Accounting Standards & International Financial Reporting Standards (IFRS)

Accounting Standards- Introduction, Purpose and Importance

Objectives

After going through this lesson, you shall be able to understand the following concepts.

- Meaning of Accounting Standards
- Nature & Scope of Accounting Standards
- Uses of Accounting Standards
- Limitations of Accounting Standards
- Accounting Standards Issued by The Institute of Chartered Accountants of India (ICAI)

Meaning of Accounting Standards

The main objective of preparation of financial statements is to summarise the financial position of a business enterprise for an accounting period in monetary terms. In order to compare the financial position of an enterprise with that of another enterprises, there needs to be a consistency in the method of preparation of financial statements across various companies. In order to make these methods and principles uniform and consistent across organisations the accounting standards have evolved.

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

According to Kohler, "*A code of conduct imposed on an accountant by customs, law and professional bodies*"

Nature & Scope of Accounting Standards

The below mentioned are the basic points explaining the nature of accounting standards.

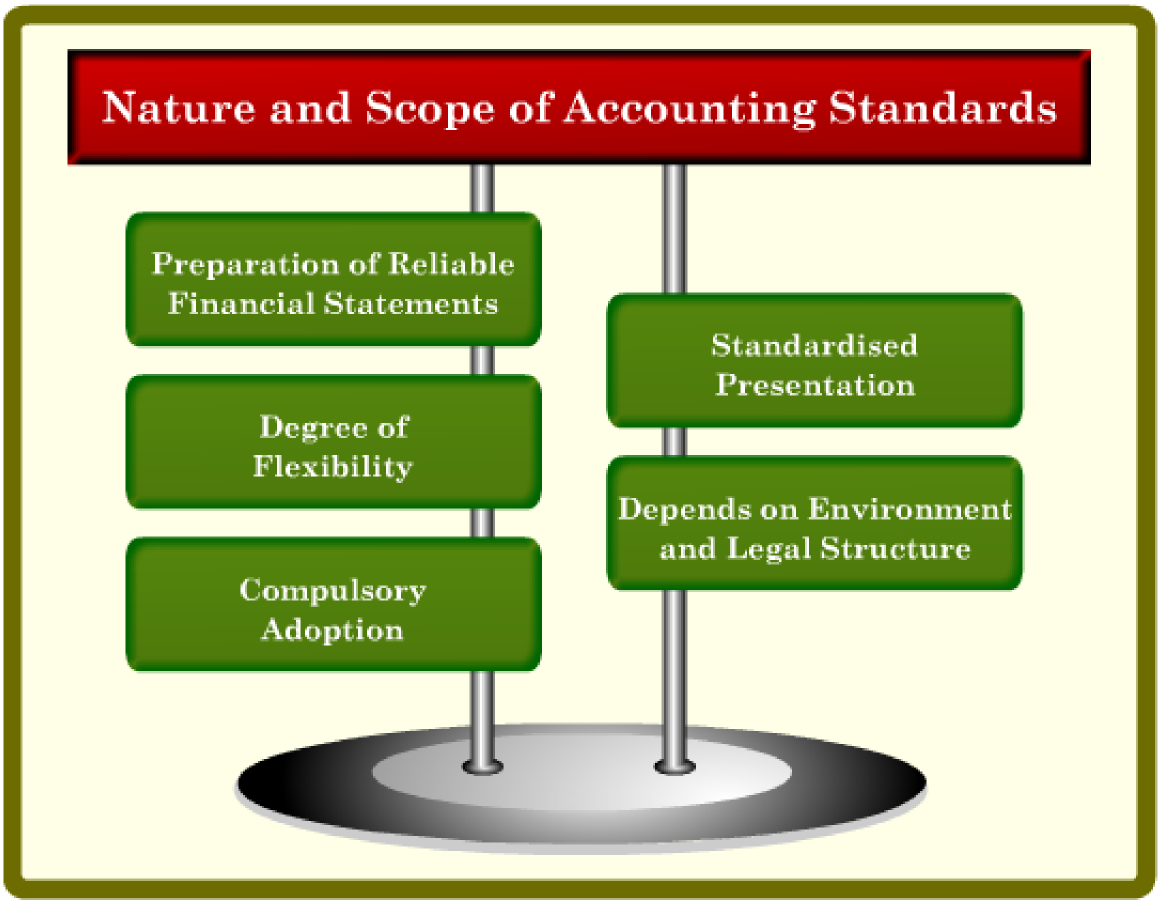
1. Accounting standards are a set of guidelines that help in the **preparation of reliable financial statements.**

2. Accounting standards help in bringing a **standardisation of presentation** and help in removal of variations that exist in treatment of accounting information.

