# ACCOUNTING STANDARDS

# AS.1 DISCLOSURE OF ACCOUNTING POLICIES

1. **Meaning:**
   Accounting policy refers to specific accounting principles and methods of applying those principles in preparation and presentation of financial statements.

2. **Conditions to be satisfied for adopting accounting policy :**
   a) **Prudence :**
      - ✓ A (conservatism) probable loss is to be recognised but probable income is not to be recognised unless it is virtually certain.
      - ✓ Inventories are valued at cost or net realisable value whichever is lower.
      - ✓ Probable loss on completion of a contract is to be provided immediately.

   b) **Substance:**
      Is more important than form.
      Transactions and other events should be accounted for and presented in accordance with their substance and financial reality not merely with their legal form.
      Example: depreciation is allowed to the lessee even though he is not the owner.

   c) **Materiality:**
      - ✓ All material facts which are necessary are to be satisfied.
      - ✓ Facts which are not of material nature need not be disclosed separately.

3. **Why the standards are issued?**
   - ➢ Different enterprises are following different accounting policies .so we can't give meaning full comparison between enterprises.
   - ➢ All accounting policies must be disclosed.
   - ➢ They must be disclosed at one place instead of being scattered all over the pages.

4. **When separate discloser is not required?**

   If an enterprise adopt the following fundamental accounting assumptions separate disclosure that they are followed is not necessary.
   - ❖ **Going concern:**
     The enterprise is a continuing concern not to be liquidated nearby future.

   - ❖ **Consistency in policies :**
     The enterprise is following the same accounting policies from time to time
     i. When there is a statutory requirement.
     ii. Accounting standard requires.
     iii. For better preparation and presentation of financial statements.

   - ❖ **Accrual method:**
     Expenses and incomes are recognised as and when they are incurred irrespective of actual cash payments
     Example: outstanding incomes and expenses should be taken into account while preparing financial statements.

5. **Change in accounting policy :**
    - Any change in accounting policy should be disclosed.
    - The effect of such a change should be quantified.
    - If quantification is not possible the facts should be disclosed.
    - The change is to be disclosed in the year or years in which it has an impact on financial statements.

      **Example:** change in method of depreciation.
      Change in the method of valuation of inventories.

6. **Which enterprises the standards do not apply?**
   The standards do not apply to an enterprise which is not of a commercial nature (non-profit enterprise)
   For example: charitable institutions and cooperative societies etc.
   Note: it the enterprise has any part which is of a commercial nature the standards apply in total to the entire enterprise.

7. **Conflict:**
   When there is a conflict between an accounting standard and a statutory requirement then the statue will prevail over the accounting standard.
   For example: valuation of fixed assets when a loan is taken in foreign currency to purchase that fixed asset.

8. **Applicability of accounting standards :**
    1) Companies
    2) Other than companies

**1) Companies:**

Authority- NACAS (national advisory committee on accounting standards)

**<u>Non small & medium company (non SMC)</u>**

- ✓ Enterprises which are listed in stock exchange in India or outside India or in the process of listing.
- ✓ The companies are bank or financial institution or insurance company.
- ✓ The company turnover is more than 50 crores in the immediately preceding accounting year.
- ✓ The company have borrowings including public deposits exceeding 10 crores at any time during the immediately preceding accounting year.
- ✓ The company is a holding company or subsidy of non SMC.
- ✓ All accounting standards from 1 to 29 are applicable in full.

**<u>Small &medium company (SMC):</u>**

**Other than non SMC**

**<u>Application of accounting standards:</u>**

- Full exemption – AS 3,17
- Partial exemption- AS 15, 19,20,28,29.
- Not applicable due to legal reason – AS 21,23,25,27.
- Other are applicable in full

**2) <u>Other than companies :</u>**

Authority – ICAI

**Level – I**

- ✓ Enterprises which are listed in stock exchange in India or outside India or in the process of listing.
- ✓ The companies are banks including co-operative societies or financial institution or insurance company.
- ✓ The company turnover is more than 50 crores in the immediately preceding accounting year.
- ✓ The company have borrowings including public deposits exceeding 10 crores at any time during the immediately preceding accounting year.
- ✓ The company is a holding company or subsidy of non SMC.
- ✓ All accounting standards from 1 to 29 are applicable in full.

