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Module 1

Chapter 2

Generally Accepted Accounting Principles(GAAP) and Accounting Standards

CHAPTER AT A GLANCE (Chapter 2)

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- **2.02.02** Accrual Concept
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CHAPTER AT A GLANCE (Chapter 2)

2.01
GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

Meaning

The financial statements are produced following the

- accepted accounting concepts or principles
- for its uniform understanding.

They are known as **'Generally Accepted Accounting Principles' (GAAP).**

2.01
GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

GAAP are

- authoritative standards or set of rules
- concepts and conventions
- meant to provide guidelines
- and detailed procedure used in preparing financial statements and
- handling specific accounting situations.

GAAP are thus, ground rules of accounting so that similar economic events are reported by all in the same manner.

2.02 ACCOUNTING CONCEPTS

Broadly there are two Accounting Concepts

i) Fundamental Accounting Concepts

ii) Other Accounting Concepts

2.02
ACCOUNTING CONCEPTS

Fundamental Accounting Concepts

2.02.01 Going Concern Concept:

Assumes

- that business shall continue for an indefinite period
- there is no intention to close the business or
- scale down it's operations significantly.

2.02
ACCOUNTING CONCEPTS

Fundamental Accounting Concepts

2.02.01 Going Concern Concept (Contd...)

It is because of this concept that a distinction is made between

- capital expenditure and revenue expenditure.

Fixed assets are recorded at their original cost and

- depreciated in a systematic manner without reference to their market value.

2.02
ACCOUNTING CONCEPTS

Fundamental Accounting Concepts

2.02.02 Accrual Concept

- A transaction is recorded at the time when it takes place
- not when the settlement takes place.

2.02
ACCOUNTING CONCEPTS

Fundamental Accounting Concepts

2.02.02 Accrual Concept (Contd...)

Illustration

M/s. RSM & Co. purchases computers on 1st January, 2010 amounting to Rs. 5,00,000 to be paid on 15th April, 2010.

2.02
ACCOUNTING CONCEPTS

Fundamental Accounting Concepts

2.02.02 Accrual Concept (Cont.)

- Since the asset has been acquired by the enterprise and therefore has incurred a liability for the amount on 1st January, 2010,
- it must record the transaction in its books of account on 1st January, 2010.
- The transaction on recording shall reflect that the enterprise owns assets (computers) worth Rs. 5,00,000 and also owes an equal amount of money to the supplier.

2.02
ACCOUNTING CONCEPTS

Fundamental Accounting Concepts

2.02.03 Consistency Concept

holds that

- Once accounting practices selected and adopted,
- should be applied consistently year after year.

The concept helps in better understanding of accounting information and makes it comparable with the previous years.

Consistency eliminates personal bias and is particularly important when alternative accounting practices are equally acceptable

2.02
ACCOUNTING CONCEPTS

Fundamental Accounting Concepts

2.02.03 Consistency Concept (Contd...)

For example,

- two methods of charging depreciation, Written-down Value Method and Straight Line Method, are equally acceptable.
- The method once chosen and applied should be applied consistently year after year.

2.02
ACCOUNTING CONCEPTS

Fundamental Accounting Concepts

2.02.03 Consistency Concept (Contd...)

- It however, does not mean that accounting practice once adopted can not be changed.
- It can be changed if it is at variance with law or accounting standards.
- Whenever change is made, its effect on accounts must be disclosed.

2.02

ACCOUNTING CONCEPTS

Other Accounting Concepts

2.02.04 Money Measurement Concept

- Transactions and events that can be measured in money terms are only recorded in the books of accounts.
- In other words, money is the common denominator in recording and reporting the transactions.
- This concept makes accounting information more meaningful and useful for analysis of financial statements.

2.02
ACCOUNTING CONCEPTS

2.02.05 Dual Aspect Concept

- Every transaction has two aspects, a debit and a credit of equal amount.
- Simply stated, for every debit there is a credit of equal amount and vice versa
- Dual Aspect Concept can be expressed in term of Equation

Assets = Capital + Liabilities.

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2.02
ACCOUNTING CONCEPTS

Other Accounting Concepts

2.02.04 Money Measurement Concept (Contd...)

However, the concept suffers from two major limitations:

- Transactions and events that cannot be measured in money terms are not recorded, howsoever important they may be to the enterprise.
- Money is considered as having static value as the transactions are recorded at the value on the transaction date and the subsequent changes in the money value are ignored.

2.02
ACCOUNTING CONCEPTS

2.02.06 Accounting Period or Periodicity Concept

- According to the Accounting Period or Periodicity Concept the life of an enterprise is broken into smaller intervals (usually a year) so that its performance is measured at regular intervals.
- It enables the users of accounting information to take timely decisions that may be required according to the current business situation.
- Also the Government can assess the tax liability of the enterprise for the year.

