Department of Commerce

University of Calcutta

Study Material

Cum

Lecture Notes

Only for the Students of M.Com. (Semester II)-2020

University of Calcutta

(Internal Circulation)

Dear Students,

Hope you, your parents and other family members are safe and secured. We are going through a world-wide crisis that seriously affects not only the normal life and economy but also the teaching-learning process of our University and our department is not an exception.

As the lock-down is continuing and it is not possible to reach you face to face class room teaching. Keeping in mind the present situation, our esteemed teachers are trying their level best to reach you through providing study material cum lecture notes of different subjects. This material is not an exhaustive one though it is an indicative so that you can understand different topics of different subjects. We believe that it is not the alternative of direct teaching learning.

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Stay safe and stay home.

Best wishes.

Paper CC205:

Accounting Theory (ACTH)

ACCOUNTING THEORY

PAPER - CC: 205

M.COM SEMESTER - II

Department of Commerce
UNIVERSITY OF CALCUTTA

CONTENTS

Module – I

Unit	Name of the Topic
I	*Theory - Conceptual Issues* **Soumya Mukherjee, Dipannita Chatterjee**
II	*Assets, Liabilities and Accounting for Depreciation* **Atanu Pramanick**
III	*Capital, Value and Profit* **Dipti Kumar Chakravorty**

Module – II

Unit	Name of the Topic
IV	*Specific Issues in Corporate Reporting* **Pema Lama**
V	*Globalisation of Accounting Standards* **Samir Lobwo, Soumya Mukherjee**
VI	*Contemporary Issues in Accounting* **Pema Lama**

Unit - I
Theory - Conceptual Issues

Definition of Theory

- The word 'Theory' has originated from the Greek word, 'Theoria'. It means to behold or view.
- A theory is a confirmed hypothesis. A 'hypothesis' is an idea or explanation that you then test through study and experimentation.
  - Theory is defined as asset of interrelated concepts, definitions and propositions that present a systematic view of phenomena (very unusual indeed) by specifying relations among variables with the purpose of explaining and predicting the phenomena.
- Simply stated, a theory is a systematic statement of the rules or principles which underline or govern a set of phenomena.

Accounting Theory

- Accounting theory is set of hypothetical, conceptual and pragmatic principles forming a general frame of reference for enquiring into the nature of accounting. It will be seen that accounting theory has been defined as a coherent set of logical principles that provides for:
  - Conceptual framework;
  - Better understanding of present accounting practice;
  - Evaluation of existing accounting practices; and
  - Guideline for future development and research
- Accounting theory is that branch of accounting which consists of the systematic statement of principles and methodology, as distinct from practice. Moreover, it refers to a generally accepted logical explanation of Accounting Practices. It is that branch of Accountancy which develops and inculcates a set of logical principles for the evaluation and development of effective accounting practices.

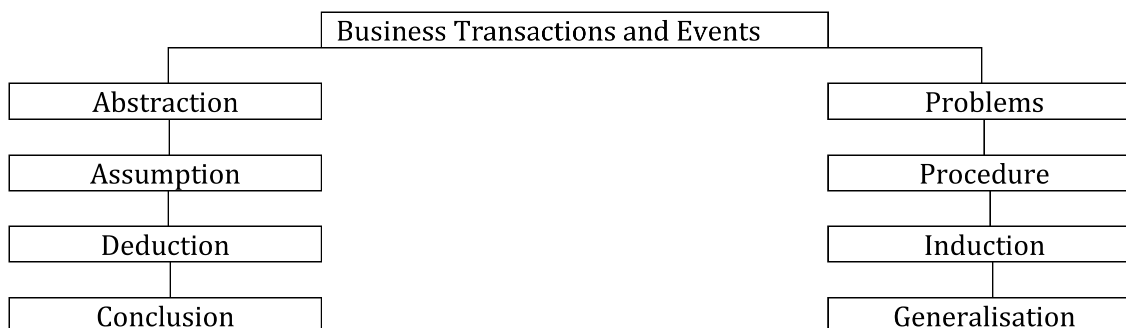
Need for Accounting Theory

Below is given some of the clearly identified need for accounting theory:

(1) Identification of problem area
(2) Conceptual framework for the study of accounting problems
(3) Summarisation about the subject and current accounting practices.
(4) One of the goals of accounting theory is to provide uniformity in practice.
(5) Predictability about further facts.
(6) Development of new practice

Methodology of development of accounting theory

- Accounting Theory is the organised body of knowledge which deals with order, reasons, relationships, objectives and methods involved in the practice of accounting. The concept of accounting theory provides the use of theory as a guide to accounting practices.
- However, the fact is that there has been a concurrent development in accounting. While accounting was developing as a practical art, it was also evolving a body of theoretical premises. The theoretical evolution of accounting is of recent original, though its practical development can be traced back five hundred years ago.
- Both the theoretical and practical approaches have contributed to the existing organised body of knowledge, presently known as accounting theory. Their approaches are different, but the purpose is the same: to develop systematic accounting practices. Under the practical approach, accountants have frequently relied on trial and error as a means to improving accounting practices whereas, the theoretical approach relied on logical, conceptual structure to develop meaningful pattern of accounting practices. But both the theoretical approach and practical approach are interested in developing some general principles and procedures for dealing with the same real world phenomena of business transactions and events.
- From the foregoing it appears that accounting theory can be extracted from the practice of accounting (*i.e.,* the practical approach) or it can result from a logically derived process through the deductive approach. The difference in not one of purpose, rather the difference is due to adoption of different methodologies. .The divergence of opinions approaches and values between accounting practice and accounting research have led to the use of two methodologies, one descriptive and the other normative. On that basis Accounting theories are:
    - Descriptive theories
    - Normative theories



Descriptive Theories

- A descriptive theory describes a particular phenomenon as it is, without any value judgment. A descriptive theory will not inform whether it’s right or wrong; rather the process of ascertaining results. The practical or conventional approach to accounting theory is essentially descriptive in character.
- Such descriptive theories are concerned with the behaviour of the practicing accountants and what they do. This approach emphasizes accounting practice as the basis from which to develop theory.

- **Normative Theories**
  - **Concept**
    - The word, 'normative' means it is related to rules, or make people to obey rules, especially rules of behaviour.
    - Normative accounting is a branch of accounting theory that is concerned with the differences between different accounting systems and the ways in which one system might be better than another.
    - The people, who are developing and using normative accounting theory, seek to understand the objectives of accounting in practice and compare its ability to meet those objectives with other systems. Normative accounting theory is generally more prescriptive than other ways of approaching accounting theory.
  - **Purpose**

    Normative accounting theorists tend to advocate not only for a standardized system of accounting, but also for a particular system that is thought to be superior to others.
  - **Feature**

    The essential feature of Normative Theory is the existence of value judgement. Normative Theories tend to justify what ought to be, rather than what it is. It imposes on the accountants responsibility of determining what should be reported rather than merely reporting what some on else has requested.
  - **Challenges**

    Normative accounting theory is subject to considerable critique from accounting and business professionals. Under this approach, theorists tend to rely heavily upon circumstantial evidence (e.g., examples of fraud) that generally fails to meet tests of academic consistency, thus suggesting challenges in developing a set of accounting concepts that could be considered objectively superior to another.

Approaches to the Formulation of Accounting Theory

New theories are formulated and existing ones are remodelled with the help of accounting theory. In different time phases for explaining accounting practices different theories have been formulated. Some of these theories have been put to storehouse in subsequent period while some others have gained momentum. So, formulation of new theory and rejection of old theories are well-accepted features of accounting theory. New theories are always formulated on the basis of new opinions or concepts. Such opinions or concepts are identified as approaches. So approaches to the formulation of accounting theory stand for the different opinions or concepts on the basis of which new accounting theories are invented. The approaches to the formulation of accounting theory are shown in the following chart:

FORMULATION OF ACCOUNTING THEORY

1. Traditional Approaches	2. Modern or New Approaches
a) *Non-theoretical or Pragmatic Approach* b) *Theoretical Approaches* ○ Deductive Approach ○ Inductive Approach ○ Ethical Approach ○ Sociological Approach ○ Economic Approach ○ Eclectic Approach	a) *Events Approach* b) *Decision Model Approach* c) *Behavioural Approach* d) *Predictive Approach*

1. Traditional Approaches: The traditional approaches discussed above mainly aim at construction of theories. These approaches may be divided into two categories: a) Non-theoretical or Pragmatic Approach; and b) Theoretical Approach.

