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2.0 INTRODUCTION

Any activity that you perform is facilitated if you have a set of rules to guide your efforts. Further, you find that these rules are of more value to you if they are standardised. When you are driving your vehicle, you keep to the left. You are in fact following a standard traffic rule. Without the drivers of vehicles adhering to this rule, there would be much chaos on the road. A similar principle applies to accounting which has evolved over a period of several hundred years, and during this time certain rules and conventions have come to be accepted as useful. If you are to understand and use accounting reports which is the end product of an accounting system then you must be familiar with the rules and conventions behind these reports.

2.1 OBJECTIVES

After going through this unit, you should be able to:

- appreciate the need for a conceptual framework of accounting;
- understand and appreciate the Generally Accepted Accounting Principles (GAAP), and
- develop an understanding of the importance and necessity for uniformity in accounting practices.

2.2 THE ACCOUNTING FRAMEWORK

The rules and conventions of accounting are commonly referred to as the conceptual framework of accounting. As with any discipline or body of knowledge, some underlying theoretical structure is required if a logical and useful set of practices and procedures are to be developed for reaching the goals of the profession, and for expanding knowledge in that field. Such a body of principles is needed to help answer new questions that arise. No profession can thrive in the absence of a theoretical framework. According to Hendriksen (1977), accounting theory may be defined as logical reasoning in the form of a set of broad principles that (i) provide a general frame of reference by which accounting practice can be evaluated, and (ii) guide the development of new practices and procedures. Accounting theory may also be used to explain existing practices to obtain a better understanding of them. But the most important goal of accounting theory should be to provide a coherent set of logical principles that form the general frame of reference for the evaluation and development of sound accounting practices.

The American Institute of Certified Public Accountants (AICPA) discusses financial accounting theory and generally accepted accounting principles as follows:

Financial statements are the product of process in which a large volume of data about aspects of the economic activities of an enterprise are accumulated, analysed, and reported. This process should be carried out in accordance with generally accepted accounting principles. Generally accepted accounting principles incorporate the consensus at a particular time as to which economic resources and obligations should be recorded as assets and liabilities by financial accounting, which changes in assets and liabilities should be recorded, when these changes should be recorded, how the assets and liabilities and changes in them should be measured, what information should be disclosed and how it should be disclosed, and which financial statements should be prepared.

Generally Accepted Accounting Principles (GAAP) encompass the conventions, rules and procedures necessary to define accepted accounting practice at a particular time........generally accepted accounting principles include not only broad guidelines of general application, but also detailed practices and procedures.

(*Source:* AICPA. Statements of the Accounting Principles Board No.4 “Basic Concept and Accounting Principles Underlying Financial Statement of Business Enterprises”, October, 1970, pp.54-55).

The word ‘principles’ is used to mean a “general law or rule adopted or professed as a guide to action, a settled ground or basis of conduct or practice”. You will note that this definition describes a principle as a **general** law or rule that is to be used as a **guide to action**. This implies that accounting principles do not prescribe exactly how each detailed event occurring in business should be recorded. Consequently, there are several matters in accounting practice that may differ from one company to another.

Accounting principles are man-made. They are accepted because they are believed to be useful. The general acceptance of an accounting principle (or for that matter, any principle) usually depends on how well it meets the three criteria of **relevance**, **objectivity**, and **feasibility**. A principle is relevant to the extent that it results in meaningful or useful information to those who need to know about a certain business. A principle is objective to the extent that the information is not influenced by the personal bias or judgement of those who furnished it. Objectivity connotes reliability or trustworthiness which also means that the correctness of the information reported can be verified. A principle is feasible to the extent that it can be implemented without undue complexity or cost.

2.3 ACCOUNTING CONCEPTS

Earlier, in unit 1, we had described accounting as the language of business. As with language, accounting has many dialects. There are differences in terminology. In dealing with the framework of accounting theory, one is confronted with a serious problem arising from differences in terminology. A number of words and terms have been used by different writes to express and explain the same idea or notion. Thus, confusion abounds in the literature insofar as the theoretical framework is concerned.

