Paramparna, Pratistha, Anusharsan

1. Accounting policies

specific Principles, Bases, Conventions, rules and Practices applied by entity in Preparing and presenting financial statements.

Principles – To Prepare F/s applying all Ind As.
Bases – Cash or Accrual, FIFO or weighted Average, Cost or Revaluation model
Conventions – Constructive obligations to pay Bonus.
rules – Goodwill once impaired cannot be reversed.
Practices – Past Experiences, improvement.

Examples of Accounting policies

1. Prepare and Present F/s applying all Ind AS.
2. Inventories – FIFO or weighted Average <LIFO not allowed>
3. PPE or Intangible Assets – Subsequently Cost model or Reval^n model
4. Investment Property – Cost Model only
5. Cash Flow statement – Direct method or Indirect method.
6. When Revenue should be recognised.

How to select and apply accounting policies ?

Firstly – Apply specific Ind As

Secondly – In the Absence of specific Ind As, Management shall use its judgement in developing and applying accounting policies that is :
a) Relevant to Decision making needs of users, and
b) Reliable in that the Financial statements :
(i) Represents Faithfully Financial position (B/s), Financial Performance (P/L) and Cash Flows
ii) Neutral (Free from Bias) iii) Prudent
iv) Complete in all material aspects v) Reflect Substance over form

In making Judgement, management shall refer to :- (CRAFTA)

i) Ind AS dealing with similar and related issues.
ii) Conceptual Framework for Financial Reporting under Ind AS.
iii) Most Recent Pronouncement of IASB (International Accounting standard Board)
iv) Other standard setting Bodies that uses similar conceptual Framework.
v) Other Accounting literature and accepted Industry Practices.

Entity shall select and apply its accounting policy consistently for similar transactions, other events and conditions (unless Ind AS permits change) so that users be able to compare F/s over time to identify trends in its Financial Position, Financial Performance and cash Flows.

An entity has grouped its property, plant and equipment into four classes viz., land, factory building, plant and machinery and furniture. The entity may propose to apply revaluation model only to land. It need not apply this model to building or plant and machinery.

Ind AS 2 'Inventories' requires that inventory be valued at lower of cost and net realizable value. In identifying cost, it allows alternative cost formulas; FIFO and Weighted average. The same cost formula must be applied to items of inventory having similar nature or use, but a different cost formula can be applied to a different classification of inventory.

Change in Accounting policy → Reasons to be provided in Notes to accounts as to why accounting policy is changed.

An Entity shall change its Accounting policy only if :-

i) change is required by Ind AS. (From Ind AS 17 to Ind AS 116)
ii) Results in F/s providing more reliable and relevant information about effects of transactions, events or conditions on entity's Financial Position, Financial Performance and cash Flows. {Also if more relevant for users to make economic decisions}

Following are not changes in Accounting Policies

1. The application of an accounting policies for transactions, other events or conditions that differ in substance from those previously occurring.
   A/c policy changed due to change of manner of business is not a change in A/c policy.
   ↳ Refer below Example.

2. Application of new accounting policies for transactions, other events or conditions that did not occur previously or were immaterial.

A company owns several hotels and provides significant ancillary services to occupants of rooms. These hotels are, therefore, treated as owner-occupied properties and classified as property, plant and equipment in accordance with Ind AS 16. The company acquires a new hotel but outsources entire management of the same to an outside agency and remains as a passive investor. The selection and application of an accounting policy for this new hotel in line with Ind AS 40 is not a change in accounting policy simply because the new hotel rooms are also let out for rent. This is because the way in which the new hotel is managed differs in substance from the way other existing hotels have been managed so far.

An entity has classified as investment property, an owner occupied property previously classified as part of property, plant and equipment where it was measured after initial recognition applying the revaluation model. Ind AS 40 on investment property permits only cost model. The entity now measures this investment property using the cost model. This is not a change in accounting policy.

How to apply change in accounting policy

If change in accounting policy due to New Ind AS (From Ind AS 17 to Ind AS 116)

Generally standard itself provide transitional provisions (Retrospective, Prospective, modified retrospective). In such case, Entity needs to follow transitional provisions accordingly.

If change in A/P made voluntarily, or, if Ind AS do not contain transition provision

In such case, it shall apply the change retrospectively.

Note: Early application of Ind AS is not a voluntary change in accounting policy.

