitors, making comparisons easier. Companies may also be benefited by using IFRS if they wish to raise capital abroad.

Some of the expert belief that full adoption and global acceptance of IFRS, the certain level of quality will be lost with full. They also believe that the significant costs associated with adopting IFRS outweigh the benefits. It is important to note here that IASB cannot force a nation to adopt these IFRS. It is the participating nation to decide how and when these IRFSs would be adopted.

IFRS is sometime confused with IAS (International Accounting Standards), which are older standards that are replaced by IFRS. The complete list of IFRS is given below:

List of International Financial Reporting Standards (IFRS):

No.	Name	Issue Year
IFRS 1	First time adoption of International Financial Reporting Standard	2008*
IFRS2	Share-based Payment	2004
IFRS3	Business Combinations	2008*
IFRS4	Insurance Contracts	2004
IFRS5	Non-current Assets held for sale and Discontinued Operations	2004
IFRS6	Exploration for and Evaluation of Mineral Assets	2004
IFRS7	Financial Instruments: Disclosures	2005
IFRS8	Operating Segments	2006
IFRS9	Financial Instruments	2014*
IFRS10	Consolidated Financial Statements	2011
IFRS11	Joint Arrangements	2011
IFRS12	Disclosure of Interests in other Entities	2011
IFRS13	Fair Value Measurement	2011
IFRS14	Regulatory Deferral Accounts	2014
IFRS15	Revenue from Contracts with Customers	2014
IFRS16	Leases	2016

Where a pronouncement has been reissued with the same or a different name, the date indicated in the above tables is the date the revised pronouncement was reissued (these are indicated with an asterisk [*] in the tables).

Scope and Process of issuing International Financial Reporting Standards (IFRS): IFRSs are established through a consultation process, the "due process", which includes interested experts and some organisations from around the world. The due process comprises the following stages, with the trustees having the opportunity to ensure compliance at various points throughout.

1) Setting the agenda,
2) Consultation with IFRS Advisory Council,
3) Planning the project,

4) Developing and publishing the discussion paper,
5) Developing and publishing the exposure draft,
6) Developing and publishing the IFRS, and
7) Procedures after the IFRS are issued.

These are discussed below:

1) Setting the agenda: At first IASB sets an agenda adding potential items by reference to the needs of users. For this the IASB consider:

a) Its relevance to users of the information and the reliability of information that could be provided;
b) Whether any existing guidance is available;
c) The possibility of increasing convergence; and
d) Resource constraints.

To help the IASB in considering its future agenda, official staff are asked to identify, review and raise issues that might warrant the IASB's attention.

New issues may also arise from a change in the IASB's conceptual framework. In addition, the IASB discusses potential items in the light of comments from other standard setters and other interested parties.

The IASB receives requests from its constituents to interpret, review or amend existing publications. The technical staffs considers all such requests, summarises major or common issues raised, and present them to the IASB from time to time for review when the IASB is next considering its agenda.

2) Consultations with IFRS Advisory Council: After setting the agenda, the IASB holds a meeting to consult with IFRS Advisory Council to take decisions on the proposed agenda item and setting priorities. In making decisions regarding its agenda priorities, the IASB also considers factors related to its convergence initiatives with accounting standards setters.

3) Planning the Project: When adding an item to its active agenda, The IASB also decides whether to conduct the project alone or jointly with other standard setters. After considering the nature of the issues and the level of interest among constituents, the IASB may establish

a working group at this stage. A team is selected for the project by the two most senior members of the technical staff.

4) **Developing and publishing the discussion paper:** Although publications of discussion paper are not mandatory, the IASB normally publishes it. Before discussion paper is published, issues related to the discussion paper are discussed in IASB meetings and publication of such a paper requires a simple majority vote by the IASB.

   If the discussion paper includes the preliminary views of the other authors, the IASB reviews the draft discussion paper to ensure that its analysis is an appropriate basis on which to invite public comments.

   For discussion papers on agenda items that are under the IASB's direction, or include its preliminary view the IASB develops the paper or its views on the basis of analysis drawn from staff research and recommendations, as well as suggestions made by the IFRS Advisory Council, working groups and standard-setters and presentations from invited parties. All discussions of technical issues related to the draft paper take place in public sessions.

5) **Developing and publishing the exposure draft:** Unlike a discussion paper, an exposure draft sets out a specific proposal in the form of a proposed standard. The development of an exposure draft begins with the IASB considering:

   a) Issues on the basis of staff research and recommendations;
   b) Comments received on any discussion paper; and
   c) Suggestions made by the IFRS Advisory Council, working groups and accounting Standard-setters, arising from public education sessions.

   After resolving issues and its meetings, the IASB instructs the staff to draft the exposure draft. When the draft has been completed and the IASB has balloted on it, the IASB publishes it for public comment.

6) **Developing and publishing the IFRS:** After resolving issues arising from the exposure draft, the IASB holds another round of discussions

to decide whether one more revised proposals on the exposure draft will be made or not. If the IASB in its meeting thinks that re-exposure draft is necessary a due process will be followed for re-drafting and publishing the IFRS. Finally, after the due process is completed, all outstanding issues are resolved, and the IASB members ballots the standard in favour of publication, the IFRS is issued.

7) **Procedure after an IFRS is issued:** After an IFRS is issued, the staff and the IASB members hold regular meetings with interested parties, including other standard-setting bodies, to help understand unanticipated issues related to the practical implementation and potential impact on its proposals.

The IFRS foundation also fosters educational activities to ensure consistency in the application of IFRSs.



CHECK YOUR PROGRESS

Q.3: Mention two objectives of IASB.

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Q.4: State the objectives of IFRS.

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3.6 LET US SUM UP

In this unit we have discussed the following:

- IASCF is renamed as The International Financial Reporting Standards Foundation, or IFRS Foundation. It is a non-profit accounting

organisation. Their principal objective is development and promotion of the IFRS through the International Accounting Standards Board (IASB).

- The objective of IFRS is to provide a global framework for how public companies prepare and present their financial statements. Usually IFRS provides general guidance for the preparation of financial statements, rather than setting rules for industry-specific reporting.
- By adopting IFRS, an entity can present its financial statements on the same basis as its foreign competitors, making comparisons easier.
- Scope and Process of issuing International Financial Reporting Standards (IFRS):
  a) Setting the agenda,
  b) Consultation with IFRS Advisory Council,
  c) Planning the project,
  d) Developing and publishing the discussion paper,
  e) Developing and publishing the exposure draft,
  f) Developing and publishing the IFRS, and
  g) Procedures after the IFRS are issued.



3.7 FURTHER READING

1) Bhattacharya, Ashis. *Financial Accounting*. New Delhi: Prentice hall of India Pvt. Ltd.
2) Dam, B. B. and Gautam, H. C. *Theory and Practice of Financial Accounting*. Guwahati: Capital Publishing Company.
3) Gupta, R. L. and Radhaswamy, M. Accountancy. New Delhi: Sultan Chand & Sons.
4) Maheshwari, S. N. *Financial Accounting*. New Delhi: Vikash Publishing House Pvt. Ltd.



3.8 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: According to T. P. Ghosh "Accounting Standards are the policy document issued by the recognised expert accountancy body relating to various aspects of measurement, treatment and disclosure of accounting transactions and events"

Ans. to Q. No. 2: The objectives of IASCF / IFRS foundation are:

I) To develop in the public interest, a single set of high-quality, understandable and enforceable global accounting standards;

II) To promote the use and rigorous application of those standards.

Ans. to Q. No. 3: The objectives of the IASBs are:

1) To formulate global standards that are transparent, enforceable, understandable and of high quality;

2) To keep or develop under review International Accounting Standard on all major financial reporting issues;

Ans. to Q. No. 4: The objective of IFRS is to provide a global framework for how public companies prepare and present their financial statements. Usually IFRS provides general guidance for the preparation of financial statements, rather than setting rules for industry-specific reporting.



3.9 MODEL QUESTIONS

Q.1: Discuss briefly about International Accounting Standards Committee Foundation (IASCF).

Q.2: Discuss the objectives, functions and responsibilities of IASB.

Q.3: Discuss the scope and process of issuing International Financial Reporting Standards (IFRS).

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UNIT 4: THE CONCEPTUAL FRAMEWORK FOR THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENT

UNIT STRUCTURE

4.1 Learning Objectives

4.2 Introduction

4.3 Scope and Objectives of Conceptual Framework of Accounting

4.4 Application of Conceptual Framework for the Preparation and Presentation of Financial Statements

4.5 Let Us Sum Up

4.6 Further Reading

4.7 Answers To Check Your Progress

4.8 Model Questions

4.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- describe the objectives and responsibilities of IASCF
- describe objectives, functions and responsibilities of IASB
- describe the objectives, scope and process of issuing IFRS.

4.2 INTRODUCTION

This concept was first developed in the House of Commons in the U.K. The Conceptual Framework first appeared in the British Companies Act 1944. Generally “Conceptual Framework” means accumulation of rational and practicable thoughts, which may be ideas, values, beliefs and postulates which intend to explain a particular state of affair. In accounting “Conceptual Framework” means a constitution which helps the preparation and presentation of financial statements. It works as the basis for preparation of books of accounts. As per the Financial Accounting Standard Board (FASB) of USA Conceptual Framework means coherent system of interrelated ‘objectives and the fundamentals’ that can lead to consistent standard.

Conceptual Framework prescribes the nature, function, and limits of financial statements. The goals and purpose of accounting are found out through objectives. Fundamentals are the underlying concepts of accounting that helps the selection of business transaction, events and circumstances to be accounted for. It also includes the recognition of transactions and events and their measurement of recording for accounting purpose. The scope of conceptual framework includes summarising of recorded transaction and their interpretation for the end users.

It should be kept in mind that conceptual framework does not help in solving specific issues and challenges in financial recording and reporting. Conceptual framework fixes the concepts that guide the preparation and presentation of financial statements for external users. It finally guide to the establishment, interpretation and application of accounting and reporting standards.

In India 'Conceptual Framework' has issue by Institute of Chartered Accountant of India.

For the first time, ICAI has issued conceptual framework for the preparation and presentation of financial statements in the year 2000. It is clarified by the ICAI that Framework is not an Accounting Standard and hence does not define standards for any particular measurement or disclosure issue. Framework does not override any specific Accounting Standard. It is stated that if there is a conflict between the Framework and Accounting Standard, the requirements of the Accounting Standard get preference over those of the framework.

4.3 SCOPE AND OBJECTIVES OF CONCEPTUAL FRAMEWORK OF ACCOUNTING

Scope of Conceptual Framework of Accounting: The scope of Conceptual Framework of Accounting issued by ICAI is limited to the following four areas. It deals with–

a) The objectives of financial statement;
b) The qualitative characteristics that determine the usefulness of information provide In financial statements;

c) Definition, recognition and measurement of the elements from which financial Statements are constructed; and

d) Concepts of capital and capital maintenance.

