FINANCIAL ACCOUNTING

UNIT-1

PART-V

Accounting Standards (AS)

Accounting Standards (AS) are basic policy documents. Their main aim is to ensure transparency, reliability, consistency, and comparability of the financial statements. They do so by standardizing accounting policies and principles of a nation/economy. So, the transactions of all companies will be recorded in a similar manner if they follow these accounting standards.

These Accounting Standards (AS) are issued by an accounting body or a regulatory board or sometimes by the government directly. In India, the Indian Accounting Standards are issued by the Institute of Chartered Accountants of India (ICAI).

Accounting Standards mainly deal with four major issues of accounting, namely

- Recognition of financial events
- Measurement of financial transactions
- Presentation of financial statements in a fair manner
- Disclosure requirement of companies to ensure stakeholders are not misinformed
- Browse more Topics under Accounting Standards
- Formulation of Accounting Standards in India
- Objectives of Accounting Standards

Accounting is often considered the language of business, as it communicates to others the financial position of the company. And like every language has certain syntax and grammar rules the same is true here. These rules in the case of accounting are the Accounting Standards (AS). They are the framework of rules and regulations for accounting and reporting in a country. Let us see the main objectives of forming these standards.

The main aim is to improve the reliability of financial statements. Now because the financial statements have to be made following the standards the users can rely on them. They know that not conforming to these standards can have serious consequences for the companies.

DR. PANKAJ KUMAR SHARMA

Then there is comparability. Following these standards will allow for inter-firm and intra-firm comparisons. This allows us to check the progress of the firm and its position in the market.

It also looks to provide one set of accounting policies that include the necessary disclosure requirements and the valuation methods of various financial transactions.

Benefits of Accounting Standards

Accounting Standards are the ruling authority in the world of accounting. It makes sure that the information provided to potential investors is not misleading in any way. Let us take a look at the benefits of AS.

1] Attains Uniformity in Accounting

Accounting Standards provides rules for standard treatment and recording of transactions. They even have a standard format for financial statements. These are steps in achieving uniformity in accounting methods.

2] Improves Reliability of Financial Statements

There are many stakeholders of a company and they rely on the financial statements for their information. Many of these stakeholders base their decisions on the data provided by these financial statements. Then there are also potential investors who make their investment decisions based on such financial statements.

So, it is essential these statements present a true and fair picture of the financial situation of the company. The Accounting Standards (AS) ensure this. They make sure the statements are reliable and trustworthy.

3] Prevents Frauds and Accounting Manipulations

Accounting Standards (AS) lay down the accounting principles and methodologies that all entities must follow. One outcome of this is that the management of an entity cannot manipulate with financial data. Following these standards is not optional, it is compulsory.

So, these standards make it difficult for the management to misrepresent any financial information. It even makes it harder for them to commit any frauds.

4] Assists Auditors

DR. PANKAJ KUMAR SHARMA

Now the accounting standards lay down all the accounting policies, rules, regulations, etc in a written format. These policies have to be followed. So, if an auditor checks that the policies have been correctly followed he can be assured that the financial statements are true and fair.

5] Comparability

This is another major objective of accounting standards. Since all entities of the country follow the same set of standards their financial accounts become comparable to some extent. The users of the financial statements can analyse and compare the financial performances of various companies before taking any decisions.

Also, two statements of the same company from different years can be compared. This will show the growth curve of the company to the users.

6] Determining Managerial Accountability

The accounting standards help measure the performance of the management of an entity. It can help measure the management's ability to increase profitability, maintain the solvency of the firm, and other such important financial duties of the management.

Management also must wisely choose their accounting policies. Constant changes in the accounting policies lead to confusion for the user of these financial statements. Also, the principle of consistency and comparability are lost.

Limitations of Accounting Standards

There are a few limitations of Accounting Standards as well. The regulatory bodies keep updating the standards to restrict these limitations.

1] Difficulty between Choosing Alternatives

There are alternatives for certain accounting treatments or valuations. Like for example, stocks can be valued by LIFO, FIFO, weighted average method, etc. So choosing between these alternatives is a tough decision for the management. The AS does not provide guidelines for the appropriate choice.

2] Restricted Scope

DR. PANKAJ KUMAR SHARMA

Accounting Standards cannot override the laws or the statutes. They have to be framed within the confines of the laws prevailing at the time. That can limit their scope to provide the best policies for the situation.

List of ICAI's Mandatory Accounting Standards (AS 1~29)

To know how many standards are issued by ICAI which are mandatory, please refer the List of Mandatory Accounting Standards of ICAI (as on 1 July 2017 and onwards) as under:

1. AS 1 Disclosure of Accounting Policies: This Standard deals with the disclosure of significant accounting policies which are followed in preparing and presenting financial statements.

2. AS 2 Valuation of Inventories: This Standard deals with the determination of value at which inventories are carried in the financial statements, including the ascertainment of cost of inventories and any write-down thereof to net realisable value.

3. AS 3 Cash Flow Statements: This Standard deals with the provision of information about the historical changes in cash and cash equivalents of an enterprise by means of a Cash Flow Statement which classifies cash flows during the period from operating, investing and financing activities.

4. AS 4 Contingencies and Events Occurring After Balance Sheet Date: This Standard deals with the treatment of contingencies and events occurring after the balance sheet date.

5. AS 5 Net profit or Loss for the period, Prior Period Items and Changes in Accounting Policies: This Standard should be applied by an enterprise in presenting profit or loss from ordinary activities, extraordinary items and prior period items in the Statement of Profit and Loss, in accounting for changes in accounting estimates, and in disclosure of changes in accounting policies.

