Chapter 1 Introduction

Generally accepted accounting principles (**GAAP**) are the standard framework for accounting used in a jurisdiction; also known as **accounting standards**. In Indian scenario, GAAP includes Accounting Standards, Accounting Standard Interpretations, Guidance Notes, Technical Guides and Opinions of Expert Advisory Committee (EAC Opinions).

This Chapter attempts to discuss **questions** relating to applicability of Indian GAAP.

Q1. Who issues Accounting Standards in India for companies?

Accounting Standards are prescribed by the Central Government as per powers granted to it under section 133 of the Companies Act, 2013, as recommended by the Institute of Chartered Accountants of India (ICAI), in consultation with and after examination of the recommendations made by the National Financial Reporting Authority (NFRA).

Q2. What is a Small and Medium Sized Company (SMC)?

"Small and Medium Sized Company" (SMC) means, a company—

(*i*) whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;

(*ii*) which is not a bank, financial institution or an insurance company;

(*iii*) whose turnover (excluding other income) does not exceed rupees two hundred and fifty crore in the immediately preceding accounting year;

(*iv*) which does not have borrowings (including public deposits) in excess of rupees fifty crore at any time during the immediately preceding accounting year; and

(*v*) which is not a holding or subsidiary company of a company which is not a small and medium-sized company.

Notes:

a. A company qualifies as a Small and Medium Sized Company if the conditions mentioned above are satisfied as at the end of the relevant accounting period.

b. Where a company, being an SMC, has qualified for any exemption or relaxation previously but no longer qualifies for the relevant exemption or relaxation in the current accounting period, the relevant standards or requirements become applicable from the current period and the figures for the corresponding period of the previous accounting period need not be revised merely by reason of its having ceased to be an SMC.

c. An existing company, which was previously not a Small and Medium Sized Company (SMC) and subsequently becomes an SMC, shall not be qualified for exemption or relaxation in respect of Accounting Standards available to an

SMC until the company remains an SMC for two consecutive accounting periods

Q3. What Accounting Standards (AS) are applicable to a company?

No.	Name	Non-SMC	SMC
AS 1	Disclosure of Accounting Policies	Applicable	Applicable
AS 2	Valuation of Inventories	Applicable	Applicable
AS 3	Cash Flow Statements	Applicable	Applicable
AS 4	Contingencies and Events Occurring After the Balance Sheet Date	Applicable	Applicable
AS 5	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies	Applicable	Applicable
AS 7	Construction Contracts	Applicable	Applicable
AS 9	Revenue Recognition	Applicable	Applicable
AS 10	Property, Plant and Equipment	Applicable	Applicable
AS 11	The Effects of Changes in Foreign Exchange Rates	Applicable	Applicable
AS 12	Accounting for Government Grants	Applicable	Applicable
AS 13	Accounting for Investments	Applicable	Applicable
AS 14	Accounting for Amalgamations	Applicable	Applicable
AS 15	Employee Benefits	Applicable	Applicable (Refer Exemption 1)
AS 16	Borrowing Costs	Applicable	Applicable
AS 17	Segment Reporting	Applicable	Not Applicable
AS 18	Related Party Disclosures	Applicable	Applicable
AS 19	Leases	Applicable	Applicable (Refer Exemption 2)
AS 20	Earnings Per Share	Applicable	Applicable (Refer Exemption 3)
AS 21	Consolidated Financial Statements	Applicable	Applicable
AS 22	Accounting for Taxes on Income	Applicable	Applicable
AS 23	Accounting for Investments in Associates in Consolidated Financial Statements	Applicable	Applicable
AS 24	Discontinuing Operations	Applicable	Applicable
AS 25	Interim Financial Reporting	Applicable	Applicable*
AS 26	Intangible Assets	Applicable	Applicable
AS 27	Financial Reporting of Interests in Joint Ventures	Applicable	Applicable

No.	Name	Non-SMC	SMC
AS 28	Impairment of Assets	Applicable	Applicable (Refer Exemption 4)
AS 29	Provisions, Contingent Liabilities and Contingent Assets	Applicable	Applicable (Refer Exemption 5)

*AS 25, *Interim Financial Reporting*, does not require a company to present interim financial report. It is applicable only if a company is required or elects to prepare and present an interim financial report. Only certain Non-SMCs are required by the concerned regulators to present interim financial results, e.g., quarterly financial results required by the SEBI. Therefore, the recognition and measurement requirements contained in this Standard are applicable to those Non-SMCs for preparation of interim financial results.

