E-ISSN: 2583-9667
Indexed Journal
Peer Reviewed Journal
https://multiresearchjournal.theviews.in/

Received: 07-11-2023
Accepted: 16-12-2023

INTERNATIONAL JOURNAL OF ADVANCE RESEARCH IN MULTIDISCIPLINARY

Volume 2; Issue 1; 2023; Page No. 31-36

Approaches to the development of accounting policies

[1]Oladeji E OLADUTIRE, *[2]Taye S ALADETANYE and [3]Adeparubi OLATERU-OLAGBEGI

[1, 2]Department of Accounting, Faculty of Administration and Management Sciences, Adekunle Ajasin University, Akungba-Akoko, P.M.B. 001, Ondo State, Nigeria
[3]Department of Accountancy, Faculty of Business Studies, Rufus Giwa Polytechnic Owo, Ondo State, Nigeria

Corresponding Author: Taye S ALADETANYE

Abstract

This study investigated the various methods used in developing accounting policy by utilizing a review of past documents. Accounting policy serves as a means to collect information about accounting methods and techniques used by firms. It is essential that companies follow their accounting policies and principles while conducting their financial activities, ensuring that their consolidated financial statements comply with IFRSs, GAAPs or both. Companies are expected to create accounting policies that align with the guidelines set forth in IAS 8, which follows the International Financial Reporting Standards. The structure of global standards serves as the foundation for developing accounting policies under the international financial reporting standards framework. The hierarchy of international standards forms the basis for constructing accounting policies within the framework of international financial reporting standards. The formation of assets and liabilities influences the development of accounting policies within a company. The study reviewed previous research on approaches to accounting policy development using a Historical Based Article Review methodology. The study concludes that companies and regions may have diverse approaches to developing accounting policies, although most companies generally follow either GAAP or IFRS when formulating their policies but there must be a unified approach to be followed for comparism. These policies consider the realities of contemporary business practices. The study suggests implementing five key accounting policies within the IFRS framework to enhance the current application of global standards in companies. Further research should examine the approaches to accounting policy development across different industries.

Keywords: Accounting policy, IFRS. IAS, GAAPs, FIFO, LIFO

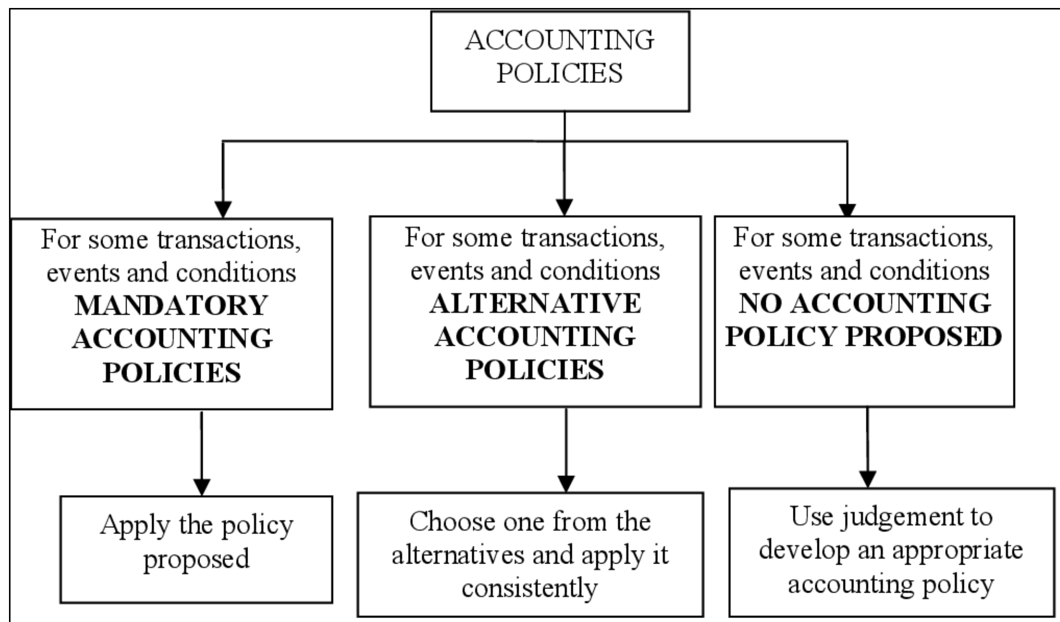
Introduction

Accounting policies are of utmost importance as they establish a uniform and comparable structure for companies to create the statement of financial position. These policies are essential in addressing complex accounting practices such as determining the most suitable methods for depreciation, recognizing goodwill, managing costs related to research and development, valuing inventory, and consolidating financial accounts. While the specifics of these policies may vary across companies, they are required to adhere to widely recognized accounting principles such as GAAP and/or IFRS. (Shukla, 2015) [12].

