

## **IPSAS 3—ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS**

### **Acknowledgment**

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 8 (Revised December 2003), “Accounting Policies, Changes in Accounting Estimates and Errors,” published by the International Accounting Standards Board (IASB). Extracts from IAS 8 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Accounting Standards Committee Foundation (IASCF).

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**IPSAS 3—ACCOUNTING POLICIES, CHANGES IN  
ACCOUNTING ESTIMATES AND ERRORS**

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International Public Sector Accounting Standard 3, “Accounting Policies, Changes in Accounting Estimates and Errors,” is set out in paragraphs 1–61. All the paragraphs have equal authority. IPSAS 3 should be read in the context of its objective, the Basis for Conclusions, and the “Preface to the International Public Sector Accounting Standards.” IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors,” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

## Introduction

IN1. IPSAS 3, “Accounting Policies, Changes in Estimates and Errors,” replaces IPSAS 3, “Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies” (issued May 2000), and should be applied for annual reporting periods beginning on or after January 1, 2008. Earlier application is encouraged.

### Reasons for Revising IPSAS 3

IN2. The IPSASB developed this revised IPSAS 3 as a response to the IASB’s project on Improvements to IASs and its own policy to converge public sector accounting standards with private sector standards to the extent appropriate.

IN3. In developing this revised IPSAS 3, the IPSASB adopted the policy of amending the IPSAS for those changes made to the former IAS 8, “Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies” made as a consequence of the IASB’s improvements project, except where the original IPSAS had varied from the provisions of IAS 8 for a public sector specific reason; such variances are retained in this IPSAS 3 and are noted in the Comparison with IAS 8. Any changes to IAS 8 made subsequent to the IASB’s improvements project have not been incorporated into IPSAS 3.

### Changes from Previous Requirements

IN4. The main changes from the previous version of IPSAS 3 are described below.

#### *Name of Standard*

IN5. The Standard is called “Accounting Policies, Changes in Accounting Estimates and Errors.”

#### *Scope*

IN6. The Standard includes criteria for the selection of accounting policies that were previously contained in IPSAS 1, “Presentation of Financial Statements.”

IN7. The Standard does not contain requirements on the presentation of items in the statement of financial performance, which are now included in IPSAS 1.

#### *Definitions*

IN8. The Standard defines new terms: change in accounting estimate, prior period errors, prospective application, retrospective application and retrospective restatement, impracticable, material and notes.

IN9. The Standard does not include definitions of the terms: extraordinary items, ordinary activities, net surplus/deficit, and surplus/deficit from ordinary activities, which are no longer required.

*Materiality*

IN10. The Standard stipulates that:

- The accounting policies in IPSASs need not be applied when the effect of applying them is immaterial; and
- Financial statements do not comply with IPSASs if they contain material errors.

*Net Surplus or Deficit for the Period*

IN11. The Standard does not include the requirements for the presentation of surplus or deficit for the period that were included in the superseded IPSAS 3, these requirements are now included in IPSAS 1.

*Accounting Policies*

IN12. The Standard specifies the hierarchy of IPSASB's pronouncements, and authoritative and non-mandatory guidance, to be considered when selecting accounting policies to apply in the preparation of financial statements. The new hierarchy is now established as a principle and printed in bold type.

IN13. The Standard does not include the allowed alternative treatments for changes in accounting policies (including voluntary changes) that were included in the superseded IPSAS 3. An entity is now required (where practicable) to account for changes in accounting policies retrospectively.

*Errors*

IN14. The Standard does not distinguish between fundamental errors and other material errors.

IN15. The Standard does not include the allowed alternative treatments for the correction of errors that were included in the superseded IPSAS 3. An entity is now required to correct (where practicable) material prior period errors retrospectively in the first set of financial statements authorized for issue after their discovery.

