

ACCOUNTING THEORY AND REGULATION

A Comprehensive Guide

3 Theory Hours + 1 Tutorial

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Semester V
MDC (Major / Core) Paper 10
ACCOUNTING THEORY AND REGULATION (3
TH + 1 TU)

Full Marks: 100

Credit of the Paper: 4

Semester end Examination (Credit 3): 75 marks

Tutorial (Credit 1): 25 marks

Total (3 TH + 1 TU): 100 marks

Unit-wise Topics and Lecture Hours

Unit	Topic	Details	Lecture Hours
1	Introduction to Accounting Theory	• Concept of accounting theory; relation with practice; Approaches to accounting theory (Inductive and Deductive) • Need for the study of accounting theory; GAAP • Capital: Meaning, capital maintenance concepts; Relation between Capital and Income (Stock and Flow) • Limitations of Historic Cost accounting; Introduction to Fair Value accounting	10
2	Introduction to Accounting Standard	• Financial accounting standards: concept, benefits, procedure for issuing accounting standards (ASs) in India • Need and challenges for a global standard; IFRS (concept only); Adoption and convergence • Introduction to Ind AS (concept only)	10
3	Accounting Standards (ASs)	• AS 1 : Disclosure of Accounting Policies • AS 2 : Valuation of Inventories • AS 4 : Contingencies and Events Occurring after the Balance Sheet Date • AS 5 : Net Profit or Loss for the Period, Prior Period Items, and Change in Accounting Policies • AS 9 : Revenue Recognition (Revised) • AS 10: Property, Plant and Equipment • AS 13: Accounting for Investment • AS 16: Borrowing Costs • AS 20: Earnings per Share	40

Total Lecture Hours: 60

Suggested Readings

- L.S. Porwal — *Accounting Theory*, Tata McGraw Hill
- Gokul Sinha — *Accounting Theory & Management Accounting*
- B. Banerjee — *Regulation of Corporate Accounting & Reporting in India*, World Press
- Frank Wood — *Business Accounting Vol. 1 & 2*, Pearson

Unit 1: Introduction to Accounting Theory

1.1 The Concept of Accounting Theory

Accounting theory provides the foundational structure for the practice of financial accounting and reporting. It is a systematic body of knowledge comprising a coherent set of principles, concepts, and postulates that explain and guide the actions of accountants. Understanding this theory is essential for appreciating the 'why' behind the 'how' of accounting procedures.

First, the meaning of accounting theory can be understood as a logical framework that serves as a frame of reference for evaluating existing accounting practices and developing new ones. It is not merely a collection of rules but a reasoned system of thought. For instance, the theory behind depreciation accounting is not just about applying a formula; it is rooted in the concept of matching the cost of an asset with the revenues it helps to generate over its useful life. This theoretical underpinning ensures that accounting is a discipline based on logic rather than arbitrary decisions.

Second, the nature of accounting theory is multifaceted. It is descriptive, in that it seeks to explain and codify the practices that accountants currently use. It is predictive, as it attempts to foresee the economic consequences of adopting certain accounting standards on the behaviour of users and preparers of financial statements. Most importantly, it is normative, meaning it prescribes what accounting practices *should* be followed to achieve specific objectives, such as providing decision-useful information. In India, the normative role of theory is evident in the formulation of Indian Accounting Standards (Ind AS) by the Institute of Chartered Accountants of India (ICAI), which are designed to align Indian reporting with global best practices.

Third, the primary objective of accounting theory is to provide a robust basis for the development of accounting standards that result in consistent, comparable, and transparent financial statements. A sound theoretical framework ensures that standards are not created in an ad-hoc manner but are internally consistent and logically derived from a set of core objectives. This helps in building trust among investors, creditors, and other stakeholders in the financial reporting system.

Finally, the importance of accounting theory in financial reporting in India cannot be overstated. As the Indian economy becomes more integrated with the global market, there is a growing need for high-quality

financial information. Accounting theory provides the intellectual rigour required to navigate complex business transactions, such as those involving financial derivatives or business combinations. It guides the ICAI and the National Financial Reporting Authority (NFRA) in setting standards that enhance the credibility and utility of financial reports prepared by Indian companies, thereby facilitating capital formation and economic growth.

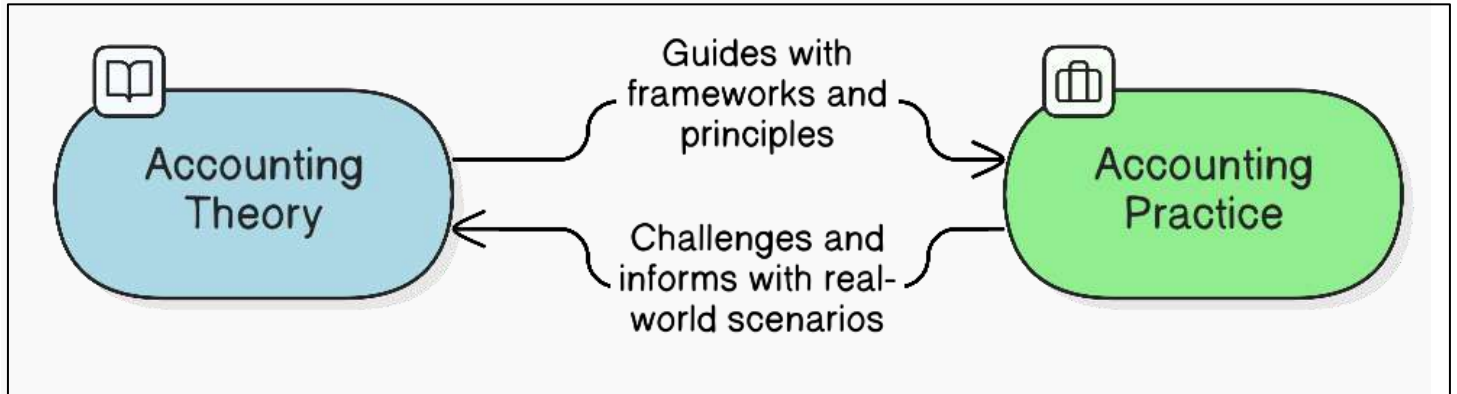
1.2 The Relationship Between Accounting Theory and Accounting Practice

The relationship between accounting theory and accounting practice is not a one-way street but a dynamic, symbiotic interaction. Theory provides the foundation for practice, while practice serves as a real-world laboratory that tests, challenges, and ultimately refines theory.

First, accounting theory guides accounting practice by providing a conceptual framework. When an accountant at an Indian firm like Tata Motors encounters a novel or complex transaction for which no specific accounting standard exists, they must rely on fundamental theoretical principles. Concepts such as the revenue recognition principle, the matching principle, or the substance over form concept provide the necessary guidance to exercise professional judgment and determine the appropriate accounting treatment. In this sense, theory is the bedrock that ensures logical consistency and coherence in the application of accounting standards.

Second, accounting practice influences theoretical development by presenting new challenges and economic realities. The practical problems faced by accountants and auditors generate critical questions that theorists and standard-setters must address. For example, the rapid growth of the e-commerce sector in India, with companies like Flipkart and Zomato, presented unique challenges in revenue recognition and accounting for customer acquisition costs. These practical dilemmas spurred theoretical debate and led to the development of more specific guidance within the Ind AS framework, ensuring that the theory remains relevant and responsive to the evolving business environment. The transition from Indian GAAP to Ind AS itself was driven by the practical need for Indian companies to be comparable with their global peers, a practical pressure that forced a significant evolution in India's accounting theory and standards.

Figure 1.1 - The Cyclical Relationship Between Accounting Theory and Practice



1.3 Methodological Approaches to Theory Formulation

The development of accounting theory is a structured process that follows distinct methodological approaches. The two most prominent approaches are the inductive and deductive methods, each offering a different pathway for constructing theoretical frameworks.

1.3.1 The Inductive Approach

The inductive approach to theory formulation involves reasoning from the specific to the general. The process begins with making empirical observations of the accounting practices of various business enterprises. By observing and analysing what accountants are actually doing in the real world, the theorist aims to identify recurring patterns, relationships, and principles. The process involves collecting a large sample of financial data, classifying and analysing it to find uniformities, and from these observed uniformities, deriving generalised principles or theories. For example, by observing that most profitable Indian companies consistently provide for all known liabilities, a theorist might inductively conclude that the principle of conservatism is a fundamental component of sound accounting practice. The primary advantage of this approach is that the resulting theory is grounded in reality and reflects what has proven workable. However, its main limitation is that it explains what *is*, but not necessarily what *should be*. It can perpetuate outdated or suboptimal practices simply because they are common.

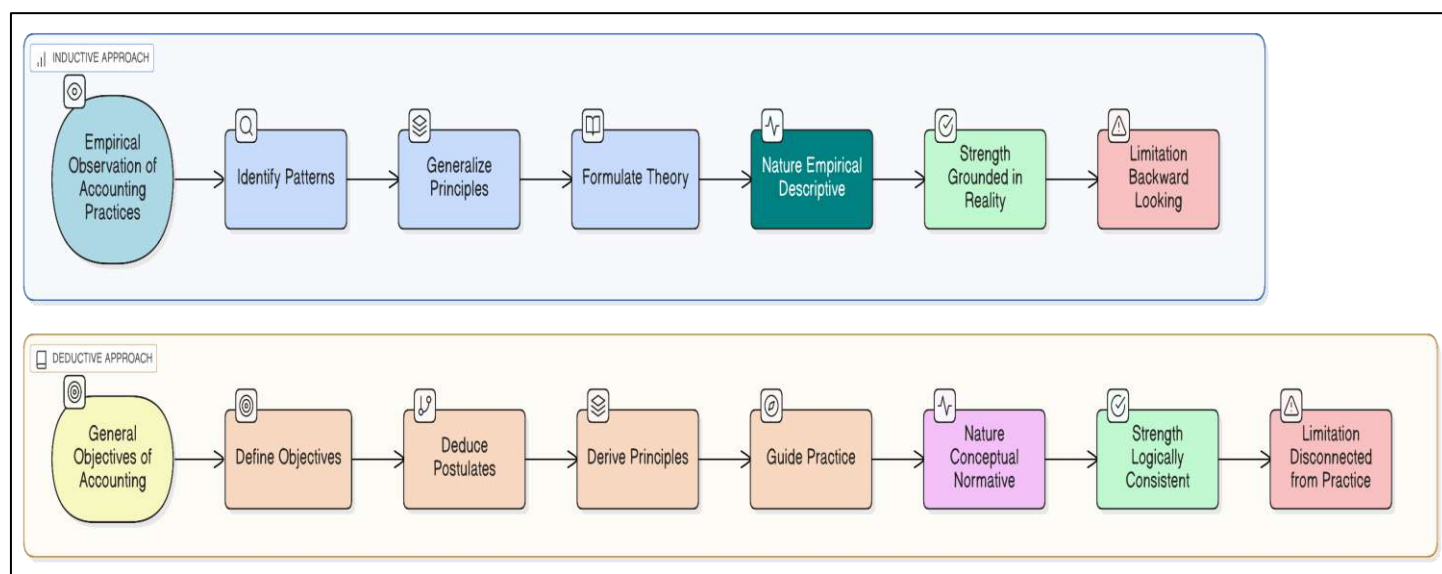
1.3.2 The Deductive Approach

In contrast, the deductive approach reasons from the general to the specific. This method begins not with observation, but with the establishment of a broad objective of accounting, such as providing information useful for economic decision-making. From this primary objective, the theorist logically deduces a set of postulates or basic assumptions about the accounting environment (e.g., the going concern assumption). These postulates then serve as the foundation for deducing specific accounting principles that guide practice. The entire structure is built on logical reasoning. The Conceptual Framework underlying Ind AS is a prime example of a product of deductive reasoning. Its strength lies in its logical consistency; if the objectives and postulates are sound, the resulting principles should be robust. This allows for the creation of standards for new issues before a widespread practice has developed. The main limitation, however, is that the validity of the entire system hinges on the acceptance of its initial objectives and postulates.

1.3.3 A Comparative Analysis

The inductive and deductive approaches represent two different philosophies for building knowledge in accounting. **One important difference is that** the inductive method is empirical and descriptive, building theory from the ground up based on observation, whereas the deductive method is conceptual and normative, deriving principles from the top down based on logic. **Another key distinction lies in their starting points:** induction begins with specific real-world practices, while deduction starts with general, abstract objectives. **Furthermore,** the inductive approach is often seen as more practical but potentially backward-looking, while the deductive approach is more logically pure and forward-looking but risks being disconnected from reality if its premises are flawed. In modern standard-setting, such as the process followed by the ICAI, neither approach is used in isolation. A combination is employed: a deductive conceptual framework provides the overall structure, but this is supplemented by an extensive inductive process of seeking feedback from companies, auditors, and investors before a new standard is issued.

