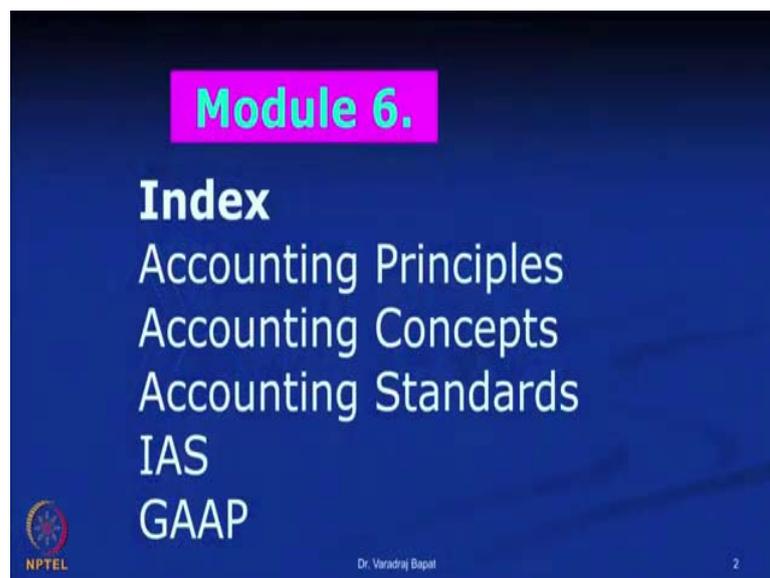


Financial Accounting
Prof. Varadraj Bapat
School of Management
Indian Institute of Technology, Bombay

Lecture – 22
Accounting Standards and Principles

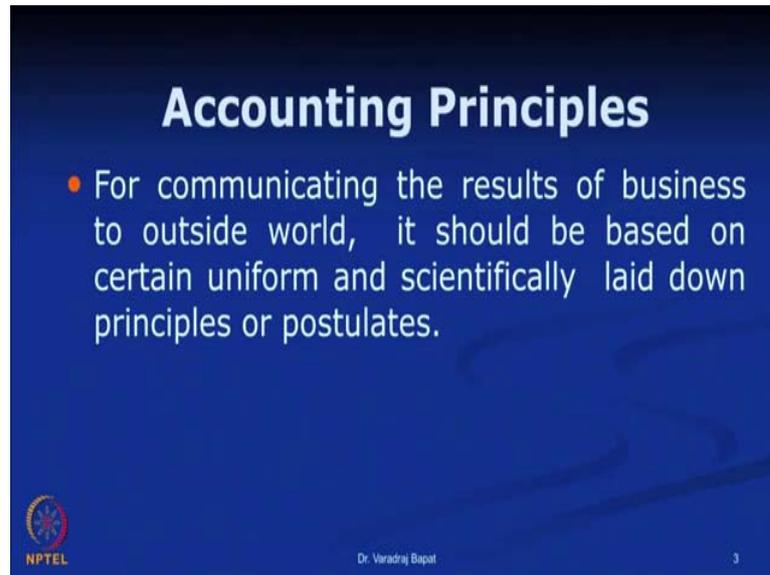
Namaste. In our last module, we had discussed corporate governance. Today we are going to discuss about very important concept of Accounting Principles, Accounting Standards, IAS, GAAP and so on. Now you have learnt already learnt what are the financial statements. Now we are going to look into the assumptions which go into preparation of these statements.

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So, this will be discussed in the current session: Accounting Principles, Concepts, Standards, IAS and GAAP.

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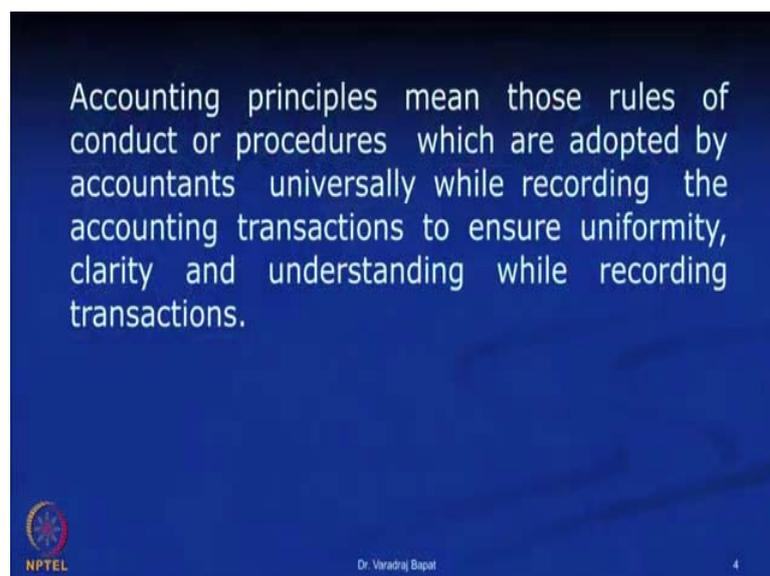
Accounting Principles

- For communicating the results of business to outside world, it should be based on certain uniform and scientifically laid down principles or postulates.

NPTEL Dr. Varadraj Bapat 3

First the accounting principles: now we know that accounting seeks to disseminate information. We record transactions, prepare statements and they are provided to the users. It is very much necessary that such communication is based on certain uniform and scientifically laid down principles; so that it is understood by everybody in the same sense.

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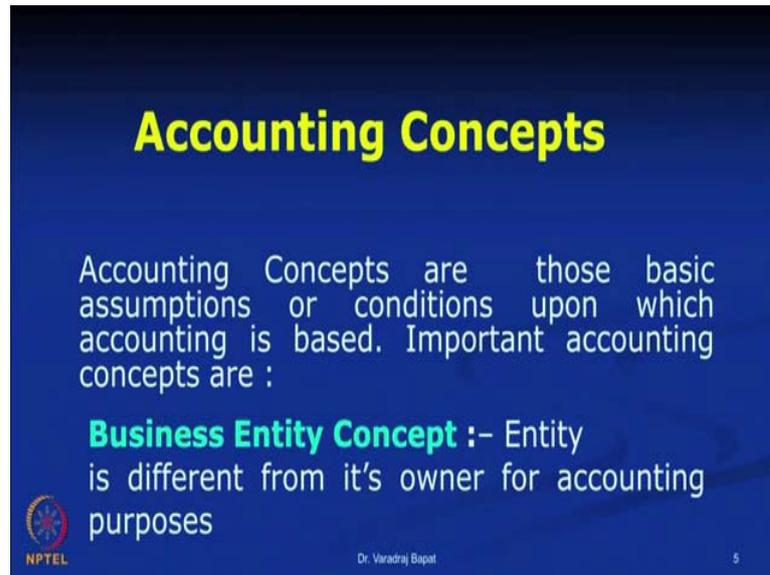


Accounting principles mean those rules of conduct or procedures which are adopted by accountants universally while recording the accounting transactions to ensure uniformity, clarity and understanding while recording transactions.

NPTEL Dr. Varadraj Bapat 4

Now, accounting principle means those rules of conduct or procedures which are adopted by accountants universally for both recording as well as for disseminating.