The policies in accounting serve as a guiding structure for companies to follow in their operations. Nevertheless, this framework allows some level of flexibility, enabling management teams to select accounting policies that benefit the financial disclosure of the firm. Given accounting principles occasional leniency some specific policies adopted by a company hold significant importance (Rayan, 2012) [9].

The way a company handles its accounting policies can provide clues about the management's approach to reporting earnings, whether they are conservative or confident. Investors should take this into account when assessing earnings reports to determine how dependable the earnings are. Additionally, external auditors, who are designated to meticulously examine a company's financial statements, should evaluate the company's accounting policies to verify their adherence to Generally Accepted Accounting Principles (GAAPs) (Shukla, 2015) [12].

Based on the above submissions, it is deduced that entities have different approaches to the development of its Accounting Policies which depends on the operations, scope and mandate of its existence. However, such policies must be guided by the Local and International GAAP.



***Source*:** Author's Design, 2023

Fig 1: Approaches to the Development of Accounting Policy

According to Deegan & Unerman (2006) [5], there are certain conventional methods of formulating accounting policy in the field of development. They are: Pragmatic approach, authoritarian approach, ethical approach, sociological approach, economical approach and eclectic approach. These methods are discussed below.

1. **Pragmatic Approach:** This method proposes that the selection of accounting policies and principles should be based on their capacity to serve the interests of the users of information retrieved from accounting and their relevance to decision-making procedures.
2. **Authoritarian Approach:** The professional organizations typically employ an authoritarian approach to establish accounting policies. This approach involves issuing pronouncements to regulate accounting practices and also aims to offer practical solutions, making it closely associated with the pragmatic approach.
3. **Ethical Approach:** The ethical perspective on accounting policy formulation prioritizes values such as justice, truth, and fairness. This implies that accounting reports and statements must remain unbiased and unaffected by any external influences or personal biases. They should be prepared without any intention of showing favoritism towards any particular individual or group.
4. **Sociological Approach:** The sociological perspective on developing an accounting policy investigates the societal implications of various accounting techniques. It is a morally conscious approach that prioritizes a more inclusive notion of equity, specifically focusing on the overall welfare of society. When it comes to reporting, an accounting principle or technique is assessed for its acceptance by considering its impact on all sectors of society. Economic Approach: Based on this perspective, the selection of various accounting methods is determined by their effect on the overall economic well-being of the country. The decision on which accounting policy to adopt is contingent upon the specific economic circumstances at hand. For instance, during periods of ongoing inflation, the last in first out (LIFO) method is considered more favorable. The LIFO method is thought to lead to a decrease in yearly net income because it assumes that the valuables/materials sold have a higher value (inflated cost) compared to the FIFO (First in First Out) or average cost method.
5. **Eclectic Approach:** This method views accounting theory and principles as the outcome of various efforts by writers, researchers, professional organizations, and government authorities. Additional methods for developing accounting policies are discussed in sections 1.2 to 1.4.

IFRSs vs GAAPs

The Generally Accepted Accounting Principles (GAAPs) and the International Financial Reporting Standards (IFRSs) are accounting standards that offer guidance on the preparation of financial statements for companies. IFRS emphasizes principles and is considered superior in accurately reflecting the economic aspects of specific transactions.

In contrast, GAAP takes a more rigid approach by following a set of specific rules. The differences between the two approaches become evident when examining the contrasting criteria for accounting policies. For example, certain accounting policies that are allowed under GAAP may not be recognized under IFRS (Vasani, 2014) [13].

Aggressive Approaches and Conservative Method

Conservative accounting policies result in a conservative portrayal of a company's current financial performance, but show stronger performance in subsequent years. This approach is considered more sustainable and allows companies to demonstrate gradual improvement, which is viewed positively by investors.

The implementation of assertive accounting practices can lead to an exaggeration of a company's past achievements, subsequently causing a decline in performance in

subsequent years, despite the company's true performance. These practices may also raise concerns among auditors or investors if they suspect that the management is manipulating earnings or mishandling costs (Vokshi & Nimani, 2013) [14].

