
**STATUTORY BOARD FINANCIAL
REPORTING STANDARD**

SB-FRS 8

**Accounting Policies, Changes in Accounting
Estimates and Errors**

SB-FRS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* was operative for Statutory Boards' financial statements for annual periods beginning on or after 1 January 2004.

This Standard is equivalent to FRS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* issued by the Council on Corporate Disclosure and Governance on 6 September 2004.

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Statutory Board Financial Reporting Standard 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (SB-FRS 8) is set out in paragraphs 1-56 and the Appendix. All the paragraphs have equal authority. SB-FRS 8 should be read in the context of its objective, the *Preface to Statutory Board Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*.

STATUTORY BOARD FINANCIAL REPORTING STANDARD SB-FRS 8

Accounting Policies, Changes in Accounting Estimates and Errors

Objective

1. The objective of this Standard is to prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors. The Standard is intended to enhance the relevance and reliability of an entity's financial statements, and the comparability of those financial statements over time and with the financial statements of other entities.
2. Disclosure requirements for accounting policies, except those for changes in accounting policies, are set out in SB-FRS 1 *Presentation of Financial Statements*.

Scope

3. ***This Standard shall be applied in selecting and applying accounting policies, and accounting for changes in accounting policies, changes in accounting estimates and corrections of prior period errors.***
4. The tax effects of corrections of prior period errors and of retrospective adjustments made to apply changes in accounting policies are accounted for and disclosed in accordance with SB-FRS 12 *Income Taxes*.

Definitions

5. ***The following terms are used in this Standard with the meanings specified:***

Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.

Statutory Board Financial Reporting Standards (SB-FRSs) are Standards and Interpretations adopted by the Accountant-General. They comprise:

- (a) ***Statutory Board Financial Reporting Standards; and***
- (b) ***Interpretations of Statutory Board Financial Reporting Standards.***

Material Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

- (a) was available when financial statements for those periods were authorised for issue; and
- (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

Retrospective application is applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.

Retrospective restatement is correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.

Impracticable Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:

- (a) the effects of the retrospective application or retrospective restatement are not determinable;
- (b) the retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or
- (c) the retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:
 - (i) provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognised, measured or disclosed; and
 - (ii) would have been available when the financial statements for that prior period were authorised for issuefrom other information.

Prospective application of a change in accounting policy and of recognising the effect of a change in an accounting estimate, respectively, are:

- (a) applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed; and
- (b) recognising the effect of the change in the accounting estimate in the current and future periods affected by the change.

6. Assessing whether an omission or misstatement could influence economic decisions of users, and so be material, requires consideration of the characteristics of those users. The *Framework for the Preparation and Presentation of Financial Statements* states in paragraph 21 that "users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence." Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making economic decisions.

Accounting Policies

Selection and Application of Accounting Policies

7. ***When a Standard or an Interpretation specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the Standard or Interpretation and considering any relevant Implementation Guidance issued by the CCDG for the Standard or Interpretation.***
8. SB-FRSs set out accounting policies that result in financial statements containing relevant and reliable information about the transactions, other events and conditions to which they apply. Those policies need not be applied when the effect of applying them is immaterial. However, it is inappropriate to make, or leave uncorrected, immaterial departures from SB-FRSs to achieve a particular presentation of an entity's financial position, financial performance or cash flows.
9. Implementation Guidance for Standards issued by the CCDG does not form part of those Standards, and therefore does not contain requirements for financial statements.
10. ***In the absence of a Standard or an Interpretation that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:***
 - (a) ***relevant to the economic decision-making needs of users; and***
 - (b) ***reliable, in that the financial statements:***
 - (i) ***represent faithfully the financial position, financial performance and cash flows of the entity;***
 - (ii) ***reflect the economic substance of transactions, other events and conditions, and not merely the legal form;***
 - (iii) ***are neutral, i.e. free from bias;***
 - (iv) ***are prudent; and***
 - (v) ***are complete in all material respects.***
11. ***In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order:***
 - (a) ***the requirements and guidance in Standards and Interpretations dealing with similar and related issues; and***
 - (b) ***the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.***
12. ***In making the judgement described in paragraph 10, management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 11.***

Consistency of Accounting Policies

13. ***An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless a Standard or an Interpretation specifically requires or permits categorisation of items for which different policies may be appropriate. If a Standard or an Interpretation requires or permits such categorisation, an appropriate accounting policy shall be selected and applied consistently to each category.***