3. Accounting standards depend on the **environment and legal structure** of the country in which the business operates. Due to constant changes in the environment of our country, the accounting standards are updated by the ICAI from time to time. In case of dispute between the Law of Land and Accounting Standards, the law will prevail.

4. It is **compulsory** for various companies to adopt accounting standards.

5. Accounting standards are **flexible,** as alternate presentations and practices are acceptable and an enterprise is free to adopt any method as long as it follows it consistently. In case the accounting practices are changed, the change must be quantified and disclosed in the financial statements.



Need for Accounting Standards
Accounting Standards are required to ensure the compliance of following information with the qualitative characteristics of accounting:

1. Profit or Loss of the business enterprise

2. Financial Position of the business enterprise

3. Inflow and outflow of Cash

All the above information must comply with the qualitative characteristics of accounting i.e. Reliability; Relevance; Understandability; and Comparability.

Accounting Standards also assures its various users about the truth and fairness of the information contained in the Financial Statements of the business enterprise.

These standards maintain uniformity in the process of accounting records as well as it assists in the comparison of books of accounts of different business enterprises.

Uses of Accounting Standards
Accounting standards serve the following purposes.

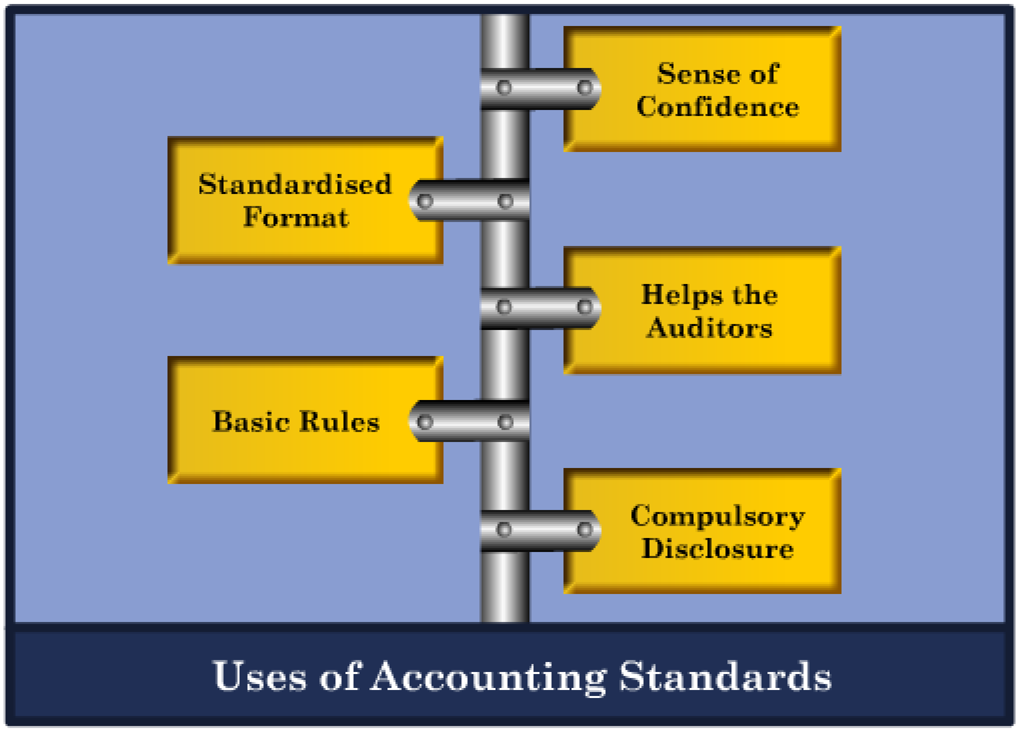
1. They provide a **standardised format** which is to be followed while preparation of accounts, minimising the variations in the method of preparation of accounts.

