ADVANCED ACCOUNTS

Notes

Advanced Accounts – ca final

Accounting for Not-For-Profit Organisations

Question 1

Explain the concept of fund theory and fund based accounting. (4 marks)(Nov' 00)

Answer

Fund theory and fund based accounting: Although, the profit motive is the driving force for any business entity, there are certain organisations which are run without profit motive. Such organisations may be governmental institutions or any non-profit institutions like colleges, universities, charitable hospitals etc. The accounting for these not-for profit entities is primarily based on the fund theory. The fund theory is based on the *equation – Assets = Restrictions on assets*. Assets represent prospective services to the fund and liabilities represent restrictions against the assets of the fund. For example, in case of a university, the most commonly used specific funds are endowment funds, development funds etc. Each of these funds has its specific assets restricted for particular purposes. Under the fund theory, the balance sheet is considered an 'inventory statement' of assets and those restrictions applicable to the assets. Revenues represent an increase in assets into the fund that are completely free of equity restrictions other than the final restriction imposed by the residual equity. The residual equity represents a final restriction on the assets and establishes the equality of assets and equities. Expenses represent the release of services for designated purposes specified in the objective of the fund. Thus, the fund theory calls for fund based accounting rather than entity based accounting.

A fund may be defined as an accounting entity "with a self balancing set of accounts regarding cash and/or other resources together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations". Thus, every fund is aimed at fulfilling some purpose and the services embodied in the assets are the primary means to achieve that purpose. Fund based accounting essentially involves preparation of financial statements fundwise and consolidation of those statements to represent the financial results/position of the organisation as a whole.

Question 2

What are, the special features of accounting for Educational Institutions? (7 marks)(May,1996)

Answer

Special Features of Accounting for Educational Institutions: An educational institution is generally not run for profit. Its, administrators, as custodians of public funds, are accountable of their proper expenditure for educational purpose. The marked difference between commercial accounting and that for educational institutions is that the former places emphasis on proper ascertainment of profits, while the latter is more generally concerned with exercising control over

expenditure so as to conform to the stipulated norms and to the academic objectives of the institution to which it relates.

In the case of institutions like colleges and universities, separate ledgers are maintained for each fund. Funds may be broadly classified into two categories - Revenue Funds and Specific Funds. Revenue Funds may be further classified as Unrestricted Fund and Restricted Fund. Specific Funds are Endowment Funds, Annuity and Life Income Funds, Development Funds etc. Separate balance sheet is prepared for each fund and a statement of activity (popularly known, as Income and Expenditure Account) is prepared for only revenue funds- both restricted and unrestricted. Finally, each individual balance sheet is consolidated to get a general balance sheet of the institution as a whole.

Revenue Funds- Restricted and Unrestricted: Revenue funds essentially record normal revenue transactions. However, the use of revenue fund may be restricted or unrestricted. In the case of restricted funds, income is recognised to the extent of expenditure incurred. The accounting basis of the unrestricted fund is the accrual method as used for commercial entities.

There may be transfers out of revenue funds to specific funds and vice-versa. Some transfers are mandatory and some are non-mandatory.

Both mandatory and non-mandatory transfers are reported separately in the financial statements of the revenue funds.

Specific Funds: Specific funds are earmarked for well defined purposes. Contributions and transfers arc directly credited to respective fund balances. Expendable resources are transferred to revenue funds except for capital outlay and debt retirement which are accounted for in development or asset fund and loan fund respectively. For the specific funds no statement of income is prepared. However a statement is prepared showing the movements in fund balances. The features of certain important specific funds are discussed below.

(a) *Endowment Funds*: Incomes from these funds usually are transferred to another fund where it may be expended. Interest revenue out of such fund is accrued at the end of accounting year. The fund is usually invested in some securities and such investment is valued at cost price. If the income out of such investment is available for unrestricted purposes it is recognised in the unrestricted fund. On the other hand if the income is to be used for some specific purpose it is transferred to that specific fund. The only time, the investment income is recognised in the endowment fund is when the terms of agreement specify that the income must be added to the endowment principal. .

