DEPARTMENT OF COMMERCE
D.B. COLLEGE, JAYNAGAR
LALIT NARAYANA MITHILA UNIVERSITY, DARBHANGA (BIHAR)

BY: DR. SHAILESH KR. SINGH
ASSISTANT PROFESSOR (GUEST)

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CORE CONCEPT OF FINANCIAL ACCOUNTING

Compliance with Accounting Standards

Accounting standards issued by the ASB under the consultation and approval by ICAI have a legal status and every company, subject to the coverage of the standard, is required to abide by the provisions of accounting standards while preparing its books of accounts and presenting annual accounts – financial statements. Section 211 of the Companies Act 1956 requires that every company should comply with the necessary accounting standards while presenting its balance sheet and profit and loss account. Companies are also required to report the deviation from accounting standard, if any, while presenting financial statements.

ACCOUNTING POLICY AND ACCOUNTING STANDARDS CONCERNING FINANCIAL STATEMENTS

Accounting policy refers to the application of accounting concepts and convention in preparing books of accounts and financial statements. The level of transparency and disclosure depends upon the accounting policies adopted while preparing financial statements. Accounting policies are the guiding principles in making projection in the financial statements. Without these, a true and fair view of financial position of the business organisation is not possible.

Accounting Standards

Accounting standards are the guidelines prepared by the Institute of Chartered Accountants of India (ICAI) for the preparation of books of account and also for making projection in the financial statements. The preparation of financial statements – final accounts at the end of the accounting year is governed by accounting standards suggested by the ICAI. The adoption of accounting standards brings in the uniformity in the books of accounts, facilitates easy interpretation and comparison of financial results. There are thirty five accounting standards developed by ICAI. Out of these, following ***accounting standards*** are prominent and are adopted almost by all companies while preparing final accounts:

- Disclosure of Accounting Policies – AS 1
- Valuation of Inventory – AS 2
- Contingencies and Events Occurring after the Balance Sheet Date – AS 4
- Net Profit or Loss for the period, prior period Items and Changes in Accounting Policies – AS 5
- Revenue Recognition – AS 9

Although adoption of all the accounting standards is must, but above-mentioned ones are most common and prominent.

(**Note:** Nominclature of these has changed after the introduction of Ind-AS)

Disclosure of Accounting Policies – AS 1

Diversity in accounting practices and dynamic nature of business transactions make it difficult to comply with all the accounting standards by every business enterprise. At the same time there are some of the aspects, which are not covered by the accounting standards, even in certain cases the prescribed accounting standard permit the adoption of more than one accounting policy for one single aspect. Due to these reasons, it is necessary that accounting policies, complied by the business enterprise while maintaining books of accounts and presenting final accounts, should be disclosed properly with reasoning for the adoption of a particular policy. Such disclosure is to help

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the readers to have appropriate interpretation of financial results of the company. At the same time, it facilitates comparison of financial results.

The accounting standard one (AS – 1) recognises three accounting assumptions. These are as follows:

(i) Going Concern
(ii) Consistency
(iii) Accrual Basis of Accounting

(i) Going concern assumption implies that business enterprises will continue its operations for a significantly longer time period in the future and there is no scope to assume the curtailment of the business activities in the near future. The straightway implication of this is that all the monetary transactions are recorded in the books of accounts at the historical cost and fixed assets are depreciated/amortised over their economic useful life and shown in the balance sheet at the historical cost less depreciation. If a business enterprise prepares its accounts by showing the assets at some other value like net realisable value, then such fact is to be disclosed at the time of presentation of final accounts.

(ii) Consistency assumption makes it binding on a business enterprise to follow particular accounting policy continuously over long time period without making frequent changes. Consistency helps in carrying uniform interpretation of financial results and facilitates the comparison. Although, a business enterprise can change its accounting policy only when such change is imposed by law/ regulation or the change is required on account of changing business/economic scenario. A proper disclosure is required as soon as there is a change in the accounting policies.

(iii) Accrual basis of accounting is considered superior over cash basis of accounting. Accrual basis of accounting is applicable for revenue and expenses. It implies that a revenue/profit is to be recognised and recorded in the books of accounts as soon as there is a reasonable claim to receive it whether actually received or not. Similarly, all the expenses which are relevant for the revenue of the current accounting year should be shown in the books of accounts whether actually paid or not. The adoption of this assumption helps in making accurate calculation of profits. Although it has one danger of recognising an income which has not been received so far and such income might be distributed by way of dividends among shareholders. Still the accrual basis is superior over the cash basis because it helps in arriving at accurate level of profit as compared to cash basis.

Accounting Prudence

In view of the uncertainty associated with the future events like realisation of profits/assets in the future, accountants are of the opinion that a suitable provision should be made in the final accounts for losses and known future liabilities. This is complied with on account of convention of conservatism. The result of this is that business enterprises make provision for doubtful debts, provision of contingencies, and provision for likely devaluation in the assets, etc.

Substance over Form

Final accounts are also called financial statements. These should disclose different transactions in accordance to their substance (importance) and not in accordance to their materiality. This implies that the importance of an item should be considered while making presentation in the financial statements and not its monetary value. Accordingly, all the items irrespective of their monetary