



AS 5

Net Profit or Loss for the period, Prior period items & Changes in Accounting policies

Question 1

(Also includes concepts from AS 29-Provisions, Contingent Liabilities & Contingent Assets) EXOX Ltd. is in the process of finalizing its accounts for the year ended 31 st March, 2017. The company seeks your advice on the following:

- (i) The Company's sales tax assessment for assessment year 2014-15 has been completed on 14th February, 2017 with a demand of Rs. 2.76 crore. The company paid the entire due under protest without prejudice to its right of appeal. The Company files its appeal before the appellate authority wherein the grounds of appeal cover tax on additions made in the assessment order for a sum of 2.10 crore. (RTP May'21)*
- (ii) The Company has entered into a wage agreement in May, 2017 whereby the labour union has accepted a revision in wage from June, 2016. The agreement provided that the hike till May, 2017 will not be paid to the employees but will be settled to them at the time of retirement. The company agrees to deposit the arrears in Government Bonds by September, 2017.*

You required to examine and give suggestions in line with the relevant Accounting Standards.

(MTP 5 Marks April '19)

Answer 1

- (i) Since the company is not appealing against the addition of Rs. 0.66 crore the same should be provided for in its accounts for the year ended on 31st March, 2017. The amount paid under protest can be kept under the heading 'Loans & Advances' and disclosed along with the contingent liability of Rs. 2.10 crore.*
- (ii) The arrears for the period from June, 2016 to March, 2017 are required to be provided for in the accounts of the company for the year ended on 31st March, 2017.*

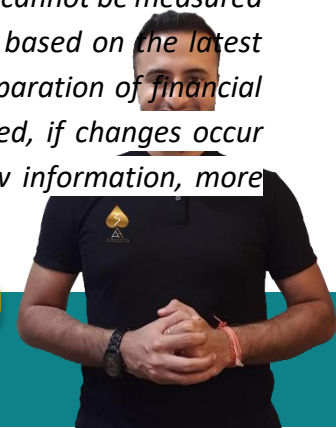
Question 2

S.T.B. Ltd. makes provision for expenses amounting Rs. 7,00,000 as on March 31, 2020, but the actual expenses during the year ending March 31, 2021 comes to Rs. 9,00,000 against provision made during the last year. State with reasons whether difference of Rs. 2,00,000 is to be treated as prior period item as per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'.

(MTP 5 Marks April 21)

Answer 2

As per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', as a result of the uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated. The estimation process involves judgments based on the latest information available. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. Estimates may have to be revised, if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments.



As per the standard, the effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate. 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. Thus, revision of an estimate by its nature i.e. the difference of Rs. 2 lakhs, is not a prior period item. Therefore, in the given case expenses amounting Rs. 2,00,000 (i.e. Rs. 9,00,000 – Rs. 7,00,000) recorded in the current year, should not be regarded as prior period item.

Question 3

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?

(MTP 4 Marks March 21, MTP 5 Marks April 22)

Answer 3

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.

Question 4

The accountant of a company has sought your opinion with relevant reasons, whether the following will be treated as change in Accounting Policy or not for the year ended 31st March, 2020. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard;

- (i) Provision for doubtful debts was created @ 2% till 31st March, 2019. From the Financial year 2019 - 2020, the rate of provision has been changed to 3%.**
- (ii) During the year ended 31st March, 2020, 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, 2020, there was change in cost formula in measuring the cost of inventories. (MTP 5 Marks Oct'19, May'20, Mar'19, Oct'18, Old & New SM, RTP May 22, RTP Nov 18, RTP Nov 19, RTP Nov '20, RTP May'20, PYP 5 Marks Nov'22)**





Answer 4

- (i) *In the given case, company has created 2% provision for doubtful debts till 31st March, 2019. Subsequently in 2019-20, 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.*

Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

Question 5

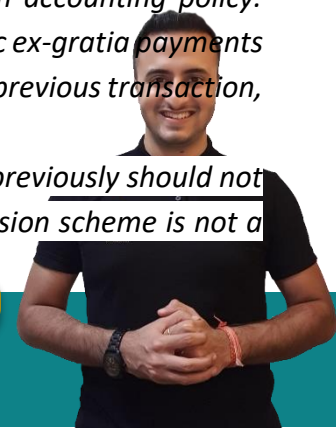
The management of Pluto Limited has sought your opinion with relevant reasons, whether the following transactions will be treated as changes in Accounting Policy or not for the year ended 31st March, 2021. Please advise them in the following situations in accordance with the provisions of Accounting Standard 5:

- (i) During the year ended 31st March, 2021; the management has introduced a formal retirement gratuity scheme in place of ad-hoc ex-gratia payments to its employees on retirement.***
- (ii) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees would receive a pension of ₹ 25,000 per month. Earlier there was no such scheme of pension in the organization.***
- (iii) Provision for doubtful Trade Receivables was created @2.5% till 31 st March, 2020. From 1st April,2020, the rate of provision has been changed to 5%***
- (iv) For the year ended 31st March,2021 there was change in the cost formula in measuring the cost of Inventories.***
- (v) Till the end of the previous year, Computers were depreciated on Straight Line Basis over a period of 5 years. From current year, the useful life of Computers has been changed to 3 years.***

(MTP 5 Marks Oct'22)

Answer 5

- (i) *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 transaction, will not be treated as change in an 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) *In the given case, company has created 2.5 % provision for doubtful debts till 31st March, 2020. Subsequently from 1st April, 2020, the company revised the estimates based on the changed circumstances and wants to create 5% 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.*
- (iv) *Change in cost formula used in measurement of cost of inventories is a change in accounting policy.*
- (v) *Change in useful life of computers from 5 years to 3 years is a change in estimate and is not a change in accounting policy.*

Question 6

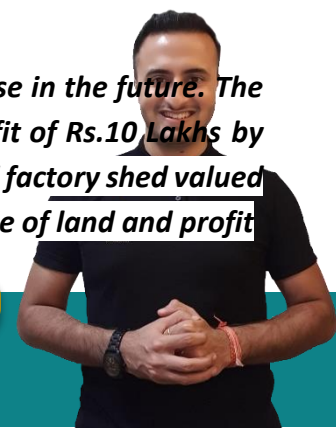
- a) ***There was a major theft of stores valued at Rs. 10 lakhs in the preceding year which was detected only during current financial year (2020-2021). How will you deal with this information in preparing the financial statements of R Ltd. for the year ended 31st March, 2021. (RTP Nov 21)***
- b) ***Management 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. Explain whether this will constitute a change in accounting policy or not as per AS 5. (RTP Nov 21, May 20)***

Answer 6

- 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.*

Question 7

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 were 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. (RTP May 18 & Nov 22)

Question 7

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.

Question 8

State whether the following items are examples of change in Accounting Policy / Change in Accounting Estimates / Extraordinary 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) Capitalization of borrowing cost on working capital.
- (vi) Legislative changes having long term retrospective application.
- (vii) Change in the 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 assets. (RTP May '23, PYP 5 Marks Jan 21)

Question 8

Classification of given items is as follows:

S.N	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	Extra -ordinary Items
(iv)	Treating operating lease as finance lease.	Prior- period Items
(v)	Capitalization 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

Question 9

As per the provisions of AS-5, extraordinary items should not be disclosed in the statement of profit and loss as a part of net profit or loss for the period. (PYP 1 Mark, May 19)

Question 9

False: 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.

Question 10

PQR Ltd. is in the process of finalizing its accounts for the year ended 31 st March, 2018. The company seeks your advice on the following:

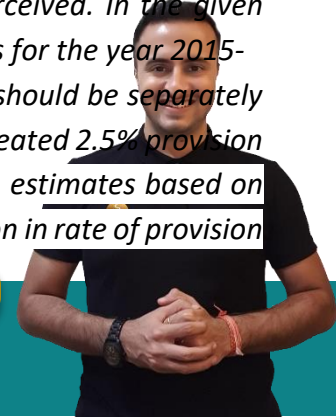
- (i) Goods worth ₹5,00,000 were destroyed due to flood in September, 2015. A claim was lodged with insurance company. But no entry was passed in the books for insurance claim in the financial year 2015-16. In March, 2018, the claim was passed and the company received a payment of ₹3,50,000 against the claim. Explain the treatment of such receipt in final account for the year ended 31 st March, 2018.
- (ii) Company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2017-18.

Subsequently, on a review of the credit period allowed and financial capacity of the customers, the company decides to increase the provision to 8% on debtors as on 31.03.2018. The accounts 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 extra-ordinary item or prior period item?

(PYP 5 Marks, May 18, RTP May 19)

Question 10

- (i) 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/omission in preparation of financial statements for the year 2015-
- (ii) 16. Hence, claim received in the financial year 2017- 18 is a prior period item and should be separately disclosed in the statement of Profit and Loss. In the given case, a limited company created 2.5% provision for doubtful debts for the year 2017-2018. Subsequently, the company revised the estimates based on the changed circumstances and wants to create 8% provision. As per AS 5, the revision in rate of provision



for doubtful debts will be considered as change in estimate and is neither a prior period item nor an extraordinary item. The effect of such change should be shown in the profit and loss account for the year ending 31st March, 2018.

Question 11

TQ Cycles Ltd. is in the manufacturing of bicycles, a labour-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 ₹ 30 lakhs. The management asked the Finance manager to charge ₹ 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.

(PYP 5 Marks May'22)

Question 11

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 ₹ 30 lakhs should be disclosed separately in the financial statements of TQ Cycles Ltd. for the year ended 31st March, 2023.

