CHAPTER TWO

GROWTH OF ACCOUNTING STANDARDS
Introduction

Today Accounting Standards have become the part and parcel of accounting practices, an indispensable part of accounting curriculum and accordingly, an object of scrutiny by the people in industry in particular, and the public in general. Hence a discussion on the genesis of the standards and a brief conceptual background of the same, it is expected, will facilitate the endeavour to prosecute a study of the standards. With a view to presenting a theoretical background on Accounting Standards, this chapter explains first the meaning of Accounting Standard followed by the identification of crises leading to standard setting. Next are presented the needs for Accounting Standards. Subsequently, present position of the standards in some major countries across the world are discussed. After presenting the standard setting procedure, it is examined whether standards could be called theories. Lastly advantages and limitations of the Accounting Standards are indicated before conclusion.

Meaning of Accounting Standard

The usual meaning of standard is a prescribed degree of excellence required for a particular purpose. It can also be referred to as a weight or a measure by which the accuracy or quality of others are measured. This degree of excellence or weight is to be prescribed or recognised by an authoritative body so that the standards thus set up are accepted by all and sundry. In the context of accounting, the term standard
means, "A mode of conduct of general application arising from
convention or advocated or imposed by higher authority." So,
accounting standard refers to a mode of conduct of accounting
application mainly imposed or advocated by the standard setting
authorities.

General acceptance of accounting standard is necessary
for ensuring uniform accounting practices among the enterprises,
industries within and outside the country. It may be pointed
out that to keep pace with the changing situation, old accounting
standards may give way to the new. So, the accountants need a
set of official rules telling them how to handle every material
aspect of their work. If all the professionals comply with this
set of rules, the process of harmonisation will be easier.
Accordingly, the accounting standard usually means the set of
official rules pronounced by standard setting bodies from time
to time to guide the professionals to tackle the problems they
face in their practices. But whether the standards provide a
prescribed degree of excellence for a particular purpose is a
different issue discussed latter in this study. However, account­
ing standards are necessary for unification of ard harmonization
among diverse accounting practices.

Crisis leading to standard setting

As the business and society became more and more complex
and technology advances at a very fast rate, huge capital is
indispensable for running the business. To meet the need,

1. E.L.Kohler, A Dictionary for Accountants, Prentice Hall of
India Private Limited, New Delhi - 110001, 5th edition,1979,
p-438.
capital is collected across the world resulting in wide separation between the people who supply the resources and the men who manage the resources. To bridge the gap there developed a system of reporting the financial information by a third party to the suppliers, i.e. the owners and creditors. They scatter widely and have little direct control on the management and the auditors who act on their behalf. Since, accountants and auditors are to work directly with the management against whom they are supposed to report in case of frauds and irregularities, they are in difficult position. That apart, the investors, creditors and the government are interested in the financial affairs of the entities for their decision actions. They are to compare between the entities within an industry and the entities within and outside the countries. For trend analysis, comparison among the performances of different years even within the firm is indispensable. All these require adoption of uniform accounting principles and policies. Otherwise comparison becomes useless, users are misguided and economy faces crisis. That is why it is found in USA that there was a deep economic depression in 1920s. At that time uniform accounting principles were not adopted. There were various accounting scandals. Even in 1960s, in UK, we find great accounting frauds which lead to the introduction of standard setting process there for economic co-operation and survival of the European Countries. European Economic Community (EEC) also directed its

members to introduce certain provisions in law in the member countries to ensure uniform accounting policies and practices. Moreover, the growth of transnational corporations require uniformity in accounting practices across the world. Because of the existing diversities in accounting and reporting practices, it becomes expensive for the government to collect and process reliable data for economic policy decision. Such diversities also lead transnational corporations to base decision on contradictory set of requirements. It may discourage international investment and may even involve hidden social cost.

Need of Accounting Standards

Accounting practices are found to vary from country to country, industry to industry or even from unit to unit of the same industry. The development of various accounting practices due to their divergence of approach have considerably reduced the utility of accounting statements. Accounting statements prepared by two different accountants from the same set of transactions or events may provide different results. But causes of differences are difficult to understand so long as the transactions are objectively recorded. If the fact is recorded as it is, there is no reason of any difference. Here, it is seen that atleast some of the records, for instance, inventory valuation, fixed asset valuation, are not supported by objective evidence. So, a measure of dispersion of the different values of the same variable (say closing stock) measured by various measurers (i.e.

$x_i$ being the values of same closing stock measured by 'i' accountants) may be treated as the degree of objectivity of the accounting statements.