Objectives/Purposes of Conceptual Framework: The objectives/ purpose of the 'Conceptual Framework' issued by the ICAI is to–

1) Assist the preparers of financial statements in applying Accounting Standards and in dealing with topics which are yet to form the subject of an Accounting Standard;
2) Assist the Accounting Standards Board (ASB) in the development of future Accounting Standards and in the process of its review of existing Accounting Standards;
3) Assist ASB in promoting harmonisation of regulations, accounting standards and procedures relating to the preparation and presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permitted by Accounting Standards;
4) Assist the auditors in forming an opinion as to whether financial statements conform with Accounting Standards;
5) Assist users of financial statements in interpreting the information contained in financial statements prepared in conformity with Accounting Standards; and
6) Provide those who are interested in the work of the Accounting Standards Board with information about its approach to the formulation of Accounting Standards.



CHECK YOUR PROGRESS

Q.1: What is meant by Conceptual Framework in accounting terminology?.

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Q.2: Mention two objectives of the 'Conceptual Framework' issued by the ICAI.

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4.4 APPLICATION OF CONCEPTUAL FRAMEWORK FOR THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

The Conceptual Framework generally concerned with general purpose financial statements. It is applied in the preparation and presentation of general purpose financial statements. Such financial statements are prepared and presented at least annually and are directed towards the common information needs of a wide range of users. Some of these users may require and have the power to obtain information in addition to that contained in the financial statements. Many users, however, have to rely on the financial statements as their major source of financial information and such financial statements should, therefore, be prepared and presented with their needs in view.

Financial statements form a part of the process of financial reporting. Usually, a complete set of financial statements normally includes a balance sheet, a statement of profit and loss, a cash flow statement and those notes and other statements and explanatory material that are integral part of the financial statements. The framework applies to the financial statements of all reporting enterprises engaged in commercial, industrial and business activities, whether in the public or in the private sector. A reporting enterprise is an enterprise for which there users who rely on the financial statements as their major source of financial information about the enterprise. It should be remembered that the information needs of all the users cannot be met

by financial statements, but most of the needs are common to all users. The financial statements is provide information about the financial position, performance and cash flows of an enterprise that is useful to wide range of users in making economic decisions. Financial statements prepared for the purpose to meet the common needs of most users. However, financial statements do not provide all the information that users may need to make economic decisions. In this context the objectives of general purpose financial reporting as pronounced by the IASB in its recent revision (2013) of 'The Conceptual Framework for Financial Reporting' is worth mentioning. It has issued the objective of general purpose financial reporting in the following way:

"The objectives of general purpose financial reporting are to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or selling loans and other forms of credit. Many existing and potential investors, lenders and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial reports for much of the financial information they need. Consequently, they are the primary users to whom general purpose financial reports are directed.

General purpose financial reports do not and cannot provide all of the information that potential investors, lenders and other creditors need. In order to meet their objectives, financial statements are prepared on the accrual basis of accounting. Accrual accounting depicts the effects of transactions and other events and circumstances on a reporting entity's economic resources and claims in the periods in which those effects occur, even if the resulting cash receipts and payments occur in a different period. This is important because information about a reporting entity's economic resources and claims and changes in its economic resources and claims during a period provides a better basis for assessing the entity's past and future performance than information solely about cash receipts and payments during that period.

The financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future."

MEANING OF FINANCIAL STATEMENTS:

In ordinary sense, Financial Statements means a statement relating to financial matter. But in accounting, the term is specifically used to refer to the two statements which the accountant prepares at the end of a period of time for a business enterprise (Mayer, 1978). They are the Balance Sheet or a statement of financial position, and the revenue or Income Statement or Statement of Profit and Loss. These two statements usually show the figures for the current year and the immediate preceding year. Balance Sheet reflects the assets, liabilities, capital and retained earnings as on a certain date and the Statement of Profit and Loss shows the results of operations during a certain period. This information is usually supplemented with schedules (only for the current year or reporting year). Such schedules show a little more information for the use of the interpreter. These are the schedules of capital, plant and machinery, land and building, current assets, current liabilities, long term loan, debenture reserve and surplus etc.

Financial statements are the records that reflect the financial activities of a business, an individual or any other organisation. Financial statements are meant to present the business information as clearly and concisely as possible for both the entity and for user groups. Financial statements for an entity include Statement of profit and loss and Balance Sheet.

DEFINITIONS OF FINANCIAL STATEMENTS:

In the words of John N. Myer, "The financial statements provide a summary of the accounts of a business enterprise, the balance sheet reflecting the assets, liabilities and capital as on a certain date and the income statement showing the results of operations during a certain period." According to W. B. Meig, "Financial statements are organised summaries of detailed information and are thus a form of analysis. The type of statements accountants prepare, the way they arrange items on these statements and their standards of disclosure are all influenced by a desire to provide information in a convenient for."

According to the American Institute of Certified Public Accountants (AICPA), "Financial statements reflect a combination of recorded facts; accounting conventions and personal judgements and the judgements and conventions applied affect them recorded facts, according to conventions and personal judgements." Financial statements are prepared as an end result of financial accounting and are the major sources of financial information of an enterprise.

According to Section 2(40) of the Companies Act, 2013 "financial statement" in relation to a company, includes–

- A balance sheet as at the end of the financial year;
- A statement of profit and loss, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;
- Cash flow statement for the financial year;
- A statement of changes in equity, if applicable; and
- Any explanatory note annexed to, or forming part of, any document referred to In sub-clause (i) to sub-clause (iv).

However, the financial statement prepared and present in respect to One Person Company (OPC), Small Company and Dormant Company, may not include the cash flow statement i.e. there is an exemption given to above mentioned company under the Companies Act from preparing the cash flow statement for the purpose of inclusion in financial statement.

Financial statements provide information on the various elements of financial statements like assets, liabilities, capital, revenue and expenses and the net result of operation during the financial period. In order to make the information more useful and meaningful, such elements which form a part of financial statements have to be analysed in a systematic manner. Financial statements analysis is largely a study of relationships among the various financial factors in a business as disclosed by a single set of statements. Analysis of financial statements is a study of relationship among various financial facts and figures as include in financial statement, i.e. Balance Sheet and Statement of Profit and Loss.

OBJECTIVES OF FINANCIAL STATEMENTS:

The objectives of financial statements are to present true and fair view of financial position and income statement for the use of its users. The different users group are using financial statements. They need different types of information as per their requirements. Therefore, the major objectives of financial statements are fulfilling the needs of such users. Even though, some of the objectives are briefly explained below:

1) **Knowing Profitability of Business:** Financial statements are required to ascertain Whether the business is earning adequate profit and to know whether the profits have increased or decreased as compared to the previous year, so that corrective measures can be taken well in advance.
2) **Examining the Solvency of the Business:** Financial statements help to analyse the position of the business in respect of the capacity of the enterprise to repay its short term as well as long term liabilities.
3) **Judging the Growth of the Business:** Through comparison of data of two or more years of enterprise or comparison with other firm, we can draw a meaningful conclusion in respect of the business. For example, increase in revenue from operation with simultaneous increase in the profits of the business, indicates a healthy sign for the growth of the business.
4) **Judging the Financial Strength of the Business:** Financial statements help the entity in determining solvency of the business and help to answer various aspects viz, whether it is capable to purchase assets from its own resources and/or whether the entity can repay its outside liabilities as and when they become due.
5) **Selection of Appropriate Policy:** To make a comparative study of the profitability of the entity with other entities engaged in the same trade, financial statements help the management to adopt sound business policy by making intra firm comparison.
6) **Forecasting and Preparing Budgets:** Financial statements help us to find out the weak spots of the business so that the management can take necessary arrangement to remove these short comings.

Financial statements help the management to make forecast and prepare budgets.

7) **Communicating with Different Parties:** Financial statements are prepared in order to communicate with different parties about their financial position. It can be said that the basic financial statements are a necessary step towards the successful management of a commercial enterprise.

Users of Financial Statements: The information disclosed in financial statements is very useful to a number of parties. These users may be grouped as Internal Users and External Users. These are described as below:

A) Internal Users:

1) Owners: Owner provides capital and bears all the risk of the enterprise. Therefore, owner wants to know whether their funds are being properly utilised or not. He/ She wants to know about fund position, profit position, position of assets and liabilities etc. which they get from financial statements. They need information to guide them to determine whether they should buy, hold sells their securities. They are also interested in information which enables them to assess the ability of the entity to pay dividend.
2) Managers: Accounting information are significant to managers for the purpose of Planning, decision making, controlling, motivating, directing and monitoring the functioning of an enterprise.
3) Employees: Generally employees are interested in financial information in order to assess the stability of their employment, to lodge their claim for hike in wage, share in profit, bonus etc.

B) External Users:

1) Creditors: Creditors and suppliers of materials use accounting information to ascertain to short term liquidity, long term liquidity or solvency position, the ability of the entity to repay the amount in scheduled time and the earning capacity.
2) Bankers and Lenders: Bankers and lenders who advance money to a business entity are interested in financial statements to ascertain the short term and long term debt servicing capacity

of the business entity. Short term lenders are interested in liquidity position and long term lenders are interested in solvency position of the borrowing entity.

3) Investors: Investors are interested in accounting information to determine the regularity of receiving income on investment and safety of their investment in the business entity. For this purpose, they require various information from financial statements such as the amount of equity investment, long term debt, net profit, preference dividend, debenture interest etc.

4) Consumers: Consumers use financial information to safeguard their interest in regard to quality of products, price charged and to uphold the consumer movement.

5) Government and Regulatory Agency: Government and regulatory agency are interested in financial information in order to assess, levy and collect sales tax, excise duty, custom duty, income tax, wealth tax etc. Financial information are also useful to government in formulating industrial policy, fiscal policy for business, other connected legislation for controlling and monitoring the working of business enterprise. Other regulatory authorities.



CHECK YOUR PROGRESS

Q.3: Mention two objectives of financial statements.

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Q.4: Mention two external and internal users of financial statements.

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4.5 LET US SUM UP

In this unit we have discussed the following:

- In accounting "Conceptual Framework" means a constitution which helps the preparation and presentation of financial statements
- As per the Financial Accounting Standard Board (FASB) of USA Conceptual Framework means coherent system of interrelated 'objectives and the fundamentals' that can lead to consistent standard.
- Conceptual Framework prescribes the nature, function, and limits of financial statements.
- In India 'Conceptual Framework' has issue by Institute of Chartered Accountant of India.
- The objectives of general purpose financial reporting are to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.
- The financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future.

- The objectives of financial statements are to present true and fair view of financial position and income statement for the use of its users.



4.6 FURTHER READING

1) Bhattacharya, Ashis. *Financial Accounting*. New Delhi: Prentice hall of India Pvt. Ltd.
2) Dam, B. B. and Gautam, H. C. *Theory and Practice of Financial Accounting*. Guwahati: Capital Publishing Company.
3) Gupta, R. L. and Radhaswamy, M. Accountancy. New Delhi: Sultan Chand & Sons.
4) Maheshwari, S. N. *Financial Accounting*. New Delhi: Vikash Publishing House Pvt. Ltd.



4.7 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: In accounting "Conceptual Framework" means a constitution which helps the preparation and presentation of financial statements. It works as the basis for preparation of books of accounts.