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Accounting Concepts

Accounting Concepts are those basic assumptions or conditions upon which accounting is based. Important accounting concepts are :

Business Entity Concept :- Entity is different from it's owner for accounting purposes

NPTEL Dr. Varadraj Bapat 5

Now, these are the important accounting concepts. Now these are the basic assumptions or conditions upon which the accounting is based. The first one is business entity concept. Now many times for a proprietary concern, the owner and the business look together for the outsider they appear as one thing, but in accounting we always keep in mind that owner is separate from the entity and the accounts are being prepared for a particular entity.

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Dual Aspect Concept :- Recording simultaneously debits credits
 $Equity + Liabilities = Assets$

Cost Concept :- Assets are normally recorded basis of historical cost i.e. acquisition cost. Market value is immaterial, except on concepts of revaluation.

NPTEL Dr. Varadraj Bapat 6

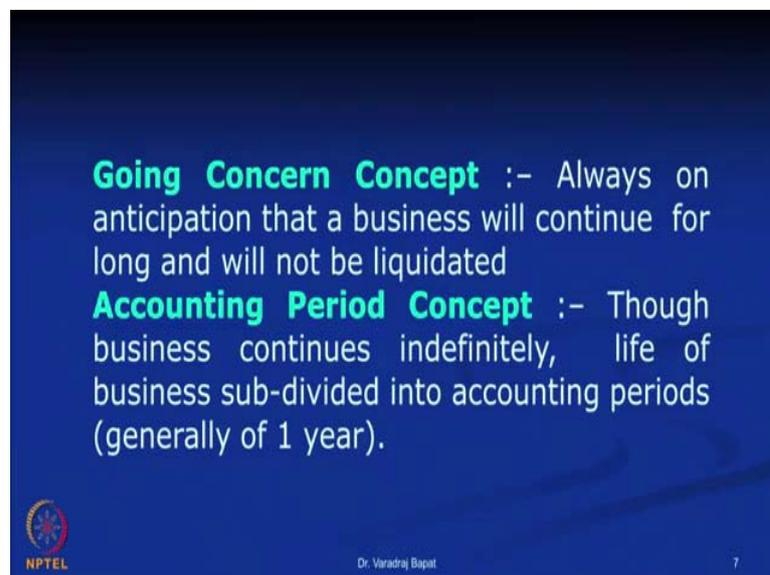
Next is dual aspect. We know that for every transaction there are two effects. Sometimes those are called as debit or credit because of two effects the balance sheet always tally.

We have already seen the balance sheet equation that

Equities + Liabilities = Assets.

The next one is known as cost concept. Now assets are normally to be recorded that historical cost that is at the acquisition cost. We ignore market value unless there is some specific condition for taking it into account otherwise both the asset valuation as well as recording of expenses happen on actual cost.

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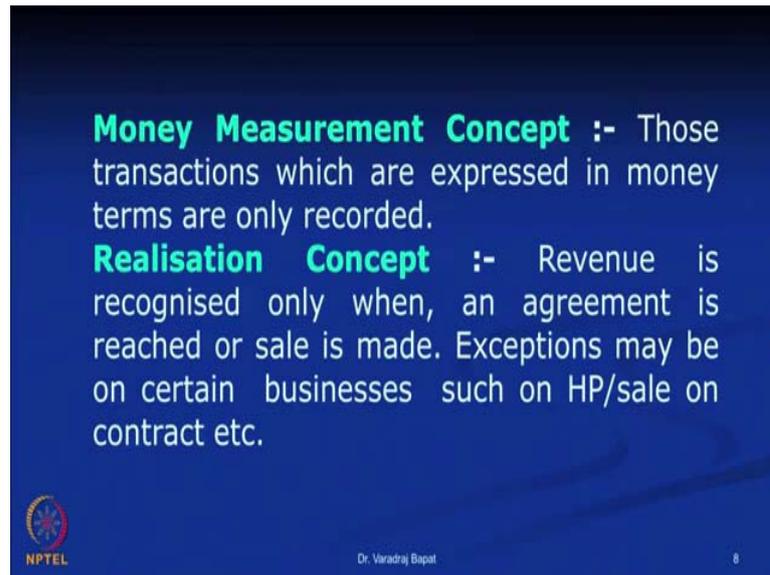


Going concern: this is a very important assumption that it is anticipated that business will continue for long foreseeable future and is not likely to be liquidated in a short period. The accounting is always done with the assumption of continuity of the business concern.

Next one is accounting period concept. We all know that the business is a continuous process. It keeps on happening transactions keep on coming, but as far as the accounting is concerned, the whole of business life is divided into certain periods which are known as accounting periods. Normally there is a 1 year accounting period. Within 1 year, you can have a quarter or a month, but we cannot have some system where accounts are not closed at any point of time.

Normally in India the, are you aware of the accounting period in India? Normally it is from first April to thirty first March. So, at the end of every thirty first March, profit and loss and balance sheet and cash flow and all other statements are prepared books are considered to be closed and then the new books are opened from first April or from the first day of the next financial year that is as per accounting period concept.

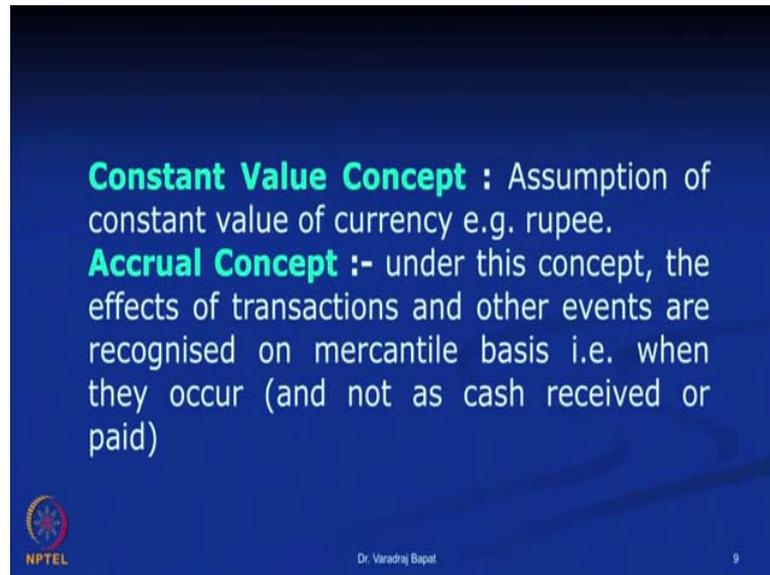
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Next one is money measurement concept. Now, all transactions which are expressed in money terms alone are recorded. There could be some other transactions like good will or like good contacts or relations which or emotions which cannot be measured in money and such things cannot be recorded in accounting.

Next is realisation concept. Now revenue is recognized only when, a particular agreement is reached. So, only in case of realization of a transaction, the transaction is recorded.