*Criteria for Exemptions from Requirements (Impracticability)*

IN16. The Standard requires that 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, or
- An error on all prior periods,

The entity changes the comparative information as if the new accounting policy had always been applied; or the error had been corrected, prospectively from the earliest date practicable.

IN17. The Standard includes guidance on the interpretation of impracticable.

*Disclosures*

IN18. The Standard requires more detailed and additional disclosure of the amounts of adjustments as a consequence of changing accounting policies or correcting prior period errors than was required by the superseded IPSAS 3.

IN19. The Standard requires, rather than encourages the disclosure of:

- An impending change in accounting policy when an entity has yet to adopt a new IPSAS which has been published but not yet come into effect; and
- Known or reasonably estimable information relevant to assessing the possible impact that application of the new IPSAS will have on the entity's financial statements in the period of initial application.

**Amendments to Other Pronouncements**

IN20. The Standard includes an authoritative appendix of amendments to other IPSASs that are not part of the IPSASs Improvements project and will be impacted as a result of the proposals in this IPSAS.

## Objective

1. The objective of this Standard is to prescribe the criteria for selecting and changing accounting policies, together with the (a) accounting treatment and disclosure of changes in accounting policies, (b) changes in accounting estimates, and (c) the corrections of errors. This 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 IPSAS 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 not considered in this Standard, as they are not relevant for many public sector entities. International or national accounting standards dealing with income taxes contain guidance on the treatment of tax effects.
5. **This Standard applies to all public sector entities other than Government Business Enterprises.**
6. The "Preface to International Public Sector Accounting Standards" issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1.

## Definitions

7. **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 correction of errors.**

**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 recognized, measured, or disclosed; and
  - (ii) Would have been available when the financial statements for that prior period were authorized for issue;

from other information.

**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 a misuse of, reliable information that:

- (a) Was available when financial statements for those periods were authorized 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.

**Prospective application** of a change in accounting policy and of recognizing 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) Recognizing the effect of the change in the accounting estimate in the current and future periods affected by the change.



**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.

Terms defined in other IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the Glossary of Defined Terms published separately.

### Materiality

8. Assessing whether an omission or misstatement could influence decisions of users, and so be material, requires consideration of the characteristics of those users. Users are assumed to have a reasonable knowledge of the public sector 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 and evaluating decisions.

## Accounting Policies

### Selection and Application of Accounting Policies

9. **When an IPSAS 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.**
10. IPSASs set out accounting policies that the IPSASB has concluded 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 IPSASs to achieve a particular presentation of an entity's financial position, financial performance, or cash flows.
11. IPSASs are accompanied by guidance to assist entities in applying their requirements. All such guidance states whether it is an integral part of IPSASs. Guidance that is an integral part of IPSASs is mandatory. Guidance that is not an integral part of IPSASs does not contain requirements for financial statements.
12. **In the absence of an IPSAS that specifically applies to a transaction, other event, or condition, management shall use its judgment in developing and applying an accounting policy that results in information that is:**
  - (a) **Relevant to the 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.**
- 13. Paragraph 11 requires the development of accounting policies to ensure that the financial statements provide information that meets a number of qualitative characteristics. Appendix A in IPSAS 1 summarizes the qualitative characteristics of financial reporting.
- 14. **In making the judgment, described in paragraph 12, management shall refer to, and consider the applicability of, the following sources in descending order:**
  - (a) **The requirements in IPSASs dealing with similar and related issues; and**
  - (b) **The definitions, recognition and measurement criteria for assets, liabilities, revenue and expenses described in other IPSASs.**
- 15. **In making the judgment described in paragraph 11, management may also consider (a) the most recent pronouncements of other standard-setting bodies, and (b) accepted public or private sector practices, but only to the extent that these do not conflict with the sources in paragraph 14. Examples of such pronouncements include pronouncements of the IASB, including the “Framework for the Preparation and Presentation of Financial Statements,” IFRSs, and Interpretations issued by the IASB’s International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).**

