

Exposure Draft

Accounting Standard (AS) 5 (Revised 20XX) (Corresponding to IAS 8)

Accounting Policies, Changes in Accounting Estimates and Errors

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Issued by
Accounting Standards Board

The Institute of Chartered Accountants of India

Exposure Draft

Accounting Standard (AS) 5 (Revised 20XX)
(Corresponding to IAS 8)

Accounting Policies, Changes in Accounting Estimates and Errors

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Exposure Draft

Accounting Standard (AS) 5 (Revised 20XX)¹ (Corresponding to IAS 8)

Accounting Policies, Changes in Accounting Estimates and Errors

Following is the Exposure Draft of the Accounting Standard (AS) 5 (Revised 20XX), Accounting Policies, Changes in Accounting Estimates and Errors, issued by the Accounting Standards Board of the Institute of Chartered Accountants of India, for comments. The Board invites comments on any aspect of this Exposure Draft. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

*Comments should be submitted in writing to the Secretary, Accounting Standards Board, The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi – 110 002, so as to be received not later than **April 07, 2010**. Comments can also be sent by e-mail at edcommentsasb@icai.org or asb@icai.org.*

*(This Exposure Draft of the revised Accounting Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles. This Exposure Draft of the revised Accounting Standard should be read in the context of its objective and the Preface to the Statements of Accounting Standards²)*

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

¹ This Exposure Draft is issued pursuant to the decision to converge with IFRSs in respect of accounting periods commencing on or after April 1, 2011. All existing Accounting Standards and new Accounting Standards which are referred to in this Exposure Draft are also being revised or formulated, as the case may be, to converge with IFRSs from the afore said date. References to the other standards may be viewed accordingly.

² Attention is specifically drawn to paragraph 4.3 of the Preface, according to which accounting standards are intended to apply only to items which are material.

- 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 AS 1 (Revised 20XX) *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 AS 22 (Revised 20XX) *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.

Accounting Standards (ASs) are Standards issued by the Institute of Chartered Accountants of India (ICAI).

Material Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make 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 approved 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 approved for issue from 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* issued by the Institute of Chartered Accountants of India states in paragraph 26 that 'It is assumed that users have a reasonable knowledge of business and economic activities and accounting and 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 an AS specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the AS.**
- 8 ASs 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 ASs to achieve a particular presentation of an entity's financial position, financial performance or cash flows.
- 9 ASs are accompanied by guidance to assist entities in applying their requirements. All such guidance states whether it is an integral part of ASs. Guidance that is an integral part of the ASs is mandatory. Guidance that is not an integral part of the ASs does not contain requirements for financial statements.
- 10 **In the absence of an AS 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, ie 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 in ASs 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 an AS specifically requires or permits categorisation of items for which different policies may be appropriate. If an AS 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 an AS; 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 AS 10 (Revised 20XX) *Property, Plant and Equipment* or AS 26 (Revised 20XX) *Intangible Assets* is a change in an accounting policy to be dealt with as a revaluation in accordance with AS 10 or AS 26, 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 an AS in accordance with the specific transitional provisions, if any, in that AS; and**
 - (b) **when an entity changes an accounting policy upon initial application of an AS 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 an AS is not a voluntary change in accounting policy.
- 21 In the absence of an AS 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 an AS). 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 an AS 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 AS;
 - (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 AS 20 (Revised 20XX) *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 AS 20 (Revised 20XX) 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 AS 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 AS 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 AS;
 - (b) the nature of the impending change or changes in accounting policy;
 - (c) the date by which application of the AS is required;
 - (d) the date as at which it plans to apply the AS initially; and
 - (e) either:
 - (i) a discussion of the impact that initial application of the AS 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 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 ASs 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 approved 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 approved 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 (eg 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 AS 20 (Revised 20XX) 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

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- 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 reporting period. 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 approved for issue

from other information. For some types of estimates (eg 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 AS 30 (Revised 20XX) *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 AS 15 (Revised 20XX) *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 approved 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 An entity to which this Accounting Standard is applicable shall apply it for accounting periods commencing on or after the date (to be announced separately) and will be mandatory in nature³ from that date.

