

2. MEANING OF ACCOUNTING STANDARD

Accounting standards are the policy documents issued by the recognised expert accountancy body relating to various aspects of measurement, treatment and disclosure of accounting transactions and events. These standards are in conformity with applicable law, customs, usage and business environment in the country.

Accounting standards provide a framework for preparation of financial statements. If there are no accounting standards everybody will colour his financial statements in the manner in which he likes.

Q. 2. What is an Accounting Standard?

(Nov. 2018)

3. NATURE

The accounting standards issued by ICAI are recommendatory in nature in the initial period. The recommendatory period is allowed to smoothen the process of transition so that no organisation will have difficulty in conforming to the standards once they are made mandatory.

Once the standard is made mandatory it is applicable to all the organisations whose accounts are audited by the members. In the case of mandatory standards, it becomes the duty of the auditor to see that accounting standards are followed in preparation of financial statements.

If standards are not followed, the auditor has to make a disclosure in his report.

Accounting standards have no legal backing and hence are not enforceable on the public.

Following steps are required to make the standards effective :

1. Self regulation on the part of business organisations.
2. Legal backing to the accounting standards.
3. Publishing the use of accounting standards.
4. Avoidance of duplication of authority.

Q. 3. What is the nature of Accounting Standards?

4. OBJECTIVES

The objective of Accounting Standards :

- (i) To Standardise the diverse Accounting Policies.
- (ii) To Standardise the Accounting Practices.
- (iii) To eliminate non-comparability of Financial Statements.
- (iv) To enhance reliability of Financial Statements.

Q. 4. What are the objectives of Accounting Standards?

5. COMPLIANCE WITH ACCOUNTING STANDARDS

1. Mandatory Standards

Accounting standards become mandatory from the respective dates mentioned in the standard. As Accounting standards are mandatory, financial statements must be prepared and presented as per the accounting standards. A statutory auditor has to examine whether financial statements have been prepared as per the mandatory accounting standards. If there is any deviation

the auditor must make adequate disclosure so that the users of financial statements come to know about deviation.

As per section 143(3) (e) of the companies Act, 2013, the Audit Report shall state that the financial statements comply with the accounting standards.

As per Sec. 134(5)(a) the Director's Responsibility Statement shall state that accounting standards have been followed in preparation of annual accounts.

2. Responsibility of Compliance

Management of the enterprise is responsible for ensuring compliance with accounting standards.

3. Compliant Financial Statements

The financial statements are said to be compliant with accounting standards when they comply with all the accounting standards.

Q. 5. Explain the provision regarding compliance of Accounting Standards.

6. ADVANTAGES

6.1 Advantages of Accounting Standards

Following are the advantages of Accounting standards :

1. Transparency

It provides transparency in financial statements. The users interpret the financial statements of different companies by using the same assumptions.

2. Guidance

A.S. provide guidance to the accountants. The new accounting transactions arising from technology such as internet sales, changes in pension plan can be recorded properly with the help accounting standards.

3. Provide a Benchmark

When accounting standards are used in accounting it becomes easy to see the upward or downward trends in business. Investors and organisations can measure the performance of one company against another company.

4. Maintain Uniformity

Accounting standards remove variations in accounting treatment and maintain uniformity in preparation and presentation of financial statements.

5. Uniform disclosure

Financial statements of different companies disclose uniformly beyond the requirement of law.

6. Maintain business records

All the financial transactions are recorded in a systematic manner in the books of accounts.

7. Improve reliability of financial statements

Accounting standards create a sense of confidence in the minds of the users of financial statements.

8. Help the professionals

Accounting standards help the accountants and auditors to perform their work in the changing environment. They can perform their duties properly.

9. Determination of accountability

Standards facilitate in determination of corporate and managerial accountability. Standards are important for assessment of managerial performance.

Q. 6. Explain advantages of Accounting standards

(Nov. 2018)

7. DISADVANTAGES

1. There may be rigidity in application of Accounting Standards.
2. There may be differences in the accounting standards of different countries
3. The standards are required to be framed within the scope of the law.

Q. 7. What are the disadvantages of Accounting Standards?

8. NEED AND IMPORTANCE OF ACCOUNTING STANDARDS

Accounting standards are important due to the following :

1. Eliminates effect of diverse accounting policies. Financial statements become more meaningful and comparable.
2. Enhances reliability of financial statements : Uniform guidelines enhance reliability of financial statements.
3. **Ensures Comparability :**
Financial statements of different companies can be compared with each other.
4. **Facilitates Informed Decision Making :**
It facilitates informed decision making in lending & investments.
5. **Promotion of sound Financial System :**
It helps to promote sound financial system.
6. **Reforms in Accounting :**
It helps in evolving reforms in accounting theory and practice.
7. **Makes Financial Statements more useful :**
It facilitates disclosure beyond law.