(b) *Loan Funds*: Loan funds account for resources that may be loaned to faculty or staff. No revenue or expense accounts are used in the loan fund. All transactions affecting fund balance are recorded directly to fund balance. Interest on loan is credited to the fund balance on accrual basis. Investment income is also accrued. Administration and collection costs relating to granting and recovery of loans are directly charged to this fund. Any bad debt or provision for doubtful loans are also charged to this fund.

(c) *Annuity and Life Income Funds*: These funds account for resources that are given to a not for profit organisation provided that the organisation agrees to make periodic payments to a designated recipient. In the case of annuity funds, the

amount of periodic payment is fixed whereas payments vary with the amount of income earned in the case of life income funds.

(d) *Development Funds*: These funds are utilised for developmental purposes like acquisition of building and equipments, major repairs to fixed assets etc. Separate fund may be maintained for each developmental activity. Alternatively a combined development fund may be maintained to account for all acquisitions and/or construction of fixed assets. Any expenditure incurred for the purpose of construction or acquisition of building, laboratory etc. are met out of this fund and the asset is recognised in the general balance sheet. Consequently that portion of the fund which has been utilised for the acquisition or construction of the asset should be transferred to unrestricted fund. Depreciation on these fixed assets should be shown as part of operating expenses of unrestricted revenue fund.

To sum up the following statements are to be prepared to get a consolidated picture the organisation as a whole:

(a) Income and Expenditure Account for revenue funds.

(b) Statement showing changes in fund balances.

(c) Balance Sheet of individual funds.

(d) General Balance Sheet.

Question 3

(a) How would you describe 'Development Funds' maintained by Not-for-profit Organisations? (6 marks)(May, 2002)

(b) Write short note on Annuity and life income funds. (5marks)(November, 2003)

(c) What do you mean by restricted funds and unrestricted funds as found in the books of account of not-for-profit organizations? (4 marks) (May, 2004)

(d) Distinguish between mandatory transfers and non-mandatory transfers made by a college in its books of account. (4 marks)(May, 2004)

Answer

(a) Development Funds are utilised for developmental purposes like acquisition of buildings and equipments, major repairs to fixed assets etc. Separate fund may be maintained for each development activity. Alternatively, a combined development fund may be maintained to account for each acquisition and/or construction of fixed assets. The major sources of receipts for this fund are government or private grants/gifts (restricted to acquisition of fixed properties), income and gains of investments of unutilised fund (if any), transfers from other funds. Any expenditure incurred for the purpose of construction or acquisition of building, laboratory etc. is met out of this fund and the asset is recognised in the general balance sheet. Consequently that portion of the fund which has been utilised for the acquisition or construction of the asset should be transferred to unrestricted fund. So long as the asset is not fully acquired or constructed, the proportionate fund cannot be transferred to unrestricted fund. Depreciation can be charged, on fixed assets only after its completion or acquisition. Such depreciation should be shown as part of operating expenses of unrestricted revenue fund.

(b) The annuity and life income funds account for resources that are given to a non profit organisation provided that the organisation agrees to make periodic payment to a stated person. In case of annuity funds the agreement stipulates that periodic payments are made to a certain person for a specified amount for a specified period of time. Life income funds distribute their income to the individuals as long as they live. When the beneficiary dies, the funds become the property of the organisation and are used as specified in the gift agreement.

Annuity funds pay a fixed amount periodically whereas life income fund payments vary with the amount of income earned.

