**UNIT 3**

• **Accounting Standard (AS-2)**

AS-2 is an accounting standard issued by the Institute of Chartered Accountants of India (ICAI) which provides guidance on the valuation and disclosure of inventories in financial statements.

The standard applies to all inventories, except those that are specifically covered by another accounting standard. It requires inventories to be valued at the lower of cost or net realizable value, with cost being determined using a specific method such as first-in-first-out (FIFO) or weighted average cost.

AS-2 also provides guidance on the treatment of costs that are included in the value of inventory, such as direct costs of purchase, production or conversion, as well as indirect costs such as overheads. It requires the disclosure of the accounting policies adopted for the valuation of inventories, as well as the amount of any write-downs and any adjustments made to the value of inventories.

The objective of AS-2 is to ensure that inventories are valued in a consistent and reliable manner, and that the information provided in financial statements is relevant and useful to users.

• **Financial Statements:**

Financial statements are formal reports that provide information on an organization's financial performance and position. They are used by various stakeholders, such as investors, lenders, regulators, and managers, to make decisions related to the organization.

The three primary financial statements are:

1. Balance Sheet: This statement provides information about an organization's assets, liabilities, and equity at a specific point in time. It shows how much the organization owns (assets), how much it owes (liabilities), and how much is left over for the owners (equity).
2. Income Statement: This statement provides information about an organization's revenue, expenses, and net income over a specific period of time, such as a month, quarter, or year. It shows how much revenue the organization generated, how much it spent to generate that revenue, and how much profit or loss it made during the period.
3. Cash Flow Statement: This statement provides information about an organization's cash inflows and outflows over a specific period of time. It shows how much cash the organization generated or used in its operating, investing, and financing activities.

Financial statements are prepared in accordance with generally accepted accounting principles (GAAP) or International Financial Reporting Standards (IFRS) to ensure consistency and comparability across different organizations and industries.

**•Various Elements of Financial Statements.**

The various elements of financial statements are as follows:

1. Assets: Assets are resources controlled by an organization as a result of past events, from which future economic benefits are expected to flow to the organization. Examples include cash, accounts receivable, inventory, property, plant and equipment, and investments.
2. Liabilities: Liabilities are obligations of an organization as a result of past events, from which an outflow of resources is expected to occur in the future. Examples include accounts payable, loans, bonds, and accrued expenses.
3. Equity: Equity represents the residual interest in the assets of an organization after deducting liabilities. Examples include common stock, retained earnings, and other reserves.
4. Revenues: Revenues are inflows of economic resources resulting from the sale of goods or services or other business activities. Examples include sales revenue, rental revenue, and interest revenue.
5. Expenses: Expenses are outflows of economic resources resulting from the consumption of goods or services or other business activities. Examples include cost of goods sold, salaries and wages, rent, and interest expense.
6. Gains: Gains are increases in equity resulting from transactions or events outside the normal course of business. Examples include gains on the sale of assets, foreign exchange gains, and gains from extinguishment of debt.
7. Losses: Losses are decreases in equity resulting from transactions or events outside the normal course of business. Examples include losses on the sale of assets, foreign exchange losses, and losses from extinguishment of debt.

These elements are used in the preparation of financial statements to provide relevant and reliable information to users for decision-making purposes.

**• Methods of Inventory Valuation:**

There are several methods of inventory valuation that an organization can use. These methods are used to determine the cost of goods sold and the value of ending inventory, which are important components of the income statement and balance sheet, respectively. The following are some of the most common methods:

1. First-In, First-Out (FIFO): This method assumes that the first items purchased are the first items sold. Therefore, the cost of the oldest inventory is assigned to cost of goods sold, while the cost of the most recent inventory is assigned to ending inventory.
2. Last-In, First-Out (LIFO): This method assumes that the last items purchased are the first items sold. Therefore, the cost of the most recent inventory is assigned to cost of goods sold, while the cost of the oldest inventory is assigned to ending inventory.
3. Weighted Average Cost: This method calculates the average cost of all units in inventory and assigns this cost to both cost of goods sold and ending inventory.
4. Specific Identification: This method assigns the actual cost of each unit of inventory to cost of goods sold or ending inventory, depending on which units were sold and which units remain.
5. Standard Cost: This method uses predetermined costs for direct materials, direct labor, and overhead to calculate the cost of goods sold and ending inventory. These costs are based on estimates and can be adjusted periodically.

