

TOPIC – 10
ACCOUNTING STANDARD - 5
“NET PROFIT OR LOSS FOR THE PERIOD, PRIOR
PERIOD ITEMS & CHANGE IN ACCOUNTING

TOTAL NO. OF QUESTIONS - 16

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SERIES 100 – ICAI STUDY MODULE QUESTIONS

Q.ASS.SM.101:

Fuel surcharge is billed by the State Electricity Board at provisional rates. Final bill for fuel surcharge of Rs. 5.30 lakhs for the period October, 20X1 to September, 20X7 has been received and paid in February, 20X8. However, the same was accounted in the year 20X8-X9. Comment on the accounting treatment done in the said case.



Q.ASS.SM.102:

- (i) During the year 20X1-20X2, a medium size manufacturing company wrote down its inventories to net realisable value by ₹ 5,00,000. Is a separate disclosure necessary?
- (ii) A company signed an agreement with the Employees Union on 1.9.20X2 for revision of wages with retrospective effect from 30.9.20X1. This would cost the company an additional liability of ₹ 5,00,000 per annum. Is a disclosure necessary for the amount paid in 20X2-X3?



Q.ASS.SM.103:

The company finds that the inventory sheets of 31.3.20X2 did not include two pages containing details of inventory worth Rs.14.5 lakhs. State, how you will deal with the following matters in the accounts of Omega Ltd. for the year ended 31st March, 20X3.



Q.ASS.SM.104: (Also in RTP May20)

Explain whether the following will constitute a change in accounting policy or not as per AS 5.

- I. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement.
- II. Management decided to pay pension to those employees who have retired after completing 5 years of service in the organisation. Such employees will get pension of Rs.20,000 per month. Earlier there was no such scheme of pension in the organisation.

**Q.ASS.SM.105**

In the current year, A Ltd. changed the depreciation method from the Straight Line Method (SLM) to Written Down Value (WDV) method. When A Ltd. recomputed depreciation retrospectively as per the new method, deficiency arose in depreciation in respect of past years. Therefore, it reduced the carrying amount of the asset by the amount of deficiency and such change in carrying amount (deficiency amount) has been debited to the statement of profit and loss as an extraordinary expense.

Whether the change in the carrying amount of assets due to the change in depreciation method should be treated as an extraordinary item?

**Q.ASS.SM.106**

A company (Z Ltd.) is engaged in the business of providing consultancy services. A few days back, it received a notice from GST department raising a demand of GST on consultancy services provided by it for Rs. 500,000. Recently Z Ltd. paid the demand. In the books, the payment is recorded as an extraordinary expenditure.

Whether payment of tax demand raised by the taxation authority can be recognised as an extraordinary item?



SOLUTIONS OF ABOVE QUESTIONS OF SERIES 100

ANSWER: Q101

The final bill having been paid in February, 20X8 should have been accounted for in the annual accounts of the company for the year ended 31st March, 20X8. However, it seems that as a result of error or omission in the preparation of the financial statements of prior period i.e., for the year ended 31st March 20X8, this material charge has arisen in the current period i.e., year ended 31st March, 20X9. Therefore it should be treated as 'Prior period item' as per AS 5. As per AS 5, prior period items are normally included in the determination of net profit or loss for the current period. An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss. In either case, the objective is to indicate the effect of such items on the current profit or loss.

It may be mentioned that it is an expense arising from the ordinary course of business. Although abnormal in amount or infrequent in occurrence, such an expense does not qualify an extraordinary item as per AS 5. For better understanding, the fact that power bill is accounted for at provisional rates billed by the state electricity board and final adjustment thereof is made as and when final bill is received may be mentioned as an accounting policy.

ANSWER: Q102

(i) Although the case under consideration does not relate to extraordinary item, but the nature and amount of such item may be relevant to users of financial statements in understanding the financial position and performance of an enterprise and in making projections about financial position and performance. AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies' states that:

"When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately."

Circumstances which may require separate disclosure of items of income and expense in accordance with AS 5 include the write-down of inventories to net realisable value as well as the reversal of such write-downs.

(ii) It is given that revision of wages took place on 1st September, 20X2 with retrospective effect from 30.9.20X1. Therefore wages payable for the half year from 1.10.20X1 to 31.3.20X2 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item. Additional wages liability of ₹ 7,50,000 (for 1½ years @ ₹ 5,00,000 per annum) should be included in current year's wages.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Such an expense does not qualify as an extraordinary item. However, as per AS 5, when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

ANSWER: Q103

AS 5 on 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', defines Prior Period items as "income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods".

