UNIT 2 ACCOUNTING CONCEPTS AND STANDARDS

Structure **Page Nos.**

2.0 INTRODUCTION

All undertaken financial tasks become easy when they are performed with a defined set of rules or parameters. This framework of rules guides us to perform our activities, effectively. Now, if these set of rules are widely acceptable, they turn to be standards and thus becomes valuable to us. To understand this lets us take the example of you, driving a vehicle on the road. You are supposed to follow 'the driving rule' by keeping your vehicle on the left side of the road. You see all other travellers also follow this rule, while driving. Let us think what would happen if these vehicle drivers don't follow this rule; obviously, this would lead to creation of a chaotic situation on the road. Understandably, a similar thought process has been the backbone to the discipline of accounting where the accounting principles which have been evolving over the past several hundred years, have led to the creation of many rules and conventions which have enabled the accounting system to become more acceptable, meaningful and trustworthy. Thus it becomes important for us before making and understanding the accounting reports, to understand the rationale behind the creation of these reports. The said rationale arises from the widely familiar and accepted rules and conventions, which require to be familiarised, first. We all know that the global environments are changing and the accounting discipline also requires to match the growing business needs. Companies stay in pursuit to expand their operations internationally. There arises a challenge that different nations follow different accounting standards and there is a lack of harmony among them. This underlines the need of standardization and thus this need was met with the framing of a global set of standards referred as 'International Financial Reporting Standards (IFRS)'. These internationally proclaimed standards speak one global business accounting language not only to remove language barriers but facilitate global trade. It makes the accounting terms and reports easily understandable and comparable across international boundaries. So despite the linguistic barriers the rule standardization helps us overcome this problem through global accounting standardized framework of IFRS.

2.1 OBJECTIVES

After studying this unit, you would be able to:

- Underline the logic for the necessity and creation for a conceptually sound accounting structure;
- Understand the role of Generally Accepted Accounting Principles (GAAP);
- Appreciate the need and importance for the demand of uniformity in international accounting practices and;
- Recognise the importance of International Financial Reporting Standards (IFRS).

2.2 ACCOUNTING STRUCTURE

Accounting is a very specified and objectivity laid subject and it works under a defined set of guidelines, policies, rules, agreements, covenants and conventions. They all formulate the Accounting's conceptual framework. This framework is conceptual but remains flexible to meet to the new challenges arising from the accounting practices across the world. It serves to be the essence as a knowledge base, with logically and precisely defined acceptable rules, practices and procedures contribute towards the creation of a framework for the professionals where they can contribute with their experiential learning and knowledge in this discipline. This set of standardized rules, procedures and guiding principles become a guiding light to resolve any ambiguities or clarifications, which may arise. Thus, it would not be wrong to say that this theoretical framework would facilitate the accounting profession become globally acceptable. Hendrickson (1977) holistically, defines it "as logical reasoning in form of a set of broad principles that (i) provide a general frame of reference by which accounting practice can be evaluated, and (ii) guide the development of new practices and procedures." So this theory mitigates the ambiguities and thus makes it understandable and acceptable. As it is evolutionary in nature, it has to be governed with a basic set of core principles which would not only be a standard reference point for appraising, developing and reviewing but continually evaluate them too.

The American Institute of Certified Public Accountants (AICPA) has also worked on the varied aspects pertaining to the financial accounting theory and generally accepted accounting principles, and they say, that the "Financial statements are the product of process in which a big data pertaining to different perspectives of business actions are accumulated, analysed, and reported." These said defined set of activities and processes are followed with the generally accepted accounting principles (GAAP). The latter, envisages unanimity of various accounting professionals and firms to define the set of 'recordable activities' and they being factored and measured. It also frameworks the extent of disclosure (or recording) of the accounting information.

GAAP though is principle in nature but it involves a defined and flexible framework of conventions, rules and procedures which are important to identify the standard or acceptable account practices.

Since the essence behind these principles is standardization so various terms have been precisely defined for the ease of understanding. "Principle' is applied as a "general law or rule adopted or professed as a guide to action, a settled ground or basis of conduct or practice". You will note that this definition describes a "principle as a **general** law or rule that is to be used as a **guide to action**". This implies that accounting principles do not prescribe exactly how each detailed event occurring in business should be recorded. Consequently, there are several matters in accounting practice that may differ from one company to another.

"Accounting principles are a work of human creation and are accepted for their usefulness. The general acceptance of an accounting principle (or for that matter, any principle) usually depends on how well it meets the three criteria of **relevance**, **objectivity**, and **feasibility**. A principle is relevant to the extent that it results in meaningful or useful information to those who need to know about a certain business. A principle is objective to the extent that the information is not influenced by the personal bias or judgement of those who furnished it. Objectivity connotes reliability or trustworthiness which also means that the correctness of the information reported can be verified. A principle is feasible to the extent that it can be implemented without undue complexity or cost."

2.3 ACCOUNTING CONCEPTS

You would have understood from the earlier unit 1 that the accounting is the business language. With widespread acceptability, it showcases various forms as the languages shows dialects. It means that the accounting also has many terminologies which becomes a challenge for its global recognition and acceptance. Different combinations of words, phrases and terms have been used to convey a same or similar meaning, thereby leading to confusion with the reader. The various terms used for describing the basic ideas, each term carries its own meaning, the ambiguous use by several accounting professionals have resulted in the creation of confusion arising from generalization resulting in loose and overlapping meanings at the readers' end. Besides, the concept by an author is proposed as a convention by the other which makes the learner unconvinced and may lose interest in the subject.

So here would emphasize to put the concepts straight to get out of the terminology puzzle by acknowledging the generally accepted ideas as 'concepts'. Going further, the other such ideas not categorised as concepts are 'conventions'.

2.3.1 Concepts to be observed at the Recording Stage

i) Business Entity Concept

The Accounting subject distinct business from the owner as it treats them as two separate entities. So the accounting for the business is from the business viewpoint rather than from the owner's perspective. The concept treats a business firm of an enterprising nature distincting the firm's owner(s) from the business. So accounting activities of both require to be recorded separately. While capturing a transaction in the book of records the accountant must see how the transaction is affecting the business. Say if the business owner (a separate business entity, already discussed) takes cash out of the business for meeting his personal expenditure, the entry must be captured for the cash reduction in business. On the other hand, if the owner brings his cash in to the business he becomes the creditor to the business and the firm has to capture this cash transaction as the firm's liability to pay back to the owner.

This concept of business entity can further be understood with a limited company as in this case the business/company or firm is a separate legal entity (or personality) as like any individual despite being involved in many commercial and industrial activities. Partnership firms are hard to separate the individual nature because of separate persons. This distinctiveness gets even harder in case of sole proprietorship firm. So you would have understood that the accounting comes across such challenges to be resolved from time to time using the set of rules and conventions. We also have understood that accounting still requires separating business from the owner. It is pertinent mentioning here that the Law doesn't accept this distinction between the company and the owner(s) as distinct activities. So the accountant requires to stay aware while dealing in a legal matter.

A creditor to the company requires timely information about the firm's assets as well as the owner(s) personal assets for validating the creditworthiness. The management appoints employees who carry the responsibilities on them for managing the funds derived from firm owner(s), financial institutions etc. Their efficiencies are reflected in various periodic and annual reports and their timely compliance"

Check Your Progress 1

Do you see the application of the Business Entity Concept in any other form, not explained above?

