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**Course Name:** Post Graduate Diploma in Finance Management (PGD-FM)

**Assignment -3**

**Admission number:** ACPM PGD/108/2018

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**Submission Date**: April 09, 2019



**Assignment -3 PGD-FM**

**Qn.1.** What are operating and non-operating profits?

Non-operating income, in accounting and finance, is gains or losses from sources not related to the typical activities of the business or organization. Non-operating income can include gains or losses from investments, property or asset sales, currency exchange, and other atypical gains or losses.

Non-operating income is any profit or loss generated by activities outside of the core operating activities of a business. The concept is used by outside analysts, who strip away the effects of these items in order to determine the profitability (if any) of a company's core operations. The following are all examples of non-operating income:

* Dividend income
* Asset impairment losses
* Gains and losses on investments
* Gains and losses on foreign exchange transactions

Non-operating income is more likely to be a one-time event, such as a loss on asset impairment. However, some types of income, such as dividend income, are of a recurring nature, and yet are still considered to be part of non-operating income.

A business might attempt to use non-operating income to mask poor operational results. For example, the recipient of a round of funding could invest the cash and generate such a large amount of interest income that it is the largest part of total earnings reported.

When a company experiences a sudden spike or decline in its non-operating income, this is likely to have been caused by non-operating income, since core earnings tend to be relatively stable over time.

**Operating Income**

To recognize the operating income of a company, there is a need to understand the business fundamental of that company. It is the income that a company’s earning/losses from its core operations of their business.

For example: Ashok Leyland company is in business of manufacturing vehicles i.e. Trucks, Busses, light vehicles, Services & Sale of the spare parts for their core products (i.e. vehicles they manufacture) etc. Incomes generation form these major heads after deducting related direct and indirect costs are treated as operating income.

**Operating Income Formula**

Where Operating expenses are cost of Selling, general and administrative expenses; other misc. operating expenses etc.

**Conclusion**

Income statement analysis determines a company’s earnings performance and also provide outlook potentials with respect to its historical trends, providing an insight of how the company conducts its business in past.

It is important to bifurcate the company earnings based on their core operating business model. For this we have to eliminate the non-operating incomes/expense to arrive at core operating

**Qn. 2.** What do you understand by “Grouping” and “Marshalling” of assets and liabilities?

The rationale behind preparing financial statements is to present a summarised version of all financial activities in such a manner that all users can interpret and understand the information easily, appropriately and also take decisions accordingly.

**Grouping of assets and liabilities:**Grouping means showing similar assets and liabilities under a single head. For example, all assets that can be used for more than a year are clubbed together under the heading ‘fixed assets’, for example, building, furniture, machinery, etc.

**Marshalling of asset and liabilities:** When assets and liabilities are shown in a particular order of liquidity or permanence, they are said to be marshalled.

**1. In order of liquidity:** Liquidity means convertibility into cash. Assets that can be converted into cash in least possible time, i.e., more liquid assets are recorded first, followed by the lesser liquid assets. In a balance sheet, cash in hand is recorded at first and goodwill at last. In the same way, liabilities that are to be paid first, i.e., high priority liabilities are recorded first, followed by the lower priority ones. In a balance sheet, current liabilities are recorded first and then the long term liabilities and capital at the last.

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| --- | --- | --- | --- | --- | --- | --- |
| **Balance Sheet of.................., as on................** | | | | | | |
|  |  |  |  |  |  |  |
| **Liabilities** | | | **Amount**  **SSP** | **Assets** | | **Amount**  **SSP** |
| **Current Liabilities:** | | |  | **Current Assets:** |  |  |
| Bills Payable | |  | – | Cash in Hand |  | – |
| Sunday Creditors | | | – | Cash at Bank |  | – |
| Bank Overdraft | |  | – | Bills Receivable |  | – |
| **Long Term Loans** | |  | – | Debtors |  | – |
| **Capital:** | |  |  | Closing Stock |  | – |
| Opening balance | | – |  | **Long Term Investments** | |  |
|  | *Add*: Net Profit | – |  | **Fixed Assets:** |  |  |
|  | *Less*: Drawings | – | – | Furniture |  | – |
|  |  |  |  | Plant and Machinery | | – |
|  |  |  |  | Land and Building | | – |
|  |  |  |  | Goodwill |  | – |
|  |  |  | – |  |  | – |
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**2. In order of permanence:**It is just the reverse of the above method. In this, assets and liabilities are arranged in their reducing level of permanence. The assets with higher degree of permanence are recorded first, followed by the assets with lower degree of permanence. For example, goodwill, land and building have the highest degree of permanence and hence are recorded at the top, whereas, cash at bank and cash in hand are recorded at the bottom. In the same way, liabilities are shown according to their life in the business. Liabilities with higher level of permanence like, capital is recorded at the top and other liabilities with lower permanence are recorded at the bottom.

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| **Balance Sheet of.................., as on................** | | | | | | | | |
|  | |  |  |  |  |  |  |  |
| **Liabilities** | | |  | **Amount Rs** | **Assets** | |  | **Amount**  **Rs** |
| **Capital:** | | |  |  | **Fixed assets:** | |  |  |
| Opening Balance | | | – |  | Goodwill | |  | – |
|  | ***Add*: Net profit** | | **–** |  | **Land and Building** | |  | **–** |
|  | *Less*: Drawings | | – | – | Plant and Machinery | |  | – |
|  |  | |  |  | Furniture | |  | – |
| **Long Term Loans** | | |  | – | **Long Term Investments** | |  |  |
| **Current Liabilities:** | | |  |  | **Current Assets:** | |  |  |
| Bank Overdraft | | |  | – | Closing Stock | |  | – |
| Sunday Creditors | | |  | – | Debtors | |  | – |
| Bill Payable | | |  | – | Bills Receivable | |  | – |
|  | | |  |  | Cash at Bank | |  | – |
|  | | |  |  | Cash in Hand | |  | – |
|  | |  |  |  |  | |  |  |
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|  | |  |  | – |  |  |  | – |
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**Qn. 3. Write short notes on the following:**

1. **Outstanding of Expenses:** These are expenses which have been incurred during the year

And whose benefit has been derived during the year, but not paid for yet are called **outstanding expenses**. ... In such a case, **outstanding expenses** will be shown only in the Balance Sheet as a liability.