2. Accounting standards provide the **basic rules** on the basis of which financial statements are prepared.

3. They make it **compulsory** for the companies to make a **disclosure** of the accounting policies followed while preparation of financial statements.

4. When a company complies with the accounting standards while preparation of financial statements it creates a **sense of confidence** among the users of financial statements.

5. They **help the auditors** in auditing the books of accounts as consistent use of same accounting policies helps an auditor in forming an opinion about the financial statements.



Objectives of Accounting Standards

1. We establish standards so that we can **compare our performance with something** which is uniform for all. For example: Our marks are expressed in percentage which is a common unit of measurement for all so that the students can compare their performance with other students during the year. Similarly, these accounting standards are followed universally and this thus, makes comparison between the two firms possible.

2. Financial statements are the only **source for the stakeholders to know about the business.** These accounting standards ensure that they are prepared in a manner that people can rely and make sense out of them. For example: Researchers trying to understand the corporate governance practices of the business can rely on these statements.

3. Imagine a situation where in a classroom the teacher asks her students to study at their own will. In such a case, it would only lead to ruckus in the class. Similarly, if accounting policies and practices are left at the discretion of the business entities then they might go haywire and there will be no uniformity at all. As a result, of these standards the **diverse practices have been kept at bay.**

Benefits of Accounting Standards

1. <u>Elimination of variation in accounting treatment</u>: Accounting standards eliminate variations in accounting treatment as it works on a set of accounting principles and methods which are followed throughout the entire accounting fraternity. These standards are uniformly followed which further eliminates variation in preparation and presentation of books of accounts.

2. Full disclosure of accounting principles: AS-1 requires full disclosure of accounting principles and policies which are helpful for the various users of accounting information such as present and potential investors of a business. However, such information may not be compulsory for disclosure by the law of the country.

3. Inter and intra firm comparison: Accounting standards form a strong base for comparison of books of accounts maintained by different departments within firms (intra) or between two different firms (inter).

Limitations of Accounting Standards

1. Inflexible Framework: An accountant has to follow that method only which is mentioned in the accounting standards while preparing accounts. It is not necessary that a method appropriate in one situation would be applicable in other situations as well.

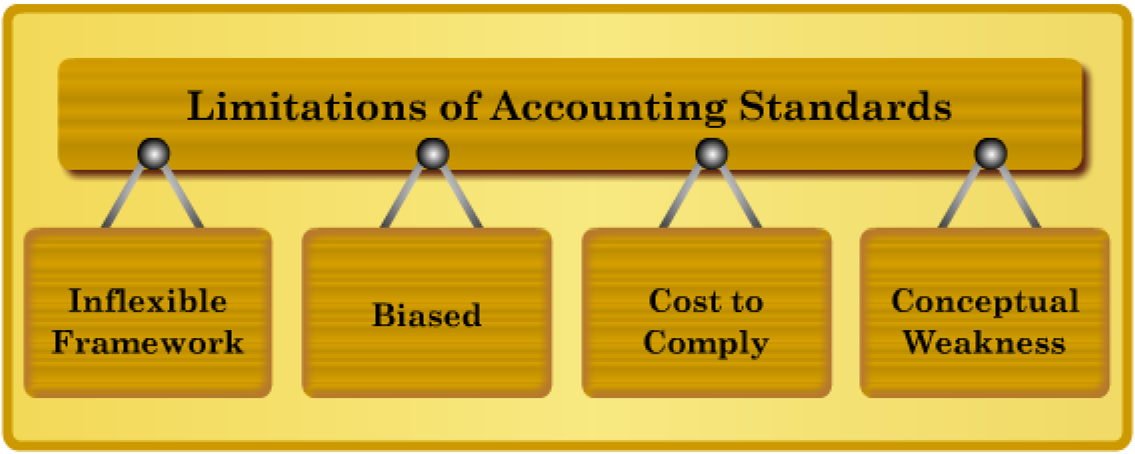
2. Biased: Accounting standards may be subject to lobbying or government pressure. Thus, in order to give unfair advantages to big corporate houses the standards might be compromised.