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Check Your Progress 2

A firm's owner or proprietor takes an amount of Rs. 75,000 towards mitigating his own personal expenses. The accountant recorded this as an 'expense' entry in the firm's book of accounts thereby making a reduction in the profits of the firm. Share your views whether the accountant has recorded the transaction correct? If not, what else he should have done?

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Check Your Progress 3

A firm's owner brings in an amount of INR 25 lakh as capital investment in his business. Share your understanding whether the firm has a corresponding liability towards the business owner, from the accounting's business entity perspective?

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ii) Money Measurement Concept

In accounting, we capture those factual transactions which are monetary in nature. As monetary transactions have money as medium for exchange and they have a defined 'value', it becomes easy to capture them in the books. A firm has a large number of assets and equities and the money measurement concept uses money as a common denominator. So the physical count of assets such as 5 tonnes of a certain raw material, 10 different manufacturing machines, 7 transportation vehicles, or 100 staff count stand no relevant.

So the money (with its denominated value) happens to be the "practical common denominator" serving a measure of profitability of the business by capturing the monetary value of the assets and equities. This concept comes with certain limitations also as it cannot capture the 'qualitative aspect' of the said assets which stand important to the business. Like the efforts done by a manager and his related sacrifices on family and the health fronts, cannot be captured in the accounting records. On the same lines, any interpersonal differences or conflicts between two head of the departments may bring in adverse results on the firm's performance making the employees become demotivated and the customer becoming dissatisfied with the product quality. This may lead to the erosion of the market share to the favour of the competitor. Similarly, due to changes in the business environment and a new product developed by the R&D team and its subsequent customer acceptance are of much significance to the business but the Money measurement concept has its limitations in capturing the above cited examples.

By now, we have understood that Accounting faces its own set of limitations in recording and showcasing the business activities, of which many of them have underlined contributions for the company's projected profitability.

The other limitation of the Money Measurement concept is the 'time value'. It treats the present value of rupee money today equal to its value which was say, ten years back or ten years in the future. That is, the concept assumes the value of the money staying 'constant' over the time period as it only records the transaction date. The alterations in 'purchasing power of money' arising out of international business environments, forex rate fluctuations and national reserves, inflation, depreciation etc. are not captured. So you can recall that rupees' value when you were young and its value now, have changed big. Let it be the fuel expenses, rentals or even milk price all have gone up substantially. The same stands true for the accountants also as they believe that rupee's purchasing power modifies, but the issue remains that this acceptance in the changing money values is not captured in the accounting books. Thus posing to be a major current accounting hindrance, it aims to resolve this measurement problem or issue to encompass the qualitative aspect besides identifying and reporting relevant information. It is proposed that a separate report be provided on the effect of pricing variations on reported financial position of the firm."

Check Your Progress 4

Validating the fact that "an organisation is the lengthened shadow of a man", if a company's Director expires in an aeroplane accident. The immediate impact is visible with the company's share value eroding significantly at the stock exchanges Will it affect the firm's accounts? Justify your stance?

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iii) Objective Evidence Concept

"The term objectivity refers to being free from bias or free from subjectivity. Accounting measurements are to be unbiased and verifiable independently." Because of this reason all accounting transactions requires to be evidenced and be duly endorsed with verifiable supporting documents like bills, invoices, receipts, cash memos, etc. These substantiate the accounting transaction be verified later by the auditors. As for the items like depreciation and the provision for doubtful debts where no documentary evidence is available, the policy statements made by management are treated as the necessary evidence.

iv) Dual Aspect Concept

One of the foundational feature of this subject, it emphasizes on the concept that every business transaction carries a 'two-fold effect' as it is traditionally and correctly phrased that "every receiver is also a giver and every giver is also a receiver". Let's recall when you go for shopping in a mall and you purchase a pair of denim for Rs 1,000. This involves two transactions; one you pay Rs.1000 and the second you carry the denims. This should explain to you the "two fold effect" i.e., (i) one asset (in form of denims) increases while (ii) decrease in the cash in hand occurs. On the same lines, if you would have chosen to buy these denims on credit, the assets with you would increase (stock of goods) while your liability towards creditors would increase too. So with this, we can conclude that all business transactions comprises of two parts: (i) the receiving aspect, and (ii) the giving aspect. To understand this from the first example further, the receiving aspect is pair of denim while the giving aspect is cash. In the second example the receiving aspect is goods (denims) and the giving aspect is the creditor. So, we conclude with this the dual nature of transactions where both the transactions are to be captured in the account books and this remains as one of the fundamental principle of "double entry book-keeping" or "the "Double Entry System of Book-keeping" which we would be deliberating on subsequently. It's time to move forward to recognize another accounting effect of this dual aspect concept, we are studying. The owner brings in the required funds (capital) to start a business. He may generate more funds as required from time to time from external agencies (creditors). Here, the dual aspect concept says that 'all receipts create corresponding obligations for their repayment'. Or, to understand in a better way, any business contribution, whether in cash or kind, not only increases its resources (assets), but also its obligations (liabilities/equities) correspondingly. Thus, at any given point of time, the total assets and the total liabilities must be equal. This equality is called 'balance sheet equation' or 'accounting equation'.

It is stated as under: Liabilities (Equities) = Assets or Capital + Outside Liabilities = Assets

The term 'assets' denotes the resources (property) owned by the business while the term 'equities' denotes the claims of various parties against the business assets. Equities are of two types: (1) owners' equity, and (ii) outsiders' equity. Owners' equity called capital is the claim of the owners against the assets of the business. Outsiders' equity called liabilities is the claim of outside parties like creditors, bank, etc. against the assets of the business.

Thus, all assets of the business are claimed either by the owners or by the outsiders. Hence, the total assets of a business will always be equal to its liabilities. When various business transactions take place, they affect the assets and liabilities in such a way that this equality is always maintained. We shall understand this with couple of exemplary transactions to see to this equality maintenance:

1. Mr. XY initiated his business with INR 1,00,000 cash, which formed the asset to the business. Business entity concept says that the business and the owner are two separate entities thus Mr. XY contribution of one lakh should be treated as the business liability.

So Capital = Assets

Rs. 1,00,000 = Rs. 1,00,000 (cash)

2. He purchased goods on credit from AB for Rs. 10,000. This increases an asset (stock of goods) on the one hand and a liability (creditors) on the other. Now the equation will be

Capital + Liabilities = Assets

Rs. 1,00,000 + Rs. 10,000 = Rs. 10,000 + Rs. 1,00,000

Capital + Creditors Stock + Cash

3. He purchased furniture worth Rs. 15,000 and paid cash. This increases one asset (furniture) and decreases another asset (cash). Now the equation will be:

Capital + Liabilities = Assets

Rs. 1,00,000 + Rs. 10,000 = Rs. 15,000 + Rs. 10,000 + Rs. 85,000

Capital + Creditors Furniture + Stock + Cash

This equation can be presented in the form of a Balance Sheet (a statement of assets and liabilities) as follows:

XY 's Balance Sheet

Capital and Liabilities	**Rs.**	**Assets**	**Rs.**
Capital	1,00,000	Furniture	15,000
(Mr. AB) Creditor	10,000	Stock of Goods	10,000
		Cash	85,000
	1,15,000		**1,15,000**

Note that the net sum on both sides of the Balance Sheet remains equal irrespective of the number of transactions and the items transacted. Also, note that the cash head in the assets gets impacted for the payments made. All this underlines the dual effect on the assets and liabilities of the business.

v) Cost Concept

Business operations require owing various resources like land, buildings, infrastructure, machinery, property rights and in accounting terms are called as ‘assets’. It is worth the price paid for, or cost incurred to acquire it.” This means that as asset purchase transactions are captured at their original purchase price and this cost is the basis for all subsequent accounting for the assets. The assets shown on the financial statements do not necessarily indicate their present market worth (or market values). This is contrary to what is often believed by an uninformed person reading the statement or report. The term ‘book value’ is used for the amount shown in the accounting records.