Note: The SMC which does not disclose certain information pursuant to the exemptions or relaxations given to it shall disclose (by way of a note to its financial statements) the fact that it is an SMC and has complied with the Accounting Standards insofar as they are applicable to an SMC on the following lines: "The Company is a Small and Medium Sized Company (SMC) as defined in the General Instructions in respect of Accounting Standards notified under the Companies Act, 2013. Accordingly, the Company has complied with the Accounting Standards as applicable to a Small and Medium Sized Company."

Further, if an SMC opts not to avail of the exemptions or relaxations available to an SMC in respect of any but not all of the Accounting Standards, it shall disclose the standard(s) in respect of which it has availed the exemption or relaxation.

Exemptions for SMC

1. AS 15—'*Employee Benefits*'

   (a) paragraphs 11 to 16 of the Standard to the extent they deal with recognition and measurement of short-term accumulating compensated absences which are non-vesting (i.e., short-term accumulating compensated absences in respect of which employees are not entitled to cash payment for unused entitlement on leaving);

   (b) paragraphs 46 and 139 of the Standard which deal with discounting of amounts that fall due more than 12 months after the balance sheet date;

   (c) recognition and measurement principles laid down in paragraphs 50 to 116 and presentation and disclosure requirements laid down in paragraphs 117 to 123 of the Standard in respect of accounting for defined benefit plans. However, such companies should actuarially determine and provide for the accrued liability in respect of defined benefit plans by using the Projected Unit Credit Method and the discount rate used should be determined by reference to market yields at the balance sheet date on government bonds as per paragraph 78 of the Standard. Such companies should disclose actuarial assumptions as per paragraph 120(l) of the Standard; and

(d) recognition and measurement principles laid down in paragraphs 129 to 131 of the Standard in respect of accounting for other long-term employee benefits. However, such companies should actuarially determine and provide for the accrued liability in respect of other long-term employee benefits by using the Projected Unit Credit Method and the discount rate used should be determined by reference to market yields at the balance sheet date on government bonds as per paragraph 78 of the Standard.

2. AS 19—'*Leases*'

   Paragraphs 22 (c), (e) and (f); 25 (a), (b) and (e); 37(a) and (f); and 46(b) and (d) relating to disclosures are not applicable to SMCs.

3. AS 20—'*Earnings Per Share*'

   Disclosure of diluted earnings per share (both including and excluding extraordinary items) is exempted for SMCs.

4. AS 28—'*Impairment of Assets*'

   SMCs are allowed to measure the 'value in use' on the basis of reasonable estimate thereof instead of computing the value in use by present value technique. Consequently, if an SMC chooses to measure the 'value in use' by not using the present value technique, the relevant provisions of AS 28, such as discount rate, etc., would not be applicable to such an SMC. Further, such an SMC need not disclose the information required by paragraph 121(g) of the Standard.

5. AS 29—'*Provisions, Contingent Liabilities and Contingent Assets*'

   Paragraphs 66 and 67 relating to disclosures are not applicable to SMCs.

Q4. Who issues Accounting Standards in India for Non-corporate Entities?

For Non-corporate Entities, Accounting Standards issued by the ICAI shall apply. Hence, Non-corporate Entities will have to be classified into the following 4 classifications:

Level I Entities (Similar to criteria for Non-SMC)

Non-corporate entities which fall in any one or more of the following categories, at the end of the relevant accounting period, are classified as Level I entities:

(i) Entities whose equity or debt securities are listed or are in the process of listing on any stock exchange, whether in India or outside India.

(ii) Banks (including co-operative banks), financial institutions or entities carrying on insurance business.

