Chapter Three

REPORTING FUNCTION OF ACCOUNTING
The accounting practice as it stands today did not develop from within, nor did it just grow. Its present status is the outcome of evolution that came through outside stimuli, as already mentioned, mainly owing to more extensive evolution in the economy which it serves. Pressures built up in various sectors of the economy and reacted upon each other, often in unpredictable ways and that at headlong speed. The system of financial reporting, possibly, is the most important product in the economy that, at the same time, holds it together and helps it go ahead under all these pressures.

'Reporting' in accounting means reporting of financial status of economic units as at any given point of time as well as the results of operations within the same period. The process of reporting, as an independent objective function contributes significantly to the evolution of accounting in all ages. This can well be evidenced from the following definition:

"Accounting can be said to be a tool for the preparation of formal report of an economic unit's transactions during a given period, presented by an individual or firm"
Reporting and the flow of accounting facts:

Accounting, in the true sense of the team, possibly begun in an environment of requirement for knowing facts about one's wealth either entrusted to the stewards for safe keeping and proper maintenance or invested in some business. The supply of knowledge about the status and progress of a business or estate to properly interested parties has, from the earliest day of civilization to this, been considered a primary function of accounting. Paciolo's description of bookkeeping objectives, as mentioned earlier, bears almost the same meaning, where he stressed on the communication of accounting facts as the primary objective of bookkeeping.

The story behind the growth of accounting has been found enriched with continuing efforts of matching the needs for

information with their supply which still seems as relevant as in earlier generations. It is thus inferred that accounting is one of the very few disciplines in the practice of which discernible knowledge may be transformed into financial or quantitative data in the form it is most useful.4

**Reporting in retrospect:**

Historically, the stewards of the Lords of the Honors were required to submit periodical reports on the status of the lord's estate, mostly in narrative form. Such a report at that time would simply serve as a document to prove honesty in the discharge of custodianship of resources placed at steward's disposal. Accounting reports, at that time, were intended to convey messages from the stewards or agents to the Lords of the estates or owners of resources giving details of stock at any a moment and its justification in terms of the legitimate events for its increase or decrease. It would exhibit simple accountability with regard to resources and their use in accordance with the mandates of the Lords or owners. But as soon as the steward or agent, on owner's behalf

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was entrusted with the resources for its use in productive endeavour, accounting objective moved ahead. Instead of serving the vision of custodianship only, accounting in the changed context, became a reporting device on the operations and status of an economic enterprise. Accounting in this regard has been described as,

"the science of recording transactions in money or money's worth in such a manner that accounts prepared at any time from the record thus kept may show the owner of the books, his true financial position."\(^5\)

**Communication to outside interest groups**: 

In an environment of general awakening of the society, the idle resources became capital of productive ventures with the objective of seeking profit. Changes accordingly occurred in accounting function. Accounting became imperative for all business transactions in order to accumulate useful data and to synchronize them into valuable reports. The need for such reports gradually grew with the

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increasing size and complexities of business organizations. A continuous additions to the forms of business organizations gave rise to a constant increase in more varied and numerous accounting processes. More and more people got involved as owners, investors, creditors and so on and became interested with the same resources and found themselves more and more dependent upon accounting reports for the supply of factual data. Accounting thus has been defined as the process of accumulating the details of financial experience and communicating summarized results there to interested parties.6

During the long course of evolution, accounting function has possibly been best discharged through the preparation and communication of accounting reports - the end product of the accounting system. It is thus described, in its most elemental as well as in its most profound sense, as the system of financial communication.7 It is in this respect, accounting

has been termed as, "the language of business." It communicates, through reports, the effects of business transactions to the interest groups. This communication consisted of data, traditionally used to keep the external forces informed. Internal use of such data for the management of resources is possibly of much later developments. Communication of economic messages on the results of events concerning wealth thus became vital in the economic system, in so far as they can be expressed in terms of quantifiable financial data, in such a way as to achieve maximum understanding by the users and the correspondence of the message with economic reality. Communicational effectiveness depends largely on the simplicity and understandability of the words and symbols used in reports. In other words, the more the knowledge of accounting language grow, the more effective has been the financial communication.

"Languages evolve and change in response to the changing needs of the society, and so does accounting." The accounting reports, as a communication device must seek to be reliable that can be used by, and not be misleading to any interest group. Here to quote Barrett, 10

"Accounting contributes to the identification, categorization and expression of economic conditions and experience by serving as a technical language." American Accounting Association's (AAA) Committee on Concepts and Standards also states that, "the primary function of accounting is to accumulate and communicate information essential to an understanding of the activities of an enterprise". It went on saying in another para that "accounting procedures and reports are based on the premise that quantitative data provide an effective means of description and are basic to the communication of quantitative information about the enterprise,"\(^1^1\) In another report, The Association (AAA) states that, "accounting, in its historical aspect, is primarily a device for expressing economic activity in terms of money".\(^1^2\) Smith,\(^1^3\) in this context defined accounting as

"a means of measuring and reporting the results of economic activities".

