CHAPTER 3

# Theory Base of Accounting, Accounting Standards and Indian Accounting Standards (Ind-AS)

## LEARNING OBJECTIVES

***This Chapter would enable you to understand:***

- Meaning and Nature of Accounting Principles
- Features of Accounting Principles
- Necessity of Accounting Principles
- Fundamental Accounting Assumptions or Concepts:
  - Going Concern
  - Consistency
  - Accrual
- Accounting Principles:
  - Accounting Entity
  - Money Measurement
  - Accounting Period
  - Full Disclosure
  - Materiality
  - Prudence or Conservatism
  - Cost or Historical Cost
  - Matching
  - Dual Aspect or Duality

  Following Accounting Principles are not prescribed in syllabus but have been discussed:
  - Revenue Recognition (Realisation)
  - Verifiable Objective
- Accounting Standards
- Meaning of Accounting Standards
- Nature of Accounting Standards
- Concept of Accounting Standards
- Objectives and Utility of Accounting Standards
- International Financial Reporting Standards (IFRS) and Indian Accounting Standards (Ind-AS)

Accounting principles, concepts and conventions commonly known as **Generally Accepted Accounting Principles** or **GAAPs** are the basic rules that define the parameters and constraints within which accounting operates. These principles are the theory base of accounting, on the basis of which financial statements are prepared. In other words, they are the guidelines for preparing the financial statements.

The Institute of Chartered Accountants of India (ICAI) has issued Accounting Standards to standardise the accounting practices adopted to prepare financial statements. Initially the accounting standards were recommendatory but were gradually made mandatory. Presently, the accounting standards issued by ICAI are applicable on non-corporate enterprises (firm). The accounting standards notified under the Companies Act, 2013 are applicable and mandatory on companies.

## MEANING AND NATURE OF ACCOUNTING PRINCIPLES

*"Principles of Accounting are the general law or rule adopted or proposed as a guide to action, a settled ground or basis of conduct or practice."*

**—American Institute of Certified Public Accountants**

Accounting Principles are the rules adopted by accountants universally while recording accounting transactions. They are the norms or rules which are followed in accounting of various items of assets, liabilities, expenses, incomes, etc. For example, Inventory (stock) is valued at lower of its cost or net realisable value. Fixed assets should be depreciated over their expected useful life. Accounting Principles are the basic or fundamental propositions generally accepted by accountants as a set of Accounting Principles based on which transactions are recorded and Financial Statements are prepared. These principles are classified into two categories:

### 1. Accounting Concepts

Accounting Concepts are the basic assumptions or fundamental propositions within which accounting operates. They are generally accepted accounting rules based on which transactions are recorded and financial statements are prepared. It is important to follow the accounting concepts because it enables the users of financial statements to understand them better and in the same manner.

### 2. Accounting Conventions

Accounting Conventions are the outcome of accounting practices or principles being followed by the enterprises over a period of time. Conventions may undergo a change with time to bring about improvement in the quality of accounting information.

## FEATURES OF ACCOUNTING PRINCIPLES

### 1. Accounting Principles are Man-Made

Accounting Principles are man-made and, therefore, they are the best possible suggestions based on practical experiences. They are recommended for use by all enterprises to ensure uniformity and understandability.

### 2. Accounting Principles are Flexible

Accounting Principles are not rigid but flexible. Accounting Principles are not permanent but change with time.

### 3. Accounting Principles are Generally Accepted

Accounting Principles are the bases and guidelines for accounting and are generally accepted. The general acceptance of an Accounting Principle usually depends on how it meets three criteria, *i.e.*,

(i) *Relevance:* Accounting Principles are relevant if they result in information that is useful to the users of accounting information.

(ii) *Objective:* Accounting Principles are objective if they are not influenced by the personal bias of the persons preparing the accounting information.

(iii) *Feasible:* Accounting Principles are feasible if they can be applied without undue complexity and cost.



## NECESSITY OF ACCOUNTING PRINCIPLES

Accounting information is better understood if it is prepared following the set of Accounting Principles uniformly. It means the same Accounting Principles are followed by all entities in preparing their final accounts. Accounting information is meaningful and useful for users of accounting information if the accounting records and financial statements are prepared following generally accepted accounting principles.

## FUNDAMENTAL ACCOUNTING ASSUMPTIONS OR CONCEPTS

Fundamental Accounting Assumptions or Concepts are the assumptions which are presumed to have been followed in preparing the annual accounts. The entities which do not follow any of the fundamental accounting assumptions are required to disclose which of these assumptions have not been followed and the reasons for not following them. The Fundamental Accounting Assumptions recognised by AS-1, Disclosure of Accounting Policies are:

### 1. Going Concern Assumption

According to this assumption, it is assumed that business shall continue for a foreseeable period and there is no intention to close the business or scale down its operations significantly. It is because of this concept that a distinction is made between *capital expenditure, i.e.*, expenditure that will give benefit for a long period and *revenue expenditure, i.e.*, one whose benefit will be consumed or exhausted within the accounting period. On the basis of this concept, fixed assets are recorded at their original cost and they are depreciated in a systematic manner over their expected useful life. For example, a machine purchased is expected to last 10 years. The cost of the machinery is spread on a suitable basis over the next 10 years for ascertaining the profit or loss for each year. The total cost of the machine is not treated as an expense in the year of purchase itself.

### 2. Consistency Assumption

According to the Consistency Assumption, accounting practices once selected and adopted, should be applied consistently year after year. The concept helps in better understanding of accounting information and makes it comparable with that of previous years. Consistency eliminates personal bias and helps in showing results that are comparable. The concept is particularly important when alternative accounting practices are equally acceptable. For example, two methods of charging depreciation, Written Down Value Method and Straight Line Method, are equally acceptable. Under the assumption, method once chosen and applied should be applied consistently year after year to make the financial statements comparable.

The accounting practice may be changed if the law or Accounting Standard requires it or the change will result in more meaningful presentation.

### 3. Accrual Assumption

According to the Accrual Assumption, a transaction is recorded in the books of account at the time when it is entered into and not when the settlement takes place. Thus, revenue is recognised when it is realised, *i.e.*, when sale is complete or services are rendered; it is immaterial whether cash is received or not. Similarly, expenses are recognised as expenses in the accounting period in which the revenue related to it is recognised, whether paid in cash or not.

The concept is particularly important because it recognises assets, liabilities, incomes and expenses as and when transactions relating to it are entered into. Under this concept, profit is regarded as earned at the time the goods or services are sold or rendered to a customer, *i.e.*, the legal title is passed to the customer, who, in turn, has an obligation to pay for them. Similarly, expense is regarded as incurred when the goods or services are purchased or availed and an obligation to pay for them is assumed.

Let us take examples to understand the Accrual Concept.

M/s. RSM & Co. purchases computers on 1st January, 2019 amounting to ₹ 5,00,000 to be paid on 15th April, 2019. Since the asset has been acquired by the enterprise and has in the process incurred a liability to the extent of that amount on 1st January, 2019, it must record the transaction in its books of account on 1st January, 2019. The transaction on recording shall reflect that the enterprise owns assets (computers) worth ₹ 5,00,000 and also owes an equal amount of money to the supplier.

Similarly, if M/s. RSM & Co. makes a sale of goods to M/s. VS & Co. on 27th February, 2019 for ₹ 15,000 on credit of two months, the sale must be recorded on 27th February, 2019 although the amount will be received on 27th April, 2019. The transaction is recorded because the revenue has been earned, although the amount has not been received. M/s. VS & Co. should also record the purchase in its books of account on 27th February, 2019 because goods have been purchased although the amount has not been paid.

## ACCOUNTING PRINCIPLES (OTHERS)

### 1. Accounting Entity or Business Entity Principle

According to the Business Entity Principle, business is considered to be separate from its owners. Business transactions are recorded in the books of account from the business point of view and not from that of the owners. Owners being regarded as separate from business are considered as creditors of the business to the extent of their capital. Their account with the business is credited with the capital introduced and profit earned during the year, etc., and debited by the drawings made. For example, when the proprietor introduces capital, Cash Account or Bank Account is debited and Capital Account is credited. Amount in the credit of the capital is a liability of the enterprise towards the proprietor. This principle applies to every form of enterprise including proprietorship firms.