(c) In a not-for-profit organization, revenue funds are received to meet operating expenses but the use of revenue funds may be restricted or unrestricted. Restricted funds account for resources whose use, by the not-for-profit organization, is restricted by the donor. For example, a grant may be received by a university from the Government for the specific purpose of research on cancer. This grant will constitute a restricted fund. The unrestricted funds account for resources that may be expended to carry out the primary purposes of the institution (e.g. instructions, research, maintenance etc.) and are not restricted to specific purposes. However, the not-for-profit organization may convert part of the unrestricted fund into a restricted fund by earmarking a certain sum for a specified purpose.

(d) The terms mandatory and non-mandatory transfers are unique to college and universities accounting and reporting. Mandatory transfers are transfers out of the revenue funds to other funds resulting from binding legal agreements or grant agreements. Non-mandatory transfers are discretionary transfers specified by the governing board for a variety of purposes such as new additions to building, repairs and replacement of plant etc. Non-mandatory transfers may also be made from specific funds to the revenue funds. Both mandatory and non-mandatory transfers are reported separately in the financial statements of the revenue funds. Also the governing board may designate unrestricted revenue fund resources for specific purposes in future periods. These board–designated funds are internal designations similar to appropriations of retained earnings for a commercial entity.

Question 4

Write short Note on Special features of accounting for non-profit entities (other than Hospitals and Educational Institutions). (6 marks) (November, 1997)

Answer

Special Features of Accounting for Not-For-Profit Entities' (other than Hospitals and Educational Institutions): Other not-for-profit organisations (other than Hospitals and Educational Institutions) include Civic organisations, Cultural organisations, Labour unions, Political parties, Religious associations etc. For these organisations, fund based accounting is used. These mainly use four types of fund: Operating-Fund (restricted and unrestricted), Development Fund, Endowment Fund and Life Membership Fund. For the operating funds, the accrual basis of accounting is used to recognise revenue and expenses. While the unrestricted operating fund accounts for all unrestricted resources received and expenses incurred for the primary purpose of the organisation, the restricted operating fund accounts for resources received from donors with restrictions imposed on their use. Development Funds are utilised for

developmental purposes like acquisition of building and equipments, major repairs to fixed assets etc. These fixed assets are shown in the balance sheet of development fund. The major sources of receipts for this fund are government or private grants/gifts (restricted to acquisition of fixed properties), income and gains of investments of unutilised fund (if any), transfers from other funds.

Membership fees, the main source of revenue, are directly taken to unrestricted operating fund However, life time contribution is directly credited to life membership fund which is simultaneously invested in outside securities. Income from such investment is credited to unrestricted operating fund. When a life member expires or his membership is terminated for some reasons, the proportionate fund balance is transferred from life membership fund to unrestricted operating fund. As regards contributions and transfers, they are directly credited to endowment fund.

The financial statements prepared by these organisations include balance sheets (fundwise), statement of activities and statement of cash flows (fundwise). The primary operating statement is the statement of activity which accounts for revenue and expenses and the resultant surplus or deficit.

Developments in Accounting

Question 1

(a) Explain the concept of 'Economic value added' (EVA for short) and its uses.

(6 marks)(November, 2002)

(b) What is economic value added and how is it calculated? Discuss.

(4 marks)(November, 2003)

Answer

(a) Economic Value Added (EVA) for short, is primarily a benchmark to measure earnings efficiency. Though the term "Economic Profit" was very much there since the inception of "Economics", Stern Stewart & Co., of USA has got a registered Trade Mark for this by the name "EVA", an acronym for Economic Value Added.

EVA as a residual income measure of financial performance, is simply the operating profit after tax less a charge for the capital, equity as well as debt, used in the business. EVA includes both profit and loss as well as balance sheet efficiency as well as the ROCE, or ROE.

In addition, EVA is a management tool to focus managers on the impact of their decisions in increasing shareholders' wealth. These include both strategic decisions such as what investments to make, which businesses to exit, what financing structure is optimal; as well as operational decisions involving trade-offs between profit and asset efficiency such as whether to make in house or outsource, repair or replace a piece of equipment, whether to make short or long production runs etc.

