ISSUES & IMPORTANCE OF ACCOUNTING STANDARDS IN ACCOUNTING PRACTICES

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INTRODUCTION

Accounting is the art of recording transactions in the best manner possible, so as to enable the reader to arrive at judgments/come to conclusions, and in this regard it is utmost necessary that there are set guidelines. These guidelines are generally called accounting policies. The intricacies of accounting policies permitted Companies to alter their accounting principles for their benefit. This made it impossible to make comparisons. In order to avoid the above and to have a harmonised accounting principle, Standards needed to be set by recognised accounting bodies. This paved the way for Accounting Standards to come into existence.

ACCOUNTING STANDARDS

Accounting Standards are the statements of code of practice of the regulatory accounting bodies that are to be observed in the preparation and presentation of financial statements. In layman terms, accounting standards are the written documents issued by the expert institutes or other regulatory bodies covering various aspects of measurement, treatment, presentation and disclosure of accounting transactions.

Accounting Standards in India are issued By the Institute of Chartered Accountants of India (ICAI). At present there are 32 Accounting Standards issued by ICAI.

ISSUE OF ACCOUNTING STANDARDS

The Institute of Chartered Accountants of India (ICAI) recognizing the need to harmonize the diverse accounting policies and practices at present in use in India constituted Accounting Standards Board (ASB) on April 21, 1977. The main role of ASB is to formulate Accounting Standards from time to time.

Accounting Standards Issued by the Institute of Chartered Accountants of India are as below:

- Disclosure of accounting policies
- Valuation Of Inventories
- Cash Flow Statements
Contingencies and events occurring after the Balance sheet Date

Net Profit or loss for the period, Prior period items and Changes in accounting Policies.

Depreciation accounting.

Construction Contracts

Revenue Recognition

Accounting for Fixed Assets

The Effect of Changes in Foreign Exchange Rates

Accounting for Government Grants

Accounting for Investments

Accounting for Amalgamation

Employee Benefits

Borrowing Cost

Segment Reporting

Related Party Disclosures

Accounting for Leases

Earning Per Share

Consolidated Financial Statement

Accounting for Taxes on Income

Accounting for Investment in associates in Consolidated Financial Statement

Discontinuing Operation

Interim Financial Reporting

Intangible Assets

Financial Reporting on Interest in Joint Ventures

Impairment of assets
DISCLOSURE OF ACCOUNTING POLICIES: Accounting Policies refer to specific accounting principles and the method of applying those principles adopted by the enterprises in preparation and presentation of the financial statements.

VALUATION OF INVENTORIES: The objective of this standard is to formulate the method of computation of cost of inventories / stock, determine the value of closing stock / inventory at which the inventory is to be shown in balance sheet till it is not sold and recognized as revenue.

CASH FLOW STATEMENTS: Cash flow statement is additional information to user of financial statement. This statement exhibits the flow of incoming and outgoing cash. This statement assesses the ability of the enterprise to generate cash and to utilize the cash. This statement is one of the tools for assessing the liquidity and solvency of the enterprise.

CONTIGENCIES AND EVENTS OCCURRING AFTER THE BALANCE SHEET DATE: In preparing financial statement of a particular enterprise, accounting is done by following accrual basis of accounting and prudent accounting policies to calculate the profit or loss for the year and to recognize assets and liabilities in balance sheet. While following the prudent accounting policies, the provision is made for all known liabilities and losses even for those liabilities / events, which are probable. Professional judgement is required to classify the likelihood of the future events occurring and, therefore, the question of contingencies and their accounting arises.

Objective of this standard is to prescribe the accounting of contingencies and the events, which take place after the balance sheet date but before approval of balance sheet by Board of Directors. The Accounting Standard deals with Contingencies and Events occurring after the balance sheet date.

NET PROFIT OR LOSS FOR THE PERIOD, PRIOR PERIOD ITEMS AND CHANGE IN ACCOUNTING POLICIES: The objective of this accounting standard is to prescribe the criteria for certain items in the profit and loss account so that comparability of the financial statement can be enhanced. Profit and loss account being a period statement covers the items of the income and expenditure of the particular period. This accounting standard also deals with change in accounting policy, accounting estimates and extraordinary items.