Ans. to Q. No. 2: The objectives of the 'Conceptual Framework' issued by the ICAI are to:

1) Assist the preparers of financial statements in applying Accounting Standards and in dealing with topics which are yet to form the subject of an Accounting Standard;
2) Assist the Accounting Standards Board (ASB) in the development of future Accounting Standards and in the process of its review of existing Accounting Standards.

Ans. to Q. No. 3: a) Knowing Profitability of Business: Financial statements are required to ascertain Whether the business is earning adequate profit and to know whether the profits have increased or decreased as compared to the previous year, so that corrective measures can be taken well in advance.

b) Examining the Solvency of the Business: Financial statements help to analyse the position of the business in respect of the capacity of the enterprise to repay its short term as well as long term liabilities.

Ans. to Q. No. 4: a) External Users: Creditors and suppliers of materials use accounting information to ascertain to short term liquidity, long term liquidity or solvency position, the ability of the entity to repay the amount in scheduled time and the earning capacity.

b) Internal Users: Owner provides capital and bears all the risk of the enterprise. Therefore, owner wants to know whether their funds are being properly utilised or not. He/ She wants to know about fund position, profit position, position of assets and liabilities etc. which they get from financial statements. They need information to guide them to determine whether they should buy, hold sells their securities. They are also interested in information which enables them to assess the ability of the entity to pay dividend.



4.8 MODEL QUESTIONS

Q.1: Discuss the scope of Conceptual Framework of Accounting issued by ICAI.

Q.2: Explain briefly the objectives of financial statements.

Q.3: Write a short note on internal and external users of financial statements.

Q.4: Discuss the objectives of Conceptual Framework of Accounting.

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UNIT 5: REGULATORY FRAMEWORK AND NATIONAL DIFFERENCES

UNIT STRUCTURE

5.1 Learning Objectives

5.2 Introduction

5.3 Relevant Provisions of Companies Act, 2013 in Regard to the Preparation and Presentation of Profit and Loss Account and Balance Sheet

- 5.3.1 Maintenance of Accounts (Section 128)
- 5.3.2 Financial Statements (Section 129)
- 5.3.3 Re-opening of Accounts on Court's or Tribunal's Orders (Section 130)
- 5.3.4 Voluntary Revision of Financial Statements or Board's Report (Section 131)
- 5.3.5 Constitution of National Financial Reporting Authority (NFRA) (Section 132)
- 5.3.6 Central Government to Prescribe Accounting Standards (Section 133)
- 5.3.7 Financial Statements, Board of Directors Report, etc. (Section 134)
- 5.3.8 Corporate Social Responsibility (CSR) (Section 135)
- 5.3.9 Right of Members to Copies of Audited Financial Statements (Section 136)
- 5.3.10 Copy of Financial Statements to be Filed with Registrar of Companies (Section 137)
- 5.3.11 Internal Audit (Section 138)

5.4 National Differences in Accounting Practices

5.5 Differences Observed in the Accounting System Across Countries

5.6 Factors Responsible for Differences in a Nation's Financial Reporting Practices

5.7 Problems Arising due to National Differences in Financial Reporting Practices

5.8 Let Us Sum Up
5.9 Further Reading
5.10 Answers to Check Your Progress
5.11 Model Questions

5.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- discuss the various regulatory framework for financial reporting
- discuss the factors responsible for national differences in accounting practices
- explain the problems arising due to national differences in financial reporting practices.

5.2 INTRODUCTION

Accounting has become a requirement for the preparation and presentation of financial statements. Financial statements are the important and basic means through which the corporate management communicates financial information to the various interested groups. Therefore, the primary objectives of a corporate entity are to preparation and presentation of financial statements. A financial statements generally includes balance sheet, statement of profit and loss, cash flow statements and some essential schedules thereof. The basic objectives of the preparation and presentation of financial statements is to provide information about financial position and performance of an entity that is beneficial to a wide range of users.

Proper and accurate compilation of financial information of a corporate entity and its disclosure through financial statements is in a manner that is uniform and understood by stakeholders. It is a significant importance to the credibility of the entity and soundness of investment decisions by the investors. Therefore, the preparation of financial statements needs to be regulated through law. It would however, not be possible for the law to prescribe all the details guidelines of the treatment of the subject. The requirement is proper disclosures of financial information through financial statements in

the interest of healthy corporate governance. However, once developed, use of such principles should be mandated through law.

5.3 RELEVANT PROVISIONS OF COMPANIES ACT, 2013 IN REGARD TO THE PREPARATION AND PRESENTATION OF PROFIT AND LOSS ACCOUNT AND BALANCE SHEET

Financial statements of companies in India are required to be presented by the board of directors at the annual general meetings of the company in accordance with the provisions of section 128 to section 138 of the Companies Act, 2013, which deals with preparation and presentation of Profit and Loss Statement and Balance Sheet of the company.

5.3.1 Maintenance of Accounts (Section 128)

Section 128 of the Companies Act, 2013 provides for books of accounts to be maintained by the company. This section provides that every entity shall prepare and keep at its registered office and at its branches such books of account and other relevant papers as may be prescribed. The entity can also maintain such books and records in the electronic mode. It is clearly mentioned in the section that the books of accounts should be kept under accrual basis and according to the double entry system. The section also provides that the entity shall retain the books of accounts with the relevant vouchers and other relevant financial records for a period of 8 financial years. Recently, the government of India has issued some draft rules framed under the New Act for public comments. Draft Rules 9.1 and 9.2 deal with procedure for maintenance of accounts by Companies.

It may be noted that for the first time new Section 2(41) defines the term “Financial Year” to mean the period ending 31st March of every year. Therefore, every company will now be required to maintain accounts from 1st April to 31st March which is the accounting year to be adopted for income tax purpose. There is only one exception to this rule that in the case of a holding company or subsidiary company

incorporated outside India which is required to maintain its accounts for a financial year which is different from 1st April to 31st March. In such case, different financial year can be adopted by getting approval of the National Company Law Tribunal (NCLT).

5.3.2 Financial Statements (Section 129)

Section 129 provides for preparation of financial statements. The term 'Financial Statement' is defined in the new Section 2(40) to include balance sheet, profit and loss account or income and expenditure account, cash flow statement, statement of changes in equity and any explanatory note annexed to the above. Section 2(40) has come into force 12-09-2013. New section 129 corresponds to existing Section 210. It provides that the financial statements shall give a true and fair view of the state of affairs of the company and shall comply with the accounting standards notified under new Section 133. It also provided that the financial statements shall be prepared in the form provided in new Schedule, i.e. Schedule III of the Companies Act, 2013.

It may be noted that in the new schedule III the provisions for preparation of balance sheet and statement of profit and loss have been given which are on the same lines as in the existing revised schedule VI. Further, in the new schedule detailed instructions have been given for preparation of consolidated financial statements as consolidation of accounts of subsidiary companies is now made mandatory in section 129.

It may be noted that of the first time a provision has been made in the new Section 129(3) that if a company has one or more subsidiaries it will have to prepare a consolidated financial statement of the entity and of all the subsidiaries in the form provided in the new schedule III. The company has also to attach along with its financial statement, separate statement containing the silent features of the financial of the subsidiary entity in such form as may be prescribed by the rules. It is also provided that if the company has interest in

any associate entity as well as joint venture shall be consolidated. For this reason "associate company" has been defined in new section 2(6) to mean a entity in which the reporting entity has significant influence i.e. it has control of at least 20% of the total share capital of the entity or has control on the business decisions under an agreement. The Central Government has power to exempt any class of companies from complying with any of the requirements of this section and the rules made under the section.

5.3.3 Re-opening of Accounts on Court's or Tribunal's Orders (Section 130)

Section 130 provides for the manner in which a company can reopen or recast its books of account or financial statements. This is a new provision made in the entity legislation for the first time. Earlier the accounts once adopted by the members of the company at the AGM cannot be reopened or recast.

Section 130 provides that if it is found that: (i) the accounts for the particular year were prepared in a fraudulent manner or (ii) the affairs of the entity were mismanaged during the relevant period casting a doubt on the reliability of financial statements, an application will have to be made by the Central Government, the income tax Authorities, the SEBI, any other statutory regulatory body or authority or any concerned party to a competent Court or Tribunal. On receipt of the order of the Court/Tribunal the entity will have to reopen its accounts or recast its financial statements in conformity with the order. The accounts so revised or recast shall be considered as final.

5.3.4 Voluntary Revision of Financial Statements or Board's Report (Section 131)

Section 131 provides for voluntary revision of financial statements or Director's Report under section, if it appears to the directors that: (i) financial statement or (ii) report of Board of Directors for a particular financial year does not comply with the provisions of

new section 129 or 134, they can revise the financial statement or director's report in respect of any of the three preceding financial years. For this purpose the directors have to make an application to the Tribunal in the prescribed manner and obtain its order. Before giving such an order the tribunal has to give notice of hearing to the central Government and to the Income Tax Authorities. It is also provided that such revised financial statements or report of directors shall such revision will have to be disclosed by the directors in their report to the members in the relevant financial year in which revision is made.

The Central Government has been authorised to make Rules about the procedure for such voluntary revision of financial statements and directors report. These rules will also provide for reporting requirements applicable ot the auditors of the entity. Draft rules 9.5 to 9.8 provide for the procedure to be followed by the entity for this reason.

5.3.5 Constitution of National Financial Reporting Authority (NFRA) (Section 132)

Section 132 of the Companies Act, 2013, the Central Government has introduced a new regulatory authority named as National Financial reporting Authority (NFRA) with wide powers to recommend, enforce and monitor the compliance of accounting and auditing standards. The National Advisory Committee on Accounting Standards **(NACAS)** of previous Companies Act, 1956 is now being renamed with enhanced power and authority as National Financial Reporting Authority **(NFRA).**

NFRA has responsible for monitoring and enforcing compliance of auditing and accounting standards and for that reason, oversee the quality of professions associated with ensuring such compliances. The authority shall investigate professional and other misconducts which may be committed by Chartered Accountancy members and firms. There is also a provision for appellate authority.

The NFRA shall be a quasi-judicial body to regulate matters related to accounting and auditing. With increasing demand of non-financial reporting it may be referred to as a national level business reporting authority to regulate standards of all kind of reporting by the entity in future. The authority will also change the way of notifying of Accounting and Auditing Standards as is evident from provisions of clauses 133 and 143 of the Companies act, 2013.

The constitution of NFRA, which is supposed to be constituted as an oversight regulatory body to recommend accounting and auditing standards, shall be governed by sub Section (3) and (4) of Section 132.

- It shall consist of a chairperson, who shall be a person of eminence and having expertise in accountancy, auditing, finance, business administration, business law, economics or similar disciplines, to be nominated by Central Government, and such other prescribed members not exceeding 15.
- The chairperson and all members shall make a declaration in prescribed form about no conflict of interest or lack of independence in respect of their appointment. The chairperson and all full-time members shall not be associated with any audit firm or related consultancy firm during course of their appointment and two years after ceasing to hold such appointment.
- The head office of **NFRA** shall be at New Delhi and it may, meet at such other places in India, as it deems fit.
- Its accounts shall be audited by **Comptroller and Auditor General of India (CAG**) and such accounts as certified by **CAG**, Together with audit report, shall be forwarded annually to the Central Government.