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Bierman[^14] defined it as

"the art of measuring and communicating financial information."

The growth of the idea of periodical financial statements:

Rapid and constant changes or progress in the form of ownership and organization of business concerns caused accounting, as already indicated, to develop in depth and to proliferate in coverage. The system of periodic closing of accounts thus, necessitated, determination of the results of enterprise operations as a whole within the period and its status thereafter. The system of periodical reporting originated from long felt necessity of financial data classification and arrangement in a logical and systematic manner. The idea of furnishing formal financial statement with regularity and precision gradually evolved from such a background need of financial communication at regular intervals. Reporting function has always been involved with the portrayal of results of the accounting process and ended possibly with the preparation and communication of financial statements. Financial statements are, precisely, descriptive monetary

measurement of financial conditions and progress of an enterprise. In fact, a financial statement means any formal tabulation of financial facts of an economic enterprise. Traditional financial statements comprised of a balance sheet and a profit and loss account. The system of double entry bookkeeping, with its much vaunted potential, contributed greatly to the organization of financial statement in a logical manner. Although the preparation and submission of financial statement became a statutory obligation very lately, yet, the history of accounting is not devoid of practical examples of the same. Periodical determination of results and status and the preparation of summary accounts to this end could be found to be recommended, in historical days, by Angelico Pietra (1586), Simon Stevin (1608), Lodovico Flori (1636) and many others. One can possibly find the root of a balance sheet — primary financial statement in those summary accounts of historical days.

The evolution of balance sheet — a report on enterprise status:

Although there could be found the use of summary

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accounts in earlier days, the organized form of such accounts relating to business enterprise was first discussed by Paciclo in his treatise Summa. While advocating the use of double entry system in bookkeeping, he opined that these summary accounts, as a synopsis of enterprise activities, could exhibit increase or decrease in stock and would help to determine the enterprise financial position. The evolution of double entry system and its application in the preparation of financial reports made it easier to show the combined effects of all transactions relating to an enterprise on the financial position of the same. In the history of accounting, there could be found the instances of the use of statement of assets and liabilities, in order to reflect the financial position, in Florence, Italy as early as in the fourteenth century. Though not of the present day standard, the Florentines have been found to prepare some type of balance sheet (Bilancio, that they called it at that time) regularly based on the balances of stocks at the end of a certain period. Profit or loss, at that time, had been determined only from the difference of balances between two balance sheet dates (i.e., one at the

beginning and the other at the close of a period). Such a balance sheet was prepared as an integral part of the ledger and drawn with all the balances of assets assembled on the left and liabilities, capital and profit on the right. The balance account was used as the formal summary of the accounts and served as standard book keeping practice for a long time. In fact, the idea that a balance sheet is a list of 'balances' and not an account grew much later on.

In the history of accounting, apart from Florentine example, the root of this primitive form of balance sheet could also be traced back as early as in the fifteenth century as the part of an statutory requirement. In response to the Italian city state laws (1427) Medici Family's self assessed statement for tax on property had been prepared in balance sheet format. The sixteenth century German Municipal laws (1516) also required separate statement for tax purposes. In 1673, periodical balancing became law in France and the provision for balancing had been included in the 'Code of Commerce', requiring the businessmen to draw the balance sheet at least bi-annually. The organizational need of the Joint

Stock Company* in the early seventh century resulted in greater interest for the preparation of financial statements from a rational re-arrangement of double entry book keeping data quite independent of ledger accounts. The organization of corporate type of enterprise not only required combined efforts in investment but also created a multi-dimensional environment of interest groups, which frequently like to get information about their investment and details of corporate ventures. With gradual increase in the information need, the balance account developed into separate statement in the form of contemporary balance sheet, though it fell short of uniformity in the arrangement of entries, of refinements of classification for better presentation and, above all of proper terminology for unified expression of the facts. 22 Although there could be found the references of profit and loss account as the next approach to financial statement in Italian book

* The name of the British East India Company could be cited as an example of Joint Stock company which was formed in early seventeenth century by a sovereign charter during the reign of queen Elizabeth. Its capital was organized on joint stock basis. Reference could also be made to Dutch East India Company which was chartered in 1602.