DEPRECIATION ACCOUNTING: It is a measure of wearing out, consumption or other loss of value of a depreciable asset arising from use, passage of time. Depreciation is nothing but distribution of total cost of asset over its useful life.
CONSTRUCTION CONTRACTS: Accounting for long term construction contracts involves question as to when revenue should be recognized and how to measure the revenue in the books of contractor. As the period of construction contract is long, work of construction starts in one year and is completed in another year or after 4-5 years or so. Therefore question arises how the profit or loss of construction contract by contractor should be determined. There may be following two ways to determine profit or loss: On year-to-year basis based on percentage of completion or On completion of the contract.

REVENUE RECOGNITION: The standard explains as to when the revenue should be recognized in profit and loss account and also states the circumstances in which revenue recognition can be postponed. Revenue means gross inflow of cash, receivable or other consideration arising in the course of ordinary activities of an enterprise such as:- The sale of goods, Rendering of Services, and Use of enterprises resources by other yielding interest, dividend and royalties. In other words, revenue is a charge made to customers / clients for goods supplied and services rendered.

ACCOUNTING FOR FIXED ASSETS: It is an asset, which is:- Held with intention of being used for the purpose of producing or providing goods and services. Not held for sale in the normal course of business. Expected to be used for more than one accounting period.

THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES: Effect of Changes in Foreign Exchange Rate shall be applicable in Respect of Accounting Period commencing on or after 01-04-2004 and is mandatory in nature. This accounting Standard applicable to accounting for transaction in Foreign currencies in translating in the Financial Statement Of foreign operation Integral as well as non-integral and also accounting for Forward exchange. Effect of Changes in Foreign Exchange Rate, an enterprises should disclose following aspects:

- Amount Exchange Difference included in Net profit or Loss;
- Amount accumulated in foreign exchange translation reserve;
- Reconciliation of opening and closing balance of Foreign Exchange translation reserve;

ACCOUNTING FOR GOVERNMENT GRANTS: Government Grants are assistance by the Govt. in the form of cash or kind to an enterprise in return for past or future compliance with certain conditions. Government assistance, which cannot be valued reasonably, is excluded from Govt. grants,. Those transactions with Government, which cannot be distinguished from the normal trading transactions of the enterprise, are not considered as Government grants.

ACCOUNTING FOR INVESTMENTS: It is the assets held for earning income by way of dividend, interest and rentals, for capital appreciation or for other benefits.

ACCOUNTING FOR AMALGAMATION: This accounting standard deals with accounting to be made in books of Transferee company in case of amalgamation. This accounting standard is not applicable to cases of acquisition of shares when one company acquires / purchases the share of another company and the acquired company is not dissolved and its separate entity continues.
to exist. The standard is applicable when acquired company is dissolved and separate entity ceased exist and purchasing company continues with the business of acquired company.

EMPLOYEE BENEFITS: Accounting Standard has been revised by ICAI and is applicable in respect of accounting periods commencing on or after 1st April 2006. The scope of the accounting standard has been enlarged, to include accounting for short-term employee benefits and termination benefits.

BORROWING COSTS: Enterprises are borrowing the funds to acquire, build and install the fixed assets and other assets; these assets take time to make them useable or saleable, therefore the enterprises incur the interest (cost on borrowing) to acquire and build these assets. The objective of the Accounting Standard is to prescribe the treatment of borrowing cost (interest + other cost) in accounting, whether the cost of borrowing should be included in the cost of assets or not.

SEGMENT REPORTING: An enterprise needs in multiple products/services and operates in different geographical areas. Multiple products/services and their operations in different geographical areas are exposed to different risks and returns. Information about multiple products/services and their operations in different geographical areas are called segment information. Such information is used to assess the risk and return in different geographical areas. Disclosure of such information is called segment reporting.

RELATED PARTY DISCLOSURE: Sometimes business transactions between related parties lose the feature and character of the arms length transactions. Related party relationship affects the volume and decision of business of one enterprise for the benefit of the other enterprise. Hence disclosure of related party transaction is essential for proper understanding of financial performance and financial position of enterprise.