**Level -II**

- ✓ The companies turnover for the immediately preceding accounting period on the basis of audited financial statements exceeds 1 crores but does not exceed 50 crores. Turn over does not include other income.
- ✓ The company have borrowings including public deposits excess of 1 core but not excess of 10 crores at any time during the accounting period.
- ✓ Holding and subsidiary enterprises of any one of the above at any time during the accounting period.
- ✓

**Application of accounting standards:**

- Full exemption – AS 3,17
- Partial exemption- AS 15, 19,20,28,29.
- Not applicable due to legal reason – AS 21,23,25,27.
- Other are applicable in full

**Level –III**

Other than levels I and II

**Application of accounting standards:**

- Full exemption – AS 3,17,18,24
- Partial exemption- AS 15, 19,20,28,29.
- Not applicable due to legal reason – AS 21,23,25,27.
- Other are applicable in full

# AS.2 VALUATION OF INVENTORIES

1. **Meaning: Inventories are the asset which are held**
   - For sale in the ordinary course of business.
     E.g. finished goods
   - For use in the process of production.
     E.g. Raw material and work in process.
   - For rendering services to customers for.
     E.g. Stores and spare parts.

   **Notes:**
   - ✓ If enterprises have stock of supplies which is consumed on regular basis in the production process then valuation of specified item should be made as per provision of AS2.
   - ✓ If a stock of supplies is to be consumed in relation to specific fixed assets the valuation of specified item should not be covered under AS-2, but shall be dealt with AS-10.
2. **Classification of inventory and carrying amount**
   Inventories are classified as follows
   - Finished goods
   - Raw materials
   - Work in process
   - Stores
   - Spare parts.
3. **Exceptions:**
   The standard is not applicable to valuation of
   - Investments which are in stock in trade.
   - Work in process of construction contracts.
   - Work in process of service providers like banks, courier service etc.
   - Producers inventories valued at NRV e.g. forest products, mines, minerals, agriculture, livestock etc.
4. **Valuation of inventories**
   Measurement principle
   Inventories should be valued at **lower of**

   - Cost (purchase cost +conversion+othercost)
     Or
   - Net realisable value (selling price less cost of completion and, cost of sale)

5. **Determination of cost (cost includes following items)**

**(a) Direct material cost**

| | |
|---|---|
| Purchase price of the material | XXX |
| **Add:** freight inward | XXX |
| **Add:** loading charges | XXX |
| **Add:** taxes and duties paid | XXX |
| **Add:** any other expenses (related to purchase) | XXX |
| **Less:** trade discount | XXX |
| **Less:** duties and taxes recovered | XXX |
| **Total** | **XXX** |

**Note: Amount of cash discount should not be adjusted as it is related to payment to supplier and not to purchase of material.**

**(b) Direct labour cost**

Direct labour cost shall be ascertained by record from wages register or payroll sheet and should not be computed by any wages valuation method.

**(c) Factory overhead**

i. **Variable factory overhead**

Factory overhead of variable nature should be applied on the basis of number of units actually produced.

ii. **Fixed factory overhead**

Allocated to units on the basis of normal capacity of productions. But in periods abnormally high production fixed production overheads are to be allocated to each unit on the basis of actual production.

iii. **Allocation of joint cost**

- ✓ At the end of the process joint product or one main product and by product may result, though cost of conversion for each category of output may not be separately identifiable.
- ✓ Joint costs are to be apportioned to joint products on rational and consistent basis.
- ✓ E.g. on the basis of sales value at split of point but however the NRV of a by-product may be deducted from the total cost to arrive at the cost of main product.

**(d) Other cost**

I. **Certain costs are necessarily incurred**

To bring the inventory to its present location and condition. Such cost though not related to purchase, labour or overheads, can be taken as form part of cost i.e. cost of designing a product as per the requirement of customer order.