Q. 8. What is the importance of Accounting Standards? / Write short note on : Need of Accounting Standards. (April 2003; Nov. 2017)

9. ACCOUNTING STANDARDS IN INDIA

On 21st April, 1977; The Institute of Chartered Accountants of India constituted Accounting Standards Board (known as A.S.B.) with a view to harmonise accounting policies and practices used in India.

The main functions of A.S.B. is to formulate the standards after taking into consideration the applicable laws, customs, usages and business environment.

10. STATUS OF ACCOUNTING STANDARDS ISSUED BY ICAI

Number of the Accounting Standard (AS)	Title of the Accounting Standard	Date from which mandatory (accounting periods commencing on or after)	Enterprises to which applicable
AS-1	Disclosure of Accounting Policies	1-4-1993	All
AS-2 (Revised)	Valuation of Inventories	1-4-2016	All
AS-3 (Revised)	Cash Flow Statement	1-4-2001	Level-1
AS-4 (Revised)	Contingencies & Events Occurring after the Balance Sheet Date	1-4-2016	All
AS-5 (Revised)	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies	1-4-1996	All
AS-7 (Revised)	Construction Contracts	1-4-2002	All
AS-9	Revenue Recognition	1-4-1993	All
AS-10 (Revised)	Property, Plants and Equipment	1-4-2016	All
AS-11 (Revised-2003)	The Effects of Changes in Foreign Exchange Rates	1-4-2004	All
AS-12	Accounting for Govt. Grants	1-4-1994	All
AS-13 (Revised)	Accounting for Investments	1-4-2016	All
AS-14 (Revised)	Accounting for Amalgamations	1-4-2016	All
AS-15 (Revised-2005)	Employees Benefit	1-4-2006	All
AS-16	Borrowing Costs	1-4-2000	All
AS-17	Segment Reporting	1-4-2001	Level-I

AS-18	Related Party Disclosures	1-4-2001	Level-I
AS-19	Leases	1-4-2001	All
AS-20	Earning Per Share	1-4-2001	All
AS-21 (Revised)	Consolidated Financial Statements	1-4-2016	Entities preparing CFS
AS-22	Accounting for Taxes on Income	1-4-2001 1-4-2002 1-4-2006	All levels
AS-23	Accounting for Investment in Associates in Consolidated Financial Statements	1-4-2002	Entities preparing CFS
AS-24	Discontinuing Operations	1-4-2004	Level-I
AS-25	Interim Financial Reporting	1-4-2002	Level-I
AS-26	Intangible Assets	1-4-2003	All levels
AS-27	Financial Reporting of Interests in Joint Ventures	1-4-2002	Entities preparing CFS
AS-28	Impairment of Assets	1-4-2004 1-4-2006 1-4-2008	All levels
AS-29 (Revised)	Provisions, Contingent Liabilities and Contingent Assets	1-4-2016	All
AS-30	Financial Instruments – Recognition and Measurement	To be announced	Level-I
AS-31	Financial Instruments – Presentation	To be announced	Level-I
AS-32	Financial Instruments – Disclosures	To be announced	Level-I

Fig. 1.1

Note : 1

AS-30, AS-31 and AS-32 standards are withdrawn.

Q. 9. What is the status of Accounting Standards?**List of IAS / IFRS and corresponding IND AS notified by MCA**

IAS NO.	TITLE	CORRESPONDING CONVERGED IND AS
IAS 1	Presentation of Financial Statements	Ind AS 1
IAS 2	Inventories	Ind AS 2
IAS 7	Cash Flow Statements	Ind AS 7
IAS 8	Accounting policies, change in accounting estimates and errors	Ind AS 8
IAS 10	Events after the Balance Sheet date	Ind AS 10
	Constuctions Centra AS	Ind AS 11
IAS 12	Income Taxes	Ind AS 12
IAS 16	Property, Plant and Equipment	Ind AS 16
IAS 17	Leases	Ind AS 17
	Revenue	Ind AS 18
IAS 19	Employees Benefits	Ind AS 19
IAS 20	Accounting for Govt. Grants and Disclosure of Government Assistance	Ind AS 20
IAS 21	The Effects of changes in the Foreign Exchange Rates	Ind AS 21
IAS 23	Borrowing Costs	Ind AS 23
IAS 24	Related party disclosures	Ind AS 24
IAS 27	Consolidated and separate financial statements	Ind AS 27
IAS 28	Investments in associates and Joint Ventures	Ind AS 28