Each method has its advantages and disadvantages, and the method chosen can have a significant impact on the financial statements. For example, LIFO tends to result in lower reported income and taxes in times of rising prices, while FIFO tends to result in higher reported income and taxes in the same situation. The method chosen should be consistent with the organization's accounting policies and the requirements of the relevant accounting standards.

**• Accounting Standard 22 mean**

Accounting Standard (AS) 22, also known as Accounting for Taxes on Income, deals with the accounting treatment of taxes on income, which includes both current and deferred taxes. The standard aims to ensure consistency and comparability in the accounting treatment of taxes on income across different organizations and industries.

The main provisions of AS 22 are as follows:

Recognition: The standard requires an organization to recognize a tax liability or asset for all taxable or deductible temporary differences between the carrying amount of assets and liabilities in the financial statements and their tax base.

Measurement: The standard requires an organization to measure the amount of tax liability or asset using the tax rates and laws that are expected to apply in the period when the liability is settled or the asset is realized.

Presentation: The standard requires an organization to present current tax assets and liabilities separately from deferred tax assets and liabilities on the face of the balance sheet. It also requires an organization to disclose the nature and amount of temporary differences that give rise to deferred tax assets and liabilities.

Disclosure: The standard requires an organization to disclose the amount of income tax expense (or income) related to continuing operations, the amount of income tax expense (or income) related to discontinued operations, and the amount of income tax expense (or income) related to other comprehensive income.

AS 22 applies to all organizations that prepare financial statements under the Generally Accepted Accounting Principles (GAAP) in India. The standard requires an organization to provide sufficient information in the notes to the financial statements to enable users to understand the nature and extent of its tax liabilities and assets.

• **Tangible and Intangible Assets:**

Tangible assets and intangible assets are two broad categories of assets that are recognized in financial accounting. The key differences between these two types of assets are as follows:

Nature: Tangible assets are physical assets that can be seen and touched. Examples of tangible assets include land, buildings, machinery, and inventory. Intangible assets, on the other hand, are non-physical assets that cannot be seen or touched. Examples of intangible assets include patents, copyrights, trademarks, goodwill, and brand recognition.

Measurement: Tangible assets are measured and recorded in financial statements based on their cost, less any accumulated depreciation. Intangible assets, on the other hand, are measured and recorded based on their acquisition cost or fair value, less any accumulated amortization.

Lifespan: Tangible assets generally have a finite lifespan and are subject to wear and tear, obsolescence, and depreciation. Intangible assets, on the other hand, can have an indefinite lifespan and may not be subject to depreciation.

Transferability: Tangible assets can be physically transferred or sold to another party. Intangible assets, on the other hand, are generally not transferable in the same way as tangible assets. Instead, they are typically licensed or assigned to another party.

Value: The value of tangible assets tends to be more stable and predictable than the value of intangible assets, which can fluctuate based on market conditions, competitive forces, and changes in technology.

In summary, tangible assets are physical assets that can be seen and touched, while intangible assets are non-physical assets that cannot be seen or touched. The two types of assets are measured, recorded, and valued differently, and have different lifespans and transferability.

**Methods of Inventory Valuation:**

Inventory valuation refers to the process of assigning a value to the inventory that a company holds in order to determine the cost of goods sold (COGS) and the value of the ending inventory. There are several methods of inventory valuation, each of which has its own advantages and disadvantages.

