

AS 1

DISCLOSURE OF ACCOUNTING POLICIES

NB Pg. No.

Question 1

In the books of M/s Prashant Ltd., closing inventory as at 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. 20X1-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.

Question 2 (RTP May'21)

NB Pg. No.

Jagannath Ltd. had made a rights issue of shares in 20X2. In the offer document to its members, it had projected a surplus of ₹40 crores during the accounting year to end on 31st March, 20X2. The draft results for the year, prepared on the hitherto followed accounting policies and presented for perusal of the board of directors showed a deficit of ₹10 crores. The board in consultation with the managing director, decided on the following:

- Value year-end inventory at works cost (₹ 50 crores) instead of the hitherto method of valuation of inventory at prime cost (₹ 30 crores).
- Provide for permanent diminution in the value of investments, which had taken place over the past five years, the amount of provision being ₹10 crores.

As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 20X1-20X2.

Solution :

As per AS 1, any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, 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. Accordingly, the notes on accounts should properly disclose the change and its effect.

Notes on Accounts:

- (i) During the year inventory has been valued at factory cost, against the practice of valuing it at prime cost as was the practice till last year. This has been done to take cognizance of the more capital intensive method of production on account of heavy capital expenditure during the year.

As a result of this change, the year-end inventory has been valued at ₹ 50 crores and the profit for the year has increased by ₹ 20 crores.

- (ii) The company has decided to provide ₹10 crores for the permanent diminution in the value of investments which has taken place over the period of past five years.

The provision so made has reduced the profit disclosed in the accounts by ₹10 crores.

Question 3

NB Pg. No.

XYZ Company is engaged in the business of financial services and is undergoing tight liquidity position, since most of the assets of the company are blocked in various claims/petitions in a Special Court. XYZ has accepted Inter-Corporate Deposits (ICDs) and it is making its best efforts to settle the dues. There were claims at varied rates of interest, from lenders, from the due date of ICDs to the date of repayment. The company has provided interest, as per the terms of the contract till the due date and a note for non-provision of interest on the due date to date of repayment was affected in the financial statements. On account of uncertainties existing regarding the determination of the amount and in the absence of any specific legal obligation at present as per the terms of contracts, the company considers that these claims are in the nature of "claims against the company not acknowledged as debt", and the same has been disclosed by way of a note in the accounts instead of making a provision in the statement of profit and loss. State whether the treatment done by the Company is correct or not.

Solution :

AS 1 'Disclosure of Accounting Policies' recognises 'prudence' as one of the major considerations governing the selection and application of accounting policies. In view of the uncertainty attached to future events, profits are not anticipated but recognised only when realised though not necessarily in cash. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.

Also as per AS 1, 'accrual' is one of the fundamental accounting assumptions. Irrespective of the terms of the contract, so long as the principal amount of a loan is not repaid, the lender cannot be replaced in a disadvantageous position for nonpayment of interest in respect of overdue amount. From the aforesaid, it is apparent that the company has an obligation on account of the overdue interest. In this situation, the company should provide for the liability (since it is not waived by the lenders) at an amount estimated or on reasonable basis based on facts and circumstances of each case. However, in respect of the overdue interest amounts, which are settled, the liability should be accrued to the extent of amounts settled.

Non-provision of the overdue interest liability amounts to violation of accrual basis of accounting. Therefore, **the treatment, done by the company, of not providing the interest amount from due date to the date of repayment is not correct.**

? Question 4 (RTP Nov'20)

NB Pg. No.

What are the three fundamental accounting assumptions recognized by AS 1? Briefly describe each one of them.

Solution :

Accounting Standard (AS) 1 recognizes three fundamental accounting assumptions. These are as 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 or cash equivalent is actually received or paid.

Question 5

NB Pg. No.

Has Accounting Standard 1 prescribed the manner in which the accounting policies followed by the entity should be disclosed?