ACCOUNTING FOR LEASES: Lease is an arrangement by which the lesser gives the right to use an asset for a given period of time to the lessee on rent. It involves two parties, a lessor and a lessee and an asset which is to be leased. The lessor who owns the asset agrees to allow the lessee to use it for a specified period of time in return of periodic rent payments.

EARNING PER SHARE: Earning per share (EPS) is a financial ratio that gives the information regarding earning available to each equity share. It is very important financial ratio for assessing the state of market price of share. This accounting standard gives computational methodology for the determination and presentation of earning per share, which will improve the comparison of EPS. The statement is applicable to the enterprise whose equity shares or potential equity shares are listed in stock exchange.

CONSOLIDATED FINANCIAL STATEMENTS: The objective of this statement is to present financial statements of a parent and its subsidiary (ies) as a single economic entity. In other words the holding company and its subsidiary (ies) are treated as one entity for the preparation of these consolidated financial statements. Consolidated profit/loss account and consolidated balance sheet are prepared for disclosing the total profit/loss of the group and total
assets and liabilities of the group. As per this accounting standard, the consolidated balance sheet if prepared should be prepared in the manner prescribed by this statement.

ACCOUNTING FOR TAXES ON INCOME: This accounting standard prescribes the accounting treatment for taxes on income. Traditionally, amount of tax payable is determined on the profit/loss computed as per income tax laws. According to this accounting standard, tax on income is determined on the principle of accrual concept. According to this concept, tax should be accounted in the period in which corresponding revenue and expenses are accounted. In simple words tax shall be accounted on accrual basis; not on liability to pay basis.

ACCOUNTING FOR INVESTMENTS IN ASSOCIATES IN CONSOLIDATED FINANCIAL STATEMENTS: The accounting standard was formulated with the objective to set out the principles and procedures for recognizing the investment in associates in the consolidated financial statements of the investor, so that the effect of investment in associates on the financial position of the group is indicated.

DISCONTINUING OPERATIONS: The objective of this standard is to establish principles for reporting information about discontinuing operations. This standard covers "discontinuing operations" rather than "discontinued operation". The focus of the disclosure of the Information is about the operations which the enterprise plans to discontinue rather than disclosing on the operations which are already discontinued. However, the disclosure about discontinued operation is also covered by this standard.

INTERIM FINANCIAL REPORTING (IFR): Interim financial reporting is the reporting for periods of less than a year generally for a period of 3 months. As per clause 41 of listing agreement the companies are required to publish the financial results on a quarterly basis.

INTANGIBLE ASSETS: An Intangible Asset is an Identifiable non-monetary Asset without physical substance held for use in the production or supplying of goods or services for rentals to others or for administrative purpose.

FINANCIAL REPORTING OF INTEREST IN JOINT VENTURES: Joint Venture is defined as a contractual arrangement whereby two or more parties carry on an economic activity under 'joint control'. Control is the power to govern the financial and operating policies of an economic activity so as to obtain benefit from it. 'Joint control' is the contractually agreed sharing of control over economic activity.

IMPAIRMENT OF ASSETS: The dictionary meaning of 'impairment of asset' is weakening in value of asset. In other words when the value of asset decreases, it may be called impairment of an asset. As per AS-28 asset is said to be impaired when carrying amount of asset is more than its recoverable amount.

PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS: Objective of this standard is to prescribe the accounting for Provisions, Contingent Liabilities, Contingent Assets, Provision for restructuring cost.
Provision: It is a liability, which can be measured only by using a substantial degree of estimation.

LIABILITY: A liability is present obligation of the enterprise arising from past events the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

FINANCIAL INSTRUMENT: Recognition and Measurement, issued by The Council of the Institute of Chartered Accountants of India, comes into effect in respect of Accounting periods commencing on or after 1-4-2009 and will be recommendatory in nature for an initial period of two years. This Accounting Standard will become mandatory in respect of Accounting periods commencing on or after 1-4-2011 for all commercial, industrial and business Entities except to a Small and Medium-sized Entity. The objective of this Standard is to establish principles for recognizing and measuring Financial assets, financial liabilities and some contracts to buy or sell non-financial items. Requirements for presenting information about financial instruments are in Accounting Standard.