(a) Non-theoretical or Pragmatic Approach

- The approach that speaks in favour of formulation of theory in conformity with the real world needs and problems and aims at finding out their solutions may be identified as pragmatic or non-theoretical approach to accounting theory.
- This is also called need based or practical approach. Here those concepts and principles are emphasised upon which are effective to meet the practical problems and useful to the users of accounting information in taking relevant decisions.
- According to this approach, accounting techniques and principles should be chosen because of their usefulness to users of accounting information and their relevance to decision making processes.
- This approach takes into consideration not only the interest of the owners but the need of all the users of accounting information as well.
- Besides, it is difficult to determine the yardstick of measuring the utility of the accepted principles under pragmatic approach due to its non-dependence on normative theories.

(b) Theoretical Approach

The theory based approaches to the formulation of accounting principles may be divided into six categories as under -

i) Deductive Approach

- This approach is used to construct normative theories.
- Normative theory is that theory which consists of principles based on standard or ideal logic.
- So, deductive approach helps formulation of those principles of accounting that explain the standard or ideal happenings with logic.
- In other words deductive approach is that outlook which follows logically and ideally correct concepts, opinions, bases and principles for formulation of accounting theory.
- The steps required for development of theories under deductive approach are**:**
  - **Objectives**: to determine the general and specific objectives of financial statements.
  - **Postulates**: to select the basic accounting concepts or postulates relating to economic, political and sociological environment.
  - **Constraints**: to set out the constraints or regulations this will guide the theory.

- **Structure**: to build up the framework of theoretical ideas.
- **Definitions**: to develop the definitions to explain the related ideas.
- **Principles**: to fix up the accounting principles on the basis of logic.
- **Application**: to develop the process of application or the techniques and methods of accounting based on the principles framed.

- The first step of developing accounting theory following deductive approach is setting up objectives of accounting. In the deductive process, the formulation of objectives is most important because different objectives might require entirely different structures and result in different principles. Due to this reason deductive approach is also called 'objectivity approach'.
- As deductive approach follows ideally right principles, from the viewpoint of justification it is identified as the best approach. But if there exists any defect in the postulates or concepts selected, the theory formulated on the basis of deductive approach may mislead the accounting activities.
- This approach has also been recognised and used by the **Financial Accounting Standards Board (FASB) of AICPA.**

ii) Inductive Approach

- This approach is used to formulate descriptive theory. The main theme of inductive theory is to arrive at a generalised decision as to the logic, reasons and assumptions acting behind the occurrence of events through observation and analysis.
- So, the inductive approach to the formulation of accounting theory may be defined as that outlook which emphasises upon developing generalised decisions and principles through observation, measurement and analysis of the events occurred.
- The process of induction consists of drawing generalised conclusions from detailed observations and measurements. It starts with observation of financial information of business enterprises and leads to draw, on the basis of repeated relationships, generalisations and principles of accounting.
- The steps required for development of theories under deductive approach are**:**
  - To observe and to keep records of all observations.
  - To find out recurring relationships, similarities and differences among these observations by analysis and classification.
  - To formulate generalised principles of accounting on the basis of recorded observations.
  - To test and apply these generalised principles.
- The main advantage of this approach lies in its independence. It is not influenced by any predetermined norm or standard model. This helps the researchers to work independently and to arrive at decisions which they think as the best outcome of their observations and analysis.
- The main drawback of the inductive approach is that the researchers in studying relationship among the data collected from observations may be influenced by pre-conceived or sub-conscious notions. Another problem of inductive approach is that the financial data collected through observations may vary from firm to firm. This creates difficulty in arriving at meaningful and generalised principles.

iii) Ethical Approach

- **D. R. Scott,** an eminent scholar of accounting, had used the ethical approach for the first time.
- The approach to the formulation of accounting theory that puts emphasis on fairness, justice and truth and considers these attributes as centres of focus for framing the theories is known as ethical approach.
- The concept of ethics is also used more or less in all other approaches to accounting theory. For this reason the ethical approach is not treated as a separate and independent approach.
- The object of this approach is to prepare the accounting statements accurately and in an unbiased manner not giving any favour to any of the interested parties.
- At present the financial statements must exhibit the true and fair view of the state of affairs of the concern. This is nothing but the acceptance of ethical approach. The main drawback of ethical approach is that it does not provide a sound and independent basis for the development of accounting principles. It also fails to form the basis for the evaluation of existing accounting principles.

iv) Sociological Approach

- The approach that emphasises on the social aspect of accounting is known as sociological approach. It is the outcome of ethical approach that takes into consideration fairness and justice for the construction of accounting theory.
- As fairness equates social welfare Glautier and Underdown have identified this approach as 'welfare approach'.
- As per this approach the accounting principles or techniques are to be evaluated on the basis of their reporting effects on the people of the society. Here it is assumed that the information supplied by accounting will be useful for social welfare.
- The object of sociological approach is to provide information to make possible an evaluation of the effect of a firm's activities on society.
- For achieving its objective the sociological approach assumes the existence of certain accepted social values. These social values are used to regulate the formulation of accounting theory.
- However, it is difficult to ascertain those social values which may be accepted by all concerned. The sociological approach to accounting theory has helped formulation of a new branch of accounting known as social or socio-economic accounting.

v) Economic Approach

- Two conditions are to be satisfied for formulating accounting theory under this approach are:
    - The principles and methods of accounting should reflect the present economic situation or 'economic reality'.
    - Selection of the accounting techniques should depend on the economic consequences.
- The approach that focuses on the concept of 'national economic welfare' for formulating accounting principles is termed as economic approach. Under this approach the impact of national economic welfare is the main determining factor for formulation of accounting principles and techniques.

- The economic approach to the formulation of an accounting theory puts emphasise on controlling the attitude of macro-economic indicators that result from the adoption of different accounting techniques.
- Sweden is the country where the accounting techniques are adjusted to the macro economic situation. Under this approach the selection of a particular accounting technique depends on a particular economic situation.
- For example, under the condition of continuous increase in price level it is more reasonable to adopt 'Last in First Out' method of pricing of materials. So this method of pricing of materials is to be adopted in times of inflation.
- The main drawback of this approach is that while framing theory it relies more on economic conditions rather than on operational problems of accounting.

vi) Eclectic Approach

- The word 'eclectic' refers to the inference of opinion from different methods. All the above approaches to the formulation of accounting theory have some special advantages with limitations as well. In comparative analysis none of these approaches is identified as the best fit to construct theories which can match up all the practical needs of the users of accounting information.
- For this reason there lies the need to develop an approach by combining all the accepted approaches. This combined approach will assist in framing such an accounting theory that can consider all the practical problems of different users of accounting information.
- This combined approach is known as eclectic approach. So eclectic approach is that approach which is built up by combining the advantages of all other approaches for formulating that theory which will assist in solving the problems of all the users. It is not a new approach but a mixture of the old ones.

2. Modern or New Approaches

The traditional approaches discussed above mainly aim at construction of theories but not evaluation of the theories already established. Due to this defect, efforts were made by the scholars of accounting to develop such approaches which would not only help in formulating new accounting theories but in verifying the same as well. These new approaches are identified as modern approaches. The important modern approaches are as under:

- Events Approach
- Decision Model Approach
- Behavioural Approach
- Predictive Approach

❖ **Events Approach**

- The events approach for the formulation of accounting theory was first proposed by George Sorter and it was endorsed by the majority of the members of the AAA committee that issued “A statement of Basic Accounting Theory” in 1966.