IAS 29	Financial Reporting in Hyper Inflationary Economies	Ind AS 29
IAS 32	Financial Instruments : Presentation	Ind AS 32
IAS 33	Earnings per share	Ind AS 33
IAS 34	Interim Financial Reporting	Ind AS 34
IAS 36	Impairment of Assets	Ind AS 36
IAS 37	Provisions, Contingent liabilities and Contingent Assets	Ind AS 37
IAS 38	Intangible Assets	Ind AS 38
IAS 40	Investment property	Ind AS 40
IAS 41	Agriculture	Ind AS 41

Q. 10. What are the IND AS notified by MCA?

13.1 Meaning of Accounting Policies

[Accounting policies are specific accounting principles and the methods of applying those principles adopted by the enterprises in the preparation and presentation of financial statements. At the time of preparation of financial statements i.e. Balance Sheet and Profit & Loss Account, there are several areas where more than one method of accounting treatment could be given.]

Notes to Accounts

It is an explanation of the management about the items in the financial statements. The management gives more explanation and information about the items in P & L A/c and Balance Sheet. Notes to accounts are integral part of financial statements.

[The following are some areas where different accounting treatments can be adopted :

1. Method of Depreciation

Depreciation can be calculated either by Straight Line Method or Written Down Value Method.

2. Treatment of Expenditure during Construction

It can be written off or capitalised or deferred.

3. Conversion or Translation of Foreign Currency Items

Foreign currency items can be converted by adopting average rate method or TT buying rate method.

4. Valuation of Inventories

Inventories may be valued by the different methods such as FIFO, Weighted Average, Standard Cost or Retail method.

5. Valuation of Investment

Valuation of investment can be done depending on the classification of investment. Investment is classified as long-term investment and current investment. Cost of investment comprises purchase price & acquisition charges such as brokerage, fees and duties etc. For the purpose of Balance

Sheet, carrying amount of investment can be valued in different manner depending on the type of investment.

- i) **Current Investment** : Carrying amount of each current investment is the lower of cost and realisable value.
- ii) **Long-term Investment** : It is usually carried / valued at cost.
- iii) **Investment Properties** : The cost of shares held in co-operative society is added to cost of investment properties if the shares in such societies are necessary to acquire the investment properties. An enterprise, which holds investment properties, should account for them as long-term investment.

Thus, investment can be given different accounting treatment in different cases.

6. Treatment of Retirement Benefits

There are several accounting treatments to be given to the retirement benefits to the employees. It depends on the several labour laws and the retirement benefit plans adopted by the enterprise.

7. Valuation of Fixed Assets

Fixed assets can be shown in financial statement either at historical cost or revalued price. Moreover, the type of fixed assets also matters in the valuation method. Examples of fixed assets are land, freehold building, leasehold building, plant & machinery, furniture & fittings etc. This account treatment in valuation of fixed asset is determined by laws, types of assets and the special cases etc.

8. Treatment of Contingent Liability

Here also, an enterprise can follow different accounting treatments in recognition and disclosure of contingent liability.

Q. 14. What are the areas where different accounting treatments can be adopted? / What are the provisions of disclosure of Accounting Policies as per AS-1? (Nov. 2016; March 2018)

Q. 17. What are the areas in which different policies may

✓ **Meaning of Notes to Accounts :**

(Notes to accounts are the explanations given by the management about the items in the financial statements i.e. Balance Sheet and Profit & Loss Account. The management of an enterprise has to give more explanation and information as regards the items given in the Profit & Loss Account and Balance Sheet and any other items by way of notes to accounts.

For Example :

- i) Disclosure of details of contingent liability by notes to accounts.
- ii) Disclosure of litigation about the claim recoverable, loan receivable etc.

Notes to accounts are part and parcel of the financial statement.)

Q. 18. What do you understand by Notes to Accounts?

13.6 Disclosure of Change in Policies

Change in Accounting Policy :

A change in accounting policy may be necessary for making the accounting data more reliable and relevant. 'Consistency' is a fundamental accounting assumption. It requires that accounting policies should be followed from one period to another.