Changes in Accounting Policies

14. ***An entity shall change an accounting policy only if the change:***

- (a) is required by a Standard or an Interpretation; or*
 - (b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.*
- 15. Users of financial statements need to be able to compare the financial statements of an entity over time to identify trends in its financial position, financial performance and cash flows. Therefore, the same accounting policies are applied within each period and from one period to the next unless a change in accounting policy meets one of the criteria in paragraph 14.
- 16. **The following are not changes in accounting policies:**
 - (a) the application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring; and*
 - (b) the application of a new accounting policy for transactions, other events or conditions that did not occur previously or were immaterial.*
- 17. **The initial application of a policy to revalue assets in accordance with SB-FRS 16 Property, Plant and Equipment or SB-FRS 38 Intangible Assets is a change in an accounting policy to be dealt with as a revaluation in accordance with SB-FRS 16 or SB-FRS 38, rather than in accordance with this Standard.**
- 18. Paragraphs 19-31 do not apply to the change in accounting policy described in paragraph 17.

Applying Changes in Accounting Policies

- 19. **Subject to paragraph 23:**
 - (a) an entity shall account for a change in accounting policy resulting from the initial application of a Standard or an Interpretation in accordance with the specific transitional provisions, if any, in that Standard or Interpretation; and*
 - (b) when an entity changes an accounting policy upon initial application of a Standard or an Interpretation that does not include specific transitional provisions applying to that change, or changes an accounting policy voluntarily, it shall apply the change retrospectively.*
- 20. For the purpose of this Standard, early application of a Standard or an Interpretation is not a voluntary change in accounting policy.
- 21. In the absence of a Standard or an Interpretation that specifically applies to a transaction, other event or condition, management may, in accordance with paragraph 12, apply an accounting policy from the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards. If, following an amendment of such a pronouncement, the entity chooses to change an accounting policy, that change is accounted for and disclosed as a voluntary change in accounting policy.

Retrospective application

- 22. **Subject to paragraph 23, when a change in accounting policy is applied retrospectively in accordance with paragraph 19(a) or (b), the entity shall adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.**

Limitations on retrospective application

- 23. **When retrospective application is required by paragraph 19(a) or (b), a change in accounting policy shall be applied retrospectively except to the extent that it is**

impracticable to determine either the period-specific effects or the cumulative effect of the change.

24. ***When it is impracticable to determine the period-specific effects of changing an accounting policy on comparative information for one or more prior periods presented, the entity shall apply the new accounting policy to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable, which may be the current period, and shall make a corresponding adjustment to the opening balance of each affected component of equity for that period.***
25. ***When it is impracticable to determine the cumulative effect, at the beginning of the current period, of applying a new accounting policy to all prior periods, the entity shall adjust the comparative information to apply the new accounting policy prospectively from the earliest date practicable.***
26. When an entity applies a new accounting policy retrospectively, it applies the new accounting policy to comparative information for prior periods as far back as is practicable. Retrospective application to a prior period is not practicable unless it is practicable to determine the cumulative effect on the amounts in both the opening and closing balance sheets for that period. The amount of the resulting adjustment relating to periods before those presented in the financial statements is made to the opening balance of each affected component of equity of the earliest prior period presented. Usually the adjustment is made to retained earnings. However, the adjustment may be made to another component of equity (for example, to comply with a Standard or an Interpretation). Any other information about prior periods, such as historical summaries of financial data, is also adjusted as far back as is practicable.
27. When it is impracticable for an entity to apply a new accounting policy retrospectively, because it cannot determine the cumulative effect of applying the policy to all prior periods, the entity, in accordance with paragraph 25, applies the new policy prospectively from the start of the earliest period practicable. It therefore disregards the portion of the cumulative adjustment to assets, liabilities and equity arising before that date. Changing an accounting policy is permitted even if it is impracticable to apply the policy prospectively for any prior period. Paragraphs 50-53 provide guidance on when it is impracticable to apply a new accounting policy to one or more prior periods.