Most importantly the real key to increasing shareholder wealth is to integrate the EVA framework in four key areas; to measure business performance; to guide managerial decision making; to align managerial incentives with shareholders' interests; and to improve the financial and business literacy throughout the organisation.

To better align managers interests with Shareholders – the EVA framework needs to be holistically applied in an integrated approach – simply measuring EVAs is not enough it must also become the basis of key management decisions as well as be linked to senior management's variable compensation.

(b) Economic Value Added (EVA) is primarily a benchmark to measure earnings efficiency. EVA as a residual income measure of financial performance is simply the operating profit after tax less a charge for the capital employed, equity as well as debt, used in the business.

Mathematically EVA= OPBT – Tax – (TCE × COC)

Where:

OPBT = Opening Profit Before Tax

TCE = Total Capital Employed

COC = Cost of Control

Because EVA includes both profit and loss as well as balance sheet efficiency as well as the opportunity cost of investor capital - it is better linked to changes in shareholders wealth and is superior to traditional financial measures such as PAT or percentage of return measures such as ROCE or ROE.

EVA, additionally, is a tool for management to focus on the impact of their decisions in increasing shareholders wealth. These include both strategic decisions such as what investments to make, which business to exit, what financing structure is optimal; as well as operational decisions involving trade-offs between profit and asset efficiency such as whether to make inhouse or outsource, repair or replace an equipment, whether to make short or long production runs etc.

Most importantly the real key to increasing shareholders wealth is to integrate EVA framework in four key areas, viz., to measure business performance, to guide managerial decision making, to align managerial incentives with the shareholders' interests and to improve the financial and business literacy throughout the organisation.

To better align managers interests with shareholders' - the EVA framework needs to be holistically applied in an integrated approach - simply measuring EVA is not enough; it must also become the basis of key management decisions as well as be linked to senior management's variable compensation.

However, EVA as a strategic tool has the following limitations:

1. Not easy to use; too complicated for small businesses.
2. Recommends inexpensive debts in order to reduce the cost of capital.
3. A passive tool, measures past performance.

Question 2

(a) **"***The content of corporate social report is essentially based on social objectives." Discuss.* *(7 marks)(November, 1998)*

(b) Enumerate the major heads identified for corporate social reporting purposes. (8 marks)(November, 1999)

(c) Write short note on Corporate Social Reporting. (4 marks)(May, 2003)

Answer

(a) The content of Corporate Social Report is essentially based on the social objectives. Brummet identified five areas wherein social objectives can be traced out, namely, Net Income Contribution, Human Resource Contribution, Public Contribution, Environmental Contribution and Product or Service Contribution.

In view of the social objectives, the importance of earning objective is not understated, rather attainment of social objectives is dependent on earning objective. A sick business entity becomes liability to the society and sustains social costs instead of generating social benefits.

Human Resource Contribution is the indicator of the impact of organisational activities (viz. pay and allowances, perks and incentives, recruitment, training and development, placement, promotion and transfer, welfare measure, etc.) on people of the organisation. Public Contribution is the indicator of general philanthropy in the cultural and social welfare programmes and contribution to national exchequer by way of tax and duties. . .

Industrial activity is supposed to consume irreplaceable resources and produces solid wastes. By this process it pollutes air and water, causes noise and spoils the environment. These are termed as negative social effects. The corporate social objective is the abatement of such negative effect. It is covered by environmental contribution.

Lastly, the Product or Service Contribution covers the qualitative aspects of the organisation's product or service. It includes quality guarantee, redressal of customers' grievances, honest exposure in advertisement etc.

Although Brummet covered wide range of objectives, still these are not essentially exhaustive. Social objectives are determined by socio-economic conditions of a country. It is difficult to set universal list of social objectives to be pursued by the corporate sector. For example, in India, regional imbalance, unemployment, reservation for weaker sections of the population, scarcity of foreign exchange, energy deficit, population pressure and illiteracy are some of the widely accepted socio-economic problems. And obviously the general expectation is that the corporate sector will positively contribute to such socio-economic problems. Since the socio-economic problems of a country change over time or the priority attached to a problem shifts. Brummet's over simplified set of contributions should be suitably moulded to fit in the perspective of socio-economic problems of a country.