A Balance Sheet of a proprietary firm (imaginary amounts) will appear as follows:

BALANCE SHEET ...
as at ...

| Liabilities | ₹ | Assets | ₹ |
|---|---|---|---|
| **Capital Account** | | **Fixed Assets** | |
| Opening Balance | 2,50,000 | Machinery | 2,00,000 |
| *Add:* Introduction during the year | 1,00,000 | Vehicles | 75,000 |
| Profit for the Year | 1,50,000 | **Current Assets** | |
| | 5,00,000 | Cash in Hand | 25,000 |
| *Less:* Drawings | 1,26,000 | Balance with Bank | 74,000 |
| | 3,74,000 | | 3,74,000 |

The Accounting Entity Principle is a useful principle as from it, responsibility accounting has developed. It has made possible ascertaining the results of each department or division of the enterprise.

### 2. Money Measurement Principle

According to the Money Measurement Principle, transactions and events that can be measured in money terms are recorded in the books of account of the enterprise. Stating differently, money is the common denominator in recording and reporting transactions. This principle suffers from two major limitations:

(*a*) Transactions and events that cannot be measured in money terms are not recorded in the books of account, howsoever important they may be to the enterprise. For example, human resources with the enterprise are important to the enterprise but are not reflected in the financial statements because they cannot be measured and expressed in money terms.

(*b*) The value of money is considered to have static value as the transactions are recorded at the value on the transaction date.

### 3. Accounting Period Principle

According to the Accounting Period Principle, the life of an enterprise is broken into smaller periods so that its performance is measured at regular intervals. The accounts of an enterprise are maintained following the Going Concern Concept, meaning the enterprise shall continue its activities for a foreseeable future. Users of Financial Statements, especially the management and banks, require information from the accounts at regular intervals so that decisions can be taken at the appropriate time. Management requires information at regular intervals to assess the performance, funds requirement (short-term as well as long-term), banks require accounting information periodically because they have invested money and have to ensure its safety and returns. Similarly, Government has to assess tax dues from the enterprise. In view of the above, the life of the enterprise is broken into smaller periods (usually one year) which is termed as the **'Accounting Period'**.

*An accounting period is the interval of time at the end of which Income Statement (Profit and Loss Account or Statement of Profit and Loss, in the case of companies) and Balance Sheet are prepared to know the results and resources of the business.*

### 4. Full Disclosure Principle

According to the Principle of Full Disclosure, "*there should be complete and understandable reporting on the financial statements of all significant information relating to the economic affairs of the entity.*" Apart from legal requirements, good accounting practice requires all material and significant information to be disclosed. Whether information should be disclosed or not always depends on the materiality of the information. Disclosure of material information will result in better understanding. For example, the reasons for low turnover should be disclosed.

### 5. Materiality Principle

Materiality Principle refers to relative importance of an item or an event. According to the **American Accounting Association**, "*an item should be regarded as material if there is a reason to believe that knowledge of it would influence the decision of an informed investor.*" Thus, whether an item is material or not will depend on its nature and/or amount. It, thus, means that it is a matter of exercising judgment to decide which item is material and which is not. And only those items should be disclosed that have significant effect or are relevant to the user. An item may be material for one enterprise but may not be material for another. For example, amount spent on repairs of building, say ₹ 2,50,000, is material for an enterprise having a turnover of say ₹ 10,00,000 but it is not material for an enterprise having a turnover of say ₹ 15,00,00,000. On the other hand, closure of a production plant, even temporarily, say because of an environmental problem is material.

### 6. Prudence or Conservatism Principle

Prudence or Conservatism Principle is many a time described using the phrase "*Do not anticipate a profit, but provide for all possible losses.*" Stating differently, *it takes into consideration all prospective losses but not the prospective profits.* The application of this concept ensures that the financial statements do not paint a better picture than what it actually is. For example, closing stock is valued at lower of cost or net realisable value (market value) or making the provision for doubtful debts and discount on debtors in anticipation of bad debts and discount.

Prudence or Conservatism Principle prescribes that anticipated expenses and losses should be accounted. Thus, as a result liabilities may be overstated. It has a drawback as it may be used to create *Secret Reserve* (*e.g.*, by creating excess provision for doubtful debts, depreciation, etc.), and thus financial statements may not depict a true and fair view of state of affairs of the business.

The Concept of Conservatism needs to be applied with caution and care so that the results reported are not distorted.

### 7. Cost Concept or Historical Cost Principle

According to the Cost Concept, an asset is recorded in the books of account at the price paid to acquire it and the cost is the basis for all subsequent accounting of the asset. Asset is recorded at cost at the time of its purchase but is systematically reduced by



charging depreciation. The market value of an asset may change with the passage of time but for accounting purposes it continues to be shown in the books of account at its book value (*i.e.*, cost at which it was purchased *minus* depreciation provided up-to-date). For example, an asset is purchased for ₹ 5,00,000 and if at the time of preparing the final accounts, even if its market value is say, ₹ 4,00,000 or ₹ 7,00,000, yet the asset shall continue to be shown at its purchase price of ₹ 5,00,000.

Cost concept brings objectivity in the preparation and presentation of financial statements. They are not influenced by the personal bias or judgments.

### 8. Matching Concept or Matching Principle

An important objective of business is to determine profit periodically. It is necessary to match 'revenues' of the period with the 'expenses' of that period to determine correct profit (or loss) for the accounting period. Profit earned by the business during a period can be correctly measured only when the revenue earned during the period is matched with the expenditure incurred to earn that revenue. It is not relevant when the payment was made or received. Therefore, as per this concept, adjustments are made for all outstanding expenses and prepaid expenses.

In brief, according to this concept, the expenses for an accounting period are matched against related revenues, rather than cash received and cash paid. This concept should be followed while preparing financial statements to have a true and fair view of the profitability and financial position of a business firm.

### 9. Dual Aspect or Duality Principle

According to the Dual Aspect Concept, every transaction entered into by an enterprise has two aspects, a debit and a credit of equal amount. Simply stated, for every debit there is a credit of equal amount in one or more accounts. It is also true *vice versa*. For example, Rahul starts a business with a capital of ₹ 1,00,000. There are two aspects to the transaction. On one hand, the business has an asset of ₹ 1,00,000 (cash) while on the other hand, it has a liability towards Rahul of ₹ 1,00,000 (capital of Rahul). Thus, we can say

Capital (Equities) = Cash (Asset)

₹ 1,00,000 = ₹ 1,00,000

Suppose further, the enterprise borrows amount from a bank; its assets will increase but this will mean that out of the total assets, amount equal to borrowing is payable to the outsiders. Thus, we can say

Owner's Equity or Capital + Claims of Outsiders = Assets

*Or*

Assets = Owner's Equity + Claims of Outsiders

This fundamental equation will always remain good. In other words, accounting equation demonstrates the fact that for every debit there is an equal credit and *vice versa*. As a matter of fact the entire system of Double Entry Book Keeping is based on this concept.

### *10. Revenue Recognition Concept*

According to the Revenue Recognition Concept, revenue is considered to have been realised when a transaction has been entered into and the obligation to receive the amount is established. It is to be noted that recognising revenue and receipt of an amount are two separate aspects. Let us take an example to understand it. An enterprise sells goods in February, 2018 and receives the amount in April, 2018. Revenue of this sales should be recognised in February, 2018, *i.e.*, when the goods are sold because the legal obligation to receive the amount is established (upon sales) in February, 2018. Let us take another example. Suppose, an enterprise has received an advance in February, 2018 for the sales to be made in May, 2018, revenue shall be recognised in May, 2018, upon sales having been made because the legal obligation to receive the amount is established in May, 2018.