Objectives of NFRA: The following are the main objectives of National Financial Reporting Authority–

- Make recommendations on formulation of accounting and auditing policies and standards for adoption by entities or their auditors;

- Monitor and enforce the compliance with accounting standards, monitor and enforce the compliance with auditing standards;
- Oversee the quality of service of professionals associated with ensuring compliance with such standards and suggest measures required for improvement in quality of service, and
- Perform such other functions as may be prescribed in relation to aforementioned objectives.

These above objectives simply bring chartered accountants, cost accountants, management accountants, company secretaries as well as independent directors/ members audit committee under jurisdiction of NFRA.

5.3.6 Central Government to Prescribe Accounting Standards (Section 133)

The Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in constitution with and after examination of the recommendations made by the NFRA.

5.3.7 Financial Statements, Board of Directors Report, etc. (Section 134)

According to **Section 2(40**) of the **Companies Act, 2013**, Financial Statements in relation to a company includes:

i) **Balance Sheet** as at the end of the financial year;
ii) **Profit and loss account**, or in case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;
iii) **Cash Flow Statement** for the financial year;
iv) **Statement of changes in equity**, if applicable; and
v) **Any explanatory note(s)** forming part of above.

The Board's report/ Directors Report is a document produced by the board of directors which details the state of the company and

its compliance with a set of financial accounting and corporate social responsibility standards. According to Companies Act, 2103, following are the provisions related to financial statements, Board's report etc.:

1) The financial statements (including consolidated financial statements, if any) shall be approved by the Board of Directors. Financial statements shall be signed by the chairperson of the company where he is authorised by the Board or by two directors out of which one shall be managing director and the chief Executive Officer, if he is a director in the company, wherever they are appointed.
2) In case of One Person Company, only by one director, for submission to the auditor for his report thereon.
3) The auditor' report shall be attached to every financial statement.
4) There shall be attached to statements laid before a company in general meeting, a report by its Board of Directors, which shall include–
    a) Extract of the annual return.
    b) Number of meeting of the Board.
    c) Directors' responsibility statement.
    d) A statement on declaration given by independent directors;
    e) Company's policy on Directors' appointment and remuneration u/s 178;
    f) Explanation or comments by the Board on every qualification, reservation or adverse remark or disclaimer made in audit report and secretarial audit report;
    g) Particulars of loans, guarantees or investments u/s 186;
    h) Particulars of contracts or arrangements with related parties in Form AOC-2;
    i) The state of company's affairs;
    j) Amount which it proposes to carry to any reserves;
    k) Amount which it recommends should be paid by way of dividend;
    l) Material changes and commitments affecting the financial position of the company which have occurred between the

end of the financial year of the company and the date of the report;

m) Conservation of energy, technology absorption, foreign exchange earnings and outgo;

n) Development and implementation of a risk management policy;

o) Policy developed has been made by the Board of its own performance and that of its committees and individual directors (for listed company having paid up capital of Rs. 25 crore);

p) Such other matters as may be prescribed.

5) The report of the Board of Directors to be attached to the financial statements under this section shall, in case of one person company, mean a report containing explanation or comments by the board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report.

6) The Directors' Responsibility Statement shall state that–

a) In the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;

b) The Directors had selected such accounting policies and applied them consistently and made judgements and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period;

c) The Directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and preventing and detecting frauds and other irregularities;

d) The directors had prepared the annual accounts on a going concern basis; and

e) In case of listed company, the directors has laid down internal financial controls to be followed by the company and that such

internal financial controls are adequate and were operating effectively;

f) The directors had introduced proper system to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively;

g) The Board's report and any annexure thereto under sub-section(3) shall signed by its chairperson of the company if he is authorised by the Board and where he is not so authorised, shall be signed by at least two directors, one of whom shall be a managing director, or by the director where there is one director.

h) A signed copy of financial statement (including consolidated financial statement, if any) shall be issued, circulated or published along with a copy each of–

   i) Any notes annexed to or forming part of such financial statement;

   ii) The auditor's report; and

   iii) The Board's report reffered to in sub-section (3).

i) If a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to twenty five lakh rupees and every officer of the company who is an default shall be punish bale with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakhs rupees, or with both.

5.3.8 Corporate Social Responsibility (CSR) (Section 135)

1) Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility committee of

the Board consisting of three or more directors, out of which at least one director shall be an independent director.

2) The Board's report u/s 134(3) shall disclose the composition of the Corporate Social Responsibility Committee.
3) The Corporate Social Responsibility committee shall–
   - Formulate and recommend to the Board, a corporate social responsibility policy which shall indicate the activities to be undertaken by the company as specified in schedule VII.
   - recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and
   - monitor the Corporate Social responsibility Policy of the company from time to time.
4) The Board of every company referred to in sub-section (1) shall–
   a) after taking into account the recommendation made by the corporate Social Responsibility Committee approve the CSR Policy for the company and disclose contents of such policy in its report and also place it on the company's website, if any, in such manner as may be prescribed, and
   b) ensure that the activities as are included in CSR Policy of the company are undertaken by the company.
5) The Board of every company referred shall ensure that the company spends, in every financial year, at least two percent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its CSR Policy. Company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for CSR activities. Provide further that if the company fails to spend such amount, the Board shall, in its report the reasons for not spending the amount. (Explanation – for the purpose of this section 'average net profit' shall be calculated in accordance with the provision of section 198.)

5.3.9 Right of Members to Copies of Audited Financial Statements (Section 136)

Financial statements includes consolidated financial statements, if any, auditor's report and every other document required by law to be annexed or attached to the financial statements, which are to be laid before a company in its general meeting, shall be sent to every member of the company, tom every trustee for the debenture holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled, not less than twenty one days before the date of the meeting.

For listed companies, the provisions of this section shall be deemed to be complied with, if the copies of the documents are made available for inspection at its registered office during workings hours for a period of twenty one days before the date of the meeting and a statement containing the salient features of such documents in the prescribed form or copies of the documents, as the company may deem fit, is sent to every member of the company and to every trustee for the holders of any debentures issued by the company not less than twenty one days before the date of the meeting unless the shareholders ask for full financial statements. Listed company shall also place its financial statements including consolidated financial statements, if any, and all other documents required to be attached thereto, on its website. Each and every company having a subsidiary or subsidiaries shall–

a) Place separate audited accounts in respect of each of its subsidiary on its website, if any;
b) Allot a copy of separate audited financial statements in respect of each of its subsidiary, to any shareholders of the company who ask for it.

A company shall provide every member or trustee of the holder of any debentures issued by the company to inspect the documents stated at its registered office during the business hours. In case of

default made in comply with the provisions, the company shall be liable to a penalty of rupees twenty five thousand and every officer of the company who is in default shall be liable to a penalty of five thousand rupees.

5.3.10 Copy of Financial Statements to be Filed with Registrar of Companies (Section 137)

A copy of financial statements along with consolidated financial statement, if any, along with all the documents which are required to be or attached to such financial statements under this Act, duly adopted at the annual general meeting of the company, shall be filed with the registrar within the thirty days of the date of annual general meeting. This filling is permitted with additional fees for a longer period [Section 403].

In case of un-adopted financial statement, if any shall also filled with other required documents with the registrar within the thirty days of the date of annual general meeting and the registrar shall taken them in his record as provisional till the financial statements are filled with him after adoption in the adjourned annual general meeting for the purpose.

In case of one man company shall file a copy of the financial statement duly adopted by its member, along with all the required documents to be attached to such financial statements, within one hundred eighty days from the closure of the financial year.

A company which have been incorporated outside India and which have not established their place of business in India, shall along with its financial statements to be filed with the registrar, attach the accounts of its subsidiary(ies).

In case not holding annual general meeting for any year, financial statements along with other required documents to be attached, duly signed along with the facts and reasons for not holding the meeting shall be filed with the registrar within thirty days of the last date before which the annual general meeting should have been held.

If a company fails to file a copy of financial statements before the expiry of the period specified in section 403, the company shall be punishable with fine of one thousand rupees for every day during which the failure continues but which shall not more than ten lakhs rupees and all the officer in charge for this duties who is charged by the Board with the responsibility of complying with the provisions in this section, shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakhs rupees but which may extend to five lakhs rupees, or both.

5.3.11 Internal Audit (Section 138)

A company as may be prescribed under this Act, shall be required to appoint an internal auditor, who shall either be a chartered accountant or cost accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company. The Central Government may, by rules, prescribe the manner and the interval in which the internal audit shall be conducted and reported to the Board.



CHECK YOUR PROGRESS

Q.1: Mention two objectives of NFRA.

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Q.2: Define Financial Statements.

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5.4 NATIONAL DIFFERENCES IN ACCOUNTING PRACTICES

The practice of recording and reporting financial transactions in financial statements varies from nation to nation. The reason for differences in accounting system is basically influenced by every country's own financial system, economic condition, GDP, level of national income, per capita income etc. Each nation's accounting system is shaped by the environment in which it operates. But, it would not be viable practice for nations to sustain differences in their accounting system for long due to globalisation. Because of globalization of capital markets, the lack of comparability has become a problem as transnational financing and transnational investments have grown rapidly in recent decades. Globalisation has urged business enterprises to expand across the world and has been demanding the business enterprises to evolve a common accounting system for all nations. And the emergence of IFRS as universal business language for financial reporting, is an outcome of the arising need to bring uniformity in accounting practices.

But it would not be easy for many nations to change their accounting system in accordance to accounting practices directed by IFRS. Accordingly, many nations converged or modified their accounting principles to the tune of IFRS without deviating much from existing accounting practices. National difference in financial reporting exists, but IFRS has contributed immensely to reduce it to a considerable extent.

5.5 DIFFERENCES OBSERVED IN THE ACCOUNTING SYSTEM ACROSS COUNTRIES

Differences that are usually observed in the accounting system across countries in the following areas:

1) Disclosure requirements
2) Constituents of financial statements included in an annual report
3) Accounting Terminology
4) Recognition and measurement
5) Format used to present individual financial statements
6) Details to be provided in the financial statements.

5.6 FACTORS RESPONSIBLE FOR DIFFERENCES IN A NATION'S FINANCIAL REPORTING PRACTICES

A survey of the relevant literature has pointed out five factors commonly responsible for differences in a nation's financial reporting practices: legal system, taxation, providers of financing, inflation, and political and economic ties.

5.7 PROBLEMS ARISING DUE TO NATIONAL DIFFERENCES IN FINANCIAL REPORTING PRACTICES

1) **Preparation of Consolidated Financial Statements:** The diversity in accounting practice across countries causes problems that can be quite serious for some parties. One problem relates to the preparation of consolidated financial statements by companies with foreign operations. Each subsidiary incorporated in the country in which it is located is required to prepare financial statements in accordance with local regulations. These regulations usually require companies to keep books in local currency using local accounting principles. Each foreign operation must either maintain two sets of books prepared in accordance with both local and parent company's nation's accounting system. In either case, considerable effort and cost are involved; company personnel must develop an expertise in more than one country's accounting standards.
2) **Access to Foreign Markets:** If a company desires to obtain capital by selling stock or borrowing money in a foreign country, it might be required to present a set of financial statements prepared in accordance with the accounting standards in the country in which the capital is being obtained.
3) **Comparability of Financial Statements:** National differences in financial reporting practices results in lack of comparability of financial statements between companies from different countries. This can significantly affect the analysis of foreign financial statements for

making investment and lending decisions. A lack of comparability of financial statements also can have an adverse effect on corporations when making foreign acquisition decisions.