* First-In, First-Out (FIFO): This method assumes that the first items purchased are the first items sold. Therefore, the cost of the oldest inventory is assigned to cost of goods sold, while the cost of the most recent inventory is assigned to ending inventory. FIFO tends to result in a higher ending inventory valuation and a lower COGS, which can lead to higher reported profits and higher taxes.
* Last-In, First-Out (LIFO): This method assumes that the last items purchased are the first items sold. Therefore, the cost of the most recent inventory is assigned to cost of goods sold, while the cost of the oldest inventory is assigned to ending inventory. LIFO tends to result in a lower ending inventory valuation and a higher COGS, which can lead to lower reported profits and lower taxes.
* Weighted Average Cost: This method calculates the average cost of all units in inventory and assigns this cost to both COGS and ending inventory. This method can smooth out fluctuations in inventory costs over time and is simple to calculate.
* Specific Identification: This method assigns the actual cost of each unit of inventory to COGS or ending inventory, depending on which units were sold and which units remain. This method is most appropriate for companies that deal in unique or high-value items where each unit can be identified and tracked.
* Standard Cost: This method uses predetermined costs for direct materials, direct labor, and overhead to calculate the cost of goods sold and ending inventory. These costs are based on estimates and can be adjusted periodically. This method is useful for companies that have a stable production process and consistent costs.

The choice of inventory valuation method can have a significant impact on a company's financial statements and tax liability. The method chosen should be consistent with the company's accounting policies and the requirements of the relevant accounting standards. Companies should carefully evaluate the pros and cons of each method and select the method that is most appropriate for their business model and industry.

**Process of Accounting For Intangible Assets AS-19:**

Accounting Standard (AS) 19, "Accounting for Leases," provides guidance on the accounting treatment of intangible assets. The following is a summary of the process of accounting for intangible assets under AS-19:

* Recognition: An intangible asset should be recognized in the financial statements if it meets certain criteria. The asset must be identifiable, controlled by the company, and capable of generating future economic benefits.
* Measurement: Intangible assets are generally measured at cost, which includes all directly attributable costs necessary to acquire and prepare the asset for its intended use. If the cost cannot be
* Amortization: Intangible assets are typically subject to amortization, which is the systematic allocation of the asset's cost over its useful life. The useful life of an intangible asset should be estimated based on factors such as the expected future use of the asset and the economic environment in which it operates.
* Impairment: Intangible assets are subject to impairment testing when there is an indication that the asset may be impaired. If the carrying value of the asset exceeds its recoverable amount, an impairment loss should be recognized.
* Disclosure: The financial statements should include disclosures about the nature and carrying amount of intangible assets, including information about significant assumptions used to estimate the useful life and recoverable amount of the assets.

In summary, AS-19 requires companies to recognize intangible assets in the financial statements if certain criteria are met, and to measure and amortize these assets over their useful lives. Companies must also conduct impairment testing and provide disclosures about their intangible assets in the financial statements.

**Procedure of Accounting For Fixed Assets:**

The process of accounting for fixed assets involves several steps to ensure that these assets are properly accounted for in a company's financial statements. Here is a summary of the procedure:

* Acquisition: The first step in accounting for fixed assets is to record the acquisition of the asset. This includes the purchase price, any associated taxes, and any other costs directly related to acquiring and preparing the asset for use.
* Depreciation: Fixed assets are typically subject to depreciation, which is the systematic allocation of the asset's cost over its useful life. Depreciation is recorded in the accounting records and reduces the value of the asset over time.
* Impairment: Fixed assets are subject to impairment testing when there is an indication that the asset may be impaired. If the carrying value of the asset exceeds its recoverable amount, an impairment loss should be recognized.
* Disposal: When a fixed asset is disposed of, the accounting records must reflect the sale or disposal of the asset. This includes recording any gains or losses on the sale, as well as removing the asset and its accumulated depreciation from the accounting records.
* Physical verification: Companies should conduct periodic physical verification of their fixed assets to ensure that they are still in use and in good condition. Any discrepancies between the physical count and the accounting records should be investigated and corrected.
* Disclosure: The financial statements should include disclosures about the nature and carrying amount of fixed assets, including information about significant assumptions used to estimate the useful life and recoverable amount of the assets.