When a change in Accounting policy is applied RETROSPECTIVELY, the entity shall -

i) Adjust opening balance of each affected component of Equity (Retained Earnings) for earliest prior period presented.

ii) Adjust other comparative Amount disclosed for each prior period presented as if new accounting policy had always been applied.

Inventories

Change in Inventory measurement from FIFO to weighted Average.

31st March 2000	31st March 2001	31st March 2002	31st March 2003 (P.Y. 2002-03)	31st March 2004 (C.Y. 2003-04)
Increase in value of inventory due to cost Formula change ₹ 15000 (+)	Decrease in value of inventory due to cost Formula change ₹ 6000 (-)	Increase in value of inventory due to cost Formula change ₹ 9000 (+)	Inc in value of inventory due to cost Formula change ₹ 8500 (+)	Increase in value of inventory due to cost Formula change ₹ 6300 (+)
FIFO → 425000 W.A. → 440000				

Current year → 2003-04 (1st Balance sheet - 2004)
Previous year → 2002-03 (2nd Balance sheet - 2003)

To Apply change in Accounting policy retrospectively, Entity should prepare third Balance sheet at Beginning of Earliest Reporting Period.

Current Reporting period → 2003-04
Earliest Reporting Period → 2002-03 ⟨Since Comparatives Prepared for one year⟩

∴ Beginning of Earliest Reporting Period — 1st April 2002

Third Balance sheet (1.4.2002)

Retained Earnings ↑ ⟨15000 - 6000 + 9000⟩	18000	Inventories ↑	18000

Then Prepare Restated Comparative F/s & Current F/s using third B/sheet.

31st March 2000

Closing Inventory (FIFO) ⇒ 350000 ✓
Closing Inventory (W.A.M) ⇒ 365000

Trading A/c

Op. Inventory	500000	Sales	1500000
Purchase	900000	Closing Inventory	350000 ✓ + 15000 = 365000
G.P.	450000 + 15000 = 465000		

31st March 2001

Trading A/c

Op. Inv.	15000 ↑	Closing Inv. 9000 ↑
G. Profit	6000 ↓	

Current year 2003-04
Previous year 2002-03 ⇒ Day 1 = 1.4.2002 — Third B/sheet

31.3.02

Sh. Cap	500000	PPE	800000
O/E	1000000	I.P.	400000
Debentures	200000	Inventories	525000
O Liab	300000	Cash	275000

1.4.2002 (Third B/sheet)

Sh. Cap		500000	PPE	800000
O/E	1000000		I.P.	400000
(+) R.E.	18000	1018000	Inventories 525000 + 18000	= 543000
Debentures		200000	Cash	275000
O Liab		300000		

B/sheet

	C.Y. 2003-04	P.Y. 2002-03
Inventories	W.A.M. 6300 +	W.A.M 8500 +

P/L

COGS	WAM	WAM

1) Building

↓

PPE

↓

Revaln. model

↓

Change from Revaln. model to cost model because it results in F/s provide more reliable & relevant info

↓

Change in accounting policy.

2) Building

↓

PPE

↓

Revaln. model

↓

- Purpose of use changed from PPE to Investment property
- Manner of business changed

↓

- Ind AS 40 will be applied now instead of Ind AS 16.
- Ind AS 40 allows only cost model

↓

Revaln. model ——— Cost model.

↓

This is not a change in A/c policy.

Balance sheet

C.Y.	Comparatives. P.Y.
1st B/sheet	2nd B/sheet.

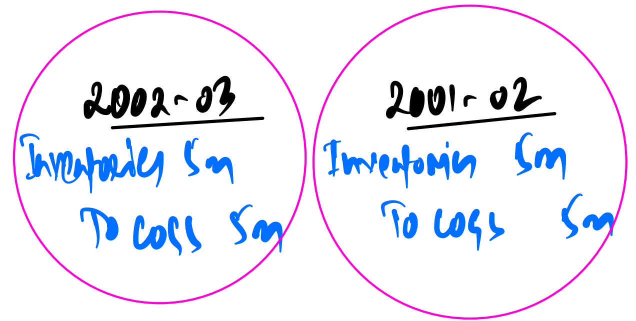
Q4

Third B/Sheet (Extract) (1.4.2001)

Retained Earnings	423m		
(+) Increase ↑	10m	Inventory ↑	10m
R.Earnings.	433m		

Inventories consumed
COGS
To Inventories

Reversal
Inventories
To COGS



Statement of P/L

	2002-03	2001-02
Revenue	324	296
COGS	(168) 173-5	(159) 164-5
G.P.	156	137
Expenses	(83)	(74)
Net Profit	73 68	63 58