### *11. Verifiable Objective Concept*

The Verifiable Objective Concept holds that accounting should be free from personal bias. Measurements that are based on verifiable evidences are regarded as objective. It means all accounting transactions should be evidenced and supported by business documents. These supporting documents are cash memo, invoices, sales bills, etc.

## ACCOUNTING STANDARDS

The rise in diversity, complexity and globalisation of business made the study of accounting information important and essential. But the diverse accounting policies being followed and the accounting treatment of transactions and events made the accounting information less meaningful and also incomparable. A need was, thus, felt that certain minimum standards should be universally applicable, so that the accounting statements have the qualitative characteristics of reliability, relevance, understandability and comparability. Therefore, an International Accounting Standards Committee (IASC) (now renamed as International Financial Reporting Board) was set up in the year 1973. The objectives of this committee are:

1. to formulate and publish in public interest, Accounting Standards to be observed in the presentation of Financial Statements and also their worldwide acceptance; and
2. to work for the improvement and harmonisation of regulation of Accounting Standards and procedures relating to the presentation of financial transactions.

The Institute of Chartered Accountants of India (ICAI) and the Institute of Cost and Works Accountants of India (now Institute of Cost Accounting of India) are members of this committee.

ICAI had set up the Accounting Standards Board (ASB) in April 1977 to identify areas of accounting where alternative and diverse practices were followed. ASB, with a purpose to bring uniformity in practices, was to develop draft Accounting Standards keeping in view the business environment and legal provisions of the country and after discussions with various stakeholders (Government, Industry Federations, etc.).



ASB submits the draft Accounting Standards to the Council, the Institute of Chartered Accountants of India which issues it for the comments of the government, industry and professionals, etc. The Council of ICAI gives due consideration to the comments received by amending the draft Accounting Standards, if necessary, before notifying it. In the case of Companies, Accounting Standards are recommended to National Financial Reporting Authority (NFRA) an authority under the Companies Act, 2013, which notifies the standards to be applicable to companies.

It should be noted that in the case of companies, accounting standards notified under the Companies Act, 2013 are followed.

Scan QR Code for the List of Standards notified under the Companies Act, 2013

## MEANING OF ACCOUNTING STANDARDS

Accounting Standards are a set of guidelines, *i.e.*, Generally Accepted Accounting Principles, that are followed for preparation and presentation of Financial Statements. They are accounting rules and procedures relating to measurement, recognition, treatment, presentation and disclosure of accounting transactions in the financial statements issued by the Council of the Institute of Chartered Accountants of India.

## NATURE OF ACCOUNTING STANDARDS

Following points highlight the nature of Accounting Standards:

1. Accounting Standards are guidelines providing the framework so that credible Financial Statements are prepared.
2. The objective of setting Accounting Standards is to bring uniformity in accounting practices and to ensure transparency, consistency and comparability.
3. Accounting Standards are prepared keeping in view the business environment and laws of the country. It, therefore, naturally means that the guidelines change with change in business environment and laws. It is because of this that Accounting Standards are being revised from time to time. It may be noted that whenever a conflict arises between law and Accounting Standards, law will prevail.
4. Accounting Standards are *mandatory* in nature.
5. Accounting Standards have also been made flexible in the sense that where alternative accounting practices are acceptable, an enterprise may adopt any of the practices with a suitable disclosure. For example, an enterprise may charge depreciation on the Written Down Value Method or Straight Line Method.

## CONCEPT OF ACCOUNTING STANDARDS

Accounting Standards prescribe the accounting rules and procedures for recognition, measurement, treatment, presentation and disclosure of accounting transactions in financial statements. They are prescribed to be followed in preparing and presenting the financial statements, so that the financial statements are based on common rules and principles for better understanding by the users.

## OBJECTIVES OF ACCOUNTING STANDARDS

Objectives of Accounting Standards are:

1. Minimise the diverse accounting policies and practices with the aim to eliminate them to the extent possible.
2. Promote better understanding of financial statements.
3. Understand significant Accounting Policies adopted and applied.
4. Facilitating meaningful comparison of financial statements of two or more entities.
5. Enhancing reliability of financial statements.

## UTILITY OF ACCOUNTING STANDARDS

Accounting Standards serve the following purposes:

1. Accounting Standards *provide the norms* on the basis of which financial statements should be prepared.
2. Accounting Standards *ensure uniformity* in the preparation and presentation of financial statements by removing the effect of diverse accounting practices. The application of Accounting Standards make financial statements more meaningful and comparable.
3. Accounting Standards *create confidence* among the users of accounting information. Accounting information based on Accounting Standards is considered reliable by users of such information.
4. Accounting Standards *help auditors* in auditing the accounts. They *help accountants* to follow uniform practices and policies.

## LIMITATIONS OF ACCOUNTING STANDARDS

1. Accounting Standards are man made. Hence, it does not pass the verification test always.
2. Accounting Standards are based on business environment and laws of the country. Hence, they change often to meet the changes.

**NOTE**

Accounting Standards (AS) are applicable on companies on which Ind-AS is not applicable or are not adopted voluntarily by the companies.

**Problem.** While preparing the accounts of company, following issues are faced:

(*i*) Production Manager is interested in recording good industrial relations in the accounts.

(*ii*) Long-term success of the company is doubtful due to market competition.

(*iii*) Although sales have not yet taken place, few reliable customers of the company have placed large orders from which huge profit is expected.

(*iv*) One of the shareholders of the company has invested his savings in shares of another company.



(*v*) At the end of the accounting period, factory rent of the company is outstanding for ₹ 10,000.

(*vi*) At present, market price of the fixed assets of the company is very high as compared to the book value and directors are interested to show the fixed assets in accounts at their current market price.

(*vii*) During the year, the company purchased pencils of ₹ 50. These had all been issued from stock and were still in use at the end of the year.

(*viii*) Directors are interested to adopt Written Down Value (WDV) Method of charging depreciation in place of Straight Line Method (SLM) in the current accounting period to show higher profit.

(*ix*) A debtor who owes an amount to the company is likely to be declared insolvent.

You are required to (*a*) state which accounting concept you would follow in dealing with each of the above problems and (*b*) explain briefly what each concept means.

**Ans.**

(*i*) *Money Measurement Concept:* Transactions and events that can be measured in money or in money terms are recorded in the books of account. Since, good industrial relations cannot be measured in money terms, they will not be reflected in the accounts.

(*ii*) *Going Concern Concept:* The business will continue for an indefinite period and there is no intention to close the business or downsize its operations significantly. The doubt of success does not lead to the inference that business will not continue for indefinite period and also the intention that the business will be downsized significantly.

(*iii*) *Realisation Concept:* Revenue is recognised when sale has been made or service has been rendered. Therefore, the revenue will be recognised when sale has been affected and not when the order is placed.

(*iv*) *Business Entity Concept:* Business is treated as a separate and distinct entity from its owners. The investment in another company's shares is by a shareholder who is distinct from the business.

(*v*) *Accrual Concept:* This concept recognises revenues and expenses as they are earned or incurred respectively ignoring the date of receipt or payment. Since, the factory rent of the company is outstanding, it will be recorded in the books of account.

(*vi*) *Historical Cost Concept:* According to the Historical Cost Concept, the asset must be shown at its cost price, which is the cost of acquisition *less* depreciation. As a good accounting practice, they should be continued to be shown at cost.

(*vii*) *Materiality Concept:* An item is recorded in the books of account on the basis of materiality. Purchased stationery (Pencil) is in use but, the amount and nature is not material. Therefore, it is debited to Stationery Account.

(*viii*) *Consistency Assumption or Concept:* All accounting principles and methods should be applied in a similar way from one period to the next so that data reported

in financial statements can be compared for one period with that of another period. Method may be changed by the company but it should be disclosed along with its impact on profit or loss.

(*ix*) *Conservatism Convention or Concept:* The concept is often stated as, "Anticipate no profit, but provide for all possible losses." Thus, provision for doubtful debts should be made against the amount of debtors.

## INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

### Introduction

Globalisation integrates the national economies into the international economy through trade, foreign direct investments, capital flow, etc. In this age of globalisation and technology, enterprises are carrying on businesses worldwide. We also understand that accounting is the language of business. Thus, business enterprises around the world should not be speaking different languages while sharing financial information. Therefore there is a need of single set of accounting standards that can unify the accounting practice worldwide. It is difficult to understand and compare worldwide financial information without a common set of accounting and financial reporting standards. The use of a single set of high quality accounting standards would facilitate investment and other economic decisions across borders, increase market efficiency, and reduce the cost of capital. Thus, International Accounting Standards (IAS) were developed, which are being withdrawn or superseded by International Financial Reporting Standards (IFRS).

The International Accounting Standards Committee (IASC) established in 1973 was replaced by International Accounting Standards Board (IASB) in the year 2001 which now issues International Financial Reporting Standards (IFRS). IASB initially adopted the accounting standards issued by IASC to be replaced by IFRS upon their issuance. The objective behind setting up the IASC and later IASB was to develop accounting standards that would be acceptable worldwide to produce and present financial information based on similar accounting standards. Thus, it is the process to improve financial reporting internationally.

### Objectives of IASB

The objectives of IASB are:

(*i*) To develop, in the public interest, a single set of high-quality, understandable, and enforceable global accounting standards that require high-quality, transparent, and comparable information in financial statements and other financial reporting to help participants in the various capital markets of the world and other users of the information to make economic decisions;

(*ii*) To promote the use and rigorous application of those standards;



(*iii*) In fulfilling the objectives associated with (*i*) and (*ii*), to take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies; and

(*iv*) To bring about convergence of national accounting standards and International Financial Reporting Standards to high-quality solutions.

### Meaning

***IFRS** are a set of accounting standards developed by the International Accounting Standards Board (IASB),* the international accounting standard-setting body. The standards issued by IASB are based on sound and clearly stated principles. Therefore, IFRS are referred to as *principles-based accounting standards.* This contrasts with set of standards, like Indian Accounting Standards, which contain significantly more application guidance. These standards are often referred to as rule-based accounting standards.

### Accounting Standards Issued by the IASC and Standing Interpretation Committee (SIC)

IASC had issued 41 accounting standards, known as the **International Accounting Standards (IAS)**, and a *Framework for the Preparation and Presentation of Financial Statements*, out of which 12 IASs have been superseded and a large number of them have been revised. Standing Interpretation Committee (SIC) was the interpretive body of the IASC. The interpretation of IAS issued by the SIC are described as SIC–1, SIC–2, etc.

IASB has adopted all outstanding IAS and SIC issued by the IASC as its own standards. Those IAS and SIC continue to be in force to the extent they are not amended or withdrawn by the IASB. New standards issued by the IASB are known as IFRS. New interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) are known as **IFRIC Interpretations**. When referring collectively to IFRS, that term includes IAS, SIC, IFRS, and IFRIC Interpretations.

### Assumptions in IFRS

The underlying assumptions in IFRS are:

***1. Accrual Assumption:*** The transactions are recorded in the books of account on accrual basis, *i.e.*, as and when they occur and not when the settlement of transactions takes place.

***2. Going Concern Assumption:*** It is assumed that the life of the business is infinite, *i.e.*, the entity will continue its operations for an indefinite period.

***3. Measuring Unit Assumption:*** Measuring unit for valuation of capital is the current purchasing power. It means assets should be reflected at current, *i.e.*, fair value.

***4. Constant Purchasing Power Assumption:*** Constant purchasing power means value of capital be adjusted to inflation in the economy at the end of the financial year.

## IFRS Based Financial Statements

The financial statements produced under IFRS are:

***1. Statement of Financial Position:*** The elements or contents of the statement are:

(i) *Asset:* Assets are the resources controlled by the enterprise as a result of past events and operations from which the future economic benefits shall flow to the enterprise.

(ii) *Liability:* Liabilities are the obligations of the enterprise from the past events and operations, which shall result in outflow of resources, *i.e.*, assets.

(iii) *Equity:* Equity is the residual interest in the assets of the enterprise after deducting liabilities. It is the real value of shareholders' equity.

***2. Statement of Comprehensive Income:*** A Statement of Comprehensive Income includes two separate statements, *i.e.* Income Statement and a Statement of Comprehensive Income are prepared. The Statement of Comprehensive Income reconciles the income or loss as per Income Statement with total comprehensive income. The elements or contents of the statement are:

(i) *Revenue:* It increases the economic benefit during the accounting period as a result of business operations or increase in value of assets or decrease in liabilities. It results in increase in the value of shareholders' equity.

(ii) *Expense:* It is a decrease in economic benefits in the form of outflows during the accounting period as a result of business operations or decrease in value of assets or increase in liabilities. It results in decrease in the value of shareholders' equity.

*3.* Statement of Changes in Equity.

*4.* Statement of Cash Flow.

*5.* Notes and Significant Accounting Policies.

## Measurement of Elements of Ind-AS Based Financial Statements

(a) *Historical Cost.* Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

(b) *Current Cost.* Assets are carried at the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

(c) *Realisable (Settlement) Value.* Assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal. Liabilities are carried at their settlement values; that is, the undiscounted amounts of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business.

(d) *Present Value.* Assets are carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business. Liabilities are carried at the present discounted value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

(e) *Fair Value.* Assets are carried at the amount at which they could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.



## Difference between IFRS and Indian GAAP or Accounting Standards

The principal differences between IFRS and Indian GAAP or Accounting Standards are as follows:

***1. IFRS are Principle based while Indian GAAP or Accounting Standards are Rule based:*** Unlike Indian Accounting Standards, IFRS do not prescribe any form for preparing the financial statements. For example, under the Indian laws, Balance Sheet is prepared according to Schedule III of the Companies Act, 2013 or in the form as near thereto. It means, a Balance Sheet item should be depicted under the prescribed head. In contrast to this, IFRS do not prescribe any form for the Balance Sheet. They prescribe that items may be shown in the Balance Sheet in accordance with the principle associated with them. For example, Redeemable Preference Shares are shown under the main head "Share Capital" under Schedule III of the Companies Act, 2013. But, in the real sense, Preference Share Capital is not a capital but loan because it carries a fixed rate of dividend and also must be redeemed in accordance with the terms of issue but not later than 25 years from the date of issue. IFRS require that since it is in the nature of loan, it should be depicted under the main head "Loans".

***2. IFRS are based on Fair Value Concept while Indian GAAP or Accounting Standards are based on Historical Cost Concept:*** Unlike Indian GAAP or Accounting Standards, IFRS require that the assets and liabilities of the company should be shown at the fair value as at the date of the Balance Sheet. Thus, in effect, depreciation is not charged on the cost of the asset but it is valued as on that date and the difference in opening and closing valuation is debited or credited to Profit and Loss Account. It means every asset and also liability will have to be valued or discounted every year to be shown in the Balance Sheet.

However, besides the above two principal differences there are differences in a number of areas and are hereunder:

Revenue Recognition

Inventory Valuation in Service Sector

Accounting for Taxes on Income

Useful Life of Intangible Assets

Current and Non-current Classification

Prior Period Items

Extraordinary Items

Regrouping/Reclassification

Impact on Fixed Assets

## India and IFRS

India had two options, *i.e.*, either to adopt IFRS as they are or converge the Indian Accounting Standards in line with the IFRS. It decided to converge its existing accounting standards with IFRS. The converged accounting standards titled **Ind-AS** have been issued and notified.

