FINANCIAL REPORTING AND FINACIAL SATTEMENT ANALYSIS

[B.Com.Semester: 6, Hons. & Genl.]

UNIT- 2

ACCOUNTING STANDARD

- **Conceptual Framework**
- **Presentation of Financial Statements (Ind AS 1)**
- **Property, Plant and Equipment (Ind AS 16)**
- **Earnings Per Share (Ind As 33)**

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Conceptual Framework

Introduction:

In India, the ICAI had issued a pronouncement with the title *'Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards'* (Framework). This Framework is primarily based on the old Conceptual Framework issued by IASB's predecessor body IASC (in year 1989). In view of the following developments at International level, the Accounting Standards Board (ASB) of ICAI has initiated necessary steps to bring out the Conceptual Framework for financial reporting under Ind AS corresponding to Conceptual Framework for financial reporting issued by IASB in March 2018.

The Conceptual Framework for Financial Reporting under Indian Accounting Standards (Conceptual Framework) describes the objective of, and the concepts for, general purpose financial reporting.

Purpose of the framework:

- The draft *Conceptual Framework* describes the objective of and concepts for general purpose financial reporting.
- It is a practical tool that helps the standard setters to formulate requirements in Standards based on consistent concepts.
- It also help preparers to develop consistent accounting policies for areas that are not covered by a standard or where there is choice of accounting policy, and to assist all parties to understand and interpret Standards.
- assist the Institute of Chartered Accountants of India (ICAI) in formulation of Indian Accounting Standards (Ind ASs) that are based on consistent concepts;
- assist preparers to develop consistent accounting policies when no Ind AS applies to a particular transaction or other event, or when an Ind AS allows a choice of accounting policy;
- Assist all parties to understand and interpret the Ind ASs.
- The draft *Conceptual Framework* is a comprehensive set of concepts for formulating financial reporting standards and financial reporting. It is structured into eight chapters and includes an appendix of defined terms.
- The draft *Conceptual Framework* incorporates specific chapters on measurements, presentation and disclosures and derecognition.
- Another important change brought out is in the area of certain critical definitions, i.e., Asset and Liability and their recognition criteria. Additional clarification has been provided in some areas such as Prudence, Substance over Form, Stewardship and Measurement uncertainty.
- The draft *Conceptual Framework* will also result into consequential amendments in certain Ind AS, for references to the Conceptual Framework.

Scope:

- The objective of financial statements.
- The qualitative characteristics that determine the usefulness of information provided in financial statements.
- Definition, recognition and measurement of elements from which financial statements are constructed.
- Concept of capital and capital maintenance.

Presentation of Financial Statements (Ind AS - 1)

- **The Ind AS -1 'Presentation of Financial Statements'** sets overall requirements for the presentation of financial statements.

- **Objective:**
  i) General purpose financial statement on the basis of theoretical frameworks.
  ii) To ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities . it sets out overall requirements for the presentation of financial statements.
  iii) Guidelines for their structure and minimum requirements for their content.

- **Scope:**
  i) An entity shall apply this standard in preparing and presenting general purpose financial statements in accordance with Indian accounting Standards.
  ii) This Standard applies equally to all entities, including those that present consolidated financial statements in accordance with Ind AS – 110, Ind AS – 27, Separate financial Statements. This Standard uses terminology that is suitable for profit oriented entities, including public sector business entities.
  iii) If entities with non –profit activates in the private sector or the public sector apply this Standard, they may need to amend the descriptions used for particular line items in the financial statements and for the financial statements themselves.
  iv) Entities whose share capital is not equity may need to adopt the financial statements presentation at the interest of members.

- **Features:**

  (a) Complete set of financial statements:
  - A statement of financial position (Balance Sheet).
  - A statement of comprehensive income (Profit and Loss Account).
  - A statement of changes in equity.
  - A statement of cash flows.
  - Significant accounting policies and other explanatory notes.
  - A statement of financial position as at the beginning of the earliest comparative period.