keeping, yet a balance sheet had served the purpose of
determining financial position, with a reference to net
gain or loss, quite well for a long time. Reference could
be made to Dutch writer Simon Stevin\(^\text{23}\) (1608) who made a
sort of balance sheet in order to compute the present
proprietorship and explained the difference between two
totals (beginning and end) in net capital as profit. He
stated that so much the present proprietorship differs from
the net capital of the previous period, that much is the
profit or loss. He termed the profit and loss account as
a 'test check' in the former computation. In his own
language, he termed the balance sheet as "state of my capital"
and the profit and loss account as "proof of my estate".
Balance sheet was stressed, indeed too much stressed, in the
past and refined in various ways over a long period of time
for better representation of financial position while income
and expense data have been considered merely incidental. In
fact, profit and loss data were presented, if at all, merely
as 'proof of estate' i.e.; to demonstrate by another route
the correctness of the balance sheet.\(^\text{24}\) The information
regarding the capital stock was the primary objective of

\(^{23}\) Geijsbeek, J.B; Ancient double entry book keeping(p.120),

\(^{24}\) Littleton, A.C; Ibid. p.153.
financial statement till the beginning of the present century and the extent of net changes in capital was the center of interest to proprietors, shareholders, lenders, and even the collector of property tax. That is why balance sheet, since its appearance, had served as a statement of 'stock' at two different points of time and profit and loss account subsequently developed to keep the account of the 'flow' within the intervening period of the occurring of changes in the stock.25

Till the first quarter of the present century, the balance sheet approach had dominated the objectives as well as the functions of accounting. It may be considered a questionable adherence to the precedent, if judged from modern context. Such an approach was, however, considered as the best means so far employed for the purpose of the presentation of information which consisted of recording and measuring the outcome of a series of exchanges and also taking stock of possessions and changes in possessions.26 Canadian Institute of Chartered Accountants (CICA), in its authoritative


terminology for accountants thus defines, "a balance sheet is a statement of current resources, unexpired costs, liabilities to be met and sources of ownership funds, rather than a statement of worth." All these events may be attributed to the reason behind the lack of paying equal attention to the development of profit and loss account and of its not becoming an inevitable companion of balance sheet for a long time. Thus, a balance sheet could be found to represent, in historical costs, the financial position* of an enterprise indicating the use and care of owner's and investors fund at a specific date. Accounting Principles Board (APB) in its opinion No. 4 also stated that the financial position of an enterprise is represented by the balance sheet and related notes. Although, the beginning of the present century witnessed the detailed presentation of financial statements

* Financial position of an enterprise at a particular time comprises its assets, liabilities and owner's equities and the relationship among them, plus contingencies, commitments and other financial matters that pertain to the enterprise at that time.

(balance sheet and profit and loss account), yet the statute did not make mandatory any statement other than balance sheet for a long time. In U.K., also British Legislation prescribed a model account in her Companies Act in 1856 with regard to the preparation of Company accounts. Its compliance was not made compulsory until the enactment of the English Companies Act of 1929. 30

**Profit and Loss Account:**

The changes and improvements surrounding accounting profession and practice in the present century caused, however, to soft pedal the balance sheet approach and placed primary emphasis on profit and loss account. This has been the outcome of gradual interest laid down by the owners of wealth, investors, management, creditors, statutory authorities and so on, more in the sources of earnings and earning power of an enterprise than in the current position alone. Accountants and professionals have always been aware of the shortcomings of the balance


(Annual report of the United States Steel Corporation(1902) consisted of balance sheet and profit and loss account (statement of financial position and statement of income and retained earnings.),
sheets, they usually produce, but instead of facing the problems, they have tended to take evasive position. The result being, the best of the financial statements could not escape fair criticism. Thus reporting on periodical income and its sources were generally considered to be fundamental objective of accounting in a changed setting.\(^\text{31}\)

Determination of income became a matter of public concern and the figures in profit and loss account and balance sheet have been found so intricably connected that there was enough justification to consider these statements as divisions of one single statement rather than separate.

The provision for profit and loss account although, evolved from the background idea of 'proof of state', as already mentioned, the twentieth century economic complexities attached much more significance to it. By the turn of the first quarter of the present century, the uses of financial statements became more and more wide. Differences in the balance sheet measures could no longer satisfy the needs of the users of financial statements in determining, besides the status, the prospect of future earnings and growth. Moreover, payment of tax on corporate income became statutory obligation

by this time. It necessitated the determination of taxable income in accordance strictly with the statutory provisions. The extent of reporting thus became dependant partly on what is demanded by the tax authorities and partly on how the users of reports, at large, perceive their needs for formally presented accounting facts. It was in this environment Securities and Exchange Commission (SEC, 1934) came into operation in the United States with the objectives, among others, of regulating the business reporting system and to bring a harmony in it to the best advantage of the users, the economy and the society as a whole. It is interesting to note that most of the recommendations, opinions, pronouncements received on accounting from the professional and academic bodies, in the recent past, relate more to the determination of income than to the portrayal of financial position in a balance sheet. Charging of depreciation, valuation of inventories, reserves and provisions, etc., are the examples of few areas that called for specific guidelines in their treatment in determining the financial results as well as their effects on financial position. Several equally acceptable alternative practices have evolved for the accounting treatment of identical items which were almost simultaneously employed. The process still continues. Efforts have been made during