**Accounting for taxes on Income as per Accounting Standard (AS)26:**

Accounting Standard (AS) 26, "Accounting for Taxes on Income," provides guidance on the accounting treatment of income taxes in financial statements. The following is an explanation of how taxes on income are accounted for under AS-26:

* Current tax: A provision for current income taxes is recognized in the financial statements in the period to which it relates. This provision is based on the taxable income for the period and the applicable tax rate.
* Deferred tax: Deferred tax is recognized for temporary differences between the carrying amounts of assets and liabilities in the financial statements and their tax bases. These temporary differences arise because accounting rules and tax rules may treat certain items differently. The deferred tax is measured at the tax rates that are expected to apply when the temporary differences reverse.
* Recognition of deferred tax assets: Deferred tax assets are recognized when it is probable that future taxable profits will be available against which the deferred tax asset can be utilized.
* Recognition of deferred tax liabilities: Deferred tax liabilities are recognized for all taxable temporary differences, except to the extent that the deferred tax liability arises from the initial recognition of goodwill or from the initial recognition of an asset or liability in a transaction that is not a business combination and that affects neither accounting nor taxable profit.
* Presentation in the financial statements: Income tax should be presented as a separate item in the income statement, except to the extent that it relates to items that are recognized in other comprehensive income or directly in equity.
* Disclosure: The financial statements should disclose the amount of current and deferred tax recognized in the period, the nature and amount of each type of temporary difference, the amount of unused tax losses and credits, and a narrative description of the factors that contributed to the recognition or reversal of deferred tax assets and liabilities.

In summary, AS-26 requires companies to recognize provisions for current income taxes and deferred tax assets and liabilities based on temporary differences between accounting and tax rules. The standard also requires the separate presentation of income tax in the income statement and disclosure of relevant information in the financial statements. Proper accounting for taxes on income is important for providing transparent and reliable financial statements to investors and other stakeholders

**Revenues recognized under AS-10:**

Accounting Standard (AS) 10, "Accounting for Fixed Assets," provides guidance on the accounting treatment of fixed assets in financial statements. The following is an explanation of how revenues are recognized under AS-10:

* Sale of Fixed Assets: When a fixed asset is sold, revenue is recognized in the financial statements at the time of sale, which is the point at which risks and rewards associated with the ownership of the asset are transferred to the buyer.
* Hire-Purchase Agreements: If a fixed asset is sold on hire-purchase terms, the revenue from the sale is recognized over the hire-purchase period. The gross amount due is initially recorded as an asset, and the interest element is recognized as revenue over the period of the hire-purchase agreement.
* Service Contracts: Revenue from service contracts related to fixed assets is recognized in the financial statements over the period of the contract as the services are provided.
* Interest Income: Interest income from finance leases and loans related to fixed assets is recognized over the term of the lease or loan based on the effective interest rate method.
* Royalties: Royalties from the use of fixed assets, such as patents or copyrights, are recognized as revenue over the period of the agreement.
* Disclosure: The financial statements should disclose the significant accounting policies adopted in determining the revenue recognition and the amounts of revenue from sale of goods, rendering of services or from others, as appropriate, recognized during the period, net of returns and trade discounts.

In summary, AS-10 requires companies to recognize revenue from fixed assets in various ways based on the type of transaction. Revenue is recognized when the risks and rewards associated with the ownership of the asset are transferred to the buyer. Revenue from service contracts, interest income, and royalties is recognized over the period of the contract or agreement. Proper accounting for revenue recognition is important for providing transparent and reliable financial statements to investors and other stakeholders.

**Various elements of financial statements:**

Financial statements are the primary means of communicating financial information about an entity to its stakeholders. The various elements of financial statements include:

Assets: Assets are resources owned or controlled by an entity as a result of past transactions or events, and from which future economic benefits are expected to flow. Examples of assets include cash, accounts receivable, inventory, property, plant and equipment, and intangible assets.