But measures by different accountants may provide different results due to adoption of different denominators in measurement. Had the uniform denominator been used, there would not have been so much differences. Due to the existence of diversified accounting policies and practices, it can not be claimed that lack of uniformity in accounting treatment of similar transaction has relaxed the degree of objectivity. So, it can be said that degree of heterogeneity in accounting practices adversely affect the utility of accounting statement.

A large variety of accounting principles and postulates are found to be used by different accountants considering their suitability. But suitable and best accounting practice depends upon the enterprise environment which is subject to change. In this connection it may be pointed out that a particular set of principles found to be suitable in a particular area of activity may prove itself quite unsatisfactory in another sphere of activity. Accounting standards formulated by different bodies are not static rather dynamic in nature which can be revised in the changed situation.

Differential treatment of identical financial transaction clearly indicates the failure of accounting profession to give a lead in developing a set of unified principles and procedures. Accounting standards has originated in response to a demand in developing improved and unified principles and procedures for financial reporting.
In this connection it may be noted that accounting is not as yet a science and accounting practices can neither be developed nor proved scientifically. Only a logical hypothesis covering the areas of problem can be repeatedly applied and if the experiment leads to the unification of practices then the said hypothesis can be recommended as a standard. So, accounting standard represents the best of accepted accounting conventions and provides a set of handy rules to professionals. They also promise to accommodate improved or even new principles of accounting.

Now a days accounting statements are used not only by the owners but by a large number of external interested groups like investors, creditors, financial analysts etc. Accounting Standards are needed to serve the often conflicting needs of these diversified users still more adequately.

In financial reporting system, disclosure requirements are found to vary widely. Judgement is required for determining the appropriate disclosure requirement so that the accounting statements are not misleading to the users. Accounting standards are needed to specify the appropriate disclosure.

In view of the increased use of financial statements both by the internal and external user groups and involvement of public funding both in corporate and noncorporate sectors, application of appropriate accounting principles, and proper, suitable and adequate disclosure have become more significant so that true and fair view of the accounting statements can be ensured for all the user groups. Accounting standards are needed to serve this purpose.
Accounting Standards issued as directives contain a number of specific accounting principles and detail disclosure requirement. The enterprise can select the appropriate principles and determine the required disclosure from the standards which would restrict arbitrary selection and application of accounting principles to suit the vested interests and would increase the credibility of financial statements.

Every accounting standard is designed to solve a particular problem area. But the nature and extent of the problems vary with a change in business environment. If the accounting is to respond to the demand that the society will increasingly place upon enterprise reporting, accounting standards currently available can be no more than the initial phase. Now a days accounting standards dominate the accountant's work and some volume of standards are in existence and some others are awaiting for despatch with clear sign of continuity.

Present position of Accounting Standards in some major countries across the world.

In most of the countries - both developed and developing accounting standards have become an integral part of financial accounting and reporting system. Various standard setting bodies are established both at national and international levels to formulate accounting standards. Present position of standard setting in some of the major countries across the world are discussed here.
Growth of accounting standards in USA

In USA growth of standards started with the formulation of generally accepted accounting principles (GAAP) after the great economic crash in 1929 followed by the Great Depression of early thirties. The history of standard setting is probably the oldest in this country. It is not the intention of this study to make an elaborate discussion of this history. So, a very brief description of the growth of accounting standards in USA is given.

In early thirties, Security Exchange Commission (SEC) showed an eager interest in improving financial reporting for regulating the stock exchange activities. Professional and academic bodies like AICPA, American Accounting Association (AAA) came forward to shoulder the responsibility of improving the financial reporting. For this purpose GAAP was formulated by AICPA, "A tentative statement of Accounting affecting corporate reports was published by AAA and "An introduction to corporate Accounting standards" was published jointly by W.A. Paton and A.C.Littleton. But for controlling frauds and misappropriation and also for regulating speculations and gambling SEC was concerned with uniform reporting and delegated the authority of standard setting in 1938 to AICPA. AICPA formed a "Committee on Accounting Procedure" (CAP) and entrusted the authority of issuing pronouncements on accounting principles and procedures. CAP functioned until 1959 and published 51 Accounting Research
Bulletins (ARBs). Through these ARBs, CAP tried to eliminate the terrible abuses of 1920s and protect the interest of investors. But ARBs were recommendary and not mandatory and in consequence these were not adopted particularly by well run companies. Hence, the uniformity/comparability issue troubled CAPs and led to its demise.