(iii) All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) exceeds rupees two hundred fifty crore in the immediately preceding accounting year.

(iv) All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of rupees fifty crore at any time during the immediately preceding accounting year.

(v) Holding and subsidiary entities of any one of the above.

Level II Entities

Non-corporate entities which are not Level I entities but fall in any one or more of the following categories are classified as Level II entities:

(i) All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) exceeds rupees fifty crore but does not exceed rupees two hundred fifty crore in the immediately preceding accounting year.

(ii) All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of rupees ten crore but not in excess of rupees fifty crore at any time during the immediately preceding accounting year.

(iii) Holding and subsidiary entities of any one of the above.

Level III Entities

Non-corporate entities which are not covered under Level I and Level II but fall in any one or more of the following categories are classified as Level III entities:

(i) All entities engaged in commercial, industrial or business activities, whose turnover (excluding other income) exceeds rupees ten crore but does not exceed rupees fifty crore in the immediately preceding accounting year.

(ii) All entities engaged in commercial, industrial or business activities having borrowings (including public deposits) in excess of rupees two crore but not in excess of rupees ten crore at any time during the immediately preceding accounting year.

(iii) Holding and subsidiary entities of any one of the above.

Level IV Entities

Non-corporate entities which are not covered under Level I, Level II and Level III are considered as Level IV entities.

Note—

a. Where an entity, being covered in Level II, Level III or Level IV, had qualified for any exemption or relaxation previously but no longer qualifies for the relevant exemption or relaxation in the current accounting period, the relevant standards or requirements become applicable from the current period and the figures for the corresponding period of the previous accounting period need not be revised merely by reason of its having ceased to be covered in Level II, Level III or Level IV, as the case may be. The fact that the entity was covered in Level II or Level III or Level IV, as the case may be, in the previous period and it had availed of the exemptions or relaxations available to that Level of entities shall be disclosed in the notes to the financial statements. The fact that previous period figures have not been revised shall also be disclosed in the notes to the financial statements.

b. Where an entity has been covered in Level I and subsequently, ceases to be so covered, the entity will not qualify for exemption/relaxation available to Level II, Level III or Level IV entities, until the entity ceases to be covered in Level I for two consecutive years. Similar is the case in respect of an entity, which has been covered in Level II or Level III and subsequently, gets covered under Level III or Level IV.

c. If an entity covered in Level II or Level III or Level IV opts not to avail of the exemptions or relaxations available to that Level of entities in respect of any but not all of the Accounting Standards, it shall disclose the Standard(s) in respect of which it has availed the exemption or relaxation.

Q5. What Accounting Standards (AS) are applicable to Non-corporate entities?

No.	Name	Level I	Level II	Level III	Level IV
AS 1	Disclosure of Accounting Policies	Applicable	Applicable	Applicable	Applicable
AS 2	Valuation of Inventories	Applicable	Applicable	Applicable	Applicable
AS 3	Cash Flow Statements	Applicable	Not Applicable	Not Applicable	Not Applicable
AS 4	Contingencies and Events Occurring After the Balance Sheet Date	Applicable	Applicable	Applicable	Applicable
AS 5	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies	Applicable	Applicable	Applicable	Applicable
AS 7	Construction Contracts	Applicable	Applicable	Applicable	Applicable
AS 9	Revenue Recognition	Applicable	Applicable	Applicable	Applicable
AS 10	Property, Plant and Equipment	Applicable	Applicable	Applicable (Refer Exemption 1)	Applicable (Refer Exemption 1)
AS 11	The Effects of Changes in Foreign Exchange Rates	Applicable	Applicable	Applicable (Refer Exemption 2)	Applicable (Refer Exemption 2)

