Disclosure of Accounting Policies AS 1

Practice Questions [PQ]

PQ No. 1: (2 Marks, N09) Year to year results of a company were not found comparable on the basis of gross profit margin. List out the probable reasons.

Answer 1: The probable reasons could be the change in the accounting policy viz.

- Change in method of recognition of sales revenue from cash basis to accrual basis or vice versa; or
- Change in valuation of closing inventory by adopting different methods year to year such as LIFO and FIFO to weighted average or vice versa.

PQ No. 2: (4 Marks, N 07) Mention areas in which different accounting policies are followed by companies.

OR

(5 Marks, N10) "Recognizing the need to harmonize the diverse accounting policies and practices, accounting standards are framed." Give examples of areas in which different accounting policies may be adopted by the enterprise.

Answer 2: Following are the examples of the areas in which different accounting policies may be adopted by different enterprises:

(i) Methods of depreciation, depletion and amortization.

(ii) Valuation of inventories.

(iii) Methods of valuing goodwill.

(iv) Valuation of investments.

PQ No. 3: (4 Marks, M13) What are the three fundamentals accounting assumptions recognized by Accounting Standard (AS) 1? Briefly describe each one of them.

Answer 3:

Accounting Standard (AS) 1 recognized three fundamental accounting assumptions. These are follows:

(i) **Going Concern:** the financial statements are normally prepared on the assumption that an enterprise will continue its operations in the foreseeable future and neither there is intention, nor there is need to materially curtail the scale of operations.

(ii) **Consistency:** the principle of consistency refers to the practice of using same accounting policies for similar transactions in all accounting periods unless the change is required (i) by a statute, (ii) by an accounting standard or (iii) for more appropriate presentation of financial statements.

(iii) **Accrual basis of accounting:** under this basis of accounting, transactions are recognized as soon as they occur, whether or not cash equivalent is actually received or paid.

PQ No. 4: Rama Ltd. follows the practice of disclosing accounting policies adopted in preparation of financial statement in the Director’s report. Comment on this practice.

Answer: The practice followed by the company is not correct. It should be disclosed as a part of financial statement in “Notes to Accounts”. The director’s report is not the part of financial statement.

PQ No. 5: L Ltd. Has disclosed accounting policies related to fixed assets in schedule E – Fixed assets, accounting policies related to Investment in schedule F – Investment and accounting policies related to Inventory in schedule G – Current assets, Loans and Advances and so on. Comment on this practice.

Answer: As Per AS 1, all significant accounting policies should be disclosed at one place and these should not be scattered over various schedule. These disclosure of policies of this company is NOT in accordance with AS-1 and should change the disclosure required by the AS.

PQ No. 6: In the books of M/s Prashant Ltd., closing inventory as on 31.03.20X2 amounts to ₹ 1,63,000 (on the basis of FIFO method).

The company decides to change from FIFO method to weighted average method for ascertaining the cost of inventory from the year 20X1-X2. On the basis of weighted average method, closing inventory as on 31.03.20X2 amounts to ₹ 1,47,000. Realisable value of the inventory as on 31.03.20X2 amounts to ₹ 1,95,000.

Discuss disclosure requirement of change in accounting policy as per AS-1.

Solution: As per AS 1 “Disclosure of Accounting Policies”, any change in an accounting policy which has a material effect should be disclosed in the financial statements. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Thus Prashant Ltd. should disclose the change in valuation method of inventory and its effect on financial statements. The company may disclose the change in accounting policy in the following manner:

'The company values its inventory at lower of cost and net realizable value. Since net realizable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present year i.e. 201X1-X2, the company has changed to weighted average method, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced current profit and value of inventory by ₹ 16,000.

PQ No. 7: B Ltd. has not complied AS-22 "Taxes on Income" and the same is disclosed in the notes on accounts. Management of the entity says as non-compliance is disclosed - Financial statement gives true and fair view. Comment.

Answer: As per AS 1, Disclosure of accounting policies is NOT A REMEDY for wrong accounting. The FSs does not give a true and fair view as they are not in compliance with AS.

PQ No. 8: Can same type of inventory at two different factories be valued by applying two different accounting policies i.e. at one factory valuation of inventory by using FIFO method and at another factory weighted average cost method?

Answer: Same type of inventory at two different factories cannot be valued by applying two different accounting policies as it does not give true and fair view. The same has been clarified by Expert Advisory Committee of ICAI.

PQ No. 9: Can different method of depreciation be followed for the same class of assets used in different plants?

Answer: As per the opinion given by Expert Advisory Committee ICAI, different methods of depreciation for the same class of assets used in different plants of the company can be applied if the management considers it appropriate to do so, after considering the factors such as type of assets, the nature of the use of such assets and the circumstances prevailing in the business.