  (b) Fair presentation and compliance with IFRS:
  An entity whose financial statements comply with IFRSs shall make an explicit and unreserved statement of such compliance in the notes.

  (c) Going concern:
  When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern.

  (d) Accrual basis of accounting:
  An entity shall prepare its financial statements except for cash flow information using the accrual basis of accounting.

  (e) Materiality and aggregation :
  An entity shall present separately each material class of similar items.

  (f) Offsetting:
  An entity shall not set off the assets and liabilities or income and expense against each other unless required or permitted by an IFRS.

(g) Frequency of reporting:

An entity shall present a complete set of financial statements at least annually.

(h) Comparative information:

An entity shall disclose comparative information in respect of the previous period for all amounts reported
in the current period's financial statements.

(i) Consistency of presentation:

An entity shall retain the presentation and classification of items in the financial statements from one period to the next unless an IFRS requires a change in presentation.

Structure and Content:

(a) Statement of Financial Position- Information to be presented in the financial position:-

- Current/ non-current distinction
- Current assets.
- Current Liabilities.
- Overall Structure.
- Line Items- Certain items of assets and liabilities must be shown as line item.
- Sub-classifications- of the line items presented should be disclosed either in the Statement of Financial Position or in the notes.

(b) Statement of comprehensive income:

- Line items: Items of income and expense.
- Material items: Nature and amount of material items of income or expenses should be disclosed separately.
- Analysis of expenses
- Other comprehensive income- changes in revaluation surplus, gain and losses as per IAS-19,certain exchange differences, gain and losses for sale of assets.

(c) Statement of change of equity:

Ind AS – 1 requires an entity to present, in a statement of changes in equity, all over changes in equity.

(d) Notes to the financial statement:

- Present information about the basis of preparation of the financial statements and the specific accounting policies used.
- Disclose in the summary of significant accounting policies or other notes.
- Disclose information about the assumptions it makes about the future and other major sources of estimation uncertainty at the end of the reporting period.
- Disclose information that enables users of its financial statements to evaluate the entity's objectives, policies and process for managing capital.
- Others: legal provisions, descriptions of the nature of operations and activities, the nature of the parent, amount proposed or declared but not distributed and related amount per share, amount of cumulative preference share not recognised.

Property, Plant and Equipment (Ind AS 16)

Definition:

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 purpose; and
- Are expected to be used during more than one period.

Applicability and Scope:

Ind AS 16 Property Plant Equipment is applicable to all Property and P&E (Plant & Equipment) unless and until any other accounting standard asks for a different treatment.

Ind AS 16 Property Plant Equipment is not applicable in the following cases:

(i) Property and P&E (Plant & Equipment) which are classified as held for sale as per Ind AS 105

(ii) Biological assets which are related to agricultural activities except bearer plants

(iii) The measurement and recognition of exploration and evaluation assets

(iv) Mineral rights and reserves like oil, natural gas and other such non-regenerative resources

Recognition criteria:

The cost of an item of Property, Plant and Equipment shall be recognised as an asset if ,

- It is probable that future economic benefits associated with the item will flow to the entity ; and
- The cost of the item can be measured reliably.

Principle of Measurement:

- **Measurement at initial recognition:**
  An item of Property, Plant and Equipment that qualifies for recognition as an asset shall be measured at its cost. The cost of an item of Property, Plant and Equipment is the cash price equivalent at the recognition date.

- **Components of cost:**
  - Its purchase price, including import duties and non-refundable purchase taxes, after reducing trade discounts and rebates.
  - 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.
  - Estimated dismantling cost if entity measures a liability specifically to the asset at time of acquisition i.e. restoration cost.
  - Cost of safety and environmental equipment.

- **Measurement after initial recognition- Accounting policy**
  - **Cost Model**- After recognition as an asset, an item of Property, Plant and Equipment shall be carried at its cost less any accumulated depreciation and any accumulated impairment losses.