#### Consistency of Accounting Policies

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

**Changes in Accounting Policies**

17. **An entity shall change an accounting policy only if the change:**
- (a) **Is required by an IPSAS; or**
  - (b) **Results in the financial statements providing reliable and more relevant information about the effects of transactions, other events, and conditions on the entity's financial position, financial performance, or cash flows.**
18. 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, 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 17.
19. **A change from one basis of accounting to another basis of accounting is a change in accounting policy.**
20. **A change in the accounting treatment, recognition, or measurement of a transaction, event, or condition within a basis of accounting is regarded as a change in accounting policy.**
21. **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 that were immaterial.**
22. **The initial application of a policy to revalue assets in accordance with IPSAS 17, "Property, Plant and Equipment," or IPSAS 31, "Intangible Assets," is a change in accounting policy to be dealt with as a revaluation in accordance with IPSAS 17 or IPSAS 31, rather than in accordance with this Standard.**
23. Paragraphs 24–36 do not apply to the change in accounting policy described in paragraph 22.

*Applying Changes in Accounting Policies*

24. **Subject to paragraph 28:**
- (a) **An entity shall account for a change in accounting policy resulting from the initial application of an IPSAS in accordance with the specific transitional provisions, if any, in that Standard; and**

(b) **When an entity changes an accounting policy upon initial application of an IPSAS that does not include specific transitional provisions applying to that change, or changes an accounting policy voluntarily, it shall apply the change retrospectively.**

25. For the purpose of this Standard, early application of a Standard is not a voluntary change in accounting policy.
26. In the absence of an IPSAS that specifically applies to a transaction, other event, or condition, management may, in accordance with paragraph 14, apply an accounting policy from (a) the most recent pronouncements of other standard-setting bodies, and (b) accepted public or private sector practices, but only to the extent that these are consistent with paragraph 14. Examples of such pronouncements include pronouncements of the IASB, including the “Framework for the Preparation and Presentation of Financial Statements,” IFRSs, and Interpretations issued by the IFRIC or the former SIC. 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**

27. **Subject to paragraph 28, when a change in accounting policy is applied retrospectively in accordance with paragraph 24(a) or (b), the entity shall adjust the opening balance of each affected component of net assets/equity for the earliest 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**

28. **When retrospective application is required by paragraph 24(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.**
29. **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 net assets/equity for that period.**
30. **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.**

31. 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 statement of financial positions 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 net assets/equity of the earliest prior period presented. Usually the adjustment is made to accumulated surpluses or deficits. However, the adjustment may be made to another component of net assets/equity (for example, to comply with an IPSAS). Any other information about prior periods, such as historical summaries of financial data, is also adjusted as far back as is practicable.
32. 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 30, 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 net assets/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 55–58 provide guidance when it is impracticable to apply a new accounting policy to one or more prior periods.

*Disclosure*

33. **When initial application of an IPSAS (a) has an effect on the current period or any prior period, (b) would have such an effect, except that it is impracticable to determine the amount of the adjustment, or (c) might have an effect on future periods, an entity shall disclose:**
- (a) **The title of the Standard;**
  - (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 for each financial statement line item affected;**
- (g) **The amount of the adjustment relating to periods before those presented, to the extent practicable; and**
- (h) **If retrospective application required by paragraph 24(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.**

34. **When a voluntary change in accounting policy (a) has an effect on the current period or any prior period, (b) would have an effect on that period, except that it is impracticable to determine the amount of the adjustment, or (c) 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 for each financial statement line item affected;**
- (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.**

35. **When an entity has not applied a new IPSAS 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 will have on the entity's financial statements in the period of initial application.**

36. In complying with paragraph 35, an entity considers disclosing:
- (a) The title of the new IPSAS;
  - (b) The nature of the impending change or changes in accounting policy;
  - (c) The date by which application of the Standard is required;
  - (d) The date as at which it plans to apply the Standard initially; and
  - (e) Either:
    - (i) A discussion of the impact that initial application of the Standard 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**

