BLOCK IV:
REPORTING CRITERIA

Unit 1 : Criteria for Information Appearing in a Published Income Statement and Balance Sheet; Reporting Comprehensive Income

Unit 2 : Segmental Reporting; Accounting Policies; Directors' Report; Notes to The Accounts

Unit-1

Criteria for Information Appearing in a Published Income Statement and Balance Sheet; Reporting Comprehensive Income

Unit Structure:

1.1 Introduction

1.2 Objectives

1.3 Criteria for Information Appearing in Published Income Statement and Balance Sheet

 1.3.1 Elements of Financial Statements

 1.3.2 Criteria for Recognition

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1.1 Introduction

The published financial statements disclose the financial performance and financial position of an entity to the various stakeholders in order to help them make informed decisions on various matters of their interest. Apart from this, the regulatory and statutory requirement also makes reporting and publishing financial information, an integral part of an entity's operations. The preparation and presentation of financial statements and other relevant reports which depends on the nature and circumstances of the entity is guided by the Acts, rules and guidelines of the place where the entity is located. This unit deals with the various reporting and disclosure requirements of an organization in India in line with the relevant provisions of the Companies Act, 2013, Accounting Standards issued by the Institute of Chartered Accountants of India (ICAI) and other necessary rules and guidelines.

1.2 Objectives

This unit deals with diverse areas of accounting and reporting and after going through this unit, you will be able to:

- Recognise the criteria which may be considered for proper recognition of items in the financial statements
- Explain the concept of comprehensive income

1.3 Criteria for Information Appearing in Published Income Statement and Balance Sheet

The ever increasing demands of globalization has thrown open challenges across the world on uniform reporting requirements. The financial reporting process is concerned with providing information that is useful in the business and economic decision making process. This information can be provided in the financial statements and additional reports of the corporate houses. The criteria for information appearing in the published Income Statement and the Balance Sheet means the basis, on which financial transactions are recorded, prepared and presented. The financial statements must present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for income, expenses assets, equity and liabilities. The criteria for information appearing in a published income statement also known as statement of profit and loss or Profit and Loss Account and balance sheet or position statement indicates the elements and the conditions to be satisfied by these elements to appear in the respective statements, that make up the financial statements complete, uniform and understandable.

1.3.1 Elements of Financial Statements

The financial effects of a business transaction and other events are portrayed in the financial statements by grouping these effects and events in broad categories which are known as elements of financial statements. The elements that are directly related and included in the income statement to measure the financial performance of an entity during a particular period are:

1. Income and
2. Expenses

Information about the nature and amount of assets and liabilities that an entity has assists the users to assess the financial strengths and weaknesses, liquidity and solvency of the entity and also the need and ability of the entity to get finance. It also demonstrates the distribution of future cash inflows among those with a claim on the entity. In this context, the elements that are directly related and included in the balance sheet to determine the financial position of an entity are:

1. Assets and
2. Equity and Liabilities

> **Stop to Consider**
>
> The elements of financial statements are:
>
> 1. Income
> 2. Expenses
> 3. Assets
> 4. Equity and Liabilities

1.3.2 Criteria for Recognition

Recognition is the process of incorporating in the financial statements especially, the statement of financial position or balance sheet all those items which meets the definition of that element and satisfies certain criteria for recognition. In general, such criteria are given below:

1. The value or the cost of that item can be reliably measured.
2. There should be probability that future economic benefits arising out of the item will flow to or from the entity.

The following criteria may be considered for proper recognition of the various elements of the financial statements individually:

1. ***Income:*** The concept of income recognition is central to accounting. Income is increase in economic benefits during the accounting period in the form of inflows or increase in assets or decrease in liabilities resulting in increase in equity, other than those relating to contributions from equity participants. Any item may be recognised as income in the income statement when an increase in future economic benefit

related to an increase in an asset or decrease of a liability has arisen and which can be measured reliably. The recognition criterion, that says revenue should be earned, is generally accepted for recognizing income in the income statement. Income includes revenue and gains. Revenue is the receipts of the entity arising in the ordinary course of business activities of the entity like sales, fees, etc. Gains are economic benefits which may or may not arise in the ordinary course of business activities of an entity. In short, revenue and gains results in inflow of funds or enhancement in assets.