Rectification of error in inventory valuation is a prior period item vide AS 5. Separate disclosure of this item as a prior period item is required as per AS 5.

ANSWER: Q104

As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy.

- I. Accordingly, introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is not a change in an accounting policy.
- II. Similarly, the adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial will not be treated as a change in an accounting policy.

Solution Q 105

As per AS 5, "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly.

A change in the method of charging depreciation is not an event that is clearly distinct from the ordinary activities of the entity. In the instant case, A Ltd. has changed the depreciation method and treated the reduction in carrying amount (or amount of deficiency in depreciation) of the asset as an extraordinary expense. This is not correct. Such deficiency should be treated as a normal expense.

A change in the estimated useful life of a depreciable asset (i.e. change in depreciation method) affects the depreciation in the current period and in each period during the remaining useful life of the asset. In both cases, the effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods, is recognised in future periods.

The change in depreciation method is considered as a change in accounting estimate as per the provisions of AS 5.

SOLUTION Q106

No, payment of tax cannot be recognised as an extraordinary item.

As per AS 5, "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" an extraordinary item is income or expenses that arise from events or transactions that are clearly distinct from ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly. In the given case, providing consultancy service is an ordinary activity of Z Ltd. Thus, GST paid pursuant to the demand raised by GST department is also a part of an ordinary activity of Z Ltd. Recognising such payments as an extra-ordinary item is contrary to AS 5.

SERIES 200 – QUESTIONS OF RTPs/MTPs/PAST EXAMS**Q.ASS.RMP.201:**

A limited company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 20X1-X2.

Subsequently on a review of the credit period allowed and financial capacity of customers, the company decided to increase the provision to 8% on debtors as on 31.3.20X2. The accounts of the company were not approved by the Board of Directors till the date of decision. While applying the relevant accounting standard can this revision be considered as an extraordinary item or Prior Period Item?

**Q.ASS.RMP.202: (RTP May18 & Nov22)**

Bela Ltd. has a vacant land measuring 20,000 sq. mts, which it had no intention to use in the future. The Company decided to sell the land to tide over its liquidity problems and made a profit of Rs 10 Lakhs by selling the said land. Moreover, there was a fire in the factory and a part of the unused factory shed valued at Rs 8 Lakhs was destroyed. The loss from fire was set off against the profit from sale of land and profit of Rs 2 lakhs was disclosed as net profit from sale of assets. You are required to examine the treatment and disclosure done by the company and advise the company in line with AS 5.

**Q.ASS.RMP.203: (RTP May19 + Old Course PM)**

Goods of Rs. 5,00,000/- were destroyed due to flood in September 2017. A claim was lodged with insurance company, but no entry was passed in the books for insurance claim.

In March, 2020, the claim was passed and the company received a payment of Rs. 3,50,000/- against the claim. Explain the treatment of such receipt in final accounts for the year ended 31st March, 2020.

**Q.ASS.RMP.204: (EXAM May22)**

TQ Cycles Ltd. is in the manufacturing of bicycles, a labor-intensive manufacturing sector. In April 2022, the Government enhanced the minimum wages payable to workers with retrospective effect from the 1st January, 2022. Due to this legislative change, the additional wages for the period from January 2022 to March 2022 amounted to Rs. 30 lakhs. The management asked



the Finance manager to charge Rs. 30 lakhs as prior period item while finalizing financial statements for the year 2022-23. Further, the Finance manager is of the view that this amount being abnormal should be disclosed as extra-ordinary item in the Profit and loss account for the financial year 2021-22. Discuss with reference to applicable Accounting Standards.

Q.ASS.RMP.205: (RTP Nov18, Nov19, May22 & MTP May20, Nov22) (EXAM Nov22)



The Accountant of Mobile Limited has sought your opinion with relevant reasons, whether the following transactions will be treated as change in Accounting Policy or not for the year ended 31st March, 2017. You are required to advise him in the following situations in accordance with the provisions of AS 5

- (i) Provision for doubtful debts was created @ 2% till 31st March, 2016. From the Financial year 2016-2017, the rate of provision has been changed to 3%.
- (ii) During the year ended 31st March, 2017, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.
- (iii) Till the previous year the furniture was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years.
- (iv) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of Rs. 20,000 per month. Earlier there was no such scheme of pension in the organization.
- (v) During the year ended 31st March, 2017, there was change in cost formula in measuring the cost of inventories.

Q.ASS.RMP.206: (MTP May21, May22)

A company created a provision of Rs. 7,50,000 for staff welfare while preparing the financial statements for the year 2020-21. On 31st March 2021, in a meeting with staff welfare association, it was decided to increase the amount of provision for staff welfare to Rs. 10,00,000. The accounts were approved by Board of Directors on 15th April, 2021.