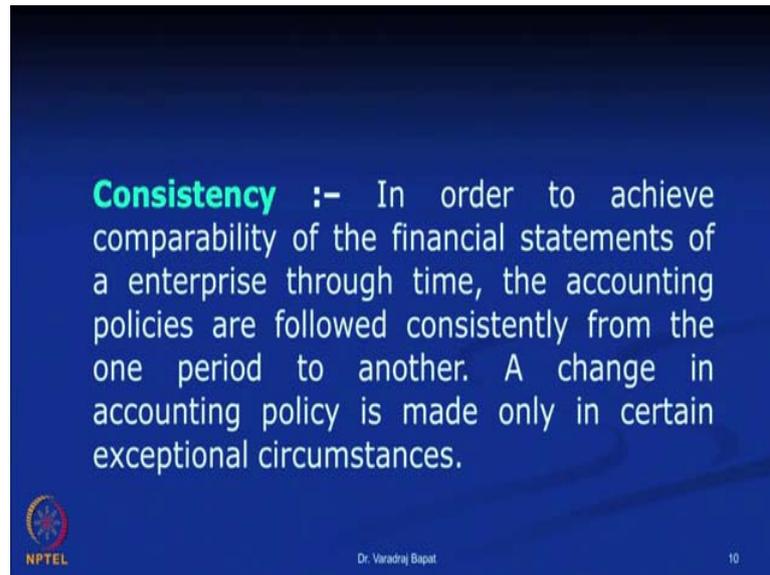
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Constant Value Concept: so, there is an assumption of constant value of currency; for example, rupee. We do not assume that the value of rupee though is changing vis-a-vis the foreign currency we do not record the changes in the value of currency. The value of currency also changes because of inflation, but those are not the business transactions. We record the transaction only when some transactions happens with third party, otherwise the value of currency is considered to be constant.

Next is Accrual Concept. This is one very important concept because transactions may happen, but payment may not come. So, receipt of cash or payment of cash could be delayed or it could be advanced, but the transaction date is a date when the agreement or a particular contract is reached. This is called as a accrual Concept. So, transactions are recorded as and when they accrue or as and when they occur; not as and when the cash is received or paid.

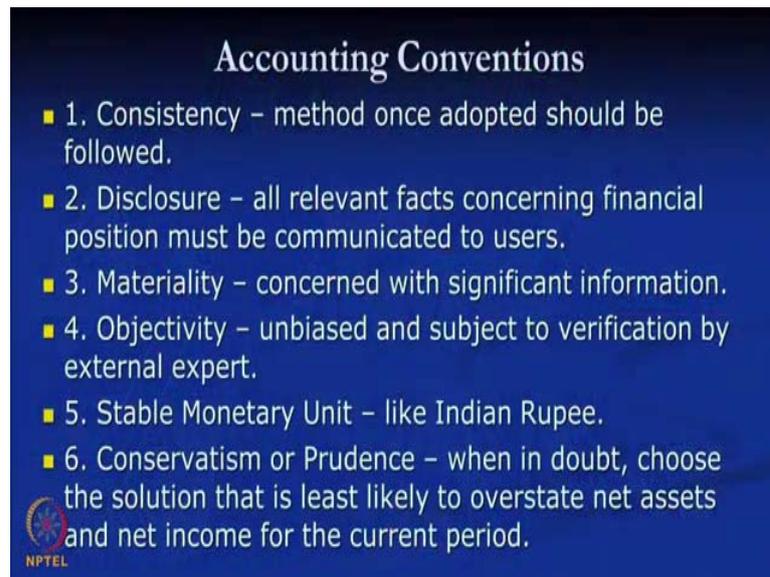
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The next one is Consistency. Now the accounting policies or assumptions are the base for making the entries or for preparation of statements. Now once you decided to use a particular assumption or use a particular accounting concept that should not be changed from period to period because accounting statements should be comparable from different period.

Now, in order to achieve the comparability, it is necessary that the accounting principles and policies are followed from one period to another in a consistent manner. If for some special reason, the change in the accounting policy is necessary; it needs to be separately disclosed and the effect of such changes also required to be disclosed.

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Accounting Conventions

- 1. Consistency – method once adopted should be followed.
- 2. Disclosure – all relevant facts concerning financial position must be communicated to users.
- 3. Materiality – concerned with significant information.
- 4. Objectivity – unbiased and subject to verification by external expert.
- 5. Stable Monetary Unit – like Indian Rupee.
- 6. Conservatism or Prudence – when in doubt, choose the solution that is least likely to overstate net assets and net income for the current period.

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Now, here the accounting conventions are given in short. One of the convention, we have already seen that is known as consistency. That method or a principle once adopted should be followed for a longer period of time. Disclosure – all relevant information and fact concerning the financial position must be made available to the users, it should be communicated, it should be disclosed properly. Materiality – many times some transactions are too small, they are insignificant. It is necessary that significant information is shared, it is recorded that is why materiality of transaction is also taken into account.

Objectivity- now, whenever a particular choice is to be made or whenever a particular assumption is to be chosen, unbiased and objective view is to be taken. Next is Stable Monetary Unit. We have already seen it like the way we have Indian rupee or whatever currency we are recording it is considered to be of a stable value. The last one is very important Conservatism or Prudence. We have discussed it earlier also that if there are two choices either you can use valuation method a or b, use that method which shows lower value because accountants avoid any overstatement of income or overstatement of asset, we go for a more conservative approach or a prudent approach where the value recorded is as low as possible and not on a higher side.

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Fundamental Accounting Assumptions as per AS1 are:

Going Concern, Consistency, and Accrual

If nothing has been mentioned about fundamental accounting assumptions in the financial statements then it is

NPTEL Dr. Varadraj Bapat 12

As per AS1, AS1 refers to Accounting Standard 1. There are three assumptions which are considered as fundamental accounting assumptions which is going concern, consistency and accrual. Now it is always assumed that any accounting statements which are prepared are on the basis of these three assumptions. That is why they are called as Fundamental Accounting Assumption.

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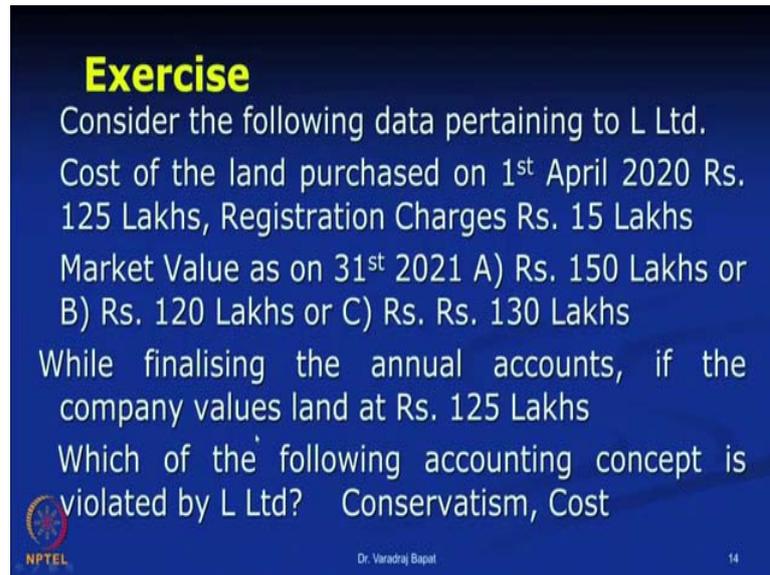
assumed that they have already been followed in the preparation of financial statements.

However, if any of the above mentioned fundamental accounting assumption is not followed then this fact should be disclosed.