In 1959 CAP was replaced by Accounting Principles Board (APB). With a view to narrowing the areas of differences this Board issued 31 opinions on various fundamental topics. The APB was criticized for being very closely connected with the AICPA and for being dominated by practicing certified Public Accountants (CPAs). Moreover, the Board had no power to enforce its opinions and all the opinions were also not supported by research findings. Accordingly, APB was dissolved in 1973. Due to these failures of APB, it was replaced by Financial Accounting Standard Board (FASB) in 1973 on the basis of "Wheat Committee" Recommendations. FASB was composed of seven full time members from AAA (Academicians), AICPA (practicing accountants), Financial Analysts Federation, Financial Executive Institute, National Association of Accountants and the Securities Industry Association. The Board is functioning till now. It is well equipped in terms of resources and is independent of the AICPA. Initially it published its views as exposure drafts inviting comments. It is very careful about public hearings. Its final statements
are called "Standards". FASB is far more active and detailed in standard setting than CAP or APB. It is fighting hard for ensuring uniformity and comparability in financial reporting. Till now, it has issued 105 standards.

Standard setting in United Kingdom

History of standard setting in UK is also very old. However, 1942 to 1969 may be regarded as the major turning period during which the Institute of Chartered Accountants of England and Wales issued series of Recommendations on Accounting Principles almost similar to ARBs in USA. But these recommendations were not binding on the companies. The institute drafted suitable recommendations from time to time to meet the changing need of the time. But business world in 1960s became more sophisticated. It was a chaotic era in finance and accounting and as complex as in the society in general. During this period formed the conglomerates (group formed by merging of unrelated firms), soaring stock prices tied with ever growing price earning ratio; large-scale law suits against public accountants manifested the frustration of the investors. A number of financial scandals in 1960s revealed - (a) unacceptable variability of accounting practices, (b) tranished the image of the professionals and (c) gave rise to fears of government regulations. Three chartered institutes of the country met together and set "standing Steering Committee" (ASSC) in 1970. Other three
bodies joined them in 1976 and the new committee titled Accounting Standard Committee (ASC) was formed. Its function was similar to APB in USA.

The ASC issues Exposure Drafts (ED), circulates them for discussion among members and other interested persons, invites comments and suggestions from them. After amendment and acceptance by ASC they become "Statement of Standard Accounting Practices" (SSAP). ASC is still functioning and has issued 23 SSAP upto 1988.


In 1972 the Secretary General appointed the group of Eminent persons to examine the impact of Trans-National Corporations (TNCs) on economic development and international relations. The group noted the diversity in corporate reporting as per Table given below.⁵

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⁵. Ibid, PP. 485-86.
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Key: R: Required by law or otherwise mandatory
      MA: Practice of majority of companies
      H: Practice of about half of companies
      MI: Practice of minority of companies
      N: Not found in practice or not applicable
      NP: Not permitted
      — Information not available
TABLE 3-2. REPORTING REQUIREMENTS AND PRACTICES OF SELECTED DEVELOPING COUNTRIES WITH RESPECT TO SELECTED ITEMS OF FINANCIAL INFORMATION

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<th>Intercompany Payables Shown Separately</th>
<th>Long-Term Debt: Amount Outstanding, Terms, Interest Rate Disclosed</th>
<th>Sales and Other Revenue in Reporting Period Disclosed</th>
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Source: See Table 2.1.
Key: See Table 2.1.

*Historical cost financial statements replaced by price level-adjusted statement.
As a consequence to the above diversities, various difficulties were encountered by the governments in utilising such information for decision-making. According to the recommendation of the group for formulating an international system of standardised accounting and reporting and on the instruction of the Economic and Social Council, the Secretary General formed the Group of Experts on International Standards of Accounting and Reporting (GEISAR).

In 1978 GEISAR suggested a list of minimum disclosure to be incorporated in the TNC reports. The list required disclosure of adopted accounting policies, financial information on the members of TNC Groups, non-financial information on employment, population control measures, transfer pricing policy etc. The recommendations differ from Generally Accepted Accounting Principles (GAAP) on some aspects. Anyway, such an attempt to super-impose a comprehensive disclosure system on an accounting base that vary from country to country was highly criticised.

But the Secretary General considered the recommendations a step forward and started negotiation of an intergovernmental agreement to implement the suggestions. It was desired that through such an agreement each government would commit itself to legislative and other actions to make obligators the application of International reporting standards by TNCs.