- **To formulate accounting theory on the basis of relevant economic events affecting the users' decisions is known as events approach.** The principal argument used in favour of the events approach is that, due to wide ranging use and heterogeneous users of financial statements, accountants should not direct the published financial statements to specified 'assumed' group.
- Events are of two types: Monetary event and Non-monetary event. Under this approach the main objective of accounting is to supply information of those monetary events which have relevance in decision making of the users.
- **Advantages:** The main advantage of this approach is that it helps **maximisation of forecasting accuracy of the accounting statements** because it takes into consideration all probable information of an economic event which may be useful to the users. Given this argument, the **events approach suggests expansion of accounting data in the financial statements**.
- **Disadvantages:** The limitations of the events approach, however, are the following:
  - Events approach presupposes that the **users are knowledgeable enough** to be able to classify and aggregate accounting data for their own use.
  - Events approach **does not explicitly mention which data are to be selected for the financial statements**.
  - There is definite limit to the amount of data a person can handle at a time. **The expansion of data may cause information overload to the users**.

❖ **Decision Model Approach**

- The accounting approach, where an ideally adequate decision model is pre-determined on the basis of anticipated needs of the users of the financial statements, is identified as decision model approach.
- **In this approach, the information need of different users for making decisions is emphasised upon**. Keeping an eye to this need all probable information which may be helpful to the users is presumed with care.
- On the basis of such anticipated information standard or ideal decision models are pre-fixed.
- **Advantages**: Such accounting principles or techniques are formulated which may be the best fit for meeting information need of the users.

❖ **Behavioural Approach**

- In most of the approaches to the formulation of accounting theory, how the accounting practice should be done that is emphasised upon. But how is the accounting theory applied or used in practice that question is not considered at all.
- The behavioural approach is concerned with direct evidence of user's reaction to accounting reports as a basis for descriptive generalisation about the behavioural aspects of particular accounting techniques and problems such as:
  - The adequacy of disclosure;
  - The usefulness of financial statement data;
  - Attitudes about corporate reporting practices;
  - Materiality Judgement; and

  - The decision effects of alternative accounting valuation bases.
- In behavioural approach, developed by the modern thinkers of accounting, the behavioural aspect of accounting theory is accepted as the basis for formulation of theory. So the approach, where the need and behaviour of the users of accounting information are taken as the primary consideration for the formulation of accounting theory, is identified as behavioural approach.
- The development of this approach started in the first phase of the decade of 1960, before which the traditional approaches were dominating the accounting field. **C.T. Devine** introduced this approach for the first time in 1960.
- Accounting is practice oriented work which directly and indirectly affects human behaviour. This behaviour orientation of accounting paves the way of introducing the concept of behavioural science in developing its principles and techniques. Under this approach it is accepted that accounting should be done keeping an eye to the objectives and behaviour of the users of accounting information. For this purpose, the choice of accounting principles should be based on what information the users need and what would be their behaviour in relation to that information. As accounting is identified as a behavioural process the behavioural approach makes accounting ideas nearer to behavioural science.
- This approach is on the process of continuous research. It has not yet been finalised and no theory has yet been formulated following this approach. But no doubt, it has created great enthusiasm among the thinkers of accounting and in near future, something positive and constructive can be expected of it.

❖ **Predictive Approach**

- Like other modern approaches this approach is also decision oriented; but here decision is not the primary goal, primary goal is prediction for decision. Under the traditional approach accounting measures are generally used for non-predictive purposes e.g., accountability and reporting on stewardship. In the predictive approach however, accounting measures are not just considered as post-mortem exercise. This approach is based on predictive forecasting to take future decisions on the basis of data supplied by accounting. Under predictive approach the principles are formulated taking into consideration the predictive capacity of accounting information.
- According to this approach, when accountant confronted with the choice between different measurement alternatives, they will select that measure alternative, which provide the greatest predictive power in respect to a given event. The predictive approach is directly related to the predictive ability of financial data and is purported to provide a purposive criterion to relate the function of collecting financial data to the task of decision-making.
- W.H. Beaver, W. Frank, J.K. Simmons and others have made contribution to develop this approach. The FASB in its Statement of Financial Accounting No. 2 considered the predictive ability of accounting information as a criterion of the quality of accounting information

All the modern approaches, as discussed above, are still in a developing stage. Like the traditional approaches, they have not yet been used and widely tested for formulating accounting theories.

Comparison between Descriptive Theory and Normative Theory

- **Concept:** The descriptive theory is predictive model whose validity is independent of the acceptance of goal structure. On the contrary, normative theory requires a commitment to goals and therefore requires a policy maker to make value judgments.
- **Purpose:** Descriptive theories are concerned with how the world works, e.g., if a business enterprise changes from FIFO to LIFO and the share market has not anticipated the change, the share price will rise. On the other hand, normative theories are concerned with prescriptions, goal setting. E.g., the statement, 'if prices are rising, choosing a LIFO system will maximize the value of the firm' is refutable by evidence. Thus given an objective, a researcher can turn a prescription into a conditional prescription and assess the empirical validity.

Generally Accepted Accounting Principles (GAAP)

GAAP are the common set of accounting principles, standards and procedures that are used by accountants to prepare the financial statements. They are derived from practice, and on being useful get accepted into the accounting system. These principles are developed by the professional accounting bodies of different countries of the world, with the aim of attaining uniformity in accounting practiced by the entities of the respective countries. As such different GAAP have developed in different countries of the world. The GAAP must aim to satisfy the following three basic criteria:

(a) *Usefulness i.e.* making the information relevant and meaningful to the users of financial statements.
(b) *Objectivity i.e.* ensuring that the information is reliable, verifiable, trustworthy and unbiased.
(c) *Feasibility i.e.* making it applicable without much complexity and cost.

Accounting Principles

Accounting principles refer to those **rules of action** which are universally adopted by the accountants for recording accounting transactions. They act as the guidelines for recording and reporting transactions.

Features

- They have evolved out of assumptions made and conventions followed in accounting.
- They provide explanations to the current accounting practices.
- They act as the 'grammar' of accounting language.

Classification

Accounting Principles can be classified into two categories:

- Accounting Concepts; and
- Accounting Conventions.

Accounting Concepts

Accounting Concepts refers to the **assumptions** on the basis of which the transactions are recorded in the books of accounts and financial statements are drafted. They are perceived, presumed and accepted in accounting to provide a unifying structure and internal logic to the accounting process. They are also referred to as **Accounting Postulates**.

Features

- These are the necessary assumptions and ideas which are fundamental to accounting practice.
- These are the ideas which have been accepted universally.
- It is the foundation on which the superstructure of accounting is developed.
- The concepts provide the support to the basic structure of accountancy.
- It is not subject to any proof.

Classification

The different accounting concepts are:

1. Entity concept 2. Going concern concept 3. Money measurement concept	4. Dual aspect concept 5. Periodicity concept 6. Matching concept	7. Accrual concept 8. Realisation concept 9. Cost concept

Accounting Conventions

These are the **traditions or customs** that are observed by the accountants for preparation of financial statements. They have evolved out the different accounting practices followed by different entities over a period of time.

Features

- They have been developed by the accountants by usage and practice.
- Conventions need not have universal application.
- The accounting conventions have developed over a period of time.

Classification

The different accounting conventions are: 1. Conservatism; 2. Consistency; 3. Materiality; 4. Full Disclosure.

Distinguish between Accounting Concept and Accounting Convention

It should be noted that the terms 'Concepts' and 'Conventions' are usually used interchangeably, but they are different from each other:

1. Assumption
2. **Purpose:** 'Concepts' are primarily concerned with maintenance of books of accounts, while 'Conventions' are applied for preparation of financial statements.