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* Tax on incomes in Great Britain and United States dates from 1842 and 1909 respectively. Act of 1922 relates to India.
the last few decades and are still continuing, to reduce the number of alternatives as well as the gaps in the reported results due to them. The outcome seems hopeful but a comprehensive set of rules that can ensure the identical accounting treatment for the same kind of transactions in every case, are still, far from being achieved.

The idea of Maximum disclosure:

The provision for the preparation of profit and loss account and its submission to interest groups has been incorporated in the Company Law for the first time in England. The British Companies Act of 1929 made obligatory the preparation and presentation of profit and loss account along with the balance sheet. It was soon followed by India by incorporating in her Companies Act of 1936 such provisions relating to the preparation and submission of profit and loss account.

Contrary to the convention of secrecy, cherished for a long time in the past, more disclosure came to be entertained with respect of reporting financial facts to outsiders. Yet, early practice of financial reporting under statutory obligation was found to reveal as minimum facts as the law would require. The profit and loss account, thus prepared in conformity with the statute was of very limited use to the interest groups.
The economic complexities of the early 40's (inter-war period) acted as instrumental in forcing the architects of the 1929 Companies Act of England to recognize further the importance of the profit and loss account in the efforts of restricting misrepresentation by company management. This led to the amendment of 1929 Companies Act in late 40's following Cohen Committee (1945) report on company law. The amended enactment came into force in 1948 with the title English Companies Act of 1948. In this report, company law has been suggested to be viewed as a socio-economic legislation instead of a law and order legislation. The new enactment has gone most of its way in improving the financial reports that can produce maximum disclosure in order to reduce uncertainty in the eco-business environment. In India too, immediate need was felt for an extensive revision of the company law to ensure efficient and honest management in the corporate sector in order to safeguard the interest of the investors, creditors and others. Towards this end the Companies Act of 1936 of India has been amended in 1956 following the recommendations of the Bhada Committee (1950). In the amended law maximum

33. Gupta, N.Das; Financial Reporting in India, New Delhi, Sultan Chand and Sons, 1977, p.15.
stress has been placed on 'disclosure and publicity' of accounting facts. Maximum disclosure has been emphasised in view of the primary accounting objective of protection of the interest of shareholders and creditors alike and the society at large.

**True and fair view:**

Accounting reports to be useful generally seeks to be truthful because usefulness of accounting depends on the confidence that is placed on it. In accounting, truthfulness signifies more than receiving the stamp of endorsed honesty but required to justify its results in terms of current social concepts of fairness with regard to economic entities and its performance and efficiency. The commonly used phrase in the accounting literature, 'true and fair view of the state of affairs' of an economic entity stems from such concept of general fairness of the accounting reports in terms of its usefulness. Scott viewed the concept of fairness as an important principle in accounting and made such statement as "accounting rules, procedures, techniques should be fair.

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unbiased and impartial,* so that it can produce true and fair view of the state of affairs*. General fairness of accounting reports has been widely discussed during the decades following World War-II. Referring to a monograph dealt with 'fairness', published in 1950 by Arthur Anderson and Company, it could be observed that, fairness and maximum disclosure in accounting reports gained prominence from the point of view of economic as well as social usefulness.

In the language of the monograph, it goes "that the one basic postulate underlying accounting principles may be stated as that of fairness - fairness to all segments of the business community (shareholders, management, creditors, customers and the public), determined and measured in the light of socio-economic environment and the modes of the thought and customs of all such segments - to the end that the accounting based upon this postulate shall produce financial accounting for the lawfully established economic rights and interests that is fair to all segments.*35 Pattilo36

* 'Fair' implies eliminating one's own feelings and prejudices, 'Unbiased' implies absence of all prejudices and a disposition to be fair to all, and 'Impartial' implies absence of favour or bias against either person or side. 37


in the middle of 60's observed that the current social concept of fairness is selected from the connotations of justice, truth and fair, as the basic standard by which to measure the propriety of accounting principles and rules which purport to be the means of attaining accounting objectives of communication of economic facts. He surmised that all accounting propositions should be judged from the point of its reflection of fairness to all parties before being included into accounting structure. A sense of fairness, justice and reasonableness has always been the source of accounting procedures in the past. Traditional procedures, however, were directed towards protection objectives while in modern practice full disclosure has been made the center of all attention in view of their varied usefulness. Cowan,\(^\text{38}\) in this context described that double entry concept gained applicability in response to common needs for reliability and comparability of the accounting reports which fostered the concept of general acceptance and true and fair view. He concluded by saying that "fairness to all and general acceptance tend to reflect custom and compromise".