No.	Name	Level I	Level II	Level III	Level IV
AS 12	Accounting for Government Grants	Applicable	Applicable	Applicable	Applicable
AS 13	Accounting for Investments	Applicable	Applicable	Applicable	Applicable (Refer Exemption 3)
AS 14	Accounting for Amalgamations	Applicable	Applicable	Applicable	Applicable
AS 15	Employee Benefits	Applicable	Applicable (Refer Exemption 4)	Applicable (Refer Exemption 4)	Applicable (Refer Exemption 4)
AS 16	Borrowing Costs	Applicable	Applicable	Applicable	Applicable
AS 17	Segment Reporting	Applicable	Not Applicable	Not Applicable	Not Applicable
AS 18	Related Party Disclosures	Applicable	Applicable	Not Applicable	Not Applicable
AS 19	Leases	Applicable	Applicable (Refer Exemption 5)	Applicable (Refer Exemption 5)	Applicable (Refer Exemption 5)
AS 20	Earnings Per Share	Applicable	Not Applicable	Not Applicable	Not Applicable
AS 21	Consolidated Financial Statements	Applicable	Not Applicable	Not Applicable	Not Applicable
AS 22	Accounting for Taxes on Income	Applicable	Applicable	Applicable	Applicable only for current tax related provisions (Refer Exemption 6)
AS 23	Accounting for Investments in Associates in Consolidated Financial Statements	Applicable	Not Applicable	Not Applicable	Not Applicable
AS 24	Discontinuing Operations	Applicable	Applicable	Not Applicable	Not Applicable
AS 25	Interim Financial Reporting	Applicable	Not Applicable	Not Applicable	Not Applicable

No.	Name	Level I	Level II	Level III	Level IV
AS 26	Intangible Assets	Applicable	Applicable	Applicable	Applicable (Refer Exemption 7)
AS 27	Financial Reporting of Interests in Joint Ventures	Applicable	Not Applicable	Not Applicable	Not Applicable
AS 28	Impairment of Assets	Applicable	Applicable (Refer Exemption 8)	Applicable (Refer Exemption 8)	Not Applicable
AS 29	Provisions, Contingent Liabilities and Contingent Assets	Applicable	Applicable (Refer Exemption 9)	Applicable (Refer Exemption 9)	Applicable (Refer Exemption 9)

Note: An MSME which does not disclose certain information pursuant to the exemptions or relaxations given to it shall disclose (by way of a note to its financial statements) the fact that it is an MSME and has complied with the Accounting Standards insofar as they are applicable to entities falling in Level II, Level III or Level IV, as the case may be.

Further, if an entity covered in Level II, Level III or Level IV opts not to avail of the exemptions or relaxations available to that Level of entities in respect of any but not all of the Accounting Standards, it should disclose the Standard(s) in respect of which it has availed the exemption or relaxation.

Exemptions for Non-Corporate Entities

1. Accounting Standard (AS) 10, Property, Plant and Equipment

   Paragraph 87 relating to encouraged disclosures is not applicable to Level III and Level IV Non-company entities.

2. AS 11, *The Effects of Changes in Foreign Exchange Rates*

   Paragraph 44 relating to encouraged disclosures is not applicable to Level III and Level IV Non-company entities.

3. AS 13, *Accounting for Investments*

   Paragraph 35(f) relating to disclosures is not applicable to Level IV Non-company entities.

4. AS 15, *Employee Benefits*

   (A) Level II and Level III Non-company entities whose average number of persons employed during the year is 50 or more are exempted from the applicability of the following paragraphs:

(a) paragraphs 11 to 16 of the standard to the extent they deal with recognition and measurement of short-term accumulating compensated absences which are non-vesting (i.e., short-term accumulating compensated absences in respect of which employees are not entitled to cash payment for unused entitlement on leaving);

(b) paragraphs 46 and 139 of the Standard which deal with discounting of amounts that fall due more than 12 months after the balance sheet date;

(c) recognition and measurement principles laid down in paragraphs 50 to 116 and presentation and disclosure requirements laid down in paragraphs 117 to 123 of the Standard in respect of accounting for defined benefit plans. However, such entities should actuarially determine and provide for the accrued liability in respect of defined benefit plans by using the Projected Unit Credit Method and the discount rate used should be determined by reference to market yields at the balance sheet date on government bonds as per paragraph 78 of the Standard. Such entities should disclose actuarial assumptions as per paragraph 120(l) of the Standard; and

(d) recognition and measurement principles laid down in paragraphs 129 to 131 of the Standard in respect of accounting for other long-term employee benefits. However, such entities should actuarially determine and provide for the accrued liability in respect of other long-term employee benefits by using the Projected Unit Credit Method and the discount rate used should be determined by reference to market yields at the balance sheet date on government bonds as per paragraph 78 of the Standard.