2.02
ACCOUNTING CONCEPTS

2.02.07 Matching Concept

According to the Matching Concept,

- cost incurred to earn the revenue should be recognised as expense in the period when revenue is recognised as earned.
- Under this concept the expenses for an accounting period are matched against revenues for the period.

2.02
ACCOUNTING CONCEPTS

The Matching Concept operates as follows:

- When an item of revenue is recognised as income,

  all related expenses incurred (whether paid or not) are also be recognised as expense.

- If an expense is incurred against which the revenue will be earned in the next period

  the amount is carried to the next period (and shown in the balance sheet as an asset) and then in next year it is treated as an expense.

2.02
ACCOUNTING CONCEPTS

2.02.08 Realisation Concept

- Any change in the market value of an asset or liability is not recognized as a profit or loss
- until the asset is sold or the liability is paid off (discharged)

2.02
ACCOUNTING CONCEPTS

2.02.09 Business Entity Concept

According to the Business Entity Concept,

- business is considered to be separate from its owners.
- transactions, therefore, are recorded in the books of accounts from the business point of view and not owners
- owners being separate from the business are considered creditors of the business to the extent of their capital.

2.02
ACCOUNTING CONCEPTS

2.02.10 Materiality Concept

According to the American Accounting Association,

- "an item is 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 shall depend on its nature and/or amount

2.02
ACCOUNTING CONCEPTS

2.02.11 Conservatism or Prudence Concept

According to this concept

- all anticipated losses and expenses should be accounted but
- not the anticipated incomes and gains.

2.02
ACCOUNTING CONCEPTS

2.02.12 Concept of Full Disclosure

The Concept of Full Disclosure requires that

- “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 be disclosed.

2.02
ACCOUNTING CONCEPTS

2.02.13 Historical Cost Concept

According to the Historical Cost Concept,

- an asset is recorded in the books of account
- at the price paid to acquire it and
- cost is the basis for all subsequent accounting of the asset.

2.02
ACCOUNTING CONCEPTS

2.02.14 Objective Evidence Concept

- Objectivity means reliability, trustworthiness and verifiability, which means that there is some evidence for ascertaining the correctness of the reported information
- It means all accounting transactions should be evidenced and supported by business documents
- Supporting documents are cash memos, invoices, sale bills, etc., and provide the basis for accounting and audit

2.03
ACCOUNTING STANDARDS

Meaning and Need of Accounting Standards

Accounting Standards are

- the policy document guiding
- the measurement,
- treatment and
- disclosure of accounting transactions.
- They are issued by the accountancy body such as
- The Institute of Chartered Accountants of India

2.03
ACCOUNTING STANDARDS

Meaning and Need of Accounting Standards (Contd...)

Accounting Standards are

- guidelines for accounting policies and practices
- to be adopted and followed in accounting and
- presentation of financial statements.

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2.03
ACCOUNTING STANDARDS

Utility of Accounting Standards

1. Accounting Standards *provide the norms* on the basis of which financial statements should be prepared.
2. Accounting Standards ensure uniformity in
   - preparation and presentation of financial statements
   - by removing the effect of diverse accounting practices.
3. Accounting Standards create a sense of confidence among the users of accounting information.
4. Accounting Standards *help auditors* in auditing accounts. They *help accountants* follow uniform practices and policies.

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2.04
Accounting Standards Issued by the ICAI

AS No	Title of Accounting Standard
AS – 1	Disclosure of Accounting Policies.
AS – 2	Valuation of Inventories (Revised).
AS – 3	Cash Flow Statement (Revised).
AS – 4	Contingencies and Events Occurring after the Balance Sheet Date (Revised)
AS – 5	Prior Period and Extraordinary Items and Changes in Accounting Policies
AS – 6	Depreciation Accounting (Revised)

2.04
Accounting Standards Issued by the ICAI

AS – 7	Accounting for Construction Contracts
AS – 8	Accounting for Research and Development
AS – 9	Revenue Recognition
AS – 10	Accounting for Fixed Assets
AS – 11	Accounting for the Effects of Changes in Foreign Exchange Rates (Revised)
AS – 12	Accounting for Government Grants
AS – 13	Accounting for Investments

2.04
Accounting Standards Issued by the ICAI

AS – 14	Accounting for Amalgamations
AS – 15	Accounting for Retirement Benefits in the Financial Statements of Employers
AS – 16	Borrowing Costs
AS – 17	Segment Reporting
AS – 18	Related Parties Disclosures
AS – 19	Leases
AS – 20	Earning Per Share

2.04
Accounting Standards Issued by the ICAI

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 Venture

2.04
Accounting Standards Issued by the ICAI

AS – 28	**Impairment of Assets**
AS – 29	Provisions, Contingent Liabilities and Contingent Assets
AS – 30	Financial Instruments: Recognition and Measurement
AS – 31	Financial Instruments: Presentation
AS – 32	Financial Instruments: Disclosures and Limited Revision to AS-19 on Leases

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