The guiding principles that led to the preparation of early financial statements were to submit accounts only

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to reveal financial position. They were, however, revised from time to time to fulfil only the minimum statutory requirements. In fact, the minimum standard of disclosure in accounting has been dictated in the past by law alone.

**Emergence of accounting principles**

The surprising fact that there is any other system whose communication are subject to such wide divergence of presentation and interpretation as are the reports that flow from accounting. The accounting reports bear diverse messages from within the same set of data in the face of varied expectations of its users and as such forces the environment of accounting to accommodate such characteristics as diversity and uncertainty. It is diverse, not because of the complexities of the multitude of exchange transactions but because of the infinite variety of accounting entities and further complexities of human and social behaviour of the contributing parties. Uncertainty is a reality in every economic environment. It was there in the past, as it is now, in the face of constant changes. Every such change requires factual data that permit learning and adaptation to the changing conditions. In the face of uncertainty, "accounting information" as stated in the AAA committee report, has been and still, is the chief means of reducing uncertainty under which external users act as well as a primary means of
reporting on stewardship." Increasing variety of enterprise entities led to numerous accounting objectives which again contributed several points of view to be simultaneously tenable with regard to accounting practices. In the absence of any authoritative regulations of permanent nature, accounting gradually evolved from long experience over a period of few centuries and in the midst of varied conventions, standards, procedures, objectives and concepts. Experience, in this subject, produced set of concepts, postulates and finally, principles which were adopted by individual practitioner or the professional societies in preparing accounting reports. There has been lack of objective standard in the practice. The principles have grown in number and gained applicability largely by precedent and tradition. Chambers termed this situation to be a common lack of philosophical background of accounting and accused accountants for not having any complete system of thought about the subject. The realization for such a rationalistic background came in this subject also, of course very late. During the first quarter of this century, Paton described the function of

39. AAA; A Statement of Basic Accounting Theory, 1966, pp.1-5.
accounting in more categorical terms although he concisely avoided giving definition of accounting in modern term. However, his description of accounting was found to come closure to what the latter authors, in this subject, termed it i.e; definition. Patton (1922) stated that

"It is the function of accounting to record values, classify values, and to organize and present value data in such a fashion that the owners and their representatives may utilize wisely the capital at their disposal."

The pioneer attempt of giving definition for the subject, however, was taken by the American Institute of Accountants (AIA). Its first definition on the subject also was formulated from the background of a description of the nature of accounting activity which at that time did not go beyond reporting financial position. It came through the institute committee on terminology, which in 1940 defined accounting as

"the art of recording, classifying, summarizing in a significant manner and in terms of money, transactions and events which are in part, at least, of a financial
Most of the early definitions placed more emphasis on the use of accounting data by owners and other suppliers of capital. Such attempt of defining accounting gave impetus to more standards of financial reporting which have shown steady improvements both in quality of accounting and the quality and quantity of the facts thus produced. This is, possibly the outcome of the recognition of the greater participation and coordination among the users of accounting reports in matters of framing rules and regulations, technically, however, known in the literature as 'postulates'.

"Initially", Accounting Terminology Bulletin No.1 states, "accounting postulates are derived from experience and reason: after postulates so derived have proved useful, they become accepted as principles of accounting". 43

*Accounting principles "are simply a general law or rule adopted or professed as a guide to action, a settled ground or basis of conduct or practice". 44


44. AICPA, Accounting Terminology Bulletin, Vol.1, P.9. (American Institute of Accountants has subsequently been named as American Institute of Certified Public Accountants).
Most of the principles were one day conceived and practised by some unknown accountant or researcher out of practical need and these after being generally accepted received the status of principles. Ideally, accounting principles have always been expected to be clear and definite enough so that intelligent and well informed professionals will agree, reasonably closely with one another as to how a transaction should be recorded and the report to be approached to the users of financial statements, when given a description of the facts about a given transaction and in a given environment in which it occurs. 45 Without authoritative expression of fundamental concepts, no discipline can hold utilitarian label, and accounting is no exception. It has, however, been observed that accounting principles are founded on considerations of utility and are subject to modification as the criteria of usefulness change. 46 Wide variety of accounting practices, as already mentioned, have come in use which have nevertheless, been harmonized in the past. Early twentieth century practitioners, accounting societies, statutory authorities and other related bodies recognized the alarming effects of the