Accounting Standards

- **Accounting standards** are the written statements issued by the statutory accounting bodies on specific accounting policies for the preparation and presentation of uniform and consistent

financial statements. These standards provide the terms and conditions of accounting policies and practices by way of codes, guidelines and adjustments. In a nut-shell, accounting standards provide the rules in relation to recognition, measurement and disclosure of financial information for preparation of financial statements.

- The **primary objective** of issuing accounting standard is to standardize the prevalent diverse accounting policies and practices. This is done for the dual purpose of:
  - eliminating the non-comparability of financial statements to the extent possible; and
  - adding reliability to the financial statements.

Major Difficulties in Setting up Accounting Standard

The following points highlight the four major difficulties faced in setting up accounting standard. The difficulties are:

1. Difficulties in Definition
2. Political Bargaining in Standard Setting
3. Conflict in Accounting Theories
4. Pluralism.

1. Difficulties in Definition

- ***Scope of Accounting not properly defined:*** To agree on the scope of accounting and of principles or standards, is admittedly most difficult. Some, for example, equate accounting with public accounting that is mainly with auditing and the problems of the auditor. Another opinion is that it (accounting) is frequently assumed to have a basis in a private enterprise economy.
- ***Principles vs. Rules:*** Some use "principles" as a synonym for "rules or procedure". The result is that the number of principles becomes large and most uneven in coverage and in quality. Another group seems to equate "Accounting concept" with "Accounting convention," that is, with consensus or agreement. If this is the case, then a principle can be changed if all agree it should be or alternatively, the only propositions that can qualify as principles are those that command consensus or agreement.

Such disagreement leads to difficulty in-standard setting and further does not make the standards totally acceptable to society.

2. Political Bargaining in Standard Setting

Earlier, but not so many years ago, accounting could be thought of as an essentially non-political subject. But, today, as the standard setting process reveals, accounting can no longer be thought of as non-political. The numbers that accountants report, have a significant impact on economic behaviour. Accounting rules therefore affect human behaviour. The stories conveyed by annual reports confirm or disappoint investor expectations and have the power to move millions (whether of money or persons). For the entire bloodless image that accounting may have, people really care about the way the financial score is kept. Hence, the process by which they are made is said to be political.

The setting of accounting standards is as much a product of political action as of flawless logic or empirical findings. The setting of standards is a social decision. Standards place restrictions on behaviour; therefore, they must be accepted by the affected parties. Acceptance may be forced or voluntary or some of both. In a democratic society, getting acceptance is an exceedingly complicated process that requires skilful marketing in a political arena. Accounting standard setting is certainly a political process, responding to pressures from the economic environment and compromising between the conflicting interests of different parties. It is important that standard-setters be aware of this and that they be aware of the specific pressure and interests involved. It would be unrealistic to expect to determine standards without such difficulties, and the best way to deal with them is to admit their existence rather than pretending to ignore them.

3. Conflict in Accounting Theories

There has been remarkable growth in accounting theories especially relating to income measurement, asset valuation, and capital maintenance. Though much of the developments has taken place abroad, (USA, UK, Canada, Australia, etc.), accounting in other countries has also been influenced. While the theorists battled on, the various sectional interests found that the theories could be used to support their own causes and arguments. At present, there is not a single theory in accounting which commands universal acceptance and recognition. There is no best answer to the different terms like profit, wealth, distributable income, value, capital maintenance, and so forth. We cannot say what the best way to measure profit is. If the profession truly wishes to be helpful it needs to discover from users, or to suggest to them, what would support their decision-making, and then do develop the measures which best reflect those ideas. The search for an agreed conceptual framework could be regarded as essential to orderly standard setting and a responsible way for the standard-setter to act. Also, it could be helpful in distracting critics while getting on with the real issues in accounting problems. Absence of a conceptual framework, i.e., a set of interlocking ideas on accountability and measurement is not conducive to standard setting and improved financial accounting and reporting.

4. Pluralism

The existence of multiple accounting agencies has made the task of standard setting more difficult. In India, company financial reporting is influenced by although in different degrees, by Accounting Standards Board of ICAI, Ministry of Corporate Affairs, Institute of Cost and Works Accountants of India, Securities and Exchange Board of India (SEBI). No one agency has jurisdiction over the entire area of accounting standards.

Similarly in other countries also, there is plurality of accounting bodies. For example, in USA there are organisations like Securities and Exchange Commission, Financial Accounting Standards Board, American Institute of Certified Public Accountants. In U.K., there are Accounting Standards Board of ICAEW and Companies Acts to deal with accounting matters and financial reporting. If pluralism were reduced or eliminated, the path toward the goal would be smoother. However, the absence of pluralism is not a necessary condition for agreement on standards developed by a single accounting body. No one would claim that the mere absence of an obstacle constitutes a sufficient condition for success. A standard setter has to face many difficulties in standard setting process. In a rational

way, a standard setting body should first define the objectives of financial accounting and reporting, identify user groups to be served, and the information which were useful to them before starting the process of standard setting

Procedure for issue of Accounting Standards in India

In India, the accounting standards are issued by the Accounting Standard Board (ASB) of the ICAI. The Board adopts the following procedure for formulation of accounting standards:

1. ***Determination of the areas of accounting standard***: Firstly, the ASB determines the broad areas in which accounting standards need to be formulated, and also the priority in the selection thereof.
2. ***Constitution of Study Group***: In the process of development of accounting standards, ASB constitutes a Study Group to consider the specific subject. The motive behind constitution of this group is to assist the ASB in its activities.
3. ***Dialogue with various representatives***: The ASB, thereafter, hold dialogues with the representatives of the Government, public sector undertakings, industry and other organisations for getting their views.
4. ***Preparation of Exposure Draft***: On the basis of the work of the Study Group and the dialogues with the stakeholders, an exposure draft of the proposed standard is prepared.
5. ***Issuance for circulation***: The exposure draft is thereafter issued for comments by members of the ICAI and the public at large.
6. ***Consideration of views and drafting the Standard***: The comments received on the Exposure Draft are taken into consideration, and thereafter the draft of the proposed standard is finalised by the ASB and submitted to the Council of the ICAI.
7. ***Modification of proposed Standard***: The Council of the ICAI considers the final draft of the proposed standard, and if found necessary, modify the same in consultation with ASB.
8. ***Issuance of Accounting Standard***: Finally, the Accounting standard gets issued under the authority of the Council.

Unit - II
Assets, Liabilities and Accounting for Depreciation

Current/ Non - Current distinction

An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications in its balance sheet.

- **Current Assets:** An entity shall classify an asset as current when - (a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle; (b) it holds the asset primarily for the purpose of trading; (c) it expects to realise the asset within twelve months after the reporting period; or (d) the asset is cash or a cash equivalent (as defined in Ind AS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.
- An entity shall classify all other assets as non-current.

The operating cycle of an entity is the time between the acquisition of assets for processing and their realization in cash or cash equivalents. When the entity's normal operating cycle is not clearly identifiable, it is assumed to be twelve months. Current assets include assets *(such as inventories and trade receivables)* that are sold, consumed or realised as part of the normal operating cycle even when they are not expected to be realised within twelve months after the reporting period.

Current assets also include assets held primarily for the purpose of trading (examples include some financial assets that meet the definition of held for trading in Ind AS 109) and the current portion of non - current financial assets. Some current liabilities (such as trade payables and some accruals for employee and other operating costs) are part of the working capital used in the entity's normal operating cycle.