NPTEL Dr. Varadraj Bapat 13

If these any of this assumption is not true it is required to be disclosed, but there is no need to disclose these three because it is assumed that they are always followed.

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Exercise

Consider the following data pertaining to L Ltd.
Cost of the land purchased on 1st April 2020 Rs. 125 Lakhs, Registration Charges Rs. 15 Lakhs
Market Value as on 31st 2021 A) Rs. 150 Lakhs or B) Rs. 120 Lakhs or C) Rs. Rs. 130 Lakhs
While finalising the annual accounts, if the company values land at Rs. 125 Lakhs
Which of the following accounting concept is violated by L Ltd? Conservatism, Cost

NPTEL Dr. Varadraj Banpat 14

Now, a very small exercise; now consider the following data pertaining to L limited. The cost of land purchased on first April 2020 is 125 lakhs and registration charges are 15 lakhs.

Now, there are three possible market values as on thirty first March, 2021 that is the year ending on March thirty first 2021. Rs.150 Lakhs is a value possibility A or B 120 Lakhs or C 130 Lakhs. Now what company did was while finalizing the annual accounts, it has considered the value of land as 125 Lakhs. Now is it correct? What will be the value in your opinion in each of the scenario A, B and C and which of the accounting assumption is violated by company L? Just think over.

Now, if you take scenario A where the market value is 150, how much is a cost of land? Will we consider 125 or we will add registration charges also? We are not going for cost of purchase, we call it cost of acquisition which includes cost of purchase plus any incidental expense one time expenses like registration fee. So, 125 plus 15, the cost of land to the company is 140. In scenario A, the market value is 150. So, what should we consider as a cost as a value in the balance sheet?

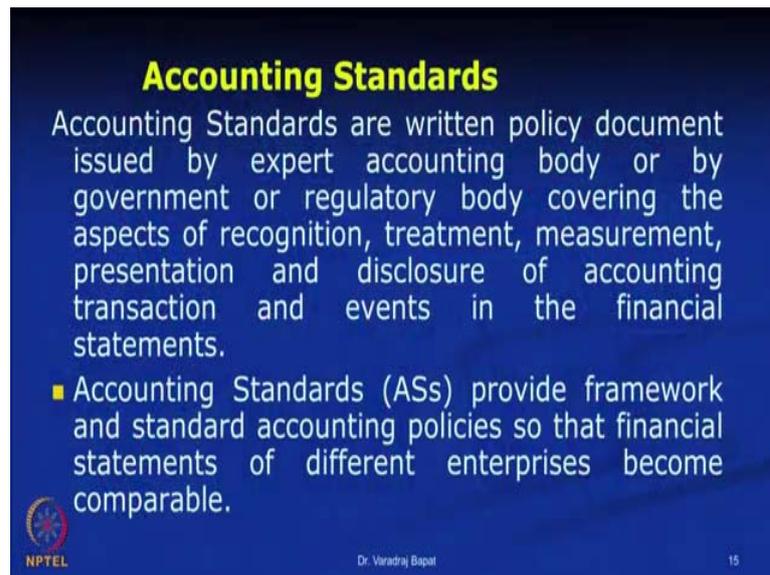
We take lower of the 2, 140 or 150. So, in scenario A, the valuation will be made at 140 Lakhs. Now company has made it at 125. So, they have violated a principle called as cost principle or cost concept because the cost of acquisition of land is 140, they have

wrongly calculated it as 125. Got it? Now in scenario B; in scenario b, the cost remains same which is 140, the market value has gone down it is only 120.

So, what should we consider it as? Should they value at 140 or they should value at 120? This is not stock. If it is a stock or inventory, we take cost or market value whichever is less that is 140 or 120 we would have taken 120, but this is a land. So, it is a long term asset. So, we will not go by the market value, we will still value it at 140.

In case of B or in case of C any of the cases, we will value it at 140 and the concept which the company has violated is Cost Concept. They are not violated conservatism concept. Are you getting? If they happen to value it at 150, they would violate Conservatism Concept because land is a fixed asset it should always be recorded at cost when we say cost at the acquisition costs. Are you getting? Ok.

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Accounting Standards

Accounting Standards are written policy document issued by expert accounting body or by government or regulatory body covering the aspects of recognition, treatment, measurement, presentation and disclosure of accounting transaction and events in the financial statements.

- Accounting Standards (ASs) provide framework and standard accounting policies so that financial statements of different enterprises become comparable.

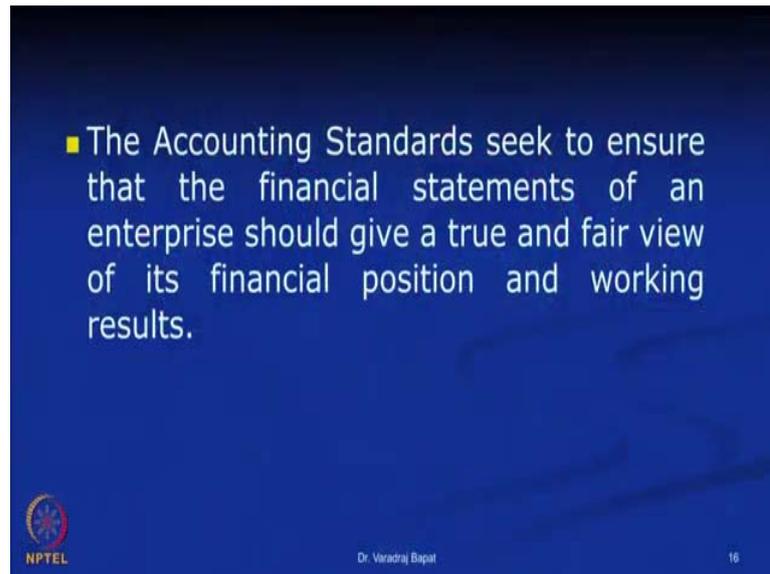
NPTEL Dr. Varadraj Bapat 15

Now, go to let us go to accounting standards. Now accounting policies and principles are used for a very long period of time perhaps for hundreds of years and different countries and different areas have different accounting standard policies. Although most of the policies are common, there are different conventions in different areas. Now to standardize these policies accounting standards were introduced. So, these are written policy documents which are issued by some expert accounting body or by regulatory body or by government. And they give certain guidelines about recognition, treatment, measurement, presentation, disclosure and so on. And they are standardized that is why

they are called standard and they should be uniformly followed within that territory maybe that country or that region or so on.