You are required to explain the treatment of such revision in financial statements for the year ended 31st March 2021 in line with the provisions of AS 5?

Q.ASS.RMP.207: (RTP Nov21)

- a. There was a major theft of stores valued at Rs. 10 lakhs in the preceding year which was detected only during current financial year (2020-2021). How will you deal with this information in preparing the financial statements of R Ltd. for the year ended 31st March, 2021.
- b. Management decided to pay pension to those employees who have retired after completing 5 years of service in the organisation. Such employees will get pension of Rs. 20,000 per month. Earlier there was no such scheme of pension in the organization. Explain whether this will constitute a change in accounting policy or not as per AS 5.

Q.ASS.RMP.208: (EXAM Jan21) (RTP May23)

State whether the following items are an example of Change in Accounting policy / Change in Accounting Estimates / Extra-Ordinary Items / Prior Period Items / Ordinary Activity.

- i) Actual Bad Debts turning out to be more than provisions.
- ii) Change from Cost model to Revaluation model for Measurement of carrying amount of PPE.
- iii) Government grant receivable as compensation for expenses incurred in previous accounting period.
- iv) Treating Operating Lease as Finance Lease.
- v) Capitalisation of borrowing cost on working capital.
- vi) Legislative changes having long-term retrospective application.
- vii) Change in method of depreciation from straight line to WDV.
- viii) Government grant becoming refundable.
- ix) Applying 10% depreciation instead of 15% on furniture.
- x) Change in useful life of fixed asset.

Q.ASS.RMP.209: (RTP Jan'25)

During the course of the last three years, a company owning and operating Helicopters lost four Helicopters. The company's accountant felt that after the crash, the maintenance provision created in respect of the respective helicopters was no longer required, and proposed to write it back to the Profit and Loss account as a prior period item.

Is the company's proposed accounting treatment correct? Discuss.

Q.ASS.RMP.210: (RTP May'25)

The Accountant of Heera Ltd. has sought your opinion with relevant reasons, whether the following transactions will be treated as change in Accounting Policy or not for the year ended 31st March, 2024. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard;

- (i) Till the previous year the furniture was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years.
- (ii) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ` 20,000 per month. Earlier there was no such scheme of pension in the organization.
- (iii) During the year ended 31st March, 2024, there was change in cost formula in measuring the cost of inventories.

SOLUTIONS OF ABOVE QUESTIONS OF SERIES 200

ANSWER: Q201

As per para 21 of AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the preparation of financial statements involves making estimates which are based on the circumstances existing at the time when the financial statements are prepared. It may be necessary to revise an estimate in a subsequent period if there is a change in the circumstances on which the estimate was based. Revision of an estimate, by its nature, does not bring the adjustment within the definitions of a prior period item or an extraordinary item [para 21 of AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies].

In the given case, a limited company created 2.5% provision for doubtful debts for the year 20X1-20X2. Subsequently in 20X2 the company revised the estimates based on the changed circumstances and wants to create 8% provision. As per AS-5 (Revised), this change in estimate is neither a prior period item nor an extraordinary item.

However, as per para 27 of AS 5 (Revised), a change in accounting estimate which has material effect in the current period, should be disclosed and quantified. Any change in the accounting estimate which is expected to have a material effect in later periods should also be disclosed and quantified.

SOLUTION Q202

As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" Extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

In the given case the selling of land to tide over liquidation problems as well as fire in the Factory does not constitute ordinary activities of the Company. These items are distinct from the ordinary activities of the business. Both the events are material in nature and expected not to recur frequently or regularly. Thus, these are Extraordinary Items.

Therefore, in the given case, disclosing net profits by setting off fire losses against profit from sale of land is not correct. The profit on sale of land, and loss due to fire should be disclosed separately in the statement of profit and loss.

SOLUTION Q203

As per the provisions of AS 5 “Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies”, prior period items are income or expenses, which arise, in the current period as a result of error or omissions in the preparation of financial statements of one or more prior periods. Further, the nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on current profit or loss can be perceived.

In the given instance, it is clearly a case of error in preparation of financial statements for the year 2017-18. Hence, claim received in the financial year 2019-20 is a prior period item and should be separately disclosed in the statement of Profit and Loss.

Solution Q204

As per AS 5 “Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies” prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. The term does not include other adjustments necessitated by circumstances which though related to prior periods, are determined in the current period.