3. Cost to Comply: We live in a dynamic environment and in order to keep up with the needs of business from time to time, new accounting standards are issued by the ICAI and in order to comply with these the company has to incur various costs. Sometimes a company has to design new procedures, which require large financial investment in the form of employee training cost, labour cost, system upgradation etc.

4. Conceptual Weakness: Earlier standards were not based on a sound conceptual framework of accounting but the ICAI is committed to rectify these.

5. Affected by errors: Accounting Standards have been developed by human beings. So, there can be a chance of errors while developing these standards.

6. Drafted within the ambit of law- Accounting Standards must adhere with the law of country. It cannot go beyond the boundaries prescribed by law of the country.



Applicability of Accounting Standards

Accounting Standards are applicable to the following organizations:

Sole proprietorship unit
Hindu undivided family
Partnership firm
Companies
Societies
Charitable organization
Trusts
International Financial Reporting System
Association of persons
Cooperative societies

Accounting Standards Issued By the Institute of Chartered Accountants of India (ICAI)

The following are the mandatory Accounting Standards (AS) as on July 1, 2012 by The Institute of Chartered Accountants of India (ICAI) -

- AS 1 Disclosure of Accounting Policies
- AS 2 Valuation of Inventories
- AS 3 Cash Flow Statements
- AS 4 Contingencies and Events Occurring after the Balance Sheet Date
- AS 5 Net Profit or Loss for the period, Prior Period Items and Changes in Accounting Policies

• AS 6 Depreciation Accounting

• AS 7 Construction Contracts (revised 2002)

• AS 9 Revenue Recognition

• AS 10 Accounting for Fixed Assets

• AS 11 The Effects of Changes in Foreign Exchange Rates (revised 2003),

• AS 12 Accounting for Government Grants

• AS 13 Accounting for Investments

• AS 14 Accounting for Amalgamations

• AS 15 Employee Benefits (revised 2005)

• AS 16 Borrowing Costs

• AS 17 Segment Reporting

• AS 18 Related Party Disclosures

• AS 19 Leases

• AS 20 Earnings Per Share

• AS 21 Consolidated Financial Statements

• AS 22 Accounting for Taxes on Income

• AS 23 Accounting for Investments in Associates in Consolidated Financial Statements

• AS 24 Discontinuing Operations

• AS 25 Interim Financial Reporting

• AS 26 Intangible Assets

• AS 27 Financial Reporting of Interests in Joint Ventures

• AS 28 Impairment of Assets

- AS 29 Provisions, Contingent Liabilities and Contingent Assets

The below mentioned are the Accounting Standards that are not mandatory as on July 01, 2012:

- AS 30 Financial Instruments: Recognition and Measurement and Limited Revisions to AS 2, AS 11 (revised 2003), AS 21, AS 23, AS 26, AS 27, AS 28 and AS 29

- AS 31, Financial Instruments: Presentation

- AS 32, Financial Instruments: Disclosures, and limited revision to Accounting Standard (AS) 19, Leases

IFRS, Concepts and their Convergence with Indian AS

Objectives

After going through this lesson, you shall be able to understand the following concepts.

- Overview
- Underlying Assumptions in IFRS
- IFRS Based Financial Statements
- IFRS & Indian Context
- List of Indian Accounting Standards (Ind-AS)

Overview

By now, we have been able to understand that accountancy is the language of business. But in today’s globalised environment, business does not operate in just one country rather they operate around the world. However, it must be emphasised that around the globe different countries follow different accounting standards.

This leads to a need for global set of standards commonly referred to as '***International Financial Reporting Standards (IFRS)***'. IFRS are designed to serve as a common global language of business affairs so that accounts of various companies are understandable and comparable across international boundaries. National accounting standards prevailing in different countries are being replaced by these International Financial Reporting Standards.

International Financial Reporting Standards (IFRS) are a set of standards developed by International Accounting Standard Board (IASB) stating how a particular transaction shall be treated or an event shall be reported in financial statements.