(B) Level II and Level III Non-company entities whose average number of persons employed during the year is less than 50 and Level IV Non-company entities irrespective of number of employees are exempted from the applicability of the following paragraphs:

(a) paragraphs 11 to 16 of the Standard to the extent they deal with recognition and measurement of short-term accumulating compensated absences which are non-vesting (i.e., short-term accumulating compensated absences in respect of which employees are not entitled to cash payment for unused entitlement on leaving);

(b) paragraphs 46 and 139 of the Standard which deal with discounting of amounts that fall due more than 12 months after the balance sheet date;

(c) recognition and measurement principles laid down in paragraphs 50 to 116 and presentation and disclosure requirements laid down in paragraphs 117 to 123 of the Standard in respect of accounting for defined benefit plans. However, such entities may calculate and account for the accrued liability under the defined benefit plans by reference to some other rational method, e.g., a method based on the assumption that such benefits are payable to all employees at the end of the accounting year; and

(d) recognition and measurement principles laid down in paragraphs 129 to 131 of the Standard in respect of accounting for other long-term employee benefits. Such entities may calculate and account for the accrued liability under the other long-term employee benefits by reference to some other rational method, e.g., a method based on the assumption that such benefits are payable to all employees at the end of the accounting year.

5. AS 19—*Leases*

(a) Paragraphs 22 (c), (e) and (f); 25 (a), (b) and (e); 37 (a) and (f); and 46 (b) and (d) relating to disclosures are not applicable to Level II Non-company entities.

(b) Paragraphs 22 (c), (e) and (f); 25 (a), (b) and (e); 37 (a), (f) and (g); and 46 (b), (d) and (e) relating to disclosures are not applicable to Level III Non-company entities.

(c) Paragraphs 22 (c),(e) and (f); 25 (a), (b) and (e); 37 (a), (f) and (g); 38; and 46 (b), (d) and (e) relating to disclosures are not applicable to Level IV Non-company entities.

6. AS 22—*Accounting for Taxes on Income*

(a) Level IV Non-company entities shall apply the requirements of AS 22 for Current tax defined in paragraph 4.4 of AS 22, with recognition as per paragraph 9, measurement as per paragraph 20 of AS 22, and presentation and disclosure as per paragraphs 27-28 of AS 22.

(b) Transitional requirements: On the first occasion when a Non-company entity gets classified as Level IV entity, the accumulated deferred tax asset/liability appearing in the financial statements of immediate previous accounting period, shall be adjusted against the opening revenue reserves.

7. AS 26—*Intangible Assets*

Paragraphs 90(d)(iii); 90(d)(iv) and 98 relating to disclosures are not applicable to Level IV Non-company entities.

8. AS 28—*Impairment of Assets*

Level II and Level III Non-company entities are allowed to measure the 'value in use' on the basis of reasonable estimate thereof instead of computing the value in use by present value technique. Consequently, if Level II or Level III Non-company entity chooses to measure the 'value in use' by not using the present value technique, the relevant provisions of AS 28, such as discount rate, etc., would not be applicable to such an entity. Further, such an entity need not disclose the information required by paragraph 121(g) of the Standard.

Also, paragraphs 121(c)(ii); 121(d)(i); 121(d)(ii) and 123 relating to disclosures are not applicable to Level III Non-company entities.

9. AS 29—*Provisions, Contingent Liabilities and Contingent Assets*

Paragraphs 66 and 67 relating to disclosures are not applicable to Level II, Level III and Level IV Non-company entities.

Q6. Is the Accounting Standards issued by ICAI applicable to Charitable / Religious Organizations?