Figure 1.2 - A Comparison of Inductive and Deductive Approaches in Accounting Theory



1.4 The Rationale for Studying Accounting Theory

A formal study of accounting theory is indispensable for any serious student or practitioner of accounting. Its importance extends far beyond academic curiosity, providing the intellectual foundation for the profession.

1. To Provide a Framework for Standardization: Accounting theory is essential for the development and standardization of accounting practices. Without a guiding theory, accounting standards would become a patchwork of inconsistent, ad-hoc rules, making it impossible to compare the financial statements of different companies. In India, the theoretical framework guides the Accounting Standards Board (ASB) of the ICAI in creating a harmonized set of principles (AS and Ind AS). This ensures that companies like Reliance Industries and Infosys, despite operating in different sectors, prepare their financial statements on a basis that is consistent and comparable, fostering trust in the Indian capital markets.

2. To Enhance Decision-Making Capabilities: An understanding of theory enhances the decision-making capabilities of both preparers and users of financial information. For a Chartered Accountant preparing financial statements, theory provides the basis for exercising professional judgment in ambiguous situations not explicitly covered by a standard. For an investor in the National Stock Exchange (NSE), understanding the theory behind different accounting methods (e.g., depreciation methods, inventory valuation) allows them to understand the meaning behind the numbers, appreciate the limitations of financial statements, and make more informed investment decisions.

3. To Provide Conceptual Clarity: Theory provides conceptual clarity by answering the fundamental "why" questions that underlie accounting procedures. It transforms the practice of accounting from a mere technical, rule-following exercise into a professional discipline rooted in logical reasoning. Understanding why inventory is valued at cost or net realizable value, whichever is lower (a theoretical concept of prudence), is more empowering than simply memorizing the rule. This deeper understanding allows accountants to adapt to new and unforeseen circumstances.

4. To Understand the Evolution of Financial Reporting: Studying theory is crucial for understanding the historical and ongoing evolution of financial reporting. It illuminates why certain principles like historical cost became dominant and why they are now being challenged by alternatives like fair value. Understanding the theoretical debates surrounding the convergence of Indian GAAP with IFRS, for instance, provides context for the significant changes in financial reporting in India over the last decade and prepares students for the future direction of the profession.

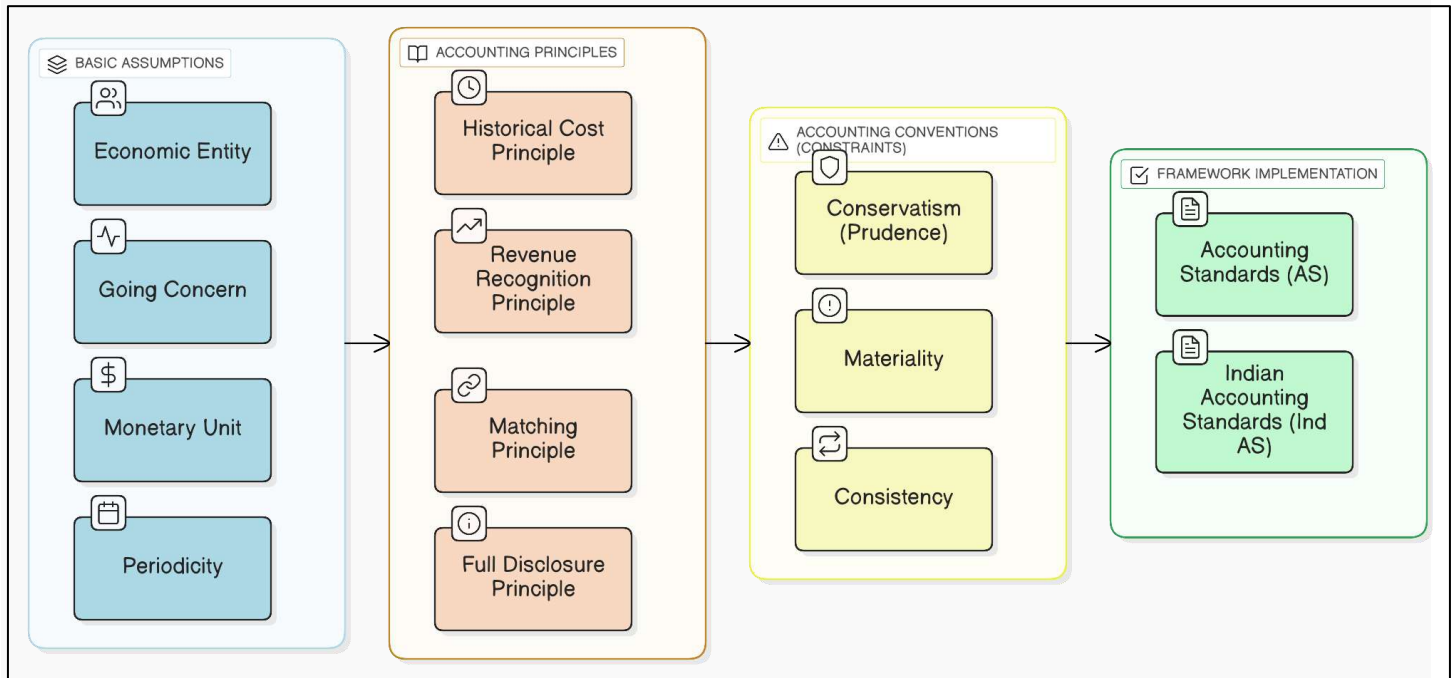
1.5 The Framework of Financial Reporting: GAAP in India

Generally Accepted Accounting Principles (GAAP) represent the comprehensive framework of standards, conventions, and rules that accountants follow. In the Indian context, GAAP is not a single set of rules but a framework that has evolved, now primarily comprising Accounting Standards (AS) and Indian Accounting Standards (Ind AS).

Meaning and Purpose: The primary purpose of GAAP in India is to ensure that financial reporting is transparent, consistent, and comparable across different organizations. This standardization, mandated by the Companies Act, 2013, and regulated by bodies like the ICAI and NFRA, allows investors, lenders, and government agencies to make meaningful comparisons and informed judgments about the financial health of Indian enterprises.

Features: A key feature of Indian GAAP is its two-tiered structure. Certain large, listed, and high-net-worth companies are required to comply with Ind AS, which are converged with International Financial Reporting Standards (IFRS). Other companies continue to follow Accounting Standards (AS), which are based on the older Indian GAAP. This phased approach was adopted to ease the transition to global standards.

Figure 1.3 - The Hierarchical Structure of GAAP



Assumptions: The entire framework of GAAP is built on a foundation of basic assumptions. These include the **Economic Entity** assumption (a business, like a local kirana store, is treated as separate from its owner), the **Going Concern** assumption (it is assumed that a company like Larsen & Toubro will continue to operate for the foreseeable future), the **Monetary Unit** assumption (transactions are recorded in Indian Rupees, and the effects of inflation are generally ignored), and the **Periodicity** assumption (the life of a business is divided into distinct periods, such as a financial year from April 1st to March 31st).

Principles: Building on these assumptions are key principles. The **Historical Cost Principle** dictates that assets are recorded at their purchase price (e.g., land bought in 1990 is still shown at its 1990 cost). The **Revenue Recognition Principle**, as defined in Ind AS 115, states that revenue is recognized when control of goods or services is transferred to the customer. The **Matching Principle** requires that expenses incurred to generate revenue (e.g., cost of goods sold) are recognized in the same period as the revenue. The **Full Disclosure Principle** mandates that all information that could affect a user's understanding must be disclosed in the financial statements or their notes.

Conventions (Constraints): Finally, these principles are tempered by conventions or constraints. The convention of **Conservatism (or Prudence)** suggests that when in doubt, an accountant should choose the solution that is least likely to overstate assets or income. The convention of **Materiality** allows accountants to disregard trivial matters; for example, expensing a ₹100 stapler immediately rather than depreciating it over its life is acceptable for a large company. **Consistency** requires that a company uses the same accounting methods from one period to the next to ensure comparability.

1.6 Conceptualizing Capital and its Maintenance

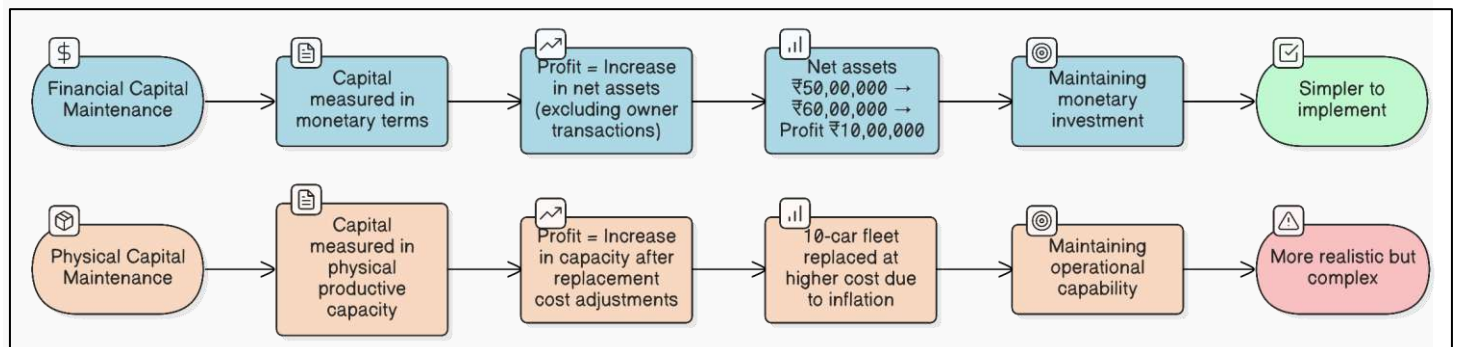
The measurement of profit is fundamentally linked to the concept of capital maintenance. In simple terms, a profit can only be recognized after the initial capital of the business has been preserved or "maintained." There are two primary theories for defining and maintaining capital.

Meaning of Capital: In accounting, capital is generally understood as the net assets or equity of an entity, calculated as Total Assets minus Total Liabilities. It represents the owners' residual claim on the assets of the business.

Financial Capital Maintenance: This is the concept predominantly used in India under both AS and Ind AS. Under this view, capital is defined in monetary terms (e.g., Indian Rupees). A profit is earned only if the financial amount of net assets at the end of a period is greater than the financial amount at the beginning, after excluding any transactions with owners. For example, if a business starts the year with net assets of ₹50,00,000 and ends the year with net assets of ₹60,00,000 (with no owner contributions or withdrawals), it has earned a profit of ₹10,00,000. This concept is straightforward and focuses on preserving the monetary value of the investment.

Physical Capital Maintenance: In contrast, this concept defines capital in terms of the entity's physical productive capacity. A profit is earned only if the physical capacity of the business at the end of the period exceeds its capacity at the beginning. For instance, if a taxi company's capital is defined as its ability to operate a fleet of 10 cars, profit is the income earned after setting aside enough funds to replace those 10 cars at their current cost. If a machine costing ₹2,50,000 needs to be replaced at the end of its life, and its replacement cost has risen to ₹3,00,000 due to inflation, the extra ₹50,000 is treated as a capital maintenance adjustment, not as a distributable profit. This concept is economically more realistic but is far more complex to implement in practice.