## INDIAN ACCOUNTING STANDARDS (IND-AS)

### Introduction

Globalisation integrates the national economies into the international economy through trade, foreign direct investments, capital flow, etc. In this age of globalisation and technology, enterprises are carrying on businesses worldwide. We also understand that accounting is the language of business. Thus, business enterprises around the world should not be speaking different languages while sharing financial information. Therefore there is a need of single set of accounting standards that can unify the accounting practice worldwide. It is difficult to understand and compare worldwide financial information without a common set of accounting and financial reporting standards. The use of a single set of high quality accounting standards would facilitate investment and other economic decisions across borders, increase market efficiency, and reduce the cost of capital. Thus, International Accounting Standards (IAS) were developed, which are being withdrawn or superseded by International Financial Reporting Standards (IFRS).

At the same time, business environment and laws in every country are different. Therefore, it is not possible to have single set of accounting standards that will apply in all the countries. International Accounting Standards Board (IASB) has issued such standards termed as International Financial Reporting Standards (IFRS). India, instead of adopting IFRS, decided to prepare its own accounting standards equivalent to IFRS. Thus, Ind-AS can be said to be converged standards of IFRS. These accounting standards are known as **Indian Accounting Standards (Ind-AS)**.

Ind-AS are notified under the Companies Act, 2013 and are applicable to companies:

(*i*) Listed on the Stock Exchange in India;

(*ii*) Having net worth of ₹ 250 crores or more; and

(*iii*) Their holding, subsidiary, associate and joint venture companies.

Besides the above companies, other companies may adopt Ind-AS voluntarily.

The objective behind issuing Ind-AS is to prepare financial statements of a company on the lines of internationally accepted accounting principles and practices and complying with the country's business environment and laws.

### Difference between Indian Accounting Standards (Ind-AS) and Accounting Standards (AS)

The principal differences between Ind-AS and Accounting Standards are as follows:

***1. Ind-AS are Principle based while Accounting Standards are Rule based:*** Balance Sheet is prepared by a company (on which Ind-AS is not applicable) according to Schedule III of the Companies Act, 2013. It means, a Balance Sheet item should be



depicted under the prescribed head. In contrast to this, Ind-AS do not prescribe any form for the Balance Sheet. They prescribe that items may be shown in the Balance Sheet in accordance with the principle associated with them. For example, Redeemable Preference Shares are shown under the main head "Share Capital" under Schedule III of the Companies Act, 2013. But, it is shown as loan because it carries a fixed rate of dividend and also must be redeemed in accordance with the terms of issue but not later than 25 years from the date of issue. Ind-AS require that since it is in the nature of loan, it should be depicted under the main head "Loans".

***2. Ind-AS involves Fair Value Concept while Accounting Standards are based on Historical Cost Concept:*** Unlike Accounting Standards, Ind-AS prescribes that the assets and liabilities of the company may be shown at the fair value as at the date of the Balance Sheet. But, financial instruments (Securities, etc.) should be valued at fair value. Thus, in effect, when fair value is adopted for fixed assets, depreciation is not charged on the cost of the asset but it is valued as on that date and the difference in opening and closing valuation is debited or credited to Profit and Loss Account. It means every asset and also liability will have to be valued or discounted every year to be shown in the Balance Sheet.

### Meaning of Ind-AS

*Ind-AS are a set of accounting standards notified under the Companies Act, 2013 that converge with International Financial Reporting Standards (IFRS).*

Ind-AS are based on sound and clearly stated principles and therefore, Ind-AS are said to be *principle-based accounting standards*. This contrasts with Accounting Standards that are applicable on companies on which Ind-AS are not applicable, which are *rule-based accounting standards.*

### Underlying Assumptions in Ind-AS

The underlying assumptions in Ind-AS (Ind-AS 101) are:

***1. Going Concern Assumption:*** It is assumed that the life of the business is infinite, *i.e.*, the entity will continue its operations for an indefinite period.

***2. Accrual Assumption:*** The transactions are recorded in the books of account on accrual basis, *i.e.*, as and when they occur and not when the settlement of transactions takes place.

### Ind-AS Based Financial Statements

The financial statements prepared under Ind-AS are:

***1. Statement of Financial Position:*** The elements or contents of the statement are:

(*i*) *Asset:* Assets are the resources controlled by the enterprise as a result of past events and operations from which the future economic benefits shall flow to the enterprise.

(ii) *Liability:* Liabilities are the obligations of the enterprise from the past events and operations, which shall result in outflow of resources, *i.e.*, assets.

**2. *Statement of Changes in Equity:*** Equity is the residual interest in the assets of the enterprise after deducting liabilities. It is the real value of shareholders' equity.

**3. *Statement of Comprehensive Income:*** A Statement of Comprehensive Income includes two separate statements, *i.e.* Income Statement and a Statement of Comprehensive Income are prepared. The Statement of Comprehensive Income reconciles the income or loss as per Income Statement with total comprehensive income. The elements or contents of the statement are:

(i) *Revenue:* It increases the economic benefit during the accounting period as a result of business operations or increase in value of assets or decrease in liabilities. It results in increase in the value of shareholders' equity.

(ii) *Expense:* It is a decrease in economic benefits in the form of outflows during the accounting period as a result of business operations or decrease in value of assets or increase in liabilities. It results in decrease in the value of shareholders' equity.

4. Statement of Cash Flow.

5. Notes and Significant Accounting Policies.

### Valuation Principles

Ind-AS prescribes that every company shall value its financial assets (securities) at Fair Value whereas other assets can be valued at historical cost or at Fair Value. But, whichever of the two methods is adopted, shall have to be consistently followed:

Fair Value means the price that would be received when an asset is sold or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Stating differently, it is a price which a buyer would be willing to pay for an asset and a seller would be willing to accept.

However, for the purposes of Ind-AS in many cases, fair value is estimated, (except in the case of quoted financial securities) for which Valuation Rules are notified.

### Applicability of Ind-AS

Ind-AS applies to following companies:

(a) Companies that are listed on Stock Exchange, in India; and

(b) Companies having net worth of ₹ 250 crores or more.

Other companies may follow Ind-AS voluntarily.

Ind-AS will also apply on the Holding, Subsidiary, Associate and Joint-venture Companies on which Ind-AS applies or is voluntarily adopted.

### Ind-AS Under the Companies Act, 2013

So far the number of Ind-AS issued and notified under the Companies Act, 2013 are 40, list of which is given hereunder.

Scan QR Code for the List of Indian Accounting Standards



## QUESTIONS

### Higher Order Thinking Skills (HOTS) Questions

**Q. 1.** Rahul, the proprietor of M/s. R.K. & Co. purchased an air-conditioner and installed it at his residence. The payment was made by issuing a cheque from the account of M/s. R.K. & Co. The Accountant debited the Drawings Account with the amount whereas Rahul is of the view that it should be debited to the Fixed Assets. In your view, who is correct and why?

**Ans.** The Accountant is correct because according to the Business Entity Concept business is separate and distinct from the owners. Since, the air-conditioner has been installed at the residence of the proprietor, *i.e.*, for his personal use, it is drawings by the owner.

**Q. 2.** Which accounting principle requires that personal expenses of proprietor or partners should be debited to Drawings Account?

**Ans.** Accounting Entity or Business Entity Principle.

**Q. 3.** Production at a factory had to stop for a week due to a labour strike. The owner estimated the loss of production and the likely loss of profit arising out of the situation. He directed the accountant to record the loss in the books of account. Is the owner correct in recording the likely loss? Give reasons.

**Ans.** No, the owner is not correct because transactions and events are recorded in the books of account if they can be measured in money terms and on the basis of evidences. In the present case, evidence to the effect of loss or profit does not exist on the basis of which the owner can measure the loss in money terms.

**Q. 4.** Under which accounting principle, quality of manpower is not recorded in the books of account?

**Ans.** Money Measurement Principle.

**Q. 5.** The assets of Standard Sugar Co. were acquired by the Government on 1st April, 2000 and the company received a compensation of ₹ 10 crores. The company did not have any other business as on the date of acquisition and has also not ventured into any other business after acquisition of assets. The company placed the amount so received in a fixed deposit with a bank, which is lying deposited with the bank as on date also. It has also filed a case in the Court seeking higher compensation. Is the company a going concern?