**In other words,** *outstanding expenses* are those *expenses* which have been incurred during the current accounting period and are due to be paid; however, the payment is not made. Such an item is to be treated as a payable for the business. Examples – *Outstanding* salary, *outstanding* rent, *outstanding* subscription, *outstanding* wages, etc.

1. Accrued Incomes: **Accrued income** is **income** which has been earned but not yet

Received. **Income** must be recorded in the accounting period in which it is earned. Therefore, **accrued income** must be recognized in the accounting period in which it arises rather than in the subsequent period in which it will be received.

1. **Intangible Assets:** Reputation, name recognition, and intellectual property such as

Knowledge and know how. Intangible assets are the long-term resources of an entity, but have no physical existence. They derive their value from intellectual or legal rights, and from the value they add to the other assets. Intangible assets are generally classified into two broad categories:

(1) Limited-life intangible assets, such as patents, copyrights, and goodwill, and

(2) Unlimited-life intangible assets, such as trademarks. In contrast to tangible assets,

Intangible assets cannot be destroyed by fire, hurricane, or other accidents or disasters and can help build back destroy tangible assets.

However, they normally cannot be used as collateral to raise loans, and some intangible assets (goodwill, for example) can be destroyed by carelessness, or as a side effect of the failure of a business. Whereas tangible assets add to an entity's current market value, intangible assets add to its future worth. An approximation of the monetary value of a firm's intangible-assets is computed by deducting the net value of its tangible assets from its market value. In some cases (such as the Coca Cola trademark), the value of a firm's intangible assets far outweighs the value of its tangible assets.

1. **Fictitious Assets**

Fictitious Assets: The best way to understand fictitious assets is to memorize the meaning of the word “fictitious” which means “not true” or “fake”. Fictitious assets are not assets at all, however, they are shown as assets in the financial statements only for the time being. In fact, they are expenses & losses which for some reason couldn’t be written off during the accounting period of their incidence.

They are written off against the firm’s earnings in more than one accounting period. Basically, they are amortized over a period of time. They are recorded as assets in financial statements only to be written off in a future period.

Examples of Fictitious Assets

* Promotional expenses of a business
* Preliminary expenses
* Discount allowed on issue of shares
* Loss incurred on issue of debentures

They are shown in the balance sheet on the asset side under the head “Miscellaneous Expenditure”. (To the extent not written off or adjusted)

1. **Cost of Conversion**

Conversion costs are terms used in cost accounting that represents the combination of direct labor costs and manufacturing overhead costs. In other words, conversion costs are a manufacturer's product or production costs other than the cost of a product's direct materials.

1. **Cost of Goods Sold**

Cost of goods sold (COGS) refers to the direct costs attributable to the production of the goods sold in a company. This amount includes the cost of the materials used in creating the good along with the direct labor costs used to produce the good. ... Cost of goods sold is also referred to as "cost of sales."

1. **Direct vs. Indirect Expenses**

The difference between direct costs and indirect costs... Examples of direct costs are direct labor, direct materials, commissions, piece rate wages, and manufacturing supplies. Examples of indirect costs are production supervision salaries, quality control costs, insurance, and depreciation.

**Qn.4.** Briefly explain the accounting concepts which guide the accountant at the recording stage.

**Accounting** is defined by the American Accounting Association as “The process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information.”

Accounting concept refers to the basic assumption and rules and principles which work as the basis of recording of business transaction and preparing accounts. This concept assumes that, for accounting purposes, the business enterprise and its owners are two separate independent entities.

Accounting principles are built on a foundation of a few basic concepts. These concepts are so basic that most preparers of financial statements do not consciously think of them. As stated earlier, they are regarded as self-evident. Some accounting researchers and theorists argue that certain of the present accounting concepts are wrong and should be changed. Nevertheless, in order to understand accounting as it now exists, one must understand the underlying concepts currently used. Basic accounting concepts discussed herein may not be identical to those listed by other authors or groups. However, these are the concepts that are widely accepted and used in practice by preparers of financial statements and by auditors while verifying such statements.

The basis accounting concepts are explained as below:-

1. **Entity concept:**

The entity concept assumes that the financial statements and other accounting information are for the specific business enterprise which is distinct from its owners. Consequently, the analysis of business transactions involving costs and revenue is expressed in terms of the changes in the firm’s financial conditions.

Similarly, the assets and liabilities devoted to business activities are entity assets and liabilities. The transactions of the enterprise are to be reported rather than the transaction of the enterprise’s owners. This concept, therefore, enables the accountant to distinguish between personal and business transactions. The concept applies to sole proprietorship, partnership, companies, and small and large enterprise. It may also apply to a segment of a firm, such as division, or several firms, such as when inter-related firms are consolidated.

1. **Going-Concern Concept:**

A business entity is viewed as continuing in operation in the absence of evidence to the contrary. Because of the relative permanence of enterprises, financial accounting is formulated assuming that the business will continue to operate for an indefinitely long period in the future.

The going-concern concept justifies the valuation of assets on a non-liquidation basis and it calls for the use of historical cost for many valuations. Also, the fixed assets and intangibles are amortized over their useful life rather than over a shorter period in expectation of early liquidation.

The going-concern concept leads to the proposition that individual financial statements are part of a continuous, inter-related series of statements. This further implies that data communicated are tentative and that current statements should disclose adjustments to past year statements revealed by more recent developments.

1. **Money Measurement Concept:**

A unit of exchange and measurement is necessary to account for the transactions of business enterprises in a uniform manner. The common denominator chosen in accounting is the monetary unit. Money is the common denominator in terms of which the exchangeability of goods and services, including labour, natural resources and capital, are measured.

1. **Accounting Period Concept:**

Financial accounting provides information about the economic activities of an enterprise for specified time periods that are shorter than the life of the enterprise. Normally, the time periods are of equal length to facilitate comparison.

The time period is identified in the financial statements. The time periods are usually of twelve months. Sometimes quarterly or half-yearly statements are also issued. These are considered interim and different from annual statements. For managerial use, statements covering shorter periods such as a month or a week may also be prepared.