As per preface to the Statement of Accounting Standards, "Accounting Standards apply in respect of any enterprise (whether organised in corporate, co-operative or other forms) engaged in commercial, industrial or business activities, irrespective of whether it is profit oriented or it is established for charitable or religious purposes. Accounting Standards will not, however, apply to enterprises only carrying on the activities which are not of commercial, industrial or business nature, (e.g., an activity of collecting donations and giving them to flood affected people). Exclusion of an enterprise from the applicability of the Accounting Standards would be permissible only if no part of the activity of such enterprise is commercial, industrial or business in nature. Even if a very small proportion of the activities of an enterprise is considered to be commercial, industrial or business in nature, the Accounting Standards would apply to all its activities including those which are not commercial, industrial or business in nature."

Hence, Accounting Standards would apply to Charitable/Religious Organizations even if a very small proportion of its activities is considered to be commercial, industrial or business in nature.

Q7. What is the applicability/ authority of Guidance notes issued by the ICAI?

As per the ICAI, Guidance Notes are recommendatory in nature. Further, in a situation where certain matters are covered both by an Accounting Standard and a Guidance Note, the Guidance Note or the relevant portion thereof will be considered as superseded from the date of the relevant Accounting Standard coming into effect, unless otherwise specified in the Accounting Standard.

Q8. What is the form of financial statements for companies?

As per Section 129 of the Companies Act, 2013, the financial statements shall be in the form or forms as may be provided for different class or classes of companies in Schedule III. Schedule III has been covered separately in this Book.

Division 2
Accounting Standards - Analysed

ACCOUNTING STANDARD (AS) 1
DISCLOSURE OF ACCOUNTING POLICIES

A. Introduction

Accounting Standard (AS) 1 'Disclosure of Accounting policies' deals with the disclosure of significant accounting policies followed in preparing and presenting financial statements. *(Para 1 of AS 1)*

The purpose of this standard is to promote better understanding of the financial statements by establishing through an AS the disclosure of significant accounting policies and the manner in which accounting policies are disclosed in the financial statements. Such disclosure would facilitate a more meaningful comparison between the financial statements of different enterprises. *(Para 8 of AS1)*

The view presented in the financial statements of an enterprise of its state of affairs and of the profit or loss can be significantly affected by the accounting policies followed in the preparation and presentation of the financial statements.

The accounting policies vary from enterprise to enterprise. Disclosure of significant accounting policies followed is necessary if the view presented is to be properly appreciated. *(Para 2 of AS 1)*

Accounting Standards require the disclosure of certain accounting policies, e.g., translation policies in respect of foreign currency items. *(Para 4 of AS 1)*

In general, accounting policies are not at present regularly and fully disclosed in all financial statements. Many enterprises include in the notes on the accounts, descriptions of some of significant accounting policies. But the nature and degree of disclosure vary considerably between the corporate and non-corporate sectors and between units in the same sector. *(Para 6 of AS 1)*

2. Fundamental accounting assumptions

The following have been generally accepted as fundamental accounting assumptions in the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. However, if a fundamental accounting assumption is not followed, the fact should be disclosed. *(Paras 9 and 27 of AS1)*

(a) Going concern

Going concern concept assumes that the enterprise has neither the intention nor the necessity of liquidating or of curtailing materially the scale of its operations and that the enterprise will continue in operation for the foreseeable future.

(b) Consistency

It is assumed that the accounting policies are consistent from one period to another.

(c) Accrual

Revenue and costs are accrued that is recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate. *(Para 10 of AS 1)*

3. Nature of accounting policies

The accounting policies refer to the specific accounting principles and the methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements. *(Para 11 of AS 1)*

There is no single list of accounting policies which are applicable to all circumstances and since enterprises operate in diverse and complex economic situations, the choice of appropriate accounting principles and the methods of applying those principles in the specific circumstances of each enterprise calls for considerable judgment by the management of the enterprise. *(Para 12 of AS 1)*

To make the comparison between the financial statements of different enterprises meaningful, it is necessary to reduce the number of available acceptable alternative accounting principles and methods of applying those principles, particularly in case of corporate enterprises. *However, it is not likely to be eliminated altogether in view of the differing circumstances faced by the enterprises.(Para 13 of AS 1)*

