AS 1: Disclosure of Accounting policies

IPCC Paper 1: Accounting Chapter 1 Unit 2

CA. Yagnesh Desai, FCA

Learning Objectives

In this chapter we will learn

What types of policies should an enterprise disclose.

It also mentions consideration in selection of accounting policies

Applicability

This standards was introduced in 1979

It is applicable to corporates as well all non corporate entities.

Introduction

- This statement deals with disclosure of significant accounting policies followed in preparing and presenting financial statements;

- ***Significance***:

➢ The accounting policies followed vary from enterprise to enterprise .

➢ Disclosure of significant accounting policies followed is necessary if the view presented is to be properly appreciated.

Introduction - 2

- In some cases the disclosures of accounting policies are required by law as well.

- The nature and degree of disclosures vary considerably between the corporate and non-corporate sectors and between units in the same sector.

- In some cases statement of accounting policies form part of accounts and in some cases it is given as supplementary information.

Fundamental Accounting Assumptions

1
- Going Concern

2
- Consistency &

3
- Accrual

4
- Since these are presumed - Only the deviation are to be disclosed

Assumption 1: Going Concern

- The enterprise is normally viewed as a going concern i.e. as continuing in operation for the foreseeable future – How Long ?

- It is assumed that the enterprise has neither the intention nor necessity of liquidation or of curtailing Materially the scale of operation.

Assumption 2: Consistency

- It is assumed that the accounting policies are consistent from one period to another.

- **Why is this assumption so important ??**

Because It enables better comparison of Financial Statements of different periods.

Assumption 3: Accrual

- Revenues and costs are accrued, i.e., recognised as they are earned or incurred and recorded in the financial statements of the periods to which they relate.

Areas in which different Accounting Policies vary.

Some examples areas in which different accounting policies may be adopted:

- ✓Methods of depreciation, depletion and amortisation.
- ✓Valuation of fixed assets
- ✓Valuation of inventories,
- ✓Treatment of goodwill
- ✓Valuation of investments

Considerations in selection of Policies

- Financial statements prepared on the basis of accounting policies should represent a true and fair view of the state of affairs of the enterprise as at the Balance Sheet date and that of results of operation for the period in the Statement of Profit & Loss.

1. Prudence

A sensible & careful attitude that makes you avoid unnecessary risks.

In view of inherent uncertainties and inadequate information about future

Profits are NOT anticipated but recognised only when they are realised,

Provision is made for all known liabilities and losses even though only an estimate can be made as it cannot be determined with certainty- probability plays an important role.

1. Prudence Ensures

Profits and assets are not overstated

Liability and losses are not understated

Well that does not mean that prudence helps create hidden reserves.

1. Prudence Example

Measuring closing inventory at lesser of cost or net realisable value

In case of construction contracts , recognising anticipated losses in full even if cost not accrued. In such cases, prudence overrides accruals

2. Substance Over Form

Transactions & Events should be accounted for and presented in accordance with

Their substance & financial reality

And **NOT** legal form

2. Substance over Form – Example.

For example, an enterprise sales goods Rs. 1,50,000 and concurrently agrees to buy back the same after one month for Rs. 1,55,000

This is more of financing arrangement under garb of sale and purchase agreement.

3. Materiality

- What do you understand by the term “Materiality” ?

Material Items mean items the knowledge of which might influence the decision of the users of the financial statements

- **All** material items should be disclosed in the financial statements.

- It is relative term, for example, Rs. one lakhs for an enterprise having turnover of Ten lakhs is materials as compared to enterprise having turnover of Rs. 1,000 crore.

3. Materiality – Nature & Magnitude

Materiality is NOT just governed by the size ,i.e, the magnitude, but also by the nature

A loss by fraudulent practices of certain employees can indicate a serious flaws in the enterprise’s internal control system requiring immediate attention , then loss by theft. In this case , materiality is governed by nature and not magnitude or the quantum

Disclosure of Change in Accounting Policies

One of the very vital disclosures is about Changes in accounting polices which has material effect in the current period or in later period.

Just the fact there is change in accounting polices is not enough.