This, however, does not mean that the accounting policies once adopted cannot be changed to maintain the 'comparability' quality of the accounting data. Infact, change in accounting policy may be necessary to make the accounting data more reliable and relevant.

A change in accounting policies should be made in the following conditions :

- i) Adoption of different accounting policies is required by statute or for compliance with an Accounting Standard.
- ii) It is considered that change would result in more appropriate presentation of financial statement.

In case, there is any change in accounting policies in preparation of financial statement from one period to subsequent period and it affects the state of affairs of Balance Sheet and Profit & Loss Account of current period or the financial statement of later period, then this kind of change must be disclosed in financial statement. The amount, by which the financial statement is affected should be disclosed to the extent ascertainable.

Para 26 of AS-1 suggests that where such amount is not ascertainable, wholly or in part, the fact should be indicated.

Q. 23. What are the provisions regarding change in Accounting Policies?

13.7 Illustration

Consequent upon the issuance of mandatory Accounting Standard-2 (AS-2) by the Institute of Chartered Accountants of India, the A.B.C. Co. Ltd., has revised its accounting policy relating to valuation of inventories to include applicable fixed production overheads. As a result of this change there is an increase in value of inventory and profit before tax by ₹ 102 lakhs.

14. PRACTICAL APPLICATIONS

Illustration : 1

Pragati Educational Trust sent a copy of Income & Expenditure Account and Balance Sheet for the year 2020-21 to all its members. Mr. Jayant, Managing Trustee of the Trust sent a separate letter to each member containing a note on the accounting policies followed for preparation of financial statements.

Comment on the above.

Solution

As per AS-1, accounting policies followed for preparation of financial statements should form part of final accounts. Separate letter about the accounting policies should not be sent. The policies should have been disclosed as a part of note to the final accounts.

Illustration : 2

Overconfident Ltd. prepared Profit & Loss Account and Balance Sheet for the year 2020-21. The accounting policies about Profit & Loss Account have been disclosed below Profit & Loss Account and accounting policies about Balance Sheet have been disclosed below Balance Sheet. Comment.

Solution

As per AS-1, the accounting policies adopted for preparation of final accounts should form part of final accounts. These policies should be disclosed at one place only forming part of accounts. It should not be disclosed separately.

Illustration : 3

Cautious Ltd. prepared Profit & Loss Account and Balance Sheet on cash basis. Comment.

Solution

As per AS-1, accrual basis is the fundamental accounting assumption. The company follows cash basis, i.e., records income when it is actually received and expenses when actually paid. If the accounting assumption is not followed, it should be disclosed in the form of a note to the accounts.

Illustration : 4

Prudent Ltd. had sales of ₹ 500 crores in 2020-21. Cash sale of ₹ 500 was shown separately by the company.

Comment.

Solution

As per AS-1, materiality convention should be followed. Cash sale of ₹ 500 in total sales of ₹ 500 crores is not material. It need not be disclosed separately.

Illustration : 5

Lethargic Ltd. followed WDV Method of depreciation till 31st March, 2021. On 1st April, the company changed the method of depreciation to Fixed Instalment Method. The company did not disclose this in the notes. Comment.

Solution

As per AS-1, any change in the policy should be disclosed in the year in which the change is made. The company did not follow AS-1.

Illustration : 6

Befikir Ltd. prepared final accounts for the year 2020-21. During the year, accident took place in the factory. The worker who injured lodged a claim of ₹ 2,50,000 against the company. The case is pending in the court. The accountant did not disclose this in the accounts. Comment.

Solution

Claim for compensation pending in the court is a contingent liability. As per AS-1, it should be disclosed as a foot note to the final accounts. The company did not respect provisions of AS-1.]

Illustration : 7

The gross block of fixed assets are shown at cost of acquisition. It includes taxes, duties and other identified direct cost. Interest on borrowing to finance the fixed assets is not capitalised comment.

Solution

The policy appears to be correct.

Illustration : 8

The finished goods inventory is valued at prime cost and at market value whichever is lower. Comment.

Solution

The policy is not as per AS 2.

Illustration : 9

Draft the accounting policies to be disclosed in the financial statements for the following items :

- Revenue recognition – Sale of goods
- Depreciation

Solution

- Sales are recognized when goods are invoiced and dispatched to customers and are recorded inclusive of excise duty and net trade discount and sales tax.
- Depreciation is charged on straight line method as the rates specified in schedule XIV of the companies act.