A pertinent example is cash, itself. It has also been observed that longer an asset is kept in a firm, less would be the probability of the accounting value matching the market value of the asset retained. This remains a problem area for an accounting professional.

The cost concept doesn’t factor the future anticipated cost of a firm’s asset. Any asset is assumed to have long & limited life. The cost of an asset reduces over a time period and the account professionals terms this as ‘depreciation process’ which we would be understanding in coming units. Yes, by that time, we would understand depreciation as process by virtue of which an asset’s cost gets periodically reduced (or written off) by factoring it as expense over some accounting period. This means that depreciation as expenses eats into the firm’s profits. While factoring depreciation, the accountant doesn’t brings into the account the current market value of the depreciating asset, rather there exists no correlation in depreciation vis a viz asset’s current market value. It is required to be clarified here that the logic behind depreciation is to spread and allocate the asset’s cost for its useful life to the firm and certainly not to appropriate it with its current market value.

This may exclaim you on the reasons why the assets get marked as ‘costs’, in the accounting records and there exists a wide difference between their market prices and book recorded prices. The main argument is that the cost concept meets all the three basic criteria of **relevance**, **objectivity** and **feasibility**.

Check Your Progress 5

A firm buys a building in 2021 for INR 5 crore. The market was booming at that time and by the end of the FY 2021-22, the market value of the building quoted Rs.7 crore. The company went ahead to appreciate the building in their book of records as INR 7 crore for the Financial year 2021-22. Share your opinion on this, as an accounting professional and how would you rate this practice?

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Check Your Progress 6

A company buys a transportation vehicle on a good discounted price of INR 4,00,000, while the prevailing market price is Rs. 6,00,000. Share your views whether the company should capture the value of the vehicle in their account records as INR 4,00,000 or INR 6,00,000? Please share the reasons to support your stance.

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vi) Accrual Concept

All the accounting concepts studied so far seeks to address various accounting situations and their solutions. This, accrual concept is another such endeavour which distinct the receipt of cash, and the right to receive it, and the payment of cash and the legal obligation to pay it. In the practical business transactions scenarios, the obligation to pay and the actual movement of cash may not happen at the same time and the "accrual concept" recognises this distinction. So while recording a "sale of goods" transaction, the revenue may be received either (i) before the right to receive arises, or (ii) after the right to receive has been created. The accrual concept provides a guideline to the accountant as to how s/he should treat the cash receipt and the rights related thereto. In the former case the receipt will not be recognised as the revenue of the period for the reason that the right to receive the same has not yet arisen. In the latter case the revenue will be recognised even though the amount is received in the subsequent period.

The same process be followed pertaining to the expense made by the company.it has been practically observed that the cash payments towards the expenses made are done either before or after their due date. So in accounting terms the due amounts which are required to be paid are categorised as expenses. It also means that the advance payments (i.e., it does not belong to the accounting period in question) should not be accounted for as 'expense', thereby treating the entity receiving such advance payments as 'debtor' by the time his due date of payment arrives. Where an expense has been incurred during the accounting period, but no payment has been made, the expense must be recorded and the person to whom the payment should have been made is shown as a creditor.

Check Your Progress 7

The year of a company (from the accounting perspective) gets over on the 31st December every year. For this company, their premise rent amounts to INR 1,00,000 for the last quarter is delayed and thus couldn't be timely paid for any reasons. As an accounts professional, share your understanding whether this due rental to be paid, should be factored in the company's book of accounts for closing purposes?

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Check Your Progress 8

A govt. furniture supplier dispatches various furniture goods to govt. departments. He finds that few invoices totalling INR 50, 000 were yet to be paid by said departments and their due date has already surpassed on 31st March i.e the closing date of the yearly book of accounts. Now share your opinion, explaining whether the supplier consider the revenue of INR.50, 000 into the closing year account while evaluating the net profit of his firm?

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2.3.2 Concepts to be observed at the Reporting Stage

i) Continuity Concept or Going Concern Concept

Whereas earlier we have understood that the business person and the firm are two separate legal entities; now we take it further with the going concern concept. It says that the 'Accounting' understands the business (an accounting entity) will continue with their business operations perpetually i.e long in the future. Thus a business entity is factored as "a going concern" that is assumed to sustain its activities continually or at least, in the foreseeable future. This means it is also believed that the firms' owners have no intentions, nor any necessity to close the firm.

This assumption becomes significant as it makes the business being understood as a "mechanism for adding value to the resources it consumes". The business's success is evaluated by subtracting output values (sales or revenues) from the input values (expenses). So, an un-utilized resource becomes 'cost' rather than being recorded at market values. The continuity concept factors such costs be realized in the future rather than selling them in the markets in present.

This concept serves to enable the assumption that the business remains perpetual and shall be a going entity in the future or at least in foreseeable future this concept becomes the foundation for many valuations and allocations in the firm's accounting task. In case of depreciation (or amortisation), the process banks on the said concept. It also serves the investor to stay invested or invest in fresh in a company. It is also true that based on this accounting concept the accounting process remain transparent for capturing the records and thereafter reporting the investments, management's efficiency and reporting the firm's position. Also, this concept doesn't factors the higher current market values or the liquidation values which stand important in the other concepts studied by now. This assumption provides a basis for the application of **cost** in accounting for assets.

Though the accountant stands with this concept theoretically, he has to comprehend that the firm's business, partially or wholly may cease to exist or operate, or be sold or exited (say within a year or two), then the resources could be reported at their current values (or liquidation values).

ii) Matching Concept

Also widely known as the "Matching of Costs against Revenues Concept", it assumes that to ascertain the firm's accounting results like PnL, Balance sheet etc. requires collecting all revenues and expenses of that period. Further, you may also understand the expenses of an accounting year should match with the firm's generated revenues of that particular accounting year, which brings forth the issue of 'appropriation' to match the "appropriate costs with appropriate revenues". Inflows (revenues) of that accounting period must be identified or forecasted to appropriate costs spent for getting the said inflow. So costs when deducted from the revenues results in net resultant for the queried period. So it is important to understand the importance of recognizing the revenues and costs for a time period. This requires following set of accounting rules which says "The Timing of Revenue Recognition Revenue is recognized in the period in which it is earned or realized". This is as per the 'realization principle' which clearly states that "while factoring revenues of a defined time period the transactions happened rather than when cash inflow occurred". So while accounting for "the sale of goods (or services)" (i) the revenue is only accepted to be 'realized' when sales transaction happens and not at the time when payment is realized or cash is accepted for the said debtor. ii) Revenues generated from sources like rentals received, interest earned, or commission charges are time bound so are accounted

for on defined times. Income generated from them is appropriated in the Profit and Loss statement in the accounting year in which they are earned. For eg, a firm invested by buying certain govt. securities or bonds on 1st October' 2020 amounting to one lakh on which interest earning would be 12%, to be paid on half-yearly basis i.e on every 1st day of the month of April and October. The first interest credited amount of INR 6000/- happens on 1st April' 2021. As per the obligation the company would be preparing their Profit and Loss for the calendar year 2020 i.e, from 1st Jan' 2020 till 31st Dec' 2020). The abovementioned interest credited for the period 1st of October to 31st of March. (half yearly) has to factor INR 3000 for the period 1st October to 31st December - quarter (Three Month) amounting to INR three thousand should be factored in the header "Interest Income on investments made" in Profit and Loss A/c for the year 2020. Noteworthy is that the said amount has not been received during the said year.
The Timing of Costs Recognition: This matching principle says "the expenses should be recognized in the same period as the associated revenues." This means,

i) Costs of goods require matching to sales revenue. So, in process of making the Profit and Loss Account for a said year, one should not factor in cost of all goods made in that year, rather, factor cost of goods sold (COGS) in that particular year. COGS is calculated by "subtracting the cost of closing stock from the cost of goods produced".