4) **Quality of Accounting Information:** Many countries do not have appropriate accounting system to produce good quality financial reports. It will severely affect the overall quality of accounting information.

Due to above mentioned problems associated with accounting practices across the globe, attempts to reduce the accounting differences across countries have been ongoing for over three decades. This process is known as harmonization. The ultimate goal of harmonization is to have one set of international accounting standards that are followed by all companies around the world.



CHECK YOUR PROGRESS

Q.3: Mention the areas where differences are usually observed in the accounting system across countries.

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Q.4: Mention the factors responsible for differences in a nation's financial reporting practices.

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5.8 LET US SUM UP

In this unit we have discussed the following:

- Financial statements of companies in India are required to be presented in accordance with the provisions of section 128 to section 138 of the Companies Act, 2013.
- National difference in financial reporting exists, but IFRS has contributed immensely to reduce it to a considerable extent.
- Differences that are usually observed in the accounting system across countries in the following areas:
  - Disclosure requirements
  - Constituents of financial statements included in an annual report
  - Accounting Terminology
  - Recognition and measurement
  - Format used to present individual financial statements
  - Details to be provided in the financial statements
- factors commonly responsible for differences in a nation's financial reporting practices: legal system, taxation, providers of financing, inflation, and political and economic ties.
- Problems arising due to national differences in financial reporting practices
  - Preparation of Consolidated Financial Statements
  - Access to foreign markets:
  - Comparability of Financial Statements
  - Quality of Accounting Information



5.9 FURTHER READING

1) Bhattacharya, Ashis. *Financial Accounting*. New Delhi: Prentice hall of India Pvt. Ltd.

2) Dam, B. B. and Gautam, H. C. *Theory and Practice of Financial Accounting*. Guwahati: Capital Publishing Company.
3) Gupta, R. L. and Radhaswamy, M. Accountancy. New Delhi: Sultan Chand & Sons.
4) Maheshwari, S. N. *Financial Accounting*. New Delhi: Vikash Publishing House Pvt. Ltd.



5.10 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: The following are two objectives of National Financial Reporting Authority–

1) Make recommendations on formulation of accounting and auditing policies and standards for adoption by entities or their auditors;
2) Monitor and enforce the compliance with accounting standards, monitor and enforce the compliance with auditing standards;

Ans. to Q. No. 2: The term 'Financial Statement' is defined in the new Section 2(40) to include balance sheet, profit and loss account or income and expenditure account, cash flow statement, statement of changes in equity and any explanatory note annexed to the above.

Ans. to Q. No. 3: Differences that are usually observed in the accounting system across countries in the following areas:

1) Disclosure requirements
2) Constituents of financial statements included in an annual report
3) Accounting Terminology
4) Recognition and measurement
5) Format used to present individual financial statements
6) Details to be provided in the financial statements.

Ans. to Q. No. 4: Five factors commonly responsible for differences in a nation's financial reporting practices: legal system, taxation, providers of financing, inflation, and political and economic ties.



5.11 MODEL QUESTIONS

Q.1: Explain the relevant provisions of Companies Act, 2013 in regard to the preparation and presentation of Profit and Loss Account and Balance Sheet.

Q.2: Discuss the various problems arising due to national differences in financial reporting practices

Q.3: Write briefly about NFRA.

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UNIT 6: CONSOLIDATED FINANCIAL STATEMENTS

UNIT STRUCTURE

6.1 Learning Objectives

6.2 Introduction

6.3 Concept of 'Group', 'Holding Companies', and 'Subsidiary Companies'

6.4 Types of Holding Companies and Subsidiary Companies

6.5 Meaning of Consolidated Financial Statements

6.6 Advantages of Consolidated Financial Statements

6.7 Legal Requirements on Consolidation

6.8 Meaning of Minority Interest

6.9 Calculation of Minority Interest

6.10 Inter-Company Transactions

6.11 Inter-Company Holding

6.12 Treatment of Preference Shares of Subsidiary Company

6.13 Bonus Shares

6.14 Cost of Control or Capital Reserve

6.15 Capital Profits and Revenue Profits

6.16 Let Us Sum Up

6.17 Further Reading

6.18 Answers To Check Your Progress

6.19 Model Questions

6.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- explain the meaning of 'Group', 'Holding Companies' and 'Subsidiary Companies'
- explain the meaning of Minority Interest
- calculate Minority Interest
- elaborate the meaning and need of Consolidated Financial Statements
- describe the legal requirements on Consolidation.

6.2 INTRODUCTION

Now-a-day, no company is self-dependent for supply of raw materials, components etc. A business house is dependent on other business houses. With the expansion of the size, in order to assure uninterrupted supply of inputs, the management of the company tries to acquire more and more control on such firms supplying raw materials and components and also on agencies engaged in marketing the output.

The company acquiring the controlling interest in another company is called the Holding Company and the company in which the controlling interest is acquired is called Subsidiary Company.

Section 129 (Clause 3) of the Companies Act, 2013 mandated the companies having one or more subsidiaries, to prepare Consolidated Financial Statements. According to this section, where a company has one or more subsidiaries, it shall, in addition to separate financial statements will prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own. Consolidated financial statements are the financial statements of a 'group' presented as those of a single enterprise, where a 'group' refers to a parent and all its subsidiaries.

In this unit we will cover the concept of Group, Holding Company and Subsidiary company, meaning of Consolidated Financial Statements, types of Holding Companies, advantages and disadvantages of Holding Companies, meaning and calculation of Minority Interest, meaning and need of Consolidated Financial Statements and legal requirements on consolidation of Financial Statements.

6.3 CONCEPT OF 'GROUP', 'HOLDING COMPANY' AND 'SUBSIDIARY COMPANY'

A '**group of companies**' is a collection of parent and subsidiary corporations that function as a single economic entity through a common source of control. This control is exercised by one company over the other by–

1) Purchasing specified number of shares
2) Exercising control over the board of directors.

The term '**holding company**' has been defined under section 2(46) of the Companies Act, 2013. Section 2(46) of the Companies Act states that "holding company", in relation to one or more other companies, means a company of which such companies are subsidiary companies.

According to Section 2(87) of the Companies Act, 2013, a subsidiary company is a company in which the holding company–

a) controls the composition of the Board of Directors; or

b) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies.

It may be explained in this way: *A holding company is a company which controls another company known as subsidiary company by owning its all or majority of the shares carrying voting rights or controlling the composition of its board of directors.*

For example Company Y is a subsidiary of Company X and Company Z is a subsidiary of Company Y. Company Z is a subsidiary of Company X. If Company AB is a subsidiary of Company Z, Company AB will also be subsidiary of Company Y and consequently also of Company X.

As per Indian Accounting Standard 21 (AS 21) on Consolidated Financial Statements **a subsidiary company** is an enterprise that is controlled by another enterprise known as the parent company and a **parent company** is an enterprise that has one or more subsidiaries.

The company acquiring the controlling interest in another company is called the Holding Company and the company in which the controlling interest is acquired is called Subsidiary Company.



CHECK YOUR PROGRESS

Q.1: Define Holding Company and Subsidiary Company.

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6.4 TYPES OF HOLDING COMPANIES AND SUBSIDIARY COMPANIES

A holding company may acquire more than fifty percent of the equity shares of subsidiary company or may acquire all the shares of subsidiary company. From this point of view there may be two types of Holding Company. These are:

i) Holding company which acquires all the equity shares of subsidiary company; or,

ii) Holding company which acquires majority of the equity shares of the subsidiary company.

Types of Subsidiary Companies: From the above, it is clear that there are two types of subsidiary companies :

i) Wholly owned subsidiary company; and

ii) Partly owned subsidiary company.

i) Wholly owned subsidiary company: Where all the shares of the subsidiary company are held i.e. owned by the holding company, such subsidiary company is termed as wholly owned subsidiary company. In such a case, all the shares of the subsidiary company are purchased by the holding company.

II) Partly owned subsidiary company: Where majority of the shares of the subsidiary are held i.e. owned by the holding company, such a subsidiary is known as partly owned subsidiary company. In such a case, some of the shares of the subsidiary are owned by persons (shareholders) other than the holding company. The interest of such shareholders other than the interest of the holding company is termed as ‘‘Minority Interest’’.

Above distinctions are required to be kept in mind because the principle of consolidation of final accounts will vary depending on whether the subsidiary is a fully owned subsidiary or a partly owned subsidiary.



CHECK YOUR PROGRESS

Q.2: Define 'Wholly owned subsidiary company' and 'Partly owned subsidiary company'**.**

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6.5 MEANING OF CONSOLIDATED FINANCIAL STATEMENTS

Financial statements in the context of holding company means Balance sheets and Profit and Loss Accounts of both the holding company and its subsidiary. Therefore, consolidation of financial statements means consolidation of Balance Sheets and Profit and Loss Accounts of both holding company and its subsidiary.

Consolidation of Balance Sheet implies preparation of a single Balance Sheet by aggregating all items of assets and liabilities, appearing in the respective Balance Sheets of both the holding company and its subsidiary company.

Consolidation of Profit and Loss Accounts imply preparation of a single Profit and Loss Account by aggregating all items of incomes and expenses, etc., appearing in the respective Profit and Loss Accounts of both the holding company and its subsidiary company.

These consolidated financial statements are intended to present financial information about a holding company and its subsidiary(ies) as a single economic entity to show the economic resources controlled by the group, the obligations of the group and results of the group achieved with its resources. The various outside parties concerned with the holding company and its subsidiaries may also be interested in the consolidated final accounts.

6.6 ADVANTAGES OF CONSOLIDATED FINANCIAL STATEMENTS

Users of the financial statements of a parent company (holding company) are usually concerned with the financial position and results of operations of not only the enterprise itself but also of the group as a whole. For this purpose, consolidated financial statements are prepared and presented by a parent (holding company). The following are the advantages of Consolidated Financial Statements (CFS):

i) CFS provides financial information about a parent and its subsidiary(ies) as a single economic entity;
ii) CFS shows the economic resources controlled by the group;
iii) CFS shows the obligations of the group; and
iv) CFS shows the results the group achieved with its resources.
v) CFS meets the information need of the investors for taking investment decisions.

6.7 LEGAL REQUIREMENTS ON CONSOLIDATION

According to Section 212 of the Companies Act 1956, a holding company must attach the following documents with its balance sheet in respect of each of its subsidiary (ies):

i) a copy of the balance sheet of the subsidiary;
ii) a copy of its profit and loss account;
iii) a copy of the report of its Board of Directors;
iv) a copy of the report of its auditors;
v) a statement showing:
    a) the extent of the holding company's interest in the subsidiary at the end of the financial year of the subsidiary company;
    b) the profits (after deduction of losses of the subsidiary) so far as they concern the holding company separately for the current financial year and for previous financial years and separately for profits already dealt with in the books of the holding company and not so dealt with.

