AS-1: DISCLOSURE OF ACCOUNTING POLICIES

Objectives

- *Disclosure of significant accounting policies followed in preparing and presenting financial statements.*
- *Manner in which accounting policies are disclosed in financial statements*

Accounting Policies

Meaning	**These are:** → Specific accounting principles (Like AS 2 – Lower of Cost or NRV) and → Methods of applying those principles (Like AS 2 – FIFO or Weighted Average) adopted by the enterprise in the preparation & presentation of financial statements.
Notes	• There is no single list of accounting policies which are applicable to all circumstances. The differing circumstances in which the enterprises operate make alternative accounting policies acceptable. • Choice of the appropriate accounting policies in these specific circumstances of each enterprise requires considerable judgement by the management of the enterprise.

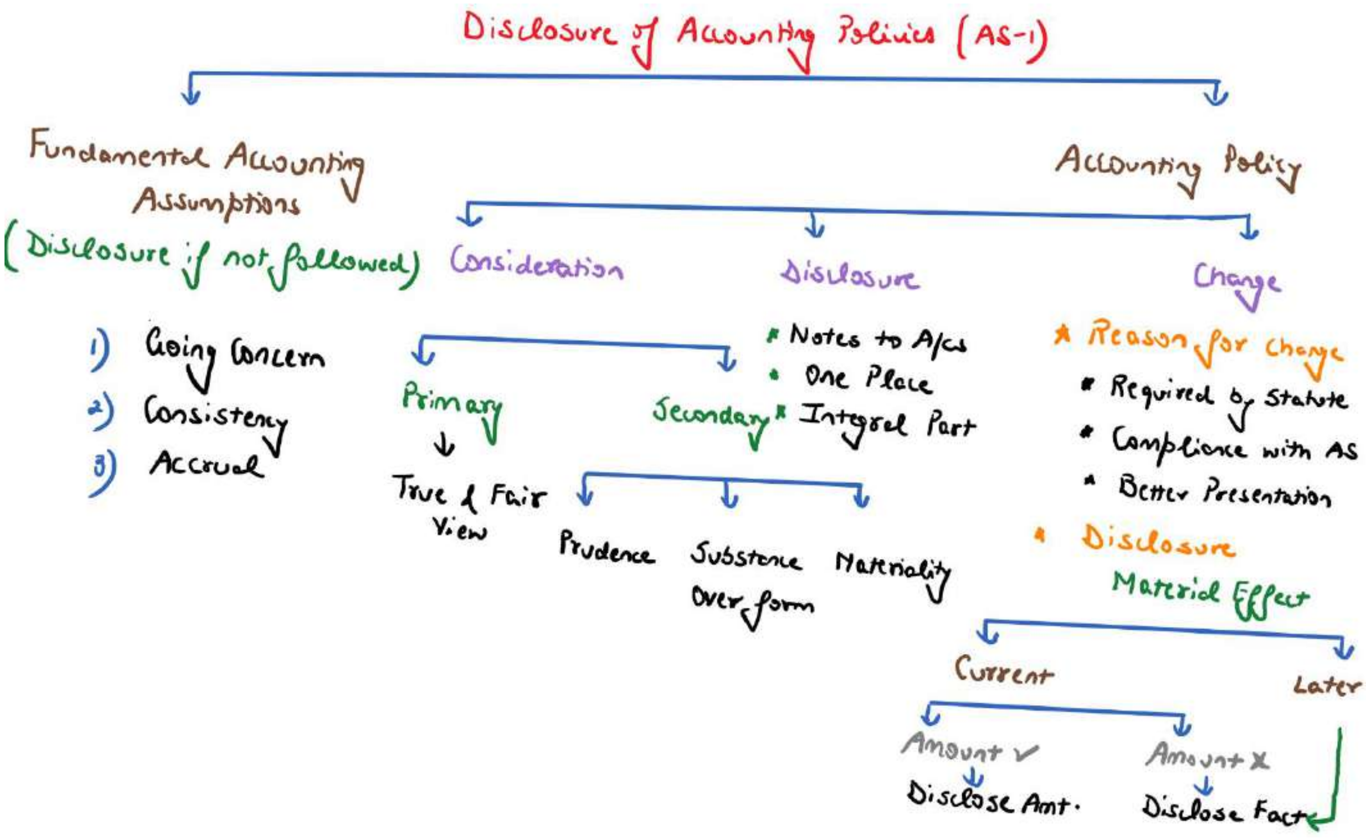
Fundamental Accounting Assumptions *(PARA 10)*

Name	***Going concern***	It is assumed that an enterprise will continue its operations in the foreseeable future and neither there is intention, nor there is need to materially curtail the scale of operations.
	Consistency	It is assumed that accounting policies are consistent from one period to another.
	Accrual	Under this basis of accounting, transactions are recognised as soon as they occur, whether or not cash or cash equivalent is actually received or paid.
Notes	• If the above said assumptions are followed in financial statements, specific disclosure is not required. • If a fundamental accounting assumption is not followed, the fact should be disclosed. • Disclosure is necessary if not followed.	

