

2

ACCOUNTING STANDARD – 1

DISCLOSURE OF ACCOUNTING POLICIES

“Failure doesn't mean the game is over, it means try again with Experience”

1. WHAT IS ACCOUNTING POLICY?

Meaning: The accounting policies refer to the:

- Specific Accounting Rules and
- the methods

adopted by the entity for the preparation and presentation of financial statements.

Examples of Accounting Policies to prepare financial statements:

Items to be disclosed	Method of disclosure or valuation
Inventories	FIFO, Weighted Average etc.
Cash Flow Statement	Direct Method, Indirect Method
Measurement of PPE	Cost Basis or Revaluation Basis
Measurement of Investments	Cost Basis or Market Value Basis
Measurement of Revenue from Service Contracts	% of Completion Method (or) Completed Contract Method

An Extract from the Annual Report of Infosys Ltd. for the year ended 31st March, 2023:

Notes to Standalone Financial Statements

2.1 Property, plant and equipment

Accounting policy

Property, plant and equipment are stated at cost, less accumulated depreciation and impairment, if any. Costs directly attributable to acquisition are capitalized until the property, plant and equipment are ready for use, as intended by the Management. The charge in respect of periodic depreciation is derived at after determining an estimate of an asset's expected useful life and the expected residual value at the end of its life. The Company depreciates property, plant and equipment over their estimated useful lives using the straight-line method.

The estimated useful lives of Assets are as follows:

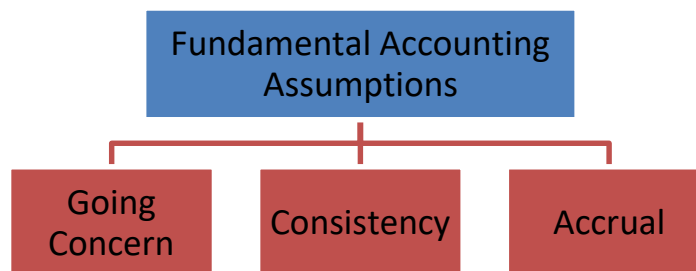
Building	22-25 Years
Plant and Machinery	5 Years
Office Equipment	5 Years
Computer Equipment	3-5 Years

Furniture and Fixtures	5 Years
Vehicles	5 Years
Lease hold Improvements	Lower of Useful life of Asset or Lease Term

- Based on technical evaluation, the Management believes that the useful lives, as given above, best represent the period over which the Management expects to use these assets. Hence, the useful lives for these assets is different from the useful lives as prescribed under Part C of Schedule II of the Companies Act 2013.
- Includes solar plant with a useful life of 25 years.
- Depreciation methods, useful lives and residual values are reviewed periodically, including at each financial year end. The useful lives are based on historical experience with similar assets as well as anticipation of future events, which may impact their life, such as changes in technology.

2. IMPORTANT PROVISIONS OF AS 1

1. All significant Accounting Policies adopted in the preparation and presentation of financial statements should be disclosed.
2. The disclosure of Significant Accounting policies as such should form part of financial statements and the significant accounting policies should normally be disclosed at one place.
3. According to AS - 1 there are three fundamental accounting assumptions:

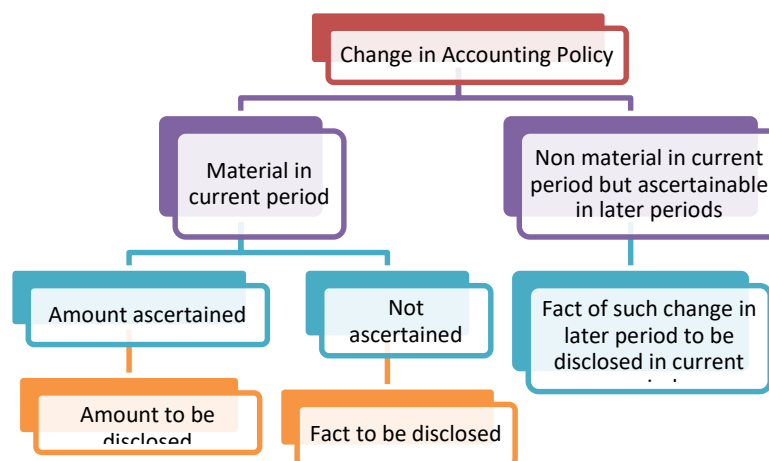


4. If the fundamental accounting assumptions are followed in the financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.
5. While selecting any accounting policy following three principles should be considered:
 - **Substance over Form:** Actual reality or substance of a transaction is more important than just how it looks on paper.
 - **Materiality:** Only information that is significant enough to affect decisions should be included in financial statements.