2. ***Expenses:*** Expenses are recognised when a decrease in future economic benefit related to a decrease in an asset or increase of a liability arises and which can be measured reliably. Expenses include losses also. Expenses are recognised in the determination of profit or loss if it arises in the ordinary course of business activities of an entity like purchase of raw materials, wages, rent, etc. Similarly, losses are decrease in economic benefits which may or may not arise in ordinary course of business activities of an entity. In short, expenses and losses results in outflow of funds or decrease in assets and if this condition is satisfied the items are recognised under the income statement. Expenses are recognized on the basis of a direct association between the costs incurred and the earnings of specific items of income. This process is known as matching of costs with revenues. When economic benefits are expected to arise over several accounting periods and the association with income cannot be determined directly, expenses are recognized in the income statement on the basis of systematic and rational allocation procedures. These allocation procedures are intended to recognize expenses in the accounting periods in which the economic benefits associated with these items are consumed or expire.

3. ***Assets:*** Assets are resources controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity. As such, an asset is recognised in the balance sheet when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured in a reliable manner. For example, debtors. An asset is not recognized in the balance sheet when expenditure has been incurred for which it is considered improbable that economic benefits will flow to the entity beyond the current accounting period. It is because the degree

of certainty that economic benefits will flow to the enterprise beyond the current accounting period is insufficient to warrant the recognition of an asset.

4. ***Equity and Liabilities:*** Equity is the residual interest in the assets of the enterprise after deducting all liabilities. Liabilities are present obligation of the entity which arises from past events and is expected to result in outflow of resources from the entity. A liability is recognised in the balance sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably. For example, creditors.

Check Your Progress

Q1. What are the elements of an income statement?

Q2. What are the criteria for recognising assets in the balance sheet?

1.3.3 Statutory Provisions

Financial statements of a company are prepared in accordance with Section 129 of the Companies Act, 2013 which requires the financial statements to show true and fair view of the state of affairs of the company. According to Section 2 (40) of the Act, financial statement includes Balance Sheet, Statement of Profit and Loss, Cash Flow Statement, Statement of Changes in Equity and Notes to Accounts. Schedule III of the Companies Act, 2013 (earlier Revised Schedule VI of the Companies Act, 1956) which provides the form and content of preparation and presentation of financial statements considers Shareholders' Funds, Share Application Money pending Allotment, Non-Current Liabilities and Current Liabilities as components of Equity and Liabilities.

Shareholders' Funds are further classified into Share Capital, Reserves and Surplus and Money Received against Share Warrants. Non-Current Liabilities are classified into Long-Term Borrowings, Deferred Tax Liabilities, Other Long Term Liabilities and Long Term Provisions. Similarly, Current Liabilities are also classified as Short Term Borrowings, Trade Payables, Other Current Liabilities and Short Term Provisions.

According to Schedule III of the Companies Act, 2013, assets consist of Non-Current Assets and Current Assets. Non-Current Assets are classified into Fixed Assets, Non-Current Investments, Long Term Loans and Advances and Other Non-Current Assets. On the other hand, Current Assets are classified as Current Investments, Inventories, Trade Receivables, Cash and Cash Equivalents, Short Term Loans and Advances and Other Current Assets.

A liability shall be recognized and classified as current when it satisfies any of the following criteria:

a. It is expected to be settled in the entity's normal operating cycle (time between the acquisition of assets for processing and their realization in cash or cash equivalents and when the normal operating cycle cannot be identified, it is assumed to have duration of 12 months);

b. It is held primarily for the purpose of being traded;

c. It is due to be settled within twelve months after the reporting date; or

d. The entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date.