ii) Expenses such as salaries, wages, interest, rent, insurance, etc., are recognized on time basis. In other words, they are related to the year in which the service is obtained or the expense is incurred, whether paid immediately or payable at a later date.

iii) Depreciation on fixed assets is also factored in as a 'Cost' since it is dependent on time. With this, we can summarize with the following statement, "all revenue earned during an accounting year, whether received or not, and all costs incurred, whether paid or not have to be taken into account while preparing the Profit and Loss Account for the year". On the same lines, any financial transaction of previous year having amount involved to be paid in the current year requires not being factored in the ongoing accounting year's revenue and costs. It indicates towards yet another aspect namely the "accrual basis of accounting" which would be we would be detailing in the forthcoming units. Coming back to focus on the 'Matching Concept'; it has consequences for evaluating the profit and loss for a accounting year.

    1. While making annual financial statements it requires to be adhered that the costs pertaining to a particular financial year (F.Y) and the same is applicable for revenues also. For example, when we prepare the Profit and Loss Account for 2017, we shall take into account all those incomes that were earned during 2017, and similarly consider only those costs which were incurred in 2017. Any costs or incomes which relate to 2018 shall be excluded.
    2. It requires to be ensured that "all costs incurred during the accounting period (whether paid or not) and all revenues earned during that year (whether received or not) are fully taken into account."
    3. We should consider only those costs which relate to the revenue taken into account. This is the reason why we consider only the cost of goods sold, and not the cost of goods produced during that period.

iii) Full Disclosure Concept

We understand that the various financial statements whether been made monthly, quarterly, half-yearly or annually serve a basic function of communicating trustworthy financial information to all the stakeholders in a standard format. These statements are the sole basis to assess the performance and financial position of the firm. These stakeholders can be investors, lenders, suppliers and internal as well as external customers. So it becomes the responsibility of the accountant to adhere to the standard norms while publishing such financial statements as they bring much needed credibility and add to the goodwill of the firm. Such statements should be elaborative and having foot-notes to disclose all relevant information of a material nature which relate to the profit and loss and the financial position of the business. It is therefore, necessary that the disclosure should be full, fair and adequate.

iv) Accounting Period Concept

On one hand the business is considered perpetual in nature, the results can be ascertained once the business cease to exist, all its assets sold and all liabilities paid. Still the accounting statements are required to be made at regular and defined intervals. There always remains a curiosity with the stakeholders to remain updated on the financial position of the company and can't afford any delay in this. This puts additional pressure on the accountant to report the changes in the wealth of a firm at varied time intervals depending on established or prevailing reporting practices or traditions, government and legal compliances. These annual reports may be adhered and compiled on calendar year or financial year (as defined by government). Still many firms choose 'natural' business year, known for ending at relatively lower or lowest business activity in the twelve-month period horizon. It may however, be clarified that the annual reporting is typically for external reporting while shorter span reporting at the intervals, say of one month or three months is for internal reporting and compliance purposes.

In an effort of factoring earnings and the cost of those earnings for a specified accounting period, requires encompassing all the revenues and costs pertaining of that accounting period requires to be factored irrespective of whether or not they have been received in cash, or paid in cash. Withstanding all these issues in allocations and adjustments, the relevance of these short-term reports (i.e., yearly reports) owe a great deal of importance for business owners, management, creditors, and stakeholders and they look forward to the accountant for the timely publication of such reports.

Some other concepts, e.g., the Matching concept, the Realisation concept and the Dual Aspect concept are discussed in units 4 and 5, and as such, they have not been taken up here.

After going through the above accounting concepts, you would have concluded that all the concepts stand important on their own, but they may demonstrate conflict when they interact. So the knowledge of the accountant comes handy in such scenarios. For example, in case of business properties' valuation perspective, let a company buy a land parcel in 2000 amounting to INR 6,00,000 and it began the construction in the next year i.e 2001 to commence the business activities, the very next year. The company showcased stellar results meeting to the stakeholders' expectations. Now, the Balance Sheet (a statement of assets and liabilities) for the year 2010 is being prepared and 'Land' is required to be valued. The estimated current market price of this land is Rs. 60, 00,000.

Now, as an accounting professional, would you agree to the proposition of the land be recorded at INR 60 lakh? The accounting principle makes us accounted in the Balance sheet at the purchase price only. To begin with, **money measurement concept** inhibits us from recognising the price appreciation because of market and inflationary reasons. Then comes the **realisation concept** which stops us for unrealised profits being factored in the book of accounts by the time the said asset (land, here) is not sold for money. Adding to that, the **continuity**, or **going concern concept**, doesn't recognises the market value of land thus is not factored in balance sheet as the land remains as the asset and an integral input to pursue business operations. Assuming the contrarian view, if the land be depicted in balance sheet at the estimated current market value may attract the business owner to abandon/ stop the business by selling land and retire himself. Next, the principle of **objectivity** makes the argument more challenging. As the price of the said land at the time of acquisition in 2001 is a verifiable document with proofs arising from the sale deed and other relevant supportive documentary evidences. But in case of the 2010 land estimation value may be suspected as various valuations would be based on varied calculations involving time frames, usage, market demand, availability and other commercial aspects. An accredited valuer may be hired for his valuation methodology be accepted as verifiable evidence of land's prevailing market price. Further, the land requires to be free from all encumbrances, or the cost of already constructed premise in that land, its quality of construction and compliance to the legal bylaws. Here, the **conservatism concept** inhibits accepting the said land market estimation value on accuracy concerns.

v) Concept of Conservatism

This concept is also called as the concept of prudence, and is known for its statement "anticipate no profit, provide for all possible losses". It makes the accountant raise his guard with abundant caution. This makes him face an interesting proposition of having an option of capturing values of for assets and revenues on the lesser value while higher valuations towards liabilities and expenses. The concept states to recognise revenues or gains only when realized as cash or assets (usually legally enforceable debts). This is ultimate cash realisation of which can be assessed with reasonable certainty. The concept says to "factor in for all known liabilities, expenses, and losses whether the amount of these is known with certainty, or is at best an estimate in the light of the information available. Probable losses in respect of all contingencies should also be provided for."

