DEPARTMENT OF COMMERCE
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CORE CONCEPT OF FINANCIAL ACCOUNTING

implication which are likely to have influence on the decision making should be disclosed properly. For example, expenses which account for 1 per cent of total revenue of the company or ₹5,000, whichever is higher should be disclosed in the income statements under separate heading so as to facilitate control and analysis. Similarly, purchase item may be shown in one account as consolidated amount but the items which account for about 10 per cent or more of the total material consumed should be shown separately.

Valuation of Inventory — AS 2

The closing inventory, i.e. unsold as well as unused goods are the asset of the business enterprise at the end of the year likely to generate economic benefits in the next year. This includes stock of raw material, work-in-process and finished goods. The closing stock of one year becomes the opening stock of next financial year and to be shown as an expense in the next financial year. Therefore, closing stock affects calculation of profit and valuation of assets for two consecutive financial years. Its valuation should be done appropriately and mechanism of valuation should be disclosed properly.

Contingencies and Events Occurring after the Balance Sheet Date — AS 4

Balance sheet is presented at the end of accounting year, but publication of balance sheet along with income statement is made at a later date in the annual report. The annual report contains certain more facts like director's report, auditor's report, business progress, future scenario and other related facts. These are the facts, which help in easy understanding of financial statements. There are certain events, which take place after the balance sheet date but before the date of presentation of such balance sheet. These events certainly have a bearing on the financial results as well as on the status of assets and liabilities as depicted in the financial statements. The events occurring after the balance sheet date are classified as follows:

- Contingencies (contingent events)
- Adjusting events
- Non-adjusting events

Contingencies are such incidences/items, which are not certain and outcome of these completely depend upon certain future outcome/decision. This may be a court case pending decision against the business enterprise. Such outcome/decision if goes against the company then the profits, assets and liabilities as stated in the financial statements might get affected adversely. As these items are contingent and cannot be shown in the financial statements but these certainly have a bearing on the financial results as depicted in the financial statements. This accounting standard requires that these contingent items should be disclosed properly in the annexures forming the part of annual report. Such disclosure facilitates proper interpretation of the financial results.

Adjusting events are such activities which take place after the balance sheet date and there is a sufficient evidence of their existence as on balance sheet date but could not be noticed and recorded in the books of accounts on balance sheet date. These are like:

(i) Certain dues from customers becoming bad debts just after the balance sheet date and there is a significant evidence about it becoming bad debts on the date of balance sheet but could not be provided for in the financial statements.

(ii) Wrong valuation of inventory due to some error or lack of sufficient information on the date of balance sheet and there is significant evidence that the error existed on the balance sheet date.

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(iii) Error in reporting foreign exchange income and there is significant evidence about it that such error existed on the date of balance sheet.

All these adjusting events have an impact on the financial results as depicted in the financial statements; hence require an adjustment in the financial statements.

Non-adjusting events are the events, which occur after the balance sheet date and there is not significant evidence about its existence on the balance sheet. These items do not have an impact on the financial results of the even date; therefore they do not require any adjustment in the financial statement. Still these events make significant impact on the financial results of the future; therefore their impact should be disclosed in director's report forming the part of annual report. For example, certain assets damaged due to fire but after the balance sheet date and is likely to impair operating activities for the next accounting year. This may certainly be a concern for the decision makers/ stakeholders; therefore it should be disclosed in the annual report. Being non-adjusting events these are not shown in the financial statements.

Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies — AS 5

The financial implications of monetary transactions relating to the calculation of profit/loss for the accounting year differ with regard to their practical implication. Different items considered while arriving at the profit/loss for the accounting year are classified as regular, rare, prior period items, adjusting items and items relating to changes in accounting policies. These items may be regarding revenue/profit or expenses/losses. Out of these, only regular items are the one which are expected to be repeated not only in the next accounting year but in the years to come also. On the contrary, rest of the items is not expected to be repeated again and again. The provisions of this accounting standard provide that the income statement should disclose all these items distinctly in the income statements (Trading Account and Profit & Loss Account) so as to facilitate easy understanding of the financial statements and make the comparison meaningful. Accordingly different revenue and expense items should be classified as (i) ordinary (ii) ordinary but exceptional (iii) extra-ordinary (iv) prior period items (v) changes in accounting policies. The aim of such classification and disclosure in the financial statement is to provide a clear view about the special nature of different items.

The ***ordinary items*** are the one, which relate to the regular course of business activities or are incidental to the business activities. These items are expected to continue in the future also and support the regularity of income in the future also. Items of ordinary and routine activities but are exceptional due to their size/incidence or magnitude should be disclosed distinctly as ***ordinary but exceptional*** items so that the impact of these is clearly interpreted and analysed. The revenue and expenses, which arise from non-routine activities, are called ***extraordinary items***, as these are non-recurring in nature, therefore these items should be presented in the financial statements clearly and distinctly so that one can have clear interpretation about the financial results of the company. ***Prior period items*** are the one which are shown in the current year's financial statements as a result of an error in preparing financial statements of one or more prior financial years. The impact of these items should be shown under a separate heading so that one can make clear interpretation about the financial result of the current accounting year. ***Changes in accounting policies*** like changes in making provision for doubtful debts, changes in method of inventory valuation, etc. are the related items affecting the presentation of profit for the year.

The provisions of AS 5 require that the monetary implication of these items should be disclosed properly in the financial statements.