  - **Revaluation model**- After recognition as an asset, an item of Property, Plant and Equipment whose fair value can be measured reliably shall be 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. Revaluation shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined by using fair value at the end of the reporting period.

- **Increase or decrease due to revaluation**: If an assets amount is increased as a result of a revaluation , the increase shall be recognised in other comprehensive income and treated as revaluation surplus. If an assets amount is decreased as a result of revaluation. The decreased shall be recognised in other comprehensive income to the extent of any credit balance existing in the revalidation surplus in respect of that asset.

- **Measurement of Depreciation**:

  - **Measurement:** The depreciable amount of Property, Plant and Equipment shall be allocated on as systematic basis over its useful life.

  - **Depreciable amount**: it is the cost of an asset or other amount substituted for cost, less its residual value.

  - **Depreciation for the year**: Depreciable amount / useful life

  - **Methods of Depreciation:**
    - ✓ Straight line- a constant charge over useful life.
    - ✓ Diminishing Balance: A decreasing charge over useful life.
    - ✓ Account for as a change in accounting estimate and just depreciation charge for current and future period.

  - Depreciation commences when the Property, Plant and Equipment is ready for use.
  - Depreciation is regarded as an expense in the Statement of Profit and Loss.
  - Property, Plant and Equipment in form of land does not depreciate as it has unlimited useful life.

- **Residual value:** is a reasonable estimated value of the Property, Plant and Equipment at the end of its economic life.

- **Useful life:** it is period over which Property, Plant and Equipment expected to be used by the enterprise.

- **Derecognition:** The carrying amount of an Property, Plant and Equipment shall be derecognised:
  - On disposal or
  - When no future economic benefits are expected from its use or disposal.

- **Disclosure: Number of disclosure requirements for asset carried at –**
  - Cost Model (Discuss in page 5)
  - Revaluation Model (Discuss in page 5)

Earnings Per Share (Ind As 33)

Objective:

This standard prescribes the principles for determination and presentation of EPS. If an entity discloses the EPS, then it should be calculated in accordance with this standard. If an entity presents both CFS and SFS then EPS shall be presented in both FS.

Scope:

An entity that discloses earnings per share shall calculate and disclose earnings per share in accordance with this Standard.

Key Definitions:

- **Anti dilution**

Anti dilution is an increase in earnings per share or a reduction in loss per share resulting from the assumption that convertible instruments are converted, that options or warrants are exercised, or that ordinary shares are issued upon the satisfaction of specified conditions.

- **Dilution**

Dilution is a reduction in earnings per share or an increase in loss per share resulting from the assumption that convertible instruments are converted, that options or warrants are exercised, or that ordinary shares are issued upon the satisfaction of specified conditions.

Basic Earnings Per Share-

- **EPS =**

$$\frac{\textbf{Profit or loss attributable to ordinary equity holders of the parent enterprise}}{\textbf{Weighted average number of ordinary shares outstanding during the period}}$$

- **Earnings:**

- Where any item of income or expense which is otherwise required to be recognised in profit or loss in accordance with Ind AS is debited or credited to securities premium account/other reserves, the amount in respect thereof shall be deducted from profit/ loss from continuing operations for the purpose of calculating basic EPS.
- After tax amount of preference dividend on cumulative preference shares should be deducted irrespective of declaration of dividend.
- Any original issue discount or premium on increasing rate preference shares is amortised to retained earnings using the effective interest method and treated as a preference dividend for the purposes of calculating earnings per share

- **Shares:**

- For the purpose of calculating basic earnings per share, the number of ordinary shares shall be the weighted average number of ordinary shares outstanding during the period.
- Contingently issuable shares are treated as outstanding and are included in the calculation of basic earnings per share only from the date when all necessary conditions are satisfied.
- The weighted average number of ordinary shares outstanding during the period and for all periods presented shall be adjusted for events, other than the conversion of potential ordinary shares, that have changed the number of ordinary shares outstanding without a corresponding change in resources.
- In a capitalisation or bonus issue or a share split, ordinary shares are issued to existing shareholders for no additional consideration. Therefore, the number of ordinary shares outstanding is increased without an increase in resources. The number of ordinary shares outstanding before the event is adjusted for the proportionate change in the number of ordinary shares outstanding as if the event had occurred at the beginning of the earliest period presented.