- An entity classifies such operating items as current liabilities even if they are due to be settled more than twelve months after the reporting period. The same normal operating cycle applies to the classification of an entity's assets and liabilities. When the entity's normal operating cycle is not clearly identifiable, it is assumed to be twelve months. Other current liabilities are not settled as part of the normal operating cycle, but are due for settlement within twelve months after the reporting period or held primarily for the purpose of trading. Examples are some financial liabilities that meet the definition of held for trading in Ind AS 109, bank overdrafts, and the current portion of non-current financial liabilities, dividends payable, income taxes and other non-trade payables. Financial liabilities that provide financing on a long-term basis (i.e. are not part of the working capital used in the entity's normal operating cycle) and are not due for settlement within twelve months after the reporting period are non-current liabilities.
- An entity classifies its financial liabilities as **current** when they are due to be settled within twelve months after the reporting period, even if - (a) the original term was for a period longer than twelve months, and (b) an agreement to refinance or to reschedule payments on a long-term basis is completed after the reporting period and before the financial statements are approved for issue. If an entity expects, and has the discretion, to refinance or roll over an obligation for at least twelve months after the reporting period under an existing loan facility, it

classifies the obligation as non-current, even if it would otherwise be due within a shorter period. However, when refinancing or rolling over the obligation is not at the discretion of the entity (for example, there is no arrangement for refinancing), the entity does not consider the potential to refinance the obligation and classifies the obligation as current. Where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the entity does not classify the liability as current, if the lender agreed, after the reporting period and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach. However, an entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.

Every company, to which Ind AS is applicable, is required to prepare its financial statements in accordance with schedule III of Companies Act, 2013. Modifications are permitted in certain circumstances for instance where modification is required to comply with Ind AS.

PART I –BALANCE SHEET

Name of the Company……………………..
Balance Sheet as at ………………………

(Rupees in…………)

	Particulars	**Note No.**	**Figures as at the end of current reporting period**	**Figures as at the end of the previous reporting period**
	1	**2**	**3**	**4**
	ASSETS			
(1)	**Non-current assets**			
	(a) Property, Plant and Equipment			
	(b) Capital work-in-progress			
	(c) Investment Property			
	(d) Goodwill			
	(e) Other Intangible assets			
	(f) Intangible assets under development			
	(g) Biological Assets other than bearer plants			
	(h) Financial Assets			
	(i) Investments			
	(ii) Trade receivables			
	(iii) Loans			
	(iv) Others (to be specified)			
	(i) Deferred tax assets (net)			
	(j) Other non-current assets			
	Current Assets			
	(a) Inventories			
(2)	(b) Financial Assets			
	(i) Investments			
	(ii) Trade receivables			
	(iii) Cash and cash equivalents			
	(iv) Bank balances other than (iii) above			
	(v) Loans			
	(vi) Others (to be specified)			
	(c) Current Tax Assets (Net)			
	(d) Other current assets			

	Total Assets			
(1)	**EQUITY AND LIABILITIES** **Equity** (a) Equity Share capital (b) Other Equity **LIABILITIES** **Non-Current Liabilities** (a) Financial Liabilities (i) Borrowings (ii) Trade payables (iii) Other financial liabilities (other than those specified in item (b) to be specified) (b) Provisions (c) Deferred tax liabilities (Net) (d) Other non-current liabilities			
(2)	**Current Liabilities** (a) Financial Liabilities (i) Borrowings (ii) Trade payables (iii) Other financial liabilities (other than those specified in item (c) (b) Other current liabilities (c) Provisions (d) Current Tax Liabilities (Net)			
	Total Equity and Liabilities			

Ind AS 2: Inventories

Inventories are assets - (a) held for sale in the ordinary course of business; *or* (b) in the process of production for such sale; *or* (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

Objective -The objective of this standard is to prescribe the accounting treatment for inventories. This Standard deals with the determination of cost and its subsequent recognition as an expense, including any write-down to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

Scope - ***This standard applies to all inventories except –***

(a) Financial instruments *(Ind AS 32, Financial Instruments: Presentation and Ind AS 109, Financial Instruments*); and (b) biological assets *(i.e. living animals or plants)* related to agricultural activity and agricultural produce at the point of harvest *(Ind AS 41, Agriculture).*

This standard does not apply to the measurement of inventories held by -

- Producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at net realisable value in accordance with well - established practices in those industries.
- Commodity broker - traders who measure their inventories at fair value less costs to sell. When such inventories are measured at fair value less costs to sell, changes in fair value less costs to sell are recognised in profit or loss in the period of the change.

Definition – (a) Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. *(See Ind AS 113, Fair Value Measurement)*

(b) Net realizable value refers to the net amount that an entity expects to realize from the sale of inventory in the ordinary course of business.
Fair value reflects the price at which an orderly transaction to sell the same inventory in the principal *(or most advantageous)* market for that inventory would take place between market participants at the measurement date. The former is an entity-specific value; the latter is not. Net realizable value for inventories may not equal fair value less costs to sell.

❖ **Measurement of Inventories**

Inventories shall be measured at the lower of cost and net realisable value.

- **Cost of inventories:** The cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.
- **Costs of purchase:** The costs of purchase of inventories comprise the purchase price, import duties and other taxes *(other than those subsequently recoverable by the entity from the taxing authorities)*, transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.
- **Costs of conversion:** The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and equipment and the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly or nearly directly with the volume of production, such as indirect materials and indirect labour.

  The allocation of fixed production overheads to the costs of conversion is based on the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognised as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

  A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by - product. When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the

production process when the products become separately identifiable or at the completion of production. Most by-products, by their nature, are immaterial. When this is the case, they are often measured at net realisable value and this value is deducted from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost.

- **Other costs:** Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. For example, it may be appropriate to include non-production overheads or the costs of designing products for specific customers in the cost of inventories. Examples of costs excluded from the cost of inventories and recognised as expenses in the period in which they are incurred are - (a) abnormal amounts of wasted materials, labour or other production costs; (b) storage costs, unless those costs are necessary in the production process before a further production stage; (c) administrative overheads that do not contribute to bringing inventories to their present location and condition; and (d) selling costs.

❖ Cost Formulas

The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects shall be assigned by using specific identification of their individual costs.

The cost of inventories, other than those dealt in the above paragraph, shall be assigned by using the first-in, first-out (FIFO) or weighted average cost formula. An entity shall use the same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different nature or use, different cost formulas may be justified.

For example, inventories used in one operating segment may have a use to the entity different from the same type of inventories used in another operating segment. However, a difference in geographical location of inventories (or in the respective tax rules), by itself, is not sufficient to justify the use of different cost formulas.

The FIFO formula assumes that the items of inventory that were purchased or produced first are sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced. Under the weighted average cost formula, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the entity.

▪ Net Realisable Value

The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined. The cost of inventories may also not be recoverable if the estimated costs of completion or the estimated costs to be incurred to make the sale have increased. The practice of writing inventories down below cost to net realizable value is consistent with the view that assets should not be carried in excess of amounts expected to be realized from their sale or use.

Inventories are usually written down to net realisable value item by item. In some circumstances, however, it may be appropriate to group similar or related items. This may be the case with items of inventory relating to the same product line that have similar purposes or end uses, are produced and marketed in the same geographical area, and cannot be practicably evaluated separately from other items in that product line. It is not appropriate to write inventories down on the basis of a classification of inventory, for example, finished goods, or all the inventories in a particular operating segment.

Estimates of net realizable value are based on the most reliable evidence available at the time the estimates are made, of the amount the inventories are expected to realise. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period to the extent that such events confirm conditions existing at the end of the period.

Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when a decline in the price of materials indicates that the cost of the finished products exceeds net realizable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value.

A new assessment is made of net realizable value in each subsequent period. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in net realizable value because of changed economic circumstances, the amount of the write-down is reversed *(i.e the reversal is limited to the amount of the original write-down)* so that the new carrying amount is the lower of the cost and the revised net realizable value. This occurs, for example, when an item of inventory that is carried at net realizable value, because its selling price has declined, is still on hand in a subsequent period and its selling price has increased.

- **Recognition as an expense**

When inventories are sold, the carrying amount of those inventories shall be recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realizable value and all losses of inventories shall be recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realizable value, shall be recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another asset in this way are recognised as an expense during the useful life of that asset.