The basic aim of IFRS is to enable comparison of financial statements not just in our country but around the globe. This is quite difficult as every country today has its own standards, for example, in US, US GAAPs are followed and similarly in India, Indian GAAPs are followed. So, it becomes very difficult to comprehend all such standards which are being followed around the world in one set of rules.

Underlying Assumptions in IFRS

1. **Measuring unit assumption:** Measuring unit is the current purchasing power. It means that assets and liabilities are not to be shown at the historical cost in the Balance sheet but at their current or fair value.

2. **Units of Constant Purchasing Power:** It requires that inflation prevailing in the country should be accounted for i.e. value of capital should be adjusted to inflation at the end of financial year.

3. **Going concern:** It is assumed that life of the business is infinite i.e. the entity will continue to exist for an indefinite period in future.

4. **Accrual assumption:** Transactions are recorded on accrual basis i.e. as and when they occur and the actual date of payment or receipt is immaterial.

Need of International Financial Reporting Standards (IFRS)

1. <u>Check on manipulation in financial statements</u>: IFRS helps to keep a check on the manipulation associated with the figures related to financial statements. This encourages a consistency in the recognition and measurement of financial statements.

2. <u>Global harmony, uniformity and comparability</u>: IFRS help the economies of the world to establish global harmony, uniformity and comparability in the process of preparation of their financial statements.

3. <u>Flow of foreign investment</u>: The Financial Reporting Standards and Accounting Standards together create a sense of security in the minds of foreign investors which facilitate a free flow of direct as well as indirect flow of foreign investments across the countries.

IFRS Based Financial Statements

1) Statement of Financial Position (Balance Sheet)

2) Statement of Comprehensive Income (Profit and Loss Account)

3) Statement of Changes in Equity

4) Statement of Cash Flows

5) Notes and Significant Accounting Policies

Measurement of the Elements of IFRS Based Financial Statements

IFRS as discussed earlier have evolved because of the world coming closer and closer as a result of the globalization. For comparison of the firms across the globe, it thus, becomes essential for them to prepare their financial statements uniformly.
Various elements like assets and liabilities, etc., contained in the IFRS based financial statements can be measured using the bases as mentioned below to different extents:

1. **Historical Cost:** This is in conformity with the Historical cost concept studied in the previous chapter. So, going with it we record all our assets at an amount we paid to acquire them and liabilities at the amount of money we received in lieu of the obligation. For example: Furniture purchased for Rs. 8000 then this will be the amount so recorded.

2. **Current Cost:** As we are all well aware by now, that the prices of the goods that we own like television, laptops, etc., never stays the same. It is for this reason, that we sometimes carry our assets in the Balance Sheet at the price or amount we will currently pay for them. Also, the liabilities are carried at before discount value for the settlement of the obligation.

3. **Settlement (Realisable) Value:** Here, the computation is based on what we would get in return if the assets are sold and what we will pay for our liabilities in the future if calculated at present. Based on this, assets are carried at the present discounted value (i.e. the value of Rs. 1 earned today is much more than that earned in the future owing to uncertainties) of the net cash inflows that it would generate in the normal course of the business. Similarly, liabilities are carried at the present discounted value (i.e. what we pay tomorrow is much less than what we pay today.) of the future net cash outflows that we are expected to pay in the normal course of the business.

IFRS & Indian Context

Implementation of IFRS by the Indian corporate sector has been rolled out in phases. Initially, not every company was required to adopt IFRS while preparing its books of accounts. However, very lately i.e. from the financial year (2016-17) adoption of IFRS has been mandated by the ICAI.

In this context, it must be noted that either the IFRS can be directly adopted as issued by the International Board of Accounting Standards or the existing accounting standards can be altered (or converged) so as to conform to the provisions as contained in the newly issued IFRS. Such accounting standards are known as IND-AS.