inconsistent practices on accounting reports and their misleading facts. Though there could be observed conflict over the sources of authority in the selection of the principles of accounting, yet there could be found the beginning of authoritative pronouncements regarding accounting principles and practice. The first of such pronouncements came in April, 1917 for a "Memorandum of Balance Sheet Audit" which was published by the Federal Reserve Board of the United States under the title 'Uniform Accounting' through Federal Reserve Bulletin. It was initiated by the Federal Trade Commission and the memorandum was prepared by the AIA, at the request of the former. This memorandum was later published in a book let form in 1929 by the Institute under the title 'Verification of Financial Statements' under the auspices of the Federal Reserve Board. During 30's the Institute (AIA) proceeded a step further and joined hands with the New York Stock Exchange in such efforts to develop ways to educate the public, specially the interest

* One group led by G.O. May took the position that accounting Principles should be determined in cooperation with those who use financial statements. The group represented by R.H. Montogromery, on the other hand, asserted that accounting principles should be determined by accountants on behalf of the business community.

groups, about the significance as well as limitations of the financial statements and to make corporate published report more informative and authoritative. Their joint efforts led the accounting principles to be judged by their general acceptance in the society at large to gain wider understandability and applicability. It was from this background, possibly, the phrase "Generally Accepted Accounting Principles" (GAAP) first sounded in this discipline.

**Generally accepted accounting principles:**

Generally accepted accounting principles came as a frame of reference of the validity of the accounting statements and was primarily directed towards external utility of such reports. GAAP have emanated through years of practice and general agreement by the professional bodies. Their emergence though came through the professional bodies but their developments have been much influenced by their acceptance in the business and financial community. The phrase GAAP led to the notion of a range of accepted principles - a basic framework of general guidelines and detailed procedures that together make up accepted accounting practice at

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any given time and within which the management would be
free to choose those principles that are applicable to its
own situation. Its widespread application has been
observed in the AICPA's auditor's certificate while giving
report on the financial statements. Not being compulsory,
but by convention the auditor's certificate contains, among
other things, "in conformity with generally accepted
accounting principles applied on a basis consistent with
that of the preceding year or years." Though there
observed conflict as mentioned earlier, over the source and
authority for the formulation of accounting principles, yet
there found general agreement on the condition that every
principle required to be conferred 'general acceptance'
through the formal recognition of the professional bodies
as a standard of application in the preparation and presen-
tation of financial statements. In an effort to stimulate
wider acceptance of accounting principles, large number of
pronouncements and recommendations came from the professional

49. Horngren, C.T.; Accounting for Management Control; an
introduction, New Delhi, Prentice-Hall, India,
1975, p.31, also Moonitz, M; Op.Cit., p.266.
50. Eaton, Marquis G; Financial reporting in a changing
society, Journal of Accountancy, August, 1957
also see AICPA, Statement of Auditing Standards,
and academic bodies. The AIA (at present AICPA) issued 51 Accounting Research Bulletins through the Committee on Accounting Procedures (1938-1959), 31 opinions (known as APB opinions) through the Accounting Principles Board (APB 1962-1973) and presently issuing Financial Statement Concepts through the Financial Accounting Standard Board (FASB). The contribution of the American Accounting Association (AAA) to the dilemmas and challenges of the accounting practice is no less important. The Association also from the very beginning made efforts to erect for accounting practice a strong foundation of concepts and standards. It too, followed the committee route and since 1936 prepared and presented several statements on accounting principles or on standards through the Committee on Concepts and Standards.

In United Kingdom, accounting practice and the accounting profession have been regulated by the statute and the dominant point of view in the accounting field certainly was that expressed in British Legislation on


Company Law and Company Accounting. The function of independent accountant was clearly defined and the selection of accounting principles, standards, rules and procedures was left with the company management. The company law made management free in choosing the accounting principles, those best serve its needs for the presentation of fair and complete financial statements. But it was required that each company must disclose what principles it is following and must follow them consistently.\textsuperscript{54} Under the broad frame of legal references, the accounting profession made significant contribution to the framework of accounting principles, since late nineteenth century. In U.K. also accounting principles emanated more through the recommendations of the Institute of Chartered Accountants in England and Wales (ICAEW), which since 1942 started issuing official recommendations on accounting principles. These recommendations did not carry any mandatory provision. Rather they were objectively prepared with such scope of revision, modification, replacement or abandonment, when necessary. ICAEW issued as many as 27 recommendations over a period of over two and half decades (1942-1968). Of late, since 1970, the Institute started issuing Statement of Standard Accounting

Practices (SSAP) through the Accounting Standard Steering Committee (ASSC). Similar attempts were made in other countries as well. Reference could be made to Australia, Canada, New Zealand, France, etc.