A contingency is defined as "a condition, or a situation, the ultimate outcome of which−gain or loss−cannot be determined accurately at present." It would be ascertained only post happening of the event. It may be understood that the said event may not even happened. Say, a client may file a suit in the court of law against the firm and we don't know the verdict. So from the accounting point of view, it becomes pertinent to factor or provision the expected loss in the company's financial statements. Thus, as a solicitation of the said concept "net assets and incomes are more likely to be understated than overstated". This makes us advocate the practice of valuing inventory (stock of goods left unsold) at cost or market price, whichever is lower valued. You would observe that this is an extension of what the cost concept said initially. Though many professionals have a contrarian view about this concept as it hinders true profit valuation and thereby distortedly presenting the facts in the firm's financial statements. So it is correct to state that a rational use of conservatism is advocated as over-conservatism leads to falsification of the financial data.

Check Your Progress 9

A company is negotiating to get an order for Rs.5 lakhs from XYZ Company. It is confident to get an order and as a result, it shows this order as a part of its sales revenue. Will you approve such an accounting treatment of probable order to be obtained in coming years?

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vi) Materiality Concept

Business operations involve many activities and many of them may not serve to be important from the accounting perspective. The role of accountant is again important here to adjudge whether the vent or happening carries a financial aspect or benefit to the company. In any of the cases, observing and recording of such events is costly but is required for the event be evaluated for relevance later. The discussed concept states for the items of less importance may not be appropriately treated on accounting theory. Small petty or stationery items may cost less and have a life of couple of years, but requires book keeping effort having a larger cost implication than the derived benefit behind this recording task. As this item is not going to make any impact on the business operations or the profitability of the firm, the suffered cost actually becomes an expense. Also, some said stationery item stock may stay unutilized in that accounting year. Thus the book keeping entry would treat the cumulative amount spent on stationery purchase as 'expense' in the very year the stationery items were purchased. The balance of the said inventory may be treated by the accountant as 'insignificant' to be classified as an asset but as resource for the next accounting year. In other words, the cumulative value of expenditure on stationery be classified as 'expense' for the said period in which this expense got made.

This classification or differentiation between adjudging an event as "material or immaterial" rests with the sense of professionalism and situation of the accountant. Also, there are no guiding directives to help upon. This importance allocation may be adjudged on the comparative relationship with respect to other alike situations and value based decisions. However, a set of rules requires to be established for a commonly followed policy framework for wider acceptance and adherence.

Check Your Progress 10

A firm buys an office table for Rs. 800. Though it is, theoretically speaking, an asset having a life, of more than one year, the firm shows it as an expense of the year, and reduces the profit for the year. Is this accounting practice justifiable? Give reasons.

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vii) Consistency Concept

Practically, there are various means to capture an accounting event in the firm's accounting books. For example, the trade discount received towards buying raw material can be subtracted from cost of goods, thereby recording the net amount (post trade discount reduction) or another way could be capturing the trade discount as 'income' while the whole cost (without trade discount) be entered. Other activities where the same differential treatment is administered is while depreciation. "It is a decrease in the value of assets caused by wear and tear, and passage of time" discussed concept, reiterates to the accountant to follow and continue with one method or procedure for all similar forthcoming events. However, the accountant has the prerogative of resorting to other method on logical grounds.

The appreciable part of the accounting subject and its concepts is the ability of drawing valid conclusions by utilizing the various reports pertaining to the accounting information. It facilitates data comparison of data at specific intervals with even of previous periods. This supports citing of differences and calls for the introspection of the management for a timely corrective action. "Comparing like with the like" leads to following of ongoing methods or procedures as any deviation in this regard may affect the reported financial position of the firm. Also, this discussed inconsistency leads to the scope of data manipulation and still to corrupt practices.

Check Your Progress 11

Depreciation is being done in a firm and it is being asked to be charged for a machine at the rate of INR 15,000 per annum for the initial 3 yrs. Subsequently, it is to be depreciated at INR 10,000 for the next two years. Thereafter, the depreciation is provisioned for INR 8,000 for the remaining years. Please share your thoughts on the depreciation practice being followed here?

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2.4 ACCOUNTING STANDARDS

By now we have understood that the rules, conventions, concepts in the world of accounting form the basic structure of accounting. We also have observed overlapping and co-existence of these concepts. So for a coherent approach involving the best practices followed internationally, one requires to be facilitated for equated comparison and evaluation. This requires availability of the desired information at the right time with the deployment of correct accounting methods. Practicing various accounting practices leads to difficulty in comparing reports of the firms. Usage of alternative accounting methods may even led to the non-uniformity of results in the same corporate entity but separate business units.

2.4.1 Need for Accounting Standards: we all have understood by now that various stakeholders require the published financial statements for taking the right investment decisions in the firm. The Indian Companies Act specifies the various types of information the companies require to disclose, report and publish via their financial statements. The firm's accountant or accounts professional owes this responsibility towards timely and authentic financial information be presented. Since this publication is in a standard and predefined format, discretion may not be allowed to tamper with the format, methods and followed procedures. This results in the company's goodwill creation and reputation as a transparent, disciplined and consistent in authentic data reporting. For example, one firm may have reported loss in its annual financial statements but then also declares a dividend arising out of manipulation of numbers. The firm may be able to retain its shareholders, lenders, suppliers and investors in short duration and prevent share capital erosion but in the longer run this decision may prove devastating to them.

We have understood by now, the importance of these financial reports to the investors, shareholders and other beneficiaries. We also have agreed to the need of standardized approach for reporting the financial statements for international coherence. Such financial reports reveal the management's competencies in allocating the scares resources in an effective and efficient way. This calls for the availability and acceptance of widely acceptable and appropriate standards for the unified benefit of the investor as well as the nation. We have discussed the financial reporting requires data presentation in a 'comparative way' and be followed extensively by the industries. The stakeholder desires transparency while reporting of financial statements and would certainly wouldn't expect any change in accounting methods. He banks on the firm's management competencies resulting in better allocation of resources yielding rich dividends. A prerogative to firms let choose their own reporting stands would be chaotic both for the company but the national economy too. It may lead to unplanned resource utilization leading to shortages. So an approach of reporting fictitious profits by the less efficient companies to shift the resources towards them in the shorter duration, which would result in its scarcity with the more efficient companies thereby, making a coupling impact on both.

2.4.2 Benefits of Accounting Standards

There are many benefits of accounting standards. Let us discuss the main benefits of Accounting Standards one by one.

1) Standardized Accounting: Perhaps the most important advantage of the FASB standard setting for businesses is the uniform set of accounting principles it promotes. The FASB clearly states the generally-accepted accounting principles that businesses must follow to avoid confusion. For example, the FASB prevents businesses from using one method for calculating inventory at the beginning of a fiscal year and finishing the year with another method. Without the accounting standards set forth by the FASB, businesses could use accounting methods that portray financial data inaccurately to investors.

2) Problem Identification: The FASB standard setting provides a framework upon which potential accounting problems are identified and corrected. Because all businesses in the US use the same accounting principles, any problems or inadequacies in the accounting process are quickly identified and reported to the FASB. The FASB then investigates the problem and, if needed, modifies or writes a new accounting rule for the accounting process. For example, if businesses find that reporting a certain type of liability on their income statement unfairly lowers their net income, they can appeal to the FASB so that it can identify problems with the standard setting.