**Ans.** The company is not a going concern because it has not commenced any business post acquisition. The company is only seeking higher compensation and not quashing the acquisition order of the Government. It has invested the compensation received in the fixed deposit which remains deposited as on date also. Thus, the company does not have intentions to conduct the business.

**Q. 6.** Which concept (principle) assumes that a business enterprise will not be liquidated in the near future? *(Delhi 2010)*

**Ans.** Going Concern Concept.

**Q. 7.** An infrastructure company building highways has a contract to construct road of 25 kms. The project is likely to be completed in 4 years. It has approached a bank seeking finance. The bank has requested them to prepare projected yearly accounts whereas the company has argued that since the project shall be completed in 4 years, projected accounts should be prepared for the end of the project. Is the company correct in its view? Give reasons.

**Ans.** No, the company is not correct because the bank requires year-wise projected accounts firstly, to assess the time when the funds shall be required and also how much funds shall be required; and secondly it shall be in a position to monitor the progress of the project at regular intervals.

**Q. 8.** Which accounting principle requires that life of a business be broken into smaller parts?

**Ans.** Accounting Period Principle.

**Q. 9.** Gurpreet purchased 1,000 sq. yards land to build a factory and paid ₹ 15 lakhs towards its cost including registration charges. At the end of the financial year, the value of the land came down to ₹ 13 lakhs. Gurpreet recorded the land at ₹ 13 lakhs and booked a loss of ₹ 2 lakhs. Is he correct in treating the fall in value as a loss?

**Ans.** No, Gurpreet is not correct because he has purchased a fixed asset by paying ₹ 15 lakhs. The Cost Concept of Accounting holds that an asset should be recorded in the books at the price paid.

**Q. 10.** Under which accounting concept asset is recorded at cost, even if the market price is more or less?

**Ans.** Cost Concept.

**Q. 11.** If one aspect of a transaction is not recorded, which accounting concept is not followed?

**Ans.** Dual Aspect Concept.

**Q. 12.** Under which concept if advance is received against sale of goods, the advance received is recorded as 'Advance Against Sale' and not Sales?

**Ans.** Revenue Recognition Concept.

**Q. 13.** An enterprise prepares its accounts under the accrual basis. Salaries amounting to ₹ 10,000 for the month of March, 2019 were not paid. The owner did not want to account it in the books of account on the ground that the amount was not paid. The enterprise closes its books of account on 31st March every year. Is he correct?

**Ans.** No, the owner is not correct because under the Accrual Concept, expense should be accounted at the time when it is incurred and not when it is paid. Salaries for March 2019 have become due on 31st March, 2019 and therefore, should be accounted in the books of account for the year ended 31st March, 2019.

**Q. 14.** Rent for the month of March, 2019 is not paid. Under which accounting concept it should be recorded as expense for the year ended 31st March, 2019?

**Ans.** Accrual Concept.

**Q. 15.** 'Capital is a liability for the business.' Explain this statement with the principle applied. *(MSE Chandigarh 2011)*

**Ans.** According to Accounting Entity or Business Entity Principle capital is a liability for the business. This principle requires that for accounting purpose, a distinction should be made between business affairs and personal affairs and in the accounting books of the business only business transactions be recorded. The amount invested by the owner is recorded in his Capital Account and the amount withdrawn by the owner from the business for his personal use is recorded in Drawings Account. The amount in the credit of the Capital Account is a liability of the business towards the owner.

**Q. 16.** 'Closing Stock is valued at lower of cost or market price.' Which concept of Accounting is applied here? *(Delhi 2010)*

**Ans.** Prudence Concept.

**Q. 17.** A company lost vital machinery in an accident on 2nd March, 2019 which will have adverse impact on its production capacity. As a result, it is likely to loose business to its competitors. The company has not disclosed this fact in its annual report for the year ended 31st March, 2019. Do you think it is complying with the Convention of Full Disclosure?

**Ans.** No, the company is not complying with the Convention of Full Disclosure as loss of vital machinery has adverse impact on the business and thus, on its profitability. It being material information should have been disclosed.



**Q. 18.** An investment company has been valuing its inventory of land at lower of market price or cost. It now wants to value its inventory at the current market price which is higher than the cost. Which accounting concept will be violated?

**Ans.** Prudence Concept.

**Q. 19.** An investment company has securities as current assets having market value substantially lower than the cost price. The company continues to show them at cost. Do you think the Concept of Prudence is being followed?

**Ans.** No, the company is not following the Concept of Prudence. It should bring down the value of current assets to its market value because the financial statements will otherwise show a better picture than what it actually is.

## Multiple Choice Questions (MCQs)

1. *Select the best alternative:*

(*i*) According to the Business Entity Concept
- (*a*) transactions between the business and its owners are not recorded.
- (*b*) transactions between the business and its owners are recorded considering them to be one single entity.
- (*c*) transactions between the business and its owners are recorded from the business point of view.
- (*d*) None of the above.

(*ii*) According to the Money Measurement Concept
- (*a*) all transactions and events are recorded.
- (*b*) all transactions and events which can be estimated in money terms are recorded in the books of account.
- (*c*) all transactions and events which can be measured in money terms are recorded in the books of account.
- (*d*) None of the above.

(*iii*) According to the Cost Concept
- (*a*) assets are recorded at the value paid for acquiring them.
- (*b*) assets are recorded by estimating the market value at the time of purchase.
- (*c*) assets are recorded at lower of cost or market value.
- (*d*) None of the above.

(*iv*) According to the Going Concern Concept
- (*a*) assets are recorded at cost and are depreciated over their useful life.
- (*b*) assets are valued at their market value at the year-end and are recorded in the books of account.
- (*c*) assets are valued at their market value, recorded in the books and depreciation is charged on the market value.
- (*d*) None of the above.

(*v*) According to the Accrual Concept
- (*a*) transactions and events are recorded in the books at the time of their settlement in cash.
- (*b*) transactions and events are recorded in the books at the time when they are entered into.
- (*c*) transactions and events may be recorded either at the time of the settlement or when they are entered into.
- (*d*) None of the above.

(*vi*) According to the Convention of Consistency
(*a*) accounting policies and practices once adopted should be consistently followed.
(*b*) accounting policies and practices adopted may be changed as per the management's decision.
(*c*) accounting policies and practices once adopted cannot be changed under any circumstances.
(*d*) None of the above.

(*vii*) According to Going Concern Concept, a business is viewed as having
(*a*) a limited life. (*b*) a very long life.
(*c*) an indefinite life. (*d*) None of these.

(*viii*) According to which of the following accounting concepts, even the proprietor of a business is treated as creditor to the extent of his capital?
(*a*) Money Measurement Concept (*b*) Dual Aspect Concept
(*c*) Cost Concept (*d*) Business Entity Concept

(*ix*) According to which of the following concepts, in determining the net income from business, all costs which are applicable to the revenue of the period should be charged against that revenue?
(*a*) Matching Concept (*b*) Money Measurement Concept
(*c*) Cost Concept (*d*) Dual Aspect Concept

(*x*) Valuation of stock at lower of cost or net realisable value is an example of
(*a*) Consistency Convention. (*b*) Conservatism Convention.
(*c*) Realisation Concept. (*d*) Matching Concept.

(*xi*) During the life-time of an entity, accounting produces financial statements in accordance with which of the following accounting concept?
(*a*) Matching (*b*) Conservatism
(*c*) Accounting period (*d*) Cost

(*xii*) X Ltd. follows the Written Down Value Method of depreciating machinery year after year due to
(*a*) comparability. (*b*) convenience.
(*c*) consistency. (*d*) All of these.

(*xiii*) The Convention of Conservatism takes into account
(*a*) all prospective profits and prospective losses.
(*b*) all prospective profits and leaves out prospective losses.
(*c*) all prospective losses but leaves out prospective profits.
(*d*) None of the above.

(*xiv*) IASB upon coming into existence has adopted
(*a*) all IAS and SIC. (*b*) some IAS and SIC.
(*c*) none of the IAS and SIC. (*d*) None of these.