Solution :

Paras 18–20 of Accounting Standard 1, Disclosure of Accounting Policies, lay down the manner in which accounting policies have to be disclosed, which is stated as under:

- To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.
- Such disclosure should form part of the financial statements.
- All disclosures should be made at one place instead of being scattered over several statements, schedules & notes.

Question 6 (MTP Apr'21, Mar'22, Oct '23, RTP May'20, PYQ May '22)

NB Pg. No.

State whether the following statements are 'True' or 'False'. Also give reason for your answer.

- Certain fundamental accounting assumptions underline the preparation and presentation of financial statements. They are usually specifically stated because their acceptance and use are not assumed.
- If fundamental accounting assumptions are not followed in presentation and preparation of financial statements, a specific disclosure is not required.
- All significant accounting policies adopted in the preparation and presentation of financial statements should form part of the financial statements.
- Any change in an accounting policy, which has a material effect should be disclosed. Where the amount by which any item in the financial statements is affected by such change is not ascertainable, wholly or in part, the fact need not to be indicated.
- There is no single list of accounting policies which are applicable to all circumstance. (5 Marks)

Solution :

- False;** As per AS 1 "Disclosure of Accounting Policies", certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.
- False;** As per AS 1, if the fundamental accounting assumptions, viz. Going Concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.
- True;** To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. The disclosure of the significant accounting policies as such should form part of the

financial statements and they should be disclosed in one place.

- iv. **False;** Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.
- v. **True;** As per AS 1, there is no single list of accounting policies which are applicable to all circumstances.

The differing circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles acceptable.

? Question 7

NB Pg. No.

Give examples of areas where accounting policies adopted could be different for different enterprises. Would there be any adverse impact due to the adoption of different policies, and if yes, how does Accounting Standard 1 seek to address such issue?

Solution :

There are various areas where different accounting policies could be adopted by different entities within the same industry. An entity may choose to value its inventories using FIFO method, whereas another entity may choose to value the same using Weighted Average method.

While an entity is free to choose its accounting policy as long as in the financial statements reflect a true and fair view of the state of affairs of the enterprise as at the balance sheet date and of the profit or loss for the period ended, the application of different accounting policies by different entities affects the comparability of the financial statements of such different entities by stakeholders, analysts, investors etc. To mitigate the loss of comparability, Accounting Standard 1, Disclosure of Accounting Policies requires disclosure of significant accounting policies as a part of the financial statements. This would help users of the financial statements to understand the policies followed by different entities, particularly if they belong to the same industry, and make a correct analysis of each entity resulting in more informed decision-making.

Question 8 (MTP Apr'22, Apr'23, PYQ Nov'18, Dec'21, RTP May'20, Nov'23)

NB Pg. No.

HIL Ltd. was making provision for non-moving stocks based on no issues having occurred for the last 12 months up to 31.03.2019. The company now wants to change it and make provision based on technical evaluation during the year ending 31.03.2020. Total value of stock on 31.3.20 is Rs. 120 lakhs. Provision required based on technical evaluation amounts Rs. 3.00 lakhs. However, provision required based on 12 months (no issues) is Rs. 4.00 lakhs. You are required to discuss the following points in the light of Accounting Standard (AS)-1:

- Does this amount to change in accounting policy?
- Can the company change the method of accounting?
- Explain how it will be disclosed in the annual accounts of HIL Ltd. for the year 2019-20.

(5 Marks)

Solution :

The decision of making **provision for non-moving inventories** on the basis of technical evaluation **does not amount to change in accounting policy**. Accounting policy of a company may require that provision for non-moving inventories should be made but the basis for making provision will not constitute accounting policy. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

In the given case, considering the total value of inventory, the change in the amount of required **provision of non-moving inventory from Rs. 4 lakhs to Rs. 3 lakhs are also not material**.

The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of HIL Ltd. for the year 2019-20 in the following manner:

"The company has provided for non-moving inventories on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the value of net assets at the end of the year would have been lower by Rs. 1 lakh."

