Accounting Policies, Valuation Principles and Estimates

Accounting Policy

1. Principles
2. Methods of applying those principles
3. Based on concepts and conventions
4. Choice may depend on management judgement

Few Situations Where Different Policies are Followed

1. Valuation of inventory - ex: FIFO, LIFO, Weighted Average etc
2. Valuation of investment - cost or MP w.e.l
3. Depreciation – WDV, SLM, annuity method etc

How to Select?

Considerations:

1. prudence
2. substance over form
3. materiality

Investments

1. Short term:

these are valued at cost or MP w.e.l, 2 reasons:

- Prudence concept
- They may be sold in short run

2. Long term:

Valued at cost, and provision made for permanent diminution if necessary. Reason –

- Not sold in short run
- Prudence

Change in Accounting Policy

Can be made only under following 3 circumstances

1. Required by law
2. For compliance with an Accounting standard
3. For better presentation of FS / true a fair view

When the change is the, the impact on financial statements must be quantified and disclosed

EX:

	SLM		WDV
	YEAR 1		
Book value	1000		
Dep@10%	100		
Book value	900	change	900
dep@10%	100		90
book value	800		810

Thus, in year 2, when you shifted to WDV depreciation reduced, resulting in higher profit.

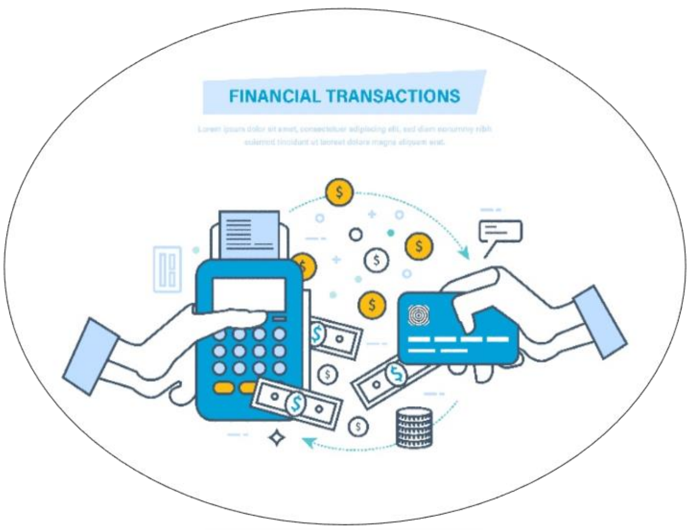
Measurement

Involves 3 elements

1. Identification
2. Selection of scale
3. Evaluation of measuring standard

What to Measure?

1. Financial events
2. Transactions
3. Objects of financial nature
4. Includes Items Relating to past, present or future



Measuring Scale????

What do we use to measure???

MONEY!!!!!

Limitations of Money as Measuring Scale

1. Not stable over time

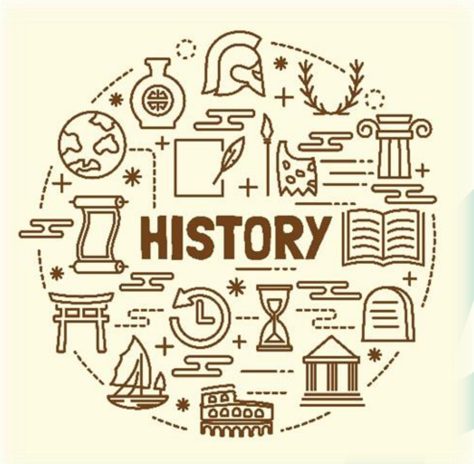
Limitations of Money as Measuring Scale

2. No universal application

Valuation Principles

1. Historical cost: Cost of acquiring

Ex: Assets = cost of asset+ DAC



2. Current Cost

Refers to the cost currently in the market.

i.e. the cost of purchasing the same or equivalent asset on the valuation date.

Ex: car purchased 3 years ago for ₹ 10 Lakh current cost for similar car is ₹ 12 lakh

3.Realisable Value

Recoverable amount if asset is currently sold in the market. In case of liabilities, settlement value is taken.

ex: Asset purchased 3 years ago for 10 Lakhs, if sold now will fetch ₹5 lakh.

4.Present Value

Discounted value of future cash inflows

What is discount????

= the rate at which money depreciates in value

$$\text{Present value} = \frac{\text{Future Value}}{(1+r)^N}$$

Where ‘r’ is discount rate and ‘n’ is number of years

Does Money Lose its Value??

Yes, it does,

Money may lose value due to <u>inflation,</u> but

Time Value of Money

- Deposit-10,000 in bank
- Interest rate is 7% p.a.
- Earn- ₹ 700 in a year, and so,

  future value = 10,700
- How?
- CI formula = $A \text{ (or } F) = P(1+R)^n$

  $= 10000(1+0.07)^1$

  $= 10,700$

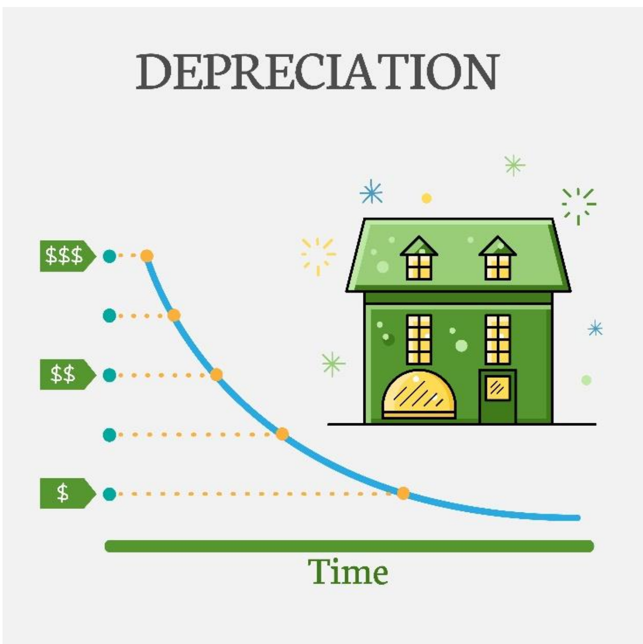
change the formula, $$P = \frac{A \text{ (or } F)}{(1+r)^N}$$

Present value technique - considers the interest which the amount would earn, if it had been invested and therefore discounts it at that rate.

In other words, TIME VALUE OF MONEY

Accounting Estimates

Items for which exact amount cannot be derived



Accounting Estimates

Ex: Depreciation, amortization, provision for Doubtful debts, accruals etc.