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. — 31.3 — 5.5

28.2 ↓ Apartment purchase.

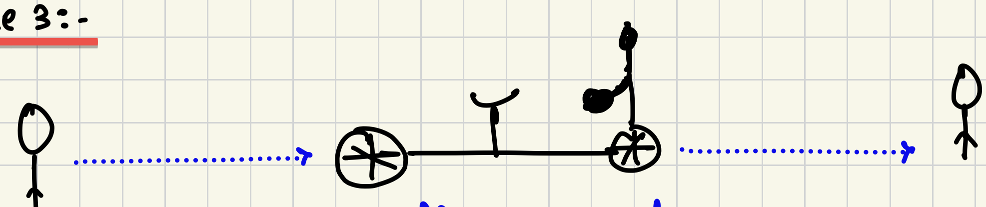
5.5 "Legal Registry"

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

31.3
↓
Aptt. → Asset ?

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

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
↓
Disclosure in current Period
↓
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.

DPQ , Question 4 :-

1) Contract Revenue to be recognised

Calculation of Stage of Completion

Stage of completion = $\dfrac{\text{Cost Incurred}}{\text{Total contract Costs}}$

$= \dfrac{\text{Work certified + Work uncertified}}{\text{Work cert + work uncerti + Estimated further costs}}$

$= \dfrac{250 + 80}{250 + 80 + 220}$

$= 60\%$

Contract Revenue to be recognised :- $500 \times 60\% = 300$

2) Calculation of profit loss to be recognised.

Contract revenue recognised = $500 \times 60\%$	=	300
Contract cost	=	330
Proportionate loss recognised	=	30
Total loss	=	50
Additional Provision for loss	=	20

3) Amount due from / to customer

= (Work Certified + Work uncertified − Total loss) − (Progress payment received + Progress payment receivable)

$= (250 + 80 - 50) - (200 + 70)$

$= 280 - 270$

$= 10$

	(₹ in lakhs)
Total cost of construction	*47.60*
Less: Total contract price	*(45.00)*
Total foreseeable loss to be recognized as expense	*2.60*

According to of AS 7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

Question 14 ⇒ Self Study

Rajendra undertook a contract ₹ 20,00,000 on an arrangement that 80% of the value of work done, as certified by the architect of the contractee should be paid immediately and that the remaining 20% be retained until the Contract was completed. In Year 1, the amounts expended were ₹ 8,60,000, the work was certified for ₹ 8,00,000 and 80% of this was paid as agreed. It was estimated that future expenditure to complete the Contract would be ₹ 10,00,000. In Year 2, the amounts expended were ₹ 4,75,000. Three-fourth of the work under contract was certified as done by December 31st and 80% of this was received accordingly. It was estimated that future expenditure to complete the Contract would be ₹ 4,00,000. In Year 3, the amounts expended were ₹ 3,10,000 and on June 30th, the whole Contract was completed. Show how Contract revenue would be recognized in the P & L A/c of Mr. Rajendra each year.

(PYP 5 Marks , Nov 20)(MTP 5 Marks Sep '23)

Answer 14

(a) Year 1	₹
Actual expenditure	*8,60,000*
Future estimated expenditure	*10,00,000*
Total Expenditure	*18,60,000*

Y1
SOC = 860000 / (860000 + 1000000) = 46.24%
Rev. Rec = 2000000 × 46.24% = 924800
Cost = 860000
Profit = 64800

% of work completed = 8,60,000/18,60,000 x 100 = 46.24%(Rounded off)

Revenue to be recognized (cumulative) = 20,00,000 x 76.95% = 15,39,000

Less: revenue recognized in Year 1 = (9,24,800)

Revenue to be recognized in Year 2 ₹ 6,14,200

Year 2	
Actual expenditure	*4,75,000*
Future Expenditure	*4,00,000*
Expenditure incurred in year 1	*8,60,000*
	17,35,000

Year 2 :- SOC :- (860000 + 475000) / (860000 + 475000 + 400000) = 1335000 / 1735000 = 76.95%

% of work completed= 4,75,000+8,60,000/ 17,35,000= 76.95%(Rounded off)

Revenue to be recognized (cumulative) = 20,00,000 ×76.95% = 15,39,000

Less: revenue recognized in Year 1 = (9,24,800) Revenue to be recognized in Year 1 = Rs. 6,14,200

Year 3

Whole contract got completed therefore total contract value less revenue recognized up to year 2 will be amount of revenue to be recognized in year 3 i.e. 20,00,000 – 15,39,000 (9,24,800 + 6,14,200) = ₹ 4,61,000. Note: Calendar year has been considered as accounting year.

CR = 2000000 × 76.95% = 1539000 − 924800 = 614200
CC = 1335000 − 860000 = 475000
P = 139200

Question 15, DPQ

	(₹000's)
Fixed Contract Price	35000
Work Certified	17500
Work not certified	3815

(Includes → 262500 materials issued out of which 140000 lying unsed at year end)

Estimated cost of completion	17325
Progress payment received	14000
Progress payment to be received	4900

Escation in cost by 8% and accordingly contract price is increased by 8%.

Solution :-

1) Contract Revenue to be recognised

Stage of Completion :- $\frac{\text{Cost Incurred}}{\text{Total Cost}} = \frac{17500 + (3815-140)}{17500+(3815-140)+17325} = \frac{21175}{38500}$

$= 55\%$

Contract Revenue Recognised $= (35000 + (8\% \times 35000)) \times 55\% = 20790$

2) Calculation of Profit / Loss to be recognised

a) Total Contract Revenue = 37800
b) Total Contract Cost = 38500
c) Total Loss = 700

i) Contract Revenue Recognised = 37800 × 55% = 20790
ii) Contract cost Incurred = 21175
iii) Proportionate Loss recognised = 385
iv) Total loss = 700
v) Additional provision for loss = 315

Calculation of amount due from / to customers

(Work Certified + work uncertified - Loss) − (Progress payment received + Progress payment receivable)

= (21175 − 700) − (14000 + 4900)

= 20475 − 18900

= 1575