Withdrawal of other pronouncements

- 55 This Standard supersedes AS 5 *Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies* (Revised 1997) in respect of the entities to which this Accounting Standard is applicable

- 56 [Deleted]

³ This implies that, while discharging their attest function, it will be the duty of the members of the Institute to examine whether this Accounting Standard is complied with in the presentation of financial statements covered by their audit. In the event of any deviation from this Accounting Standard, it will be their duty to make adequate disclosures in their audit reports so that the users of financial statements may be aware of such deviations.

Guidance on implementing AS 5 (Revised 20XX) Accounting Policies, Changes in Accounting Estimates and Errors

(This guidance accompanies, but is not part of, AS 5 (Revised 20XX).)

Example 1 – Retrospective restatement of errors

- 1.1 During 20X2, Beta Co discovered that some products that had been sold during 20X1 were incorrectly included in inventory at 31 December 20X1 at Rs. 6,500.
- 1.2 Beta's accounting records for 20X2 show sales of Rs.104,000, cost of goods sold of Rs. 86,500 (including Rs. 6,500 for the error in opening inventory), and income taxes of Rs. 5,250.
- 1.3 In 20X1, Beta reported:

	Rs.
Sales	73,500
Cost of goods sold	(53,500)
	20,000
Profit before income taxes	20,000
Income taxes	(6,000)
	14,000
Profit	

- 1.4 20X1 opening retained earnings was Rs. 20,000 and closing retained earnings was Rs. 34,000.
- 1.5 Beta's income tax rate was 30 per cent for 20X2 and 20X1. It had no other income or expenses.
- 1.6 Beta had Rs.5,000 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 statement of profit and loss

	20X2 Rs.	(restated) 20X1 Rs.
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

	Share capital Rs.	Retained earnings Rs.	Total Rs.
Balance at 31 December 20X0	5,000	20,000	25,000
Profit for the year ended 31 December 20X1 as restated	—	<u>9,450</u>	<u>9,450</u>
Balance at 31 December 20X1	5,000	29,450	34,450
Profit for the year ended 31 December 20X2	—	<u>16,800</u>	<u>16,800</u>
Balance at 31 December 20X2	<u>5,000</u>	<u>46,250</u>	<u>51,250</u>

Extracts from the notes

- 1 Some products that had been sold in 20X1 were incorrectly included in inventory at 31 December 20X1 at Rs. 6,500. The financial statements of 20X1 have been restated to correct this error. The effect of the restatement on those financial statements is summarised below. There is no effect in 20X2.

Example 2 – Prospective application of a change in accounting policy when retrospective application is not practicable

- 2.1. During 20X2, 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.
- 2.2. In years before 20X2, Delta's asset records were not sufficiently detailed to apply a components approach fully. At the end of 20X1, 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 20X2. 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 20X2. 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 20X2.
- 2.3. Additional information:

Delta's tax rate is 30 per cent

	Rs.
Property, plant and equipment at the end of 20X1:	
Cost	25,000
Depreciation	(14,000)
Net book value	<u>11,000</u>
Prospective depreciation expense for 20X2 (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 20X2 (new basis)	2,000

Extract from the notes

- 1 From the start of 20X2, 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 20X2 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 Rs. 6,000; increase the opening deferred tax provision by Rs. 1,800; create a revaluation surplus at the start of the year of Rs. 4,200; increase depreciation expense by Rs. 500; and reduce tax expense by Rs. 150.

Appendix A:

References to matters contained in other Accounting Standards

This Appendix is an integral part of Accounting Standard 5 (Revised 20XX).

