



AS 1

Disclosure of Accounting Policies

Question 1

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:

- (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.

(MTP 5 Marks March '21, MTP 5 Marks April '22 & MTP 5 Marks April '23) (PYP Nov '18, 5 Marks, PYP 5 Marks Dec'21) (Same concept different figures- MTP 5 Marks Mar'23, RTP May'20 & Nov '23)

Answer 1

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.”

Question 2

State whether the following statements are 'True' or 'False' in line with the provisions of AS 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.

(v) There is no single list of accounting policies which are applicable to all circumstances.

(MTP 5 Marks April 21, Oct 19, Mar 22, May'20 & Oct '23, RTP 5 Marks May 20, PYP 5 Marks May '22, Old & New SM)

Answer 2

- (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 at 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 3

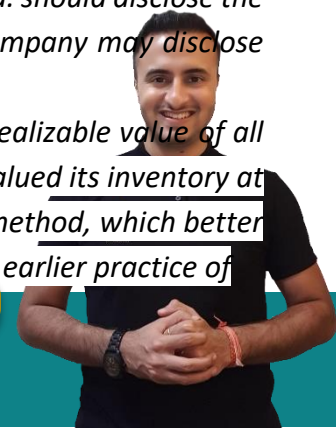
In the books of Rani Ltd., closing inventory as on 31.03.2020 amounts to ₹1,75,000 (valued based on FIFO method). The Company decides to change from FIFO method to weighted average method for ascertaining the costs of inventory from the year 2019-20. On the basis of weighted average method, closing inventory as on 31.03.2020 amounts to ₹1,59,000. Realizable value of the inventory as on 31.03.2020 amounts to ₹2,07,000. Discuss disclosure requirements of change in accounting policy as per AS 1.

(MTP Nov '21, 5 Marks, MTP Oct'18 5 Marks, RTP May 23, PYP 5 Marks Dec'21, Old & New SM)

Answer 3

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 Rani 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. 2019-20, 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 (1,75,000 – 1,59,000).”

Question 4

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 31 st 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

(MTP Apr'19, Aug'18, Oct'22 5 Marks)

Answer 4

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 5

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

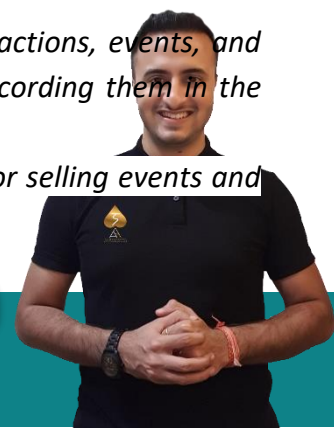
(PYP May'19, 5 Marks)

Answer 5

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 6

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.*** **(PYP 5 Marks May '23)**

Answer 6

- (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*
- (5) *statements (The director's report is not part of financial statements).*