The various terms used for describing the basic ideas are: concepts, postulates, propositions, basic assumptions, underlying principles, fundamentals, conventions, doctrines, rules, etc. Although each of these terms is capable of precise definition, general usage by the profession of accounting has served to give them loose and overlapping meanings. The same idea has been described by one author as a concept and by another as a convention. To take another instance, the idea implied in conservatism has been labelled by one author as a (modifying) convention, by another as a principle, and by yet another as a doctrine. The wide diversity in terminology to express the basic framework can only serve to confuse the learner.

Without falling into the trap of this terminological maze, we will explain below, some widely recognised ideas and we call all of these concepts. We do feel, however, that some of these ideas have a better claim to be called concepts, while the rest should be called conventions. Fundamental accounting concepts are broad, general assumptions that underlie the periodic financial accounts of business enterprises. The reason why some of these ideas should be called concepts is that they are basic assumptions and have a direct bearing on the quality of financial accounting information. The alteration of any of the basic concepts (or postulates) would change the entire nature of financial accounting.

Business Entity Concept

In accounting we make a distinction between business and the owner. All the records are kept from the viewpoint of the business, rather than from that of the owner. An enterprise is an economic unit, separate and apart from the owner, or owners. As such, transactions of the business and those of the owners should be accounted for, and reported separately. In recording a transaction, the important question is how does it affect the business? For example, if the owner of a shop were to take cash from the cash box for meeting certain personal expenditure, the accounts would show that cash had been reduced even though it does not make any difference to the owner himself. Similarly, if the owner puts cash into the business, he has a claim against the business for capital brought in.

This distinction can be easily maintained in the case of a limited company because a company has a legal entity (or personality) of its own. Like a human being, it can engage itself in economic activities of producing, owning, managing, storing, transferring, lending, borrowing and consuming commodities and services. Distinction, however, is difficult in the case of partnership, and even more so in the case of a one-man business. Nevertheless, accounting still maintains separation of business and owner. This implies that, owner's personal and household expenses or obligations (e.g., expenditure on food, clothing, housing, entertainment, debts, mortgages, etc.) will not appear in the books of account. It may be clarified that it is only for accounting purposes that partnerships and sole proprietorships are treated as separate and apart from the owners though the law does not make such a distinction. A creditor would be justified in looking to both the business assets and the private estate of the owner for satisfaction of his claim. One reason for this distinction is to make it possible for the owners to have an account of the performance from those who manage the enterprise. The managers are entrusted with funds supplied by owners, banks, and others; they are responsible for the proper use of the funds. The financial accounting reports are designed to show how well this responsibility has been discharged.

Money Measurement Concept

In accounting, only those facts which can be expressed in terms of money are recorded. As money is accepted not only as a medium of exchange but also as a measuring rod of value, it has a very important advantage since a number of widely different assets and equities can be expressed in terms of a common denominator. Without this adding heterogeneous factors like five buildings, ten machines, six trucks will not have much meaning.

While money is probably the only practical common denominator and a yardstick, we must realise that this concept imposes two sever limitations. In the first place, there are several facts which, though vital to the business, cannot be recorded in the books of account because they cannot be expressed in money terms. For example, the state of health of the Managing Director of a company, who has been the key contributor to the success of business, is not recorded in the books. Similarly, the fact that the Production Manager and the Chief Internal Auditor are not on speaking terms, or that a strike is about to begin because labour is dissatisfied with the poor working conditions in the factory, or that a competitor has recently taken over the best customer, or that it has developed a better product, and so on will not be recorded even though all these events are of great concern to the business.

From this standpoint, one could say that accounting does not give a complete account of the happenings in the business. You will appreciate that all these have a bearing on the future profitability of the company.
Second, the use of money implies that a rupee today is of equal value to a rupee ten years back or ten years later. In other words, we assume that there is a stable or constant value of the rupee. In the accounts, money is expressed in terms of its value at the time an event is recorded. Subsequent changes in the purchasing power of money do not affect this amount. You are, perhaps, aware that most economies today are in inflationary conditions with rising prices. The value of a rupee in the 80s has

depreciated to an unbelievably low level in the 90s. Most accountants know fully well that the purchasing power of a rupee does change, but very few recognise this fact in accounting books and make an allowance for changing price level. This is so, despite the fact that the accounting profession has devoted considerable attention to this problem, and numerous suggestions have been made to account for the effects of changes in the purchasing power of money. In fact, one of the major problem of accounting today is to find means of solving the measurement problem, that is, how to extend the quality and the coverage of meaningful information. It will be desirable to present, in a supplementary analysis, the effect of price level changes on the reported income of the business and the financial position.