Retained Earnings

	R.E. (new)	R.E. (old)
Retained Earnings	423m	423m
(+) 1.4.2001 (Third B/S)	10m	-
	433m	423m
(+) 2001-02 Revised Profit	63m	58m
	496m	481m
(+) 2002-03 Profit	73m	68m
R.Earnings (31.3.03)	569m	549m

Statement of changes in Equity (extract)

	Retained earnings	Retained earnings (Original)
At 1st April, 20X1	423	423
Change in inventory valuation policy	10	-
At 1st April, 20X1 (Restated)	433	-
Profit for the year 20X1-20X2	63	58
At 31st March, 20X2	496	481
Profit for the 20X2-20X3	73	68
At 31st March, 20X3	569	549

When it is impracticable to determine the period-specific effects of changing an accounting policy on comparative information for one or more prior periods presented, then the entity shall apply the new accounting policy to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable, which may be the current period, and shall make a corresponding adjustment to the opening balance of each affected component of equity for that period.

Thus, if it is impracticable for an entity to change the policy from day 1, because it is impracticable to determine period-specific effects for one or more comparative prior periods presented, it can apply the changed policy from the earliest period for which it would be practicable to make the changes in policies retrospectively which may be the current period.

In the example given in the section 1.5.5.2 above, if comparative information is presented for two years i.e., 20X6-20X7 and 20X7-20X8 and if it is not practicable to apply the changed policy retrospectively from 20X6-20X7, then, the entity can apply the changed policy retrospectively from 20X7-20X8. This may happen if it is not practicable to compute inventory value in accordance with the changed policy as on 1st April, 20X6, for example, due to loss of latest purchase bills for the year 20X5-20X6 and computer records of the same are also lost.

In the above example, if comparative information is presented for one year and if it is not practicable to compute the opening inventory value as at 1st April, 20X7, the entity can apply the changed policy retrospectively from 20X8-20X9.

2008-09	2007-08	2006-07
C.Y.	P.Y.	P.Y.
✓	X	X

Q3. 1.4.2001

C.A. of Asset = 11000
(+) F.V. Increase = 6000
17000 → TB of Asset = 11000 ∴ DTL = 6000 × 30% = 1800

1) Asset 6000
To Revaluation Surplus (OCI) 6000

2) Reval^n Surplus 1800
To DTL 1800

OR

1) and 2) Asset 6000
To Reval^n Surplus 4200
To DTL 1800

1.4.2001 Revised C.A. of Asset after Revaluation = 17000

31.3.2002 Depriciation (New Basis) = 2000 → C.A. (31.3.02) = 15000

Depⁿ already charged = 1500

∴ Additional Depⁿ = 500

3) Depⁿ 500

To Asset 500

4) CTL 150

To P/L 150 ✓

2. Change in Accounting Estimates

There are many uncertainities in business activities and therefore many items in F/s can only be estimated.
Estimation involves based on latest and reliable information.

Estimation may be required of :-

1. Bad debts {Expected Credit loss as per Ind AS 109}
2. Fair value of Financial Assets and Financial Liabilities.
3. Warranty obligations.
4. Useful lives or expected pattern of consumption in Depreciable Assets.
5. Expected Residual Value of PPE or Intangible Assets.
6. Inventory obsolescence (NRV)

An Estimate may need revision as a result of new information or more experience.
By its nature, Revision of an estimate does not relate to prior periods and its not the correction of an error.

Accounting treatment for change in Accounting Estimates

The effect of change in accounting Estimates shall be recognised PROSPECTIVELY in Profit or loss in —

i) The period of change – if change affects that period only.
ii) The period of change and future periods – if change affects both.

SBP scheme
Vesting period = 3 years
Fair value of option = 600000
∴ Expenses every year = $\frac{600000}{3 \text{ years}}$ = 200000 → Exp (1st yr) = 200000
After 1st yr end, Fair value changed to ₹ 800000 → Exp (2nd yr) 333333
∴ Additional ₹ 200000 expenses split in 2nd & 3rd year.
(3rd yr) :) 266667

$\frac{800000}{3}$

Example

During the financial year ended 31st March, 20X2, Entity ABC introduced a new range of electric motors. It sold the motors with a standard warranty of two years. Warranty provides assurance that a product will function as expected and in accordance with certain specifications and it has been assessed that it is not a separate performance obligation under Ind AS 115.