NB Pg. No.

Question 9 (RTP Jan'25)

ABC Ltd. was making provision for non-moving inventories based on no issues for the last 12 months up to 31.3.2023.

The company wants to provide during the year ending 31.3.2024 based on technical evaluation:

Total value of inventory	Rs.100 lakhs
Provision required based on 12 months issue	Rs.3.5 lakhs
Provision required based on technical evaluation	Rs.2.5 lakhs

Does this amount to change in Accounting Policy? Can the company change the method of provision?

Solution :

The decision of making provision for non-moving inventories on the basis of technical evaluation does not amount to change in accounting policy.

Accounting policy of a company may require that provision for non-moving inventories should be made. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made.

In the given case, considering the total value of inventory, the **change in the amount of required provision of non-moving inventory from Rs.3.5 lakhs to Rs.2.5 lakhs is also not material.**

The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of ABC Ltd. for the year 2023-24:

"The company has provided for non-moving inventories on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the **profit for the year** and the **corresponding effect** on the year end net assets would have been **lower by Rs.1 lakh.**"

NB Pg. No.

Question 10 (MTP Apr'19, Aug'18, Oct'22)

Kumar Ltd. had made a rights issue of shares in 2017. In the offer document to its members, it had projected a surplus of Rs. 40 crores during the accounting year to end on 31st March, 2017. The draft results for the year, prepared on the hitherto followed accounting policies and presented for perusal of the board of directors showed a deficit of Rs. 10 crores. The board in consultation with the managing director, decided not to provide for "after sales expenses" during the warranty period; Till the last year, provision at 2% of sales used to be made under the concept of "matching of costs against revenue" and actual expenses used to be charged against the provision. The board now decided to account for expenses as and when actually incurred. Sales during the year total to Rs. 600 crores.

As chief accountant of the company, you are asked by the managing director to draft the notes on accounts for inclusion in the annual report for 2016-2017

Solution :

As per AS 1, any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, 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.

Accordingly, the notes on accounts should properly disclose the change and its effect.

Notes on Accounts:

So far, the company has been providing 2% of sales for meeting "after sales expenses during the warranty period. With the improved method of production, the probability of defects occurring in the products has reduced considerably.

Hence, the company has decided not to make provision for such expenses but to account for the same as and when expenses are incurred. **Due to this change, the profit for the year is increased by Rs. 12 crores** than would have been the case if the old policy were to continue.

? Question 11 (PYQ May'19)

NB Pg. No.

What do you mean by 'Accrual' in reference to AS-1? Also, specify any three reasons for 'Accrual Basis of Accounting'.

(5 Marks)

Solution :

The term "Accrual" has been explained in the AS 1 on Disclosure of Accounting Policies, as "Revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate"

Reasons for Accrual Basis of Accounting

1. Accrual basis of accounting, attempts to record the financial effects of the transactions, events, and circumstances of an enterprises in the period in which they occur rather than recording them in the period(s) in which cash is received or paid by the enterprise.
2. Receipts and payments of the period will not coincide with the buying producing or selling events and other economic events that affect entity performance.
3. The goal of Accrual basis of accounting is to follow the matching concept of income and expenditure so that reported net income measures an enterprise's performance during a period instead of merely listing its cash receipts and payments.
4. Accrual basis of accounting recognizes assets, liabilities or components of revenues and expenses for amounts received or paid in cash in past, and amounts expected to be received or paid in cash in the future.
5. Important point of difference between accrual and accounting based on cash receipts and outlay is in timing of recognition of revenues, expenses, gains and losses.

? Question 12 (PYQ - May'23)

NB Pg. No.