The effect of changes should be discloses wherever ascertainable. If not ascertainable – the fact should be mentioned.

If the change in policies has no significant impact in current year , but material impact in future years ,the fact should be disclosed in the year of change.

Disclosures- CAUTION !

- Disclosure of accounting policies or of change therein CANNOT remedy a wrong or inappropriate treatment of the items in the accounts.

Disclosures

- All significant accounting policies adopted should be disclosed;
- Disclosures should form part of the financial statements, and should be disclosed at one place and not scattered.;

Disclosures

- The disclosures mentioned earlier are Minimum disclosure.
- Additional Disclosures can always be provided by an entity
- **E.G:**

In case of estimation of figures , disclosures may be provided regarding the assumptions made and method followed in determining the estimation (for example: Depreciation calculation : Straight line method or Reducing balance method)

Accounting Policy – Tata Steel

TATA STEEL

Hundred and fifth annual report 2011-12

NOTES TO BALANCE SHEET AND STATEMENT OF PROFIT AND LOSS

1. ACCOUNTING POLICIES

(a) Basis for Accounting

The financial statements are prepared under the historical cost convention on an accrual basis of accounting in accordance with the Generally Accepted Accounting Principles, Accounting Standards notified under Section 211(3C) of the Companies Act, 1956 and the relevant provisions thereof.

During the year, Revised Schedule VI notified under the Companies Act, 1956 has become applicable to the Company for preparation and presentation of its financial statements. The Company has reclassified the previous year figures in accordance with the requirements applicable in the current year.

(b) Revenue Recognition

(i) Revenue from sale of goods is recognised net of rebates and discounts on transfer of significant risks and rewards of ownership to the buyer. Sale of goods is recognised gross of excise duty but net of sales tax and value added tax.

(ii) Revenue from services rendered is recognised on pro-rata basis in proportion to the stage of completion of the related transaction.

(iii) Export incentive under various schemes notified by the Government has been recognised on the basis of credits afforded in the pass book/amount received.

(c) Employee Benefits

(i) Short-term employee benefits are recognised as an expense at the undiscounted amount in the Statement of Profit and Loss of the year in which the employee has rendered services.

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Loss of the year in which the employee has rendered services.

(ii) Post employment benefits are recognised as an expense in the Statement of Profit and Loss for the year in which the employee has rendered services. The expense is recognised at the present value of the amount payable towards contributions. The present value is determined using the market yields of government bonds, at the balance sheet date, as the discounting rate.

(iii) Other long-term employee benefits are recognised as an expense in the Statement of Profit and Loss for the year in which the employee has rendered services. Estimated liability on account of long-term benefits is discounted to the present value, using the market yield on government bonds, as on the date of balance sheet.

(iv) Actuarial gains and losses in respect of post employment and other long-term benefits are charged to the Statement of Profit and Loss.

(v) In respect of the Employee Separation Scheme, the increase in the net present value of the future liability for pension payable to employees, who have opted for retirement under the Employee Separation Scheme of the Company, is charged to the Statement of Profit and Loss.

(d) Tangible Assets

Tangible assets are stated at cost less accumulated depreciation and net of impairment, if any. Pre-operation expenses including trial run expenses (net of revenue) are capitalised. Borrowing costs during the period of construction is added to the cost of eligible tangible assets.

Blast Furnace relining is capitalised. The written down value of the asset consisting of lining/relining expenditure embedded in the cost of the furnace is written off in the year of fresh relining.

(e) Intangible Assets

Intangible assets are stated at cost less accumulated amortisation and net of impairments, if any. An intangible asset is recognised if it is probable that the expected future economic benefits that are attributable to the asset will flow to the Company and its cost can be measured reliably. Intangible assets having finite useful lives are amortised on a straight-line basis over their estimated useful lives.

(f) Depreciation and Amortisation

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(f) Depreciation and Amortisation

(i) Capital assets whose ownership does not vest with the Company are depreciated over their estimated useful life or five years, whichever is less.