- **Prudence:** When there is uncertainty its better not to recognise potential gains but to make provisions for potential losses in future. (Note: Refer Example 1)
6. **Changes in Accounting Policies:** An enterprise can change its accounting policies & presentation only when any of the following three conditions are satisfied:
- Adoption of different accounting policy is required by any statute/law. (or)
 - Adoption of different accounting policy is for the purpose of compliance with an accounting standard.
 - It is considered that change would result in more appropriate presentation of financial statements.

7. Disclosure of Change in Accounting Policy:

- A simple disclosure that an accounting policy has been changed is not of much use for a reader of a financial statement. The effect of change should therefore be disclosed wherever ascertainable.
- Any change in accounting policies which affects the financial statements of current period, or which is reasonably expected to have effect in later periods' financial statements, then such change should be disclosed.
- The amount by which such change affects the financial statements should also be disclosed to the extent ascertainable i.e. the change should be quantified in the financial statements.



(Note: Refer Example 2 below)

3. IMPORTANT EXAMPLES

Example 1 (ICAI Module): Prudence

The most common example of exercise of prudence in selection of accounting policy is the policy of valuing inventory at lower of cost and net realisable value.

Suppose a trader has purchased 500 units of certain article @ ₹10 per unit. He sold 400 articles @ ₹15 per unit. If the net realisable value per unit of the unsold article is ₹15, the trader shall value his stock at ₹10 per unit and thus ignoring the profit ₹500 that he may earn in next accounting period by selling 100 units of unsold articles. If the net realisable value per unit of the unsold article is ₹8, the trader shall value his stock at ₹8 per unit and thus recognising possible loss ₹200 that he may incur in next accounting period by selling 100 units of unsold articles.

Profit of the trader if net realisable value of unsold article is ₹15

= Sale - Cost of goods sold = $(400 \times ₹15) - (500 \times ₹10 - 100 \times ₹10) = ₹2,000$ Profit of the trader if net realisable value of unsold article is ₹8

= Sale - Cost of goods sold = $(400 \times ₹15) - (500 \times ₹10 - 100 \times ₹8) = ₹1,800$

Example 2 (ICAI Module): Effect of Change in Accounting Policy

A company has switched from FIFO to Weighted average formula for ascertaining cost of inventory. If the closing inventory by FIFO is ₹2 lakh and then by weighted average formula is ₹1.8 lakh, the change in accounting policy pulls down profit and value of inventory by ₹20,000. The company may disclose the change in accounting policy in the following manner:

"The company values its inventory at lower of cost and net realisable value. Since net realisable 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 the company has changed to weighted average formula, **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 profit and value of inventory by ₹20,000".

4. MCQ's from ICAI Resources

1. Which of the following is NOT a major consideration in selection and application of accounting policies?
 - (a) Prudence
 - (b) Comparability
 - (c) Materiality
 - (d) Substance over form

2. Adoption of different accounting policies by different companies operating in the same industry affects which of the qualitative characteristics the most?
 - (a) Comparability
 - (b) Relevance
 - (c) Faithful representation
 - (d) Reliability

3. Which of the following statement would not be correct in relation to disclosures to be made in the financial statements after making any change in an accounting policy?
 - (a) Any change in an accounting policy which has a material effect should be disclosed.
 - (b) The amount by which any item in the financial statements is affected by such change should be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.
 - (c) If a change is made in the accounting policies which has no material effect on the financial statements for the current period but which is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.
 - (d) If a change is made in an accounting policy which has material effect on the financial statements for the current period and is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed only in the later periods i.e. year(s) next to the year in which the change is adopted.

ANSWERS	1	2	3
	b	a	d

5. MCQ's Created by Jai Sir and Team

4. Fundamental accounting assumption is
- Materiality
 - Business Entity
 - Going concern
 - Dual aspect
5. Which of the following is included in the consideration for selection of accounting policies:
- Going concern
 - Consistency
 - Prudence
 - Accrual
6. All significant Accounting Policies are disclosed
- In Auditors' Report
 - In notes to Accounts of the financial statements
 - Board of Directors Report
 - Audit Committee Report
7. The major considerations governing the selection and application of accounting policies are
- Prudence.
 - Substance over form.
 - Materiality.
 - All of the three.

ANSWERS	4	5	6	7
	c	c	b	d