All other liabilities are classified as non-current.

Similarly, an asset shall be classified as current when it satisfies any of the following criteria:

a. It is expected to be realized in, or is intended for sale or consumption in, the entity's normal operating cycle ;

b. It is held primarily for the purpose of being traded;

c. It is expected to be realized within twelve months after the reporting date; or

d. It is cash or cash equivalents unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.

All other assets not satisfying any of the above conditions are classified as non-current assets.

Stop to Consider

According to Schedule III of the Companies Act, 2013, assets are broadly classified as:

1. Current Assets and
2. Non-Current Assets

Similarly, liabilities are classified as:

1. Current Liabilities and
2. Non-Current Liabilities.

1.4 Reporting Comprehensive Income

The income statement provides an overview of sales, expenses and taxes. At the end of preparing the income statement one can determine the net profit or loss or income of the business but it is not necessarily all inclusive. That is, it only includes income from business operations and business activities that occur due to the company's routine and day-to-day activities. There are times when companies earn profits or incur losses from the change in value of certain assets and the net impact on earnings is found in comprehensive income and not in the statement of profit or loss.

Comprehensive income is also known as an all-inclusive concept of income. It is the change in equity or net assets of an entity during a period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distribution to owners.

Comprehensive Income=Revenues + Gains – Expenses - Losses

The major components of comprehensive income are:

1. Items relating to entity's ongoing major or central operations
2. Results of transactions in investments in other entities
3. Payment or recovery of taxes
4. Exchange and other transfers between the entity and other entities that are not its owners
5. Items which cannot be estimated with complete reliability
6. Unusual items occurring infrequently but are also unqualified to be extraordinary items

7. Unrealised changes in the value of assets and liabilities when these are recognised by the accounting model in use.

In other words, comprehensive income includes transactions causing a net increase or decrease in shareholder's interests during the period except transactions between the enterprise and its shareholders including dividends. For example, holding gains or losses on assets, whether realised or not. Comprehensive income is a useful measure of overall performance of an entity. It provides more useful information for the users of financial statements to evaluate the importance of the items and their effects on operating results.

Check Your Progress

1. What is the all-inclusive concept of income?

1.5 Summing Up

- Recognition is the process of incorporating an item in the income statement and balance sheet that meets the definition of an element and satisfies the criteria for recognition.
- The general criteria for recognition of items in the financial statements are given below:
  1. The value or the cost of that item can be reliably measured.
  2. There should be probability that future economic benefits arising out of the item will flow to or from the entity.
- Comprehensive Income is the change in equity or net assets of an entity during a period from transactions and other events and circumstances from non-owner sources.

1.6 Model Questions

Short Answer Questions

Q1. What are the criteria for recognizing income in the income statement?

Q2. What is meant by accrual concept in accounting?

Long Answer Questions

Q1. Explain the criteria for recognizing a current asset and current liability?

Q2. Explain the concept of comprehensive income.

1.7 References and Suggested Readings

1. The Companies Act, 2013 (No. 18 of 2013). The Gazette of India Extraordinary. Part II. Section I.
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Unit-2

Segmental Reporting; Accounting Policies; Directors' Report; Notes to The Accounts

Unit Structure:

2.1 Introduction

2.2 Objectives

2.3 Segmental Reporting

  2.3.1 Conditions for Identifying a Reportable Segment

  2.3.2 Benefits of Segment Reporting

  2.3.3 Disadvantages of Segment Reporting

2.4 Accounting Policies

2.5 Directors' Report

2.6 Notes to the Accounts

2.7 Summing Up

2.8 Model Questions

2.9 References and Suggested Readings

2.1 Introduction

Accounting as the language of a business is ever evolving. The information that is generated from accounting is known as accounting information. Accounting information bridges the gap between business transactions and decision making. As such proper reporting of accounting information is crucial for effective decision making by various users. In this unit some important reporting aspects like segment reporting for diversified businesses, accounting policies adopted by a business and its disclosure, responsibility of the Board of Directors' reflected through the Director's Report and significant information appearing in Notes to Accounts are explained considering the relevant statutory provisions and guidelines issued in this respect. Adhering to statutes while reporting accounting information is important to aid informed decision by stakeholders.