1. **Cost Concept:**

The cost concept requires that assets be recorded at the exchange price, i.e., acquisition cost or historical cost. Historical cost is recognized as the appropriate valuation basis for recognition of the acquisition of all goods and services, expenses, costs and equities.

For accounting purposes, business transactions are normally measured in terms of the actual prices or costs at the time the transaction occurs, i.e., financial accounting measurements are primarily based on exchange prices at which economic resources and obligations are exchanged. Thus, the amounts at which assets are listed in the accounts of a firm do not indicate what the assets could be sold for.

1. **Dual-Aspect Concept:**

This concept lies at the heart of the whole accounting process. The accountant records events affecting the wealth of a particular entity. The question is—which aspect of this wealth is important? Since an accounting entity is an artificial creation, it is essential to know to whom its resources belong to or what purpose they serve.

It is also important to know what kind of resources it controls, e.g., cash, buildings or land. Accounts recording systems have therefore developed so as to show two main things: (a) the source of wealth, and (b) the form it takes. Suppose Mr. X decides to establish a business and transfers UGX. 1,000,000 from his private bank account to a separate business account.

**He might record this event as follows:**

**Business entity records**

|  |  |
| --- | --- |
| Liabilities | Assets |
| Sources | **Form of wealth** |
| X’s capital UGX 1,000,000 | Cash at bank UGX 1000,000 |

Clearly, the source of wealth must be numerically equal to the form of wealth. Since they are simply different aspects of the same thing, i.e., in the form of an equation: S (sources) must equal F (forms).

Moreover, any transaction or event affecting the wealth of entity must have two aspects recorded in order to maintain the equality of both sides of the accounting equation.

**If business has acquired an asset, it must have resulted in one of the following:**

(a) Some other asset has been given up.

(b) The obligation to pay for it has arisen.

(c) There has been a profit, leading to an increase in the amount that the business owes to the proprietor.

(d) The proprietor has contributed money for the acquisition of asset.

This does not mean that a transaction will affect both the source and form of wealth.

**There are four categories of events affecting the accounting equation:**

(a) Both, sources and forms of wealth, increase by the same amount.

(b) Both, sources and forms of wealth, decrease by the same amount.

(c) Some forms of wealth increase while others decrease without any change in the source of wealth.

(d) Some sources of wealth increase while others decrease without any change in the form in which wealth is held.

The example given above illustrates category (a) since the commencing transaction for the entity results in the source of wealth, and form of wealth, cash, both increasing from zero to UGX. 1,000,000. By contrast, X might decide to withdraw UGX. 200,000 cash from the business.

**Then financial position of business entity would result in:**

|  |  |
| --- | --- |
| Liabilities (Source of wealth) | Assets (Form of wealth) |
| X’s capital UGX 800,000 | Cash UGX 800,000 |

It is essential to appreciate why both sides of the equation decrease. By taking out cash, X automatically reduces his supply of private finance to the business by the same amount. Suppose now that Mr. X buys stocks of goods for UGX. 300,000 with the available cash. His supply of capital does not change, but the composition of the business assets does.

|  |  |
| --- | --- |
| Source of wealth UGX | Form of wealth UGX |
| X’s capital 800,0000 | Stock 300,000 |
|  | Cash 500,000 |
| 800,000 | **800,000** |

The two aspects of this transaction are not in the same direction but compensatory, an increase in stocks of setting a decrease in cash. Similarly, sources of wealth also may be affected by a transaction. Thus, if X gives his son Y, a UGX. 200,000 share in the business by transferring part of his own interest, the effect is as follows:

|  |  |
| --- | --- |
| Source of wealth (UGX) | Form of wealth (UGX) |
| X’s capital 600,000 | Stocks 300,000 |
| Y’s capital 200,000 | Cash 500,000 |
| 800,000 | **800,000** |

If, however, X gives Y UGX. 200,000 in cash privately and Y then puts it into the business, both sides of equation would be affected. Y’s capital of UGX. 200,000 being balanced by an extra UGX. 200,000 in cash, X’s capital remaining at UGX. 80,000.

1. **Accrual Concept:**

Accrual accounting attempts to record the financial effects on an enterprise of transactions and other events and circumstances that have cash consequences for the enterprise in the periods in which those transactions, events and circumstances occur rather than only in the periods in which cash is received or paid by the enterprise. Accrual accounting is concerned with the process by which cash expended on resources and activities is returned as more (or perhaps less) cash to the enterprise, not just with the beginning and end of that process. It recognizes that the buying, producing, selling and other operations of an enterprise during a period, as well as other events that affect enterprise performance often do not coincide with the cash receipts and payments of the periods.”

1. **Conservatism Concept:**

This principle is often described as “anticipate no profit, and provide for all possible losses.” This characterization might be viewed as the reactive version of the mini-max managerial philosophy, i.e., minimizes the chance of maximum losses.

The concept of accounting conservatism suggests that when and where uncertainty and risk exposure so warrant, accounting takes a wary and watchful stance until the appearance of evidence to the contrary. Accounting conservatism does not mean intentionally understating income and assets; it applies only to situations in which there are reasonable doubts. For example, inventories are valued at the lower ends of cost or market value.

1. **Matching Concept:**

The matching concept in financial accounting is the process of matching (relating) accomplishments or revenues (as measured by the selling prices of goods and services delivered) with efforts or expenses (as measured by the cost of goods and services used) to a particular period for which the income is being determined.

1. **Realization or Recognition Concept:**

The realization or recognition concept indicates the amount of revenue that should be recognized from a given sale. Realization rules help the accountant in determining that a revenue or expense has occurred, so that it can be measured, recorded, and reported in financial reports.

1. **Consistency Concept:**

This concept requires that once an organization has decided on one method, it should use the same method for all subsequent transactions and events of the same nature unless it has sound reasons to change methods. If accounting methods are frequently changed, comparison of financial statements for one period with those of another period would be difficult.

1. **Materiality Concept:**

In law there is a doctrine called de minimis non curat lex, which means that the court will not consider trivial matters. Similarly, the accountant does not attempt to record events so insignificant that the work of recording them is not justified by the usefulness of the results.

1. **Full Disclosure Concept:**

The full disclosure concept requires that a business enterprise should provide all relevant information to external users for the purpose of sound economic decisions. This concept implies that no information of substance or of interest to the average investors will be omitted or concealed from an entity’s financial statements.