Disclosure

28. ***When initial application of a Standard or an Interpretation has an effect on the current period or any prior period, would have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:***
- (a) the title of the Standard or Interpretation;***
 - (b) when applicable, that the change in accounting policy is made in accordance with its transitional provisions;***
 - (c) the nature of the change in accounting policy;***
 - (d) when applicable, a description of the transitional provisions;***
 - (e) when applicable, the transitional provisions that might have an effect on future periods;***
 - (f) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:***
 - (i) for each financial statement line item affected; and***
 - (ii) if SB-FRS 33 Earnings per Share applies to the entity, for basic and diluted earnings per share;***

- (g) *the amount of the adjustment relating to periods before those presented, to the extent practicable; and*
- (h) *if retrospective application required by paragraph 19(a) or (b) is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.*

Financial statements of subsequent periods need not repeat these disclosures.

29. *When a voluntary change in accounting policy has an effect on the current period or any prior period, would have an effect on that period except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:*

- (a) *the nature of the change in accounting policy;*
- (b) *the reasons why applying the new accounting policy provides reliable and more relevant information;*
- (c) *for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:*
 - (i) *for each financial statement line item affected; and*
 - (ii) *if SB-FRS 33 applies to the entity, for basic and diluted earnings per share;*
- (d) *the amount of the adjustment relating to periods before those presented, to the extent practicable; and*
- (e) *if retrospective application is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.*

Financial statements of subsequent periods need not repeat these disclosures.

30. *When an entity has not applied a new Standard or Interpretation that has been issued but is not yet effective, the entity shall disclose:*

- (a) *this fact; and*
- (b) *known or reasonably estimable information relevant to assessing the possible impact that application of the new Standard or Interpretation will have on the entity's financial statements in the period of initial application.*

31. In complying with paragraph 30, an entity considers disclosing:

- (a) the title of the new Standard or Interpretation;
- (b) the nature of the impending change or changes in accounting policy;
- (c) the date by which application of the Standard or Interpretation is required;
- (d) the date as at which it plans to apply the Standard or Interpretation initially; and
- (e) either:
 - (i) a discussion of the impact that initial application of the Standard or Interpretation is expected to have on the entity's financial statements; or
 - (ii) if that impact is not known or reasonably estimable, a statement to that effect.

Changes in Accounting Estimates

32. As a result of the uncertainties inherent in business activities, many items in financial statements cannot be measured with precision but can only be estimated. Estimation

involves judgements based on the latest available, reliable information. For example, estimates may be required of:

- (a) bad debts;
 - (b) inventory obsolescence;
 - (c) the fair value of financial assets or financial liabilities;
 - (d) the useful lives of, or expected pattern of consumption of the future economic benefits embodied in, depreciable assets; and
 - (e) warranty obligations.
33. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.
34. An estimate may need revision if changes occur in the circumstances on which the estimate was based or as a result of new information or more experience. By its nature, the revision of an estimate does not relate to prior periods and is not the correction of an error.
35. A change in the measurement basis applied is a change in an accounting policy, and is not a change in an accounting estimate. When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate.
36. ***The effect of a change in an accounting estimate, other than a change to which paragraph 37 applies, shall be recognised prospectively by including it in profit or loss in:***
- (a) ***the period of the change, if the change affects that period only; or***
 - (b) ***the period of the change and future periods, if the change affects both.***
37. ***To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, it shall be recognised by adjusting the carrying amount of the related asset, liability or equity item in the period of the change.***
38. Prospective recognition of the effect of a change in an accounting estimate means that the change is applied to transactions, other events and conditions from the date of the change in estimate. A change in an accounting estimate may affect only the current period's profit or loss, or the profit or loss of both the current period and future periods. For example, a change in the estimate of the amount of bad debts affects only the current period's profit or loss and therefore is recognised in the current period. However, a change in the estimated useful life of, or the expected pattern of consumption of the future economic benefits embodied in, a depreciable asset affects depreciation expense for the current period and for each future period during the asset's remaining useful life. 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 as income or expense in those future periods.

Disclosure

39. ***An entity shall disclose the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods, except for the disclosure of the effect on future periods when it is impracticable to estimate that effect.***
40. ***If the amount of the effect in future periods is not disclosed because estimating it is impracticable, an entity shall disclose that fact.***

Errors

41. Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with SB-FRSs if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are authorised for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period (see paragraphs 42-47).
42. ***Subject to paragraph 43, an entity shall correct material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery by:***
- (a) ***restating the comparative amounts for the prior period(s) presented in which the error occurred; or***
 - (b) ***if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.***