Figure 1.4 - A Conceptual Comparison of Capital Maintenance Models



1.7 The Interplay of Capital and Income: Stock and Flow Concepts

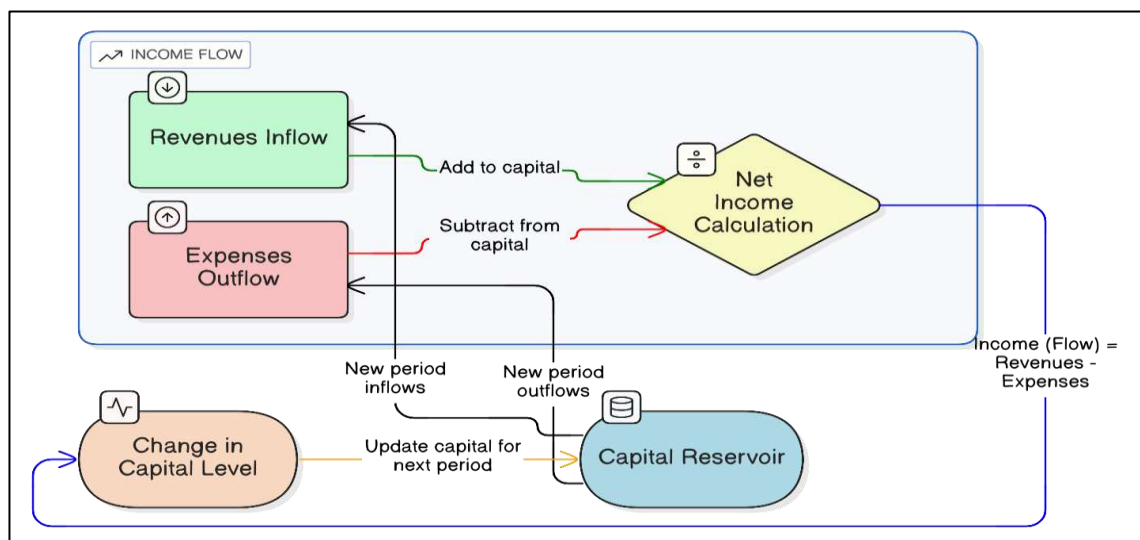
The relationship between capital and income is best understood through the economic concepts of stock and flow. These concepts help clarify the purpose of the two primary financial statements.

First, a stock is a measure of a quantity at a specific point in time. The Balance Sheet is a statement of stocks. It presents a snapshot of an entity's assets, liabilities, and equity (capital) on a particular date. For example, the Balance Sheet of a company like Asian Paints Ltd. as on 31st March 2025 would show its cash balance, inventory level, and total debt at that precise moment. Capital itself is a stock concept, representing the residual wealth of the entity at that point in time.

Second, a flow is a measure of a quantity over a period of time. The Statement of Profit and Loss (Income Statement) is a statement of flows. It reports the revenues, expenses, gains, and losses that have occurred between two dates, thereby explaining the change in wealth over that interval. For instance, the Statement of Profit and Loss for Asian Paints Ltd. for the year ended 31st March 2025 would show the total sales revenue earned and expenses incurred during that entire twelve-month period. Income, therefore, is a flow concept.

Third, the interaction between stock and flow is fundamental. The income flow during a period explains the change in the capital stock between the beginning and end of that period (assuming no capital transactions with owners). This can be visualized as a reservoir: the amount of water in the reservoir at any moment is the stock (capital), while the water flowing in from rivers (revenues) and out through canals (expenses) are the flows. The net flow (profit or loss) determines whether the stock of water increases or decreases over time.

Figure 1.5 - The Relationship Between Capital (Stock) and Income (Flow)



1.8 Critiques of Traditional Measurement: Limitations of Historical Cost Accounting

The historical cost principle, a cornerstone of traditional accounting, has been valued for its objectivity and verifiability. However, it faces significant limitations, especially in an economy like India's that experiences periods of inflation.

First, it leads to unrealistic valuation during inflation. Historical cost accounting requires that assets be recorded at their acquisition price. During periods of rising prices, the carrying value of assets recorded years ago becomes increasingly disconnected from their current economic value. For example, a piece of land purchased by a company in a prime location in Bengaluru in 1995 for ₹10,00,000 may still be shown on the Balance Sheet at ₹10,00,000, even though its current market value could be over ₹10 crores. This severely understates the true financial position of the company.

Second, it causes income distortion. The valuation issues lead directly to problems in income measurement. Depreciation expense on a machine purchased for ₹20,00,000 ten years ago is calculated based on that historical cost. In an inflationary environment, the cost to replace that machine might be ₹50,00,000. By charging lower depreciation based on the old cost, the company understates the true economic cost of using the asset. This results in an overstatement of reported profit. This "fictitious" profit may lead to the company paying higher taxes and dividends than it can truly afford, thereby eroding its real capital.

Third, it impairs comparability between firms. Historical cost accounting creates significant comparability challenges. An investor trying to compare two cement companies may be misled if one company (Company A) holds an old, fully depreciated plant, while the other (Company B) has a new, modern plant. Company A will report very low depreciation expense and potentially higher profits, but this is merely an accounting artifact, not a reflection of superior operational efficiency. Company B's higher depreciation charge, while reflecting economic reality, makes its profits appear lower, creating a non-level playing field for comparison.

1.9 An Alternative Perspective: Introduction to Fair Value Accounting

In response to the limitations of historical cost, fair value accounting has emerged as a significant alternative, especially with the adoption of Ind AS.

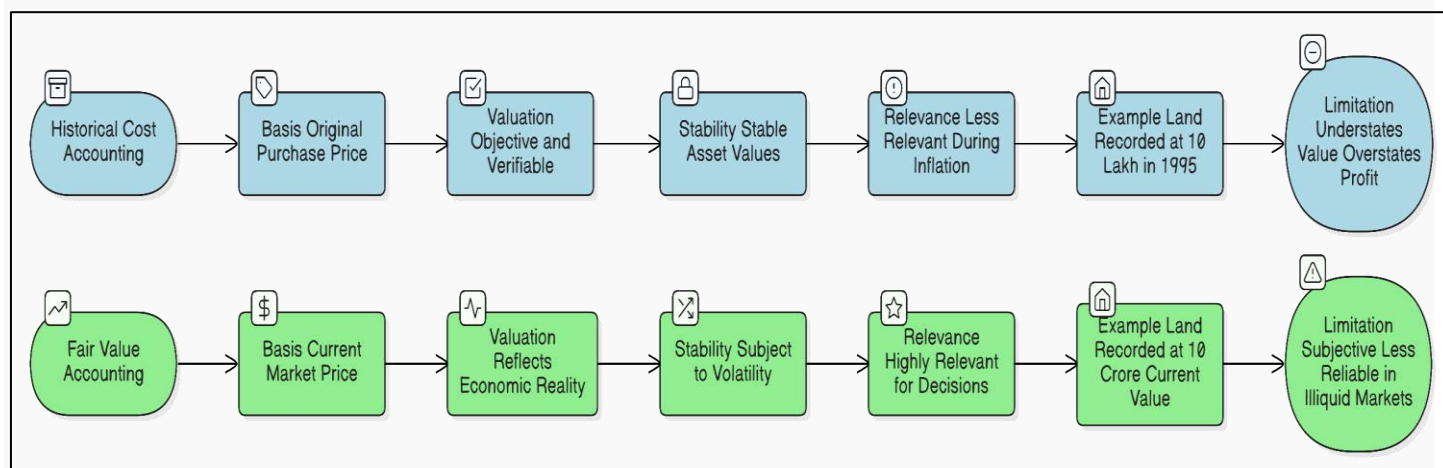
First, the meaning of fair value is defined under Ind AS 113 as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It is an "exit price" concept. The conceptual foundation of fair value is **relevance**. Proponents argue that

reporting assets and liabilities at their current market values provides a more timely and accurate picture of a company's financial position. For example, reporting the investment in equity securities listed on the NSE at their current market price gives a more relevant picture of their value than their original purchase price.

Second, the primary advantage of fair value is its relevance. It reflects current economic conditions. For financial instruments, real estate, and certain other assets, fair value provides information that is far more useful for decision-making than outdated historical costs. For instance, knowing the fair value of land held by a real estate developer in Mumbai is critical for any investor assessing the company's worth.

Third, fair value accounting faces significant challenges, primarily a potential lack of reliability and objectivity. While determining the fair value of a share of Reliance Industries is easy (it's quoted on the stock exchange), determining the fair value of a private, unlisted subsidiary or a unique piece of custom-built machinery requires significant management judgment and complex valuation models. This introduces subjectivity and can lead to volatility in reported earnings, as asset values fluctuate with market sentiment, even if the company has no intention of selling them. This debate between the reliability of historical cost and the relevance of fair value is a central tension in modern accounting.

Figure 1.6 - A Comparative Overview of Historical Cost and Fair Value Accounting



Chapter Summary

First, this chapter introduced accounting theory as the logical framework that underpins financial reporting. We established that theory is descriptive, predictive, and normative, and its primary objective is to guide the development of sound, consistent accounting standards, which is particularly important in the context of India's evolving economy.

Second, the symbiotic relationship between theory and practice was explored, showing how theory guides professional judgment while practical challenges from the Indian business environment drive the evolution of theory, as seen in the development of Ind AS.

Third, we examined the two main approaches to theory formulation: the inductive method (reasoning from specific observations to general principles) and the deductive method (reasoning from general objectives to specific rules). Modern standard-setting in India uses a blend of both.

Fourth, the chapter detailed the structure of GAAP in India, built upon a hierarchy of objectives, assumptions, principles, and conventions. This framework ensures the comparability and reliability of financial statements.

Fifth, key conceptual debates in measurement were introduced, starting with the concepts of financial and physical capital maintenance, which define how profit is measured. This was linked to the understanding of capital as a stock concept (Balance Sheet) and income as a flow concept (Statement of Profit and Loss).

Finally, the chapter contrasted the traditional historical cost model with the fair value approach. We analysed the limitations of historical cost, such as its irrelevance during inflation, and introduced fair value as a more relevant but potentially less reliable alternative, highlighting the central trade-off between relevance and reliability that shapes modern financial reporting under Ind AS.

Unit 2

Introduction to Accounting Standards

1.0 Introduction to Financial Accounting Standards

In the vast and complex world of business, financial statements serve as the primary medium of communication between a company and its stakeholders, including investors, creditors, government agencies, and the public. To ensure this communication is clear, consistent, and credible, a common set of rules and guidelines is indispensable. These rules are formally known as Accounting Standards (ASs). We shall now delve into the concept, purpose, and significance of these standards within the Indian context.

1. Concept of Accounting Standards: An Accounting Standard is an authoritative written policy document issued by an expert accounting body or by the government or other regulatory authority. These documents prescribe the principles and procedures for recognition, measurement, treatment, presentation, and disclosure of accounting transactions and events in the financial statements. In essence, they act as a framework to guide accountants in preparing and presenting financial information, thereby ensuring that the financial statements of an enterprise are based on a common set of principles and are not influenced by the subjective judgments of the preparer.

2. Purpose of Accounting Standards: The fundamental purpose of setting accounting standards is to standardise the diverse accounting policies and practices prevalent in a country. By doing so, they aim to eliminate, or at least reduce to a reasonable extent, the variations in the treatment of accounting transactions. For instance, without a standard like AS 10 (Property, Plant and Equipment), one company might charge depreciation using the straight-line method while another, in the same industry, might use the written-down value method for identical assets, making a direct comparison of their profitability misleading. The standards provide a common language for financial reporting, much like grammar provides rules for a language, ensuring that everyone can understand it correctly.

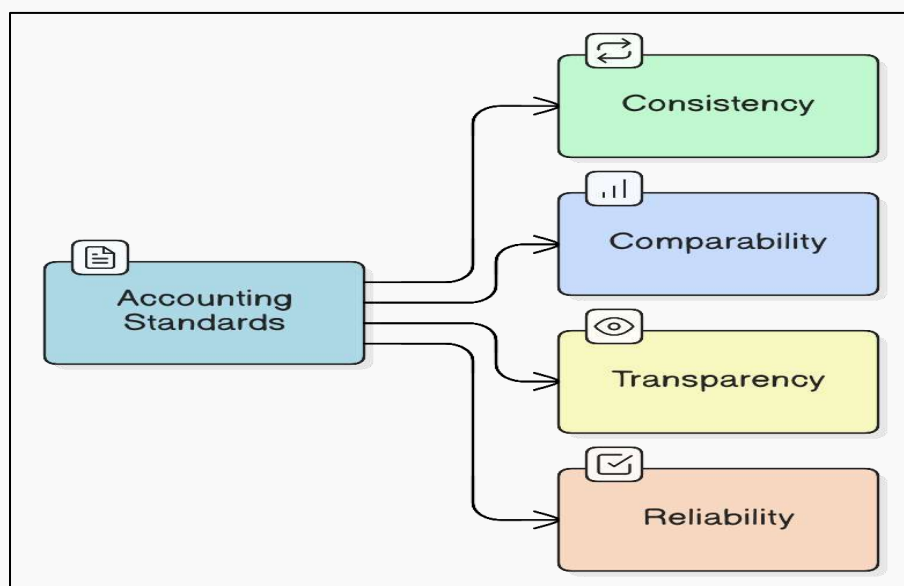
3. Importance in India: The importance of accounting standards in a developing and rapidly globalising economy like India cannot be overstated. First, they enhance the credibility and reliability of financial statements, which is crucial for attracting both domestic and foreign investment. When investors are confident that the financial data is prepared based on robust standards, they are more willing to invest capital. Second, they assist auditors in conducting their audits of financial statements, providing a benchmark against which the fairness of the presentation can be judged. Third, they facilitate the comparison of financial performance not only between different companies within India (inter-firm comparison) but also over different time periods for the

same company (intra-firm comparison). This comparability is vital for making informed economic decisions.

