

## TOPIC- 2

### ACCOUNTING STANDARD – 1

### DISCLOSURE OF ACCOUNTING POLICIES

#### TOTAL NO. of QUESTIONS - 7

#### **Q.ASI.SM.01: (MTP Nov18)**

In the books of M/s Prashant Ltd., closing inventory as on 31.03.2015 amounts to Rs 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 2014-15. On the basis of weighted average method, closing inventory as on 31.03.2015 amounts to Rs 1,47,000. Realisable value of the inventory as on 31.03.2015 amounts to Rs 1,95,000.

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

#### **Q.ASI.SM.02:**

Jagannath Ltd. had made a rights issue of shares in 2012. In the offer document to its members, it had projected a surplus of ₹40 crores during the accounting year to end on 31st March, 2014. 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:



- (i) Value year-end inventory at works cost (₹50 crores) instead of the hitherto method of valuation of inventory at prime cost (₹30 crores).
- (ii) Provide depreciation for the year on straight line basis on account of substantial additions in gross block during the year, instead of on the reducing balance method, which was hitherto adopted. As a consequence, the charge for depreciation at ₹27 crores is lower than the amount of ₹45 crores which would have been provided had the old method been followed, by ₹18 crores.
- (iii) 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 ₹600 crores.
- (iv) Provide for permanent fall in the value of investments - which fall had taken place over the past five years - the 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 2013-2014.

**Q.ASI.SM.03:**

XYZ Company is engaged in the business of financial service 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 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 profit and loss account. State whether the treatment done by the Company is correct or not.

**Q.ASI.RMP.04: (RTP May20) (MTP Nov19, May20 & May22) (EXAM May22)**

(a) ABC Ltd. was making provision for non-moving inventories based on no issues for the last 12 months up to 31.3.2019.

The company wants to provide during the year ending 31.3.2020 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?

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

1. 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.
2. If fundamental accounting assumptions are not followed in presentation and preparation of financial statements, a specific disclosure is not required.
3. All significant accounting policies adopted in the preparation and presentation of financial statements should form part of the financial statements.
4. 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 needs not to be indicated.
5. There is a single list of accounting policies which are applicable to all circumstances

**Q.ASI.RMP.05: (EXAM Nov18) (MTP May21 & May22)**

HIL Ltd. was making provision for non-moving stocks based on no issues having occurred for the last 12 months upto 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:

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

**Q.ASI.RMP.06: (Exam May23)**

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.

**Q.ASI.SM.07:**

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

- (i) 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.
- (ii) If fundamental accounting assumptions are not followed in presentation and preparation of financial statements, a specific disclosure is not required.
- (iii) All significant accounting policies adopted in the preparation and presentation of financial statements should form part of the financial statements.
- (iv) 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.

## SOLUTIONS OF ABOVE QUESTIONS

### Solution Q1

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 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 i.e., 2014-15, 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 Rs 16,000.

### Solution Q2

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 is increased by ₹20 crores.
- (ii) In view of the heavy capital-intensive method of production introduced during the year, the company has decided to change the method of providing depreciation from reducing balance method to straight line method. As a result of this change, depreciation has been provided at ₹27 crores which is lower than the charge which would have been made had the old method and the old rates been applied, by ₹18 crores. To that extent, the profit for the year is increased.
- (iii) 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 ₹12 crores than would have been the case if the old policy were to continue.

The company has decided to provide ₹10 crores for the permanent fall 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.

**Solution Q3**

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 non-payment 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.

**Solution Q4**

a) 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 2019-20:

"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."

b)

1. **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.
2. **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.
3. **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.
4. **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.
5. **False;** 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.

**SOLUTION Q5**

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 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 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.”

**Solution Q6**

(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).

**SOLUTION Q7**

- (i) **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.
- (ii) **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.
- (iii) **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.