7 Accounting policies and standards

A Valuation and measurement

Investors in companies want to know how much the companies are worth, so companies regularly have to publish the value of their assets and liabilities. Companies also have to calculate their profits or losses: their managers need this information, and so do shareholders, **bondholders** and the tax authorities.

Companies can choose their **accounting policies** – their way of doing their accounts. There are a range of methods of **valuation** – deciding how much something is worth – and **measurement** – determining how big something is – that are accepted by law or by official accounting standards. In the USA, there are Generally Accepted Accounting Principles (GAAP). In most of the rest of the world there are International Financial Reporting Standards (IFRS), set by the International Accounting Standards Board. These are technical rules or **conventions** – accepted ways of doing things that are not written down in a law.

Although businesses can choose among different accounting policies, they have to be consistent, which means using the same methods every year, unless there is a good reason to change a policy: this is known as the **consistency** principle. The policies also have to be **disclosed** or revealed to the shareholders: the Annual Report will contain a 'Statement of Accounting Policies' that mentions any changes that have been made. This enables shareholders to compare profits and values with those of previous years.

Areas in which the choice of policies can make a big difference to the final profit figure include **depreciation** – reducing the value of assets in the company's accounts (see Unit 9), the valuation of stock or inventory, and the making of **provisions** – amounts of money deducted from profits – for future pension payments.

As there is always more than one way of presenting accounts, the accounts of British companies have to give **a true and fair view** of their financial situation – meaning there are various possibilities – rather than *the* true and fair view – meaning only one is possible.

BrE: depreciation; AmE: depreciation, amortization
BrE: a true and fair view; AmE: a fair presentation

B Historical cost and inflation accounting

The aim of accounting standards (see Unit 3) is to provide shareholders with the information that will allow them to make financial decisions. This is one reason why in many countries accounting follows the **historical cost** principle: companies record the original purchase price of assets, and not their (estimated) current selling price or replacement cost. This is more objective, and the current value is not important if the business is a **going concern** – a successful company that will continue to do business – as its assets are not going to be sold, or do not currently need to be replaced.

However, some countries with regular high inflation, e.g. in South America, use **inflation accounting** systems that take account of changing prices. One system used is **replacement cost accounting,** which values all assets at their **current replacement cost** – the amount that would have to be paid to replace them now.

7.1 Match the two parts of the sentences. Look at A and B opposite to help you.

1 Companies' managers, investors, creditors and the tax authorities all
2 There are different ways of doing accounting but companies have to be consistent,
3 Companies have to disclose or make known
4 The historical cost principle is that the price paid to buy assets,
5 A going concern usually doesn't

a and not their current value, is recorded in accounts.
b need to know the current market value of its assets.
c need to know about the size of profits or losses.
d which accounting methods they are using.
e which means regularly using the same methods.

7.2 Are the following statements true or false? Find reasons for your answers in A and B opposite.

1 Companies are told which accounting policies to use.
2 Companies can change their accounting policies whenever they like, as long as they disclose this in their Annual Report.
3 Companies could produce several profit figures, depending on how they depreciated their assets, valued their inventory, etc.
4 There is only one correct interpretation of a company's financial position, and company accounts must show this.
5 In a lot of countries, companies do not record the current value of their assets.
6 In countries with high inflation, companies value their assets at their current replacement cost.

7.3 Complete the table with words from A and B opposite and related forms. Put a stress mark in front of the stressed syllable in each word. The first one has been done for you.

Verb	Noun(s)	Adjective
	calcu'lation	–
–		consistent
–		conventional
measure		–
present		–
		valuable

Over to you

Which are the most important accounting standards or rules in your country – GAAP, IFRS, IAS, or something else?