2.0 Benefits of Accounting Standards in India

The implementation of a structured set of accounting standards brings forth numerous benefits that strengthen the financial reporting ecosystem of a country. In India, these benefits have been instrumental in improving the quality of corporate reporting. Let us examine the primary advantages in detail.

Figure 2.1: Core Benefits of Accounting Standards



First, Promoting Consistency: Accounting standards ensure that similar transactions are accounted for in a consistent manner by an enterprise from one period to another. This consistency is vital for meaningful trend analysis. For example, consider a manufacturing company, say, Bharat Heavy Electricals Limited (BHEL). If it values its inventory using the 'First-In, First-Out' (FIFO) method in one year and the 'Weighted Average Cost' method in the next, its reported profit could fluctuate significantly due to the change in accounting policy alone, not due to any real change in its operational efficiency. AS 2 (Valuation of Inventories) mandates consistent application of a chosen valuation formula, thereby ensuring that the reported profits reflect the actual performance of the company.

Second, Enhancing Comparability: A key objective of financial reporting is to allow stakeholders to compare the financial health and performance of different companies before making investment or credit decisions. Standards make this comparison possible by ensuring that all companies follow the same set of rules. For instance, an investor wishing to compare the financial performance of two major Indian IT firms, such as Infosys and Wipro, can do so with confidence because both prepare their financial statements based on the same set of standards (Ind AS). Without this common framework, if one company recognised revenue upon contract signing and the other upon project

completion, their reported revenues and profits would not be comparable, rendering any analysis futile.

Third, Ensuring Transparency through Disclosure: Modern accounting standards place a strong emphasis on disclosure. They require companies to provide not just the core financial statements but also a wealth of supplementary information in the notes to accounts. This transparency helps users understand the underlying assumptions and risks. For example, AS 18 (Related Party Disclosures) requires a company to disclose transactions with its subsidiaries, key management personnel, or other related entities. This is crucial for a large conglomerate like the Reliance Group, as it allows investors to assess whether transactions between group companies are conducted at arm's length and are not detrimental to the interests of minority shareholders.

Fourth, Improving Reliability: Financial statements are considered reliable when they are neutral, free from material error and bias, and faithfully represent the economic reality of the transactions. Accounting standards contribute to reliability by providing clear guidelines that reduce the scope for creative accounting or intentional manipulation of profits. For example, AS 29 (Provisions, Contingent Liabilities and Contingent Assets) lays down strict criteria for when a provision (a liability of uncertain timing or amount) can be recognised. A company cannot simply create a provision of, say, ₹50 Crores to reduce its current year's profit and reverse it in a future year to inflate profits. The standard ensures that provisions are recognised only when there is a present obligation arising from a past event, making the financial statements more trustworthy.

3.0 Procedure for Issuing Accounting Standards (ASs) in India

The formulation and issuance of Accounting Standards in India is a rigorous and consultative process, designed to ensure that the final standards are robust, relevant, and widely accepted. The Institute of Chartered Accountants of India (ICAI) has historically been at the forefront of this process, working in conjunction with governmental and regulatory bodies.

3.1 The Standard-Setting Bodies and their Roles

The standard-setting landscape in India involves a collaborative effort between several key entities. It is essential to understand their hierarchical relationship and distinct roles.

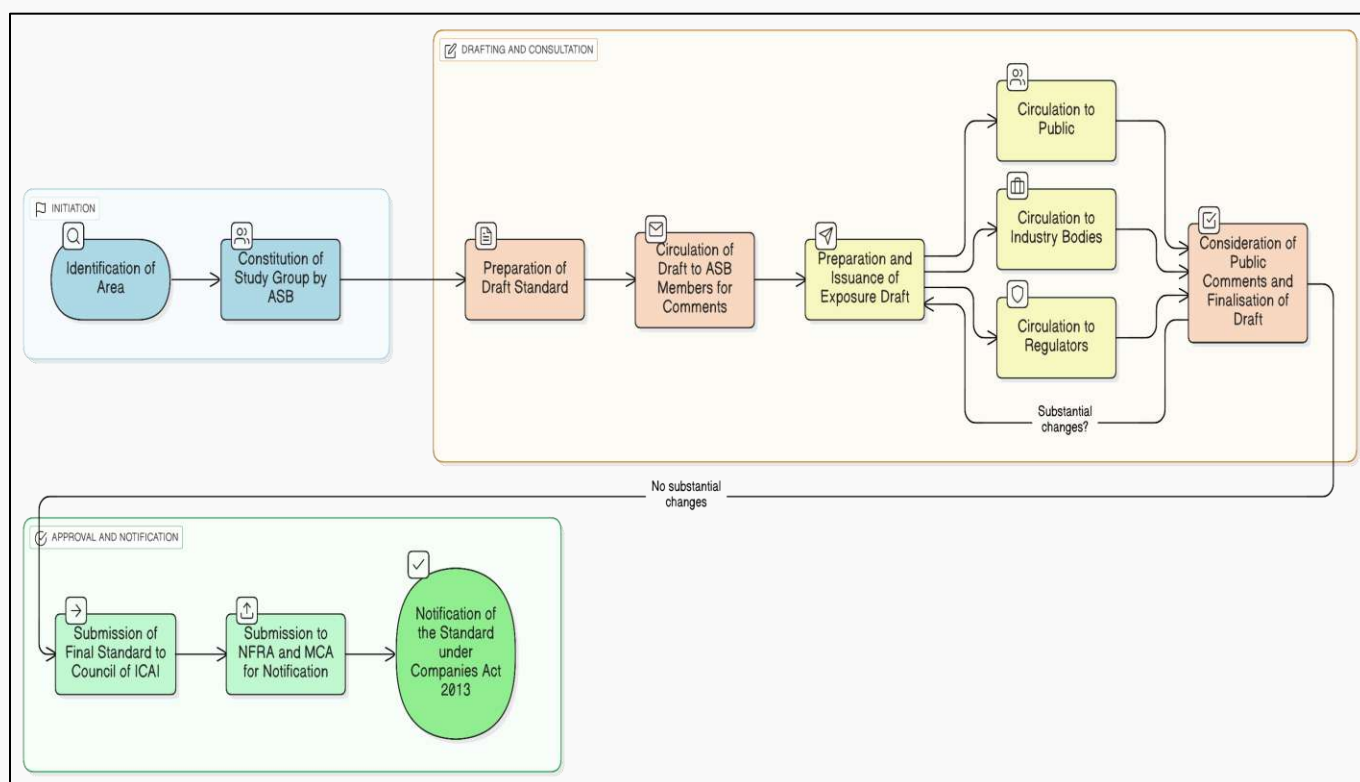
Level	Body	Primary Role
Apex Authority	Ministry of Corporate Affairs (MCA), Government of India	Prescribes Accounting Standards for companies under the Companies Act, 2013, giving them legal backing.
Independent Regulator	National Financial Reporting Authority (NFRA)	Recommends standards to the MCA for notification. Monitors and enforces compliance with accounting and auditing standards.

		Has oversight over auditors of listed and large unlisted companies.
Recommending Body	Institute of Chartered Accountants of India (ICAI)	Develops and recommends Accounting Standards (or amendments) to NFRA/MCA after a detailed due process. Issues standards for non-corporate entities.

3.2 The Due Process for Issuing Standards

The Accounting Standards Board (ASB) of the ICAI is responsible for formulating the standards. The procedure followed is systematic and transparent, involving extensive consultation with stakeholders. The steps are as follows:

Figure 3.2: Flowchart of the Standard-Setting Process in India



First, Identification of the Need: The ASB identifies a broad area or a specific issue that requires a new standard or modification of an existing one. This need may arise due to changes in the economic environment, new types of business transactions, or the need to align with global practices.

Second, Constitution of a Study Group: The ASB constitutes a study group or task force to undertake research and prepare an initial draft. This group comprises members of the ICAI Council, industry experts, academics, and representatives from regulatory bodies like SEBI and CBDT.

Third, Preparation and Circulation of the Exposure Draft (ED): Based on the work of the study group, the ASB prepares an Exposure Draft of the proposed standard. This ED is a crucial document that is widely circulated for public comment. It is sent to the members of the ICAI, industry associations (like CII, FICCI), government departments, and academic institutions. The ED is also hosted on the ICAI's website to invite comments from any interested party.

Fourth, Analysis of Comments and Finalisation: The ASB holds extensive deliberations on the comments received on the Exposure Draft. Meetings are held with representatives of key bodies who have provided feedback. After considering all viewpoints, the draft is modified as deemed appropriate.

Fifth, Issuance and Notification: The final draft of the standard is submitted to the Council of the ICAI for its approval. Once approved, the standard is recommended to the National Financial Reporting Authority (NFRA). NFRA, after its review, recommends the standard to the Ministry of Corporate Affairs (MCA). The MCA then notifies the standard under the Companies Act, 2013, making it legally mandatory for companies to comply with it. This multi-layered review process ensures that the final standard is well-vetted and robust.

4.0 The Need for and Challenges of Global Accounting Standards

In an increasingly interconnected global economy, the existence of different national accounting standards can create confusion and act as a barrier to international trade and investment. This has led to a strong global movement towards the harmonisation of accounting standards, with the goal of establishing a single set of high-quality standards that can be used worldwide.

4.1 The Need for Global Harmonisation for India

1. Facilitating Global Investment: India is a major destination for Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). International investors find it difficult and costly to understand and analyse financial statements prepared under different national accounting rules. When Indian companies present their financial statements using globally accepted standards, it becomes easier for foreign investors to compare them with companies from other countries, thereby boosting investor confidence and facilitating capital flows. For example, a US-based pension fund looking to invest in the Indian telecom sector can more easily compare Reliance Jio and Bharti Airtel if both report under a framework that is similar to global norms.

2. Assisting Indian Multinational Companies (MNCs): Many Indian companies have become global players with operations and listings on foreign stock exchanges. For instance, companies like Infosys and Wipro are listed on US stock exchanges. If they had to prepare one set of accounts based on Indian standards for domestic purposes and another set based on US standards (US GAAP) for their American listing, it would result in significant additional costs and complexity. A single,

globally accepted standard simplifies this process, reduces costs, and ensures consistency in reporting across jurisdictions.

3. Improving Cross-Border Trade and Mergers: Global standards make it easier for companies to engage in cross-border mergers and acquisitions. When both the acquiring company and the target company use the same accounting language, the process of due diligence and business valuation becomes more straightforward and reliable. This fosters a more dynamic and efficient global market for corporate control.

4.2 Challenges in Achieving Global Harmonization

1. Differences in Legal and Regulatory Systems: Every country has its own unique legal framework, such as the Companies Act in India, which often dictates specific accounting treatments or disclosure requirements. Harmonising accounting standards requires aligning them with these diverse legal systems, which can be a formidable challenge. For example, the definition of a 'subsidiary' or the requirements for dividend distribution may differ, impacting how consolidation or profit appropriation is accounted for.

2. Economic and Cultural Diversity: The economic structures of countries vary significantly. The accounting needs of a highly developed economy with deep capital markets may be very different from those of an emerging economy where small and medium-sized enterprises (SMEs) dominate. A complex, fair-value-based standard that is suitable for large MNCs may be too costly and burdensome for a small family-owned business in India to implement. Cultural attitudes towards transparency and regulation also play a role.

3. Implementation and Transition Costs: Shifting from a long-established national standard to a new global one is a massive undertaking. It involves significant costs related to training accountants and auditors, upgrading IT systems, and educating users of financial statements. There is also the challenge of 'unlearning' old rules and applying new, often more complex, principles. This transition period can be disruptive and requires careful planning and management by both companies and regulators.

5.0 An Introduction to IFRS

The most prominent effort towards global accounting harmonisation is represented by the International Financial Reporting Standards (IFRS). IFRS are a set of accounting standards developed and maintained by the International Accounting Standards Board (IASB), an independent, not-for-profit organisation.

1. Concept and Objectives of IFRS: IFRS are designed as a common global language for business affairs so that company accounts are understandable and comparable across international boundaries. They are principle-based standards, meaning they provide a broad framework and require the application of professional judgment, rather than providing detailed,

prescriptive rules for every possible situation. The primary objective of the IFRS Foundation is to develop a single set of high-quality, understandable, enforceable, and globally accepted financial reporting standards based upon clearly articulated principles.