Unit - III
Capital, Value and Profit

Accounting Capital

In accounting, Capital is defined from different dimensions as follows –

- Share Capital: Total numbers of shares of different denominations (1st item of the liabilities side of balance sheet)
- Residual Equity or Proprietorship/Ownership Capital: Capital plus reserves and surplus
- Entity Capital/Capital Employed: Ownership Capital plus Long Term Debt
- Gross Asset approach to Capital: Value of all assets except fictitious asset. Entity capital is also the Net Asset approach to capital

Accounting Capital Vs. Economic Capital

- Economic Capital refers to 'produced means of production.' So, it must be man-made and then it must be used for production, not for consumption. Thus, land is not a part of economic capital, though in accounting it is included in capital.
- In Economics, financial assets do not constitute capital. In Accounting, they are the part of capital. In accounting, assets are mainly valued under Historical Cost Method. In Economics under NPV method. So, Capital figure differs.

Accounting Income

Like Capital, Income is also defined from different standpoints.

a) Accounting Income is Net Profit: This is Proprietary Income/Business Income of owners.

b) Net Profit plus interest: It is ROCE or Managerial Income.

c) Net Profit + Interest + Rent + Wages: It is Value Added income. It is Sale - Purchase/COGS

Accounting Income Vs. Economic Income

- Accounting income always money income. But Economic income, real income sometimes it is psychic income.
- In Accounting, income means amount accruing to owners for their capital and organising activity. In Economics, income means the remuneration of only the organising activities.
- Income means closing capital minus opening capital. Capital is valued differently in economics and accounting. So, two incomes differ.

Use and Consumption of Capital

One must use capital to generate Income. But the used capital may not be fully consumed in the process of income generation or production. Raw material, amount spent for wages etc are totally exhausted or lost in the process. But the fixed capital like machines etc are not fully exhausted, a part of it can only be lost in the process. So, all uses are not consumptions, though all consumptions

are also the uses. Part of fixed capital that is consumed in 'depreciation'. Here, production, however, does not mean only change of shape, i.e. manufacturing, but also change of time or place i.e. trading.

Maintenance of Capital

Old resource/ capital are consumed in production process, new resources are produced and sold. Then, again a businessman is to purchase the resources that he had at the beginning in order to continue the production process. For thus a part of the sale proceeds is to be kept aside which is equal to the original capital. Other part of sale proceeds is free for consumption and it is 'Income'. So, to get income, you must first set aside your invested capital and this is known as ***'Maintenance of Capital'***.

Sale Proceeds or Gross Revenue = Invested Capital + Income

= Return of Capital + Return on Capital

Concept of Capital Maintenance has three different approaches -

i) Maintenance of Nominal Capital - This concept is the old concept and it refers to the maintenance of capital in original money value or initial monetary term.

ii) Maintenance of Real Capital - Objective of capital maintenance is to purchase the same resources in the next period that we had at the beginning. But after a certain period, say one year, the price of those resources may increase by 10%. Then, Capital to be maintained should be Rs. 11,000/-, not Rs. 10,000/-.

iii) Maintenance of Physical Capital - Some accounting writers believe and argue that Capital will truly be maintained if the same physical resources that we had at the beginning exist at the end. If there is some depletion or loss of assets during the period, identical assets or resources are to acquired to keep the business equally well off or to maintain the physical capital.

Valuation of Capital / Assets

How do you value the capital or assets is important for income measurement as well as to know your financial condition on a particular date. So, far there have been a number of methods for such valuation

i) Historical Cost Method, ii) Current Purchasing Power Method, iii) Replacement Cost Method,

iv) Net Realisable Value Method, v) Net Present Value Method, vi) Deprival Value Method, vii) Fair Value Method *(as per Ind AS-113 – only Definition, Orderly Transaction, Principal Market, Independent Party, Value Hierarchy – Level 1, 2 and 3*).

Income Measurement

Income is determined mainly in two ways –

i) Revenue Expense (R-E) Approach and **ii) Balance Sheet Approach (NW_t - NW_{t-1})** Whereas, NW = Net Wealth and t = time/year

Whatever approach we follow, we will get the same result. But gradually we are moving to (ii) approach, as the first approach known as Profit and Loss Approach also requires proper matching, revenue recognition, allocation etc. that are subjective as well as complicated.

Two dimensions of Income Measurement

i) Life time Income - It is measured in case of terminable venture like business, once at the end of venture. This income is cash to cash income. So, it does not require valuation, allocation etc. This income thus is a fact and objective.

ii) Periodic Income - It is the income for a period usually one year. In case of going concern we determine periodic income. Artificially we give a cut – off date, say 31st March each year. But on that date some goods may remain unsold, some unrealized income, some unpaid expenses. So, here we depend on a number of estimates and the income that we determine thereby becomes an opinion, not fact. We depend on Matching Principles and Revenue Recognition principles to reduce distortion. Still, this income remains subjective.

Unit - IV
Specific Issues in Corporate Reporting

Social Reporting

Social reporting is defined as reporting of some meaningful, definable domain of a business enterprise's activities that have social impact. Put another way, it implies the measurement and reporting, internal or external of information concerning the impact of a business enterprise and its activities on society.

Uses of Social Responsibility Information

1. Internal Users (Management)

Top Management or Board of Directors needs social performance information to respond to a critical press, to answer shareholders questions and to ensure that company policies are properly followed. Because of their growing legal liability, they need to know in some detail what sort of social programmes the company is having and what result it is getting. They also need complete information about the effects of the company on society, it is probably more important that they be fully informed as to negative effects, since this is where the criticism will be directed and this is where the directors may have to defend themselves. Labour unions can also be expected to seek social performance information about their companies.

2. External Users (Shareholders and other investors)

The external users demand for social accounting information is even more diverse. Social accounting and reporting are needed by present and potential investors by large institutions and individuals. There are ethical investors who are concerned with not only economic performance but also with social responsibility performance of business enterprises while making investment decisions.

3. Impact on Share Prices

The disclosure of social information helps investors in studying the negative effects of social awareness expenditures on earnings per share along-with any compensating positive effects that reduce risk or create interest for a particular investment. Between firms competing in the capital markets those perceived to have the highest expected future earnings in combination with the lowest expected risk from environmental and other factors will be most successful at attracting long term funds.

Scope of Social Responsibility Reporting

The areas for the purpose of social reporting have been identified such as -

1. Net Income Contribution

The growing attention which other social objectives are receiving does not reduce the importance of the income objective. A business organisation cannot survive without an adequate financial surplus; long-range planning includes calculating the minimum return to shareholders. There is a clear correlation between income and other objectives. The failure to recognize a social responsibility may well affect the organisation's income performance either in the short term or the long term.

2. Human Resource Contribution

It reflects the impact of organisational activities (such as recruiting practices, training programmes, experience building - job enrichment, wage and salary levels, fringe benefit plans, management-union relations, employee skills, employee knowledge, employee attitudes, employee self actualization, congruence of employee and organisational goals, mutual trust and confidence, job security, transfer and promotion policies, occupational health, freedom from undue stress) on the people who constitute the human resources of the organisation.

3. Public Contribution

This area considers the impact of organisational activities on individuals (contributions to educational, cultural or charitable organisations, financial or manpower support for public transportation, health services, community problem solving, equal opportunity employment practices, training and employment of handicapped persons) generally outside the organisation.

4. Environmental Contribution

This area involves the environmental aspects of production, covering the use of resources, the production process and the product itself including recycling and other positive environmental activities. Attention has been drawn in recent years to the negative aspects of organisational activities such as the pollution of air and water, noise and spoiling of the environment. Moreover, industrial activities lead to a net use of irreplaceable resources and a net production of solid wastes.

5. Product or Service Contribution

This area concerns the qualitative aspects of the organisation's product or service such as product utility, product life-durability, product safety and serviceability as well as the welfare role of the product or service. Moreover, it includes customer satisfaction, truthfulness in advertising, completeness and clarity of labeling and packaging.

Unit - V
Globalisation of Accounting Standards

Meaning of Standardisation

Standardisation refers to the imposition of a more rigid and narrow set of rules. In accounting, concept of standardisation adopted by European Community (EC) is Harmonisation which permits the prevalence of different standards in different member nations. Which are in harmony with each other.