Although the members of the commission on TNCs had some reservations on the recommendations, they desired follow-up action. Accordingly, an ad hoc 34 members Inter Governmental Working Group (IWG) of Experts on International standards of Accounting and Reporting was formed by the Economic and Social Council. The representatives of various international organisations, such as EEC, International Chamber of Commerce,
the IASC etc. Co-operated with IWG. Since 1980, the IWG concentrated on some activities and discussed on GEISAR's minimum list but did not resolve. The troublesome difference arose between the developing and industrial nations. The work would have been easier had there been a more precise goal for IWG. It is expected that the group will demand increasingly on the works of the IASC in setting such a goal.

Accounting rule making is possible only at the back ground of given state of enforcemental capabilities. Despite these limitations, these attempts help minimise differences in accounting practices in the world.

**Standard setting in India**

The history of standard setting in India is considered to be new in comparison with the global development in accounting standards, particularly the development in USA and UK. The Institute of Chartered Accountants of India initiated the standard setting process in this country as late as in 1977. The institute recognised the fact that diverse accounting policies and practices are in use in India. It also felt the necessity of harmonising these policies and practices keeping in view the diversified needs of various users of financial statements. Encouraged by the International developments in the field of accounting and also to serve the accounting profession in India more adequately the Institute constituted the Accounting Standards Board (ASB) in April 1977.
The ASB is constituted giving adequate representation to major interested parties, and at present, it consists of members of the Council of the Institute and representative of industry, bank, company Law Board, Central Board of Direct Taxes and the Comptroller and Auditor General of India.

The main function of ASB is to formulate Accounting Standards. While formulating the Accounting Standards, ASB takes into consideration the applicable laws, customs, usages, business and economic environment and also the recommendations of International Accounting Standard Committee. Accounting Standards formulated by the ASB are issued under the authority of the Institute of Chartered Accountants of India. The Institute has so far issued eleven Accounting Standards out of which eight standards are made mandatory.

Standard setting procedure

The process adopted for formulating accounting standards by various agencies, including FASB, (America), ASC(UK), IASC (International) and ASB (India) are more or less similar. Although the procedure of setting the standards are constantly evolving, usually they consist of three stages. These are as follows:-

Step I : Identification of problem area : At the initial stage it is required to identify a current burning accounting

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issue where accounting practices vary widely and which require immediate investigation. At the early phase of standard setting programme, concentration was made on known problem areas and accordingly a strategic plan of development has been lacking. But, gradually, more pressing problems are being resolved and new problem areas that may arise in future may be taken up for consideration. At this stage a memorandum describing the nature and magnitude of the problem is prepared by a sub-committee. So, a complete but brief description of the problem to be tackled should occupy the face of the standard as a medical practitioner write the name of disease at the top left corner of the prescription.

Step II: A logical analysis and reasoned discussion of the way of solving the problem: Such a discussion may be backed by one or more formal research studies and findings of the same should be widely published. Usually the embryonic standard prescribing the proposed solution is drafted by a sub-committee and is released as Exposure Draft for comments. The standard setters can also hold private consultation with the parties affected by the topic under consideration. Under certain circumstances they can also take oral interview from the interested parties. Opinions of the
different appropriate interested groups should be obtained and in some way or other all the affected parties should be made involved in the procedure of setting the standard.

Comments received from the interested groups, views available from private consultation and oral interview are properly interpreted and evaluated to way out the solution of the problem. It is generally agreed that without a proper diagnosis, a disease cannot be cured. In the light of the interpretation and evaluation of comments and views, Exposure Draft is amended suitably.

Step III: Issue of standard with prescribed solution:

This is the final statement issued for best accounting practice. Such a final statement emerges after several amendments in the way as discussed above. It contains specific directives to be followed by the accountants for solving the particular problem in hand. An effective medicine is likely to cure the disease.

From the above discussion regarding the procedure of standard setting it is seen that there is an authority which guides the accountants how both to think and act. Accounting standards direct them to behave in a particular way. But in most cases accounting standards do not contain anything about
identification of problem and logical analysis and reasoned discussion of the way of solving the problem. They contain only the prescribed solution. Inclusion of other two aspects is also considered important so that the accountants could know why to do and how to do in addition to what to do. However these are not included, may be, due to the following reasons:

a) It will make the accounting Standards unduly large,
b) Reasoning may be critical and proved to be false, and
c) Different authority will attempt to find out alternative solution with different reasoning.

Can standards be called theories?