IFRS versus Indian Generally Accepted Accounting Principles (GAAP)

Basis	IFRS	Indian GAAP/ Accounting Standard

1. Scope	Nearly 120 countries or jurisdictions allow or require their domestic companies to comply with IFRS and 90 countries have fully adopted it.	It is followed by the Indian companies only and hence is very limited in the scope.
2. Created by	International Accounting Standards Board (IASB) has developed it.	It was developed by the Ministry of Corporate Affairs (MCA).
3. Recording of Assets and Liabilities	Assets and Liabilities are recorded at the fair value at the date of Balance Sheet. This means that the values have to be revised every year.	Assets and Liabilities are recorded at their historical cost.
4. Treatment of Depreciation	Since the value is revised every year so no depreciation is charged on the cost of asset but is valued on that date and the difference between opening and closing valuation is debited or credited to P&L A/c.	Depreciation is charged on the cost of the asset.
5. First time Adoption	It gives very clear and lucid instructions on how to adopt these standards for the very first time.	No such instructions are given on first time adoption.
6. Disclosure requirements	Companies following IFRS have to give a note that their financial statements comply with IFRS.	No such note is to be give as it is presumed that the companies in India are complying with it.
7. Currency used in the presentation	Financial statements are normally expressed in the functional currency i.e. the currency of the economy in which the business entity operates but if not then it has to be converted using the exchange rates.	Financial statements are expressed in the Indian rupee hence no question of the exchange rates.

List of Indian Accounting Standards (Ind –AS)

Indian Accounting Standards (Ind-AS)	Name	International Accounting Standards (IAS) / International	Existing Accounting Standards (AS)

		Financial Reporting Standards (IFRS)	
Ind As-1	Presentation of Financial Statements	IAS 1	AS 1
Ind As-2	Inventories	IAS 2	AS 2
Ind As-7	Statement of Cash Flows	IAS 7	AS 3
Ind As-8	Accounting Policies, Changes in Accounting Estimates and Errors	IAS 8	AS 5
Ind As-10	Events after the Reporting Period	IAS 10	AS 4
Ind As-11	Construction Contracts	IAS 11	AS 7
Ind As-12	Income Taxes	IAS 12	AS 22
Ind As-16	Property, Plant and Equipment	IAS 16	AS 6, 10
Ind As-17	Leases	IAS 17	AS 19
Ind As-18	Revenue	IAS 18	AS 9
Ind As-19	Employee Benefits	IAS 19	AS 15
Ind As-20	Accounting for Government Grants and Disclosure of Government Assistance	IAS 20	AS 12
Ind As-21	The Effects of Changes in Foreign Exchange Rates	IAS 21	AS 11
Ind As-23	Borrowing Costs	IAS 23	AS 16
Ind As-24	Related Party Disclosures	IAS 24	AS 18
Ind As-27	Consolidated and Separate Financial Statements	IAS 27	AS 21
Ind As-28	Investments in Associates	IAS 28	AS 23
Ind As-29	Financial Reporting in Hyperinflationary Economies	IAS 29	–
Ind As-31	Interests in Joint Ventures	IAS 31	AS 27

Ind As-32	Financial Instruments: Presentation	IAS 32	AS 31
Ind As-33	Earnings per Share	IAS 33	AS 20
Ind As-34	Interim Financial Reporting	IAS 34	AS 25
Ind As-36	Impairment of Assets	IAS 36	AS 28
Ind As-37	Provisions, Contingent Liabilities and Contingent Assets	IAS 37	AS 29
Ind As-38	Intangible Assets	IAS 38	AS 26
Ind As-39	Financial Instruments: Recognition and Measurement	IAS 39	AS 30
Ind As-40	Investment Property	IAS 40	–
Ind As-101	First-time Adoption of Indian Accounting Standards	IFRS 1	–
Ind As-102	Share based Payment	IFRS 2	–
Ind As-103	Business Combinations	IFRS 3	AS 14
Ind As-104	Insurance Contracts	IFRS 4	–
Ind As-105	Non-Current Assets Held for Sale and Discontinued Operations	IFRS 5	AS 24
Ind As-106	Exploration for and Evaluation of Mineral Resources	IFRS 6	–
Ind As-107	Financial Instruments: Disclosures	IFRS 7	AS 32
Ind As-108	Operating Segments	IFRS 8	AS 17