You are required to comment on the following cases as per the provisions of Accounting Standard-1 'Disclosure of Accounting Policies':

1. Bee Limited has not complied with AS-2 "Valuation of inventories" and the same is disclosed in the Notes on Accounts. Management is of the view that the financial statements give a true and fair view as non-compliance with AS-2 is disclosed.
2. Cee Limited sold its Office Building for ₹ 10,00,000 on 1st March, 2023. The buyer has paid the full amount and taken possession of the building. The book value of the Office Building is ₹ 4,00,000. On 31st 2023, documentation and legal formalities are pending. The company has not recorded the disposal and the amount received is shown as an advance.
3. Dee Limited has prepared its accounts on cash basis and the same is not disclosed.
4. Jee Limited disclosed significant accounting policies adopted in the preparation of

financial statements, in the Directors' Report.

(5 Marks)

Solution :

1. As per AS-1 disclosure of accounting policies is **not a remedy for wrong or inappropriate treatment** in accounting. In the given case the financial statement does not give a true and fair view as they are not in compliance with AS-2.
2. **Considering the substance over form as per AS-1, documentation and legal formalities represent the form of the transaction, although the legal title has not been transferred**, the economic reality and substance are that the rights and beneficial interest in the Office Building have been transferred. Therefore, recording of acquisition/ disposal (by the transferee and transferor respectively) would in substance represent the transaction entered into.
3. Accrual is a fundamental accounting assumption. If it is not followed by the company, the **facts should be disclosed under AS-1**. Hence the company should disclose the fact that the cash basis of accounting has been followed in the notes on accounts.
4. The **practice followed by the company is not correct**. It should be disclosed as part of financial statements (The director's report is not part of financial statements).

Question 13 (PYQ Nov'23)

NB Pg. No.

Discuss Disclosure requirements in following cases as per AS 1.

- (i) Accountant of A Ltd. charges a probable loss of losing a suit in books of accounts and also disclosed the same fact in financial statements. The probability of losing the suit is 25%.
- (ii) Accountant of A Ltd. capitalized all the revenue expenses of repair and maintenance during the year to Plant & Machinery and is also disclosing the same as company policy in financial statements.
- (iii) A Ltd. has followed accrual basis of accounting since incorporation. The chief accountant also disclosed this fact in financial statements.
- (iv) A Ltd. was providing for after sales expenses @ 2% of sales for covering expenses during the warranty period. Now A Ltd. observes that actual after sales expenses were much less as compared to provision because of better technology used in manufacturing of the products. Now, the Board of A Ltd. decides to account for these expenses as and when they occur. Sales during the period are ₹ 50 crores.

Solution :

(5 Marks)

- (i) In this case, accountant of company created a provision for damages of probability of losing a suit by a charge against profits. Unless the probability of losing the suit is more than probability of not losing it, there should not be any creation of provision for such probable losses. So there is **no need to charge such loss against profit and disclosing the same in financial statements**.
- (ii) Repairs and maintenance are **revenue expenditure and should not be added to the value of assets**, as these expenses do not increase the capacity of asset. Hence such expenses should be charged to profit & loss statement.
Further the chief accountant also disclosed its policy of adding repairs to value of assets by way of notes to accounts. As per AS 1 disclosure is not a method to correct the wrong treatments. So the contention of chief accountant is wrong.
- (iii) Accrual is one of the Fundamental accounting assumptions. If fundamental accounting assumptions are followed properly then **no specific disclosure is required**.
Disclosure is **required only when there is deviation** and the company is **not following** fundamental accounting assumptions. So the company need not disclose this in financial statements.
- (iv) As per AS 1, any change in the accounting policies which has a material effect in the current

period or which is reasonably expected to have a material effect in later periods should be disclosed. Accordingly, the **notes on accounts should properly disclose the change and its effect.**

Note: So far, the company has been providing 2% of sales for meeting after sales expenses during the warranty period. Now the company has improved the quality of its products with better technology and has been observing that actual expenses are very less than the provision, Hence, the company has decided not to make provision for such expenses but to account for the same as and when expenses are incurred. Due to this change, the profit for the year is increased by ₹1 crore than would have been the case if the old policy were to continue.