(*xv*) IFRS are
(*a*) rule based accounting standards.
(*b*) principle based accounting standards.
(*c*) partially rule based and partially principle based accounting standards.
(*d*) None of the above.



(*xvi*) IFRS are based on
(*a*) historical cost. (*b*) fair value.
(*c*) both historical cost and fair value. (*d*) None of these.

(*xvii*) Ind-AS are
(*a*) rule based accounting standards.
(*b*) principle based accounting standards.
(*c*) partially rule based and partially principle based accounting standards.
(*d*) None of the above.

(*xviii*) Assets (except Securities) may be valued under Ind-AS on.
(*a*) historical cost. (*b*) fair value.
(*c*) both historical cost and fair value. (*d*) None of these.

[(*i*) (*c*); (*ii*) (*c*); (*iii*) (*a*); (*iv*) (*a*); (*v*) (*b*); (*vi*) (*a*); (*vii*) (*c*); (*viii*) (*d*); (*ix*) (*a*); (*x*) (*b*); (*xi*) (*c*); (*xii*) (*c*); (*xiii*) (*c*); (*xiv*) (*a*); (*xv*) (*b*); (*xvi*) (*b*); (*xvii*) (*b*); (*xviii*) (*a*).]

2. *State the accounting concept/convention involved in each of the following situation:*

(*i*) The calibre or quality of the management team is not disclosed in the Balance Sheet.
(*ii*) Advance received from a customer is not taken as income or sales.
(*iii*) Assets are recorded in books at the cost incurred for acquisition of such assets.
(*iv*) Revenue must be recognised when it is realised and expenses are recognised when incurred.
(*v*) A business for which financial statements are prepared is separate and distinct from the owner of the entity.
(*vi*) The assumption is made that the entity in question will remain in business for an indefinite period of time.
(*vii*) Capital contributed by the proprietor is credited to his Capital Account.
(*viii*) Financial statements of the firm are prepared every year on 31st March.
(*ix*) Goods sold on credit to Ramesh—Ramesh's A/c is debited and Sales A/c is credited.
(*x*) Sale has been made in the year ended 31st March, 2018 but the amount has not been realised. Revenue should be recognised as earned in the year ended 31st March, 2018.
(*xi*) Sale is recognised on the basis of Cash Memo or Invoice.
(*xii*) Closing Stock is valued at lower of cost or market value.
(*xiii*) Harpreet has entered into agreement whereby he will earn ₹ 10 lakhs for the services to be provided in the next year. The income should be recognised as revenue in the next year after services have been provided.
(*xiv*) Purchase of pen is treated as expense.

[(*i*) *Money Measurement Concept;* (*ii*) *Revenue Recognition Concept;* (*iii*) *Cost Concept;* (*iv*) *Accrual Concept;* (*v*) *Business Entity Concept;* (*vi*) *Going Concern Concept;* (*vii*) *Business Entity Concept;* (*viii*) *Accounting Period Concept;* (*ix*) *Dual Aspect Concept;* (*x*) *Revenue Recognition Concept;* (*xi*) *Verifiable Evidence Objective;* (*xii*) *Prudence Concept;* (*xiii*) *Revenue Recognition;* (*xiv*) *Materiality Concept.*]

## Very Short Answer Type Questions

**Q. 1.** What do you understand by Accounting Concepts?
**Ans.** Accounting concepts are the basic assumptions or fundamental propositions within which accounting function is carried out.

**Q. 2.** Explain Dual Aspect Concept. *(Delhi 2002; MSE Chandigarh 2003, 2006; KVS 2008)*
**Ans.** Every transaction has two aspects a debit and a credit of equal amount. It means for every debit there is a credit of equal amount in one or more accounts and *vice versa*. According to Dual Aspect Concept, both the aspects are recorded in the books of account.

**Q. 3.** Explain Business Entity Concept.
**Ans.** According to the Business Entity Concept, proprietor of the business is a separate and distinct entity from business. The transactions are recorded in the books of account from the point of view of business, not from the point of view of the proprietor.

**Q. 4.** Explain Going Concern Concept. *(KVS 2007, 2012; Delhi 2010)*
**Ans.** According to the Going Concern Concept, it is assumed that the business will continue for a foreseeable future and there is no intention to close or scale down the operations significantly.

**Q. 5.** Explain Revenue Recognition Concept. *(Delhi 2011)*
**Ans.** According to the Revenue Recognition Concept, revenue is considered to have been realised when a transaction has been entered into and the obligation to receive the amount has been established.

**Q. 6.** Explain Verifiable Objective Concept.
**Ans.** According to the Verifiable Objective Concept, accounting should be free from personal bias. Measurements that are based on verifiable evidences are regarded as objective.

**Q. 7.** Explain Historical Cost Concept. *(Delhi 1999)*
**Ans.** According to the Historical Cost Concept assets are recorded in the books of account at the prices paid to acquire them and it is the basis for all subsequent accounting of the assets.

**Q. 8.** Explain Accounting Period Concept. *(Delhi 1998, 2001; MSE Chandigarh 2003, 2004)*
**Ans.** According to the Accounting Period Concept, life of the business is broken into smaller periods (one year) so that its performance is measured at regular intervals.

**Q. 9.** Explain Consistency Convention. *(Delhi 2004; KVS 2012)*
**Ans.** According to the Consistency Convention, accounting practices once selected and adopted should be applied consistently year after year.

**Q. 10.** Explain Money Measurement Concept. *(Delhi 2001, 2004, 2006, 2011, 2012; KVS 2012)*
**Ans.** According to the Money Measurement Concept, transactions and events that can be measured in terms of money are recorded in the books of account.

**Q. 11.** Explain Accrual Concept. *(Delhi 2001; KVS 2007, 2008)*
**Ans.** According to the Accrual Concept, a transaction is recorded in the books of account at the time when it is entered into and not when the settlement takes place. For example, sales made on credit will be recorded in the books of account on the date of sales, not when the amount is received.



**Q. 12.** Explain Principle of Matching Revenue with Cost. *(Delhi 1999, 2001)*
**Ans.** According to the Matching Concept, cost incurred to earn revenue should be recognised as expense in the period when revenue is recognised as earned.

**Q. 13.** Why is it necessary for accountants to assume that a business entity will remain a going concern?
**Ans.** Going Concern Concept is a fundamental accounting concept. It is because of this concept, distinction is made between capital and revenue expenditures and thus assets and liabilities are recognised.

**Q. 14.** How does the Matching Principle apply to depreciation? *(MSE Chandigarh 2012)*
**Ans.** According to the Matching Principle, the expenses for an accounting period are matched against related revenues for the determination of profit. On account of this principle, the purchase price of the fixed asset is not taken but only depreciation on fixed asset related to the accounting period is taken.

**Q. 15.** Why should a business follow the consistency principle? *(MSE Chandigarh 2009)*
**Ans.** Comparability is a qualitative characteristic of a financial statement, *i.e.*, the financial performance of a year may be compared with that of another year. It is possible only when accounting practices are consistently followed.

**Q. 16.** Explain **any three** of the following accounting conventions:
*(MSE Chandigarh 2012)*
*(KVS 2012)*
(*i*) Full Disclosure,
(*ii*) Consistency,
(*iii*) Materiality and
(*iv*) Conservatism. *(Delhi 2008, 2012; KVS 2012)*

**Ans.** (*i*) According to the Convention of *Full Disclosure*, all significant information relating to the economic affairs of the entity should be reported in the financial statements in an understandable manner.
(*ii*) According to the Convention of *Consistency*, accounting practices once selected and adopted should be consistently applied year after year.
(*iii*) According to the Convention of *Materiality*, a transaction should be reported in the financial statements on the basis of its materiality. An item is material if it can influence the decision of the user.
(*iv*) According to the Convention of *Conservatism*, anticipated losses should be accounted while anticipated incomes should not be accounted.