**Qn.7** what are the accounting concepts to be observed at the reporting stage? Explain any two in detail.

Let us take an example. In India there is a basic rule to be followed by everyone that one should walk or drive on his/her left hand side of the road. It helps in the smooth flow of traffic. Similarly, there are certain rules that an accountant should follow while recording business transactions and preparing accounts. These may be termed as accounting concept. Thus, this can be said that: Accounting concept refers to the basic assumptions and rules and

Principles which work as the basis of recording of business transactions and preparing accounts.

**Concepts to be observed at the Reporting Stage**

The following concepts have to be kept in mind while preparing the final accounts.

* Going Concern Concept
* Accounting Period Concept
* Matching Concept
* Conservatism Concept
* Consistency Concept
* Full disclosure Concept
* Materiality Concept

We can therefore explain some of these concepts in details as below:

* Going Concern Concept: This concept states that a business firm will continue to carry on its activities for an indefinite period of time. Simply stated, it means that every business entity has continuity of life. Thus, it will not be dissolved in the near future. This is an important assumption of accounting, as it provides a basis for showing the value of assets in the balance sheet; For example, a company purchases a plant and machinery of SSP100, 000 and its life span is 10 years. According to this concept every year some amount will be shown as expenses and the balance amount as an asset. Thus, if an amount is spent on an item which will be used in business for many years, it will not be proper to charge the amount from the revenues of the year in which the item is acquired. Only a part of the value is shown as expense in the year of purchase and the remaining balance is shown as an asset.
* Accounting Period Concept: All the transactions are recorded in the books of accounts on the assumption that profits on these transactions are to be ascertained for a specified period. This is known as accounting period concept. Thus, this concept requires that a balance sheet and profit and loss account should be prepared at regular intervals. This is necessary for different purposes like, calculation of profit, ascertaining financial position, tax computation etc. Further, this concept assumes that, indefinite life of business is divided into parts. These parts are known as Accounting Period. It may be of one year, six months, three months, one month, etc. But usually one year is taken as one accounting period which may be a calender year or a financial year.

|  |
| --- |
| Year that begins from 1st of January and ends on 31st of December, is known as Calendar Year. The year that begins from 1st of April and ends on 31st of March of the following year, is known as financial year. |

As per accounting period concept, all the transactions are recorded in the books of accounts for a specified period of time. Hence, goods purchased and sold during the period, rent, Salaries etc. paid for the period are accounted for and against that period only

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**Qn.6** Explain the role of Management Accountant in a modern business organization.

To being with, we first need to understand what management accounting is all about. One simple definition of management accounting is the provision of financial and non-financial decision-making information to managers. However according to the Institute of Management Accountants (IMA): "Management accounting is a profession that involves partnering in management decision making, devising planning and performance management systems, and providing expertise in financial reporting and control to assist management in the formulation and implementation of an organization's strategy".

Management accountants (also called managerial accountants) look at the events that happen in and around a business while considering the needs of the business. From this, data and estimates emerge. Cost accounting is the process of translating these estimates and data into knowledge that will ultimately be used to guide decision-making.

Therefore the roles of management accountant can be explained as detailed below:-

As we earlier on said Management Accountant is an officer who is entrusted with Management Accounting function of an organization. He plays a significant role in the decision making process of an organization. The organizational position of Management Accountant varies from concern to concern depending upon the pattern of management system. He may be an executive in some concern, while a member of Board of Directors in case of some other concern. However, he occupies a key position in the organization. In large concerns, he is responsible for the installation, development and efficient functioning of the management accounting system. He designs the frame work of the financial and cost control reports that provide with the most useful data at the most appropriate time. The Management Accountant sometimes described as Chief Intelligence Officer because apart from top management, no one in the organization perhaps knows more about various functions of the organization than him. Tandon has explained the position of Management Accountant as follows:

“The management accountant is exactly like the spokes in a wheel, connecting the rim of the wheel and the hub receiving the information. He processes the information and then returns the processed information back to where it came from”.

### ****Role of Management Accountant****

Management Accountant, otherwise called Controller, is considered to be a part of the management team since he has the responsibility for collecting vital information, both from within and outside the company. The functions of management accountant are:

* To establish, coordinate and administer, as an integral part of management, an adequate plan for the control of operations. Such a plan would provide, to the extent required in the business cost standards, expense budgets, sales forecasts, profit planning, and programme for capital investment and financing, together with necessary procedures to effectuate the plan.
* To compare performance with operating plan and standards and to report and interpret the results of operation to all levels of management, and to the owners of the business. This function includes the formulation and administration of accounting policy and the compilations of statistical records and special reposts as required.
* To consult withal segments of management responsible for policy or action conserving any phase of the operations of business as it relates to the attainment of objective, and the effectiveness of policies, organization strictures, procedures.
* To administer tax policies and procedures.
* To supervise and coordinate preparation of reports to Government agencies.
* The assured fiscal protection for the assets of the business through adequate internal; control and proper insurance coverage.
* To continuously appraise economic and social forces and government influences, and interpret their effect upon business.

### ****Duties and Responsibilities of Management Accountant****

The primary duty of Management Accountant is to help management in taking correct policy-decisions and improving the efficiency of operations. He performs a staff function and also has line authority over the accountants. If management accountant feels that a decision likely to be taken by the management based on the information tendered by him shall be detrimental to the interest of the concern, he should point out this fact to the concerned management, of course, with tact, patience, firmness and politeness. On the other hand, if the decision taken happens to be wrong one on account of inaccuracy, biased and fabricated data furnished by the management accountant, he shall be held responsible for wrong decision taken by the management. Following are the duties of Management Accountant or controller:

* The installation and interpretation of all accounting records of the corporative.
* The preparation and interpretation of the financial statements and reports of the corporation.
* Continuous audit of all accounts and records of the corporation wherever located.
* The compilation of costs of distribution.
* The compilation of production costs.
* The taking and costing of all physical inventories.
* The preparation and filing of tax returns and to the supervision of all matters relating to taxes.
* The preparation and interpretation of all statistical records and reports of the corporation.
* The preparation as budget director, in conjunction with other officers and department heads, of an annual budget covering all activities of the corporation of submission to the Board of Directors prior to the beginning of the fiscal year. The authority of the Controller, with respect to the veto of commitments of expenditures not authorized by the budget shall, from time to time, be fixed by the board of Directors.
* The ascertainment currently that the properties of the corporation are properly and adequately insured.
* The initiation, preparation and issuance of standard practices relating to all accounting, matters and procedures and the co-ordination of system throughout the corporation including clerical and office methods, records, reports and procedures.
* The maintenance of adequate records of authorized appropriations and the determination that all sums expended pursuant there into are properly accounted for.
* The ascertainment currently that financial transactions covered by minutes of the Board of Directors and/ or the Executive committee are properly executed and recorded.
* The maintenance of adequate records of all contracts and leases.
* The approval for payment(and / or countersigning ) of all cheques, promissory notes and other negotiable instruments of the corporation which have been signed by the treasurer or such other officers as shall have been authorized by the by-laws of the corporation or form time to time designated by the Board of Directors.
* The examination of all warrants for the withdrawal of securities from the vaults of the corporation and the determination that such withdrawals are made in conformity with the by-laws and /or regulations established from time by the Board of Directors.
* The preparation or approval of the regulations or standard practices, required to assure compliance with orders of regulations issued by duly constituted governmental agencies.

Qn.11 Explain the following:

1. Accounting Equation
2. Convention of materiality
3. Accounting standards
4. Accounting process
5. Branches of accounting
6. Accounting a source of financial information.

The above lists of accountant terminologies are explained as below:

1. The term **accounting equation** to my understanding is considered to be the foundation of the double-entry accounting system. Meaning that the accounting equation shows on a company's balance sheet whereby the total of all the company's assets equals the sum of the company's liabilities and shareholders' equity.

In other words, the accounting equation or balance sheet equation forms the building blocks for the entire double entry accounting system. It shows that every asset owned by the company is equal to the claims (liabilities and equity) against the asset. The accounting equation looks like this. Asset = Liabilities + Equity.

**Accounting Equation**

**Assets = Liabilities + Equity**

In its most basic form, the accounting equation shows what a company owns, what a company owes, and what stake the owners have in the business. The equation starts off with the company assets. These are the resources that the company has to use in the future like cash, accounts receivable, equipment, and land.

Most of the time, the company doesn’t own its assets completely outright. There are claims to these assets. For instance, the company might have a loan on the company car, a mortgage on the building, or even owe money to its shareholders. That is why the second part of the accounting equation is made up of the claims on company assets. All of these claims on the company assets are separated into two categories: liabilities and equity.

**Example**

Liabilities are claims on the company assets by other companies or people. In other words, it’s the amount of money owed to other people. A bank loan or mortgage is a good example. The bank has a claim to the business building or land that is mortgaged.

Equity on the other hand is the shareholders’ claims on the company assets. This is the amount of money shareholders have contributed to the company for an ownership stake. Equity also includes retained earnings. Equity is usually shown after liabilities in the accounting equation because liabilities must have to be repaid before owners’ claims. You might also notice that the accounting equation is in the same order as the balance sheet.

Once all of the claims by outside companies and claims by shareholders are added up, they will always equal the total company assets.

1. **Convention of Materiality:** In accounting, the concept of materiality allows you to violate another accounting principle if the amount is so small that the reader of the financial statements will not be misled.

This convention proposed that while accounting only those transactions will be considered which have material impact on financial status of the organization and other transactions which have insignificant effect will be ignored. It gives relative importance to an item or event. That is to say a transaction which will influence the economic decision of users of financial information is regarded as material.

A classic example of the materiality concept or the materiality principle is the immediate expensing of a £10 wastebasket that has a useful life of 10 years. The matching principle directs you to record the wastebasket as an asset and then depreciate its cost over its useful life of 10 years. The materiality principle allows you to expense the entire £10 in the year it is acquired instead of recording depreciation expense of £1 per year for 10 years. The reason is that no investor, creditor, or other interested party would be misled by not depreciating the wastebasket over a 10-year period.

Determining what is a material or significant amount can require professional judgment. For example, $5,000 might be immaterial for a large, profitable corporation, but it will be material or significant for a small company that has very little profit.

In summary, materiality concept also permits accountants to ignore another accounting principle or concept if such action does not have an important effect on financial statements of the entity. For example, a company may charge its telephone bill to expense in the period in which it is paid rather than in the period in which the telephone service is used. This treatment is a violation of matching principle of accounting. However, the accounting for telephone or other utility bills on cash basis is very convenient because the monthly cost is not known until the utility bill is received. Under this cash basis approach, the telephone bill charged to expense actually belongs to prior month but the error in financial statements resulting from this action is likely to be immaterial.

1. **An accounting standard**is a common set of principles, standards and procedures that define the basis of financial accounting policies and practices. Accounting standards improve the transparency of financial reporting in all countries.

We can also explain accounting standards as those rules and guidelines set up by governing bodies, like **FASB** and **IASB**, to keep accounting practices consistent and understandable across all companies and industries. However these rules have an impact both on a national economy and on the economic and fiscal policy. With the implementation of accounting guidelines on a national scale, countries are able to implement a common terminology in the economic world and perform a precise, uniform, objective and correct calculation of data on the financial position and results of business units.

In these regards, the standardization of the accounting procedures helps businesses to record and monitor their business activity and achieve comparability of accounting information between companies that operate in the same industry. By applying the same accounting principles and methods, businesses ensure homogeneous, reliable and accurate data and information about their assets, liabilities, financial position, and overall activity.

**Let’s look at an example.**

Company XYZ has bought a second plant for £400,000. In the purchase contract, it is stated that the value of the land is £100,000, and the value of the building is £300,000. Also, the company pays notary fees amounting to £10,000. In addition, Company XYZ leases new machinery for £120,000 and duration of 4 years. The annual rent amounts to £30,000. The initial value of transport is £100,000.

In conclusion, we can say accounting standards are authoritative standards for financial reporting and are the primary source of generally accepted accounting principles (GAAP). Accounting standards specify how transactions and other events are to be recognized, measured, presented and disclosed in financial statements. The objective of such standards is to provide financial information to investors, lenders, creditors, contributors and others that is useful in making decisions about providing resources to the entity.