Based on results of testing of the motors during trials prior to commercial production, Entity ABC made a provision for warranty costs amounting to ₹ 1,00,000 for motors sold during the year ended 31st March, 20X2.

Provision

During financial year 20X2-20X3, a defect was discovered in the motors that had not come to light during the trials. The defect resulted in the entity incurring an amount of ₹ 2,00,000 during the financial year 20X2-20X3 on repairs of motors sold during the financial year 20X1-20X2. Besides, the entity expects to incur ₹ 1,50,000 as costs during the year 20X3-20X4 on meeting its warranty obligations in respect of motors sold during the financial year 20X2-20X3.

In preparing its financial statements for the year ended 31st March, 20X3, the entity would carry forward a warranty provision of ₹ 1,50,000 in respect of motors sold during the financial year 20X1-20X2. It would recognise an amount of ₹ 2,50,000 (₹ 2,00,000 plus ₹ 1,50,000 minus ₹ 1,00,000) in respect of motors sold during the financial year 20X1-20X2 as an expense in profit or loss for the financial year 20X2-20X3. The warranty provision included in the comparatives for financial year ended 31st March, 20X2 would not be adjusted.

The provision for warranty costs in respect of motors sold during the financial year 20X2-20X3 would be made by considering the information concerning the defect in motors that came to light during the financial year 20X2-20X3.

31st March 2002
Warranty Exp (P/L) 100000
To Provision for warranty (Liab) 100000

Next year (2002-03)
Provision for warranty Exp 100000
Warranty Exp (P/L) 100000
To Bank 200000

Warranty Exp (P/L) 150000
To Prov. for warranty 150000

2002-03
Expenses recognized in P/L → 100000 + 150000 → 250000
Prov. for warranty (Liab) → 150000

3. ERRORS

Ind As 8 deals with treatment of Errors taken place in past but not discovered at that time. Subsequently when discovered, it is necessary to correct such errors in F/s

Prior Period Errors are ommissions from, and misstatements in entity's F/s for one or more prior periods arising from failure to use, or misuse of reliable information that —

a) was available when F/s for those periods were approved for issue, and

b) could reasonably be expected to have been obtained and taken into account in preparation and presentation of those F/s.

Common types of ERRORS

a) Mathematical Mistakes :- E.g. wrong calculations, Errors in totals, carry forward of wrong balances etc. ⟨Errors of commission⟩

b) Ommissions :- Mistakes happened due to Ommission to record a material transactions due to oversight.

c) Frauds :- Major thefts Undetected in the Past.

d) Misinterpretation of Facts – Adjusting Events or Non Adjusting Events.

e) Mistakes in Applying Accounting policies – E.g. As a general rule, Assets and Liabilities and income and expenses should not be offset unless permitted by Ind AS.

Treatment of Errors

1. Potential Errors of Current period – corrected before F/s are approved for issue.

2. Prior Period Errors discovered subsequently – corrected in comparative information presented in F/s.

Situation 1

Errors discovered relates to comparative prior period presented.

Restate the comparative amounts for the prior period presented in which error occured.

Current Year (2003-04) | Previous Year (2002-03)

Adjustment of Errors

Third Balance sheet not required.

Situation 2

Errors discovered relates to period before earliest comparative prior period presented.

Restate the opening balance of Assets, Liabilities and Equity (Retained Earnings) for the earliest prior period presented.

i.e. To prepare Third Balance sheet

Current Year (2003-04) | Previous Year (2002-03)

Comparatives

Third B/sheet prepared on 1.4.2002

Consolidated balance sheet

	Notes	31 March 2019	31 March 2018 Restated**	1 April 2017 Restated**
ASSETS				
Non-current assets				
Property, plant and equipment	3	137,048	97,023	88,145
Capital work-in-progress	3	17,450	3,100	-

Consolidated statement of profit and loss

	Notes	Year ended 31 March 2019	Year ended 31 March 2018 Restated**
Continuing operations			
Revenue from operations [31]	20	221,783	201,107
Other income	21(a)	4,430	3,444

1.4.2002 ———— 31.3.03

Error

31.3.03
Approve
F/S

2002-03

2003-04

2004-05

2002-03 31.3.03 → Error

2003-04
1/4/2003 (2002-03) Approved

2002-03
CY

1/9/2003 Prior Period Error

2003-04

2003-04

2002-03
Corresponding
Adjusted

2000-01
Error

2003-04
C.Y.