Continuity Concept

Accounting assumes that the business (an accounting entity) will continue to operate for a long time in the future, unless there is good evidence to the contrary. The enterprise is viewed as a **going concern,** that is, as continuing in operation, at least in the foreseeable future. The owners have no intention, nor have they the necessity to wind up or liquidate its operations.

This assumption is of considerable importance, for it means that the business is viewed as a mechanism for adding value to the resources it uses. The success of the business can be measured by the difference between output values (sales or revenues) and input values (expenses). Therefore, all unused resources can be reported at cost rather than at market values as, according to the continuity concept, the future instead of selling them out rightly in the market.

The assumption that the business is not expected to be liquidated in the foreseeable future, in fact, establishes the basis for many of the valuations and allocations in accounting. For example, depreciation (or amortisation) procedures rest upon this concept. It is this assumption which underlies the decision of investors to commit capital to enterprise. The concept holds that continuity of business activity is the reasonable expectation for the business unit for which the accounting function is being performed. Only on the basis of this assumption can the accounting process remain stable and achieve the objective of correctly recording and reporting on the capital invested, the efficiency of management, and the position of the enterprise as a going concern. Under this assumption neither higher current market values nor liquidation values are of particular importance in accounting. This assumption provides a basis for the application of **cost** in accounting for assets.

However, if the accountant has good reasons to believe that the business, or some part of it, is going to be liquidated, or that it will cease to operate (say within a year or two), then the resources could be reported at their current values (or liquidation values).

Cost Concept

The resources (land, buildings, machinery, property rights, etc.) that a business owns are called assets. The money values assigned to assets are derived from the cost concept. This concept states that an asset is worth the price paid for, or cost incurred to acquire it. Thus, assets are recorded at their original purchase price and this cost is the basis for all subsequent accounting for the assets. The assets shown on the financial statements do not necessarily indicate their present market worth (or market values). This is contrary to what is often believed by an uninformed person reading the statement or report. The term 'book value' is used for the amount shown in the accounting records.

In the case of certain assets, the accounting values and market values may be similar; cash is an obvious example. In general, the longer an asset has been owned by the company the less, are the chances that the accounting value will correspond to the market value.

The cost concept does not mean that all assets remain on the accounting records at their original cost for all time to come. The cost of an asset that has a long but limited life, is systematically reduced during its life by a process called 'depreciation' which will be discussed at some length in a subsequent unit. Suffice it to say that depreciation is a process by which the cost of the asset is gradually reduced (or written off) by allocating a part of it to expense in each accounting period. This will have the effect of reducing the profit of each period. In charging depreciation the intention is not to change depreciation equal to the fall in the market value of the asset. As such, there is no relationship between depreciation and changes in market value of the assets. The purpose of depreciation is to allocate the cost of an asset over its useful life and not to adjust its cost so as to bring it closer to the market value.

You must be wondering why assets are shown at cost, even when there are wide differences between their costs and market values. The main argument is that the cost concept meets all the three basic criteria of **relevance**, **objectivity** and **feasibility**.

Accrual Concept

The accrual concept makes a distinction between the receipt of cash, and the right to receive it, and the payment of cash and the legal obligation to pay it. In actual business operations, the obligation to pay and the actual movement of cash may not coincide. The accrual concept recognises this distinction. In connection with the sale of goods, revenue may be received (i)before the right to receive arises, or (ii) after the right to receive has been created. The accrual concept provides a guideline to the accountant as to how s/he should treat the cash receipt and the rights related thereto. In the former case the receipt will not be recognised as the revenue of the period for the reason that the right to receive the same has not yet arisen. In the latter case the revenue will be recognised even though the amount is received in the subsequent period.