DR. PANKAJ KUMAR SHARMA

6. AS 7 Construction Contracts: This Standard prescribes the accounting for construction contracts in the financial statements of contractors.

7. AS 9 Revenue Recognition: This Standard deals with the bases for recognition of revenue in the Statement of Profit and Loss of an enterprise. The Standard is concerned with the recognition of revenue arising in the course of the ordinary activities of the enterprise from: a) Sale of goods; b) Rendering of services; and c) Interest, royalties and dividends.

8. AS 10 Property, Plant and Equipment: The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment (PPE).

9. AS 11 The Effects of Changes in Foreign Exchange Rates: AS 11 lays down principles of accounting for foreign currency transactions and foreign operations, i.e., which exchange rate to use and how to recognise in the financial statements the financial effect of changes in exchange rates.

10. AS 12 Government Grants: This Standard deals with accounting for government grants. Government grants are sometimes called by other names such as subsidies, cash incentives, duty drawbacks, etc.

11. AS 13 Accounting for Investments: This Standard deals with accounting for investments in the financial statements of enterprises and related disclosure requirements.

12. AS 14 Accounting for Amalgamations: This Standard deals with accounting for amalgamations and the treatment of any resultant goodwill or reserves.

13. AS 15 Employee Benefits: The objective of this Standard is to prescribe the accounting treatment and disclosure for employee benefits in the books of employer except employee

DR. PANKAJ KUMAR SHARMA

share-based payments. It does not deal with accounting and reporting by employee benefit plans.

14. AS 16 Borrowing Costs: This Standard should be applied in accounting for borrowing costs. This Standard does not deal with the actual or imputed cost of owners' equity, including preference share capital not classified as a liability.

15. AS 17 Segment Reporting: The objective of this Standard is to establish principles for reporting financial information, about the different types of segments/ products and services an enterprise produces and the different geographical areas in which it operates.

16. AS 18 Related Party Disclosures: This Standard should be applied in reporting related party relationships and transactions between a reporting enterprise and its related parties. The requirements of this Standard apply to the financial statements of each reporting enterprise and also to consolidated financial statements presented by a holding company.

17. AS 19 Leases: The objective of this Standard is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosures in relation to finance leases and operating leases.

18. AS 20 Earnings Per Share: AS 20 prescribes principles for the determination and presentation of earnings per share which will improve comparison of performance among different enterprises for the same period and among different accounting periods for the same enterprise.

19. AS 21 Consolidated Financial Statements: The objective of this Standard is to lay down principles and procedures for preparation and presentation of consolidated financial statements. These statements are intended to present financial information about a parent and its

DR. PANKAJ KUMAR SHARMA

subsidiary(ies) as a single economic entity to show the economic resources controlled by the group, obligations of the group and results the group achieves with its resources.

20. AS 22 Accounting for Taxes on Income: The objective of this Standard is to prescribe accounting treatment of taxes on income since the taxable income may be significantly different from the accounting income due to many reasons, posing problems in matching of taxes against revenue for a period.

21. AS 23 Accounting for Investments in Associates: This Standard should be applied in accounting for investments in associates in the preparation and presentation of consolidated Financial Statements (CFS) by an investor.

22. AS 24 Discontinuing Operations: The objective of AS 24 is to establish principles for reporting information about discontinuing operations, thereby enhancing the ability of users of financial statements to make projections of an enterprise's cash flows, earnings generating capacity, and financial position by segregating information about discontinuing operations from information about continuing operations. AS 24 applies to all discontinuing operations of an enterprise.

23. AS 25 Interim Financial Reporting: This Standard applies if an entity is required or elects to publish an interim financial report. The objective of AS 25 is to prescribe the minimum content of an interim financial report and to prescribe the principles for recognition and measurement in complete or condensed financial statements for an interim period.

24. AS 26 Intangible Assets: AS 26 prescribes the accounting treatment for intangible assets (i.e. identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes).

DR. PANKAJ KUMAR SHARMA

25. AS 27 Financial Reporting of Interests in Joint Ventures: The objective of AS 27 is to set out principles and procedures for accounting for interests in joint ventures and reporting of joint venture assets, liabilities, income and expenses in the financial statements of venturers and investors.

26. AS 28 Impairment of Assets: The objective of AS 28 is to prescribe the procedures that an enterprise applies to ensure that its assets are carried at no more than their recoverable amount. The asset is described as impaired if its carrying amount exceeds the amount to be recovered through use or sale of the asset and AS 28 requires the enterprise to recognise an impairment loss in such cases. It should be noted that AS 28 deals with impairment of all assets unless specifically excluded from the scope of the Standard.

27. AS 29 Provisions, Contingent Liabilities and Contingent Assets: The objective of AS 29 is to ensure that appropriate recognition criteria and measurement bases are applied to provisions and contingent liabilities and that sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount. The objective of this Standard is also to lay down appropriate accounting for contingent assets.

Note:

1. ICAI has withdrawn the AS 8 on Accounting for Research and Development.

2. ICAI Amends AS 2, AS 4, AS 10, AS 13, AS 14, AS 21, AS 29 and withdraws AS 6.

3. ICAI withdraws its Announcement on Treatment of exchange differences under AS 11

4. Companies (Accounting Standards) Amendment Rules, 2018 notified by MCA: AS 11 amended

DR. PANKAJ KUMAR SHARMA