# ****Accounting Process:**** The word “Accounting” brings along with itself thousands of years of history and can be traced back to the ancient times. There are proofs which suggest that accounting might be more than 7000 years old. Now, let’s just quickly get back to the modern times and try to understand what really accounting and the accounting process are. Accounting is a set of concepts and techniques that are used to identify, measure, record, classify, summarize and report financial information of an economic unit to the users of the accounting information. The economic unit is considered as a separate legal entity. Accounting information is widely used by various types of parties for several different reasons. Few of them are

|  |  |  |
| --- | --- | --- |
| **Who uses it** | **Type of user** | **Main Purpose** |
| Business Managers | Internal | For trends, budgeting and detecting performance bottlenecks |
| Owners | Internal | To interpret the profit and loss associated with the business |
| Employees | Internal | **To check the financial health and keep a check on recent developments of  the business** |
| **Investors** | **External** | **They provide risk capital, to keep a track of ROI and associated risk** |
| **Lenders** | **External** | **Banks, NBFCs etc.** they **are mainly concerned with the financial stability of a  business to provide loans, overdraft, etc.** |
| **Government** | **External** | **Legal purposes of tax calculations, collect state and a country level data** |
| **Research Agencies** | **External** | **To analyse financial health and accordingly provide ratings to the business** |
| **Creditors** | **External** | **To analyse the liquidity of a business and deciding a credit limit** |

Using generally accepted accounting principles, accountants record and report financial data in similar ways for all firms. They report their findings in financial statements that summarize a company’s business transactions over a specified time period. As mentioned earlier, the three major financial statements are the balance sheet, income statement, and statement of cash flows.

People sometimes confuse accounting with bookkeeping. Accounting is a much broader concept. Bookkeeping, the system used to record a firm’s financial transactions, is a routine, clerical process. Accountants take bookkeepers’ transactions, classify and summarize the financial information, and then prepare and analyse financial reports. Accountants also develop and manage financial systems and help plan the firm’s financial strategy.

The accounting procedures used today are based on those developed in the late 15th century by an Italian monk, Brother Luca Pacioli. He defined the three main accounting elements as assets, liabilities, and owners’ equity. Assets are things of value owned by a firm. They may be tangible, such as cash, equipment, and buildings, or intangible, such as a patent or trademarked name. Liabilities—also called debts—are what a firm owes to its creditors. Owners’ equity is the total amount of investment in the firm minus any liabilities. Another term for owners’ equity is net worth.

# Branches of Accounting: In order to meet the ever increasing demands made on accounting by different interested parties (such as owners, management, creditors, taxation authorities and other government agencies, etc.) the various branches of accounting have come into existence.

* The branches are as follows:
* Financial accounting
* Cost accounting
* Managerial accounting

We can further discuss the above branches briefly as below:

* **Financial Accounting:** The main purpose of financial accounting is to ascertain the true result (profit or loss) of the business operations during a particular period of time and to state the financial position of the business on a particular point of time. Financial accounting produces general purpose reports for the use by the great variety of people who are interested in the organization but who are not actively engaged in its day-to-day operation.
* **Cost Accounting:** The main object of cost accounting is to determine the cost of goods manufactured or produced by the business. It also helps the management of the business in controlling the costs by indicating avoidable losses and wastes.

In order to set prices of the products of the companies, correct calculation of all manufacturing as well as non-manufacturing costs is necessary. Cost accounting is also helpful to accomplish this task.

* **Managerial Accounting**: The object of managerial accounting is to communicate the relevant information periodically to the management of the business to enable it to take suitable decisions.

Financial accounting is the oldest and the other branches have developed from it according to the need of different parties. The object of financial accounting can only be achieved by recording business transactions in a systematic manner according to a set of principles.

1. **Accounting a source of financial information:** Accounting is the management information system of any organization and is concerned with providing necessary information to the management, i.e. it is a source of information. ... The accounting records business transaction which is the source of generating information.

Providing information has become the most important objective of accounting. Every steps in the process of accounting generates information. The accounting information should ensure to:-

* Provide relevant information to make the decision appropriate and effective
* Provide information for maintaining and utilizing resources effectively
* Provide appropriate information’s to different interest groups
* provide effective information directing the controlling of an organisation’s human and material resources
* Provide information facilitating social function and control

As we know all like titles in accounting is done by a person known as an accountant. An accountant generates accounting information by observing, screening and recognizing events and transactions in the business.

He measures and processes information and compile reports comprising accounting information that is communicated to the users. Then these are interpreted and uses by management and other user groups. It is the responsibility of the accountant that the information provided must be relevant adequate and reliable for decision making.

## ****Users of Accounting Information****

Accounting information is used by many parties for making decisions in business. All those who use accounting information about the business to make decisions called Users. They are basically users of accounting information. These are different parties in the business who have some stake in the business. Users have a stake in the business in the form of

* Investment in business
* Loans to the business
* Goods sold on credit to the business
* Job in the business.
* Consumers of goods and services produced by the business etc.

But the main purpose of all the users is that all of them want to know about the performance, progress, and working of the business organization. The users of accounting information are divided broadly into two categories:-

1. Internal users
2. External users

## ****Internal Users****

These are the parties who have directly involved with the management and working of the organization. They work with the organization and have the power to influence the working of an organization. For them too, accounting is a source of information. Internal uses include owners, partners, directors, managers, and employee etc. Different users need different information from the accounting.

## ****External Users****

All those parties and individual who are not directly involved in the management and operation of the business now is external users. These do not have the power to influence the working of the organization. Such users include investors, creditors, suppliers, customers, banks, financial institutions, government, existing shareholders, potential shareholder and supplier of raw materials etc. Every different user needs a different kind of accounting information.

**Question.9.** Why do accounting practices be standardized? What progress has been made in India regarding standardization of accounting?

Accounting standard is a method or an approach established and issued by recognized expert accountancy body. It is used in preparing financial statement viz., Profit & Loss Account and Balance Sheet of various concerns operating different fields.

