Accounting Policy

Accounting Principle
⇓
Inv : Cost / NRV → Lower

Apply karne ki methods.

Cost :- FIFO / WA

Considerations while selecting accounting policy

1) **Primary Consideration** :- True & fair View of financial statements

Eg:- If inventory is valued at cost / NRV → higher, profit that has not yet realised will get recognised.

If sale and repurchase transactions are recognised as revenue, then effectively a loan / finance agreement will be misrepresented as revenue.

2) **Other Considerations:** a) **Prudence**

Anticipated Profits ⟶ ×
Anticipated Losses ⟶ Recognised.

Eg :- Inventory if valued at higher of cost / NRV will defy prudence as anticipated income will get recognised.

b) **Substance over form** : Transactions recorded on the basis of actual substance and not merely on the basis of legal form.

Example 1 :-

"Finance Lease"

Lessor → Legal owner

Lessee → Substantially all risks & rewards

Asset will be recorded in the books of Lessee.

Example 2 :-

28.2 — Apartment purchase.

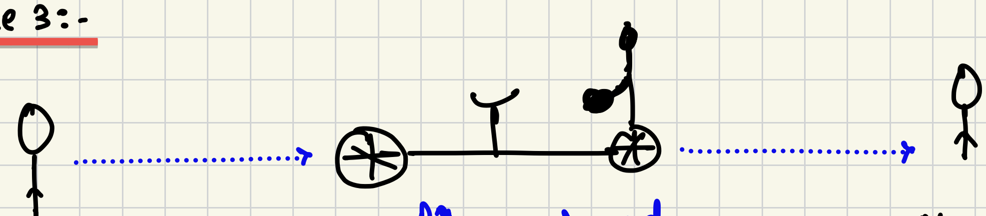
80% payment = 1crore
possession received
↓
Actual risks & rewards are with the purchaser.

31.3 → Apt. → Asset ?

Apt. will be recorded as an asset in the books of purchaser.

5.5 — "Legal Registry"

Example 3 :-



Mr.Hero.

Bike purchased
↓
Hire Purchase Transaction.

Mr. Zomato Delivery Guy.

Date of Purchase → Possession

Y1, Y2, Y3, Y4 — Installment Payment.

Y4 ↓ Legal Ownership transferred

to Mr. Zomato Delivery Guy.

from the date of purchase, the bike will appear as an asset in the books of Zomato Delivery Guy because he has all risks and rewards of ownership from the date of purchase.

c) Materiality : Accounting Policies applied on all material items in the financial statements should be disclosed.

Material :- Any information / amount that influence the decision of users of financial statements.

Disclosure of Accounting Policy

→ Financial Statements
→ One place

NOTE :- mere disclosure of Incorrect Accounting Policies at one place in the financial statements cannot be considered as a remedy for adopting incorrect accounting policies.

Change in Accounting Policy

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Disclosure in current Period

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Information to be disclosed

Impact in Current Period

→ Quantify impact in P&L and B/S

→ Quantification not possible : disclose fact that such change will have material impact in the current period.

Impact in later Periods

→ Disclose fact of change.

→ Such change will have impact in later period.

NOTE :- AS-5 talks about when an Accounting Policy can be changed.

AS-1 talks about the disclosures required once an Accounting Policy is changed.

Fundamental Accounting Assumption

If the below mentioned 3 FAAs are followed, then no separate disclosure is required.

If however, any one of the assumptions is not followed, then we will have to disclose the same.

FAA → CAG

Consistency :- All accounting policies are consistently followed from one period to another.

Accrual :- Financial Statements are prepared on accrual basis.

Incomes / Revenue / Gain → Recognise when realise though not necessarily in cash.

Expenses / Losses → Recognise when incurred. No need to wait for cash payment.

Going Concern :- Entity neither has need nor intention to discontinue its business in forseeable future.