Prominent Accounting Policies

Various accounting policies may be adopted by different companies, with the requirement of following regulations set by either the IFRS or GAAP. The following list outlines several fundamental methods employed by companies when it comes to accounting policies:

1. Valuation of fixed assets
2. Accounting conventions adopted
3. Valuation of Investments
4. Cost Incurred for research and development
5. Recognition of profits on long-term contracts
6. Treatment of goodwill
7. Foreign Exchange currency items translation
8. Depreciation and Inventory policies
9. Treatment of contingent liabilities
10. Treatment of leases
11. Historical or current cost accounting

Importance of Accounting Policies

Accounting policies hold significant importance for companies, investors, and the government due to various reasons.

Firms and public sector retaining a hold on statements of financial positions

Firms must comply with some international accounting standards, regulations when preparing financial statements. This practice allows for proper monitoring of financial statements and ensures the safeguarding of investor interests. Bulycheva, Busheva, Eliseeva, and Zavyalova (2022) [4] emphasize the importance of this approach.

Proper Framework

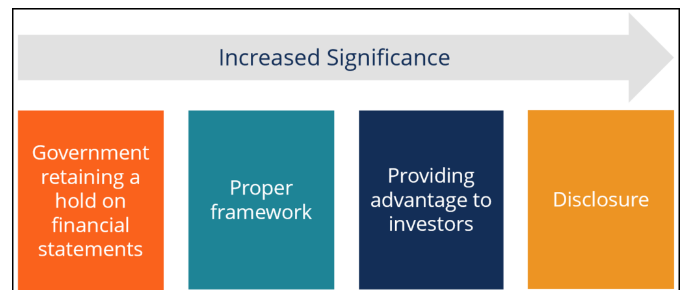
Accounting policies serve as a guideline that companies can adhere to in order to maintain a consistent and standardized presentation of their financial statements.

Providing Advantage to Investors

Investors can feel more assured in companies that have clearly stated their adherence to specific accounting policies and provided transparent financial figures that can be easily compared to those of other companies, thanks to the standardized format they follow (Springer, 2022) [4].

Disclosure

A company is required to openly communicate the accounting policies they adhere to. These policies contain detailed guidelines on how companies should reveal information to investors, and it is essential for companies to adhere to the appropriate disclosure standards. The diagram presented displays the ranking of accounting policies in terms of importance. Out of the four mentioned reasons, disclosure is regarded as extremely crucial as it serves as the foundation for the policies utilized in the creation of financial statements, allowing investors to scrutinize and comprehend them with confidence.



Source: Wood & Sangster, 2005 [15].

Fig 2: The ranking of importance of accounting policies.

Operational Meaning of Terms

1. LIFO: Last In Last Out
2. FIFO: First In First Out
3. GAAPs: This is the Local Accounting Principles that is Generally Accepted
4. IFRSs: This is the International Standards on Financial Reporting
5. COGS: Cost of Goods Sold

This study aims to look into the different approaches to accounting policy development.

Materials and Methods

Literature Review

Accounting policies in China were formulated through evaluation and suggestions. In the Chou dynasty, accounting was utilized to assess the efficiency of government initiatives. The government assigned six officials, including the Sky Officer, who oversaw the management of government assets, finances, and accounting. The budget played a dual role, serving not only for financial oversight but also to allocate power, set obligations, and ensure accountability. Moreover, the implementation of financial reports was initiated, necessitating that all government departments compile comprehensive reports on their activities annually.

These reports were overseen and assessed by designated supervisors before being forwarded to the prime minister for evaluation and suggestions on governmental strategies. Eventually, the prime minister would present these recommendations to the emperor.

According to Oladutire, Shittu and Olonite (2023) [1, 8], in their study looked at the behaviour of accounting practices from an international accounting, Neuroaccounting and the generally accepted accounting principles perspectives. The study adopted a thematic analysis approach for the empirical review, which was appropriate due to the numerous contributions by scholars on the behaviour of accounting policies. The research suggested that the selection of accounting practices by a company can be linked to an attempt to reduce costs of contracting, and that the distinct accounting practices employed by a reporting entity can have a notable effect on the comprehension of financial reports when studied through ratio analysis. It is crucial to bear in mind the impact that altering accounting policies can have on the income statement and financial position. This can result in direct and indirect consequences on important ratios such as return on capital employed and gearing. The results of this research indicate that having a grasp of

accounting policies is crucial for efficient business administration. This study suggests that companies should provide more information about the evaluation of assets, including land and buildings, the depreciation policy, the system used to evaluate the worth of inventory, the liquidity rate based on cost flow assumptions (LIFO, FIFO, etc.), the treatment of overhead costs, the choice of temporal or closing rate method for translating foreign transactions, leases allocation and goodwill valuation in the financial statement. Additionally, it is recommended that top management be trained in neuroscience accounting, as this new discipline may completely change the future of accounting.