FINANCIAL INSTRUMENT: PRESENTATION: The objective of this Standard is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset. The principles in this Standard complement the principles for recognising and measuring financial assets and financial liabilities in Accounting Standard Financial Instruments:

FINANCIAL INSTRUMENTS, DISCLOSURES AND LIMITED REVISION TO ACCOUNTING STANDARDS: The objective of this Standard is to require entities to provide disclosures in their financial statements that enable users to evaluate:

- the significance of financial instruments for the entity’s financial position and performance; and
- the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the reporting date, and how the entity manages those risks.

IMPLEMENTATION OF ACCOUNTING STANDARDS

LEVEL I COMPANY

Enterprises, which fall in any one or more of the following categories, at any time during the accounting period, are classified as Level I enterprises:

i) Enterprises whose equity or debt securities are listed whether in India or outside India.
ii) Enterprises, which are in the process of listing their equity or debt securities as evidenced by the board of directors’ resolution in this regard.

iii) Banks including co-operative banks.

iv) Financial Institutions

v) Enterprises carrying on insurance business.

vi) All commercial, industrial and business reporting enterprises, whose turnover for the immediately preceding accounting period on the basis of audited financial statements exceeds Rs. 500 million. Turnover does not include ‘other income’.

vii) All commercial, industrial and business reporting enterprises having borrowings, including public deposits, in excess of Rs. 100 million at any time during the accounting period.

viii) Holding and subsidiary enterprises of any one of the above at any time during the accounting period.

LEVEL II COMPANY

Enterprises, which are, not Level I enterprises but fall in any one or more of the following categories are classified as Level II enterprises;

i) All commercial, industrial and business reporting enterprises, whose turnover for the immediately preceding accounting period on the basis of audited financial statements exceeds Rs. 4 million, but does not exceed Rs. 500 million. Turnover does not include ‘other income’.

ii) All commercial, industrial and business reporting enterprises having borrowings, including public deposits, in excess of Rs. 10 million but not in excess of Rs. 100 million at any time during the accounting period.

iii) Holding and subsidiary enterprises of any one of the above at any time during the accounting period.

LEVEL III COMPANY

Enterprises, which are not covered under Level I and Level II are considered as Level III enterprises.

APPLICABILITY

Level II and Level III enterprises are considered as SMEs

Level I enterprises are required to comply fully with all the accounting standards.
INTERNATIONAL HARMONISATION OF ACCOUNTING STANDARDS

Recognising the need for international harmonisation of accounting standards, in 1973, the International Accounting Standards Committee (IASC) was established. It may be mentioned here that the IASC has been reconstituted as the International Accounting Standards Board (IASB). The objectives of IASC included promotion of the International Accounting Standards for worldwide acceptance and observance so that the accounting standards in different countries are harmonised. In recent years, need for international harmonisation of Accounting Standards followed in different countries has grown considerably as the cross-border transfers of capital are becoming increasingly common.

ACCOUNTING STANDARDS-SETTING PROCESS

The accounting standard setting, by its very nature, involves reaching an optimal balance of the requirements of financial information for various interest-groups having a stake in financial reporting. With a view to reach consensus, to the extent possible, as to the requirements of the relevant interest-groups and thereby bringing about general acceptance of the Accounting Standards among such groups, considerable research, consultations and discussions with the representatives of the relevant interest-groups at different stages of standard formulation becomes necessary. The standard-setting procedure of the ASB, as briefly outlined below, is designed in such a way so as to ensure such consultation and discussions:

- Identification of the broad areas by the ASB for formulating the Accounting Standards.
- Constitution of the study groups by the ASB for preparing the preliminary drafts of the proposed Accounting Standards.
- Consideration of the preliminary draft prepared by the study group by the ASB and revision, if any, of the draft on the basis of deliberations at the ASB.
- Circulation of the draft, so revised, among the Council members of the ICAI and 12 specified outside bodies such as Standing Conference of Public Enterprises (SCOPE), Indian Banks’ Association, Confederation of Indian Industry (CII), Securities and Exchange Board of India (SEBI), Comptroller and Auditor General of India (C& AG), and Department of Company Affairs, for comments.
- Meeting with the representatives of specified outside bodies to ascertain their views on the draft of the proposed Accounting Standard.
- Finalisation of the Exposure Draft of the proposed Accounting Standard on the basis of comments received and discussion with the representatives of specified outside bodies.
- Issuance of the Exposure Draft inviting public comments.
• Consideration of the comments received on the Exposure Draft and finalisation of the draft Accounting Standard by the ASB for submission to the Council of the ICAI for its consideration and approval for issuance.