It is given that revision of wages took place in April, 2022 with retrospective effect from 1st January, 2022. Therefore, wages payable for the period from 1.01.2022 to 31.3.2022 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item. The full amount of wages payable to workers will be treated as an expense of current year and it will be charged to profit & loss account for the year 2022-23 as normal expenses.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Such an expense does not qualify as an extraordinary item. Therefore, finance manager is incorrect in treating increase as extraordinary item. However, as per AS 5, when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

Therefore, additional wages liability of Rs. 30 lakhs should be disclosed separately in the financial statements of TQ Cycles Ltd. for the year ended 31st March, 2023.

SOLUTION Q205

- (i) In the given case, Mobile limited created 2% provision for doubtful debts till 31st March, 2016. Subsequently in 2016-17, the company revised the estimates based on the changed circumstances and wants to create 3% provision. Thus, change in rate of provision of doubtful debt is change in estimate and is not change in accounting policy. This change will affect only current year.
- (ii) As per AS 5, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous policy, will not be treated as change in an accounting policy.
- (iii) Change in useful life of furniture from 5 years to 3 years is a change in estimate and is not a change in accounting policy.
- (iv) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is not a change in accounting policy.
- (v) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

ANSWER: Q206

As per AS 5 “Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies”, the change in amount of staff welfare provision amounting Rs. 2,50,000 is neither a prior period item nor an extraordinary item. It is a change in estimate, which has been occurred in the year 2020-21.

As per the provisions of the standard, normally, all items of income and expense which are recognized in a period are included in the determination of the net profit or loss for the period. This includes

extraordinary items and the effects of changes in accounting estimates. However, the effect of such change in accounting estimate should be classified using the same classification in the statement of profit and loss, as was used previously, for the estimate.

SOLUTION Q207

- (a) Due to major theft of stores in the preceding year (2019-2020) which was detected only during the current financial year (2020-2021), there was overstatement of closing inventory of stores in the preceding year. This must have also resulted in the overstatement of profits of previous year, brought forward to the current year. The adjustments are required to be made in the current year as 'Prior Period Items' as per AS 5 (Revised) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies. Accordingly, the adjustments relating to both opening inventory of the current year and profit brought forward from the previous year should be separately disclosed in the statement of profit and loss together with their nature and amount in a manner that their impact on the current profit or loss can be perceived. Alternatively, it may be assumed that in the preceding year, the value of inventory of stores as found out by physical verification of inventories was considered in the preparation of financial statements of the preceding year. In such a case, only the disclosure as to the theft and the resulting loss is required in the notes to the accounts for the current year i.e. year ended 31st March, 2021.
- (b) As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Accordingly, the adoption of a new accounting policy of paying pension to retired employees is a policy for events or transactions which did not occur previously. Hence, it will not be treated as a change in an accounting policy.

SOLUTION Q208

Classification of given items is as follows:

Sr. No.	Particulars	Remarks
(i)	Actual bad debts turning out to be more than provisions	Change in Accounting Estimates
(ii)	Change from Cost model to Revaluation model for measurement of carrying amount of PPE	Change in Accounting Policy
(iii)	Government grant receivable as compensation for expenses incurred in previous accounting period	Item of Ordinary Activity
(iv)	Treating operating lease as finance lease.	Prior- period Items
(v)	Capitalisation of borrowing cost on working capital	Prior-period Items (as interest on working capital loans is not eligible for capitalization)
(vi)	Legislative changes having long term retrospective application	Ordinary Activity
(vii)	Change in the method of depreciation from straight line to WDV	Change in Accounting Estimates
(viii)	Government grant becoming refundable	Extra -ordinary Items
(ix)	Applying 10% depreciation instead of 15% on furniture	Prior- period Items
(x)	Change in useful life of fixed assets	Change in Accounting Estimates

SOLUTION Q209

The balance amount of maintenance provision written back to profit and loss account, no longer required due to crash of the helicopters, is not a prior period item because there was no error in the preparation of previous periods' financial statements. The term 'prior period items', as defined in AS 5 (revised) "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", refer only to income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. The balance amount left in the provision created earlier is not as a result of error in the past. So it will not be considered as prior period item.

Such write back of provision is not an ordinary feature of the business, it shall be considered as an extra-ordinary item.

As per paragraph 8 of AS 5, extraordinary items should be disclosed in the Statement of Profit and Loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the Statement of Profit and Loss in a manner that its impact on current profit or loss can be perceived. Hence, the amount so written-back (if material) should be disclosed as an extraordinary item as per AS 5 rather than as prior period items.

SOLUTION Q210

- (i) Change in useful life of furniture from 5 years to 3 years is a change in estimate and is not a change in accounting policy.
- (ii) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is not a change in accounting policy.
- (iii) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.



Student Notes:-