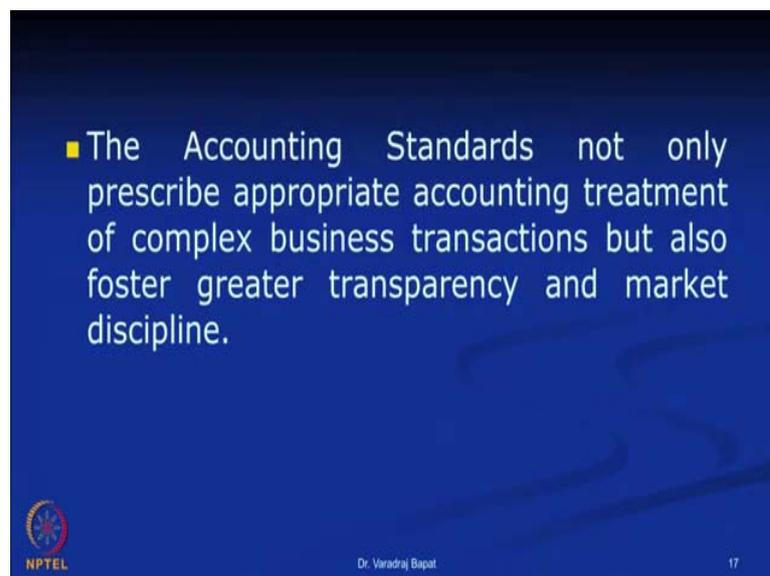
Now accounting standards provide framework and standard policies so that if you compare the financial statements of different entities, they are very much comparable.

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Now, Accounting Standards seek to ensure that financial statements of an enterprise give a true and fair view of its financial position and working results.

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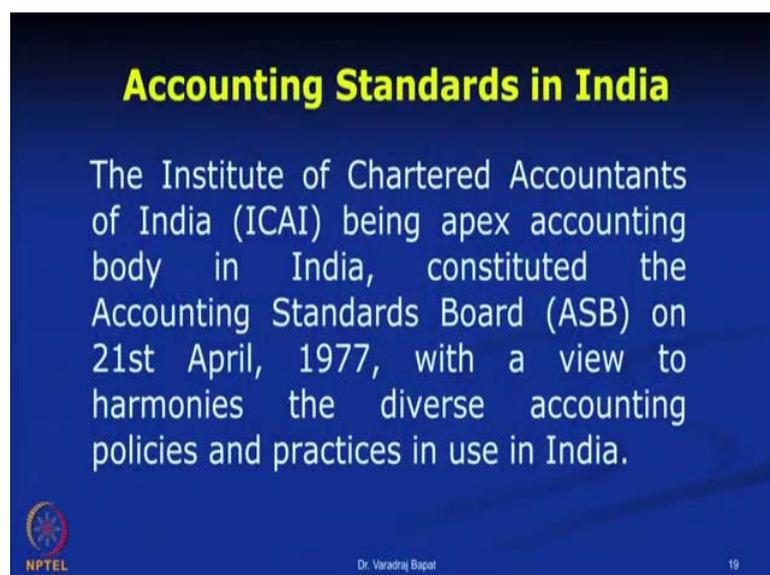
Now, Accounting Standards not only prescribe appropriate treatment, but they foster greater transparency and market discipline.

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In general, Accounting Standards promote uniformity, rationalization, comparability and transparency. Sometimes these accounting standards are also called as Financial Reporting Standards. They have the same meaning.

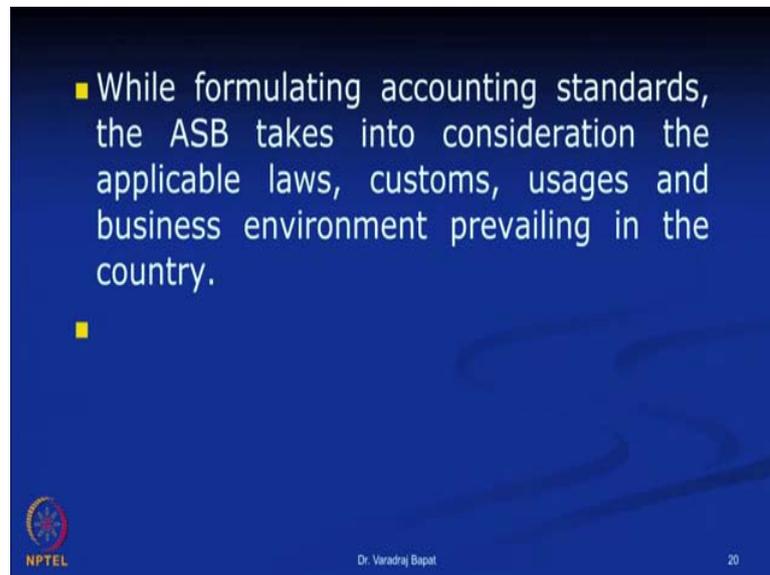
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Now, different countries have different accounting standards. As far as India is concerned, what standards we use, we will discuss about it. I think you all would have

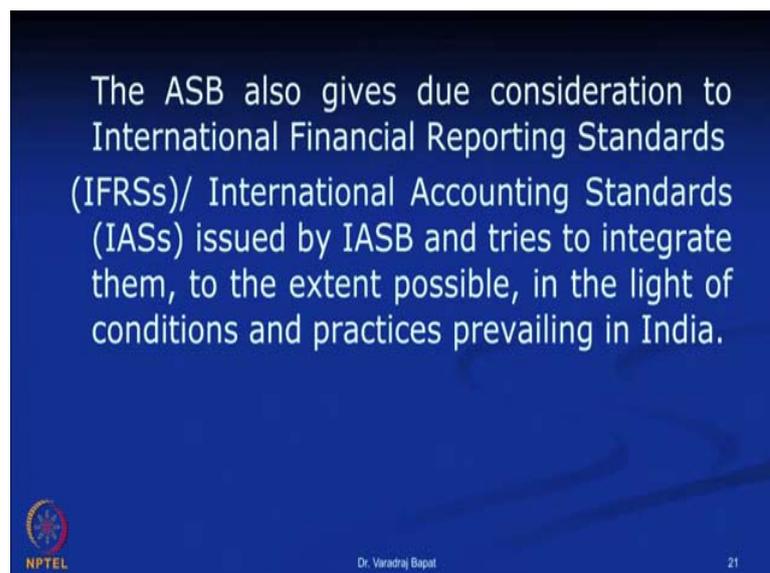
heard about Institute of Chartered Accountants of India or ICAI. This is apex accounting body in India which constituted ASB or Accounting Standard Board in 1977 in order to harmonize various accounting policies and principles.

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While harmonizing or while coming out with the standards, they do give consideration to law, customs, usage and business environment in the country.

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Now, ASB gives due consideration to International Standards also. There are 2 sets of International Standards. One is International Financial Reporting Standard or IFRS as

they are known as or the other one are International Accounting Standards or IAS. Now an effort has been made right from 1977 to harmonize Indian Standards with the global standards.

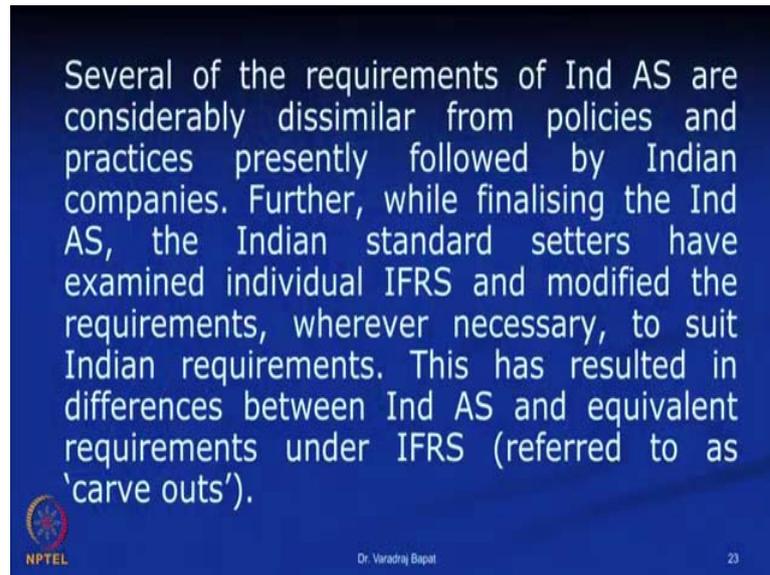
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Now, we will come to IND AS. Now the earlier set of standards which were being used in India were called as AS.