To know the need of anything, you need to first imagine how the scenario would be, had it not been at the first place. So, without accounting standards

* All entities would be doing accounting as per their own formed policies.
* All the entities would be showing profit by deferring the expenditure.
* Investors would not be able to compare financials of different entities as all would be following their own accounting policies.
* Entities would also apply accounting policies as per their need and there would not be any consistency.

Thus, we need the accounting standards

* So that investors can rely on the financials presented to them
* There is transparency in the accounting system
* To eliminate the non-comparability of financial statements
* To provide set of standard accounting policies, valuation norms and disclosure requirements

**Therefore,** Accounting Standards are used as one of the main compulsory regulatory mechanisms for preparation of general-purpose financial reports and subsequent audit of the same, in almost all countries of the world. Accounting standards are concerned with the system of measurement and disclosure rules for preparation and presentation of financials statements. They appear with a set of authoritative statements of how particular types of transactions, events and other costs should be recognized and reported in the financial statements. Accounting standards are devised to furnish useful information to different users of the financial statements, to such as shareholders, creditors, lenders, management, investors, suppliers, competitors, researchers, regulatory bodies and society at large and so on. In fact, such statements are designed and prescribed so as to improve & benchmark the quality of financial reporting.

The rapid growth of international trade and internationalization of firms, the Developments of new communication technologies, the emergence of international competitive forces is perturbing the financial environment to a great extent. Under this global business scenario, the residents of the business community are in badly need of a common accounting language that should be spoken by all of them across the globe. A financial reporting system of global standard is a pre-requisite for attracting foreign as well as present and prospective investors at home alike that should be achieved through harmonization of accounting standards.

Accounting Standards are the policy documents (authoritative statements of best accounting practice) issued by recognized expert accountancy bodies relating to various aspects of measurement, treatment and disclosure of accounting transactions and events. As relate to the codification of Generally Accepted Accounting Principles (GAAP). These are stated to be norms of accounting policies and practices by way of codes or guidelines to direct as to how the items, which go to make up the financial statements should be dealt with in accounts and presented in the annual accounts. The aim of setting standards is to bring about uniformity in financial reporting and to ensure consistency and comparability in the data published by enterprises.

Accounting standards vary from one country to another. There are various factors that are responsible for this. Some of the important factors are

- Legal structure

- Sources of corporate finance

- Maturity of accounting profession

- Degree of conformity of financial accounts

- Government participation in accounting and

- Degree of exposure to international market.

**The current status of IAS (Indian Accounting Standards):**

In India, the Statements on Accounting Standards are issued by the Institute of Chartered Accountants of India (ICAI) to establish standards that have to be complied with to ensure that financial statements are prepared in accordance with generally accepted accounting standards in India (India GAAP). From 1973 to 2000 the IASC has issued 32 accounting standards. These standards, as a matter of fact, most of the countries in the world, which are interested, and confidence in adopting these standards may be followed. But it is observed that many countries are not adopting the standards in the presentation of accounting information. With a view to examine the time gap for indianisation of International Accounting Standards, the information is analyzed and presented in Annexure - I. The table shows that the average gap for indianisation of International Accounting Standards is 6.13 years. It shows that for adopting IAS in India, it is taking 6.13 years for one accounting standard. This analysis points out the poor research work, and development in the accounting field.

**A significant criticism of IAS;**

\* That the standards are too broad based and general to ensure that similar accounting method is applied in similar circumstances. For Instance, the accounting for expenses incurred under a Voluntary Retirement Scheme ( VRS ) , in which the methods used range from pay-as-you-go to Amortization of the present value of future pension payments over the period of benefit.   
\* It may be noted that in several important areas, when the Indian Standards are implemented, the accounting treatment in these areas could lead to differences in the restatement of accounts in accordance with US GAAP. Some of these areas are:

- Consolidated financial statements

- Accounting for taxes on income

- Financial Instruments

- Intangible Assets

\* Restatement to US GAAP:

A restatement of financial statements prepared under India GAAP to U.S. GAAP requires careful planning in the following areas:

- Involvement of personnel within the accounts function and the time frame within which the task is to be completed.

\* The timetable for restatement of the financial statements to US GAAP would depend upon the size of the company and the nature of its operations, the number of subsidiaries and associates. The process of conversion would normally take up to 16 weeks in a large company in the initial year. It is thus necessary to streamline the accounting systems to provide for restatement to U.S. GAAP on a continuing basis.

**Question.10. Is it possible to give a true and fair view of a company’s position using accounting information? Explain.**

Yes it’s possible to give a true and fair view of a company’s position using accounting information as explained under:

True and fair view in auditing means that the financial statements are free from material misstatements and faithfully represent the financial performance and position of the entity

TRUE AND FAIR VIEW is one of the most prominent principles of accounting. It suggests that an enterprise should provide a true and fair view about its financial conditions and operating results. The concept of true and fair view does not mean absolute truth about enterprises. Financial statements are a product of management’s judgments and estimates. The principle of true and fair view requires comparative truth about the enterprises picture. True and fair view is rather defined operationally; it is thought to be accomplished by complying with all other lower accounting principles.

True and fair is not something that is merely a separate add-on to accounting standards. Rather the whole essence of standards is to provide for recognition, measurement, presentation and disclosure for specific aspects of financial reporting in a way that reflects economic reality and hence that provides a true and fair view.

Accounting standards are arrived at after extensive consultation and after full due process.

Further reviews are performed to ensure that IFRS meet the criteria for endorsement by the

European Commission to ensure they would give a true and fair view.

However, where directors and auditors do not believe that following a particular accounting

policy will give a true and fair view they are legally required to adopt a more appropriate

policy, even if this requires a departure from a particular standard. As IAS 1 states, an entity Cannot rectify inappropriate accounting policies by disclosure. These circumstances are more likely to arise where the precise circumstances were not contemplated during the development of the relevant standard

Against that background, it is clear that if auditors are to discharge properly their legal and professional responsibilities, they should stand back as they approach finalisation of those accounts and consider whether, viewed as a whole and in view of the issues that they have addressed in the course of the audit, the accounts do indeed give a true and fair view.

**Conclusion**

It will be evident from the above that the FRC expects preparers, those charged with governance and auditors:

* Always to stand back and ensure that the accounts as a whole do give a true and fair view;
* To provide additional disclosures when compliance with an accounting standard is insufficient to present a true and fair view;
* To use the true and fair override where compliance with the standards does not result in the presentation of a true and fair view; and
* To ensure that the consideration they give to these matters is evident in their deliberations and documentation.