**Q. 17.** Give the meaning of 'Full Disclosure Principle' of Accounting. *(Delhi 2012)*
**Ans.** According to the Convention of Full Disclosure, all significant information relating to the economic affairs of the entity should be reported in the financial statements in an understandable manner.

**Q. 18.** Explain Accounting Standards briefly. *(Delhi 2010)*
**Ans.** Accounting Standards are a set of guidelines, *i.e.*, Generally Accepted Accounting Principles, issued by the accounting body of the country, *i.e.*, The Institute of Chartered Accountants of India, that are followed for preparation and presentation of financial statements. The objective of setting Accounting Standards is to bring uniformity in accounting practices and to ensure transparency, consistency and comparability.

**Q. 19.** What is the main objective of setting accounting standards? *(Delhi 2011)*

*Or*

What is meant by Accounting Standards? Explain **one** objective of Accounting Standards. *(KVS 2012)*

**Ans.** Accounting Standards are the guidelines for the preparation and presentation of Financial Statements. The objective of setting Accounting Standards is to bring uniformity in accounting practices and to ensure transparency, consistency and comparability.

**Q. 20.** 'Accounting Standards have been evolved to improve the reliability and credibility of Financial Statements. Accounting Standards provide the solution in case of conflicts among various groups.' In the light of this statement, enumerate the objectives of Accounting Standards.

**Ans.** Objectives of Accounting Standards are:

(*i*) Minimise the diverse accounting policies and practices with the aim to eliminate them to the extent possible.

(*ii*) Promote better understanding of financial statements.

(*iii*) Understand significant Accounting Policies adopted and applied.

(*iv*) Facilitating meaningful comparison of financial statements of two or more entities.

(*v*) Enhancing reliability of financial statements.

**Q. 21.** Briefly explain your understanding of IFRS.

**Ans.** IFRS are the accounting standards issued by the IASB, recommended to be used by the enterprises globally to produce financial statements following a single set of accounting standards. IFRS are principle based accounting standards in comparison to rule based Indian Accounting Standards. Also they are based on fair value concept.

**Q. 22.** Which financial statements are prepared under IFRS?

**Ans.** Financial Statements prepared under IFRS include:

(*i*) Statement of Financial Position;

(*ii*) Statement of Comprehensive Income;

(*iii*) Statement of Changes in Equity;

(*iv*) Statement of Cash Flow; and

(*v*) Notes and Significant Accounting Policies.

**Q. 23.** Briefly explain the elements of Statement of Financial Position.

**Ans.** *Assets:* Assets are the resources controlled by the enterprise as a result of past events and operations from which the future economic benefits shall flow to the enterprise. Thus, assets shall include tangible and intangible assets, which an enterprise owns.

*Liabilities:* Liabilities are the obligations of the enterprise from the past events and operations, which shall result in outflow of resources, *i.e.*, assets.

*Equity:* Equity is the difference between the assets and liabilities.

**Q. 24.** Briefly explain the elements of Statement of Comprehensive Income.

**Ans.** A Statement of Comprehensive Income comprises of two statements, *i.e.*, Income Statement and a Statement of Comprehensive Income are prepared. The Statement of Comprehensive Income reconciles the income or loss as per Income Statement with total comprehensive income. The elements or contents of the statement are:

(*i*) *Revenue:* It increases the economic benefit during the accounting period because of business operations and/or increase in the value of assets or decrease in liabilities. As a result of it, value of shareholders equity increases.



(*ii*) *Expense:* It is a decrease in economic benefits in the form of outflows during the accounting period because of business operations and/or decrease in the value of assets or increase in liabilities. As a result of it, value of shareholders equity decreases.

**Q. 25.** Briefly explain your understanding of Ind-AS.

**Ans.** Ind-AS are the accounting standards issued by the Ministry of Corporate Affairs, Government of India, and notified under the Companies Act, 2013 prescribed to be used by the enterprises to prepare financial statements. They are principle based accounting standards in comparison to rule based Accounting Standards. Also they are based on fair value concept.

**Q. 26.** Which financial statements are prepared under Ind-AS?

**Ans.** Financial Statements prepared under Ind-AS include:

(*i*) Statement of Financial Position;

(*ii*) Statement of Comprehensive Income;

(*iii*) Statement of Changes in Equity;

(*iv*) Statement of Cash Flow; and

(*v*) Notes and Significant Accounting Policies.

**Q. 27.** Briefly explain the elements of Statement of Comprehensive Income.

**Ans.** A Statement of Comprehensive Income comprises of two statements, *i.e.*, Income Statement and a Statement of Comprehensive Income are prepared. The Statement of Comprehensive Income reconciles the income or loss as per Income Statement with total comprehensive income. The elements or contents of the statement are:

(*i*) *Revenue:* It increases the economic benefit during the accounting period because of business operations and/or increase in the value of assets or decrease in liabilities. As a result of it, value of shareholders equity increases.

(*ii*) *Expense:* It is a decrease in economic benefits in the form of outflows during the accounting period because of business operations and/or decrease in the value of assets or increase in liabilities. As a result of it, value of shareholders equity decreases.

## Short Answer Type Questions

1. What is the Matching Concept? Why should a business concern follow this concept? Discuss. *(KVS 2004)*
2. 'Business units last indefinitely.' Mention and explain the concept on which the statement is based. *(MSE Chandigarh 2004; KVS 2005)*
3. What is Money Measurement Concept? Which one factor can make it difficult to compare the monetary value of one year with the monetary values of another years?
4. "Only financial transactions are recorded in accounting." Explain the statement. *(MSE Chandigarh 2011)*

   [**Hint:** According to Money Measurement Principle only those transactions are recorded in the books of account which can be measured in terms of money. In other words, non-financial transactions or facts, like the efficiency of the management will never be recorded in the books of account.]
5. What are the objectives of Ind-AS? **(Any two)**

6. 'Accounting Standards have been evolved to improve the reliability and credibility of Financial Statements. Accounting Standards provide the solution in case of conflicts among various groups'. In the light of this statement enumerate the objectives of Accounting Standards. *(KVS 2016)*
7. Discuss the Accounting Convention based on the premise 'Do not anticipate profits but provide for all losses.' *(MSE Chandigarh 2008)*
8. Explain **any three** of the following:
   (*i*) Business Entity Concept
   (*ii*) Matching Concept
   (*iii*) Consistency Concept
   (*iv*) Dual Aspect Concept *(KVS 2010)*
9. Explain **any two** of the following concepts:
   (*i*) Money Measurement Concept
   (*ii*) Business Entity Concept
   (*iii*) Matching Concept *(Delhi 2007)*
10. Explain the following accounting concepts with an example of each:
    (*i*) Going Concern Concept
    (*ii*) Matching Concept *(Delhi 2009)*
11. Explain the Business Entity Concept with example. *(MSE Chandigarh 2009)*
12. What are Accounting Standards? Name **any two** Accounting Standards. *(MSE Chandigarh 2007)*
13. Define Accounting Standards. Explain its **any two** objectives. *(MSE Chandigarh 2011)*
14. Define Accounting Standards. Who is responsible for issuing Accounting Standards in India? *(MSE Chandigarh 2008)*
15. What are the **two** basic objectives of having Accounting Standards? *(Delhi 2009, 2010)*
16. Explain the following briefly with appropriate example:
    (*i*) Revenue Recognition (Realisation) Concept
    (*ii*) Conservation or Prudence Concept
    (*iii*) Money Measurement Concept *(Delhi 2011)*
17. Explain the following:
    (*i*) Going Concern Concept
    (*ii*) Dual Aspect Concept *(KVS 2015)*
18. 'Accounting Standards have been evolved to improve the reliability and credibility of Financial Statements. Accounting Standards provide the solution in case of conflicts among various groups.' In the light of this statement, enumerate the objectives of Accounting Standards. *(KVS 2015)*
19. (*i*) What is the principle of conservation or prudence?
    (*ii*) What are the objectives of IFRS? **(Any two)** *(MSE Chandigarh 2015)*

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