GENERAL ACCOUNTING
SECTION 1506
accounting changes

Additional Resources

Background Information and Basis for Conclusions

> The paragraph numbering **in** this Section corresponds to that **in** International Financial Reporting Standard IAS 8, "Accounting Policies, **Changes in** Accounting **Estimates** and Errors" (December 2003) on which the Section is based. Accordingly, when a particular paragraph **in** IAS 8 has not been adopted, it is identified as "[Not used]".

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OBJECTIVE

.01 The objective of this Section is to prescribe the criteria for changing accounting policies, together with the accounting treatment and disclosure of **changes in** accounting policies, **changes in** accounting **estimates** and corrections of errors. This Section 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.

.02 Disclosure requirements for accounting policies, except those for **changes in** accounting policies, are set out **in** DISCLOSURE OF ACCOUNTING POLICIES, Section 1505.

SCOPE

.03 ♦ *This Section shall be applied **in** accounting for **changes in** accounting policies, **changes in** accounting **estimates** and corrections of prior period errors. This Section shall be applied to a change **in** individual accounting policies but not to **changes in** accounting policies upon the complete replacement of an entity's primary basis of accounting.* [JULY 2009]

.04 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 INCOME TAXES, Section 3465.

DEFINITIONS

.05 The following terms are used **in** this Section with the meanings specified:

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

(b) 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.

(c) **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:

(i) was available when financial statements for those periods were completed; and

(ii) 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.

(d) **Retrospective** [1] application is applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.

(e) **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.

(f) 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 if:

(i) the effects of the retrospective application are not determinable;

(ii) the retrospective application requires assumptions about what management's intent would have been **in** that period; or

(iii) the retrospective application requires significant **estimates** of amounts and it is impossible to distinguish objectively information about those **estimates** that:

— provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognized, measured or disclosed; and

— would have been available when the financial statements for that prior period were completed;

from other information.

(g) **Prospective application** of a change **in** accounting policy and of recognizing the effect of a change in an accounting estimate is, unless otherwise defined in other primary sources of GAAP (see GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section 1100):

(i) applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed; and

(ii) recognizing the effect of the change in the accounting estimate in the current and future periods affected by the change.

.06-.13 [Not used]

CHANGES IN ACCOUNTING POLICIES

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

(a) is required by a primary source of GAAP (see GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section 1100)*; 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. [JAN. 2007]

.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 1506.14.

.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. [JAN. 2007]

.17-.18 [Not used]

Applying changes in accounting policies

.19 ♦ *Subject to paragraph* 1506.23*:*

(a) an entity shall account for a change in accounting policy resulting from the initial application of a primary source of GAAP in accordance with the specific transitional provisions, if any, in that primary source of GAAP; and

(b) when an entity changes an accounting policy upon initial application of a primary source of GAAP that does not include specific transitional provisions applying to that change, or changes an accounting policy voluntarily, it shall apply the change retrospectively. [JAN. 2007]

.20 For the purpose of this Section, early application of a primary source of GAAP is not a voluntary change in accounting policy.

.21 An entity that changes its accounting policy as a result of following sources other than primary sources of GAAP accounts for such a change as a voluntary change in accounting policy.

Retrospective application

.22 ♦ *Subject to paragraph* 1506.23*, when a change in accounting policy is applied retrospectively in accordance with paragraph* 1506.19*(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.* [JAN. 2007]

Limitations on retrospective application

.23 ♦ *When retrospective application is required by paragraph* 1506.19*(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.* [JAN. 2007]

.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.* [JAN. 2007]

.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.* [JAN. 2007]

.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 primary source of GAAP). 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 1506.25, 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 1506.50-.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 primary source of GAAP 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 primary source of GAAP;

(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 EARNINGS PER SHARE, Section 3500*, 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 1506.19*(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. [JAN. 2007]

.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 EARNINGS PER SHARE, Section 3500, 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. [JAN. 2007]

.30 ♦ *When an entity has not applied a new primary source of GAAP 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 primary source of GAAP will have on the entity's financial statements **in** the period of initial application.* [JAN. 2007]

.31 **In** complying with paragraph 1506.30, an entity considers disclosing:

(a) the title of the new primary source of GAAP;

(b) the nature of the impending change or **changes in** accounting policy;

(c) the date by which application of the primary source of GAAP is required;

(d) the date as at which it plans to apply the primary source of GAAP initially; and

(e) either:

(i) a discussion of the impact that initial application of the primary source of GAAP 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 judgments 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 1506.37 applies, shall be recognized prospectively by including it **in** net income **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. [JAN. 2007]

.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 recognized by adjusting the carrying amount of the related asset, liability or equity item **in** the period of the change.* [JAN. 2007]

.38 Prospective recognition of the effect of a change **in** an accounting estimate, unless otherwise described **in** a primary source of GAAP, 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 net income, or the net income 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 net income and therefore is recognized **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 recognized as income or expense **in** the current period. The effect, if any, on future periods is recognized 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.* [JAN. 2007]

.40 ♦ *If the amount of the effect **in** future periods is not disclosed because estimating it is impracticable, an entity shall disclose that fact.* [JAN. 2007]

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 generally accepted accounting principles 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 completed. 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 1506.42-.47).

.42 ♦ *An entity shall correct material prior period errors retrospectively **in** the first set of financial statements completed 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. [JAN. 2007]

.43-.45 [Not used]

.46 The correction of a prior period error is excluded from net income for the period **in** which the error is discovered. Any information presented about prior periods, including any historical summaries of financial data, is restated.

.47 [Not used]

.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 recognized on the outcome of a contingency is not the correction of an error.