The following are the areas (*though the list is not exhaustive)* in which different accounting policies may be adopted by different enterprises:

(a) Methods of depreciation and amortisation;

(b) Treatment of expenditure during construction;

(c) Conversion or translation of foreign currency items;

(d) Valuation of inventories;

(e) Treatment of goodwill;

(f) Valuation of investments;

(g) Treatment of retirement benefits

(h) Valuation of fixed assets;

(h) Treatment of contingent liabilities

(Para14 of AS 1)

4. Considerations in the selection of accounting policies

The primary consideration in the selection of accounting policies by an enterprise is that the financial statements prepared and presented on the basis of such accounting policies should represent a true and fair view of the state of affairs of the enterprise as at the balance sheet date and of the profit or loss for the period ended on that date. *(Para 16 of AS 1)*

The major considerations governing the selection and application of accounting policies are:

(a) ***Prudence:*** In view of the uncertainty attached to future events, profits are not anticipated but recognised only when realised, though not necessarily in cash. Provision is made for all known liabilities and losses, though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.

(b) ***Substance over form:*** The accounting treatment and presentation in financial statements of transactions and events should be governed by their substance and not merely by the legal form.

(c) ***Materiality:*** Financial statements should disclose all 'material items',i.e, items the knowledge of which might influence the decisions of the user of the financial statements.

(Para 17 of AS 1)

The threshold of materiality is applicable to all items of financial statements. It needs to be determined under the specific facts and circumstances of the entity concerned as to whether non-disclosure of an item could influence the decisions of the users of the financial statements. For this purpose, apart from the percentage/absolute amount of the item, other factors such as nature of the item, impact on profit/loss, etc., should also be considered. (EAC opinion)

5. Disclosure of accounting policies

All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. *(Para 24 of AS 1)*

Such disclosure should form part of the financial statements and the significant accounting policies normally should be disclosed at one place. *(Para 25 of AS 1)*

Any change in accounting policies, which have a material effect on the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. *(Paras 22 and 26 of AS 1)*

Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item in the accounts. *(Para 23 of AS1)*

6. Compliance to ASs and consistency of accounting policies in preparation of financial statements -Companies Act, 2013

As per **section 134(3) of the Companies Act, 2013,** the financial statements laid before the company in a general meeting shall include a report by the Board of Directors. The

Director's Responsibility Statement referred to in clause (c) of section 134(3) shall state that:

(i) In preparation of the annual accounts, the applicable ASs have been followed with proper explanation relating to material departures;

(ii) The accounting policies selected have been applied consistently and the judgments and estimates used by the Directors are reasonable and prudent and give a true and fair view of the state of affairs of the company at the end of the financial year and profit and loss of the company for that period;

(iii) Proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of the Companies Act, 2013, have been taken for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;

(iv) The annual accounts have been prepared on a going concern basis.

7. Opinions

Consideration of materiality while applying accrual basis of accounting

Facts of the case: A company has adopted an accounting policy that expenses incurred up to Rs. 25,000 relating to a future period are expensed in the current year and not accounted as 'prepaid expenses'.

EAC's opinion: Though 'accrual' is one of the fundamental accounting assumptions, the materiality threshold is applicable to this accounting assumption also. If an information is immaterial on the consideration of materiality, its accounting treatment would not have any effect on the decisions of the users of the financial statements. Thus, it has to be established under the facts and circumstances of the company as to whether the amount of Rs. 25,000 would be material or not in respect of each item, or in the aggregate. The concept of materiality is subjective and therefore different professionals may reach different decision depending on their professional judgement.

Disclosure of income/expenditure pertaining to prior years

If errors or omissions pertaining to items of income and expenditure are not material, as determined by a company, the company may follow an accounting policy of not disclosing such errors or omissions separately as prior period items.

Accounting of cash rebates – Whether in compliance with accrual basis of accounting?