Liabilities: Liabilities are present obligations of an entity arising from past transactions or events, the settlement of which is expected to result in an outflow of resources embodying economic benefits. Examples of liabilities include accounts payable, notes payable, bonds payable, and accrued expenses.

Equity: Equity represents the residual interest in the assets of an entity after deducting liabilities. Equity includes contributed capital, retained earnings, and other reserves.

Revenues: Revenues are inflows of economic resources resulting from the sale of goods, the rendering of services, or the use of assets. Revenue is recognized when it is earned, and the amount can be reliably measured.

Expenses: Expenses are outflows or depletions of economic resources incurred by an entity in the process of generating revenue. Expenses are recognized when they are incurred, and the amount can be reliably measured.

Gains and losses: Gains and losses arise from transactions or events that are outside the ordinary course of an entity's activities. Gains and losses are recognized when they occur and can be reliably measured.

Comprehensive income: Comprehensive income includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. Comprehensive income includes gains, losses, revenues, and expenses that are not recognized in the income statement but are reported in other comprehensive income.

The elements of financial statements are the building blocks of financial reporting, and they provide information about an entity's financial position, performance, and cash flows. Understanding these elements is essential for stakeholders to make informed decisions about investing, lending, or transacting with an entity.

**Accounting Standard 22 and 19:**

Accounting Standard (AS) 22 and AS 19 are both related to accounting for intangible assets, but they cover different aspects. The main differences between these two standards are as follows:

* Objective: AS 22 deals with the accounting treatment of taxes on income, while AS 19 provides guidance on the accounting treatment of intangible assets. The objective of AS 22 is to prescribe the accounting treatment of taxes on income in the financial statements, whereas AS 19 focuses on how to recognize, measure, and disclose intangible assets in the financial statements.
* Scope: AS 22 applies to all enterprises, including companies, firms, and other entities that are liable to pay taxes on income under the Income Tax Act, while AS 19 applies to all enterprises that have intangible assets.
* Definition of Assets: AS 19 defines an intangible asset as an identifiable non-monetary asset without physical substance, while AS 22 does not provide a definition of an asset.
* Recognition: AS 19 provides guidance on the recognition of intangible assets, whereas AS 22 does not deal with the recognition of assets.
* Measurement: AS 19 provides guidance on the measurement of intangible assets, while AS 22 provides guidance on the measurement of taxes on income.
* Disclosure: AS 19 requires specific disclosures about intangible assets in the financial statements, including the useful life, amortization method, and impairment indicators, while AS 22 requires disclosures about the impact of taxes on income on the financial statements.

AS 22 and AS 19 are two different accounting standards that cover different aspects of accounting. AS 22 focuses on the accounting treatment of taxes on income, while AS 19 deals with the recognition, measurement, and disclosure of intangible assets in the financial statements.

**AS-9 vs. 10:**

AS-9 and AS-10 are two different accounting standards issued by the Institute of Chartered Accountants of India (ICAI) that deal with different aspects of financial accounting. The main differences between these two standards are as follows:

* Objective: AS-9 provides guidance on the accounting treatment of revenue recognition in the financial statements, while AS-10 deals with the accounting treatment of fixed assets in the financial statements.
* Scope: AS-9 applies to all enterprises, including companies, firms, and other entities that prepare financial statements, while AS-10 applies to all enterprises that hold fixed assets.
* Definition: AS-9 defines revenue as the gross inflow of cash, receivables, or other considerations arising in the course of ordinary activities, while AS-10 defines fixed assets as assets that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.
* Recognition: AS-9 provides guidance on the recognition of revenue, while AS-10 provides guidance on the recognition of fixed assets.
* Measurement: AS-9 provides guidance on the measurement of revenue, while AS-10 provides guidance on the measurement of fixed assets.
* Disclosure: AS-9 requires specific disclosures about revenue in the financial statements, including the accounting policies and the amount of revenue recognized, while AS-10 requires specific disclosures about fixed assets in the financial statements, including the depreciation method, the useful life of the assets, and the amount of depreciation charged.