2.2 Objectives

This unit deals with diverse areas of reporting accounting information and after going through this unit, you will be able to:

- Identify reportable segments for segmental reporting
- Understand the need for disclosure of accounting policies
- Discuss the contents of a Director's Report
- Explain the significance of Notes to Accounts

2.3 Segmental Reporting

An entity may venture into diversified business activities or a new area of operation which may be significant in terms of sales, profits or losses or assets employed. The diversified nature of their operations in different industries, activities and geographical areas necessitates modifications in the nature of financial reporting practices of these entities. Each of these diversified area are considered as segments of the entity and as such reporting for each of these segments needs to be made by every such entity with different segments.

Accounting Standard-17 (AS-17), issued by the Institute of Chartered Accountants of India (ICAI), relates to segment reporting which commenced with effect from 1.4.2001. The objectives of AS-17 are to inform about the different geographical areas in which the enterprise has its operations and also to inform about the various products and services which the enterprise offers. This enables better understanding of the enterprise's performance by systematic and overall assessment of the risks and returns of the enterprise. Entities whose securities are listed in the stock exchange, or who are in the process of listing their securities in the stock exchange or all other enterprises whose turnover for the accounting period exceeds rupees fifty crores are required to adhere to segment reporting.

Many enterprises provide groups of products and services or operate in geographical areas that are subject to differing rates of profitability, opportunities for growth, future prospects, and risks. Segment information about different types of products and services of an enterprise and its operations in different geographical areas is relevant to assessing the risks and returns of a diversified or multi-locational enterprise but may not be determinable from the aggregated data. Therefore separate reporting is very necessary for separate segments.

In this backdrop it would be prudent to understand the meaning of various terms often used in segment reporting as given below:

- ***Enterprise revenue:*** It is the revenue earned from sale to external customers as reported in the Statement of Profit & Loss.
- ***Segment revenue:*** It is the revenue from transactions with other segments of the enterprise and any other portion of enterprise revenue that is directly attributable to a segment and can be allocated to a segment on a reasonable basis.
- ***Segment result:*** Segment result is the profit or loss of a segment and is the difference between segment revenue and segment expenses.
- ***Segment assets:*** Segment assets are used and employed in a segment for conducting its operating activities.
- ***Segment liabilities:*** Segment liabilities are operating liabilities that result from the operating activities of a segment, and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.
- ***Reportable Segment:*** According to AS-17, a reportable segment is a business segment or a geographical segment identified on the basis of foregoing definitions for which segment information is required to be disclosed by this Standard.
- ***Business Segment:*** A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments. Factors that should be considered in determining whether products or services are related include: (a) the nature of the products or services; (b) the nature of the production processes; (c) the type or class of customers for the products or services; (d) the methods used to distribute the products or provide the services; and (e) if applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities.
- ***Geographical segment:*** A geographical segment is a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic

environments. Factors that should be considered in identifying geographical segments include: (a) similarity of economic and political conditions; (b) relationships between operations in different geographical areas; (c) proximity of operations; (d) special risks associated with operations in a particular area; (e) exchange control regulations; and (f) the underlying currency risks.

Stop to Consider

- Segment information about different types of products and services of an enterprise and its operations in different geographical areas is relevant to assessing the risks and returns of a diversified or multi-locational enterprise.
- Aggregated data may not be able to determine this.
- Therefore, separate reporting is very necessary for separate segments.