Disclosure of prior period errors

.49 ♦ ***In** applying paragraph 1506.42, an entity shall disclose the following:*

(a) the nature of the prior period error;

(b) for each prior period presented, the amount of the correction:

(i) for each financial statement line item affected; and

(ii) if EARNINGS PER SHARE, Section 3500, applies to the entity, for basic and diluted

earnings per share; and

(c) *the amount of the correction at the beginning of the earliest prior period presented.*

(d) [Not used]

Financial statements of subsequent periods need not repeat these disclosures. [JAN. 2007]

IMPRACTICABILITY IN RESPECT OF RETROSPECTIVE APPLICATION

.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 retrospective application of a new accounting policy (including, for the purpose of paragraphs 1506.51-.53, its prospective application to prior periods), 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 recognized 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 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 completed;

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 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 retrospectively.

.53 Hindsight is not 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 recognized, 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 FINANCIAL INSTRUMENTS — RECOGNITION AND MEASUREMENT, Section 3855, 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 EMPLOYEE FUTURE BENEFITS, Section 3461, 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 completed. 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 This Section applies to interim and annual financial statements relating to fiscal years beginning on or after 1 January 2007. Earlier application is encouraged.

.55-.56 [Not used]

IMPLEMENTATION GUIDANCE

This guidance is not an integral part of this Section. It does not constitute a primary source of generally accepted accounting principles, as specified **in** GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section 1100.

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 CU6,500.

1.2 Beta's accounting records for 20X2 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 20X1, Beta reported:

	CU
Sales	73,500
Cost of goods sold	(53,500)
Income before income taxes	20,000
Income taxes	(6,000)
Net income	14,000
	=====

1.4 20X1 opening retained earnings was CU20,000 and closing retained earnings was CU34,000.

1.5 Beta's income tax rate was 30 percent for 20X2 and 20X1. 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

	20X2	(restated) 20X1
	CU	CU
Sales	104,000	73,500
Cost of goods sold	(80,000)	(60,000)
Income before income taxes	24,000	13,500
Income taxes	(7,200)	(4,050)
Net income	16,800	9,450
	=====	=====

Beta Co
Statement of Changes in Equity

	Share capital	Retained earnings	Total
	CU	CU	CU
Balance at 31 December 20X0	5,000	20,000	25,000
Net income for the year ended 31 December 20X1 as restated	—	9,450	9,450
Balance at 31 December 20X1	5,000	29,450	34,450
Net income for the year ended 31 December 20X2	—	16,800	16,800
Balance at 31 December 20X2	5,000	46,250	51,250
	=====	=====	=====

Extracts from the Notes

1 Some products that had been sold in 20X1 were incorrectly included in inventory at 31 December 20X1 at CU6,500. The financial statements of 20X1 have been restated to correct this error. The effect of the restatement on those financial statements is summarized below. There is no effect in 20X2.

	Effect on 20X1
	CU
(Increase) in cost of goods sold	(6,500)
Decrease in income tax expense	1,950
(Decrease) in net income	(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

2.1 During 20X2, 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 capitalized such costs. Gamma has now decided to treat these costs as an expense, rather than capitalize 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.

2.2 Gamma capitalized borrowing costs incurred of CU2,600 during 20X1 and CU5,200 in periods before 20X1. All borrowing costs incurred in previous years in respect of the acquisition of the power station were capitalized.

2.3 Gamma's accounting records for 20X2 show net income before interest and income taxes of CU30,000; interest expense of CU3,000 (which relates only to 20X2); and income taxes of CU8,100.

2.4 Gamma has not yet recognized any depreciation on the power station because it is not yet in use.

2.5 In 20X1, Gamma reported:

	CU
Income before interest and income taxes	18,000
Interest expense	—
Income before income taxes	18,000
Income taxes	(5,400)
Net income	12,600
	=====

2.6 20X1 opening retained earnings was CU20,000 and closing retained earnings was CU32,600.

2.7 Gamma's tax rate was 30 percent for 20X2, 20X1 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

	20X2	(restated) 20X1
	CU	CU
Income before interest and income taxes	30,000	18,000
Interest expense	(3,000)	(2,600)
Income before income taxes	27,000	15,400
Income taxes	(8,100)	(4,620)
Net income	18,900	10,780
	=====	=====

Gamma Co
Statement of Changes in Equity

	Share capital	(restated) Retained earnings	Total
	CU	CU	CU
Balance at 31 December 20X0 as previously reported	10,000	20,000	30,000
Change in accounting policy for the capitalization of interest (net of income taxes of CU1,560) (Note 1)	—	(3,640)	(3,640)
Balance at 31 December 20X0 as restated	10,000	16,360	26,360
Net income for the year ended 31 December 20X1 (restated)	—	10,780	10,780
Balance at 31 December 20X1	10,000	27,140	37,140
Net income for the year ended 31 December 20X2	—	18,900	18,900
Balance at 31 December 20X2	10,000	46,040	56,040
	=====	=====	=====

Extracts from the Notes

1 During 20X2, 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 capitalized 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 20X1 have been restated. The effect of the change on 20X1 is tabulated below. Opening retained earnings for 20X1 have been reduced by CU3,640, which is the amount of the adjustment relating to periods prior to 20X1.

	CU
Effect on 20X1	
(Increase) in interest expense	(2,600)

Decrease **in** income tax expense	780
(Decrease) **in** net income	(1,820)
Effect on periods prior to 20X1	
(Decrease) **in** net income (CU5,200 interest expense less tax of CU1,560)	(3,640)
(Decrease) **in** assets **in** the course of construction and **in** retained earnings at 31 December 20X1	(5,460)
	=====

Example 3 — [Not used]

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Footnotes

1. The terms "retrospective" and "retroactive" are intended to have the same meaning in the CICA Handbook – Accounting.