37. As a result of the uncertainties inherent in delivering services, conducting trading, or other 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) Tax revenue due to government;
  - (b) Bad debts arising from uncollected taxes;
  - (c) Inventory obsolescence;
  - (d) The fair value of financial assets or financial liabilities;
  - (e) The useful lives of, or expected pattern of consumption of future economic benefits or service potential embodied in, depreciable assets, or the percentage completion of road construction; and
  - (f) Warranty obligations.
38. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.
39. 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.
40. 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.

41. **The effect of a change in an accounting estimate, other than a change to which paragraph 42 applies, shall be recognized prospectively by including it in surplus or deficit in:**
- (a) **The period of the change, if the change affects the period only; or**
  - (b) **The period of the change and future periods, if the change affects both.**
42. **To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of net assets/equity, it shall be recognized by adjusting the carrying amount of the related asset, liability, or net assets/equity item in the period of change.**
43. 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 surplus or deficit, or the surplus or deficit 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 surplus or deficit, and therefore is recognized in the current period. However, a change in the estimated useful life of, or the expected pattern of consumption of economic benefits or service potential embodied in, a depreciable asset affects the 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 revenue or expense in the current period. The effect, if any, on future periods is recognized in future periods.

#### **Disclosure**

44. **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 on future periods, except for the disclosure of the effect on future periods when it is impracticable to estimate that effect.**
45. **If the amount of the effect in future periods is not disclosed because estimating it is impracticable, the entity shall disclose that fact.**

#### **Errors**

46. Errors can arise in respect of the recognition, measurement, presentation, or disclosure of elements of financial statements. Financial statements do not comply with IPSASs 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 authorized 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 47–51).

47. **Subject to paragraph 48, an entity shall correct material prior period errors retrospectively in the first set of financial statements authorized for issue after their discovery by:**
- (a) **Restating the comparative amounts for 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 net assets/equity for the earliest prior period presented.**

#### **Limitations of Retrospective Restatement**

48. **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.**
49. **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 net assets/equity for the earliest period for which retrospective restatement is practicable (which may be the current period).**
50. **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.**
51. The correction of a prior period error is excluded from surplus or deficit for the period in which the error is discovered. Any information presented about prior periods, including historical summaries of financial data, is also restated as far back as is practicable.
52. 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 50, restates the comparative information prospectively from the earliest date practicable. It therefore disregards the portion of the cumulative restatement of assets, liabilities, and net assets/equity arising before that date. Paragraphs 55–58 provide guidance on when it is impracticable to correct an error for one or more prior periods.
53. 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**

54. **In applying paragraph 47, 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 for each financial statement line item affected;**
  - (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**

55. 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 56–58, its prospective application to prior periods) or retrospective restatement to correct a prior period error, and it may be impracticable to re-create the information.
56. 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 reporting 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.
57. 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 authorized 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.

58. 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 recognized, measured, or disclosed in a prior period. For example, when an entity corrects a prior period error in classifying a government building as an investment property (the building was previously classified as property, plant, and equipment), it does not change the basis of classification for that period, if management decided later to use that building as an owner-occupied office building. In addition, when an entity corrects a prior period error in calculating its liability for provision of cleaning costs of pollution resulting from government operations in accordance with IPSAS 19, "Provisions, Contingent Liabilities and Contingent Assets," it disregards information about an unusually large oil leak from a naval supply ship during the next period that became available after the financial statements for the prior period were authorized 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**

59. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2008. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2008, it shall disclose that fact.**
- 59A. **Paragraphs 9, 11, and 14 were amended by "Improvements to IPSASs" issued in January 2010. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2011. Earlier application is encouraged.**
60. When an entity adopts the accrual basis of accounting as defined by IPSASs for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

**Withdrawal of IPSAS 3 (2000)**

61. This Standard supersedes IPSAS 3, “Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies,” issued in 2000.

## Appendix

### Amendments to Other IPSASs

#### IPSAS 2, “Cash Flow Statements,” is amended as follows:

Paragraphs 40 and 41 on extraordinary items are deleted.