Limitations on Retrospective Restatement

43. ***A prior period error shall be corrected by retrospective restatement except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the error.***
44. ***When it is impracticable to determine the period-specific effects of an error on comparative information for one or more prior periods presented, the entity shall restate the opening balances of assets, liabilities and equity for the earliest period for which retrospective restatement is practicable (which may be the current period).***
45. ***When it is impracticable to determine the cumulative effect, at the beginning of the current period, of an error on all prior periods, the entity shall restate the comparative information to correct the error prospectively from the earliest date practicable.***
46. The correction of a prior period error is excluded from profit or loss for the period in which the error is discovered. Any information presented about prior periods, including any historical summaries of financial data, is restated as far back as is practicable.
47. When it is impracticable to determine the amount of an error (e.g. a mistake in applying an accounting policy) for all prior periods, the entity, in accordance with paragraph 45, restates the comparative information prospectively from the earliest date practicable. It therefore disregards the portion of the cumulative restatement of assets, liabilities and equity arising before that date. Paragraphs 50-53 provide guidance on when it is impracticable to correct an error for one or more prior periods.
48. Corrections of errors are distinguished from changes in accounting estimates. Accounting estimates by their nature are approximations that may need revision as additional information becomes known. For example, the gain or loss recognised on the outcome of a contingency is not the correction of an error.

Disclosure of Prior Period Errors

49. ***In applying paragraph 42, an entity shall disclose the following:***
- (a) ***the nature of the prior period error;***
 - (b) ***for each prior period presented, to the extent practicable, the amount of the correction:***
 - (i) ***for each financial statement line item affected; and***

- (ii) ***if SB-FRS 33 applies to the entity, for basic and diluted earnings per share;***
- (c) ***the amount of the correction at the beginning of the earliest prior period presented; and***
- (d) ***if retrospective restatement is impracticable for a particular prior period, the circumstances that led to the existence of that condition and a description of how and from when the error has been corrected.***

Financial statements of subsequent periods need not repeat these disclosures.

Impracticability in Respect of Retrospective Application and Retrospective Restatement

50. In some circumstances, it is impracticable to adjust comparative information for one or more prior periods to achieve comparability with the current period. For example, data may not have been collected in the prior period(s) in a way that allows either retrospective application of a new accounting policy (including, for the purpose of paragraphs 51-53, its prospective application to prior periods) or retrospective restatement to correct a prior period error, and it may be impracticable to recreate the information.
51. It is frequently necessary to make estimates in applying an accounting policy to elements of financial statements recognised or disclosed in respect of transactions, other events or conditions. Estimation is inherently subjective, and estimates may be developed after the balance sheet date. Developing estimates is potentially more difficult when retrospectively applying an accounting policy or making a retrospective restatement to correct a prior period error, because of the longer period of time that might have passed since the affected transaction, other event or condition occurred. However, the objective of estimates related to prior periods remains the same as for estimates made in the current period, namely, for the estimate to reflect the circumstances that existed when the transaction, other event or condition occurred.
52. Therefore, retrospectively applying a new accounting policy or correcting a prior period error requires distinguishing information that
- (a) provides evidence of circumstances that existed on the date(s) as at which the transaction, other event or condition occurred, and
 - (b) would have been available when the financial statements for that prior period were authorised for issue
- from other information. For some types of estimates (e.g. an estimate of fair value not based on an observable price or observable inputs), it is impracticable to distinguish these types of information. When retrospective application or retrospective restatement would require making a significant estimate for which it is impossible to distinguish these two types of information, it is impracticable to apply the new accounting policy or correct the prior period error retrospectively.
53. Hindsight should not be used when applying a new accounting policy to, or correcting amounts for, a prior period, either in making assumptions about what management's intentions would have been in a prior period or estimating the amounts recognised, measured or disclosed in a prior period. For example, when an entity corrects a prior period error in measuring financial assets previously classified as held-to-maturity investments in accordance with SB-FRS 39 *Financial Instruments: Recognition and Measurement*, it does not change their basis of measurement for that period if management decided later not to hold them to maturity. In addition, when an entity corrects a prior period error in calculating its liability for employees' accumulated sick leave in accordance with SB-FRS 19 *Employee Benefits*, it disregards information about an unusually severe influenza season during the next period that became available after the financial statements for the prior period were authorised for issue. The fact that significant estimates are frequently required when

amending comparative information presented for prior periods does not prevent reliable adjustment or correction of the comparative information.

Effective Date

54. **Statutory Boards shall apply this Standard for annual periods beginning on or after 1 January 2004.**

Appendix

Guidance on Implementing SB-FRS 8

This guidance accompanies, but is not part of, SB-FRS 8.