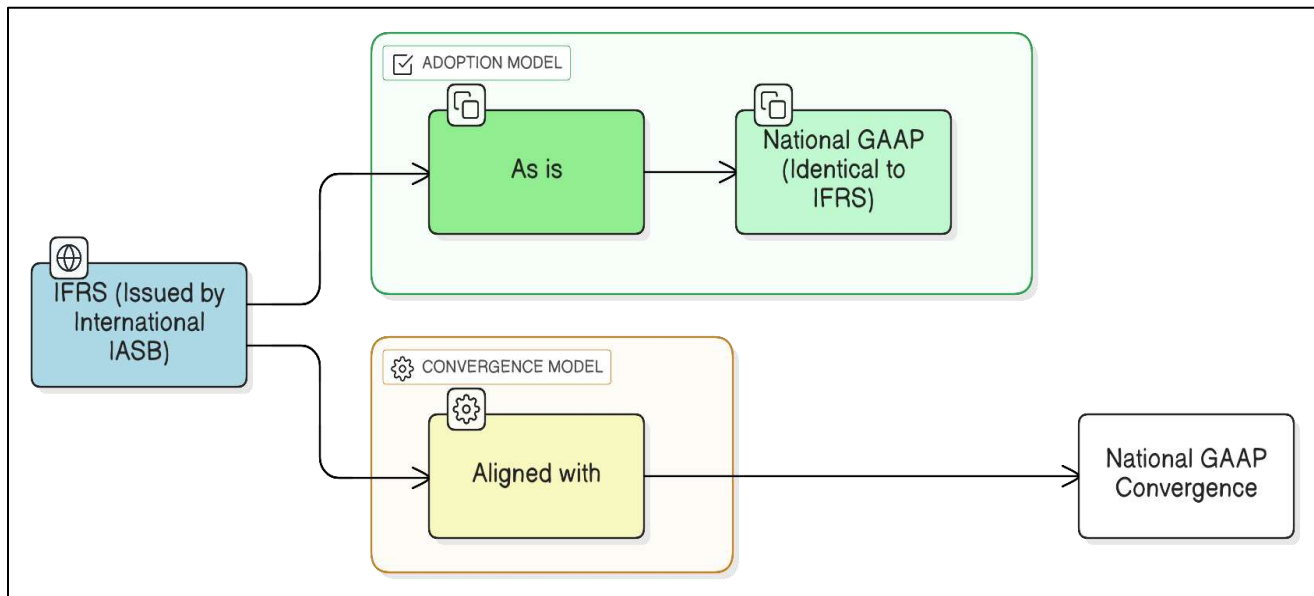
2. Global Importance of IFRS: The importance of IFRS has grown immensely, with more than 140 jurisdictions now requiring or permitting the use of IFRS for publicly listed companies. This widespread adoption means that IFRS has become the de facto global standard for financial reporting. For an Indian company seeking to raise capital from international markets, preparing IFRS-compliant financial statements is almost a necessity. It enhances their reputation and provides access to a larger pool of capital at potentially lower costs.

Aspect	Traditional Indian AS (Accounting Standards)	IFRS (International Financial Reporting Standards)
Basis	Primarily 'Rule-based'. Provides specific rules for transactions.	'Principle-based'. Provides a framework, requiring professional judgment.
Valuation Focus	Primarily based on Historical Cost.	Mixed model, with a greater emphasis on 'Fair Value' accounting.
Example: Fixed Assets	Generally carried at historical cost less depreciation. Revaluation is permitted but less common.	Permits carrying Property, Plant, and Equipment at either historical cost or revalued amount (fair value).
Financial Instruments	Limited and basic guidance.	Comprehensive and complex standards (IFRS 9) covering classification, measurement, and impairment.
Consolidation	Based on control through voting power or board composition.	Based on a broader concept of 'control', which includes de facto control even without a majority stake.

6.0 Adoption versus Convergence of IFRS

When a country decides to align its accounting standards with IFRS, it faces a fundamental choice between two primary strategies: 'Adoption' or 'Convergence'. India made a strategic choice to converge its standards rather than adopt IFRS wholesale. Let us understand the distinction and the rationale behind India's decision.

Figure 6.1: Conceptual Models of Adoption and Convergence



1. The Meaning of Adoption: Adoption, also known as the 'big bang' approach, means that a country decides to completely replace its national accounting standards with IFRS as issued by the IASB. In this model, the country gives up its sovereign right to set accounting standards and accepts IFRS in its entirety, including all future standards and amendments issued by the IASB. This ensures perfect comparability with other IFRS-adopting countries but offers no flexibility to cater to unique national circumstances.

2. The Meaning of Convergence: Convergence is a process where a country's national standard-setter (like the ICAI in India) revises its national standards to align them with IFRS. While the goal is to make the national standards as close to IFRS as possible, this approach allows for certain modifications, known as 'carve-outs' or 'carve-ins'. A 'carve-out' is when a specific requirement of an IFRS is removed from the corresponding national standard. A 'carve-in' is when an additional requirement, not present in IFRS, is added to the national standard. This approach creates standards that are substantially similar to IFRS but are tailored to the country's specific legal and economic environment.

3. Why India Chose Convergence: India's decision to converge with IFRS, leading to the creation of Indian Accounting Standards (Ind AS), was a pragmatic one. First, direct adoption would have meant ceding control over standard-setting to a foreign body (the IASB), which was a significant sovereignty concern. Second, certain IFRS principles were in direct conflict with existing Indian laws, such as the Companies Act, 2013. For example, the presentation format of the Statement of Profit and Loss and the Balance Sheet is prescribed in Schedule III of the Companies Act. A direct adoption of IFRS would have required immediate and extensive amendments to Indian law. Third, certain economic realities specific to India needed special consideration. For instance, accounting

for foreign currency fluctuations on long-term monetary items is a significant issue for Indian companies that borrow heavily in foreign currency. Ind AS 21 provides an option related to this that is not available under IFRS, providing a smoother transition for Indian corporates. By choosing convergence, India achieved a balance between being globally aligned and addressing its unique national requirements.

7.0 An Introduction to Ind AS (Indian Accounting Standards)

As a result of the convergence strategy, India developed a new set of standards known as Indian Accounting Standards, or Ind AS. These standards are now mandatory for a large section of Indian companies and represent a paradigm shift in the country's financial reporting landscape.

1. Concept and Structure of Ind AS: Ind AS are a set of accounting standards that are converged with IFRS. They are named and numbered in the same way as the corresponding IFRS. For example, the Indian standard on revenue recognition, Ind AS 115, corresponds to IFRS 15, 'Revenue from Contracts with Customers'. While they are based on IFRS principles, they include certain carve-outs and carve-ins to make them suitable for the Indian context. The structure of Ind AS is therefore IFRS-converged, not IFRS-identical.

2. Applicability of Ind AS: The Ministry of Corporate Affairs (MCA) has notified a phased implementation of Ind AS for Indian companies. The applicability is based on listing status and net worth. Broadly, the requirements are as follows:

Phase I (From 1 April 2016): Mandatory for all listed and unlisted companies with a net worth of ₹500 Crore or more.

Phase II (From 1 April 2017): Mandatory for all other listed companies and unlisted companies with a net worth between ₹250 Crore and ₹500 Crore.

Companies that do not meet these criteria continue to apply the traditional Accounting Standards (AS). This phased approach was designed to give smaller companies more time to prepare for the transition.

3. Key Differences between AS and Ind AS: The shift from AS to Ind AS is not merely a change of rules; it is a move towards a new philosophy of accounting. Some of the key differences are: *First*, Ind AS are principle-based, whereas the older AS are more rule-based. This requires accountants to exercise greater professional judgment. *Second*, Ind AS place a much stronger emphasis on fair value accounting compared to the historical cost model predominantly used in AS. For example, under Ind AS, certain financial assets and liabilities must be measured at fair value. *Third*, the concept of 'control' for the purpose of consolidation is much broader under Ind AS 110 than under the old AS 21, potentially bringing more entities into the consolidation net. *Fourth*, Ind AS introduces complex new standards for areas like financial instruments (Ind AS 109) and revenue recognition (Ind AS 115), which were treated much more simply under the old AS.

4. Examples of Ind AS Application: Major Indian companies like Reliance Industries Limited, Tata Consultancy Services (TCS), and Infosys were among the first to transition to Ind AS. Their annual reports are now prepared in accordance with Ind AS and provide a wealth of information that was not previously available under the old standards. For example, the financial statements of Reliance Industries now include extensive disclosures on financial instruments, fair value hierarchies, and the impact of new standards, making their reports more transparent and comparable to their global peers like ExxonMobil or Shell.

8.0 Chapter Summary

In this chapter, we have explored the fundamental concepts surrounding accounting standards and their evolution in the Indian and global context. The key takeaways are as follows:

1. Accounting Standards are authoritative policy documents that provide a common framework for preparing and presenting financial statements. Their primary purpose is to standardise accounting practices to enhance consistency, comparability, transparency, and reliability of financial information.
2. In India, the process of issuing standards is a collaborative effort led by the ICAI's Accounting Standards Board, with final notification by the Ministry of Corporate Affairs (MCA) based on recommendations from the independent regulator, NFRA. This due process involves extensive public consultation.
3. Globalisation has created a pressing need for a single set of international accounting standards to facilitate cross-border investment and operations. IFRS, issued by the IASB, has emerged as the leading global benchmark.
4. Countries can either 'adopt' IFRS directly or 'converge' their national standards with them. India chose the path of convergence to maintain sovereign control and address specific national legal and economic requirements, while still achieving substantial alignment with global best practices.
5. This convergence has resulted in the creation of Indian Accounting Standards (Ind AS), which are now mandatory for most large Indian companies. Ind AS are principle-based, focus more on fair value, and are significantly more complex and comprehensive than the traditional Accounting Standards (AS), marking a major step forward in the quality of financial reporting in India.

Unit 3: Accounting Standards (ASs)

Accounting Standards (ASs) are authoritative statements of how particular types of transactions, events, and other conditions should be reflected in financial statements. Issued by the Institute of Chartered Accountants of India (ICAI), these standards aim to standardise accounting policies and practices. The primary objective is to ensure transparency, consistency, comparability, reliability, and relevance of financial reporting. This chapter provides a comprehensive overview of select key Accounting Standards that form the bedrock of financial accounting and reporting in India for non-corporate entities and certain other entities not required to adopt Ind AS.

1. AS 1: Disclosure of Accounting Policies

This standard deals with the disclosure of significant accounting policies followed in preparing and presenting financial statements. The purpose is to promote a better understanding of the financial statements by providing clarity on the basis of their preparation.

1.1. Meaning and Objectives of Accounting Policies

First, accounting policies are defined as the specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements. For instance, the choice between the Straight-Line Method (SLM) and Written Down Value (WDV) method for depreciation is a choice of accounting policy. The primary objective of disclosing these policies is to ensure that the financial statements are intelligible and can be meaningfully compared over different periods and with those of other enterprises. This disclosure facilitates a more informed judgement by the users of these statements.

1.2. Importance of Transparency and Consistency

Transparency in financial reporting is paramount, as it builds trust among stakeholders such as investors, creditors, and the public. By clearly disclosing the accounting policies, an enterprise reveals the basis on which its financial position and performance have been measured. Furthermore, consistency in the application of these policies from one period to another is crucial for comparability. If an enterprise changes its depreciation method from WDV to SLM, the resulting profit figure would not be directly comparable to the previous year's profit unless the effect of this change is disclosed, as mandated by AS 5.

1.3. Fundamental Accounting Assumptions

AS 1 specifies three fundamental accounting assumptions that are presumed to have been followed in the preparation of financial statements. If they are not followed, the fact must be disclosed. These assumptions are:
First, Going Concern: This assumption implies that the enterprise will continue its operations for the

foreseeable future and has neither the intention nor the necessity of liquidation or of curtailing materially the scale of its operations.

Second, Consistency: This assumption requires that accounting policies are applied consistently from one period to another to ensure comparability of financial statements. Any change in policy and its financial effect must be disclosed.

Third, Accrual: This assumption dictates that revenues and costs are recognised as they are earned or incurred, not as money is received or paid. This provides a more accurate picture of an enterprise's performance during a period than the cash basis.

1.4. Areas of Diverse Accounting Policies and Disclosure Example

Enterprises have choices in several areas of accounting, which necessitates disclosure. Key areas include the methods of depreciation, depletion, and amortisation; the valuation of inventories (e.g., FIFO, Weighted Average); the valuation of investments; the treatment of goodwill; and the recognition of revenue. The selection of a particular policy can significantly impact the reported profit and financial position.