The Appendix in IPSAS 2, which illustrates a cash flow statement for an entity, is amended to remove an extraordinary item. The revised Appendix is set out below.

#### Direct Method Cash Flow Statement (paragraph 27(a))

##### Notes to the Cash Flow Statement

##### *Reconciliation of Net Cash Flows from Operating Activities to Surplus/(Deficit)*

(in thousands of currency units)	<b>20X2</b>	<b>20X1</b>
<b>Surplus/(deficit) from ordinary activities</b>	X	X
<b>Non-cash movements</b>		
Depreciation	X	X
Amortization	X	X
Increase in provision for doubtful debts	X	X
Increase in payables	X	X
Increase in borrowings	X	X
Increase in provisions relating to employee costs	X	X
(Gains)/losses on sale of property, plant, and equipment	(X)	(X)
(Gains)/losses on sale of investments	(X)	(X)
Increase in other current assets	(X)	(X)
Increase in investments due to revaluation	(X)	(X)
Increase in receivables	(X)	(X)
<b>Net cash flows from operating activities</b>	<b>X</b>	<b>X</b>

**Indirect Method Cash Flow Statement (paragraph 27(b))****Public Sector Entity—Consolidated Cash Flow Statement for Year Ended December 31, 20X2 (In Thousands of Currency Units)**

(in thousands of currency units)	20X2	20X1
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Surplus/(deficit)	X	X
<b>Non-cash movements</b>		
Depreciation	X	X
Amortization	X	X
Increase in provision for doubtful debts	X	X
Increase in payables	X	X
Increase in borrowings	X	X
Increase in provisions relating to employee costs	X	X
(Gains)/losses on sale of property, plant, and equipment	(X)	(X)
(Gains)/losses on sale of investments	(X)	(X)
Increase in other current assets	(X)	(X)
Increase in investments due to revaluation	(X)	(X)
Increase in receivables	(X)	(X)
<b>Net cash flows from operating activities</b>	<b>X</b>	<b>X</b>

**IPSAS 18, “Segment Reporting,” is amended as described below.**

The definition of accounting policies in paragraph 8 is amended to read as follows:

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

Paragraph 57 is amended to read as follows:

57. IPSAS 1 requires that when items of revenue or expense are material, the nature and amount of such items shall be disclosed separately. IPSAS 1 identifies a number of examples of such items, including write-downs of inventories and property, plant, and equipment; provisions for restructurings; disposals of property, plant, and equipment; privatizations and other disposals of long-term investments; discontinuing operations; litigation settlements; and reversals of provisions. The encouragement in paragraph 56 is not intended to

change the classification of any such items or to change the measurement of such items. The disclosure encouraged by that paragraph, however, does change the level at which the significance of such items is evaluated for disclosure purposes from the entity level to the segment level.

Paragraphs 69 and 70 are amended to read as follows:

69. Changes in accounting policies adopted by the entity are dealt with in IPSAS 3. IPSAS 3 requires that changes in accounting policy shall be made by an IPSAS, or if the change will result in reliable and more relevant information about transactions, other events or conditions in the financial statements of the entity.
70. Changes in accounting policies applied at the entity level that affect segment information are dealt with in accordance with IPSAS 3. Unless a new IPSAS specifies otherwise, IPSAS 3 requires that:
  - (a) A change in accounting policy be applied retrospectively, and that prior period information be restated, unless it is impracticable to determine either the cumulative effect or the period specific effects of the change;
  - (b) If retrospective application is not practicable for all periods presented, the new accounting policy shall be applied retrospectively from the earliest practicable date; and
  - (c) If it is impracticable to determine the cumulative effect of applying the new accounting policy at the start of the current period, the policy shall be applied prospectively from the earliest date practicable.