(b) Considering the major socio-economic problems of the country, eight major heads may be identified for Social Reporting purposes:

I. Employment Opportunities.

II. Foreign Exchange Transactions

III. Energy Conservation.

IV. Research and Development.

V. Contribution to Government Exchequer.

VI. Social Projects

VII. Environmental Control.

VIII. Consumerism.

I. Creation of employment opportunities during the year may be classified into opportunities in India and opportunities abroad. In India employment may be created either by expansion/diversification in backward or other areas. However, employment protection by absorption of sick units may also be treated as employment opportunities. Moreover, the corporate enterprise may create new openings abroad by adopting foreign projects. In all such cases, quantitative information needs to be disclosed giving break-up of SC/ST persons, physically handicapped persons, women and other workers appointed during the year. Tax advantage or subsidy received for establishing industrial units in backward areas or absorption of sick units should be disclosed properly. If the corporate enterprise follows human resource accounting system, it may show human assets created during the year and costs incurred for such purpose.

II. In view of the scanty foreign exchange reserve, it is desirable to disclose foreign exchange transactions in details. Foreign exchange inflows occur by exports or earnings from foreign projects. Also saving in foreign exchange is equivalent to foreign exchange inflows. An enterprise can save foreign exchange by import substitution and replacement of foreign technology/technician. Foreign exchange outflows are caused by purchase of' raw materials/spares, plant and machinery capital repayment, payment of dividend and interest. It is desirable to report inflows and outflows for each currency separately and a summary statement in Indian currency. Any tax advantage/export subsidy received for foreign exchange ernings should be disclosed as an item of social cost.

III. Energy purchased/generated and energy consumed per unit of standard product are to be reported along with consumption norm of the industry. Energy Audit Reports prepared by BICP may be followed for industry norms wherever applicable. Positive/negative variation in energy consumption should be reported along with reasons therefor.

IV. Recurring/non-recurring cost incurred for research and development is to be reported along with results. If possible, effect of research and development activities may be quantified in terms of cost saved/profit added. Any tax advantage/subsidy received is to be reported as social cost incurred along with the generation of social benefits from research and development.

V. Contribution to Government exchequer by way of sales tax, income tax, excise, custom and other duties needs to be reported as an item of social benefits.

VI. Contribution to social projects may be further classified into direct involvement of corporate enterprise and donations to different organisations. Social projects like construction of road, establishment of school, college, research institute, hospital, stadium, etc. may be earmarked alongwith the categories of beneficiaries and cost involved.

In case of donation to any organisation, the nature of the organisation may be stated along with the tax advantage received by way of such donations.

(Contribution of the corporate enterprise for development of sports and games, cultural matters and self-employment programmes may be reported as creation of social benefit).

VII. Negative social effect caused by the corporate enterprise may be quantified stating use of irreplaceable resources and nature of pollution caused. Action taken and cost involved for pollution control should be reported as an item of social benefit.

VIII. Failures in terms of complaints received against improper quality, poor service etc. may be reported under social costs. Action taken and cost involved for undertaking quality control and customers' service should be reported under social benefits.

(c) Corporate Social Reporting is the information communique with respect to discharge of social responsibilities of corporate entity. The transition in accounting function from historical cost based profitability accounting to social responsibility accounting is a good fit to the present-day data requirement of the "Users of accounts".

The content of Corporate Social Report is essentially based on the social objectives, namely Net Income Contribution, Human Resource Contribution, Public Contribution, Environmental Contribution and Product or Service Contribution.