Similar treatment would be given to expenses incurred by the firm. Cash payments for expenses may be made before or after they are due for payment. Only those sums which are due and payable would be treated as expenses. If a payment is made in advance (i.e., it does not belong to the accounting period in question) it will not be treated as an expense, and the person who received the cash will be treated as a debtor until his right to receive the cash has matured. Where an expense has been incurred during the accounting period, but no payment has been made, the expense must be recorded and the person to whom the payment should have been made is shown as a creditor.

The Concept of Conservatism

The concept of conservatism, also known as the concept of prudence, is often stated as "anticipate no profit, provide for all possible losses". This means an accountant should follow a cautious approach. Facing a choice, he should record the lowest possible value for assets and revenues, and the highest possible value for liabilities and expenses. According to this concept, revenues or gains should be recognised only when they are realised in the form of cash or assets (usually legally enforceable debts) the ultimate cash realisation of which can be assessed with reasonable certainty. Further, provision must be made for all known liabilities, expenses, and losses whether the amount of these is known with certainty, or is at best an estimate in the light of the information available. Probable losses in respect of all contingencies should also be provided for. A contingency is a condition, or a situation, the ultimate outcome of which−gain or loss−cannot be determined accurately at present. It will be known only after the event has occurred (or has not occurred). For example, a customer has filed a suit for damage against the company in a court of law. Whether the judgement will be favourable or unfavourable to the company cannot be determined for sure. Hence, it will be prudent to provide for likely loss in the financial statements. As a consequence of the application of this concept, net assets and incomes are more likely to be understated than overstated. Based on this concept is the widely advocated practice of valuing inventory (stock of goods left unsold) at cost or market price, whichever is lower. You will note that this convention, in a way, modifies the earlier cost concept. It should be stated that the logic of this convention has been under stress recently; it has been challenged by many writers on the ground that it stands in the way of fair determination of profit, and the disclosure of true and fair financial position of the business enterprise. The concept is not applied as strongly today as it used to be in the past. In any case, conservatism must be applied rationally as over-conservatism may result in misrepresentation.

Materiality Concept

There are many events in business which are trivial or insignificant in nature. The cost of recording and reporting such events will not be justified by the usefulness of the information derived. The materiality concept holds that items of small significance need not be given strict theoretically correct treatment. For example, a paper stapler costing Rs. 30 may last for three years. However, the effort involved in allocating its cost over the three-year period is not worth the benefit than can be derived from this operation. Since the item obviously is immaterial when related to overall operations, the cost incurred on it may be treated as the expense of the period in which it is acquired. Some of the stationery purchased for office use in any accounting period may remain unused at the end of that period. In accounting, the amount spent on the entire stationery would be treated as an expense of the period in which the stationery was purchased, notwithstanding the fact that a small part of it still lies in stock. The value (or cost) of the stationery lying in stock would not be treated as an asset and carried forward as a resource to the next period. The accountant would regard the stock lying unused as immaterial. Hence, the entire amount spent on stationery would be taken as the expense of the period in which such expense was incurred. Where to draw the line between material and immaterial events is a matter of judgement and common sense. There are no hard and fast rules in this respect. Whether a particular item or occurrence is material or not, should be determined by considering its relationship to other items and the surrounding circumstances. It is desirable to establish and follow uniform policies governing such matters.

Consistency Concept

In practice, there are several ways to record an event or a transaction in the books of account. For example, the trade discount on raw material purchased may be deducted from the cost of goods and net amount entered in the books, or alternatively trade discount may be shown as the income with full cost of raw material purchased entered in the books. Similarly, there are several methods to charge depreciation (which is a decrease in the value of assets caused by wear and tear, and passage of time) on an asset, or of valuing inventory. The consistency concept requires that once a company has decided on one method and has used it for some time, it should continue to follow the same method or procedure for all subsequent events of the same character unless it has a sound reason to do otherwise. If for valid reasons the company makes any departure from the method it has been following so far, then the effect of the change must be clearly stated in the financial statements in the year of change.