3) Private Regulation: The FASB is a private entity with no affiliation to the US 2.4.2government. Despite this, the Securities and Exchange Commission relies on the FASB to set the accounting rules that all companies in the US must follow. The SEC can technically create an accounting oversight board or government agency to set accounting rules. However, using the FASB eases the burden on the US government and lets the private sector dictate accounting rules

4) International Accounting Standard: The FASB is advantageous because it actively promotes an internationally recognized set of accounting rules. Globalization has deeply connected foreign financial markets; a standard set of accounting rules would make financial reporting more accurate and fair between countries. One of the goals of the FASB is to make financial reporting more uniform globally with the cooperation of the International Accounting Standards Board (IASB)

2.4.3 Indian Accounting Standards scenario: Our nation is one of the leading developing nations of the world and requires to match with the international standard accounting practices being followed across the world. Another challenge is the wide National demographic and geographic diaspora which further increases the need for a harmonised accounting policies and practices across the country. Taking forward this legacy is the Institute of Chartered Accountants of India (ICAI) formed the Accounting Standards Board (ASB) in April 1977 with noted representation from the industry as well as from the government. Its proposals for standards are vetted and circulated to external agencies, including representative bodies of trade, commerce, and industry.

Since these standards are in recommendatory format in the proposal structure they are suggested to be implemented by the stock exchange listed firms, corporate bodies, institutions and other commercial bodies.

It is recommended to you that you study these standards and deliberate it to find out the qualitative aspect of these accounting standards. More you would gain insights on the structured rules, policies and procedures of accounting and the need for their standardization. You may come cross hurdles in understanding few terminologies or logical aspects of these standards but their understanding to you would open up new thinking directions in your minds. The more you study the next units, the more you will increase your inquisitiveness to study more about these accounting standards and the need of the same in our country.

The implementation of these accounting standards in our country has been a challenge since they were established without designing the theoretical framework. In the absence of the latter it has been questioned on these accounting standards and principles proposed to be implemented for lack direction and coherence. Other developed nations like UK and

USA also faced similar situation but they were swift to resolve such issues. The US develop a conceptual framework project through FASB and structurally intended to define objectives of financial reporting. This led to suggesting of accounting concepts and standards commonly known as "Generally Accepted Accounting Principles (GAAP). Any attempt to develop a conceptual framework regarding the objectives of reporting will have to take into consideration the answers to the following questions:

i) Who are the users of financial reports?
ii) What decisions do these user groups have to take?
iii) What information can be provided that would assist them to take such decisions?

The objectives, as you have already noted, depend upon the economic, social, legal and political environment of the country.

Section 133 of Companies Act, 2013 requires the companies to comply with the prevailing accounting standards. As on 1st April, 2021 there are 32 accounting standards specified by ICAI, AS from 1-29 are mandatory and AS 30, 31 and 32 are non mandatory and have been withdrawn.

Following is the list of these standards:

- **AS 1 Disclosure of Accounting Policies**
- **AS 2 Valuation of Inventories**
- **AS 3 Cash Flow Statements**
- **AS 4 Contingencies and Events Occurring after the Balance Sheet Date**
- **AS 5 Net Profit or Loss for the period, Prior Period Items and Changes in Accounting Policies**
- **AS 6 Depreciation Accounting**
- **AS 7 Construction Contracts (revised 2002)**
- **AS 8 Accounting Policies, Changes in Accounting estimates and Errors.**
- **AS 9 Revenue Recognition**
- **AS 10 Accounting for Fixed Assets**
- **AS 11 The Effects of Changes in Foreign Exchange Rates (revised 2003),**
- **AS 12 Accounting for Government Grants**
- **AS 13 Accounting for Investments**
- **AS 14 Accounting for Amalgamations**
- **AS 15 Employee Benefits (revised 2005)**
- **AS 16 Borrowing Costs**
- **AS 17 Segment Reporting**
- **AS 18 Related Party Disclosures**
- **AS 19 Leases**
- **AS 20 Earnings Per Share**
- **AS 21 Consolidated Financial Statements**
- **AS 22 Accounting for Taxes on Income.**
- **AS 23 Accounting for Investments in Associates in Consolidated Financial Statements**
- **AS 24 Discontinuing Operations**
- **AS 25 Interim Financial Reporting**
- **AS 26 Intangible Assets**
- **AS 27 Financial Reporting of Interests in Joint Ventures**
- **AS 28 Impairment of Assets**
- **AS 29 Provisions, Contingent Liabilities and Contingent Assets**
- **AS 30 Financial Instruments: Recognition and Measurement**

Check your progress 12
Choose the most appropriate answer from the options given below:

1. The purpose of the International Accounting Standards Board is to:
   a. issue enforceable standards which regulate the financial accounting and reporting of multinational corporations.
   b. develop a uniform currency in which the financial transactions of companies through-out the world would be measured.
   c. promote uniform accounting standards among countries of the world.
   d. arbitrate accounting disputes between auditors and international companies.
2. What is not a source of pressure that may influence the accounting standard setting process?

   a. Congress.
   b. Lobbyist.
   c. CPA firms.
   d. None of the above.

3. What is a possible danger if politics plays too big a role in accounting standard setting?
   a. Accounting standards that are not truly generally accepted.
   b. Individuals may influence the standards.
   c. User groups become active.
   d. The FASB delegates its authority to elected officials.
4. What is not a reason that accounting standards may differ across countries?
   a. Governments.
   b. Language.
   c. Culture.
   d. Past Practice.
5. What would be an advantage of having all countries adopt and follow the same accounting standards?
   a. Consistency.
   b. Comparability.
   c. Lower preparation costs.
   d. b and c

2.5 THE CHANGING NATURE OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

Primarily, it is the responsibility of the accounting professional to contribute towards the development of internationally acclaimed standards. There are professional accounting bodies like American Institute of Certified Public Accountants (AICPA) and Institute of Chartered Accountants of India (ICAI) who have immensely contributed in framing the "Generally Accepted Accounting Principles". They came across many hindrances in form of cultural, language and distance barriers, political and polito-socioeconomic environment's impact. This noted contribution was not only from the academic knowledge pooling but in depth evaluation of the legal, regulatory and tax law framework of the government. This led to the formulation of widely accepted accounting principles being followed by various stock exchanges and other regulatory agencies like the Securities and Exchange Board of India (SEBI) who have laid down rules for disclosure and the extent of accounting information.

We all understand that the Business environment is evolves rapidly and its constituents of political, economic and financial environments have individual as well as coupling effect on the business. Thus the business operations require to keep abreast with the rapid changes and their regular monitoring and evaluation for the continued relevance of GAAP. So it means that the GAAP are also not standards but evolving standards being developed with the changing business environments. So the business firms require to continuously upgrading themselves with modifications in GAAP for developing and reporting, generally acceptable financial statements with the stakeholders.

2.6 ATTEMPTS TOWARDS STANDARDISATION

Institute of Chartered Accountants in England and Wales had worked since 1942 towards accounting framework standardization, the visible progress was observed with the establishment of the Accounting Statements Committee (ASC). There was a non-confirmatory stance of the public at large towards the applicable financial reporting systems which were prerogatively having dissimilar practices resulting in reporting of massive financial losses with some large investors. This led to the wealth erosion of large-cap companies leading the dire requirement of standardization in financial reporting standards. So ASC started working on identifying the gap areas and narrow down on the applicable to the standard best practices in the area of accounting and report making. For this accountants from various companies were brought together to form a standardised "Exposure Draft" on specific topics discussed. This was shared with the public at large, seeking reviews and feedback for consideration. This made way for formulating a formal statement of the accounting methods pertaining to individual accounting issues. These statements were called "Statement of Standard Accounting Practice (SSAP)." Once drafted, they were sent for adoption by the accounting profession. Such was the importance and need of this practice that a notification was sent by Institute itself signifying for the acceptance by the profession. By now, nineteen statements of standard accounting practice, in addition to some exposure drafts under consideration, have been issued by the ASC.