II. **Exclusion from the cost of inventory**

- ✓ Following expenses are charged in profit and loss account and included in cost of inventory.
- ✓ Cost related to abnormal material labour or other production costs with comparable characteristics.
  Shortage cost.
  Administration overhead cost.
  Selling and distribution cost, interest expense.

III. **Interest and inventory valuation**

Interest cost should not be forming part of inventory cost.

**As per AS-16, interest can be added with cost of inventor only of time is the major factor in bringing about a change in the condition.**

IV. **CENVAT credit and Excise duty vs. cost of inventory**

- ✓ Excise duty paid or payable is an element of cost, and should be include in valuation.
- ✓ Any amount recoverable from tax authorities by way of CENVAT credit will have to be excluded in the valuation of finished goods items.

**6. NET REALISABLE VALUE(NRV)**

**Meaning of NRV**

It is defined as the estimated selling price in the ordinary course of business less the estimated cost of completion and estimated cost necessary to make sale.

| | |
|---|---|
| Estimated sales value | XXX |
| Less: estimated further cost | XXX |
| Less: estimated selling expenses | XXX |
| **Net realisable value** | **XXX** |

## 7. Valuation of raw material

Materials and other supplies held for use in production of inventories need not be written down below their cost, if the selling price of the finished product containing those materials exceed the cost of the finished goods (SP>cost). But if the selling price is lower than cost (SP<cost), then those materials may be valued at their replacement price.

## 8. Contract of sale

- if and enterprise having closing stock which is covered by contract of sale then independent market price should not be considered for the valuation of closing stock.
- In case, enterprise is having any doubt in relation to maturity of the contract then provision of loss on valuation can be recorded on closing stock on the limit covered by contract of sale with reference to independent market price.

## 9. Valuation of empty bottle

Where enterprise takes possession of the empty bottles left behind by the customers at its bar, it constitutes an asset for the enterprise, being a resource controlled by the company as a result of past events which future economic benefits are expected to flow to it.

It is the nature or inventory as it is consumed in the production process (i.e. primary packing of beer).

Since the bottles are acquired by the company without incurring any cost, they should be capitalized at a nominal value of 1. Which is the value at which they should figure in the balance sheet, and should not be recognised as income.

**10. Valuation of empty drums/bags received along with materials**

if the amount is not material, these need not be reflected in the balance sheet if the amount is material , these should be disclosed separately under “current assets”, based on their net realisable value, empties are not covered under “inventories”.

**11. Cost formula**

- ✓ Inventories are purchased for **a special job** and which are **not inter changeable** are to be valued at **“special identification price”** i.e. price as which they are purchased.
- ✓ In **other cases** inventories are to be valued either on **FIFO method or weighted average method.**
- ✓ **Standard cost method** may be adopted if the cost fairly approximates to the actual cost.
- ✓ In retail business where a large number of rapidly changing items are traded **“retail price method or adjusted selling price method”** may be followed, when no other method can be adopted. In this method closing stock is valued at selling price (sales value) and from this estimated gross profit is deducted to arrive at the value of closing stock.

**12. Disclosure**

- ✓ Accounting policy for inventory valuation cost or NRV whichever is lower and the cost formula adopted for valuation FIFO or weighted average methods.
- ✓ Carrying amounts of inventories and their classification
  Finished goods, raw materials and work in process, stores and spare parts.

## <u>Some problem tricks</u>

- ✓ NPV>replacement value …………….> Raw material is **converted** to finished product.
  **Closing stock is valued cost or NRV whichever is lower**
- ✓ NPV<replacement value……………..> Raw material is **not converted** into finished product.
  **Closing stock is valued cost or replacement price whichever is lower.**

**<u>Partly finished goods</u>**

- ✓ If the goods are partially finished then it has no replacement price if NRV is + ve we can continue to the production.
  Closing stock is valued at cost or NRV whichever is lower.
- ✓ If NPV is – ve we cannot continue to the production.
  Closing stock is valued at zero.