Considering the major socio-economic problems of the country, eight major heads can be identified for social reporting purpose:

(i) Employment Opportunities;

(ii) Foreign Exchange Transactions;

(iii) Energy Conservation;

(iv) Research and Development;

(v) Contribution to Government Exchequer;

(vi) Social Projects;

(vii) Environmental Control;

(viii) Consumerism.

Initially, it is difficult to express social costs incurred by a corporate enterprise and social benefits generated in money terms. Until suitable methologies are available for conversion of social cost-benefit in money terms, it is desirable to begin with descriptive social report. Further research is necessary in

this area either to improve heads of corporate social reporting in the context of dynamic socio-economic environment.

Question 3

After the HAVOC caused by TSUNAMI, a group of companies undertakes during the period from January, 2005 to March, 2005 various commercial activities, having granted considerable subsidy, along the related coast line. The management intends to highlight the results of such activities while publishing financial statements for the year 2004-2005. What is the scope? (4 marks)(May,2005)

Answer

Corporate social reporting is information communique with respect to discharge of social responsibilities of corporate entity. Through 'Corporate Social Report' the corporate enterprises disclose the manner in which they are discharging their social responsibilities. More specifically, it is addressed to the public or society at large, although it can be squarely used by other user groups also.

In the given case, the group of companies has positively contributed to the social cause and the commercial activities undertaken by them come under the purview of corporate social reporting. Normally, such information is not required to be given mandatorily in the financial report due to the lack of any generally accepted standard of social responsibility for business entities. However, everyone agrees that all business entities should be socially responsible but how the individual entity weighs its priorities of social responsibility depends on the personal choice or preference of the group of persons in the management of an enterprise.

The group of companies (referred in the question) can voluntarily highlight the results of various commercial activities, undertaken by them along the related coast line through a 'note to accounts' while publishing financial statements for the year ended 2004-2005. Infact bringing out the results of such Tsunami relief activities in the Tsunami affected areas may imbibe a sense of social responsibility among other entities through 'Corporate Social Report'.

Question 4

Write short notes on:

(a) Jaggi and Lau model on valuation on group basis of Human Resources.(4 marks)(May, 2003)

(b) *Opportunity cost (HRA). (5 marks)(November, 2003)*

Answer

(a) According to Jaggi and Lau Model, proper valuation of human resources is not possible unless the contributions of individuals as a group are taken into consideration. A group refers to homogeneous employees whether working in the same department or division of the organisation or not. An individual's expected service tenure in the organisation is difficult to predict but on a group basis it is relatively easy to estimate the percentage of people in a group likely to leave the organisation in future. This model attempted to calculate the present value of all existing employees in each rank. Such present value is measured with the help of the following steps:

(i) Ascertain the number of employees in each rank.

(ii) Estimate the probability that an employee will be in his rank within the organisation or terminated/promoted in the next period. This probability will be estimated for a specified time period.

(iii) Ascertain the economic value of an employee in a specified rank during each time period.

(iv) The present value of existing employees in each rank is obtained by multiplying the above three factors and applying an appropriate discount rate.

Jaggi and Lau simplified the process of measuring the value of human resources by considering a group of employees as valuation base. But in the process, they ignored the exceptional qualities of certain skilled employees. The performance of a group may be seriously affected in the event of exit of a single individual.

(b) Opportunity Cost: It is one of the Economic value models used for measurement and valuation of Human assets. As per this model, opportunity cost is the value of an employee in his alternative use. This opportunity cost is used as a basis for estimating the value of Human resources. Opportunity cost value may be established by competitive bidding within the firm so that in effect, Managers must bid for any scarce employee. A Human asset will have a value only if it is a scarce resource, that is, when its employment in one division denies it to another division. This method excludes employees of the type of which can be readily hired from outside the firm. Also, it is in very rare cases that managers would like to bid for an employee.