AS-9 and AS-10 are two different accounting standards that deal with different aspects of financial accounting. AS-9 provides guidance on the accounting treatment of revenue recognition, while AS-10 deals with the accounting treatment of fixed assets.

**LIFO and FIFO Methods Of Inventory Accounting:**

LIFO (Last-In, First-Out) and FIFO (First-In, First-Out) are two commonly used methods of inventory accounting that are used to determine the cost of goods sold and the value of ending inventory. Here's an overview of each method:

LIFO (Last-In, First-Out): Under the LIFO method, the cost of goods sold is based on the cost of the most recent inventory items purchased. This means that the most recent costs are matched against revenue, resulting in a lower profit margin. On the other hand, the value of the ending inventory is based on the cost of the oldest inventory items, as they are assumed to remain in inventory. This means that the value of the ending inventory is based on the lower cost items, which can lead to a lower taxable income and lower taxes paid.

FIFO (First-In, First-Out): Under the FIFO method, the cost of goods sold is based on the cost of the oldest inventory items purchased, as they are assumed to be the first items sold. This means that the oldest costs are matched against revenue, resulting in a higher profit margin. On the other hand, the value of the ending inventory is based on the cost of the most recent inventory items purchased, as they are assumed to remain in inventory. This means that the value of the ending inventory is based on the higher cost items, which can lead to a higher taxable income and higher taxes paid.

Overall, the choice of using LIFO or FIFO can depend on a variety of factors, such as industry practices, tax regulations, and inventory management strategies. It's important to note that once a method is chosen, it must be consistently applied and disclosed in the financial statements.

**Accounting for fixed, intangible and taxes on Income AS-26:**

**Accounting for Fixed Assets (AS-10):**

Accounting Standard (AS) 10 deals with the accounting treatment of fixed assets in the financial statements. It provides guidance on the recognition, measurement, and disclosure of fixed assets. The standard requires that fixed assets be recognized when they are probable to generate future economic benefits, and the cost of the asset can be reliably measured. Fixed assets should be measured at cost, which includes all costs necessary to bring the asset to its working condition. Depreciation should be charged on a systematic basis over the useful life of the asset. The standard also requires specific disclosures in the financial statements, such as the depreciation method, the useful life of the asset, and the amount of depreciation charged.

**Accounting for Intangible Assets (AS-26):**

AS-26 deals with the accounting treatment of intangible assets in the financial statements. Intangible assets are non-physical assets that lack physical substance but have value. The standard provides guidance on the recognition, measurement, and disclosure of intangible assets. Intangible assets should be recognized when they are probable to generate future economic benefits, and the cost of the asset can be reliably measured. Intangible assets should be measured at cost, which includes all costs necessary to bring the asset to its working condition. Amortization should be charged on a systematic basis over the useful life of the asset. The standard also requires specific disclosures in the financial statements, such as the amortization method, the useful life of the asset, and the amount of amortization charged.

Accounting for Taxes on Income (AS-26):

AS-26 deals with the accounting treatment of taxes on income in the financial statements. The standard provides guidance on the recognition, measurement, and disclosure of taxes on income. The standard requires that income tax expense should be recognized in the period in which it is incurred, based on the principles of accrual accounting. The amount of income tax expense should be based on the tax laws and rates that have been enacted or substantively enacted at the end of the reporting period. The standard also requires specific disclosures in the financial statements, such as the current and deferred tax expenses and the amounts of unrecognized deferred tax assets and liabilities.

In summary, AS-10, AS-26, and AS-26 deal with the accounting treatment of fixed assets, intangible assets, and taxes on income, respectively. These accounting standards provide guidance on the recognition, measurement, and disclosure of these items in the financial statements, and help ensure that the financial statements provide useful and reliable information to users.