The US identified the need for setting the standards in 1933 when it formed the "Securities Exchange Commission (SEC)", a government agency. Its objective was to regulate and controls the issuance of, and dealings in securities of the companies. Thereafter, in 1957, a research-based entity, the Accounting Principles Boards (APB) got established for framing fundamental accounting postulates. And in 1973, the Financial Accounting Standards Board (FASB) was established with the responsibility of issuance of statements and articulation of GAAP.it is important to mention here that the role of SEC towards FASB pronouncements has given considerable credibility to its accounting policy statement. The FASB has been issuing statements of concepts and financial accounting standards regularly.

Standards at International Level: the globalization of the world trade across the geographical borders and to capture new markets and resources, a rapid expansion in business activities by thee global companies required accounting standardisation at the international levels. An International Congress of Accountants was organised in 1972 at Sydney, Australia for deliberating on bringing uniformity in the international accounting practices, this resulted in the formation of 'International Accounting Standards Committee (IASC)' and was provided with the responsibility of formulating international standards. IASC's member nations committed for conformance towards the IASC standards. They also agreed to provide a critical review on these accounting standards. This fast convergence for the international standards saw formation of another such professional body named 'International Federation of Accountants' (IFAC) in 1978.

Other efforts towards contribution to the international accounting standards were witnessed from other countries also. Europe saw foundation of "European Economic Community (EEC)" while Canada also contributed for standardisation of accounting practices regarding disclosure and consistency of procedures.

2.7 INTERNATIONAL FINANCIAL REPORTING STANDARDS

In today's globalized environment, business does not operate in just one country rather they operate around the world. However, it must be emphasized that around the globe, different countries follow different accounting standards. This leads to a need for a global set of standards commonly referred to as 'International Financial Reporting Standards (IFRS)'. IFRS are designed to serve as a common global language of business affairs so that accounts of various companies are understandable and comparable across international boundaries. National accounting standards prevailing in different countries are being replaced by these International Financial Reporting Standards.

They are a set of standards formulated by International Accounting Standard Board (IASB) defining the guidelines for the treatment to a financial transaction and reporting of event in the accounting statements. They are a guiding set of principles and procedures used to define the foundational parameters for various financial accounting policies and practices.

The Finance profession is one of the fastest growing in the financial world. The General Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS) are gaining momentum across many countries. Since they account for much needed transparency of financial reporting across the world. IFRS carried the responsibility of specifying on the ways various businesses to follow should be maintaining and reporting their business accounts. Created to establish a common accounting language, the goal of the international financial reporting standards is to make financial statements coherent and consistent across different industries and countries.
IFRS aims to serve as an enabler in the much needed task of comparing the financial statements across the nations. This is a practically tedious task, as most countries follow their individually followed set of standards. Say, the US, follows US GAAP and India, has its version of Indian GAAP. So, it remains a challenge to bring all such economically empowered nations on the same board.

2.7.1 Need for Convergence of IFRS

The IFRS (International Financial Reporting Standards) convergence has gained momentum all over the world and India is no exception. As the world is going global on a massive scale, the need for convergence seems all the way more important. The needs for common acceptable standards have been felt the world over and as of date, approximately 100 countries either have adopted fully or have converged IFRS standards with their own standards. The ultimate goal of convergence is to have common acceptable standards, which is practiced world over ensuring transparency & utility of financial information.
Indian Scenario – The Institute of Chartered Accountants of India (ICAI) develops Accounting Standards. India officially decided in 2007 to converge with IFRS. The ICAI and IASB (International Accounting Standard Board) then decided to work together, collaborate and develop quality and comparable accounting standards instead of fully adopting the IFRS standards completely. The ICAI decided to adopt IFRS and set the target period as April 2011 but delayed implementation due to procedural and operational reasons. Finally, the Ministry of Corporate affairs has announced the implementation of new standards effective from 1ST April 2016 over a period of four years till 1st April 2019. All applicable & existing standards would cease after the target date of implementation. The Ministry of Corporate affairs have notified the implementation dates as below.

- Listed Companies with more than 500 crores of net worth – 1st April 2016
- Listed Companies with more than 250 crores of net worth – 1stApril, 2017
- Banks, Insurance & Financial Service Companies – 1st April, 2019

The need for IFRS convergence in India is necessary due to the following reasons:

- To ensure a general understanding of best accounting practices
- To make the financial statements reliable, comparable & transparent
- To standardize financial accounting & reporting across the globe
- To promote foreign Investment & spur Industrial growth
- To eliminate information barriers for users of financial statements

Benefits

1. **Easy access to global financial capital markets** – Indian companies would be able to procure investments from abroad on cheaper favourable terms, which in turn can fund their growth and expansion.
2. **Cross Border trade & Investments** – Indian firms following IFRS would be able to do business by listing abroad and this would facilitate more trade & investment in unrepresented geographies.
3. **Eliminate differential reporting** – Indian Companies having business abroad would be able to do away with preparing separate financial statements, as they would be following IFRS standards. This would reduce duplicity in financial reporting & eliminate unnecessary reporting.
4. **Improved quality & comparability of financial reporting** – The converged IFRS standards are of high quality, easily enforceable and globally acceptable which in turn increases reliability & comparability. Lenders and Investors will have more confidence in Indian businesses because of the commonly followed Accounting standards & procedure thereby improving trust & confidence.
5. **Accounting Profession** – Accountants & Finance persons working in financial reporting domain would also benefit by highlighting their expertise & talents abroad. They will be more competent to take up challenging global roles worldwide.

2.7.2 Benefits and Challenges of IFRS

IFRS provides many benefits as far as reporting financial information is concerned. Let us discuss those benefits in brief:

i) Minimises diversity in accounting practices
ii) Improves the quality and transparency of financial reporting process
iii) Increase the trust and reliance placed by investors, analysts and stakeholders in a company's financial statements
iv) Reduces the cost of conversion of financial statements for local companies which make investments, raising capital and listing abroad
v) Provides a drive to cross border acquisition and partnership, alliance with foreign entities as well as economic growth expands globally

It also suffers from many challenges. Let us discuss these challenges one by one

1. **Training & Awareness** – Many do not know the IFRS standards & lack of knowledge & awareness makes it a difficult task of implementation. Finance professionals will have to be adequately trained and then the standards can be implemented consistently and uniformly in right spirit.
2. **Changes in Indian regulation** – Current regulations governing the financial regulation would need a complete overhaul to implement the IFRS standards. The Companies Act 1956, SEBI act 1992, IT Act 1962 etc. will have to be amended to bring them in line with IFRS regulations. These legal hurdles are a major constraint in the path of IFRS convergence.
3. **Fair Value system of measurement** – The IFRS considers the fair value system of asset measurement and the Indian GAAP recognizes historical system. This divergence of system would create volatility and subjectivity in financial statements. This would lead to different results for performance & earnings of the Company.
4. **IT systems** – Financial accounting software and tools used for reporting would have to be completely changed resulting in substantial investment in IT infrastructure for Indian Companies. Indian companies are habitually reluctant when any proposal involves cost, time & effort.

5. **Small & Medium businesses** – The SME sector in India is comparatively larger than other Countries. The cost of convergence far outweighs the advantages of convergence for these small businesses. The dearth of resource and skills in financial knowledge adds up to the problem of implementation in this sector. In addition, SME's cannot be ignored, considering the role they play in the Indian economy.