Question 5

Briefly describe the method of valuation of human resources as suggested by Jaggi and Lau. Also point out the special merit and demerit of this method.(8 marks) (May, 2006)

Answer

Jaggi and Lau suggested a model for valuation of human resources. According to them, proper valuation of human resources is not possible unless the contributions of individuals as a group are taken into consideration. A group refers to homogeneous employees whether working in the same department or division of the organization or not. An individual's expected service tenure in an organization is difficult to predict, but on a group basis, it is relatively easy to estimate the percentage of people in a group likely to leave the organization in future. This model attempts to calculate the present value of all existing employees in each rank. Such present value is measured with the help of the following steps:

(i) Ascertain the number of employees in each rank.

(ii) Estimate the probability that an employee will be in his rank within the organization on terminated/promoted in the next period. This probability will be estimated for a specified time-period.

(iii) Ascertain the economic value of an employee in a specified rank during each time period.

(iv) The present value of existing employees in each rank is obtained by multiplying the above three factors and applying an appropriate discount rate.

Jaggi and Lau tried to simplify the process of measuring the value of human resources by considering a group of employees as basis of valuation. But in the process they ignored the exceptional qualities of certain skilled employees. The performance of a group may be seriously affected in the event of exit of a single individual.

Merit

Jaggi and Lau model approached the valuation of human resources on the basis of grouping of employees. Under this method, calculations get simplified and the chances of errors get reduced.

Demerit

This model ignores individual skills of the employees. The varied skills of the employees is not recognized in the valuation process under Jaggi and Lau model.

Question 6

Briefly describe the progress made by India so far in the field of human resource accounting. (4 marks)(May, 2004)

Answer

Human resource accounting can be defined as the process of identifying, measuring and communicating information about human resources in financial statements in order to facilitate effective management. Human resource accounting is a recent phenomenon in India. Leading public sector units like OIL, BHEL, NTPC, MMTC and SAIL etc. have started reporting Human Resources in their annual reports as additional information. The Indian Companies basically adopted the model of human resource valuation as advocated by Lev and Schwartz (1971). Indian Companies focused their attention on the present value of employee earning as a measure of their human capital. However the Indian Companies have suitably modified the Lev and Schwartz model to suit their individual circumstances.

Question 7

Give an account of the growing scope of human capital reporting. (4marks)(May, 2005)

Answer

Of late there is a growing trend of shift from the traditional focus on financial reporting of quantifiable resources (which can be measured in monetary terms) to a more comprehensive approach of reporting under which human resources are also considered as measurable assets. Having followed the methods of accounting of fixed assets, one can take into account the employee-related costs like cost of recruitment, training and orientation of employees, for the purpose of capitalization and then the appropriate portion thereof can be amortised each year over the estimated years of effect of such costs.

The relevance of human resource information lies in the fact that it concerns organizational changes in the firm's human resources. The ratio of human to non-human capital indicates the degree of labour intensity of an organization. Comparison of the specific values of human capital based on the organisation's scales of wages and salaries with the general industry standards, can be a good source of information to the management. There is no standard human capital reporting format as employment reporting is relatively a new form of reporting. Usually, the report inter alia contains data pertaining to employee numbers, employment and training policies, collective bargaining arrangements, industrial disputes, pension and pay arrangement and disabled employee numbers.

Human capital reporting provides scope for planning and decision-making in relation to proper manpower planning. Also, such reporting can bring out the effect of various rules, procedures and incentives relating to work force, and in turn, can act as an eye opener for modifications of existing statutes, laws and the like.

Question 8

State the possible objections to segmental reporting. (7 marks)(May, 1998)

Answer

Objections to segmental reporting: The possible objections to segmental reporting can be enumerated as below:

(i) It is generally felt that segmental revenues and expenses are not distinguishable objectively in many cases. Revenues of a weak product line may be derived only because of the existence of a strong product line. Also many joint costs are only separable arbitrarily.

(ii) Much of segmental results depend on the inter-departmental transfer pricings which are not always logically established.

(iii) Various segments of an enterprise may use common resources which makes it difficult to arrive at a segment wise performance ratio.