So, we had a series of standards like AS1, AS2, AS3, AS4 and so on. Now in accordance with the policy of convergence, here by convergence we mean the convergence of global standards. Different countries have different standards. An effort has been made all over the globe to harmonize to bring these standards together. Now because of this policy, Ministry of Corporate Affairs has issued a press release on 21 February 2011 and they have notified a new series of standards which are called as IND AS that is a new series of Indian Accounting Standards.

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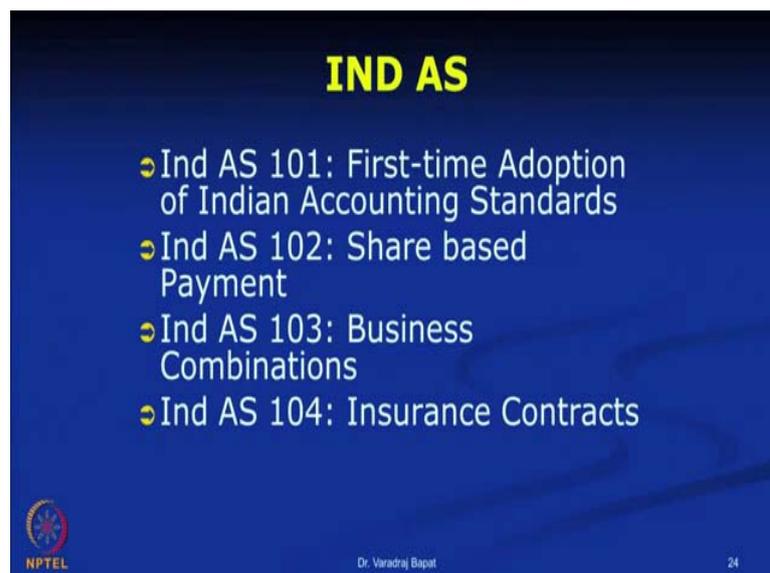
Several of the requirements of Ind AS are considerably dissimilar from policies and practices presently followed by Indian companies. Further, while finalising the Ind AS, the Indian standard setters have examined individual IFRS and modified the requirements, wherever necessary, to suit Indian requirements. This has resulted in differences between Ind AS and equivalent requirements under IFRS (referred to as 'carve outs').

NPTEL Dr. Varadraj Bapat 23

Now, several requirements of Ind AS are considerably dissimilar from policies and practices followed by Indian companies because many of the Indian companies for years were following Ind AS that is the old state of standards.

Now, International Standard which is IFRS has been examined an effort has been made to bring down the differences and as far as possible harmonize the same.

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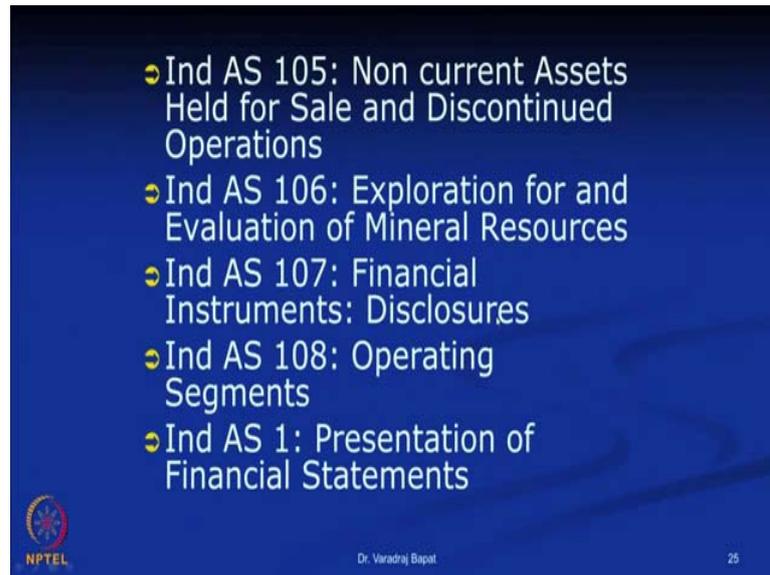
IND AS

- Ind AS 101: First-time Adoption of Indian Accounting Standards
- Ind AS 102: Share based Payment
- Ind AS 103: Business Combinations
- Ind AS 104: Insurance Contracts

NPTEL Dr. Varadraj Bapat 24

Now, this is the new set of standards which have been notified. So, Ind AS 101 is First-time Adoption of Indian Accounting Standards. Ind AS 2 is about Share based Payment.

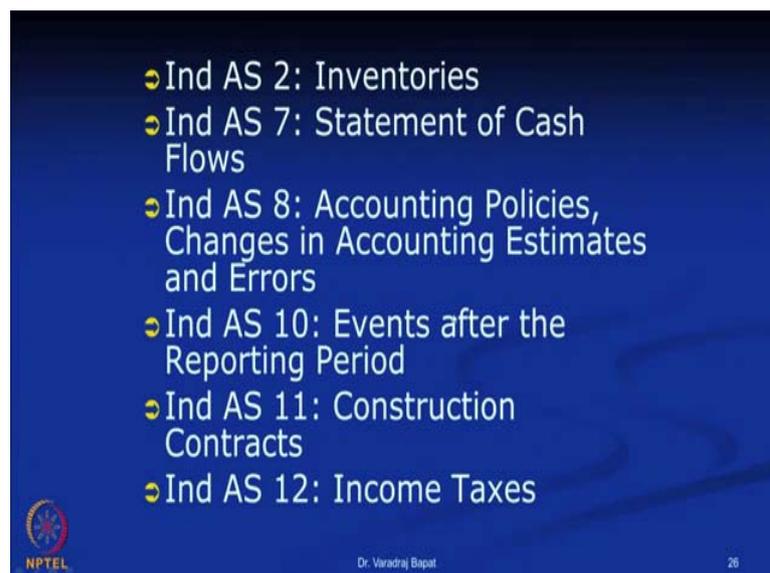
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Ind AS 3 is Business Combination then Insurance Contracts, Non current Assets Held for Sale, Exploration of Minerals, type of items. So, then AS 107 is Financial Instruments and 108 is Operating Segments.

So, these are special standards from 107 to 108. And then again a series starts from Ind AS 1 which is the presentation of Accounting Standards.

