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VIRTUAL COACHING CLASSES ORGANISED BY BOS, ICAI

INTERMEDIATE LEVEL PAPER 5: ADVANCED ACCOUNTING

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1. INTRODUCTION

Accounting Standards (ASs) are written policy documents issued by expert accounting body or by government or other regulatory body covering the aspects of recognition, measurement, presentation and disclosure of accounting transactions in the financial statements.

The Accounting Standards aim at improving the quality of financial reporting by promoting comparability, consistency and transparency, in the interests of users of financial statements.

Good financial reporting not only promotes healthy financial markets, it also helps to reduce the cost of capital because investors can have faith in financial reports and consequently perceive lesser risks.



2. OVERVIEW OF THE ACCOUNTING STANDARDS

1. AS 4 (revised): Contingencies and Events Occurring After the Balance Sheet Date

Introduction

All paragraphs of AS 4 (Revised) that deal with contingencies are applicable only to the extent not covered by other Accounting Standards prescribed by the Central Government.

the present standard (AS 4 (Revised)) deals with the treatment and disclosure requirements in the financial statements of events occurring after the balance sheet.



2. OVERVIEW OF THE ACCOUNTING STANDARDS

Contingencies

Contingency is a condition or situation, the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence, or non-occurrence, of one or more uncertain future events.



2. OVERVIEW OF THE ACCOUNTING STANDARDS

Events Occurring after the Balance Sheet Date

Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and, by the corresponding approving authority in the case of any other entity.



2. OVERVIEW OF THE ACCOUNTING STANDARDS

Two types of events can be identified:

Adjusting events-

those which provide further evidence of conditions that existed at the balance sheet date.

For example a trade receivable declared insolvent and estate unable to pay full amount against whom provision for doubtful debt was created.

Adjustment to assets and liabilities is required.

Disclosure in the financial statements is required.



2. OVERVIEW OF THE ACCOUNTING STANDARDS

Non-adjusting events-

those which are indicative of conditions that arose subsequent to the balance sheet date.

An example is the decline in market value of investments between the balance sheet date and the date on which the financial statements are approved. Ordinary fluctuations in market values do not normally relate to the condition of the investments at the balance sheet date, but reflect circumstances which have occurred in the following period.

Adjustment to assets and liabilities is not required

Disclosure in the report of the approving authority is required.



2. OVERVIEW OF THE ACCOUNTING STANDARDS

Disclosure

Disclosure of events occurring after the balance sheet date requires the following information should be provided:

The nature of the event;

An estimate of the financial effect, or a statement that such an estimate cannot be made.



2. OVERVIEW OF THE ACCOUNTING STANDARDS

Example:

A company follows April-March as its financial year. The company recognises cheques dated 31st March or before, received from customers after balance sheet date but before approval of financial statement by debiting Cheques in hand A/c and crediting the Debtors A/c. The Cheques in hand is shown in balance sheet as an item of cash and cash equivalents. All Cheques in hand are presented to bank in the month of April and are also realised in the same month in normal course after deposit in the bank.

Even if the cheques bear the date 31st March or before, the cheques received after 31st March do not represent any condition existing on 31st March. Thus the collection of cheques after balance sheet date is not an adjusting event. Recognition of cheques in hand is therefore not consistent with requirements of AS 4 (Revised). Moreover, the collection of cheques after balance sheet date does not represent any material change or commitments affecting financial position of the enterprise, and so no disclosure of such collections in the Directors' Report is necessary.



2. OVERVIEW OF THE ACCOUNTING STANDARDS

It should also be noted that, the Framework for Preparation and Presentation of Financial Statement defines assets as resources controlled by an enterprise as a result of past events from which economic benefits are expected to flow to the enterprise. Since the company acquires custody of the cheques after 31st March, it does not have any control over the cheques on 31st March and hence cheques in hand do not qualify to be recognised as asset on 31st March.