This appendix lists the appendices which are part of other Accounting Standards and makes reference to AS 5 (Revised 20XX), *Accounting Policies, Changes in Accounting Estimates and Errors*

1. Appendix ____, Introduction of Euro (Corresponding to SIC 7) contained in AS 11 *The Effects of Changes in Foreign Exchange Rates* (Revised 20XX).
2. Appendix .A, Government Assistance—No Specific Relation to Operating Activities (Corresponding to SIC10) contained in AS 12 *Accounting for Government Grants and Disclosure of Government Assistance* (Revised 20XX)
3. Appendix ____, *Consolidation—Special Purpose Entities* (Corresponding to SIC 12) contained in AS 21, *Consolidated and Separate Financial Statements* (Revised 20XX),
4. Appendix ____, *Jointly Controlled Entities— Non-Monetary Contributions by Venturers* (Corresponding to SIC 3) contained in AS 27 *Interests in Joint Ventures* (Revised 20XX)
5. Appendix ____, *Operating Leases—Incentives* (Corresponding to SIC 15) contained in AS 19 *Leases* (Revised 20XX)
6. Appendix ____, *Income Taxes—Changes in the Tax Status of an Entity or its Shareholders* (Corresponding to SIC 25) contained in AS 22 *Income Taxes* (Revised 20XX)
7. Appendix ____, *Revenue—Barter Transactions Involving Advertising Services* (Corresponding to SIC 31) contained in AS 9 *Revenue* (Revised 20XX).
8. Appendix ____, *Determining whether an Arrangement contains a Lease* (Corresponding to IFRIC 4) contained in AS 19 *Leases* (Revised 20XX).
9. Appendix A, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds (Corresponding to IFRIC 5) contained in AS 29 *Provisions, Contingent Liabilities and Contingent Assets* (Revised 20XX).
10. Appendix B, Liabilities arising from Participating in a Specific Market — Waste Electrical and Electronic Equipment (Corresponding to IFRIC 6) contained in AS 29 *Provisions, Contingent Liabilities and Contingent Assets* (Revised 20XX).

11. Appendix C, Scope of AS 33 (corresponding to IFRIC 8) contained in AS 33 *Share-based Payment* (Issued 20XX).
12. Appendix D, AS 33—Group and Treasury Share (corresponding to IFRIC 11) contained in AS 33 *Share-based Payment* (Issued 20XX).
13. Appendix __, *Customer Loyalty Programmes* (Corresponding to IFRIC 13) contained in AS 9 *Revenue* (Revised 20XX).
14. Appendix __, AS 15—*The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* (Corresponding to IFRIC 14) contained in AS 15 *Employee Benefits* (Revised 20XX).
15. Appendix -__ *Income Taxes—Recovery of Revalued Non-Depreciable Assets* (Corresponding to SIC 21) contained in AS 22 *Income Taxes* (Revised 20XX)
16. Appendix __ *Evaluating the Substance of Transactions Involving the Legal Form of a Lease* (Corresponding to SIC 27) contained in AS 19 *Leases* (Revised 20XX).
17. Appendix __ *Changes in Existing Decommissioning, Restoration and Similar Liabilities* (Corresponding to IFRIC 1) contained in AS 10, *Property, Plant and Equipment* (Revised 20XX).
18. Appendix __ *Service Concession Arrangements* (Corresponding to IFRIC 12) contained in AS 11, *Construction Contracts* (Revised 20XX)..
19. Appendix __ *Agreements for the Construction of Real Estate* (Corresponding to IFRIC 15) contained in AS 9, *Revenue* (Revised 20XX).
20. Appendix __ *Hedges of a Net Investment in a Foreign Operation* (Corresponding to IFRIC 16) contained in AS 30, *Financial instruments: Recognition and Measurement* (Revised 20XX).

Appendix B

Conflicting Legal and Regulatory Issues

Note: This Appendix is not a part of the Accounting Standard (AS) 5 (Revised 20XX) Accounting Policies, Changes in Accounting Estimates and Errors. Some of the situations or accounting treatments prescribed in AS 5 (Revised 20XX) may not be in conformity with the present requirements of applicable laws/regulations in the country. In such cases, the provisions of the applicable laws/regulations will prevail. This Appendix contains the following such instances.

Conflicting Issues with Companies Act, 1956

The Exposure draft of AS 5 (Revised 20XX), *Accounting Policies, Changes in Accounting Estimates and Errors*, requires application of change in accounting policy with retrospective effect. 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. It further requires that an entity should correct material prior period errors retrospectively in the first set of financial statements approved 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.