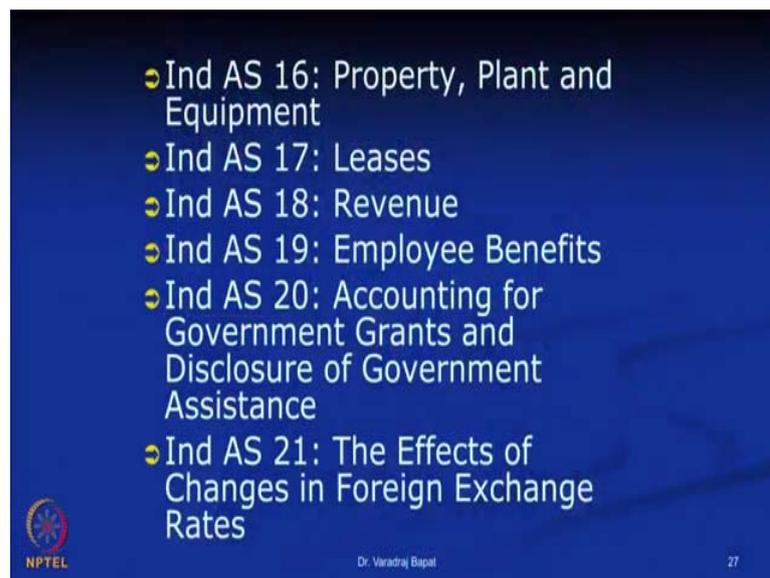
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Then we have got Ind AS 2, 7, 8, 10, 11, 12. I am not reading out all the standards, but all these are available for downloading. I will request you to download these standards. If

you are interested you can go through them in detail and if you do not want to go in so much of details, you at least try to understand various terminologies. So, that whenever a reference is made to a standard; you should be able to at least refer to it and read about it. So, this is the list of all the standards.

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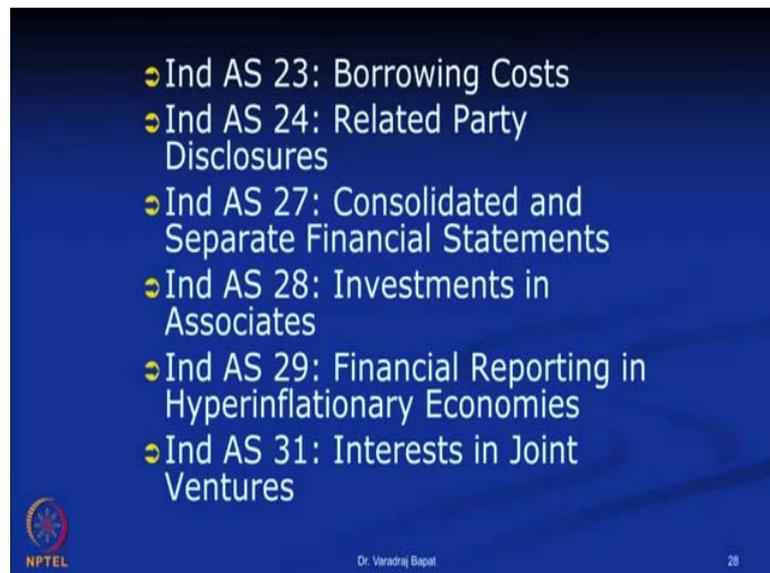


A blue slide with a list of six Ind AS standards. The text is white with yellow arrowheads. The NPTEL logo is in the bottom left, and the speaker's name and slide number are in the bottom right.

- Ind AS 16: Property, Plant and Equipment
- Ind AS 17: Leases
- Ind AS 18: Revenue
- Ind AS 19: Employee Benefits
- Ind AS 20: Accounting for Government Grants and Disclosure of Government Assistance
- Ind AS 21: The Effects of Changes in Foreign Exchange Rates

NPTEL Dr. Varadraj Bapat 27

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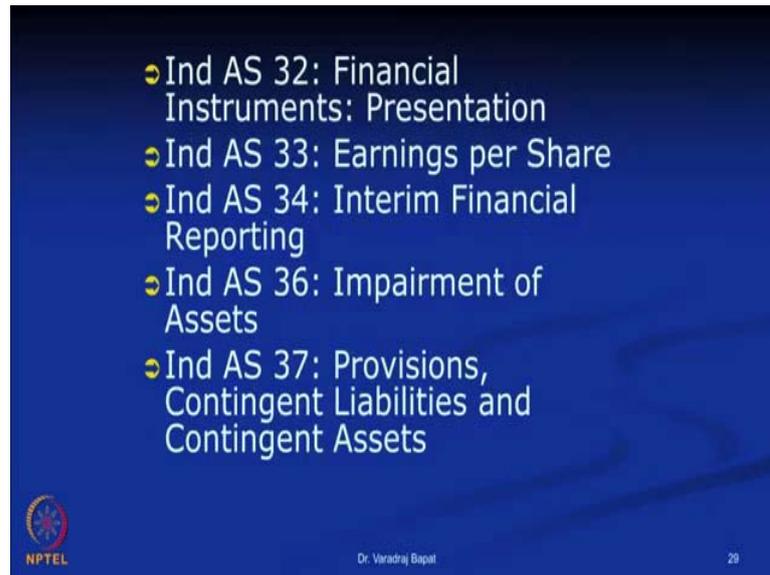


A blue slide with a list of six Ind AS standards. The text is white with yellow arrowheads. The NPTEL logo is in the bottom left, and the speaker's name and slide number are in the bottom right.

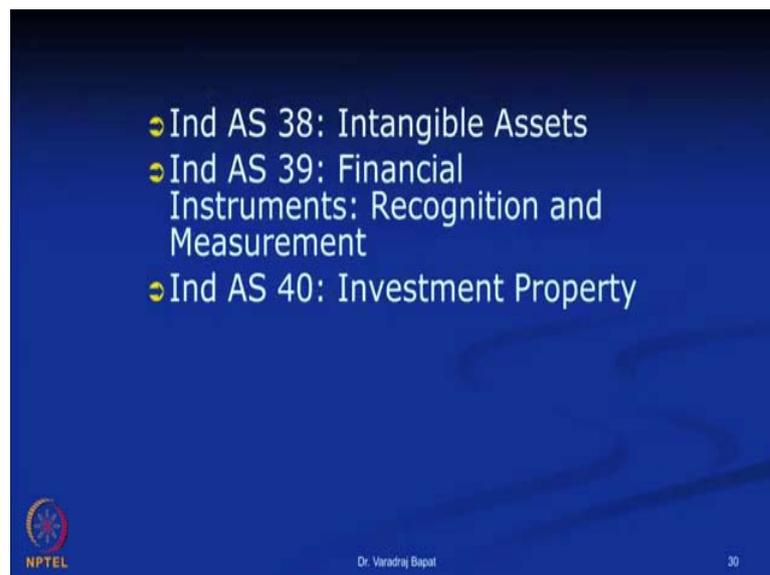
- Ind AS 23: Borrowing Costs
- Ind AS 24: Related Party Disclosures
- Ind AS 27: Consolidated and Separate Financial Statements
- Ind AS 28: Investments in Associates
- Ind AS 29: Financial Reporting in Hyperinflationary Economies
- Ind AS 31: Interests in Joint Ventures

NPTEL Dr. Varadraj Bapat 28

(Refer Slide Time: 19:56)



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Now, it is not within the purview of the course to really go through every standard, it is not necessary. We have already seen how financial statements are prepared. They are already prepared based on various standards. Now let us look at what are the International Standards.