(iv) Since the users are in no position to know the proper base for cost allocation, the segment results would be less than meaningful.

(v) The last objection consists of the competitive implications to the firm. Some academics contend that company secrets will be disclosed while others referred to the competitive hardship suffered by some firms if segmented data is required. Suppose that Company X, a small company, has a segment identical to one in Company Y, a huge conglomerate. Company X would have to disclose the segment while Company Y would not because the segment is not considered material to Y's operations.

However, considering the problems of joint cost allocation, often it is suggested to follow a contribution margin approach for reporting segmental results. By this only identifiable costs are deducted from segment revenues and gross segment margins may only be indicated. But for all practical purposes, this becomes a useless exercise when proportion of identifiable cost is insignificant.

Question 9

(a) What are derivatives and what are its characteristics? (5 marks)(November, 2003)

(b) Explain currency options related to foreign exchange. (4 marks)(May, 2004)

Answer

(a) Derivative is a product whose value is derived from the value of one or more basic variables, called bases (underlying asset, index or reference rate), in a contracted manner. The underlying asset can be equity, forex, commodity or any other asset. For example, farmers may wish to sell their harvest of wheat at a future date to eliminate the risk of a change in prices by that date. Such a transaction is an example of a derivative. The price of the derivative is driven by the spot price of wheat which is the "underlying asset".

Derivative financial instruments can either be on the balance-sheet or off the balance sheet and include options contract, interest rate swaps, interest rate flows, interest rate collars, forward contracts, futures etc. A derivative instrument is therefore a financial instrument or other contract with the following three characteristics:

(a) It has one or more underlying and one or more notional amounts or payments provisions or both. These terms determine the amount of settlement or settlements and in some cases, whether or not settlement is required;

(b) It requires no initial net investment or an initial net investment that is smaller than what is required for similar responses to changes in market factors.

(c) Its terms require or permit net settlement; it can readily be settled net by means outside the contract or it provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.

Accounting for foreign exchange derivatives is guided by AS 11 (Revised 2003). The ICAI has also issued a Guidance Note dealing with the accounting procedures to be adopted while accounting for Equity Index Options and Equity Stock Options.

(b) Currency Options give the client the right, but not the obligation, to buy/sell a specific amount of currency at a specific price on a specific date. Currency options provide a tool for hedging foreign exchange risk arising out of the firm's operations. Currency options enable the business house to remove downside risk without limiting the upride potential. Options can be put option or call option. A put option is a contract that specifies the currency that the holder has the right to sell. A call option is a contract that specifies the currency that the holder has the right to buy.

Question 10

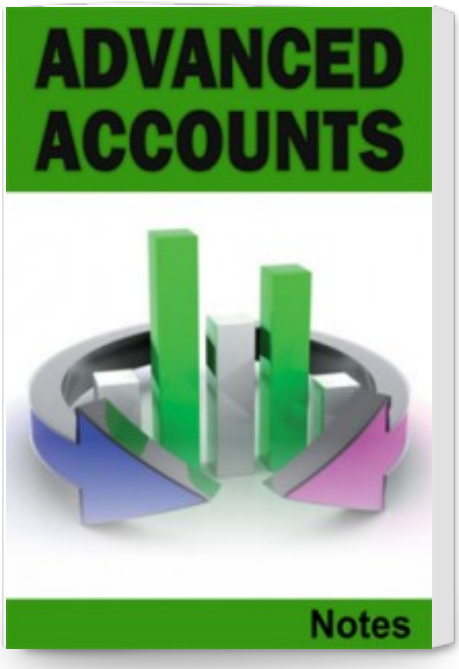
Write a short notes on:

(a) Accounting issues involved in Environmental Accounting. (6 marks)(May, 2003)

(b) Environmental Accounting. (4 marks)(Nov.2004)(Nov. 2005)

Answer

Advanced Accounts



Publisher : ICSI

Author :