This will help ensure that accounts in the UK continue to demonstrate the high quality that users have come to expect.

**Question.5. What do you understand by Dual Aspect Concept? Explain the accounting implications.**

Dual Aspect Concept is the core of the double-entry bookkeeping. It provides the very basis of recording business transactions in the books of accounts. Dual Aspect Concept assumes that every transaction has two-sided effects, i.e. it affects two accounts in their respective opposite sides. Therefore, the transaction should be recorded at two places. It means, both the aspects of the transaction must be recorded in the books of accounts. For example, an asset purchased for cash has two aspects which are

**(I) Giving of cash**

**(ii) Receiving of goods**

The concept of duality is commonly expressed in terms of fundamental accounting equation:

Assets = Liabilities + Capital

The above accounting equation states that the assets of a business are always equal to the claims of owner/owners and the outsiders this claim is also termed as capital or owner’s equity and that of outsiders, as liabilities or creditors’ equity. According to this concept for every debit, there is a correspondence credit and vice versa. Every transaction has two aspects. These two aspects may be:

* An increase in asset and decrease in other assets
* An increase in asset and simultaneously increase in liability
* A decrease in asset and increase in another asset
* A decrease in asset and decrease in liability

Similarly, there may be:

* Decreases in one liability, decrease in other liability
* Increase in one liability increases in another asset
* Decrease in liability increases in other liability
* Decrease in liability and decrease in an asset

To ensure a comprehensive and complete record, it is necessary to make two entries to record each transaction. This concept is based on the assumption that business never truly owns anything. Anything that it has (namely assets), it owes it either to outsiders (i.e., liabilities) or to the owner who is also a separate person (i.e., capital). Hence whenever a business gets anything, it must record both facts – an increase in asset and an increase in liability or capital.

Similarly, whenever anything leaves the business, there is reduction in asset and a corresponding reduction in either a liability or capital. This fact applies to all the transactions that a business may enter into at any stage of its existence.

There are two types of claims against the assets of the business, One of the owners and second of the creditors. So we can say that the total assets of a business are equal to its liabilities. Liabilities to owners are known as capital and liabilities to others are called liabilities. We can express this relationship between assets and liabilities in the form of the following equation which is also known as accounting

**Question.8. Discuss in brief the basic accounting concepts and fundamental accounting assumptions.**

There are three basic assumptions under every accounting information i.e.:

* Going concern concept.
* Accrual concept.
* Consistency.

1. **Going Concern:** The concept of going concern assumes that a business firm would continue to carry out its operations indefinitely (for a fairly long period of time) and would not be liquidated in the near future.
2. **Accrual assumption.** Transactions are recorded using the accrual basis of accounting, where the recognition of revenues and expenses arises when earned not when received. The concept states that the revenue for a business transaction should be considered realised when a legal right to receive it arises.
3. **Consistency:** this concepts state that accounting policies and practices followed by enterprises should be uniform and consistent one the period of time so that results are comparable. Comparability results when the same accounting principles are consistently being applied by different enterprises for the period under comparison, or the same firm for a number of periods.

Whereas Fundamental Accounting Assumptions when preparing the financial accounts of a company there are some theoretical accounting assumptions which are commonly followed. So unless specified otherwise, it will be assumed that such principles were implemented in the final accounts of the company. The three main assumptions we will deal with are – going concern, consistency, and accrual basis. Let us get started!

Fundamental Accounting Assumptions

Accounting assumptions are the three very basic accounting concepts or principles that are assumed to have been followed in the accounting transactions of an entity. So there is a need for a specific notation saying such concepts have been adhered to, it is understood.

However, this does not mean that such fundamental accounting principles have to be compulsorily followed by all organizations. It is absolutely acceptable if the entity does not follow such assumptions while recording their financial transactions. If these fundamental assumptions have not been followed then the entity should specifically disclose this information, along with their financial statements. This way the users know about such facts.

Now let us take a look at the three accounting assumptions as per the Accounting Standards of India.

Fundamental Accounting Assumptions

1] Going Concern

This assumption is based on the principle that while making the financial statements of an entity we will assume that the company has no plans of winding up in the near future. So the assumption is that the company will continue to exist indefinitely (far into the future), i.e. it will keep on going.

This assumption is important as it allows for the appropriate accounting of fixed assets and depreciation. Since traditionally we follow the historical cost method for valuation of assets, we have to assume that the business is in no danger of being shut down in the future. If this is the case then such assets will have to be valued at market value. But in the case of a going concern, we do not take into account the increase/decrease in prices of assets.

Another case would be that of expenses written off over a number of years like Deferred Advertising Expense. The benefit of such an expense is enjoyed over a number of years. So instead of charging the expense in one year, we amortize it. This is also possible due to the going concern assumption.

2] Consistency

The assumption states that unless mentioned otherwise the accounting policies, procedures, standards, etc followed by an entity in their accounting is assumed to have remained the same. This allows for uniformity in the financial statements of a company over the years. It also becomes easier to compare financial statements from the previous years, something that is important to potential investors and other external stakeholders.

When the accounting treatments and methodologies remain the same over a period of several years the management can properly draw conclusions about the performance of a company. It is an important aspect of planning and decision-making functions of management.

However, this does not mean that an entity cannot change accounting policies to stay relevant with times. This assumption does not completely prohibit change. Sometimes it is necessary to make changes under the following conditions

If it is a statutory requirement and the entity will have to change its accounting policy to abide by the law

Other times a change in policy will allow them to represent their accounts more fairly and appropriately.

Changes made so books of accounts can be in compliance with the Accounting Standards issued by the ICAI

So when the entity changes their policies or methods for the above reason, the users of the financial statements must be informed. Whether there is a material effect in the current year or upcoming years a disclosure must be made. This disclosure is usually made in the notes at the end of the balance sheet.

**3] Accrual**

Under this assumption, accounting transactions are recorded in the books of accounts when they occur. This is known as the Mercantile System. So as opposed to the cash system, in accrual concept, the revenue or expenditure is recognized in the year they are realized.

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