For example, consider a machine purchased for ₹10,00,000 with a useful life of 5 years. If Company A uses the Straight-Line Method (SLM), the annual depreciation is ₹2,00,000. If Company B uses the Written Down Value (WDV) method at 40%, the first-year depreciation is ₹4,00,000. This difference of ₹2,00,000 in depreciation expense directly impacts the reported profit. Without the disclosure of the depreciation method used, a user of the financial statements would be unable to make a valid comparison between the two companies.

2. AS 2: Valuation of Inventories

AS 2 (Revised) prescribes the accounting treatment for inventories. The primary issue in accounting for inventories is the determination of the cost to be recognised as an asset and carried forward until the related revenues are recognised.

2.1. Meaning and Types of Inventories

Inventories are assets held for sale in the ordinary course of business, in the process of production for such sale, or in the form of materials or supplies to be consumed in the production process or in the rendering of services. Inventories encompass several categories: first, Finished Goods, which are ready for sale; second, Work-in-Progress (WIP), which are partially completed goods; and third, Raw Materials and supplies, which await use in the production process.

2.2. Cost Formulae: FIFO and Weighted Average

The cost of inventories should comprise all costs of purchase, costs of conversion, and other costs incurred in bringing the inventories to their present location and condition. AS 2 permits two primary cost formulae for assigning costs to inventory units.

First, the First-In, First-Out (FIFO) method assumes that the items of inventory that were purchased or produced first are sold first. Consequently, the items remaining in inventory at the end of the period are those most recently purchased or produced.

Second, the Weighted Average Cost method determines the cost of each item from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. This average may be calculated on a periodic basis or as each additional shipment is received.

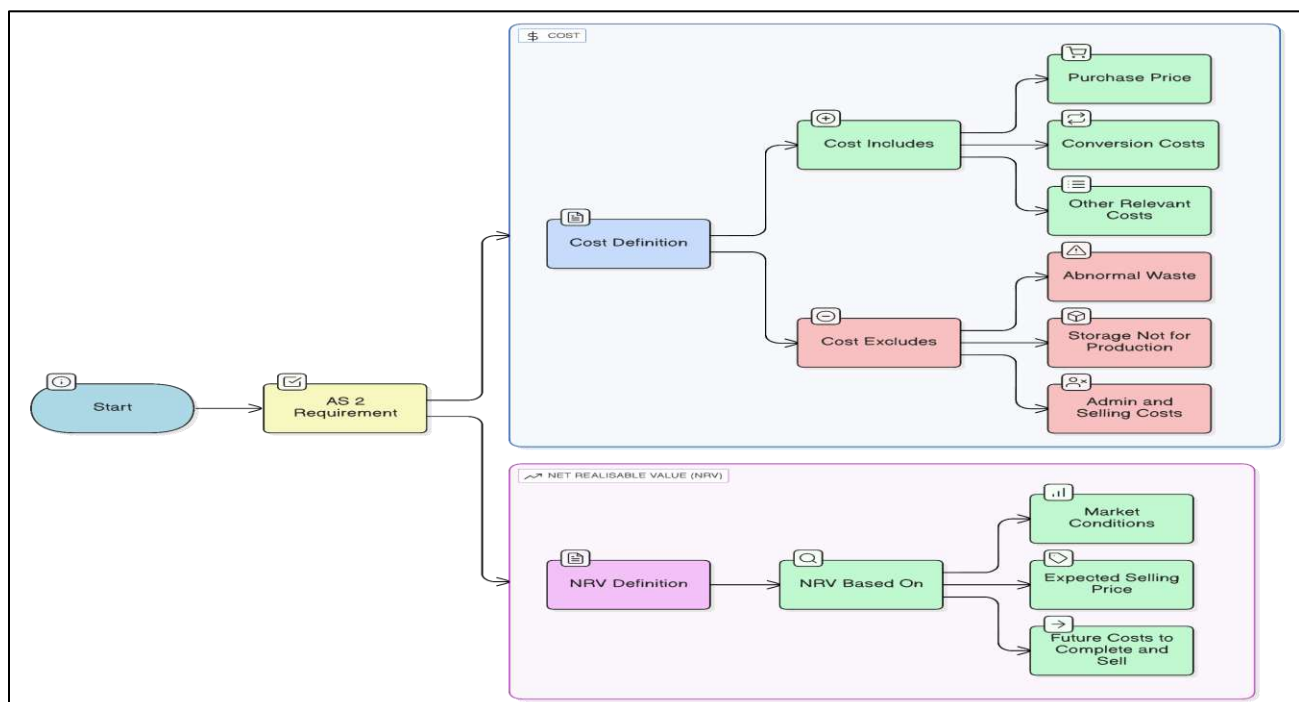
2.3. Items Excluded from Inventory Cost

Certain costs are explicitly excluded from the cost of inventories and are recognised as expenses in the period in which they are incurred. These include, first, abnormal amounts of wasted materials, labour, or other production costs; second, storage costs unless those costs are necessary in the production process prior to a further production stage; third, administrative overheads that do not contribute to bringing inventories to their present location and condition; and fourth, selling and distribution costs.

2.4. Net Realisable Value (NRV)

A central principle of AS 2 is that inventories must be valued at the lower of cost and net realisable value (NRV). NRV is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. This principle ensures that the value of an asset is not stated at an amount higher than what is expected to be realised from its sale or use. In India's dynamic pricing environment, where prices of certain goods can fluctuate, applying the NRV rule is critical to avoid overstatement of assets and profits.

Figure 2.1: Comparison of Cost vs. Net Realisable Value (NRV)



3. AS 4: Contingencies and Events Occurring After the Balance Sheet Date

This standard deals with the treatment of contingencies and events that occur after the balance sheet date but before the financial statements are approved by the Board of Directors or a similar approving authority.

3.1. Meaning of Contingencies

A 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. For example, a lawsuit filed against a company where the outcome is uncertain is a contingency. If the outcome is a probable loss that can be reasonably estimated, a provision is created. If the loss is possible but not probable, or cannot be reasonably estimated, it is disclosed as a contingent liability in the notes to the accounts.

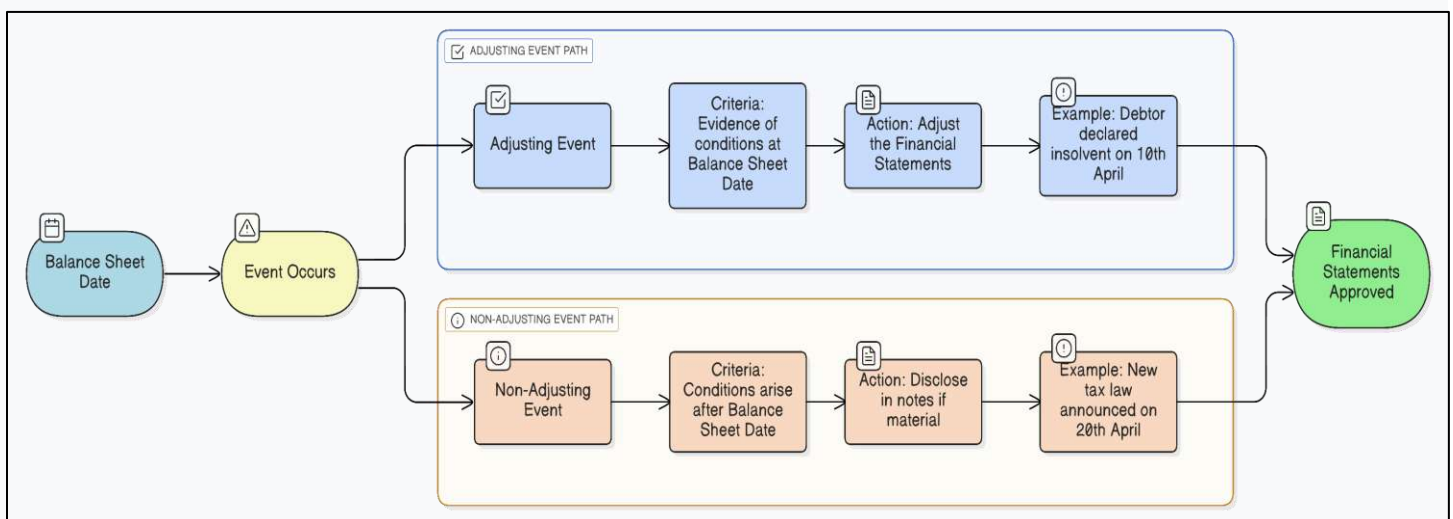
3.2. Events Occurring After the Balance Sheet Date

These are significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved. AS 4 classifies them into two types:

First, Adjusting Events are those that provide further evidence of conditions that existed at the balance sheet date. Financial statements should be adjusted for such events. An example is the settlement of a court case after the balance sheet date for an amount that confirms a liability existed at the balance sheet date.

Second, Non-Adjusting Events are those that are indicative of conditions that arose after the balance sheet date. These do not require adjustment of the financial statements. However, if they are material, they should be disclosed in the report of the approving authority. An example is a major fire destroying a factory after the balance sheet date.

Figure 3.1: Timeline for Classifying Post-Balance Sheet Events



3.3. Indian Case Examples

Consider an Indian company, ABC Ltd., with a year-end of 31st March 2024. **Adjusting Event Example:** A major debtor, who owed ₹50,00,000 as on 31st March 2024, is declared insolvent on 10th April 2024. This event confirms that the loss of the receivable had already occurred as on the balance sheet date. Therefore, ABC Ltd. must adjust its financial statements for the year ended 31st March 2024 by making a provision for the bad debt.

Non-Adjusting Event Example: On 20th April 2024, the government announces a retrospective tax law change that negatively impacts the company's future profitability. Since this condition (the new law) did not exist on 31st March 2024, it is a non-adjusting event. No adjustment is made to the financial statements, but the nature of the event and its estimated financial effect must be disclosed in the Directors' Report.

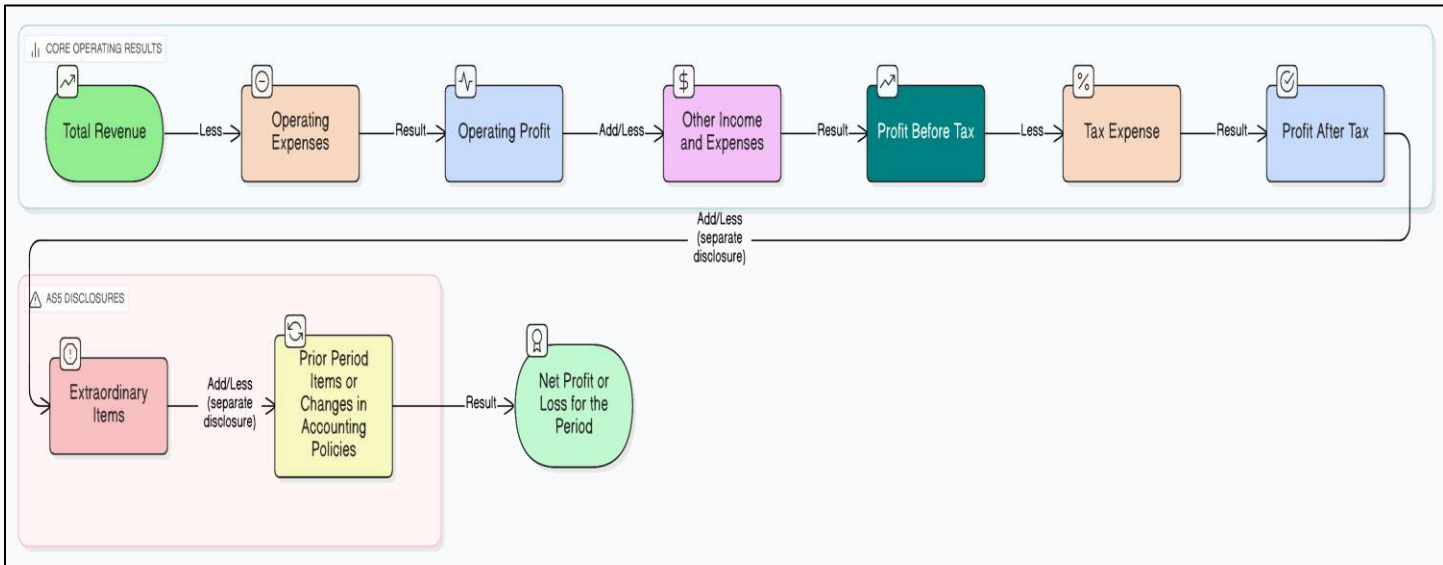
4. AS 5: Net Profit or Loss for the Period, Prior Period Items, and Changes in Accounting Policies

AS 5 prescribes the classification and disclosure of certain items in the statement of profit and loss to enhance comparability and understanding of an enterprise's financial performance.