The term "profits" refers to profits of a revenue nature and earned by the subsidiary company after the date of acquisition of shares by the holding company.

vi) where the financial year of the subsidiary company does not coincide with the financial year of the holding company, a statement showing the following:
   a) whether and to what extent there has been a change in the holding company's interest in the subsidiary company since the close of the financial year of the subsidiary company.
   b) details of any material changes which have occurred between the end of the financial year of the subsidiary company and at the end of the financial year of the holding company in respect of the subsidiaries fixed assets, its investment, the money lent by it and the money borrowed by it for any purpose other than that of meeting current liabilities.

6.8 MEANING OF MINORITY INTEREST

Minority interest is that part of the net results of operations and of the net assets of a subsidiary attributable to interests which are not owned, directly or indirectly through subsidiary(ies), by the parent. Minority interest consists of:

a) the amount of equity attributable to minorities at the date on which investment in a subsidiary is made; and
b) the minority's share of movements in equity since the date the parent-subsidiary relationship came into existence.

In other words, Minority Interest means interest held by other shareholders (other than Holding company) in the net assets of the subsidiary. Their interest consists of the following:

a) Paid up share capital held by them;
b) Proportionate share of capital profits or losses; and
c) Proportionate share of revenue profits

Both (a) and (b) together is the amount of equity attributable to minorities at the date on which investment in a subsidiary is made by the holding company.

Presentation of Minority Interest in the Consolidated Balance Sheet: The Accounting Standard (AS 21) states that the Minority Interest should be presented in the consolidated balance sheet separately from liabilities and the equity of the parent company's shareholders.

Since the Standard (AS 21) has not stated as to under which head it is to be shown, Minority Interest is shown on the liabilities side of the consolidated Balance Sheet below the paid up share capital because the minority interest represents the interest of the minority in the equity of the subsidiary and they are also the shareholders of the subsidiary.

6.9 CALCULATION OF MINORITY INTEREST

The claim of the minority shareholders in the subsidiary is termed as 'Minority Interest'. The claim of the minority shareholders of the subsidiary company has to be ascertained to prepare consolidated balance sheet. Minority Interest is shown as a liability in the Consolidated Balance Sheet.

Minority Interest consists only of the paid up value of the shares held by them. But it may so happen that the subsidiary company may have some accumulated profits and reserves or accumulated losses. Again, there may be some profits earned by the subsidiary company subsequent to the date of acquisition of shares by the holding company. Besides, there may be some profits or losses on account of revaluation of its assets on the date of acquisition of shares by the holding company. While calculating the amount of minority interest, all these items have to be taken into account and the proportionate amount of all such profits and reserves should be added to the amount of paid up share capital held by the minority shareholders, while proportionate amount of all such losses should be deducted from the amount so ascertained in order to arrive at the net amount of minority interest.

Minority Interest **=** Paid-up value of shares held by minority shareholders + Proportionate amount of the company's profits and reserves + Proportionate amount of profits on revaluation of assets

of the company_Proportionate amount of company's losses_ Proportionate amount of loss on revaluation of assets of the company, if any.

6.10 INTER-COMPANY TRANSACTIONS

Inter-company balances of holding and subsidiary companies arising from transactions such as loans, bills of exchange and ordinary trade balances are required to be eliminated from the CBS. Such inter-company balances appear as liability in the balance sheet of one company and as asset in the balance sheet of another. However, sometimes, inter-company balances are not the same owing to some goods or remittance in transit, which should be disclosed separately in the CBS.

6.11 INTER-COMPANY HOLDING

Section 19 of the Companies Act, 2013 prohibits a subsidiary company from holding shares in the holding company. According to this section, no company shall, either by itself or through its nominees, hold any shares in its holding company and no holding company shall allot or transfer its shares to any of its subsidiary companies and any such allotment or transfer of shares of a company to its subsidiary company shall be void.

However, a subsidiary may continue to be a member of its holding company when–

a) the subsidiary company holds such shares as the legal representative of a deceased member of the holding company; or
b) the subsidiary company holds such shares as a trustee; or
c) the subsidiary company is a shareholder even before it became a subsidiary company of the holding company.

6.12 TREATMENT OF PREFERENCE SHARES OF SUBSIDIARY COMPANY

If the holding company has some investments in the preference shares of subsidiary, the carrying amount of such investments along with

carrying amount of investments in equity shares of subsidiary company should set off against the holding company's share in the equity of such subsidiary. The difference is treated as goodwill or capital reserve. The interest of minority shareholders of the subsidiary company will then include such portion of preference share capital of the subsidiary company which is not held by holding company.

6.13 BONUS SHARES

The issue of bonus shares by the subsidiary company will increase the number of shares held by the holding company as well as the minority shareholders. Issue of bonus shares may or may not affect the cost of control depending upon whether such shares are issued out of capital profits or revenue profits.

a) Issue of bonus shares out of capital profit (Pre-acquisition profits): In this case there will be no effect on accounting treatment because while calculating the cost of control the share of the holding company in pre-acquisition profit is reduced because of capitalisation of profit and the paid-up value of shares held in subsidiary company is increased. Hence there is no effect on cost of control when bonus shares are issued from pre-acquisition profit.

b) Issue of bonus shares out of post acquisition profit: In this case, a part of the revenue profits will get capitalised resulting in decrease of cost of control or increase in capital reserve.

6.14 COST OF CONTROL OR CAPITAL RESERVE

A subsidiary company may have accumulated loss or profit and the holding company may be purchasing shares at a premium or at a discount and under such situation it is imperative to calculate profit or loss in acquiring the shares before preparing the CBS. Any profit earned in the acquisition of shares is credited to Capital Reserve and loss is debited to Cost of Control or Goodwill. Goodwill or Cost of Control is the excess price paid for the Investment over and above the share in equity or the asset acquired by the

holding company. On the other hand, Capital Reserve represents the excess of the share in equity or net assets of the subsidiary over and above the price paid for Investment.

6.15 CAPITAL PROFITS AND REVENUE PROFITS

In a situation where the date of purchase of shares and the date of consolidation may be different, holding companies share in profits and reserves must be divided into capital profit and revenue profit and only the capital profit will be taken into consideration for the purpose of calculating the Capital Reserve or Cost of Control as per the requirement of the situation. The division of such profits into capital and revenue profit depends upon the date of acquisition of shares in the subsidiary company. Profits earned and reserves created up to the date of acquisition of shares are considered as capital profits/pre-acquisition profits or capital reserves/pre-acquisition reserves as the case may be. Again, profits earned and reserves created during post acquisition period will be treated as revenue profit and shall be disclosed in the Consolidated Balance Sheet accordingly. Besides, profit or loss on revaluation of fixed assets of the subsidiary company should also be treated as capital profit or capital loss. All post-acquisition profits or losses are shown in the CBS and pre-acquisition profits and losses are eliminated by taking them into consideration in calculation of Cost of Control/Goodwill or Capital Reserve as per the demand of the situation.



6.16 LET US SUM UP

In this unit we have discussed the following aspects–

- A holding impany is a company which controls another company by owning its all or majority of the shares carrying voting rights or controlling the composition of its board of directors.
- The company in which the controlling interest is acquired is called Subsidiary Company.

- Where all the shares of the subsidiary company are held by the holding company, such subsidiary company is called a wholly owned subsidiary company.
- Where majority of the shares of the subsidiary are held by the holding company, such a subsidiary is called a partly owned subsidiary company.
- Consolidation of financial statements means consolidation of Balance Sheets and Profit and Loss Accounts of both holding company and its subsidiary.
- Minority interest is that part of the net results of operations and of the net assets of a subsidiary attributable to interests which are not owned, directly or indirectly through subsidiaries by the parent company.



6.17 FURTHER READING

1) Dam, B. B. and Gautam, H. C. *Corporate Accounting*. Guwahati: Capital Publishing Company.
2) Das, K. R. and others. *Corporate Accounting*. Guwahati: LBS Publication.
3) Sehgal, Dr. A. and Sehgal, Dr. D. *Advanced Accounting Corporate Accounting*. Taxman.



6.18 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: The company acquiring the controlling interest in another company is called the Holding Company and the company in which the controlling interest is acquired is called Subsidiary Company.

Ans. to Q. No. 2: Where all the shares of the subsidiary company is held i.e. owned by the holding company, such subsidiary company is termed as wholly owned subsidiary company.

Where majority of the shares of the subsidiary are held i.e. owned by the holding company, such a subsidiary is known as partly owned subsidiary company.



6.19 MODEL QUESTIONS

Q.1: State whether the following statements are true or false:

a) In India, preparation of consolidated Balance Sheet has been made compulsory under the Companies Act.

b) According to AS 21, a subsidiary is an enterprise that is not controlled by another enterprise (known as the parent).

c) A company is called holding company only when it acquires the whole of the share capital of another company.

Q.2: Give three situations under which an enterprise can become a holding company.

Q.3: Explain the different types of Holding Companies.

Q.4: Write briefly about Minority Interest?

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UNIT 7: CASH FLOW STATEMENT

UNIT STRUCTURE

7.1 Learning Objective

7.2 Introduction

7.3 Meaning of Cash Flow Statement

7.4 Purpose of Cash Flow Statement

7.5 Preparation of Cash Flow Statement

7.6 Format of Cash Flow Statement (AS3: Revised Method)

7.7 Cash Flow from Operating Activities

7.8 Cash Flow Statement under Direct Method

7.9 Differences between Cash Flow Statement and Fund Flow Statement

7.10 Uses of Cash Flow Statement

7.11 Let Us Sum Up

7.12 Further Reading

7.13 Answers To Check Your Progress

7.14 Model Questions

7.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- discuss the meaning and purpose of Cash Flow Statement
- learn about Cash Flow from Operating Activities
- prepare the Cash Flow Statement under Direct Method
- outline the distinction between Cash Flow Analysis and Fund Flow Analysis
- discuss the uses of Cash Flow Statement.

7.2 INTRODUCTION

In the earlier unit we have discussed the concept of Financial Statement Analysis and Funds Flow Analysis. In this unit, we will discuss the concept of cash flow analysis. Cash flow helps us to make projections of

cash inflows and outflows for the near future to determine the availability of cash during a particular time period. You will find this unit very interesting because, after going through this unit you will able to analyse the financial position of different companies.

7.3 MEANING OF CASH FLOW STATEMENT

In a business organisation, hundreds and thousands of transactions are done every day. Out of those transactions some are executed on cash and some are executed on credit basis. Some transactions are executed on partial cash basis and the balance amount on credit basis. So at the end of each day, week, month, quarter or a year, the organisation is left with huge number of transactions. If the management wants to know the status of the cash and cash equivalents available in the organisation, then neither Profit and Loss Account nor Balance Sheet or any other statements of accounts servers the purpose. In this circumstance, Cash Flow Statement shows the cash and cash equivalents position of an organisation which includes cash transactions. In the preparation of balance sheet and income statement, accounting is done on accrual basis but in cash flow statement, accounting is done on cash basis. Moreover, Cash Flow Statement also shows the source of cash receipts and it also reveals the purposes for which payments are made.

