**Accounting Standard-5**

**Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies**

The standard prescribes classification and disclosure of certain items in the profit and loss such that all enterprises prepare and present accounts uniformly. It is applied by enterprises presenting profit or loss from ordinary activities, extraordinary items and prior period items, in accounting for changes in accounting estimates and in disclosure of changes in accounting policies.

The disclosures as per this standard are in addition to any other disclosure required by other Accounting Standards. The tax implications of extraordinary items, prior period items, changes in accounting estimates and changes in accounting policies are not dealt with by this standard.

*Ordinary activities* are those transactions undertaken by an enterprise in its normal course of business. It also includes those transactions that are incidental to the main transaction. When profit and loss accounts are prepared for a period, transactions from ordinary activities are reported. However certain reported transactions require a separate disclosure for better understanding. Examples of such transactions are disposal of fixed assets, disposal of investments, litigation settlements or reversal of earlier provisions.

*Extraordinary items* are transactions that do not occur in the normal course of business. An example of extraordinary gain may be unexpected additional gain on sale of a unit of the enterprise.

Extraordinary items are not common to all enterprises. The nature of a transaction will determine whether the same will be an ordinary or an extraordinary transaction. A particular transaction may be ordinary for one enterprise but extraordinary for the other. Loss of goods due to floods will qualify as an extraordinary transaction but insurance claim received on the same by virtue of risk being insured may not qualify as an extraordinary transaction.

Transactions resulting due to errors or omissions of earlier accounting periods and having an impact in the current period are *prior period items.* This excludes transactions that are necessitated due to circumstances. Let us take the example of pay revisions that happen in Government organisations. The pay revision when notified is normally with retrospective effect. Payment of such arrears in salaries and wages is not a prior period transaction. Further a transaction which could not be estimated earlier, treated as a contingent transaction and reported more accurately in a later period will not qualify as a prior period transaction.

Mathematical errors or incorrect accounting treatments can occur while preparing accounts. Sometimes such transactions may be overlooked even during audit. Correction of such transactions in later years would amount to a prior period adjustment.

Whatever be the case, a prior period item should be distinguished and separate disclosure given in the profit and loss account.

*Accounting policies* are principles adopted by an enterprise in preparation of its financial statements. In any business there are inherent uncertainties and as a result many financial transactions cannot be accurately measured. Judgement is used in estimation based on latest information available.

Accounting estimates are used commonly for determining useful life of an asset or segregating obsolete stock. However, estimates made in financial transactions may become more accurate in later periods. Sometimes it becomes difficult to judge the difference between an accounting estimate and change in accounting policy. In such cases a change is treated as an accounting estimate and appropriate disclosures made. The change is reported under the head in which the original entry was or is intended to be reported. An estimate that has a material effect on the accounts in the current period or future should be disclosed separately.

A change in accounting policy is not done regularly. A change is usually triggered by a change in a statute or in compliance with a standard or when it is felt that the change results in a more appropriate presentation of the accounts. A more appropriate presentation of accounts is when the information on its profitability, asset and liability position or cash flow becomes more reliable. An enterprise following a ‘pay as you go’ basis for retirement benefits like gratuity may introduce a formal retirement plan. Such a plan will not amount to a change in accounting policy. A policy or method adopted for the first time is not a change.

When the full impact of a change in accounting policy is not known initially, the same should be disclosed in the accounts. Again when the change in accounting policy has an impact in later years, a disclosure to the effect is mandatory.

To conclude, items in the net profit or loss for a period should be classified and disclosed such that accounts of all enterprises are uniform. This is applicable for ordinary activities, extraordinary items, prior period items and in accounting for changes in accounting estimates and policies.

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