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International Accounting Standards (IAS)

- International Accounting Standards Committee (IASC) was constituted in 1973 to formulate accounting standards.
- Barring Canada, Japan and US all countries have accepted these standards.

NPTEL Dr. Varadraj Bapat 31

Now, there is a body known as IASC International Accounting Standards Committee which was formed in 1973. Now most of the countries started adopting those standards except Canada, Japan and US.

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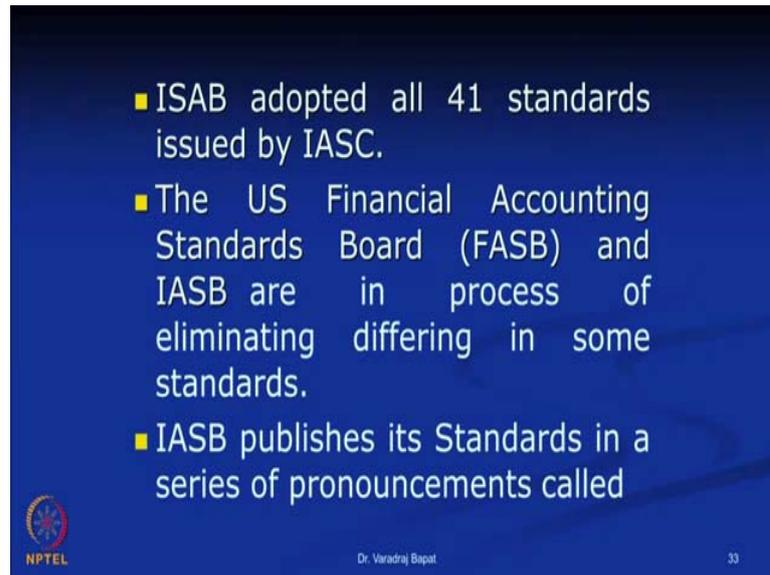
■ To give proper direction and interpretations Standards Interpretations Committee was formed in 1997.

■ IASB was constituted in 2001 to prescribe norms for treatment of several items on preparation and presentation of Financial statements.

NPTEL Dr. Varadraj Bapat 32

Now, to give proper direction and interpretations Standard Interpretation Committee was made in 1997. Now a new board known as IASB was created in 2001 to prescribe the non for norms for treatment of various items on preparation and presentation of Financial Standards.

(Refer Slide Time: 21:02)



■ IASB adopted all 41 standards issued by IASC.

■ The US Financial Accounting Standards Board (FASB) and IASB are in process of eliminating differing in some standards.

■ IASB publishes its Standards in a series of pronouncements called

NPTEL Dr. Varadraj Bapat 33

Now, IASB has adopted 41 standards of IASC. Now as I told you the American Standard sorry US Standards are not in harmony. In US, there is a body called as FASB, Financial Accounting Standard Board. FASB and IASB are in the process of eliminating the differences and bring those standards nearer.

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International Financial Reporting Standards (IFRSs). It has also adopted the body of Standards issued by the Board of the International Accounting Standards Committee (IASC).

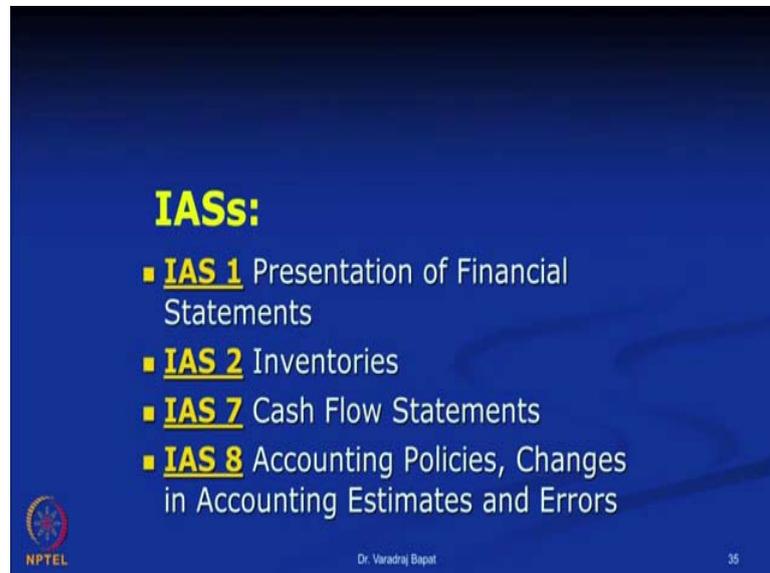
■ Those pronouncements are designated "International Accounting Standards" (IASs).

NPTEL Dr. Varadraj Bapat 34

Now, IASB purchases or publishes its standards in a series of pronouncements which are called as IFRS, International Financial Reporting Standard. It has also adopted the body

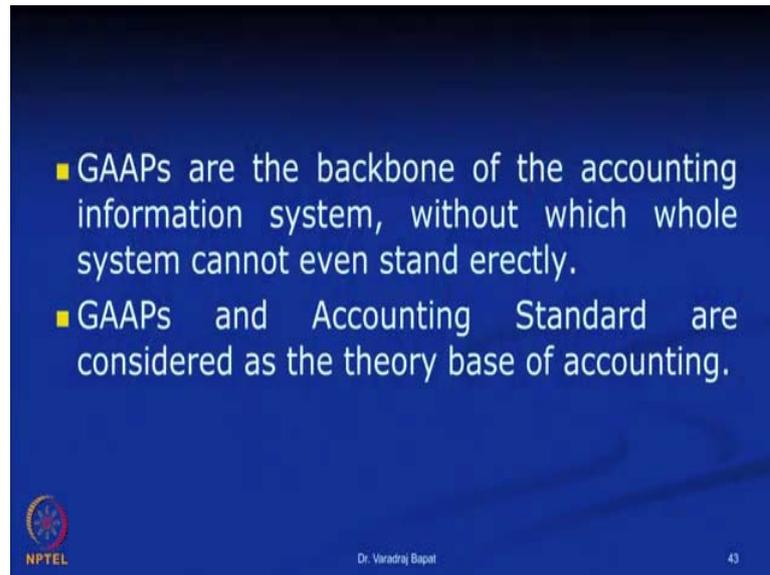
of standards issued by Board of International Accounting Standard, IASC and these pronouncements are called as International Accounting Standards or IAS.

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Now, I have given here, a list of IAS. Again I would request you to download these IAS if you have interest and then go through them in detail. So, for example, IAS 1 is about Preparation of Financial Statements, IAS 2 is on Inventory, IAS 7 is on Cash Flow Statements, IAS 8 is on Accounting Policy Changes in the Financial Estimates and Errors. If you observe carefully the news in different countries there are different gaps and they together are called as GAAP.

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Now GAAP is a backbone of accounting information system, without which system cannot even stand correctly. Now GAAPs and Accounting Standards as considered as a theory base for all the accounting. So, are you getting me? So, here we have discussed today various information about various types of standards. In future, these standards are these standards are applicable in all the statements which we made. We are not going into too much details of it, but I will request you to download them and go through in as for your own interest. Namaste.