Whereas, as per Circular: No.1/2003 dated 13.1.2003 issued by erstwhile company law board, a company could reopen and revise its accounts even after their adoption in the annual general meeting in order to comply with technical requirements of taxation laws and of any other law to achieve the object of exhibiting true and fair view. It implies that the Companies Act does not permit revision and reopening of accounts for such purposes, once adopted in the annual general meeting. All such adjustments and corrections have to be included in profit or loss of the current period.

Moreover, In this case, if comparatives are restated without re-opening and revising the accounts, such financial statements would not deem to be in agreement with books of accounts. This will be in contradiction with requirements of Section 227(3) (c), which requires that the auditors' report shall state whether the company's balance sheet and profit and loss account dealt with by the report are in agreement with the books of account and returns.

Appendix C

Note: This Appendix is not a part of the Accounting Standard. The purpose of this Appendix is only to bring out the major differences, if any, between Accounting Standard (AS) 5 (Revised 20XX) and the corresponding International Accounting Standard (IAS) 8, Accounting Policies, Changes in Accounting Estimates and Errors .

Comparison with IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors

There is no major difference between the Exposure Draft of AS 5 (Revised 20XX), Accounting Policies, *Changes in Accounting Estimates and Errors* and International Accounting Standard (IAS) 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

Appendix D

Note: This Appendix is not a part of the Accounting Standard. This Appendix is provided to bring out the major differences between the Exposure Draft of Accounting Standard (AS) 5 (Revised 20XX) Accounting Policies, Changes in Accounting Estimates and Errors and the Existing AS 5 (Revised 1997) Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies with a view to facilitate commentators in sending their comments.

Major differences between the Exposure Draft of AS 5 (Revised 20XX), *Accounting Policies, Changes in Accounting Estimates and Errors* and existing AS 5 (Revised 1997) *Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies*

1. Objective of existing AS 5 is to prescribe the classification and disclosure of certain items in the statement of profit and loss for uniform preparation and presentation of financial statements. Objective of the Exposure Draft of AS 5 (Revised 20XX) 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 Exposure Draft intends 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. Keeping in view that AS 1 (Revised 20XX), *Presentation of Financial Statements*, prohibits the presentation of any items of income or expense as extraordinary items and deals with Profit or loss for the period, and in accordance with the objective of AS 5 (Revised 20XX), this Exposure Draft does not deal with the same, which at present is dealt with by existing AS 5.
3. Existing AS 5 restricts the definition of accounting policies to specific accounting principles and the methods of applying those principles while the Exposure Draft of AS 5 (Revised 20XX) broadens the definition to include bases, conventions, rules and practices (in addition to principles) applied by an entity in the preparation and presentation of financial statements.
4. In addition to the situations allowed under the Exposure Draft of AS 5 (Revised 20XX) for change in accounting policy, existing AS 5 allows the situation where change in accounting policy is required by statute.
5. The Exposure Draft of AS 5 (Revised 20XX) requires that changes in accounting policies should be accounted for with retrospective effect subject to limited exceptions

viz., where it is impracticable to determine the period specific effects or the cumulative effect of applying a new accounting policy. Whereas, existing AS 5 does not specify how change in accounting policy should be accounted for except that the change should be accounted for as per the transitional provisions of the Standard when the change is effected consequent upon adoption of an Accounting Standard.

6. Existing AS 5 defines prior period items as incomes or expenses which arise in the current period as a result of errors or omissions in the preparation of financial statements of one or more prior periods. The Exposure Draft of AS 5 (Revised 20XX) uses the term errors and relates it to errors or omissions arising from a failure to use or misuse of reliable information (in addition to mathematical mistakes, mistakes in application of accounting policies etc.) that was available when the financial statements of the prior periods were approved for issuance and could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. The Exposure Draft of AS 5 (Revised 20XX) specifically states that errors include frauds, which is not covered in existing AS 5.

7. The Exposure Draft of AS 5 (Revised 20XX) requires rectification of material prior period errors with retrospective effect subject to limited exceptions viz., where it is impracticable to determine the period specific effects or the cumulative effect of applying a new accounting policy. Whereas, existing AS 5 requires the rectification of prior period items with prospective effect.

8. Disclosure requirements given in the Exposure Draft of AS 5 (Revised 20XX) are more detailed as compared to the disclosure requirements given in the existing AS 5.