Cash flow statement shows the movement of cash and cash equivalents from the business as well as into the business which results out of the business activities. Cash Flow Statement basically shows the cash inflows and cash out flows. When cash comes into the books of accounts in the organisation, then it is referred to as cash inflow. Similarly, when cash goes out from the books of accounts of the organisation, then it is referred to as cash outflow. The difference between the cash inflow and cash outflow is referred to as net cash flow. Cash Flow Statement explains the reasons for the changes in cash balance of a business between the two consecutive Balance Sheet dates.

7.4 PURPOSE OF CASH FLOW STATEMENT

The main objective of preparing the Cash Flow Statement is to deliver information about cash receipts, cash payments, and the difference in cash position out of business activities from the operations, investments, and financing activities of a company during a particular financial year. In other words, the Cash Flow Statements where an organisation's cash is being generated, and where its cash is being paid during a particular period of time. Thus, the Cash Flow Statements helps the management to analyse the liquidity as well as long term solvency of the business. The main purpose of Cash Flow Statement is to transform the accrual basis income statement to a cash flow statement.

Information about the cash flows of a business is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilise those cash flows. The economic decisions that are taken by users require an evaluation of the ability of an enterprise to generate cash and cash equivalents and the timing and certainty of their generation. The Standard deals with the provision of information about the historical changes in cash and cash equivalents of an enterprise by means of a cash flow statement which classifies cash flows during the period from operating, investing and financing activities.

Users of an enterprise's financial statements are interested in how the enterprise generates and uses cash and cash equivalents. This is the case regardless of the nature of the enterprise's activities and irrespective of whether cash can be viewed as the product of the enterprise, as may be the case with a financial enterprise. Enterprises need cash for essentially the same reasons, however different their principal revenue-producing activities might be. They need cash to conduct their operations, to pay their obligations, and to provide returns to their investors.

There are basically three components of Cash Flow Statements which are briefly given below:

a) **Cash Flow from Operating Activities:** In this case, all the business transactions resulting from operating activities of the business that are executed only in terms of cash are considered. Operating activities basically represents the revenue generating activities of a business. Some examples of operating activities are the cash receipts from the sale of goods and services like salaries and wages, rents, transportation and any other operating expenses for the smooth running of its business.

b) **Cash Flow from Investing Activities:** In this case, all the business transactions resulting from investment activities of the business that are executed only in terms of cash are considered. Investment activities basically represent the payments made to purchase of long term assets and thereby cash receipts from the sale of long term assets. Some examples of investment activities are the cash receipts from sale of fixed assets or any other assets, plants, machineries, equipment, the purchase or sale of a equities, debts or debentures etc.

c) **Cash Flow from Financing Activities:** Here, all the business transactions resulting from financing activities of the business that are executed only in terms of cash are considered. Financing activities are transactions between a business and its creditors and investors. Financing activities basically represents those activities that will change the equity share holding or borrowings of a business. Some examples of financing activities are the sale or purchase of a company's own shares, announcement of dividends and its payment to its shareholders, repayment of short-term loans and long-term loans, the retirement of bonds payable etc.

7.5 PREPARATION OF CASH FLOW STATEMENT

After ascertaining information regarding different sources and uses of cash, we can easily prepare the Cash Flow Statement. There is no specific format of preparing Cash Flow Statement but usually it is prepared in report

form. The information for the Cash Flow Statement is derived from the income statement and balance sheets for the current and past financial years. In preparing the Cash Flow Statement, the three components viz., operating, investment and financing activities are considered. As already discussed, operating activities are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities. Let us now cite some examples of cash flows that are generated from operating activities:

a) cash receipts from the sale of products and services
b) cash receipts from patents, royalties, fees, commissions and from such sources.
c) cash payments to suppliers for products and services
d) cash payments to the employees of the organisation
e) cash receipts and cash payments of an insurance enterprise for premiums and claims
f) cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities
g) cash receipts and payments relating to advanced derivative products like futures contracts, forward contracts, option contracts and swap contracts when the contracts are held for dealing or trading purposes.

The second component of Cash Flow Statement is all those cash that are generated from investing activities. Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents. Let us now cite some examples of cash flows that are generated from investing activities:

a) Cash payments to possess fixed assets including intangible assets as well as assets acquired to capitalised research and development activities and self-constructed fixed assets.
b) Cash receipts from the sale of fixed assets including intangible fixed assets.
c) Cash payments to acquire shares, warrants or debt instruments of other enterprises and interests in joint ventures other than cash payments for trading activities.

d) Cash receipts from disposal of shares, warrants or debt instruments of other enterprises and interests in joint ventures other than cash receipts from trading activities.

e) Cash advances and loans made to third parties other than advances and loans made by a financial enterprise.

f) Cash receipts from the repayment of advances and loans made to third parties other than advances and loans of a financial enterprise.

g) Cash payments for advanced financial products like futures contracts, forward contracts, option contracts and swap contracts other than the payments made for trading activities.

h) Cash receipts from futures contracts, forward contracts, option contracts and swap contracts other than receipts generated from trading activities.

Financing activities are activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowings of the enterprise. Let us now cite some examples of cash flows that are generated from financing activities:

a) Cash proceeds from issuing shares or other similar financial instruments.

b) Cash proceeds from issuing debentures, loans, notes, bonds, and other short or long-term borrowings.

c) Cash repayments of amounts borrowed.

The Cash Flow Statement begins with the opening balance of cash and after adding different sources of cash and subtracting application of cash, the cash balance at the end of the particular period is found. This is explained in detail in the next section.

7.6 FORMAT OF CASH FLOW STATEMENT (AS3: REVISED METHOD)

This Accounting Standard is not mandatory for Small and Medium Sized Companies, as defined in the Notification. Such companies are however encouraged to comply with the Standard.

Cash Flow Statement of … (Name of the Company) for the Year … (Current Financial Year):

Particulars	**Amount (in Rs.)**	**Amount (in Rs.)**
Cash Flows from Operating Activities:		
Cash receipts from customers		
Cash paid to suppliers and employees		
Cash generated from operations		
Income Taxes paid		
Cash flow before extraordinary item		
Net cash from operating activities		
Cash Flows from Investing Activities:		
Purchase of fixed assets		
Proceeds from sale equipment		
Interest received		
Dividends received		
Net cash from investing activities		
Cash Flows from Financing Activities:		
Proceeds from issuance of share capital		
Proceeds from long-term borrowings		
Repayment of long-term borrowings		
Interest paid		
Dividends paid		
Net cash used in financing activities		
Net increase in cash and cash equivalents		
Cash and cash equivalents at beginning of period		



CHECK YOUR PROGRESS

Q.1: Write the main objective of preparing the cash flow statement.

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Q.2: What are the three components of cash flow statement?

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Q.3: Give some examples of operating activities?

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Q.4: State true or false for the following statements:

i) Cash flow statement shows the movement of cash and cash equivalents from the business as well as into the business which results out of the business activities.

ii) Cash advances and loans made to third parties other than advances and loans made by a financial enterprise are an example of operating activity.

iii) Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

7.7 CASH FLOW FROM OPERATING ACTIVITIES

Operating activities are those activities which are the primary drivers of an organisation. For example, for a company producing mobile phones, operating activities are purchase of raw material in the form of different types plastics, chips, camera lense, monitor glass etc., other of manufacturing expenses, sale and distribution of phones, etc. All these activities are referred to as operating activities and earn the principal revenue for the organisation. Thus operating activities are different from financing and investment activities because of its nature. Operating activities are performed after the financing and investment activities are already over. Examples of financial activities are cash proceeds from shares, debentures and cash proceeds related to loans, dividends, interest etc. On the other hand some examples of investment activities are buy and sale of fixed assets like land, building, equipment, machinery etc. which is for long term.

An efficient an effective operating activity guarantees a sound internal solvency level in an organisation. Cash flows generated from the operating activities ultimately is the main driver for the profitability and sustainability of the firm. There are some indirect cash flows generated to support operating activities of a firm. For example, cash flows arising from the purchase and sale of Securities which are hold for acquiring inventories are treated as operating activities. Similarly cash advances and loans made by financial firms are also treated as operating activities since they denote the primary activity of the firm. There are two types of cash flows viz., cash inflow and cash out flow. Let us now highlight some cash inflows generated from operating activities of a mobile manufacturing firm as follows:

a) cash receipts from sale of mobile phones.
b) cash receipts from customer sale service.
c) cash receipts from sale of spare parts.
d) cash receipts from annual maintenance charges.

Let us now highlight some cash outflows out of operating activities of a mobile manufacturing firm as follows:

a) cash payments to vendors for items supplied.

b) cash payments for the services received.

c) cash payments to the employees.

d) cash payments to insurance policies.

The main purpose of preparing an operating cash flow is to show the net operating cash flow which is derived by deducting cash outflows from cash inflows.

7.8 CASH FLOW STATEMENT UNDER DIRECT METHOD

Cash flow statement from the operating activities can be found out using direct method. Cash flow statement under direct method basically considers major classes of gross cash receipts and gross cash payments. Under direct method, major cash inflows and outflows are considered like cash proceeds related to trades, employees, expenses, etc. In the profit and loss account, some items are expressed on accrual basis which are converted to cash equivalent with the following adjustments:-

1) Cash expenses = Expenses on accrual basis + Prepaid expenses in the beginning and
   Outstanding expenses in the end – Prepaid expenses in the end and Outstanding expenses in the beginning.
2) Cash payments to suppliers = Purchases + Trade Payables in the beginning – Trade Payables in the end.
3) Cash receipts from customers = Revenue from operations + Trade receivables in the beginning – Trade receivables in the end.
4) Purchases = Cost of Revenue from Operations – Opening Inventory + Closing Inventory.

7.9 DIFFERENCE BETWEEN CASH FLOW STATEMENT AND FUND FLOW STATEMENT

The basic differences between cash flow statement and fund flow statement are pointed out below:

a) Cash Flow Statement shows the cash and cash equivalents position of an organisation which includes cash transactions. On the other hand, fund flow statement is a statement of changes in financial position. Here, the word 'fund' represents the working capital of the business.

b) Cash flow statement shows the movement of cash and cash equivalents from the business as well as into the business which results out of the business activities. Cash Flow Statement basically shows the cash inflows and cash out flows. Fund flow statement is a statement summarising the significant financial changes which have occurred between the beginning and the end of company's accounting period.

c) In the preparation of balance sheet and income statement, accounting is done on accrual basis but in cash flow statement, accounting is done on cash basis. Moreover, Cash Flow Statement also shows the source of cash receipts and it also reveals the purposes for which payments are made. Fund Flow Statement is a supplementary statement and shows the sources of mobilisation of the funds and their detailed utilisation during a particular financial year. Fund Flow Statement also deal with the non-cash items.

d) Cash Flow Statement explains the reasons for the changes in cash balance of a business between the two consecutive Balance Sheet dates. On the other hand, the Fund Flow Statements clearly identify the changes in working capital and also help the management to find out the factors responsible for this working capital changes.

e) The main objective of preparing the Cash Flow Statement is to deliver information about cash receipts, cash payments, and the difference in cash position out of business activities from the operations, investments, and financing activities of a company during a particular financial year. In other words, the Cash Flow Statements where an organisation's cash is being generated, and where its cash is being paid during a particular period of time. Thus, the Cash Flow Statements helps the management to analyse the liquidity as well as long term solvency of the business. The main purpose of Cash

Flow Statement is to transform the accrual basis income statement to a cash flow statement. On the other hand, Fund Flow Statement helps management about the allocation of resources and shows the operational aspects of the business activities which are not available in Profit and Loss Account and Balance Sheet.

f) Cash flow statement helps to find out the capacity of an organisation to meet its short-term obligations and liquidity position whereas fund flow statement helps to find out the capacity of an organisation to meet its long-term obligations.