2002-03
P.Y

1.4.2002 Third B/sheet

Question 10: (RTP Nov'19 & MTP March'21)

During 20X4-X5, Cheery Limited discovered that some products that had been sold during 20X3-X4 were incorrectly included in inventory at 31st March, 20X4 at ₹ 6,500.

Cheery Limited's accounting records for 20X4-X5 show sales of ₹ 104,000, cost of goods sold of ₹ 86,500 (including ₹ 6,500 for the error in opening inventory), and income taxes of ₹ 5,250.

In 20X3-X4, Cheery Limited reported:

	₹
Sales	73,500
Cost of goods sold	(53,500)
Profit before income taxes	20,000
Income taxes	(6,000)
Profit	14,000
Basic and diluted EPS	2.8

The 20X3-X4 opening retained earnings was ₹ 20,000 and closing retained earnings was₹ 34,000. Cheery Limited's income tax rate was 30% for 20X4-X5 and 20X3-X4. It had no other income or expenses.

Cheery Limited had ₹ 50,000 (5,000 shares of ₹ 10 each) of share capital throughout, and no other components of equity except for retained earnings. State how the above will be treated /accounted in Cheery Limited's Statement of profit and loss, statement of changes in equity and in notes wherever required for current period and earlier period(s) as per relevant Ind AS.

Statement of P/L

	C.Y. (2004-05)	Comparatives P.Y. (Restated)	P.Y. (Original)
Sales	104000	73500	~~73500~~
COGS	(80000)	(60000)	~~(53500)~~
PBT	24000	13500	~~20000~~
Tax @ 30%	(7200)	(4050)	~~(6000)~~
Profit	16800	9450	~~14000~~
BEPS & DEPS {Profit / No. of sh.}	3.36	1.89	

Statement of changes in Equity

	Sh. Cap.	R. Earnings	Total
1.4.2003	50000	20000	70000
(+) Profit 2003-04		9450	9450
		29450	79450
(+) Profit 2004-05		16800	16800
31.3.05	50000	46250	96250

Question 11 (RTP May'21)

In 20X3-20X4, after the entity's 31 March 20X3 annual financial statements were approved for issue, a latent defect in the composition of a new product manufactured by the entity was discovered (that is, a defect that could not be discovered by reasonable or customary inspection). As a result of the latent defect the entity incurred ₹ 100,000 in unanticipated costs for fulfilling its warranty obligation in respect of sales made before 31 March 20X3. An additional ₹ 20,000 was incurred to rectify the latent defect in products sold during 20X3-20X4 before the defect was detected and the production process rectified, ₹ 5,000 of which relates to items of inventory at 31 March 20X3. The defective inventory was reported at cost ₹ 15,000 in the 20X2-20X3 financial statements when its selling price less costs to complete and sell was estimated at ₹ 18,000. The accounting estimates made in preparing the 31 March 20X3 financial statements were appropriately made using all reliable information that the entity could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. Analyse the above situation in accordance with relevant Ind AS.

Sales during 2002-03
↓
Provision for warranty exp = X

2003-04 → expenses incurred to repair defect = 100000
↓
Change in A/c Est.

Warranty exp (P/L)	100000	
To Bank		100000

Warranty exp (P/L) 20000
To Bank 20000

2002-03
Cost of Inventory = 15000
NRV = 18000 } lower

Cost of Inventory = 15000 → COGS

COGS 15000
To Inventory 15000

2002-03

Cost of Inventory = 15000
NRV = 13000 → lower
{18000 - 5000}

Inventory = 13000

Question 8

ABC Ltd has an investment property with an original cost of ₹ 1,00,000 which it inadvertently omitted to depreciate in previous financial statements. The property was acquired on 1st April, 20X1. The property has a useful life of 10 years and is depreciated using straight line method. Estimated residual value at the end of 10 year is Nil.

How should the error be corrected in the financial statements for the year ended 31st March,20X4, assuming the impact of the same is considered material? For simplicity, ignore tax effects.

Third B/S → 1.4.2002

Third B/S

R/E	(10000)	Mach.	100000
			(10000)
			90000

Statement of P/L

	2003-04 CY	2002-03 P.Y.
Depⁿ	(10000)	(10000)

Cost	100000
(-) Depⁿ 31.3.02	10000
(-) Dep 31.3.03	10000 → P.Y
(-) Dep 31.3.04	10000 → C.Y
	70000