(ii) In respect of other assets, depreciation is provided on a straight line basis applying the rates specified in Schedule XIV to the Companies Act, 1956 or rates based on estimated useful life whichever is higher. However, asset value upto ₹ 25,000 is fully depreciated in the year of acquisition. The details of estimated life for each category of asset are as under:

(a) Buildings and Roads — 30 to 62 years

(b) Plant and Machinery — 3 to 30 years

(c) Railway Sidings — 21 years

(d) Vehicles and Aircraft — 5 to 18 years

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(g) Impairment

Fixed assets are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable.

An impairment loss is recognised in the Statement of Profit and Loss if the carrying amount of an asset exceeds its recoverable amount.

(h) Foreign Currency Transactions

Foreign Currency Transactions (FCT) and forward exchange contracts entered into to hedge FCT are initially recognised at the spot rate on the date of the transaction/contract. Monetary assets and liabilities denominated in foreign currency and forward exchange contracts remaining unsettled at the end of the year are translated at year end rates.

The Company has elected to account for exchange differences arising on reporting of long-term foreign currency monetary items in accordance with Companies (Accounting Standards) Amendment Rules, 2009 pertaining to Accounting Standard 11 (AS-11) notified by Government of India on 31st March, 2009 (as amended on 29th December, 2011). Accordingly, the effect of exchange differences on foreign currency loans of the Company is accounted by addition or deduction to the cost of the assets so far it relates to depreciable capital assets and in other cases by transfer to "Foreign Currency Monetary Item Translation Difference Account" to be amortised over the balance period of the long-term monetary items.

The differences in translation and settlement of FCT and forward exchange contracts used to hedge FCT (excluding the long-term foreign currency monetary items accounted in line with Companies (Accounting Standards) Amendment Rules 2009 on Accounting Standard 11 notified by Government of India on 31st March, 2009 as amended on 29th December, 2011) are recognised in the Statement of Profit and Loss. The outstanding derivative contracts at the balance sheet date other than forward exchange contracts used to hedge FCT are valued by marking them to market and losses, if any, are recognised in the Statement of Profit and Loss.

Exchange differences relating to monetary items that are in substance forming part of the Company's net investment in non integral foreign operations are accumulated in Foreign Exchange Fluctuation Reserve Account.

(i) Investments

Long-term investments are carried at cost less provision for diminution other than temporary, if any, in value of such investments.

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Long-term investments are carried at cost less provision for diminution other than temporary, if any, in value of such investments. Current investments are carried at lower of cost and fair value.

(j) Inventories

Finished and semi-finished products produced and purchased by the Company are carried at lower of cost and net realisable value.

Work-in-progress is carried at lower of cost and net realisable value.

Coal, iron ore and other raw materials produced and purchased by the Company are carried at lower of cost and net realisable value.

Stores and spare parts are carried at cost. Necessary provision is made and charged to revenue in case of identified obsolete and non-moving items.

Cost of inventories is generally ascertained on the 'weighted average' basis. Work-in-progress and finished and semi-finished products are valued on full absorption cost basis.

(k) Relining Expenses

Relining expenses other than expenses on blast furnace relining are charged as an expense in the Statement of Profit and Loss in the year in which they are incurred.

(l) Research and Development

Research and Development costs (other than cost of fixed assets acquired) are charged as an expense in the Statement of Profit and Loss in the year in which they are incurred.

(m) Deferred Tax

Deferred Tax is accounted for by computing the tax effect of timing differences which arise during the year and reverse in subsequent periods.

Practice Tips

- Students must read the annual reports of the listed companies to get the clear idea of how different companies disclose the accounting polices.

- You should select the companies from different sectors like, banking, manufacturing, entertainment , software etc.

- This will also help you understand practical application of accounting standards.

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MCQ.

- As 1 is applicable to

- A) Only to Listed companies
- B) Only to Limited Companies
- C) To all enterprises , except Partnerships Firms
- D) To all enterprises

Questions

- Q.1 Give 5 Illustrations of the areas in which different accounting policies may be adopted by different enterprises.
- Q.2 Discuss the importance of accounting policies ?
- Q.3 Write a sample note on disclosure of accounting policies.

Don’t Waste time – Make the most of it.

Be

Determined

Discipline and

Dedicate – With Best Wishes