Provision for Non- Moving Stock

Question:
The management of Spsmiter Pvt. Ltd. wants to make a provision of the non moving stock based on the Technical evaluation. The company follows the principle of making the provision based on no issue for the last 12 months upto 31st March, 2010.

The following details are as under:

The value of stock	Rs. 55,99,500
Prov. Based on 12 months issue	Rs. 1,00,000
Prov. Based on Technical evaluation	Rs. 70,000

What is your opinion on the management decision and can it be treated as the change in the accounting policy ?

Ans:
As we know that as per Para 4 of AS 5 "(REVISED) NET PROFIT OR LOSS FOR THE PERIOD, PRIOR PERIOD ITEMS AND CHANGES IN ACCOUNTING POLICIES" the Accounting policies are the specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements.

The accounting policy may require for the making of provision on non-moving stock but the decision of the management for making provision based on technical evaluation does not amount to change in accounting policy. It is regarded as change in accounting estimates and the change in accounting estimates can be made in a case where more prudent estimate can be made.

Para 23 of AS 5 states that The effect of a change in an accounting estimate should be included in the determination of net profit or loss in :

(a) the period of the change; if the change affects the period only; or
(b) the period of the change and future periods, if the change affects both.

Sometimes, it is difficult to distinguish between a change in an accounting policy and a change in an accounting estimate. In such cases, the change is treated as a change in an accounting estimate, with appropriate disclosure (Para 22 of AS 5).

Thus in the given case, Spsmiter Pvt. Ltd. wants to provide Rs. 70,000 (Based on Technical Evaluation) as a provision for the non-moving stock instead of Rs. 1,00,000 (Based on 12 months issue) in the Profit and Loss account. For this change a disclosure should be made by way of "Notes to Account" in the Financial Statement for the year ended 31st March, 2011 in the following way:

"The company has provided for non-moving stocks on the basis of Technical Evaluation instead of on the basis of last 12 months issue as in the preceding years. Had the same method been followed as in the previous year, the profit for the year and the corresponding effect on the year end net assets would have been higher by Rs. 30,000."