

The Application of Substance Over Form Principle in Accounting Practice

Yanzhu Li

Hainan Vocational University of Science and Technology, Haikou 571126

Abstract: This paper systematically studies the application of the principle of substance over form in accounting practice. As the core principle of “International Accounting Standards”, this principle emphasizes the accounting based on the essence of economic business, which is of great significance to improve the quality of accounting information and promote the convergence of international accounting. It is found that this principle has wide application value in the recognition of accounting elements, selection of methods, preparation of statements and judgment of related parties, but it also faces problems in practice, such as abuse, resulting in information distortion and inadequate implementation by practitioners. The root cause of these problems lies in the large space of professional judgment and the imperfect supervision mechanism. To this end, it is necessary to improve the professional quality of accounting personnel, improve the supervision system and strengthen the legal coordination to ensure that the principle is correctly applied and plays its due role.

Keywords: Substance over form; Accounting practice; Apply

Introduction

In accounting practice, the principle of substance over form emphasizes that enterprises should conduct accounting according to the substance of economic business rather than its legal form. This principle requires accountants to grasp the economic essence of a transaction or event through its surface form, so as to ensure that financial information can truly reflect the economic activities of the enterprise. As one of the core principles of the International Accounting Standards, it guides accountants to avoid overfocusing on legal form and deviating from economic substance, which ultimately affects the reliability of financial reporting.

1. Importance of substance over form principle

The application of the principle of substance over form is of great significance to modern enterprise accounting. First of all, it helps to improve the quality of accounting information, make financial data more suitable for the actual business conditions and market environment of enterprises, and provide more valuable decision-making basis for information users. Secondly, this principle can promote the integration of enterprise accounting practice with international standards, adapt to the development trend of economic globalization, and promote the smooth development of transnational economic and trade activities. In addition, in the face of an increasingly complex business environment, this principle can also help accountants eliminate external interference, focus on economic substance, ensure the accuracy and scientific accounting results, and lay a solid foundation for the future financial decisions of enterprises.

2. Problems faced in the application of the principle of substance over form

2.1 It is easy to abuse the principle

The principle of substance over form has the risk of being abused in practical application. Because this principle gives accountants a large space for professional judgment, in the case of imperfect supervision mechanism, enterprises may use this feature to manipulate profits. Taking the provision for asset impairment as an example, although the accounting standards require that the balance between book value and net realizable value be provided, many enterprises only estimate based on experience because the current asset evaluation standard system in China is not perfect. This gives enterprises room to manipulate profits: in good years, enterprises tend to make more impairment provisions to reduce profits by increasing costs; In years of poor performance, profits are inflated by making less provision for impairment. This kind of operation not only violates the principle of authenticity of accounting information, but also may touch the legal red line.

2.2 Easily lead to distortion of accounting information

Although the theory value of the principle of substance over form is to improve the authenticity of accounting information, it may produce the opposite effect in practice. Due to the lack of effective supervision mechanism, some enterprises regulate profits by manipulating

asset impairment reserve and other ways, so as to achieve the purpose of tax avoidance. For example, an enterprise may lower its current profit and reduce the tax payable by making more provisions for impairment. Or by making less provision for impairment to dress up results. Although this practice can bring economic benefits to enterprises in the short term, in the long run, it will not only damage the reliability of accounting information, but also may expose enterprises to the risk of tax inspection and legal proceedings. At the same time, such distorted accounting information will also mislead investors' decisions and affect the healthy development of the capital market.

2.3 The practitioner does not strictly follow the principles

In accounting practice, the principle of substance over form needs to be coordinated with other accounting principles to play its due role. However, some accounting practitioners have the problem of inadequate implementation when applying this principle. The main manifestations are as follows: first, one-sided emphasis on substance over form, ignoring the coordination with other accounting principles (such as timeliness, consistency, etc.); Second, the lack of sufficient professional support in the process of professional judgment leads to the judgment result deviating from the reality; Third, affected by the pressure of enterprise management, improper accounting treatment in violation of professional ethics. These problems not only affect the quality of accounting information, but also weaken the application effect of the principle of substance over form. To solve these problems, we need to improve the professional quality of employees, improve internal control, strengthen external supervision and other aspects.

3. Main applications of the principle of substance over form

3.1 Application of accounting elements confirmation

In the recognition of asset elements, accountants need to break through the legal form to grasp the economic essence. For the classification of financial assets, it is not only based on contract terms, but also to analyze their cash flow characteristics and business models. The confirmation of the special purpose entity must penetrate the legal form to judge the actual control. The recognition of liabilities also needs to pay attention to the economic essence, such as the recognition of contingent liabilities can not only look at the contract agreement. Revenue recognition needs to focus on the actual time point of the transfer of commodity control to avoid being misled by the surface transaction form.

3.2 Application of accounting method selection

In the accounting of equity investment, we should not judge mechanically according to the surface data of shareholding ratio, but should deeply analyze the economic essence of whether the investor has actual control over the investee. In particular, in some special cases, even if the investor's shareholding is below the traditional standard of 50%, as long as it can prove that it has substantial control over the financial and operating policies of the investee, the equity method should be used for accounting. Similarly, the choice of risk avoidance methods should also be based on the essence of the business, such as the after-sale repurchase business with financing nature, should be treated as financing transactions. Asset impairment test should pay more attention to the economic essence of asset group rather than the legal form of individual asset.

3.3 Application of accounting statement preparation

In the preparation of consolidated statements, this principle requires breaking through the restriction of equity ratio and analyzing the actual control relationship. For variable interest entities, even if the shareholding ratio is low, as long as there is substantial control, it should be merged. When preparing the balance sheet, it is necessary to distinguish the economic essence of operating leases and financial leases. In the preparation of the cash flow statement, it is necessary to classify the cash flow according to the substantive nature of the cash flow, rather than only based on the superficial transaction form.

3.4 Application of related party judgment

Related party identification should not be limited to equity relationship, but should analyze the actual control and significant impact. Parties with common control or significant influence but no equity relationship shall also be identified as related parties. Particular attention should be paid to the substantive relationships formed through the arrangement of agreements, such as persons acting in concert, actual controllers, etc. This helps investors obtain more comprehensive corporate background information and promotes the standardized development of the market.

4. Conclusion

To sum up, the effective implementation of the principle of substance over form requires concerted efforts from many aspects. The improvement of professional quality of accounting personnel is the key, only through continuous learning and practice, training through the phenomenon to see the essence of professional judgment, in order to truly grasp the essence of economic business. At the same time, the construction of professional ethics can not be ignored, accounting personnel should maintain an independent and objective professional attitude,

resist all kinds of improper intervention. At the system level, it is necessary to establish a more perfect accounting information supervision mechanism, improve the ability of supervisors to identify economic essence, and ensure the authenticity of accounting information. In addition, the coordination between accounting standards and laws and regulations should be strengthened to provide clear guidance for the professional judgment of accountants. Through the comprehensive implementation of these measures, we can give full play to the positive role of the principle of substance over form, improve the quality of accounting information, and serve the economic and social development. In the future, with the continuous innovation of economic business, the application of this principle will also face new challenges, which need to be continuously studied and improved.

References

- [1] Wu Yue. Application of the Principle of Substance over Form in accounting practice [J]. Modern Marketing (Management Edition), 2020 (06) : 190-191.
- [2] Lei Fei. Application of the Principle of Substance over Form in Accounting practice [J]. Finance and Economics, 2022 (25) : 123-125.
- [3] Wang Yongheng. The Application of the principle of Substance over Form in Accounting practice [J]. China Sankei, 2023 (06) : 64-66.