You will appreciate that much of the utility of accounting information lies in the fact that one could draw valid conclusions from the comparison of data drawn from financial statements of one year with data from another year. Comparability is essential so that trends or differences may be identified and evaluated. Inconsistency in the application of accounting methods might significantly affect the reported profit and the financial position. Further, inconsistency also opens the door for manipulation of reported income and assets. The comparability of financial information depends largely upon the consistency with which a given class of events are handled in accounting records year after year.

Periodicity Concept

Although the results of the operations of a specific enterprise can be known precisely only after the business has ceased to operate, its assets have been sold off and liabilities paid off, the knowledge of the results periodically is also necessary. Those who are interested in the operating results of a business obviously cannot wait till the end. The requirements of these parties, therefore, force the accountant to report the changes in the wealth of a firm for some time periods. These time periods in actual practice vary, though a year is the most common interval as a result of established business practice, tradition, and government requirements. Some firms adopt the calendar year, and some others the financial year of the government. But more and more firms are changing to the ‘natural’ business year, the end of which is marked by relatively lower or lowest volume of business activity in the twelve-month period. The custom of using twelve-month period is applied only for external reporting. The firms usually adopt a shorter span of interval, say one month or three months, for internal reporting purposes.

The allocation of long-term costs and the difficulties associated with this process directly stem from this concept. While matching the earnings and the cost of those earnings for any accounting period, all the revenues and all the costs relating to the year in question have to be taken into account irrespective of whether or not they have been received in cash, or paid in cash. Despite the difficulties that arise in allocations and adjustments, short-term reports (i.e., yearly reports) are of such importance to owners, management, creditors, and other interested parties that the accountant has no option but to resolve such difficulties. Obviously, the utility of the periodic financial statements outweighs the difficulties.

Some other concepts, e.g., the Matching concept, the Realisation concept and the Dual Aspect concept are discussed in units 4 and 5, and as such, they have not been taken up here.

While going through all these concepts, probably you may have developed a feeling that they sometimes conflict with each other. You are right. We illustrate this by considering some of these concepts in the context of valuation of business properties. Suppose a firm acquired a piece of land in 1985 for a price of Rs. 6,00,000. Factory premises were constructed in 1986, and operations commenced in 1987. The firm has been successful in achieving the desired profit for the past year. The Balance Sheet (a statement of assets and liabilities) for the year 2005 is being prepared and 'Land' is required to be valued. The estimated current market price of this land is Rs. 60, 00,000.

Should you recommend that the land be valued at Rs. 60 lakhs? The answer is 'no', obviously. Land would be carried on the Balance Sheet at its original cost of Rs. 6, 00,000 only. This decision is supported by several of the concepts discussed in this section. In the first place, the stability of purchasing power of money implied in the **money measurement concept** prevents us from recognising accretion in values as a result of changing price levels. Then, the **realisation concept** will not allow unrealised profits to be included as long as land is held by the company and not sold away. You may note that the **continuity**, or **going concern concept**, makes any possible market value of land irrelevant for the balance sheet because the firm has to continue in business, and land will be needed by it for its own use. In this connection, it could be argued that if land were shown on the balance sheet at its estimated current market value, the owner might decide to discontinue the business, sell the land and retire. The principle of **objectivity** is now introduced into the argument. It can be easily seen that in a situation like this the cost of acquisition of land at Rs. 6,00,000 in 1985 is the objective fact because it is based on a transaction that actually took place and this objective evidence is capable of being verified. In contrast, the estimate of current market value figure may be suspect. It raises many questions. Do you have a market quotation for an identical plot of land? Has a similar plot of land been sold recently, and can we pick it up as verifiable evidence of the current market price? It may be said that even if market price for an identical plot of land is not available, estimates by an accredited valuer may be accepted as verifiable evidence of the market price. Further complications may be noticed if buildings and facilities have been erected on the plot of land. Is it possible to estimate the value of land without factory buildings and other facilities constructed on it? The answer is a flat 'no', and the conservatism concept will then deter you from accepting an estimate of market value since it cannot be ascertained with reasonable accuracy.