IFRS - Concept

- International Financial Reporting Standards (IFRS) are accounting standards issued by the International Accounting Standards Board (IASB).These are global accounting standards that are issued with the intention of ensuring uniformity in accounting across the globe.
- These are intended to provide investors and other stake-holders the ability to compare the financial performance of publicly listed companies.
- 'IFRS' is the trademark of the International Accounting Standards Committee Foundation. The Foundation owns the copyright to IFRS in all languages.
- IFRSs are now mandated for use by more than 140 countries, including the European Union and by more than two-thirds of the G20 nations. The G20 and other international organisations including the World Bank, IMF, Basel Committee etc. have consistently supported the work of the IASB and its mission of global accounting standards.
- The term 'IFRS' constitutes in its fold the International Accounting Standards (IAS), International Financial Reporting Standards (IFRS), SIC Interpretations and IFRIC Interpretations.

GAAP Vs. IFRS

A major difference between GAAP and IFRS is that GAAP is rule-based, whereas IFRS is principle-based.

- With a principle based framework there is the potential for different interpretations of similar transactions, which could lead to extensive disclosures in the financial statements. Although, the standards setting board in a principle-based system can clarify areas that are unclear. This could lead to fewer exceptions than a rules-based system.
- Another difference between IFRS and GAAP is the methodology used to assess an accounting treatment. Under GAAP, the research is more focused on the literature whereas under IFRS, the review of the facts pattern is more thorough.

Process of IFRS Standard Setting

- **Agenda Consultation**

Every five years, the Board conducts a comprehensive review and consultation to define international standard-setting priorities and develop its project work plan. The Board can also add topics to its work plan if necessary between agenda consultations. This can include topics following Post-implementation Reviews of Standards; the IFRS Interpretations Committee may also request the Board review an issue.

- **Research Programme**

Most projects with research - explore the issues, identify possible solutions and decide whether standard-setting is required. Often, set out their ideas in a discussion paper and seek public comment. If sufficient evidence found that an accounting problem exists, the problem is sufficiently important to warrant changing a Standard or issuing a new one and a practical solution can be found, then standard-setting begins.

- **Standard - Setting Programme**

If the Board decides to amend a Standard or issue a new one, we generally review the research, including comments on the discussion paper, and propose amendments or Standards to resolve issues identified through research and consultation. Proposals for a new Standard or an amendment to a Standard are published in an exposure draft for public consultation

- **Maintenance Programme**

This process includes consulting on the implementation of a new or amended standard to identify any implementation problems that may need to be addressed. If issues arise, the IFRS Interpretations Committee may decide to create an IFRIC Interpretation of the Standard or recommend a narrow-scope amendment. Such amendments follow the Board's normal due process.

- **Post - Implementation Reviews**

After a new Standard has been in use for a few years, the Board carries out research through a Post-implementation Review to assess whether the Standard is achieving its objective and, if not, whether any amendments should be considered. As a result of the Post-implementation Review, the Board may start a new research project.

Problems with IFRS

- **The new standards:** Every country stipulates a method for companies to report financial data based on rules called accounting standards. India has so far followed IGAAP. However, from FY17, it will follow Ind-AS whose principles are closely based on international accounting system called IFRS. This will increase comparability of Indian companies with their international counterparts.
- **Impact on companies:** It will impact how key financials such as revenue, operating profit, net profit, book value, goodwill, and return on equity will be computed. For instance, under the existing rules, sales are calculated after deducting excise duty. Under the new norms, excise duty will be treated as a tax on manufacturing activity. Hence, it should be a part of revenue. This will increase the revenue of companies, but depress operating margin. However, EPS will remain unchanged.

Challenges of IFRS Adoption

The principal impeding factors in the adoption process of IFRS in Europe, America and the rest of the world are not necessarily technical but cultural issues, mental models, legal impediments, educational needs and political influences. The implementation challenges include: timely interpretation of standards, continuous amendment to IFRS, accounting knowledge and expertise possessed by financial statement users, preparers, auditors and regulators, and managerial incentive.

Although IFRS has the potentials to facilitate cross-border comparability, increase reporting transparency, decrease information costs, reduce information asymmetry and thereby increase the liquidity, competition and efficiency of markets have found that cultural, political and business differences may also continue to impose significant obstacles in the progress towards a single global financial communication system because a single set of accounting standards cannot reflect the differences in national business practices arising from differences in institutions and cultures. The perception of IFRS quality by users is critical to IFRS adoption. For instance, in a recent survey, individual investors felt satisfied with the current US accounting model and do not desire movement towards IFRS adoption. Similarly, few researchers found that small businesses in the US were not prepared for IFRS because they do not see benefits in switching from GAAP to IFRS.

Unit - VI
Contemporary Issues in Accounting

Balanced Score Card (BSC)

Balanced Score Card (BSC) is a performance management and strategy development methodology that helps executives translate on organization's mission statement and overall business strategy into specific, qualifiable goals and monitors the organization's performance in terms of these goals.

Perspectives

The aim of scorecard is to provide a comprehensive framework for translating company's strategic objectives into a coherent set of performance measures from four perspectives –

i) Financial: Under this perspective, the focus will be on financial measures like operating profit, ROI, residual income, economic value added concept, revenue growth, cost reduction, asset utilization etc. These financial measures will provide feedback on whether improved operational performance is being translated into improved financial performance.
ii) Customer: This perspective typically includes several core or genetic measures that relate to customer loyalty and the result of the strategy in the targeted segment. They include market share, customer retention, new customer acquisition, customer satisfaction and customer profitability.

iii) Internal Business Processes: This perspective focuses on the internal business results that lead to financial success and satisfied customer. To meet organizational objectives and customers' expectations, organizations must identify the key business processes at which they must excel. Key processes are monitored to ensure that outcomes will be satisfactory.

iv) Learning and Growth: This perspective identifies the infrastructure that the business must build to create long-term growth and improvement. There will be focus on factors like employee capability, employee productivity, employee satisfaction, employee retention.

Benefits and Limitations

An organization can derive the following benefits by the implementation of BSC -

- It can successfully communicate corporate strategy to the functional heads and organisation's subunits and forcing them to develop their own goals to achieve the corporate mission and goals.
- It helps in focusing the whole organisation on the few key things needed to create breakthrough performance.
- It helps to integrate various corporate programs like re-engineering, customer service initiatives.
- It helps in conduct of periodic performance reviews to learn about and improve strategy.

Balanced Score Card (BSC) is subject to following limitations –

- There is no clear relation between BSC and shareholder value
- It does not lead to a single aggregate summary of control
- The measures may give conflicting signals and confuse management
- It involves substantial shift in corporate culture

Intellectual Capital

Intellectual capital has also been defined as the difference between a firm's market value and the cost of replacing its assets. Intellectual capital encompasses much more than patents, copyrights and other forms of intellectual property. It is the sum and synergy of a company's knowledge, experience, relationships, processes, discoveries, innovations, market presence and community influence.

Components of Intellectual Capital

<table>
<tr><th>Sl. No.</th><th>Components</th><th colspan="2">Items</th></tr>
<tr><td>1</td><td>Knowledge at Individual Level
Or
Human Capital</td><td colspan="2">Know–how, Education, Vocational qualifications, Work-related knowledge, Occupational assessments, Psychometric assessment, Work-related competencies, Entrepreneurial innovativeness</td></tr>
<tr><td>2</td><td>Knowledge at Group Level
Or
Relational Capital</td><td colspan="2">Brands, Customers, Customer Loyalty, Company Names, Backlog Orders, Distribution Channels, Business Collaborations, Licensing Agreements, Favourable Contracts, Franchising Agreement</td></tr>
<tr><td rowspan="2">3</td><td rowspan="2">Knowledge at Organisational Level
Or
Structural Capital</td><td>Intellectual Property</td><td>Infrastructure assets</td></tr>
<tr><td>Patents, Copyrights, Design Rights, Trademarks,</td><td>Management Philosophy, Corporate Culture, Management Processes, Information Systems, Financial Relations</td></tr>
</table>

Measuring and Reporting of Intellectual Capital

Researchers recommend a number of financial and non-financial measurement models that may be divided into following categories.