2.3.1 Conditions for Identifying a Reportable Segment

A business segment or geographical segment should be identified as a reportable segment if it satisfies any of the following conditions:

a. Its revenue from sales to external customers and from transactions with other segments is 10 percent or more of the total revenue, external and internal, of all segments; or
b. Its segment result, whether profit or loss, is 10 percent or more of-
c. The combined result of all segments in profit, or
d. The combined result of all segments in loss, whichever is greater in absolute amount; or
e. Its segment assets are 10 percent or more of the total assets of all segments.

2.3.2 Benefits of Segment Reporting

Some of the benefits that segment reporting provide are:

1. It helps in taking systematic and informed decisions by the external users like the investors relating to investments, profitability and risks of various segments of the entity which otherwise would not have been highlighted in aggregated reporting alone.

2. Consumers and the general public may be able to get the right information about the range of products and areas of their operation as well as other related information on various segments. They can also check to see the presence of any price discrimination practice followed by the entity from segment information.
3. Segment information promotes better understanding of the corporate strategy of the entities and provides a more reliable base for government policy decisions at both national and international levels.
4. It also helps the internal users like the employees and trade unions for wage negotiations and wage equality along with information on their job prospects.
5. It would also help devise the best cost allocation procedures and the bases on which transfer prices are calculated between segments.
6. Internal management system, performance evaluation, managerial performance evaluation also becomes easier and perfect with the publication of segment information.

2.3.3 Disadvantages of Segment Reporting

Some disadvantages which may arise due to segment reporting are:

1. Sometimes it becomes difficult to allocate all types of cost used commonly by all segments.
2. Identifying the right base for segmentation is yet another problem entities face at the time of segment reporting. It may be difficult for them to choose segments in terms of organization division, industry, market, consumer, product, etc. Moreover, more than one form of diversification may be present in each of the segment.
3. The costs incurred to collect, process, audit, disseminate and maintain segment records and report segment information may be more than the benefits derived from segment reporting.
4. The management may not always be willing to divulge all information in the name of segment information. In the process of segment reporting there are always possibilities of divulging trade secrets of the entity.

Despite the above disadvantages it is important for an organization to adhere to this standard and follow the rules and guidelines provided in this context in identifying the reportable segment in a proper manner for giving maximum information to the stakeholders regarding the financial results and position of the most important operating units of the organization for decision making purpose.

Check Your Progress

Q1. What is meant by Segment Revenue?

2.4 Accounting Policies

Every entity follows certain accepted set of rules, principles and policies for recording, classifying, summarizing and presenting its financial information in order to provide uniformity in accounting and reporting their financial transactions. These rules are often termed as accounting policies which makes information comparable and leads to better analysis of performances. The environment and circumstances under which an entity operates are different for different entities. As such, an accounting policy followed by one entity may not be acceptable or suitable for another entity operating under a different circumstance. Selecting the appropriate policy and the manner of applying those policies in varying circumstances needs considerable judgment by the management of the enterprise. For example, the management needs to disclose the measurement basis used in preparing the financial statements, that is, the basis on which an entity recognizes an asset and liability at initial recognition as well as subsequent measurement (like historical cost, fair value, etc.); and also the other accounting policies used that are relevant to the understanding of the financial statements along with the judgement used by the management in the process of applying the accounting policies.

Accounting Standard 1 (AS-1) issued by the ICAI in this regard on 'Disclosure of Accounting Policies' is a mandatory requirement. It requires every company registered under the Companies Act to disclose the significant accounting policies followed in preparing and presenting their financial statements. It has also listed some of the important areas in which differing accounting policies are encountered:

1. Methods of depreciation, amortization, etc.

2. Valuation of inventories
3. Valuation of fixed assets
4. Valuation of investments
5. Recognizing capital and revenue items
6. Treatment of goodwill
7. Treatment of contingent liabilities
8. Treatment of retirement benefits
9. Recognition of profit on long-term contracts
10. Conversion of translation of foreign currency items