International Accounting Standard:

Rapid changes in the socio-economic environment during the last few decades, following World War-II, prompted the need for more and effective co-operation among various countries in the field of accounting, specially accounting standard. Accounting standard means a definite level of excellence in the operation of reporting system through which meaningful facts on economic activities is communicated to interested groups, both at national and international level. In the face of growing multi-national co-operation in economic field, such standard became imperative in order to have an uniform and common working basis that can assume conformity on the part of a group or groups of entities within the range of technical and legal limits. The International Committee for Accounting Profession (ICAP) emerged from this background with the objective of developing a coordinated

accounting profession and uniform standards and to promote their world-wide acceptance and observance. Initially, accounting bodies of nine countries listed to the membership of the International Accounting Standard Committee (IASC) which was created by the former in 1973 to deal with the accounting standards. The Committee first appeared in the public with its exposure of International Accounting Standards (IAS) in 1975 regarding disclosure of accounting policies. It has so far issued 13 standards and 19 exposure drafts. In the meantime another organization has been formed in 1977, with international dimension under the title International Federation of Accountants (IFAC). It also started issuing guidelines on objectives, basic principles, professional ethics and so on.

Supplementary reporting tools:

In the face of ever growing complexities, traditional financial statements fell short of meeting the demands of the analytical bent of mind of the users of such statements.

User's need in the recent past, tended to reach much deeper in significance than mere knowledge about the position and progress of economic entities. Though the traditional balance sheet and the profit and loss account have not been abandoned (as part of statutory requirement), yet, the present day need attached more emphasis on the description and summarisation of the events and sources from which funds are being derived and the uses to which these funds are put. Management, in recent times, felt the need for such information concerning the movements of financial resources for understanding the results of its decisions and actions, while the investors and others seek such information for understanding enterprise financial position as well as for future predictions. In the first stage, provision for notes to financial statements and explanatory documents have come in use to supplement the customary balance sheet and profit and loss account in order to gain full and useful disclosure. Among the explanatory documents, Funds Flow Statement ranks first, possibly in order of importance and applicability. This statement is variously known as 'statement of sources and applications of funds', 'statement of changes in financial position' or simply 'fund statement'. The preparation of fund flow statement as supplementary to customary financial statement has become widespread in recent decades. In course of time, it became
an integral part of the presentation of financial statement in terms of specific information about where resources came from during a particular period and for what purposes they have been utilized. Though its preparation was not mandatory until recently, yet many considered it, both in developed and developing countries, as one of the basic statements for informing shareholders and other interest sectors of the financial affairs. In March, 1971 AICPA's Accounting Principles Board (APB) issued opinion No. 19 under the title "reporting changes in financial position", which made fund flow statement mandatory in the following terms: "The Board concludes that the information concerning the financing and investing activities of a business enterprise and the changes in its financial position for the period is essential for financial statement users, particularly the owners and creditors, in making economic decisions. When financial statements, purporting to present both financial position and the results of operations, are issued, a statement summarizing the changes in financial position should be presented as a basic financial statement for each period for which an income statement is presented."57 It also stated that, "........the statement of each reporting entity should disclose all important aspects of its financing and

investing activities regardless of whether cash or other elements of working capital are directly affected." Prior to this 1971 pronouncement, the Board had encouraged the preparation and presentation of such statement (APB Opinion 3, 1963), but its publication was not mandatory. International Accounting Standard Committee also recommended to include the fund flow statement as an integral part of the financial statement. While commenting on the use of fund flow statement, Lee described it as one of the principal document of financial statements and surmised that "balance sheet, profit and loss account and fund flow statement, the three, are very much related to one another and leaves little scope to regard any one statement as more important than the other two". In India, the importance of such statement has also been accordingly stressed by the Research Division of the Company Law Board in the following words:

"A study of the changes in the sources of funds for the corporate sector is extremely valuable. It reflects the importance of each capital fund for assets formation."

58. IASC; IAS 7.
Accounting policies:

Accounting policies encompass the principles, conventions, rules, procedures and bases adopted by the enterprise management in preparing and presenting financial statement. Since divergent policies are simultaneously tenable in the accounting practice for the same events under the cover of GAAP, a statement of accounting policies contributes significantly to more understandability of financial statement. Thus, disclosure of significant accounting policies on which financial statements are based became an integral part of the financial statements in recent years. Following the publication of APB’s exposure draft entitled 'Disclosure of Accounting Policies', a statement of accounting policies became compulsory in the United States. 61 IASC also suggested for the mandatory disclosure of all significant accounting policies that are used in preparing financial statement. 62

Summarized statements:

In recent years, there observed a tendency for the preparation and presentation of statements summarizing the

major items of financial statements. It is an informal statement complementary to the statutory financial statements which seeks to make the whole statement readily understandable even to those who are not familiar with the accounting jargons and technical knowledge. In India, Shastri Committee recommended for its preparation and presentation with the financial statements in the following words: "It may be desirable that a concise and clear statement of the general position is given in addition to the balance sheet". 63

**Reporting the general price level:**

It is argued in recent years that accounts should reveal not conceal the true financial position in terms of current conditions. But the latter happens more when conventional historic cost accounts failed to provide adequate information as to the impact of changes in the general price level. In the face of continuing high rate of inflation, greater emphasis has been attached to reporting on the effects of changes in price level. The nature of the necessary changes in accounting policies has been debated for many years.

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But the professionals and the academicians could not yet arrived at an agreement over the appropriate methodology for proper reporting the effects of price level changes in financial statements. Although the evolution of an agreed methodology lies in the prospective years, the accounting reports began to appear, meanwhile, with the disclosure of the effects of inflation. A number of proposals have come out to deal with the effect of inflation. These proposals generally fall into one of the two major categories: price-level adjusted financial statements and current cost accounting. The system of price-level adjusted financial statements has been recommended by both the APB and FASB. Both stated that a system of adjustment be adopted to restate the traditional statements to reflect the changes of the changes in the general purchasing power of money. But neither has chosen to issue pronouncement requiring such restatement. The Consultative Committee (CCAB), U.K., has recommended, meanwhile, the use of current cost accounting method in reporting the effects of inflation on financial statements. The idea of Current cost accounting has been taken

from the recommendations of the Sandilands Committee report. CCAB, in this case, suggested the preparation of a supplementary statement showing the effects of adjustments of specific and general price level changes on the results and financial position of the company. It is no longer a matter of divided opinion with regard to the need for accounting reports adjusted to inflation. The practice of accounting for inflation has become widespread in recent decades, though the quantum of disclosure ranges from the adoption of piecemeal adjustment measures to the preparation of supplementary statement adjusted to the effect of inflation.

Recent trend:

In an environment of ever-increasing emphasis on more detail information, the demand for constant development in accounting methodology did not remain confined only to principles, terminology, scope, etc. It also extended towards redefining the boundary of financial reports and the mode of presentation of the same. The title 'profit and loss account' gradually lost its significance in the ever-growing complexities of the accounting environment. In the recent past, such

title as 'Income Statement' has been suggested in place of profit and loss account. Business income, now-a-days, flows from a variety of sources because of the enterprise's involvement in multi-dimensional activities. It is argued that traditional profit and loss account, in most cases, failed to provide sufficient scope for the inclusion of such gains or income from diverge sources. Thus, an all-inclusive idea gradually emerged leaving behind the idea that only the normal and recurring items relating to enterprise operations during a particular period should be reflected in the operating statement. The idea of showing all income, arising from any source, in the income statement has been referred as all-inclusive concept of financial statement. It has been approached from the point of view that the results of all transactions, affecting the net increase or decrease in proprietor's stock during the period should be included in the income statement.66 This concept gained popularity, in the recent decades, because of the fact that it provides for maximum disclosure in the financial reports. Moreover, in an effort to facilitate easy comparison and necessary inferences, a multiple format in vertical manner has been introduced for income statement. Under this format, it is

suggested to group all expenses according to operating functions, such as, cost of sales, administrative expenses, selling expenses etc. Likewise all income figures, both operating and non-operating, are suggested to be added. Then the total of expenses should be deducted from the total income. Modern income statements are condensed vertical statements. All the operating details are relegated to the supplementary notes following financial statements. A statement showing the 'earning per share' came in use only recently and a 'statement of changes in stockholders equity' almost substituted the 'retained earnings statement'.

The balance sheet also presented in vertical format. Under this format, current liabilities are subtracted from current assets and thus working capital is determined. It is then added to the excess of other assets over other liabilities to determine net assets employed. These net assets are arrayed against stockholders equity, which completes the statement. It is now almost common to all accounting documents that figures of the immediately preceding year(s) are presented side by side with those of the current year.

It is today stressed that company reports are important means for furthering public relations. There developed normal
obligation on the part of the management, beyond legal requirements, to make the community know about the contribution of the company to social or community development. It is in this respect, to quote Canning\(^67\), "the profession is convinced that sound accounting reporting can only produce a dynamic and very useful tool in an economy, both from the standpoint of the management and the economy as a whole. The accounting profession has a long way to go in improving its end-products to meet the surging needs of the rapidly expanding economy and to achieve fairness for all segments within it. It is also the accounting reports that furnish the basis for a fair distribution of the shares of the economic benefits from business activities among the people in an economy\(^67\)."