- **Direct intellectual capital practices:** These methods predict dollar value of intellectual capital through identifying their components. As intellectual capital components are identified, they can be evaluated continuously and directly. They can determine the final value of the organisation intellectual capital through combination.
- **The Investment market value:** This method focuses on calculating the difference between company market value and book value of shares and it categorised the calculated difference as non-tangible assets or intellectual capital.
- **Methods of score (credit) card:** In this method different components of intangible assets or intellectual capital are identified and for each of these indicators are provided and or they are displayed in corresponding graphs. The methods of score (credit) card are similar to direct intellectual capital assets but the difference is that in these methods there is no estimation of real value of non-tangible assets.

Human Resource Accounting

'Human Resource Accounting is the process of identifying and measuring data about human resources and communicating this information to interested parties. **(The American Accounting Society Committee on Human Resource Accounting)**

Models of Human Resource Accounting (HRA)

Sl. No.	Cost Based Models
1	Capitalization of Historical Costs **- R. Likert and his associates Model**
2	Replacement Cost **- Flamholtz Model**
Sl. No.	**Economic Value Models**
1	Opportunity Cost **- Hekimian and Jones Model**
2	Discounted Wages and Salaries **- Lev and Schwartz Model**
3	Stochastic Process with Service Rewards **- Flamholtz Model**
4	Valuation on Group Basis **- Jaggi and Lau Model**

Uses of Valuation of Human Resources and its reporting

In Human Resource Accounting and Reporting, the following aspects may be highlighted -

i) **Payments/Compensation:** Payments made to employees by way of monetary and non-monetary benefits should be disclosed. Cost to Company for Labour Welfare measures should also be disclosed in the usual manner e.g. Staff Salary and Wages, PF and Other Welfare Fund Contributions, Staff Welfare Expenses, other payments made to workers etc.

ii) **Training and Development:** The details of training programme organized for employees and related expenses should be disclosed. Recognition and promotion of employees who have undergone training should also be attached.

iii) **Value of Human Asset:** An appropriate method (E.g. Lev and Schwartz Model) may be applied to arrive at the value of Human Resources. Suitable assumptions should be made, wherever necessary.

Shortcomings of Human Resource Valuation

- **Difficulty in Measurement:** An asset to be recognized in the Balance Sheet should be measured first. An asset is generally valued / measured based on cost of acquisition or expected future benefits. Generally human resources are not bought, but only hired. Future benefits can be measured tangibly for machineries, furniture as their performance follows predictable lines. However, human nature and performance is generally not on predictable lines.
- **Subjectivity:** The various models of Human Resources Valuation deal with capitalisation of Historical Costs, Replacement Costs and Estimated Future Earnings etc. The amounts associated with such costs, and also the determination of various probabilities and discount rates are subjective in nature.
- **Timing:** Unlike the owned physical resources (Fixed Assets), the company does not 'own' the human resources as such. Hence, the timing as to when such resources should be recognised in financial reporting is an issue to be addressed.

Forensic Accounting and Reporting

The term 'forensic accounting' was first used in 1946 by Maurice E. Peloubet, a partner in a New York based accounting firm. The word forensic is derived from the Latin word '*forensis*', meaning thereby belonging to the forum *(the site for public discussion and debate in ancient Rome).* It refers as assistance in disputes regarding allegations or suspicion of fraud which are likely to involve litigation, expert determination and enquiry by an appropriate authority and investigations of suspected fraud, irregularity or impropriety which could potentially lead to civil, criminal or disciplinary proceedings.

Forensic Accounting assists an organization in legal matters in two ways –

i) Investigative Accounting deals with the investigation of criminal matters relating to employee theft, securities fraud, insurance fraud etc. **ii) Litigation Support** involves the quantification of the amount of economic damages and also providing accounting assistance in litigation matters.

Techniques Involved

Some of the techniques involved in Forensic Accounting to examine the frauds are:

i) Ben Ford's Law: It is a mathematical tool and is one of the ways to determine whether a variable under the study is a case of unintentional errors or fraud on detecting any such phenomenon the variable under study is subjected to a detailed scrutiny.

ii) Theory of Relative size factor (RSF): It is a powerful test for detecting errors and measured as **RSF = Largest Record in a Subset/Second Largest Record in a Subset**. This test identifies subsets where the largest element is out of line with the other elements for that subset. It also highlights all unusual fluctuations which may be routed from fraud or genuine errors.

iii) Computer Assisted Auditing Tools (CAATs): These are computer programs that helps the auditor to perform various auditing procedures like testing details, identifying inconsistencies, sampling programs, redoing calculations etc.

iv) Data Mining Techniques: It is a set of computer-assisted techniques like discovery, predictive modeling and deviation and link analysis designed to automatically mine large volumes of data for new and unexpected patterns.

v) Ratio Analysis: This analysis gives indications of the financial health of a company, data analysis ratios report on the fraud health by identifying possible symptoms of fraud.

Reasons behind the growth of Forensic Accounting

The important reasons for the growth of forensic accounting are -

- ✓ Rotation of the statutory auditor addresses a part of the problem. The method of appointing the statutory auditors is not foolproof as it is prone to collusion and lobbying.
- ✓ The certificates of the auditors are hardly scrutinized carefully especially when the reports are unclean and qualified.
- ✓ The internal auditors can surely detect what was happening but they are hardly in a position to initiate proper action in proper time.
- ✓ Internal audit and audit committee as a part of the management function fail to shed light on the hidden aspects of corporate fraud.

Creative Accounting and Fraudulent Practices followed by the Indian Companies

Name of the Company	Year	Nature of Creative Accounting Practice Followed
WIPRO Ltd.	1996 - 97 to 1999 - 2000	Transfer of land to stock creating capital reserve with the fair value and using it to neutralize the effect on profit of reduction of land value.
Larsen & Toubro Limited	1999 - 2000 and 2001 - 02	Income recognition through transfer of loan liabilities at a lower consideration
Tata Motors, Bombay Dyeing, Mahindra and Himachal Futuristic	2001 - 2002	Direct write offs from reserves.
Bombay Dyeing & Manufacturing Company Limited	2003 and 2004 - 05	Creating provisions for possible loss on firm purchase contract and subsequent write
Hindustan Zinc Limited	2003 - 04 and 2004 - 05	Reclassifying assets in the balance sheet.
Apollo Tyres Ltd.	2004 - 05	Debiting profit and loss account with additional excise duty payable to the government and transferring equivalent amount from general reserve to neutralize the effect.
Asian Electronics Ltd.	2004 - 05	Impairment of assets: treatment of deferred tax.
ONGC, Mukund Ltd., Torrent Power ACE Ltd. and Tata Motors Ltd.	2004 - 05	Capitalization of interest as well as other intangible assets to show fixed assets value upward and understating revenue expenses.
Satyam Computers Services Limited	2008 - 09	Fraudulently incorporated a nonexistent cash component by inflating the bank balances, fudging bills, accounts receivables, interest and liabilities.
Source: Jones, M. (2011), Creative accounting, Fraud and International Accounting Standards		

Applicability of Forensic Accounting Assignment

Since each and every fraud and financial irregularity is unique, accordingly the approaches to be adopted to unveil each of them will be specific to it. Association of Chartered Certified Accountants (ACCA) has provided guidelines to perform Forensic Accounting assignment such as - i) Meeting with the client and accepting the engagement, ii) Performing conflict check, iii) Performing initial investigation, iv) Planning the audit or formation of robust action plan, v) Gathering relevant evidence, vi) Analysis of evidences and other supporting information and finally, vii) Preparation of Report.

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