AS-1 also specifies three basic or fundamental assumptions to be followed by every entity. They are:

1. ***Going Concern Concept:*** The going concern assumption is that an entity will be able to continue operating for a period of time that is sufficient to carry out its commitments, obligations, objectives, and so on.
2. ***Accrual Concept:*** Accrual concept is one of the fundamental principle of accounting which requires recording revenues when they are earned and not when they are received in cash, and recording expenses when they are incurred and not when they are paid.
3. ***Consistency Concept:*** The consistency principle states that, once an accounting principle or method is adopted, it has to be followed consistently in future accounting periods. Any change in accounting principle or method as a result of regulatory requirements or which may improve the quality of reported financial results have to be properly disclosed along with its effects.

It is assumed that every entity prepares its financial statements based on these basic assumptions. In case an entity does not follow any or all of these assumptions, the fact must be disclosed. This standard also specifies the major considerations which governs the selection and application of a particular accounting policy. These are:

1. ***Prudence:*** The prudence concept is an accounting principle that requires recording liabilities and expenses as soon as they occur, but recording revenues only when they are assured or realized. This is also known as the principle of conservatism.
2. ***Substance over Legal Form:*** Substance over legal form or substance over form is an accounting concept which means that

the economic substance of transactions and events must be recorded in the financial statements rather than just their legal form in order to present a true and fair view of the affairs of the entity.

3. ***Materiality:*** According to this concept all important financial information that has the ability to change the opinion of the users of financial statements should be included in the financial statements.

Accounting Standard-1 specifically mentioned the following disclosures to be made by the registered companies:

1. All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed to ensure proper understanding of financial statements by the user groups.
2. All disclosures should form part of the financial statements and should be made in one place instead of being scattered over several statements, schedules and notes.
3. The policies to be disclosed are mainly related with the areas in which differing accounting policies are encountered.
4. Any change in accounting policy which has a material effect like change of depreciation method from written down value method to straight line method, change in cost formula in measuring the cost of inventories, etc. should be disclosed. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable, wholly or in part, and the fact should be indicated.
5. If a change is made in the accounting policies which has no material effect on the financial statements for the current period but which is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.

The disclosure of significant accounting policies is also necessary in order to promote understanding of financial statements and also to enable proper and informed decision making by the users of the financial statements. However, it is important to understand that disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item in the accounts.

Check Your Progress

1. What are the three fundamental assumptions in accounting to be followed by every entity as per Accounting Standard 1?

2.5 Directors' Report

The Board of Directors is the representative of the shareholders who conduct the activities of a business on behalf of all the shareholders. The Board of Directors is entrusted with the responsibility of running the organization and as such it is their responsibility to meet the expectations of the shareholders and present before them the financial and other useful and significant information about the organization which had taken place during a particular financial year. Apart from presenting the financial statements the Board of Directors are required to prepare and present a report called the Board of Director's Report which is informative and analytical and had a great bearing on the credibility of the annual financial statements of an entity. For example, the report explains changes in earnings in terms of volume, price, market share, raw material costs and other related factors. It also highlights significant events, their causes, results and implications for the future in addition to providing a financial summary of the operations of the entity for a particular accounting period.

According to Section 134 of the Companies Act, 2013, the financial statements, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board at least by the chairperson of the company where he is authorized by the Board or by two directors (out of which one shall be managing director) and the Chief Executive Officer (if he is a director in the company) the Chief Financial Officer and the company secretary of the company, wherever they are appointed for submission to the auditor for his report thereon. A signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy each of:

(a) any notes annexed to or forming part of such financial statement;
(b) the auditor's report; and
(c) the Board's report

Check Your Progress

1. What information relating to risk should be provided in the Boards' Report?

2.5.1 Contents of Director's Report

Some of the important provisions along with the contents of a Board of Director's Report or simply Director's Report are given below:

- There shall be attached to statements laid before a company in general meeting, a report by its Board of Directors, which shall include—
  a) the extract of the annual return as provided under Section 92 (3);
  b) number of meetings of the Board;
  c) Directors' Responsibility Statement;
  d) a statement on declaration given by independent directors under Section 149 (6);
  e) in case of a company covered under Section 178(1), company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided under Section 178 (3);
  f) explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report and by the company secretary in practice in his secretarial audit report;
  g) particulars of loans, guarantees or investments under Section 186;
  h) particulars of contracts or arrangements with related parties referred to in Section 188 (1) in the prescribed form;
  i) the state of the company's affairs;
  j) the amounts, if any, which it proposes to carry to any reserves;
  k) the amount, if any, which it recommends should be paid by way of dividend;
  l) material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report;

m) the conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as may be prescribed;

n) a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company;

o) the details about the policy developed and implemented by the company on corporate social responsibility (CSR) initiatives taken during the year as well as the composition of CSR Committee under Section 134(3);

p) in case of a listed company and every other public company having such paid-up share capital as may be prescribed, a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors;

q) such other matters as may be prescribed.

- The Directors' Responsibility Statement shall state that—

  a) in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;

  b) the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period;

  c) the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;

  d) the directors had prepared the annual accounts on a going concern basis; and

  e) the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating

effectively. The term “internal financial controls” means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information;

f) the directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.

- The Board’s report under Section 134(3) shall disclose the composition of an Audit Committee;
- Every contract or arrangement entered into under Section 188 (1) relating to related party transactions shall be referred to in the Board’s report to the shareholders along with the justification for entering into such contract or arrangement.
- An extract of the annual return in such form (Form MGT – 9) as may be prescribed under Section 92 shall form part of the Board’s report.
- The Board’s report and any annexure thereto shall be signed by the chairperson of the company if he is authorised by the Board and where he is not so authorised, shall be signed by at least two directors, one of whom shall be a managing director, or by the director where there is one director.
- If a company contravenes these provisions, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

Stop to Consider

- Every business entity has financial and non-financial information which needs to be shared with its stakeholders.

- Board of Director's Report is a description of transactions in an entity which are basically non-financial in nature but has an important bearing on the process of informed decision making. This report is prepared by the Board of Directors of the company as per the relevant provisions of the Companies Act.

2.6 Notes to the Accounts

Financial statements provide information on the key elements of any business. This information in quantitative form only, may not help users to get a complete and comprehensive view of the entity. Therefore, this information needs to be supported with sufficient notes regarding the certainty, timing, estimation and related aspects of management judgment.

The financial statements of an organization contain various types of information which may not be easily understandable without necessary details and supporting explanations and justifications. The Companies Act, 2013 prescribes the financial reporting and disclosure requirements for all companies registered under it. All specific and necessary disclosures required to be made in accordance with different Accounting Standards or the Companies Act shall be made in Notes to Accounts.