Check Your progress 13

State whether the following statements are True/False:

1. IFRS includes both International Financial Reporting Standards and International Accounting Standards.
2. International Financial Reporting Standards preceded International Accounting Standards
3. The standard-setting structure used by the International Accounting Standards Board is very similar to that used by the Financial Accounting Standards Board.
4. The rules-based standards of IFRS are more detailed than the simpler, principles-based standards of U.S. GAAP.
5. The International Accounting Standards Board issues International Financial Reporting Standards.
6. International Accounting Standards are no longer considered part of IFRS because they have been replaced by International Financial Reporting Standards.

2.8 SUMMARY

Accounting is a fast emerging discipline and its development at the international level also, has generated a lot of interest towards it. This subject has been instrumental in providing a theoretical framework comprising of principles, rules, concepts and guidelines from time to time. These guiding rules or principles require to be widely practiced for bringing the interest from various account professionals contribute towards its development hence the name, Generally Accepted Accounting Principles (GAAP). Various initiatives for a coherent approach across the countries have been endeavoured upon, underlining the need for the accounting subject to support the international businesses.

These accounting principles are constituted with broad guidelines, wide variety of methods and practices, making it easy for wider application and adoption. However, the challenge remains in wide and uniform acceptability amongst the companies. Since the accounting professionals and investors require comparing the various financial reports of different companies, and each following their own set of rules makes the comparison become a tedious task. There is always a risk of under-reporting and concealing of facts and manipulated earnings, when there is no standardization in recording and reporting of these accounting statements. This lames the entire endeavour as the usefulness of the statements to the users. Globally, the standardization of the accounting practices is well recognised with many acclaimed institutions and professional entities are engaged in standardising the accounting practices as a unified movement focussed to bring international consensus. This requires a fact check of presently practiced ways by the accountants and then seeks in the refinement of those worked practices by motivating them to follow the standards (involving ironing their doubts or resistance, if any) thereby building a sound theory of accounting. Indian context has demonstrated significant progress in this direction with the adoption of twenty eight standards for accounting practice. In today's globalized environment, business does not operate in just one country rather they operate around the world. However, it must be emphasized that around the globe, different countries follow different accounting standards. This leads to a need for a global set of standards commonly referred to as 'International Financial Reporting Standards (IFRS)'. IFRS are designed to serve as a common global language of business affairs so that accounts of various companies are understandable and comparable across international boundaries. **Merits of IFRS are as follows**: i) Completeness, ii) Understandability, iii) Reliability, iv) Timeliness, v) Neutrality, vi) Verifiability, vii) Consistency, viii) Comparability and ix) Transparency. **The challenges of IFRS are as follows**: 1. Training & Awareness, 2. Changes in Indian regulation 3. Fair Value system of Measurement 4. IT System 5. Small & Medium businesses

2.9 KEY WORDS

Accounting framework includes generally accepted accounting principles (GAAP) on the basis of which accounting data is processed, analysed, and reported.

Accounting theory is a set of inter-related principles and propositions, which provide a general framework for accounting practice, and deal with new developments in the area.

Accrual concept says that an accountant should recognise incomes and expenses when they have actually accrued, irrespective of whether cash is received or paid.
Consistency concept envisages that accounting information should be prepared on a consistent basis from period to period, and within periods there should be consistent treatment of similar items.

Conservatism concept forbids the inclusion of unrealised gains but advocates provision for possible losses.

Cost Concept states that an asset is to be recorded in books of accounts at a price for, or at a cost incurred to acquire it.

Entity concept separates the business from owner(s), from the standpoint of accounting.

Going concern concept refers to the expectation that the organisation will have an indefinite life. This assumption has an important bearing on how the assets are to be valued.
Materiality concept admonishes that events of relatively small importance need not be given a detailed or theoretically correct treatment. They may be ignored for recording purpose.

Money measurement concept states that all transactions are to be recorded only in monetary terms and record only those transactions, which can be measured in money terms. It ignores intangibles like employee loyalty and customer satisfaction, as they cannot be expressed in money terms. It also assumes records on the basis of a stable monetary unit.

Objectivity principle requires that only the information based on definite and verifiable facts are to be recorded.

Periodicity concept divides the life of a business into smaller time periods which are generally one year, and the accountant is supposed to prepare necessary financial statements for each time period.

IFRS are designed to serve as a common global language of business affairs so that accounts of various companies are understandable and comparable across international boundaries.

2.10 ANSWER TO CHECK YOUR PROGRESS

1. Non-conformance or non-observance of 'separate entity concept' leads to issues in evaluating firm's profitability and ascertaining its financial health. The same problem gets complex when the owner has many operating businesses firms.

2. Owner withdrawing leads to firm's capital reduction unless it leads to anticipated profits. It will not be correct to account such events as operating expense. They also are not entitled for 'deductions from profits' for tax purposes.

3. Yes, because as per the entity concept the business and the proprietor are two separate entities. If the proprietor contributes some amount towards capital, it means that the business has a liability to return it to the proprietor.

4. No, the given concept doesn't factors or allows recording such events as this event's business effect cannot be objectively evaluated.

5. Revaluation doesn't matches to postulates of various accounting concepts like, cost concept, conservatism concept, and continuity concept. For factoring in the 'extraordinary gain' similar to this is generally not seen 'justified'. Still, a considerable difference occurs in historical cost of a fixed asset and its prevailing market value, so it is concluded that accounting profession be validating these revaluations to enable the annual statements like the balance sheet reflect the transparent and authenticated position of firm.

6. As per the cost concept, the company should show the value of machinery in books of accounts at Rs. 40,000 the price, which is being actually paid.

7. It should be taken into account, otherwise profit would get exaggerated.

8. It should be taken into account, otherwise profit be undermined.

9. No. Since the order is not actually obtained, the probable sales revenue could not be recognized as per the conservatism concept.

10. Though the table has a long-term life and as such can be shown as an asset, yet the materiality concept requires it to be treated as an expense.

11. It infringes the consistency concept, until there exists a acceptable and logical cause to shift from the earlier practiced process.
12. 1-c, 2-d, 3-a, 4-b, 5-d
13. i) True, ii) False, iii) True, iv) False, v) True, vi) False

2.11 SELF ASSESSMENT QUESTIONS/EXERCISES

1. Share your understanding on the "role of the Entity accounting concepts" while drafting the financial statements of a firm?

2. Logically comment on your views whether accounting information is able to furnish a transparent presentation about a firm's financial health??

3. Explain whether you came across any conflicts in any of the accounting concepts? Cite references to validate your stand?

4. Can the accounting information support in allocation of resources by the management? Is yes, how?

5. Comment on the need for global standardization of the accounting practices?

6. Mention your learnings on the contribution from India towards standardization of the accounting practices especially the GAAP?

7. What do you mean by Accounting Standards? Explain the need for issuing accounting standards in India.

8. What are the benefits of Accounting Standards and give a list of mandatory Accounting Standards in India.

9. Briefly explain the following:
   i) Conservatism Concept
   ii) Full Disclosure Concept
   iii) Accounting period Concept
   iv) Matching Concept
   v) Dual Aspect Concept
   vi) Cost Concept
   vii) Accrual Concept
   viii) Materiality Concept
   ix) Consistency Concept
   x) Business entity Concept

10. What do you mean by International Financial Reporting Standards (IFRS)? Explain the benefits and challenges of IFRS.

11. Discuss the need of Convergence of IFRS. Explain its benefits.