2.4 ACCOUNTING STANDARDS

The basic concepts, discussed in the foregoing paragraphs, are the core elements in the theory of accounting. These concepts (postulates or conventions), however, permit a variety of alternative practices to co-exist. As a result, the financial results of different companies cannot be compared and evaluated unless full information is available about the accounting methods which have been used. The variety of accounting practices have made it difficult to compare the financial results of different companies. Further, the alternative accounting methods have also enabled, the reporting of different results, even by the same company.

Need for Standards: The information contained in published financial statements is of particular importance to external users, such as shareholders and investors. Without such information they would not be able to take the right decisions about their investments. As in several other countries, Parliament in India specified in the Companies Act, the type and minimum level of information which companies should disclose in financial statements. It is the responsibility of the accounting profession to ensure that the required information is properly presented. It is evident that there should not be too much discretion to companies and their accountants to present financial information the way they like. In other words, the information contained in financial statements should conform to carefully considered standards. Public confidence in accounting information contained in financial statements will grow if they are satisfied as to the logic, consistency and fairness of the figures shown therein. For instance, a company could incur a loss and still pay dividends by manipulating the loss into a profit. In the long run, this course may have a disastrous effect on the company and its investors.

You would be better able to appreciate the function of accounting standards by relating them to the basic purpose of financial statements, which is the communication of information affecting the allocation of resources. Ideally, such information should make it possible for investors to evaluate the investment opportunities offered by different firms and to allocate scarce resource to the most efficient ones. In theory, this process should result in the capital distribution of resources within the economy, and should maximise the potential benefit to society.

In this context, unless there are reasonably appropriate standards, neither the purpose of the individual investor, nor that of the nation as a whole, can be served. The purpose is likely to be served if the accounting methods used by different firms for presenting information to investors allow correct comparisons to be made. For example, they should not permit a company to report profits which result simply from a change in accounting methods rather than from increase in efficiency. If companies were free to choose their accounting methods in this way, the consequences might be that deliberate distortions are introduced, leading eventually to misapplication of resources in the economy. The relatively less efficient companies will be able to report fictitious profits, and as a result scarce capital of society will be diverted away from the more efficient companies which have adopted more strict and consistent accounting methods.

2.5 THE CHANGING NATURE OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

Generally accepted accounting principles are usually developed by professional accounting bodies like American Institute of Certified Public Accountants (AICPA) and Institute of Chartered Accountants of India (ICAI). In developing such principles, however, the accounting profession has to reflect the realities of social, economic, legal and political environment in which it operates. Besides academic research, regulatory and tax laws of the government, e.g., Companies Act, 1956, income Tax Act, 1961, etc., in a large measure, influence the formulation of acceptable accounting principles. Stock exchanges and other regulatory agencies like the Securities and Exchange Board of India (SEBI) have laid down rules for disclosure and the extent of accounting information.

Since the environment, in which business operates, undergoes constant changes as a result of changes in economic and financial policies of the Government and changes in the structure of business, continued evaluation of the relevance of generally accepted accounting principles is required. In this sense, the principles of accounting are not ever-lasting truths. You will appreciate that it is the development of relevant accounting principles in tune with the present day needs of the society that would make it possible for the business enterprises to develop financial statements which would be acceptable and of value to the end users.

Now, we give you a brief account of the development of standards in the United Kingdom, the United States of America, India, and other countries.

2.6 ATTEMPTS TOWARDS STANDARDISATION

Standardisation in UK and USA: Though the Institute of Chartered Accountants in England and Wales began making recommendations since 1942, real progress started with the establishment of the Accounting Statements Committee (ASC) by the Institute in 1969 in the wake of public criticism of financial reporting methods which permitted diverse practices. As a result of diversity in practices some big investors had suffered heavy losses on their investments in well-known companies. The main objective of the ASC has been to narrow areas of difference and in the variety in accounting practices. The procedure used for standardisation is initiated by the issue of an "Exposure Draft" on a specific topic for discussion by accountants, and the public at large. Comments made on exposure draft are taken into consideration when drawing up a formal statement of the accounting methods for dealing with that specific topic. The statement is known as a Statement of Standard Accounting Practice (SSAP). Once the statement of standard accounting practice is adopted by the accounting profession (the fact that a statement has been issued by the Institute in itself signifies the acceptance by the profession), any material departure by any company from the standard practice in presenting its financial reports is to be disclosed in that report. So far, nineteen statements of standard accounting practice, in addition to some exposure drafts under consideration, have been issued by the ASC.