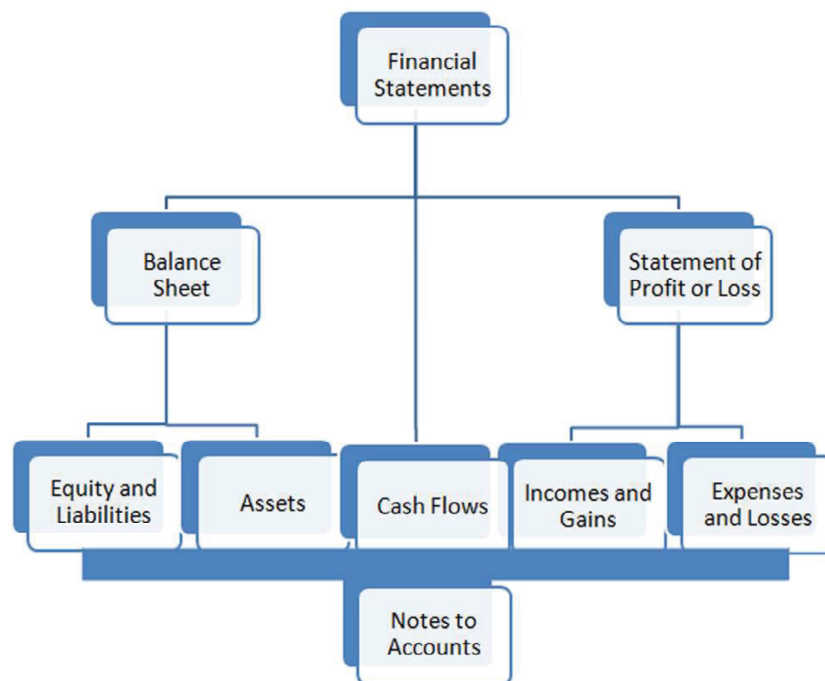
Notes to Accounts are narrative disclosures that form part of the financial statements of a company. There may be a number of notes required that are specific to a particular industry. The list below gives some common items of Notes to Accounts and should not be considered as comprehensive:

1. Disclosures related to significant accounting policies followed
2. Contingent liabilities and capital commitment
3. Prior period and subsequent items along with their financial effect
4. Payment to auditors
5. Earnings and expenses in foreign currencies
6. Extraordinary items
7. Government Grants
8. Value of imports
9. Related Party Transactions and nature of relationship with the related party
10. Amalgamation
11. Interest in joint venture
12. Leases

13. Earnings per share
14. Reconciliation of changes in goodwill and impairment losses
15. Taxes on income

Notes to Accounts establish the linkage between the information contained in the financial statements and its significance in financial decision making. The diagram below shows the relationship between Notes to Accounts and the Financial Statements of an organization.

Diagram showing the relationship between Notes to Accounts and Financial Statements



Notes to Accounts shall contain information in addition to that presented in the financial statements and shall provide where required narrative descriptions or disaggregation's of items recognised in those statements and information about items that do not qualify for recognition in those statements. Each item on the face of the Balance Sheet and Income Statement shall be cross-referenced to any related information in the Notes to Accounts. For example, in case of share capital, information on shares of holding company, shares of subsidiary company, securities convertible to equity and preference shares, shares forfeited, etc. shall be provided in Notes to Accounts to facilitate better understanding of the interested stakeholders. However, in preparing the financial statements including the Notes to

Accounts, a balance shall be maintained between providing excessive detail that may not assist users of financial statements and avoiding or missing significant information as a result of too much aggregation.

Stop to Consider

- All specific and necessary disclosures required to be made in accordance with different Accounting Standards or the Companies Act shall be made in Notes to Accounts.
- Notes to Accounts are narrative disclosures that form part of the financial statements of a company.

Check Your Progress

1. List any two items which are shown in Notes to the Accounts.

2.7 Summing Up

A reportable segment is a business segment or a geographical segment for which segment information is required to be disclosed by an entity with diversified business operations.

Accounting Standard 1 (AS-1) on 'Disclosure of Accounting Policies' requires every company registered under the Companies Act to disclose the significant accounting policies followed in preparing and presenting their financial statements.

A signed copy of every financial statement shall be issued, circulated or published along with a copy of Board of Directors' Report.

All specific and necessary disclosures are required to be made in the Notes to Accounts in accordance with different Accounting Standards or the Companies Act and this form part of the financial statements of a company.

2.8 Model Questions

Short Answer Questions:

1. What are the considerations to be kept in mind while choosing an appropriate accounting policy for an entity?

2. What is a reportable segment?

3. Why is 'Notes to Accounts' significant in financial reporting?

Long Answer Questions:

1. Explain the necessity of maintaining segment accounts by a business entity.

2. Discuss the contents of a Board of Directors' Report.

2.9 References and Suggested Readings

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