Considerations in the selection of Accounting Policies

Primary consideration	Financial statements should present true and fair view of → The state of affairs of the enterprise as at the balance sheet date and → The profit or loss for the period ended on that date	
Secondary consideration	**Prudence**	While recognizing the incomes, expenses and losses the principle of prudence should be followed. The income should be recognized only when it is certain to be received. (Profits are not anticipated) The provision should be created for all the known liabilities and losses.
	Substance over form	It implies that suitable changes may be made in the legal form of presentation to disclose the substance in a true and fair manner.
	Materiality	Any item of financial statements which can influence the decision of the user is termed as material item and all the material items should be disclosed in the financial statements

Disclosure of Accounting Policies	
Points to note	➢ All the accounting policies need to be disclosed at one place ➢ These should form an integral part of the financial statements. ➢ These are usually disclosed in "Notes to Accounts"
Examples (Areas in which different accounting policies may be adopted)	• Valuation of Inventory • Treatment of Goodwill • Valuation of Investment • Treatment of Retirement benefit • Valuation of Fixed assets • Treatment of Contingent liabilities. • Treatment of Expenditure during construction • Conversion or translation of Foreign currency items.
Change in an Accounting Policy *(PARA 26)*	
When change can be done?	Accounting policy may be changed only if → Required by Statute → For Compliance with an Accounting Standard → For better presentation or true and fair view of the financial statements
Points to note	• Any change in an accounting policy which has a material effect should be disclosed • The amount by which any item 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. • Any change in policy which does not affect the current period but can have material effect in the later periods, then such fact should be disclosed.
Disclosure requirements	• Old policy • New policy • Reason for change in policy • Impact of such change



Question 1

X Limited has sold its building for Rs. 50 lakhs to the purchaser who has paid the full price. Company has given possession to the purchaser. The book value of the building is Rs. 35 lakhs. As at 31st March, 2020, documentation and legal formalities are pending. The company has not recorded the sale. It has shown the amount received as advance. Do you agree with this accounting treatment done by X Ltd.? What accounting treatment should the buyer give in its financial statements?

Solution

Although legal title has not been transferred, the economic reality and substance is that the rights and beneficial interest in the immovable property have been transferred. Therefore, recording of disposal by the transferor would in substance represent the transaction entered into.

In view of this, X Ltd. should record the sales and recognize the profit of Rs. 15 lakhs in its Statement of Profit and Loss. It should remove building account from its balance sheet.

Further, in its 'Notes to Accounts', X Ltd. should disclose the following:

"Building has been sold and full consideration has been received and possession of the same has been handed over to the buyer. However, documentation and legal formalities are pending as on 31.3.2020."

The buyer should recognize the building as an asset in his balance sheet and charge depreciation on it. The buyer should disclose in his notes to account that possession has been received however documentation and legal formalities are pending.

Question 2

In the books of M/s Prashant Ltd. closing inventory as on 31.03.2021 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 2020-21. On the basis of weighted average method, closing inventory as on 31.03.2021 amounts to Rs. 1,47,000. Realisable value of the inventory as on 31.03.2021 amounts to Rs. 1,95,000.

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

Solution

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 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. 2020-21, 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'.

Question 3

HIL Ltd. was making provision for non-moving stocks based on no issues having occurred for the last 12 months upto 31.03.2020. The company now wants to make provision based on technical evaluation during the year ending 31.03.2021.

Total value of stock Rs. 120 lakhs

Provision required based on technical evaluation Rs. 3.00 lakhs.

Provision required based on 12 months no issues Rs. 4.00 lakhs.

You are requested 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?

Solution

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 2020-21 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 4

ABC Financial Services Ltd. is engaged in the business of financial services and is undergoing tight liquidity position, since most of the assets of the company are blocked in various claims/petitions in a Special Court. ABC Financial Services Ltd. 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 from the due date to date of repayment was mentioned in financial statements. On account of uncertainties existing regarding the determination of the amount and 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 as per relevant accounting Standard.

Solution

AS 1 recognizes '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 recognized only when realized 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.