• Consideration of the draft Accounting Standard by the Council of the Institute, and if found necessary, modification of the draft in consultation with the ASB.

• The Accounting Standard, so finalised, is issued under the authority of the Council.

RATIONALE OF ACCOUNTING STANDARDS

Accounting Standards are formulated with a view to harmonise different accounting policies and practices in use in a country. The objective of Accounting Standards is, therefore, to reduce the accounting alternatives in the preparation of financial statements within the bounds of rationality, thereby ensuring comparability of financial statements of different enterprises with a view to provide meaningful information to various users of financial statements to enable them to make informed economic decisions.

The Companies Act, 1956, as well as many other statutes in India require that the financial statements of an enterprise should give a true and fair view of its financial position and working results. This requirement is implicit even in the absence of a specific statutory provision to this effect. The Accounting Standards are issued with a view to describe the accounting principles and the methods of applying these principles in the preparation and presentation of financial statements so that they give a true and fair view. The Accounting Standards not only prescribe appropriate accounting treatment of complex business transactions but also foster greater transparency and market discipline. Accounting Standards also helps the regulatory agencies in benchmarking the accounting accuracy.

COMPLIANCE WITH ACCOUNTING STANDARDS

Accounting Standards issued by the ICAI have legal recognition through the Companies Act, 1956, whereby every company is required to comply with the Accounting Standards and the statutory auditors of every company are required to report whether the Accounting Standards have been complied with or not. Also, the Insurance Regulatory and Development Authority (IRDA) (Preparation of Financial Statements and Auditor’s Report of Insurance Companies) Regulations, 2000 requires insurance companies to follow the Accounting Standards issued by the ICAI. The Securities and Exchange Board of India (SEBI) and the Reserve Bank of India also require compliance with the Accounting Standards issued by the ICAI from time to time.

Section 211 of the Companies Act, 1956, deals with the form and contents of balance sheet and profit and loss account. The Companies (Amendment) Act, 1999 has inserted new sub-sections 3A, 3B and 3C to Section 211, with a view to ensure that the financial statements are prepared in accordance with the Accounting Standards. The new sub-sections as inserted are reproduced below:

Section 211 (3A): ‘ Every profit and loss account and balance sheet of the company shall comply
with the accounting standards’

Section 211 (3B): ‘Where the profit and loss account and the balance sheet of the company do not comply with the accounting standards, such companies shall disclose in its profit and loss account and balance sheet, the following, namely:

a) the deviation from the accounting standards;

b) the reasons for such deviation; and

c) the financial effect, if any, arising due to such deviation.

CHALLENGES

Accounting Standards are the policy documents (authoritative statements of best accounting practice) issued by recognized expert accountancy bodies relating to various aspects of measurement, treatment and disclosure of accounting transactions and events. As relate to the codification of Generally Accepted Accounting Principles (GAAP). These are stated to be norms of accounting policies and practices by way of codes or guidelines to direct as to how the items, which go to make up the financial statements should be dealt with in accounts and presented in the annual accounts. The aim of setting standards is to bring about uniformity in financial reporting and to ensure consistency and comparability in the data published by enterprises. This in result enhance value of the enterprise as stakeholders & users of Financial Statement can take appropriate decision & view about affairs of the enterprise. In modern business context, Accounting Standard & Good Corporate Governance practice has gained more importance than ever. It brings synergy, as managers are motivated to practice better corporate governance linking it with remuneration of managers. Due to invasion technology, political compulsion & increased social expectation globe is a small village for business enterprise. In the circumstances, implementing universal Accounting Standard & Corporate Governance has brought new challenges in place.

CONCLUSION

The companies have shown high degree of compliance with disclosure requirements of Accounting Standards, irrespective of size, profitability, leverage and age.

REFERENCES

- www.iasb.org
- www.icai.org