4.1. Components of Net Profit or Loss

The statement of profit and loss should present a clear picture of the enterprise's performance. AS 5 requires that all items of income and expense recognised in a period should be included in the determination of net profit or loss for the period unless an Accounting Standard requires or permits otherwise. The standard mandates separate disclosure of certain items to highlight the performance from regular operations.

Figure 4.1: Conceptual Structure of Profit/Loss Statement under AS 5



4.2. Extraordinary vs. Ordinary Items

Ordinary activities are any activities which are carried on 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. **Extraordinary items**, as per the standard, are 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. Examples include losses from an earthquake or the attachment of property by the government. These must be disclosed separately in the statement of profit and loss so that their impact on the current profit is clear.

4.3. 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. For example, if a major expense of ₹2,00,000 from the previous year was mistakenly omitted, its correction in the current year is a prior period item. These are not included in the determination of net profit for the current period. Instead, they are disclosed separately in the statement of profit and loss, and the opening balance of retained earnings is restated to correct the error.

4.4. Changes in Accounting Estimates and Policies

A change in an accounting estimate is an adjustment of the carrying amount of an asset or liability resulting from new information or new developments. For example, changing the estimated useful life of an asset from 10 years to 8 years is a change in estimate. The effect of this change is accounted for prospectively (in the current and future periods).

A change in accounting policy, such as changing the inventory valuation method from Weighted Average to FIFO, is treated differently. Such a change should be made only if required by statute, for compliance with an accounting standard, or if it results in a more appropriate presentation. The impact of the change should be quantified and disclosed. If the effect is material, the financial statements of prior periods presented for comparison should be restated.

5. AS 9: Revenue Recognition

AS 9 deals with the principles for recognising revenue in the statement of profit and loss of an enterprise. Revenue is a critical measure of an enterprise's operational performance.

5.1. Meaning and Recognition of Revenue

Revenue is the gross inflow of cash, receivables, or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties, and dividends. Revenue is measured by the charges made to

customers or clients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. Recognition is the process of incorporating an item into the financial statements. Revenue is recognised only when it is probable that future economic benefits will flow to the enterprise and these benefits can be measured reliably.

5.2. Recognition Criteria for Different Revenue Streams

AS 9 lays down specific criteria for different types of revenue.

First, for the Sale of Goods, revenue should be recognised when the seller has transferred to the buyer the property in the goods for a price, or all significant risks and rewards of ownership have been transferred to the buyer, and the seller retains no effective control over the goods.

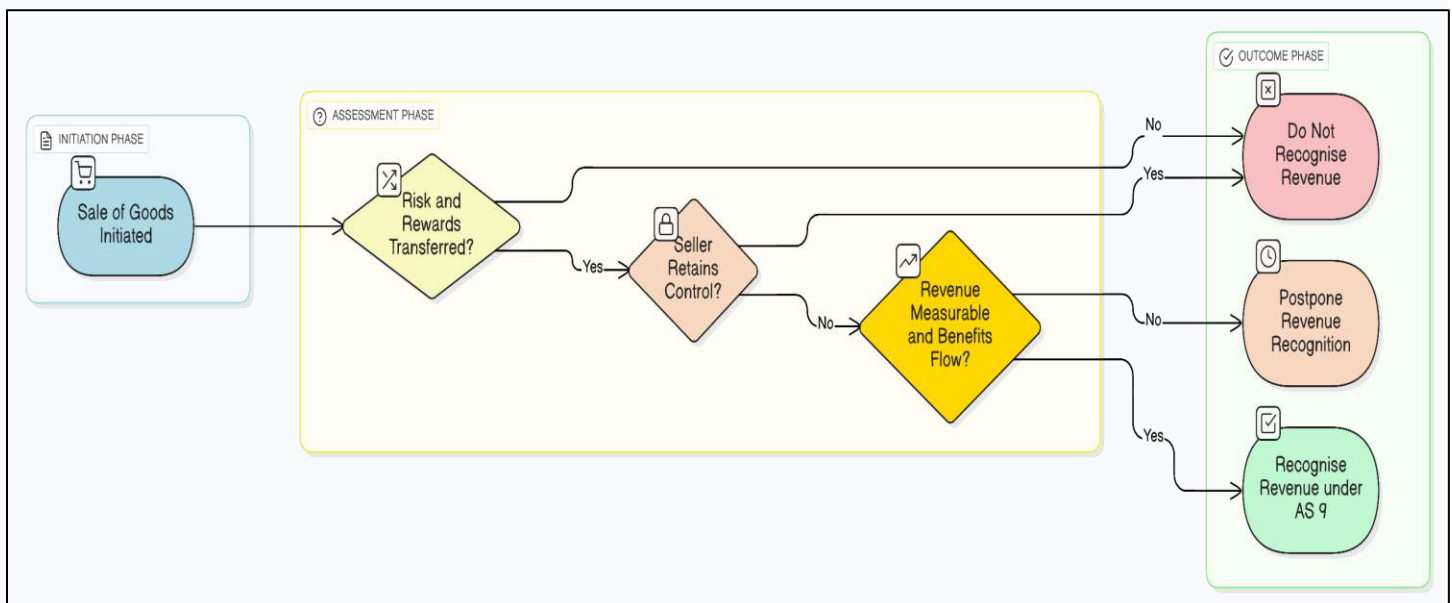
Second, for the Rendering of Services, revenue can be recognised using the proportionate completion method, where revenue is recognised in proportion to the degree of completion of the service. Alternatively, the completed service contract method may be used, where revenue is recognised only when the service is fully rendered.

Third, for Interest, Royalties, and Dividends, revenue is recognised on a time proportion basis for interest, on an accrual basis in accordance with the relevant agreement for royalties, and when the owner's right to receive payment is established for dividends.

5.3. Uncertainty of Collection

A crucial condition for revenue recognition is the certainty of its ultimate collection. When there is significant uncertainty regarding the collectability of the amount, revenue recognition is postponed. In such cases, revenue is recognised only when it becomes reasonably certain that the collection will be made, which is often upon the actual receipt of cash. For example, if goods worth ₹2,75,000 are sold to a customer with a poor credit history and deferred payment terms, and there is substantial doubt about their ability to pay, the enterprise should not recognise the revenue until the payment is received or collectability becomes certain.

Figure 5.1: Flowchart for Revenue Recognition (Sale of Goods)



6. AS 10: Property, Plant and Equipment (PPE)

AS 10 (Revised) prescribes the accounting treatment for Property, Plant and Equipment (PPE), which are often the most significant assets on a company's balance sheet.

6.1. Meaning and Components of PPE

Property, Plant and Equipment are tangible items that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes, and are expected to be used during more than one period. The cost of an item of PPE comprises its purchase price, including import duties and non-refundable purchase taxes, and any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

6.2. Initial Recognition and Subsequent Expenditure

An item of PPE is recognised as an asset if it is probable that future economic benefits associated with the item will flow to the enterprise and the cost of the item can be measured reliably. Subsequent expenditure related to an item of PPE is added to its carrying amount only when it is probable that future economic benefits, in excess of the originally assessed standard of performance, will flow to the enterprise. All other subsequent expenditure, such as day-to-day servicing (repairs and maintenance), should be recognised as an expense in the statement of profit and loss as incurred.

6.3. Depreciation Concepts

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. The depreciable amount is the cost of an asset less its residual value. Useful life is the period over which an asset is expected to be available for use by an enterprise. Depreciation begins when the asset is available for use and ceases when the asset is derecognised or classified as held for sale. The method of depreciation should reflect the pattern in which the asset's future economic benefits are expected to be consumed.

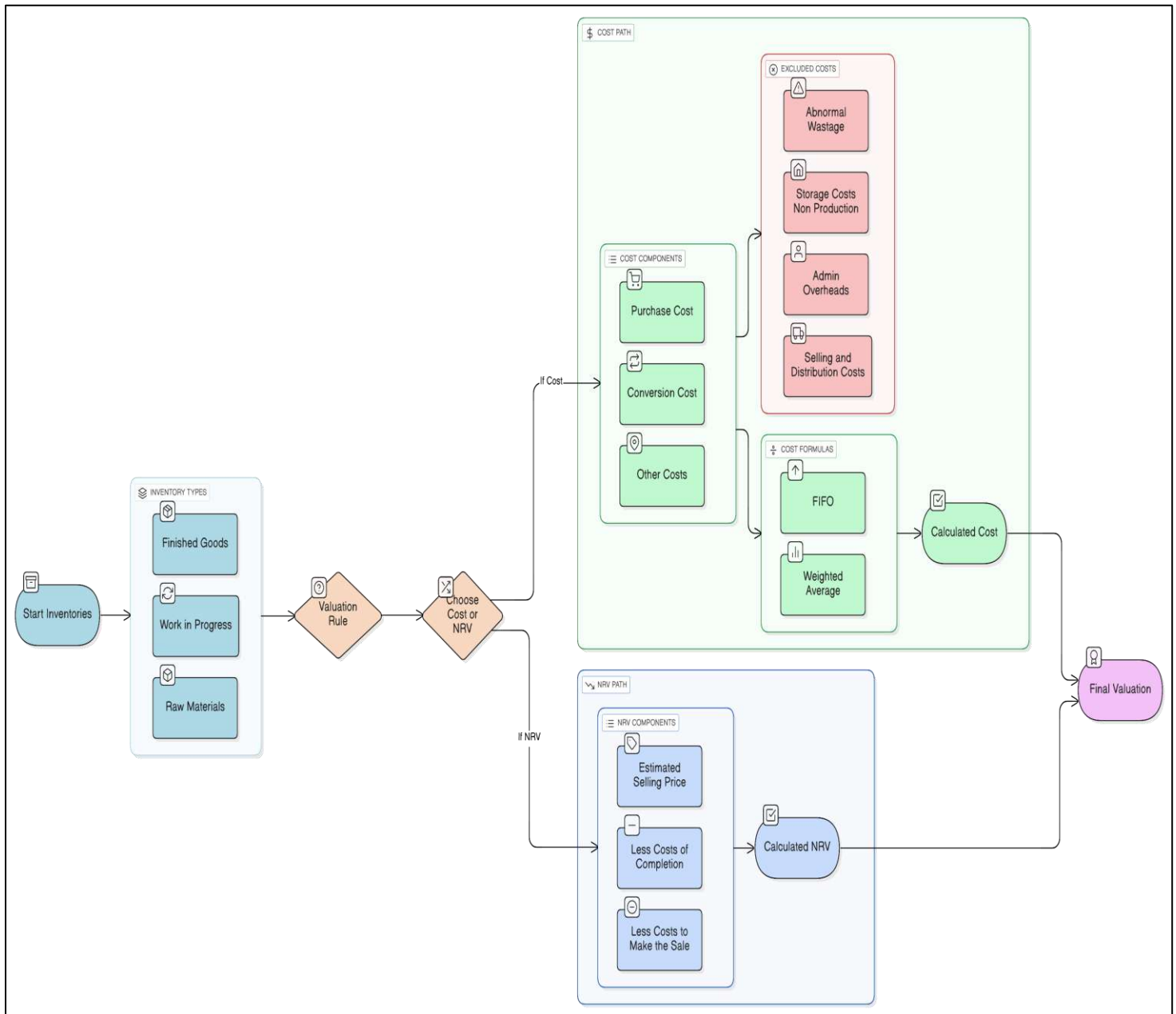
6.4. Cost Model vs. Revaluation Model

After initial recognition, an enterprise must choose its accounting policy for PPE.

First, under the Cost Model, the asset is carried at its cost less any accumulated depreciation and any accumulated impairment losses. This is the most commonly used model in India.

Second, under the Revaluation Model, an asset is carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations must be made with sufficient regularity to ensure the carrying amount does not differ materially from its fair value. Any increase in value is credited to a "Revaluation Surplus" in equity, while a decrease is first set off against any existing surplus for that asset and then charged to the profit and loss statement.

Figure 6.1: Example Depreciation Schedule (SLM)



7. AS 13: Accounting for Investments

AS 13 deals with accounting for investments in the financial statements of an enterprise and the related disclosure requirements. Investments are assets held by an enterprise for earning income by way of dividends, interest, and rentals, for capital appreciation, or for other benefits to the investing enterprise.