7.10 USES OF CASH FLOW STATEMENT

Cash flow statement is used to identify and explain the difference profits and cash and assesses the current liquidity position of a company. Let us now understand the usage of cash flow statement with some illustrations.

EXERCISE 7.1



Prepare a cash flow account for Expan Telecommunications Ltd. for the year ended 31-03-2019 from the following information–

Cash Account for the year ended 31-03-2019.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Opening Cash Balance	1,75,000	Cash Purchases of Goods	35,00,000
Equity Shares issued	2,62,500	Administrative Expenses	4,37,500
Preference Shares issued	2,62,500	Factory Expenses	2,62,500
		Income Tax	87,500
Cash Sales	4,025,000	Dividend Disbursed	2,62,500
Sale of Old Machineries	10,50,000	Loan Repaid	7,00,000
		Closing Cash Balance	5,25,000
Total	57,75,000	Total	57,75,000

Solution: Let us prepare the cash flow statement as per the direct method. Under the direct method, cash receipts from the customers and cash payments to the vendors and employees are disclosed. So, let us prepare the cash flow statement below–

Expan Telecommunications Ltd.

Cash Flow Statement of for the year ended 31-03-2019.

		Amount (Rs.)	Amount (Rs.)
A)	**Cash Flow from Operating Activity:**		
	Receipts: Cash Sales from Customers	40,25,000	
	Payments: Cash Purchases	(35,00,000)	
	Administrative Expenses	(4,37,500)	
	Factory Expenses	(2,62,500)	
	Income Tax	(87,500)	
	Net Cash from Operating Activities: (Total A)		(2,62,500)
B)	**Cash Fow from Investment Activity:**		
	Sale of Old Machineries:	10,50,000	
	Net Cash from Investmnet Activities: (Total B):		10,50,000
C)	**Cash Flow from Financing Activity:**		
	Receipts: Equity Shares issued	2,62,500	
	Preference shares issued	2,62,500	
	Payments: Loan repaid	(7,00,000)	
	Dividend disbursed	(2,62,500)	
	Net Cash from Financing Activities: (Total C)		(4,37,500)
	Net increase in Cash and Cash equivalents:		
	Total Cash Flow (A + B + C):		3,50,000
	Add: Opening Cash Balance		1,75,000
	Closing Cash Balance		5,25,000



EXERCISE 7.2

Prepare a cash flow account for Excell Tyres Ltd. for the year ended 31-03-2019 from the following information–

Cash Account for the year ended 31-03-2019.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Opening Cash Balance	75,000	Commissions Paid	1,50,000
Equity Shares issued	5,00,000	Administrative Expenses	1,00,000
Preference Shares issued	4,00,000	Factory Expenses	2,00,000
Cash Sales	18,00,000	Income Tax	2,50,000
Sale of Old Machinery	50,000	Cash Purchases of Goods	8,00,000
Sale of Old Furniture	40,000	Dividend Disbursed	2,50,000
		Legal Fees Paid	2,50,000
		Loan Repaid	6,50,000
		Closing Cash Balance	1,65,000
Total	28,65,000	Total	28,65,000

Solution: Let us prepare the cash flow statement as per the direct method. Under the direct method, cash receipts from the customers and cash payments to the vendors and employees are disclosed. So, let us prepare the cash flow statement below –

Excell Tyres Ltd Ltd.

Cash Flow Statement of for the year ended 31-03-2019

		Amount (Rs.)	Amount (Rs.)
A)	**Cash Flow from Operating Activity:**		
	Receipts: Cash Sales from Customers	18,00,000	
	Payments: Cash Purchases	–8,00,000	
	Administrative Expenses	–1,00,000	
	Factory Expenses	–2,00,000	

	Income Tax	–3,00,000	
	Commision Paid	–1,50,000	
	Legal Fees Paid	–2,50,000	
	Net Cash from Operating Activities: (Total A)		NIL
B)	**Cash Fow from Investment Activity:**		
	Sale of Old Furniture:	40,000	
	Sale of Old Machineries:	50,000	
	Net Cash from Investmnet Activities: (Total B):		90,000
C)	**Cash Flow from Financing Activity:**		
	Receipts: Equity Shares issued	5,00,000	
	Preference shares issued	4,00,000	
	Payments: Loan repaid	–6,50,000	
	Dividend disbursed	–2,50,000	
	Net Cash from Financing Activities: (Total C)		NIL
	Net increase in Cash and Cash equivalents:		
	Total Cash Flow (A + B + C):		90,000
	Add: Opening Cash Balance		75,000
	Closing Cash Balance		1,65,000



CHECK YOUR PROGRESS

Q.5: What are operating activities?

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Q.6: What are the main differences between cash flow statement and fund flow statement?

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Q.7: State true or false for the following statements:

i) Fund flow statement explains the reasons for the changes in cash balance of a business between the two consecutive Balance Sheet dates.

ii) Cash flow statement under direct method basically considers major classes of gross cash receipts and gross cash payments.



7.11 LET US SUM UP

In this unit we have discussed the purpose of Cash Flow Statement. The main objective of preparing the Cash Flow Statement is to deliver information about cash receipt cash payments, and the difference in cash position out of business activities from the operations, investments, and financing activities of a company during a particular financial year. In other words, the Cash Flow Statements where an organisation's cash is being generated, and where its cash is being paid during a particular period of time. The unit also helps to learn the preparation of Cash Flow Statement under Direct Method. The unit also discusses the difference between Cash Flow Analysis and Fund Flow Analysis. The Cash Flow Statements helps

the management to analyse the liquidity as well as long term solvency of the business. The main purpose of Cash Flow Statement is to transform the accrual basis income statement to a cash flow statement. On the other hand, Fund Flow Statement helps management about the allocation of resources and shows the operational aspects of the business activities which are not available in Profit and Loss Account and Balance Sheet.



7.12 FURTHER READING

1) Bhattacharya, A. K. (2012). *Financial Accounting for Business Managers.* PHI.
2) Ramachandran, N. & Kakani, R. K. (2011). *Financial Accounting for Management*. McGraw Hill Education.
3) Srinivasan, N. P. & Murugan, M. S. (2011). *Accounting for Management*. India: S. Chand Publishing.



7.13 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: The main objective of preparing the Cash Flow Statement is to deliver information about cash receipts, cash payments, and the difference in cash position out of business activities from the operations, investments, and financing activities of a company during a particular financial year. The main purpose of Cash Flow Statement is to transform the accrual basis income statement to a cash flow statement.

Ans. to Q. No. 2: There are basically three components of Cash Flow Statement which are briefly given below:

a) Cash Flow from Operating Activities
b) Cash Flow from Investing Activities
c) Cash Flow from Financing Activities

Ans. to Q. No. 3: Some examples of cash flows that are generated from operating activities:

a) cash receipts from the sale of products and services
b) cash receipts from patents, royalties, fees, commissions and from such sources.
c) cash payments to suppliers for products and services

Ans. to Q. No. 4: i) True; ii) False; iii) True

Ans. to Q. No. 5: Operating activities are those activities which are the primary drivers of an organisation. For example, for a company producing mobile phones, operating activities are purchase of raw material in the form of different types plastics, chips, camera lense, monitor glass etc., other of manufacturing expenses, sale and distribution of phones, etc. All these activities are referred to as operating activities and earn the principal revenue for the organisation.

Ans. to Q. No. 6: The basic differences between cash flow statement and fund flow statement is pointed out below:

a) Cash Flow Statement shows the cash and cash equivalents position of an organisation which includes cash transactions. Fund Flow statement is a statement of changes in financial position.
b) Cash flow statement shows the movement of cash and cash equivalents from the business as well as into the business which results out of the business activities. Fund flow statement is a statement summarising the significant financial changes which have occurred between the beginning and the end of company's accounting period.
c) In the preparation of balance sheet and income statement, accounting is done on accrual basis but in cash flow statement, accounting is done on cash basis. Moreover, Cash Flow Statement also shows the source of cash receipts and it also reveals the purposes for which payments are made. Fund Flow Statement is a supplementary statement and shows the sources of mobilisation of the funds and their detailed utilisation during a particular financial year. Fund Flow Statement also deal with the non-cash items.

Ans. to Q. No. 7: i) True; ii) False; iii) True



7.14 MODEL QUESTIONS

Q.1: Explain the cash concept.

Q.2: Define the cash flow statement and explain how it is different from fund flow statement.

Q.3: How do you compute cash from financing activities?

Q.4: How do you compute cash from operating activities?

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Name of the Paper: .....
Course Code: .....

Centre for Internal Quality Assurance (CIQA)
Krishna Kanta Handiqui State Open University
City Office: Housefed Complex, Guwahati-781006

Learner's Feedback on Course

Dear Learner,

Regarding the course as mentioned above, we would like to know your opinions and comments so as to improve the quality of self learning materials in future. Please respond to the following statements by ticking the number you feel most reflect your opinion. After completion of the additional comments, please detach the page and send/mail the same to us at the address given below.

The Director, Centre for Internal Quality Assurance, KKHandiqui State Open University
Housefed Complex, Dispur, Guwahati-781006
(E-mail id: ciqa@kkhsou.in)

1) Approximately how many hours did you spend for studying the units in the course? ☐☐☐

2) Please give your opinions (by ✓ mark) to the following items based on your reading of the block:

Sl. No.	Statements	Strongly Agree	Agree	Neither Agree nor Disagree	Disagree	Strongly Disagree
I)	The SLMs of the course fulfil the learning objectives set out in the beginning of each unit					
II)	The units of the SLM could satisfy my academic needs and expectations					
III)	The Unit writers have excellent knowledge about the course contents					
IV)	Language and contents of the units were presented at a level which I could readily understand					
V)	Ample opportunity for participation in the activities provided in the units					
VI)	Used enough Illustrations (Diagrams, tables etc.) for conceptual clarity					
VII)	Quality of content is engaging, relevant, and up-to-date					
VIII)	The self check questions are very helpful					
IX)	The Possible/model questions and the answers to check my progress have benefited me a lot					

Additional Comments: *(Please feel free to provide your open comments)*

1) Which aspects of the SLM, according to you, worked well?

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2) What sort of changes/improvements do you feel KKHSOU could implement to improve the overall quality of the SLM?

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Thank you for taking the time to complete this form.