The need for evolving standards in the USA was felt with the establishment of Securities Exchange Commission (SEC) in 1933. The SEC is the Government agency that regulates and controls the issuance of, and dealings in, securities of the companies. A research-oriented organisation called the Accounting Principles Boards (APB) was formed in 1957 to spell out the fundamental accounting postulates. The Financial Accounting Standards Board (FASB) was formed in 1973. The FASB issues statements from time to time, articulating the generally accepted accounting principles. The constant support given by SEC to FASB pronouncements has given considerable credibility to its accounting policy statement. The FASB, till 1985, has issued five statements of concepts and eighty-eight statements of financial accounting standards.

Standards at International Level: In view of the growth of international trade and multinational enterprises, the need for standardisation at the international level was felt. An International Congress of Accountants was organised in Sydney. Australia in 1972 to ensure the desired level of uniformity in accounting practices. Keeping this in view, the International Accounting Standards Committee (IASC) was formed and was entrusted with the responsibility of formulating international standards. All the

member countries of IASC resolved to conform to the standards developed by IASC, or at least to disclose variations from recommended standards. After its formation in 1973, the IASC has issued 40 international accounting statement to date. Another professional body, the International Federation of Accountants (IFAC) was established in 1978.
Attempts have also been made in countries in the European Economic Community (EEC), and in Canada for standardisation of accounting practices regarding disclosure and consistency of procedures.

2.8 SUMMARY

Accounting as a field of study in its developmental process has evolved a theoretical framework consisting of principles or concepts over period of time. These concepts enjoy a wide measure of support from the accounting profession. That is why they are known as Generally Accepted Accounting Principles (GAAP) . Several concepts, and their implications for business and information users, were discussed in this unit.

Since the accounting principles are broad guidelines for general application, they permit a wide variety of methods and practices. The lack of uniformity in accounting practice makes it difficult to compare the financial reports of different companies. Moreover, the multiplicity of accounting practices makes it possible for management to conceal economic realities by selecting those alternative presentations of financial result which allow earnings to be manipulated. The financial statements prepared under such conditions, therefore, may have limited usefulness for several users of information. This problem has been recognised all over the world and various professional bodies are engaged in the task of standardising accounting practices. There is a movement towards consensus building even at the international level. Such professional bodies, in fact, first look at the practices used by practising accountants They then try to obtain a refinement of those practices by a process of consensus. It is in this manner that the theory of accounting is built. In India also, some headway has been made by establishing twenty eight standards for accounting practice.

2.9 KEY WORDS

Accounting framework includes generally accepted accounting principles (GAAP) on the basis of which accounting data is processed, analysed, and reported.

Accounting theory is a set of inter-related principles and propositions, which provide a general framework for accounting practice, and deal with new developments in the area.

Accrual concept says that an accountant should recognise incomes and expenses when they have actually accrued, irrespective of whether cash is received or paid.
Consistency concept envisages that accounting information should be prepared on a consistent basis from period to period, and within periods there should be consistent treatment of similar items.

Conservatism concept forbids the inclusion of unrealised gains but advocates provision for possible losses.
Cost Concept states that an asset is to be recorded in books of accounts at a price for, or at a cost incurred to acquire it.

Entity concept separates the business from owner(s), from the standpoint of accounting.

Going concern concept refers to the expectation that the organisation will have an indefinite life. This assumption has an important bearing on how the assets are to be valued.
Materiality concept admonishes that events of relatively small importance need not be given a detailed or theoretically correct treatment. They may be ignored for recording purpose.

Money measurement concept states that all transactions are to be recorded only in monetary terms and record only those transactions, which can be measured in money terms. It ignores intangibles like employee loyalty and customer satisfaction, as they cannot be expressed in money terms. It also assumes records on the basis of a stable monetary unit.

Objectivity principle requires that only the information based on definite and verifiable facts are to be recorded.

Periodicity concept divides the life of a business into smaller time periods which are generally one year, and the accountant is supposed to prepare necessary financial statements for each time period.