The development of government and banking accounting in ancient Rome can be traced back to the practice of households maintaining records. These records, known as memos, were used to track daily cash receipts and payments. Additionally, a monthly expense account called codex accepti et expensi was used to allocate allowances. These family accounting practices held significance in Rome as citizens were obligated to provide regular reports on their financial standing. These reports were used for taxation purposes and also played a role in determining civil rights and shaping accounting policies (Alexander, 2002) [2].

The advancement of the economy and the exchange of goods and services during the capitalist era have played a crucial role in the growth and evolution of accounting. From its early stages with the introduction of double-sided accounting, accounting practices have evolved and undergone substantial changes worldwide (Asllanaj, 2010) [3].

In the 18th century, as Great Britain underwent notable economic expansion through international trade, there was also progress in the field of accounting. With the expansion of businesses, it became less customary for owners to personally manage their record-keeping. Consequently, professional accountants started to emerge in the workforce, primarily employed by businesses. Due to this modification, there was a discernible separation between managers and owners, as owners started to have reduced direct engagement in the day-to-day functioning of the business. Consequently, there was an increasing requirement to oversee managers, which resulted in the implementation of standardized procedures for auditing financial documents. This progress had a notable impact on the advancement of the accounting field. This progress had a notable impact on the advancement of the accounting field. During this time, there was an increase in the number of businesses as well as the establishment of professional associations for accountants (Neokleous, 2016) [7].

Evidence from Accounting History suggests that merchants and bankers in Venice had already been utilizing distinct double accounting principles before Cotrugli discussed them in his book. There is a widely held belief that Pacioli and Cotrugli merely provided a description of an existing system, rather than creating it themselves. The emergence of double-entry accounting in Venice at a time when Europe lacked unified policies for modern accounting prompts inquiry into its rapid development. (Sanjay, 2002) [10].

Ajewole, Seyingbo, Olonite, and Aladetanye (2023) [1, 8] conducted a research project that examined the connection between current and tangible asset, accounting policies, and the financial performance of telecommunication companies in Nigeria. To gather information, the researchers relied on secondary data from the annual reports of telecommunication firms from 2012 to 2020. Multiple regression analysis was performed using Eviews 12 software. The findings revealed that tangible assets have a significantly positive impact on Return on Assets (ROA), while intangible assets have a negligible and negative influence on Return on Equity (ROE). Conversely, tangible assets exhibit a negative and significant association with ROE, while intangible assets have a positive effect on ROA. The study concludes that the choice of accounting policies for tangible and intangible assets is crucial, particularly for enhancing ROA and ROE. It suggests increasing investment in tangible assets and reducing debt levels to improve ROA, as well as investing in advanced software to facilitate the growth of ROE in the short term. Additionally, implementing effective accounting policies for asset valuation is recommended.

In 1854, the Scotland Accounting Institute of Scotland was founded, marking the establishment of the first national accounting body. This significant event later inspired the creation of similar organizations in different nations worldwide. Following this trend, the ICAEW was established in 1880, drawing inspiration from the exchange of capital and ideas between Great Britain and the United States. This influence also had an impact on the evolution of accounting policies, theories, and practices in the US. The National Accounting Institute, now known as the Public Accountants, American Institute, was founded in 1887. These institutes have played a crucial role in establishing and educating businesses about the principles they should follow, according to established accounting practices. Throughout the 20th century, the demand for accounting information increased, leading to advancements in accounting policies, theory, and practices. Furthermore, the use of accounting software contributed to improved information retention. (Rayan, 2012) [9].

In the mid-20th century, there was an introduction of international accounting regulations with the aim of enhancing the sustainability and comparability of financial data on a worldwide level. The establishment of the International Accounting Standards Committee (IASC) took place in 1973, involving accounting organizations from various nations including France, Mexico, Canada, Australia, Germany, Ireland, United Kingdom, Japan, the United States of America and the Netherlands. Its main objective was to promote uniformity in global accounting standards.