Example 1 – Retrospective Restatement of Errors

- 1.1 During 20-2, Beta Co discovered that some products that had been sold during 20-1 were incorrectly included in inventory at 31 December 20-1 at CU6,500.*
- 1.2 Beta's accounting records for 20-2 show sales of CU104,000, cost of goods sold of CU86,500 (including CU6,500 for the error in opening inventory), and income taxes of CU5,250.
- 1.3 In 20-1, Beta reported:
- | | |
|----------------------------|-----------------|
| | CU |
| Sales | 73,500 |
| Cost of goods sold | <u>(53,500)</u> |
| Profit before income taxes | 20,000 |
| Income taxes | <u>(6,000)</u> |
| Profit | <u>14,000</u> |
- 1.4 20-1 opening retained earnings was CU20,000 and closing retained earnings was CU34,000.
- 1.5 Beta's income tax rate was 30 per cent for 20-2 and 20-1. It had no other income or expenses.
- 1.6 Beta had CU5,000 of share capital throughout, and no other components of equity except for retained earnings. Its shares are not publicly traded and it does not disclose earnings per share.

Beta Co
Extract from the Income Statement

	20-2	(restated) 20-1
	CU	CU
Sales	104,000	73,500
Cost of goods sold	<u>(80,000)</u>	<u>(60,000)</u>
Profit before income taxes	24,000	13,500
Income taxes	<u>(7,200)</u>	<u>(4,050)</u>
Profit	<u>16,800</u>	<u>9,450</u>

Beta Co
Statement of Changes in Equity

* In these examples, monetary amounts are denominated in 'currency units' (CU).

	Share capital	Retained earnings	Total
	CU	CU	CU
Balance at 31 December 20-0	5,000	20,000	25,000
Profit for the year ended 31 December 20-1 as restated		9,450	9,450
Balance at 31 December 20-1	5,000	29,450	34,450
Profit for the year ended 31 December 20-2		16,800	16,800
Balance at 31 December 20-2	5,000	46,250	51,250

Extracts from the Notes

- Some products that had been sold in 20-1 were incorrectly included in inventory at 31 December 20-1 at CU6,500. The financial statements of 20-1 have been restated to correct this error. The effect of the restatement on those financial statements is summarised below. There is no effect in 20-2.

	Effect on 20-1
	CU
(Increase) in cost of goods sold	(6,500)
Decrease in income tax expense	1,950
(Decrease) in profit	(4,550)
(Decrease) in inventory	(6,500)
Decrease in income tax payable	1,950
(Decrease) in equity	(4,550)

Example 2 – Change in Accounting Policy with Retrospective Application

- During 20-2, Gamma Co changed its accounting policy for the treatment of borrowing costs that are directly attributable to the acquisition of a hydro-electric power station under construction for use by Gamma. In previous periods, Gamma had capitalised such costs. Gamma has now decided to treat these costs as an expense, rather than capitalise them. Management judges that the new policy is preferable because it results in a more transparent treatment of finance costs and is consistent with local industry practice, making Gamma's financial statements more comparable.
- Gamma capitalised borrowing costs incurred of CU2,600 during 20-1 and CU5,200 in periods before 20-1. All borrowing costs incurred in previous years in respect of the acquisition of the power station were capitalised.
- Gamma's accounting records for 20-2 show profit before interest and income taxes of CU30,000; interest expense of CU3,000 (which relates only to 20-2); and income taxes of CU8,100.
- Gamma has not yet recognised any depreciation on the power station because it is not yet in use.

2.5 In 20-1, Gamma reported:

	CU
Profit before interest and income taxes	18,000
Interest expense	-
Profit before income taxes	<u>18,000</u>
Income taxes	<u>(5,400)</u>
Profit	<u><u>12,600</u></u>

2.6 20-1 opening retained earnings was CU20,000 and closing retained earnings was CU32,600.

2.7 Gamma's tax rate was 30 per cent for 20-2, 20-1 and prior periods.

2.8 Gamma had CU10,000 of share capital throughout, and no other components of equity except for retained earnings. Its shares are not publicly traded and it does not disclose earnings per share.