Something may be called academic if that teaches how to seek truth of a problem scientifically. Truth, again, unearths the causes of an action or event and explain real world phenomena.

But, do the standards develop thinking process or grow rationality in the minds of the accountants? Is there any method of testing hypothesis? Do they help solving all accounting problems? Standards may be called academic if answers to these questions are in affirmative. Again, answers to such questions require enumeration of how standards are formulated and how they are applied in practice.

Standards are formulated by committee of experts from the accounting profession, academicians, government, industries etc. Accordingly, the standards are indeed averages, because the members sit together and are "hampered by the need for tact and compromise, or by pressures from outside." A committee is not best fitted to establish the truth. The members may think best separately. Individually they can think more boldly and coherently than when they are on a committee. A scientist's job is to attack hypothesis, since he is not the believer of it. A committee of physicists is not set up to explore solution to unknown problem. Standard setting committees have authorities to enforce their pronouncements. But authority and logic are different. Official pronouncements may have authoritative support, but they need not necessarily be logical.

Under the circumstance, it is evident, the standards can neither explain what individual accountants do, nor provide scientifically established norms on what they should do. The standards, i.e. norms, are not based on validated hypothesis. Accordingly, in true sense of the term they are not theories.

Then, are the standards useless? Even though the standards so far formulated do not lend themselves to the above conditionalities, they attempt to introduce uniformity in accounting practices. Again the standards may get logical
support if they are backed by one or more research study on the subject matter. Any way, standards are not fulproof, but they are proceeding to perfection, and that is the sign of dynamism.

Advantages of Accounting Standards

Besides the advantages of inter-firm, inter-spatial, inter-industrial comparability derivable from the application of accounting standards the followings are their good sides:

i) They act as accounting manuals of big firms and act as handy rules for daily work. Thus the quality of the published reports are improved. In some cases they supplement the company laws. In UK standards have paved the way for amending Companies Act.

ii) Standards help analysts and investors for individual decisions as the accounts of the corporate sector are drawn on uniform basis. Governments also are helped for price control, since uniformity based cost data of the companies are available.

iii) Standard setting is very costly. Small-scale firms can avail of the opportunity of using the standards set by specialised bodies without bearing the standard setting costs. Thus small business concerns are benefited.
iv) Sometimes the accountants are forced by the management to do wrong. Standards may strengthen their resistance against such pressures as they can easily take shelter of standards.

v) Auditors can persuade his client to take a particular course of action on the plea of accounting standards. Standards make it possible for them to discharge their statutory duties more efficiently and easily.

vi) Accounting standards relating to asset valuation and income measurement lead the accountants to the right measures of value.

vii) The chance of misrepresentation and fraud will be minimised since the scope of individual judgement will be reduced to minimum level.

Limitations of standards

The following shortcomings will arise when accounting standards are adopted in practice:

i) Standard setting is too costly. It requires more resources and invites more resentments. Moreover, they burden the companies with high start-up and running costs.

ii) Standards are set on a particular situation. But situation may change subsequently when the standards will be considered hard procedures or an impediment on
progress or they may become inappropriate requiring frequent revision, amendment or even withdrawn.

iii) Since accounting figures are not always easily manageable, they do not lend themselves to standardisation. Besides, industries differ from region to region, country to country. So do the firms within the industry. Even the same firm may change their practices from year to year to suit the changing needs. The needs of different users vary. As standards serve averages, they are not suitable for all individual users.

iv) Accounting standards tried to accommodate needs of all groups of users. For this, language of the standards will have to be used in a way that will bring difficulties of interpretations.

v) Standards may affect interest of powerful lobbies. In such cases standard setters may have to bow to political pressures.

vi) Even if standards are drawn after careful consideration they can not ensure identical measurement by different accountants in all cases.

vii) Once the standards are adopted as mandatory, the will to think and judge will be lost because the accountants are forced to follow them as ready-made code of conduct.
Conclusion

Despite the limitations stated above, Accounting Standards have the utilities. The main objective of the standards is to enhance uniformity in accounting policies and practices. For the purpose, standard setters attempted their best. But how far they have been able to accommodate the thoughts of the scholars? That apart, is there any uniformity in the standards in different countries? Answers to these questions require investigation. But it is not possible to study all the accounting standards set by major standard setting bodies. However, as sample, four major issues are studied in the next four chapters to indicate how far the purpose meant for has been served. Opinions of various groups of people on them have been collected to find out the justifications of the standards. The next chapter deals with one such major standard, namely Accounting Standard on Disclosure of Accounting Policies.