IFAC which stands for the International Federation of Accountants created in Munich, Germany in 1999 is saddled with the goal of improving the accounting profession and influencing accounting policies on a global scale. The IFAC's primary goals are to promote professional standards, ethics, and quality in accounting practices across the globe with the following objectives:

1. The development and release of Accounting Standards (ASs) aim to promote the objective and unbiased observation of financial reporting.
2. The creation and advancement of guidelines for maintaining high global standards in auditing, vocational education, management accounting, and public sector.

3. Collaborating with other global organizations,
4. Act as a global ambassador for the accounting industry.

Conceptual Framework

The aim of a conceptual framework is to guide the users of a study as regards the main view or variables employed in other to avoid concepts or variable misconception in order to direct the users' view. The adopted concept for this study is the accounting policy.

Accounting Policy: This refer to the precise guidelines established by an organisation management to generate its financial statements. These policies encompass a range of accounting methods, systems of measurement, and procedures for presenting disclosures (Bulycheva, *et al*. 2022) [4].

Theoretical Review

This study has employed the theory of constraint as its basis, to show how the different perspective and constraint to the development of accounting policies

The Theory of Constraints (TOC)

This research is based on the Theory of Constraints which was created by Goldratt in 1986. TOC's main idea is that if scientific principles and logical reasoning is employed, businesses will make better accounting policies. TOC is the perfect fit for this study, as it emphasizes that having the right accounting policies can reduce risk and bankruptcy costs, which will in turn improve the company's market value.

This article investigates the use of accounting policies to manipulate earnings through the application of a Historical Based Methodology. This statement explains that businesses can determine the worth of their inventory using different approaches, including average cost, first in first out (FIFO), or last in first out (LIFO). The average cost method determines the expense of goods sold by calculating the weighted average cost of all inventory acquired or produced during the financial period. On the one hand, the FIFO method operates under the assumption that the inventory acquired or produced initially is sold. On the other hand, the LIFO method operates under the assumption that the inventory created most recently is sold.

During times when the value of a company's inventory is increasing, it has the opportunity to strategically control its earnings by implementing certain accounting techniques. As an illustration, within the manufacturing sector, a company could acquire inventory units for $10 apiece in the initial half of a month, and subsequently at a rate of $12 per unit for the latter half. The company purchases 10 units at a price of $10 and 10 units at a price of $12, and manages to sell a total of 15 units over the course of the month.

If the company chooses to adhere to its Accounting Policy and adopt the First-In-First-Out Accounting Method, the expense incurred for goods sold will amount to $160. To arrive at this figure, you would need to multiply 10 units valued at $10 per unit by 5 units valued at $12 per unit. Alternatively, when employing the average cost method, the cost of goods sold amounts to $165, derived from 15 units priced at $11 each. Conversely, opting for the LIFO method results in a cost of goods sold of $170, obtained by multiplying 10 units priced at $12 each and 5 units priced at $10 each. Hence, during periods of rising prices, opting for the FIFO method proves advantageous as it aids in lowering the cost of goods sold and enhancing profits.

Results

Different companies and regions may adopt diverse approaches when it comes to developing accounting policies. However, most companies generally follow the IFRSs or the GAAPs or both, depending on the nature and scope of the business engagement. It should be emphasized that accounting policies and principles are distinct, with principles being the fundamental accounting rules and policies relating to how a company applies those rules.

Having basic accounting policies is crucial for companies to accurately represent their financial position. It helps maintain trust among clients and stakeholders, as they rely on reliable and certified information. The entities should generally adopt five accounting policies, which include the eleven key policies stated in 1.4., which are.

a. **Revenue Recognition Policy:** When businesses gather data about their operations, they must take into account the revenue recognition principle. This principle governs the period within which earnings are recognized and disclosed on the company's financial statement. If a company follows the accrual accounting method, it records revenues in the period when services were provided. Conversely, if a company follows the cash accounting policy, the period when the revenues are received mark the point of the records.
b. **Cost Policy:** Keeping track of the assets during a company's purchase of a product or service aids in maintaining the organization's expenditure records in an organized manner. It is crucial to accurately record the cost of acquiring any item for which money is spent, as well as appropriately documenting the depreciation of these assets.
c. **Matching Policy:** Maintaining a precise and accurate accounting records, aligning expenses with the corresponding revenues generated during the same period is crucial to the health of the business. Additionally, it is important to document costs during the time frame in which they were accrued. Similarly, if any revenue has been recognized from the sale of products or services over a specific time period, the associated costs should also be acknowledged.
d. **Full Disclosure:** Financial statements must contain all necessary information to ensure accuracy and prevent any misleading interpretations. This ensures that crucial business partners and clients are well-informed about pertinent details regarding the organization or firm.
e. **Objectivity Policy:** It is important for accounting information to be consistently accurate and impartial. It is important for companies to ensure that the data is backed up by tangible evidence such as vouchers, receipts, and invoices. Maintaining an unbiased perspective is essential for relying on financial outcomes. For example, if an auditor had previously been employed by the same company as a staff member and is now conducting an audit for them, their prior association with the client could potentially impact their audit work and undermine their impartiality.