7.1. Types of Investments: Current vs. Long-term

AS 13 classifies investments into two categories based on the intention of the management at the time of purchase.

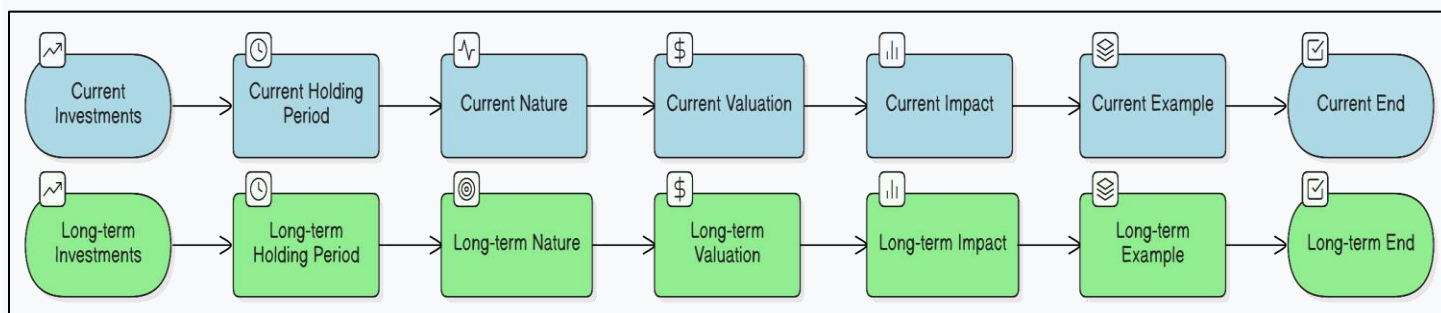
First, Current Investments are investments that are, by their nature, readily realisable and are intended to be held for not more than one year from the date on which such investment is made.

Second, Long-term Investments are all investments other than current investments. The intention is to hold them for more than one year.

7.2. Cost Determination and Valuation Principles

The cost of an investment includes the acquisition price and other costs incidental to acquisition such as brokerage, fees, and duties. The valuation principles differ for the two types of investments. Current investments must be carried at the lower of cost and fair value. Any reduction to fair value is debited to the profit and loss statement. Long-term investments are carried at cost. However, when there is a decline, other than temporary, in the value of a long-term investment, the carrying amount is reduced to recognise the decline. This reduction is also charged to the profit and loss statement.

Figure 7.1: Comparison of Current and Long-term Investments



7.3. Income and Disposal of Investments

Income from investments, such as interest and dividends, is recognised as income in the statement of profit and loss. Interest is recognised on a time proportion basis, while dividends are recognised when the right to receive payment is established. When an investment is disposed of, the difference between the carrying amount and the net disposal proceeds is recognised as a gain or loss in the profit and loss statement. For example, if long-term shares purchased for ₹1,50,000 are sold for ₹1,80,000 (net of brokerage), the gain of ₹30,000 is credited to the P&L statement.

8. AS 16: Borrowing Costs

AS 16 prescribes the accounting treatment for borrowing costs. It allows, under specific circumstances, for borrowing costs to be included in the cost of acquiring or constructing certain assets.

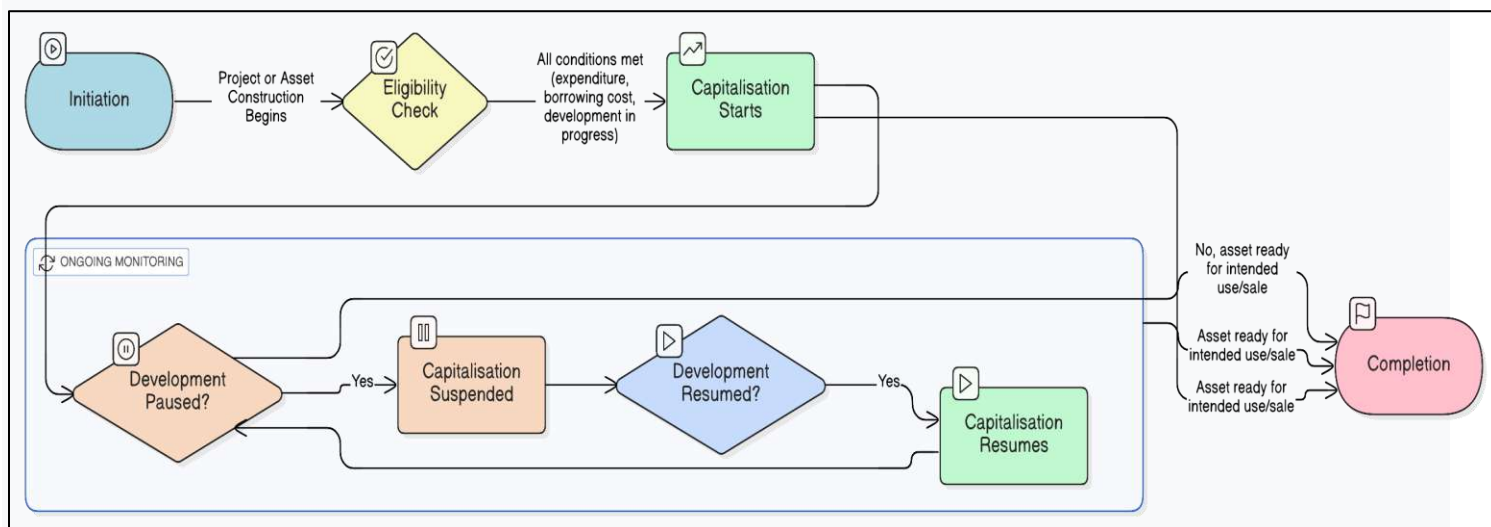
8.1. Meaning of Borrowing Costs and Qualifying Assets

Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds. This includes interest on bank overdrafts and loans, amortisation of discounts or premiums relating to borrowings, and finance charges in respect of assets acquired under finance leases. The standard permits the capitalisation of these costs only if they are directly attributable to the acquisition, construction, or production of a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Examples in the Indian context include the construction of a factory building, a power generation plant, or a large-scale manufacturing assembly line.

8.2. Capitalisation of Borrowing Costs

Capitalisation refers to the process of adding the borrowing costs to the cost of the asset, rather than expensing them in the period they are incurred. This is based on the principle that costs incurred to bring an asset to a working condition for its intended use should be part of the asset's cost. Capitalisation should commence when expenditure for the asset is being incurred, borrowing costs are being incurred, and activities to prepare the asset are in progress. Capitalisation should be suspended during extended periods in which active development is interrupted. It should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

Figure 8.1: Illustration of Borrowing Cost Capitalisation



9. AS 20: Earnings Per Share (EPS)

AS 20 prescribes principles for the determination and presentation of earnings per share, which is a key financial metric used by shareholders and potential investors to assess an enterprise's performance and profitability on a per-share basis.

9.1. Meaning and Importance of EPS

Earnings Per Share (EPS) represents the portion of a company's profit allocated to each outstanding share of common stock. It serves as an indicator of a company's profitability. For Indian shareholders, a consistent and growing EPS is often seen as a sign of a healthy and robust company, influencing investment decisions and the market price of the company's shares. AS 20 aims to improve comparability of performance among different enterprises in the same period and among different accounting periods for the same enterprise.

9.2. Basic and Diluted EPS

The standard requires the presentation of two types of EPS.

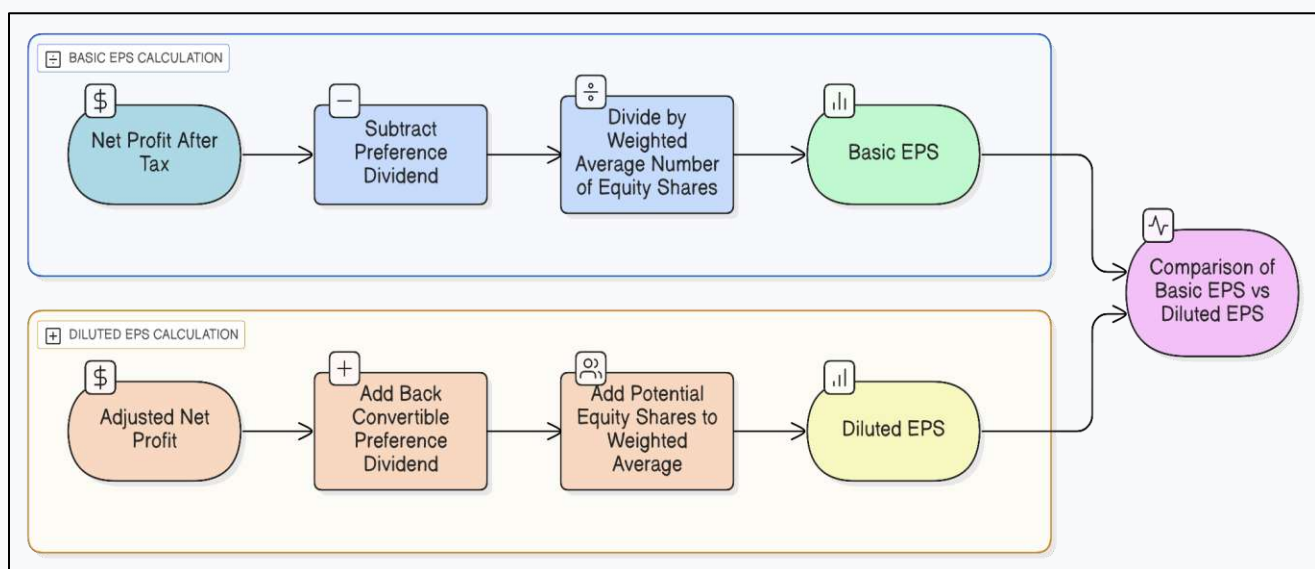
First, Basic EPS is calculated by dividing the net profit or loss for the period attributable to equity shareholders by the weighted average number of equity shares outstanding during the period. The net profit is adjusted for any preference dividends.

Second, Diluted EPS is calculated by adjusting the earnings and the number of shares for the effects of all dilutive potential equity shares. Potential equity shares are financial instruments that may entitle their holder to equity shares in the future, such as convertible debentures, share warrants, and options. Diluted EPS shows the worst-case scenario of what the EPS would be if all dilutive securities were converted into equity shares.

9.3. Weighted Average Number of Shares

The weighted average number of shares is the number of equity shares outstanding at the beginning of the period, adjusted by the number of equity shares bought back or issued during the period multiplied by a time-weighting factor. The time-weighting factor is the number of days that the shares are outstanding as a proportion of the total number of days in the period. This ensures that the effect of any change in the number of shares is appropriately reflected in the EPS calculation.

Figure 9.1: Illustration of Basic and Diluted EPS Calculation



Chapter Summary

First, this chapter has established that Accounting Standards provide the fundamental framework for consistent and transparent financial reporting in India. AS 1 underscores the importance of disclosing accounting policies and adhering to the fundamental assumptions of Going Concern, Consistency, and Accrual.

Second, the valuation and presentation of key financial statement elements were detailed. AS 2 mandates the valuation of inventories at the lower of cost or NRV, while AS 10 governs the accounting for tangible fixed assets (PPE), including their depreciation and valuation using either the cost or revaluation model. Similarly, AS 13 provides guidelines for classifying and valuing current and long-term investments.

Third, the chapter explored standards related to the timing and recognition of transactions. AS 9 provides critical criteria for revenue recognition, ensuring income is recorded only when earned and collectible. AS 4 addresses the accounting for contingencies and events occurring after the balance sheet date, distinguishing between adjusting and non-adjusting events. AS 16 specifies the conditions under which borrowing costs related to qualifying assets must be capitalised.

Finally, the presentation of performance and per-share metrics was discussed. AS 5 structures the statement of profit and loss, mandating separate disclosure for extraordinary and prior period items. AS 20 provides the methodology for calculating and presenting Basic and Diluted Earnings Per Share, a vital metric for assessing corporate profitability from a shareholder's perspective. Collectively, these standards ensure that financial statements are reliable, comparable, and relevant for all stakeholders.

This comprehensive textbook provides an in-depth exploration of accounting theory and regulation, designed specifically for Semester V students pursuing Major/Core Paper 10. The book systematically covers fundamental concepts, contemporary theories, and regulatory frameworks that govern modern accounting practices.

Through a balanced approach combining theoretical foundations with practical applications, this text equips students with the knowledge and analytical skills necessary to understand the evolution of accounting standards and their impact on financial reporting.

Key Features

- ▶ Comprehensive coverage of accounting theory and conceptual frameworks
- ▶ Detailed analysis of national and international accounting regulations