Diluted Earnings Per Share:

- **Measurement of Diluted EPS:**

Diluted EPS =

$$\frac{\text{Profit or loss/ earning available to ordinary shareholder + adjustment for conversion of POS}}{\text{Weighted average number of outstanding ordinary shares + adjustment for conversion of POS}}$$

OCI: Other comprehensive income	**POS: Potential ordinary share**

- OCI result will not be used to calculate EPS.
- Adjust profit or loss attributable to ordinary equity holders of the parent entity
- Profit or loss is increased by the after-tax amount of dividends and interest recognised in the period in respect of the dilutive potential ordinary shares and is adjusted for any other changes in income or expense that would result from the conversion of the dilutive potential ordinary shares
- The weighted average number of ordinary shares outstanding is increased by the weighted average number of additional ordinary shares that would have been outstanding assuming the conversion of all dilutive potential ordinary shares.

- **Earnings:**

- Adjust after tax effect of potential ordinary shares of dividend, interest, other changes in income and expenses
- The conversion of potential ordinary shares may lead to consequential changes in income or expenses.

- **Shares:**

- The number of ordinary shares shall be the weighted average number of ordinary shares plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares.

- **Dilutive potential ordinary share:**

- Potential ordinary shares shall be treated as dilutive when, and only when, their conversion to ordinary shares would decrease earnings per share or increase loss per share from continuing operations

- For the purpose of calculating diluted earnings per share, an entity shall assume the exercise of dilutive options and warrants of the entity. The assumed proceeds from these instruments shall be regarded as having been received from the issue of ordinary shares at the average market price of ordinary shares during the period.
- The dilutive effect of convertible instruments shall be reflected in diluted EPS.
- As in the calculation of basic earnings per share, contingently issuable ordinary shares are treated as outstanding and included in the calculation of diluted earnings per share if the conditions are satisfied.
- When an entity has issued a contract that may be settled in ordinary shares or cash at the entity's option, the entity shall presume that the contract will be settled in ordinary shares, and the resulting potential ordinary shares shall be included in diluted earnings per share if the effect is dilutive.
- For contracts that may be settled in ordinary shares or cash at the holder's option, the more dilutive of cash settlement and share settlement shall be used in calculating diluted earnings per share.
- Contracts such as purchased put options and purchased call options (ie options held by the entity on its own ordinary shares) are not included in the calculation of diluted earnings per share because including them would be antidilutive.
- Contracts that require the entity to repurchase its own shares, such as written put options and forward purchase contracts, are reflected in the calculation of diluted earnings per share if the effect is dilutive.

➢ **Retrospective Adjustment:**

If the number of ordinary or potential ordinary shares outstanding increases as a result of a capitalisation, bonus issue or share split, or decreases as a result of a reverse share split, the calculation of basic and diluted earnings per share for all periods presented shall be adjusted retrospectively.

Disclosures:

- The amounts used as the numerators in calculating basic and diluted earnings per share.
- The weighted average number of ordinary shares used as the denominator in calculating basic and diluted earnings per share.
- Instruments (including contingently issuable shares) that could potentially dilute basic earnings per share in the future, but were not included in the calculation of diluted earnings per share because they are antidilutive for the period(s) presented.

Source:

- **Rawat, D.S., Students' Guide to Accounting standards, Taxman.**
- **Hanif, M, Mukherjee, A, Financial Reporting and Financial Statement Analysis.**
- **www.indaslab.com**