In case of cash rebates allowed to customers for prompt payment, the obligation of an entity arises as soon as the customer makes the payment within the stipulated period. With respect to the 'matching concept', which is an inherent aspect of accrual, the expense of cash rebate is matched with the saving of interest to the enterprise due to early receipt of payment. This is because the purpose of allowing cash rebate is to save interest on the monies held up pending realisation of payment from the customers before the end of the stipulated period. Thus, the practice of a company to account for cash rebate for prompt payment, on settlement of bills by the customers, is in compliance with the requirement of accrual basis of accounting.

8. Comparative analysis of AS and IND AS

Particulars	AS 1	IND AS 1
Consideration in the selection of accounting policies	The major considerations for selection of accounting policies: 1. Prudence 2. Substance over form 3. Materiality	When an IND AS specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the IND AS.
Statement of profit or loss and other comprehensive income	There is no concept of other comprehensive income under Indian GAAP. Some items such as revaluation surplus which are treated as 'other comprehensive income' under Ind AS are recognised directly in equity under Indian GAAP.	The statement of profit or loss includes – (a) components of profit or loss and (b) other comprehensive income (i.e., items of income and expense that are not recognised in profit or loss as required or permitted by other Ind ASs).
Statement of changes in equity	A statement of changes in equity is currently not presented. Movements in share capital, retained earnings and other reserves are to be presented in the notes to accounts.	Requires the statement of changes in equity to be shown as a **separate statement**. **Schedule III - Division II** of the Companies Act, 2013 requires the statement of changes in equity to be shown as a **part of the balance sheet**.
Judgements and estimates	AS 1 does not specifically require disclosure of judgements and estimates that management has made in the summary of significant accounting policies or other notes.	Requires disclosure of critical judgements and estimates made by management in applying accounting policies.
Estimation uncertainty	AS 1 does not specifically require an entity to disclose information about the assumptions that it makes about the future and other major sources of estimation uncertainty at the end of the reporting period though other standards may require certain	Requires disclosure of key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. The nature of the uncertainty and

Particulars	AS 1	IND AS 1
	disclosures of the same.	the carrying amounts of such assets and liabilities at the end of the reporting period are required to be disclosed.
Capital management	AS 1 does not require an entity to disclose information that enables users of its financial statements to evaluate the entity's objectives, policies and processes of managing capital.	Requires disclosure of information about management of capital and compliance with externally imposed capital requirements, if any.

ACCOUNTING STANDARD (AS) 2
INVENTORIES

A. INTRODUCTION

"Inventory" originates from a Latin word "invenire" that means "**come upon**" or "**a list of what is found**". As per the Oxford Advanced Learners Dictionary, "Inventory" means "A complete list of items such as property, goods in stock, or the contents of a building".

Hence, Accounting Standard – 2 (AS 2) "Valuation of Inventories" deals with only those items of stock, whether raw materials, work-in-process, finished goods or stock-in-trade, that are **found** as on a particular date, i.e., closing stock.

The basic principle on which this standard thrives upon is "the Matching Concept", i.e., the simultaneous or combined recognition of revenues and expenses that result directly and jointly from the same transactions or other events. In effect, cost of an item of stock must be recognised as expense in the period in which income from sale of the stock is recognised. Alternatively, if the item of stock is not sold in a particular period, its cost should not be recognised as expense but carried forward until the related revenues are recognised.

The primary issue in the accounting for inventories is the determination of value at which the inventories are carried in the financial statements until the related revenues are recognised. This standard provides guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realisable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

B. SCOPE

This Standard applies to all inventories, except:

(a) Work-in-progress arising under construction contracts, including directly related service contracts (see AS 7, Construction Contracts);

(b) Work-in-progress arising in the ordinary course of business of service providers;

> Work-in-progress of a service provider refers to the unfinished service contracts for which revenue recognition criteria are not fulfilled as per AS 9, Revenue Recognition.
>
> For example, DAX is a courier company with March 31 as its year-end. DAX signs a contract on March 30, 2021 to deliver a parcel from Mumbai to New Jersey. On March 31, 2021, the parcel has reached Newark Airport. Since the