Conclusion

Section 1.4 of the paper presents an extensive inventory of eleven accounting policies. This study concludes that policies like the historical/current cost, valuation of investments, treatment of leases, accounting conventions, research and development cost, recognition of profits on long-term contracts, fixed assets, treatment of goodwill, handling of contingent liabilities, depreciation policy, translation of foreign currency rates and inventory policies should be a point of focus for firms in developing a sound accounting system. These specific approaches differs from firms to firm based on the business activities/operations and engagement of the firm.

Recommendation

Based on the outcome of the study, the study recommends

1. There are five accounting policies (revenue recognition, cost policy, matching policy, full disclosure policy, and objectivity policy) that should be followed when developing accounting policy according to IFRS. These policies aim to enhance the existing accounting practices used in businesses.
2. Additional research is necessary to thoroughly examine the methods utilized in the establishment of accounting policies across various sectors of the business industry.
3. Companies should invest effective accounting policy adoption. This will help in generating more revenue, be more profitable, and ultimately maximize the financial performance.

References

1. Ajewole JO, Seyingbo OA, Olonite OA, Aladetanye TS. The Nexus between Tangible and Intangible Assets and Profitability of Telecommunication Firms in Nigeria. International Journal of Advance Research in Multidisciplinary. 2023;1(1):60-69.
2. Alexander JR. History of Accounting Developments in Kosovo and Its Standardization. Account Financ Hist Res J. 2002;5(2):196-210.
3. Asllanaj R. Kontabiliteti Financiar/Financial Accounting. Prishtinë: Këshilli Botues Journal. 2010;10(4):11-18.
4. Bulycheva TV, Busheva AY, Eliseeva OV, Zavyalova TV. Innovative Approach to Accounting Policy Development in Accordance with International Financial Reporting Standards. Springer Cham Internationals. 2022;26(11):245-252.
5. Deegan C, Unerman J. Financial accounting theory. European edition. Berkshire: McGraw-Hill. 2006;6(2):15-19.
6. Hossain MS, Hasan SM, Safiuddin M. Adoption of International Financial Reporting Standards in Bangladesh: Benefits and Challenges. Journal of Business and Management. 2015;17(8):16-24.
7. Neokleous CI. Accounting for power: the history of an industry that shaped the world. Journal of Business and Management. 2016;9(2):18-24.
8. Oladutire OE, Shittu MSO, Olonite OA. Behavioural of Accounting Policies: The International, Neuroaccounting and Generally Accepted Accounting Principles (GAAPs) Perspectives. International Journal of Advance Research in Multidisciplinary. 2023;1(2):114-120.
9. Rayan E. The evolution of accounting software: past, present, future. The Journal of Accountancy. 2012;15(5):8-12.
10. Sanjay D. Accounting History. Accountability Journal of Research. 2002;28(11):76.
11. Sharm V. Management Accounting and Financial Accounting. Global Account Alliance. 2016;7(2):1-11.
12. Shukla H. Cultural and Spiritual Conviction of Accounting. Indian J Account. 2015;3(1):78-84.
13. Vasani P. Accounting Standards (India) and Convergence to IFRS. Nagpur Journal of Finance and Management. 2014;4(2):4-49.
14. Vokshi N, Ahmeti S, Dermaku A, Ujkani S. Historical Review of Accounting. Journal of Business and Management. 2013;7(3):13-16.
15. Wood F, Sangster A. Business Accounting. Pearson Education Limited. 2005;12(5):27-28.
16. Xu L, Zhang E. Exploring hegemonic change in China: A Case of Accounting Evolution. 2013;9(3):56-58.

Creative Commons (CC) License

This article is an open access article distributed under the terms and conditions of the Creative Commons Attribution (CC BY 4.0) license. This license permits unrestricted use, distribution, and reproduction in any medium, provided the original author and source are credited.