Gamma Co
Extract from the Income Statement

		(restated)
	20-2	20-1
	CU	CU
Profit before interest and income taxes	30,000	18,000
Interest expense	(3,000)	(2,600)
Profit before income taxes	<u>27,000</u>	<u>15,400</u>
Income taxes	<u>(8,100)</u>	<u>(4,620)</u>
Profit	<u><u>18,900</u></u>	<u><u>10,780</u></u>

Gamma Co
Statement of Changes in Equity

		(restated)	
	Share capital	Retained earnings	Total
	CU	CU	CU
Balance at 31 December 20-0 as previously reported	10,000	20,000	30,000
Change in accounting policy for the capitalisation of interest (net of income taxes of CU1.560) (Note)		<u>(3,640)</u>	<u>(3,640)</u>
Balance at 31 December 20-0 as restated	10,000	16,360	26,360
Profit for the year ended 31 December 20-1 (restated)		<u>10,780</u>	<u>10,780</u>
Balance at 31 December 20-1	10,000	27,140	37,140
Profit for the year ended 31 December 20-2		<u>18,900</u>	<u>18,900</u>
Balance at 31 December 20-2	<u><u>10,000</u></u>	<u><u>46,040</u></u>	<u><u>56,040</u></u>

Extracts from the Notes

1 During 20-2, Gamma changed its accounting policy for the treatment of borrowing costs related to a hydro-electric power station under construction for use by Gamma. Previously, Gamma capitalised such costs. They are now written off as expenses as incurred. Management judges that this policy provides reliable and more relevant information because it results in a more transparent treatment of finance costs and is consistent with local industry practice, making Gamma's financial statements more comparable. This change in accounting

policy has been accounted for retrospectively, and the comparative statements for 20-1 have been restated. The effect of the change on 20-1 is tabulated below. Opening retained earnings for 20-1 have been reduced by CU3,640, which is the amount of the adjustment relating to periods prior to 20-1.

<i>Effect on 20-1</i>	CU
(Increase) in interest expense	(2,600)
Decrease in income tax expense	780
(Decrease) in profit	<u>(1,820)</u>
 <i>Effect on period prior to 20-1</i>	
(Decrease) in profit (CU5,200 interest expense less tax of CU1,560)	 (3,640)
	<hr/>
(Decrease) in assets in the course of construction and in retained earnings at 31 December 20-1	<u>(5,460)</u>

Example 3 - Prospective Application of a Change in Accounting Policy When Retrospective Application is not Practicable

- 3.1 During 20-2, Delta Co changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a components approach, whilst at the same time adopting the revaluation model.
- 3.2 In years before 20-2, Delta's asset records were not sufficiently detailed to apply a components approach fully. At the end of 20-1, management commissioned an engineering survey, which provided information on the components held and their fair values, useful lives, estimated residual values and depreciable amounts at the beginning of 20-2. However, the survey did not provide a sufficient basis for reliably estimating the cost of those components that had not previously been accounted for separately, and the existing records before the survey did not permit this information to be reconstructed.
- 3.3 Delta's management considered how to account for each of the two aspects of the accounting change. They determined that it was not practicable to account for the change to a fuller components approach retrospectively, or to account for that change prospectively from any earlier date than the start of 20-2. Also, the change from a cost model to a revaluation model is required to be accounted for prospectively. Therefore, management concluded that it should apply Delta's new policy prospectively from the start of 20-2.
- 3.4 Additional information:

Delta's tax rate is 30 per cent.

	CU
Property, plant and equipment at the end of 20-1:	
Cost	25,000
Depreciation	<u>(14,000)</u>
Net book value	<u>11,000</u>
 Prospective depreciation expense for 20-2 (old basis)	 1,500
 Some results of the engineering survey:	
Valuation	17,000
Estimated residual value	3,000
Average remaining asset life (years)	7
 Depreciation expense on existing property, plant and equipment for 20-2 (new basis)	 2,000

Extract from the Notes

- 1 From the start of 20-2, Delta changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a components approach, whilst at the same time adopting the revaluation model. Management takes the view that this policy provides reliable and more relevant information because it deals more accurately with the components of property, plant and equipment and is based on up-to-date values. The policy has been applied prospectively from the start of 20-2 because it was not practicable to estimate the effects of applying the policy either retrospectively, or prospectively from any earlier date. Accordingly, the adoption of the new policy has no effect on prior years. The effect on the current year is to increase the carrying amount of property, plant and equipment at the start of the year by CU6,000; increase the opening deferred tax provision by CU1,800; create a revaluation reserve at the start of the year of CU4,200; increase depreciation expense by CU500; and reduce tax expense by CU150.