2. OVERVIEW OF THE ACCOUNTING STANDARDS

Exception to rule:

Events indicating going concern assumption inappropriate:

As per AS 4 (Revised), an event occurring after the balance sheet date should be an adjusting event even if it does not reflect any condition existing on the balance sheet date, if the event is such as to indicate that the fundamental accounting assumption of going concern is no longer appropriate.



2. OVERVIEW OF THE ACCOUNTING STANDARDS

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

Introduction

The objective of AS 5 is to prescribe the classification and disclosure of certain items in the statement of profit and loss so that all enterprises prepare and present such a statement on a uniform basis.

AS 5 requires the classification and disclosure of extraordinary and prior period items, and the disclosure of certain items within profit or loss from ordinary activities.

It also specifies the accounting treatment for changes in accounting estimates and the disclosures to be made in the financial statements regarding changes in accounting policies.



2. OVERVIEW OF THE ACCOUNTING STANDARDS

This Statement does not deal with the tax implications of extraordinary items, prior period items, changes in accounting estimates, and changes in accounting policies for which appropriate adjustments will have to be made depending on the circumstances.



2. OVERVIEW OF THE ACCOUNTING STANDARDS

Net Profit or Loss for the Period

All items of income and expense which are recognised in a period should be included in the determination of net profit or loss for the period unless an Accounting Standard requires or permits otherwise.



2. OVERVIEW OF THE ACCOUNTING STANDARDS

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

Profit or loss from ordinary activities:

- Any activities which are undertaken by an enterprise as part of its business and such related activities in which the enterprise engages in furtherance of, incidental to, or arising from, these activities.
- For example profit on sale of merchandise, loss on sale of unsold inventory at the end of the season.



2. OVERVIEW OF THE ACCOUNTING STANDARDS

Extraordinary items:

- Income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly.
- The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.



2. OVERVIEW OF THE ACCOUNTING STANDARDS

- Examples of events or transactions that generally give rise to extraordinary items for most enterprises are:
 - attachment of property of the enterprise
 - an earthquake



2. OVERVIEW OF THE ACCOUNTING STANDARDS

Exceptional items:

When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

The write-down of inventories to net realisable value as well as the reversal of such write-downs

A restructuring of the activities of an enterprise and the reversal of any provisions for the costs of restructuring.



2. OVERVIEW OF THE ACCOUNTING STANDARDS

Disposals of items of fixed assets

Disposals of long-term investments

Legislative changes having retrospective application

Litigation settlements

Other reversals of provisions



2. OVERVIEW OF THE ACCOUNTING STANDARDS

PRIOR PERIOD ITEMS

Prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods.

The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived.



2. OVERVIEW OF THE ACCOUNTING STANDARDS

CHANGES IN ACCOUNTING ESTIMATES

An estimate may have to be revised if changes occur in the circumstances based on which the estimate was made, or as a result of new information, more experience or subsequent developments.

Accounting estimates by their nature are approximations that may need revision as additional information becomes known.



2. OVERVIEW OF THE ACCOUNTING STANDARDS

The effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate.

The effect of a change in an accounting estimate that was previously included as an extraordinary item is reported as an extraordinary item.



2. OVERVIEW OF THE ACCOUNTING STANDARDS

The effect of a change in an accounting estimate that was previously included as an extraordinary item is reported as an extraordinary item.

The nature and amount of a change in an accounting estimate which has a material effect in the current period, or which is expected to have a material effect in subsequent periods, should be disclosed.



2. OVERVIEW OF THE ACCOUNTING STANDARDS

CHANGES IN ACCOUNTING POLICIES

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

Accounting Policies can be changed only:

- when the adoption of a different accounting policy is required by statute; or
- for compliance with an Accounting Standard; or
- when it is considered that the change would result in a more appropriate presentation of the financial statements of the enterprise.



2. OVERVIEW OF THE ACCOUNTING STANDARDS

The following are not changes in accounting policies:

- The adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, e.g., introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex- gratia payments to employees on retirement;
- The adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial.

Any change in an accounting policy which has a material effect should be disclosed.



THANK YOU