The following changes are made to remove references to extraordinary items:

- (a) In paragraph 27, in the definition of segment revenue, subparagraph (a) is deleted;
- (b) In paragraph 27, in the definition of segment expense, subparagraph (a) is deleted; and
- (c) In Appendix 1, the second last paragraph is deleted.

In IPSAS 19, “Provisions, Contingent Liabilities and Contingent Assets,” paragraph 111 is deleted.

In IPSASs, applicable at January 1, 2008, references to the current version of IPSAS 3, “Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies,” are amended to IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors.”

## Basis for Conclusions

*This Basis for Conclusions accompanies, but is not part of, IPSAS 3.*

### Revision of IPSAS 3 as a result of the IASB's General Improvements Project

#### Background

- BC1. The IPSASB's IFRS Convergence Program is an important element in the IPSASB's work program. The IPSASB's policy is to converge the accrual basis IPSASs with IFRSs issued by the IASB where appropriate for public sector entities.
- BC2. Accrual basis IPSASs that are converged with IFRSs maintain the requirements, structure, and text of the IFRSs, unless there is a public sector-specific reason for a departure. Departure from the equivalent IFRS occurs when requirements or terminology in the IFRS are not appropriate for the public sector, or when inclusion of additional commentary or examples is necessary to illustrate certain requirements in the public sector context. Differences between IPSASs and their equivalent IFRSs are identified in the "Comparison with IFRS" included in each IPSAS. The Comparison with IAS 8 references the December 2003 version of IAS 8 and not any other.
- BC3. In May 2002, the IASB issued an exposure draft of proposed amendments to 13 IASs<sup>1</sup> as part of its General Improvements Project. The objectives of the IASB's General Improvements Project were "to reduce or eliminate alternatives, redundancies and conflicts within the Standards, to deal with some convergence issues and to make other improvements." The final IASs were issued in December 2003.
- BC4. IPSAS 3, issued in January 2000, was based on IAS 8 (Revised 1993), "Net Profit or Loss of the Period, Fundamental Errors and Changes in Accounting Policies," which was reissued in December 2003 as IAS 8, "Accounting Policies, Changes in Accounting Estimates and Errors." In late 2003, the IPSASB's predecessor, the Public Sector Committee (PSC),<sup>2</sup> actioned an IPSAS improvements project to converge, where appropriate, IPSASs with the improved IASs issued in December 2003.
- BC5. The IPSASB reviewed the improved IAS 8 and generally concurred with the IASB's reasons for revising the IAS and with the amendments made. (The IASB's Bases for Conclusions are not reproduced here. Subscribers to the

<sup>1</sup> The International Accounting Standards (IASs) were issued by the IASB's predecessor – the International Accounting Standards Committee. The Standards issued by the IASB are entitled International Financial Reporting Standards (IFRSs). The IASB has defined IFRSs to consist of IFRSs, IASs, and Interpretations of the Standards. In some cases, the IASB has amended, rather than replaced, the IASs, in which case the old IAS number remains.

<sup>2</sup> The PSC became the IPSASB when the IFAC Board changed the PSC's mandate to become an independent standard-setting board in November 2004.



IASB's *Comprehensive Subscription Service* can view the Bases for Conclusions on the IASB's website at <http://www.iasb.org>). In those cases where the IPSAS departs from its related IAS, the Basis for Conclusions explains the public sector-specific reasons for the departure.

- BC6. IPSAS 3 does not include the consequential amendments arising from IFRSs issued after December 2003. This is because the IPSASB has not yet reviewed and formed a view on the applicability of the requirements in those IFRSs to public sector entities.

**Revision of IPSAS 3 as a result of the IASB's Improvements to IFRSs issued in 2008**

- BC7. The IPSASB reviewed the revisions to IAS 8 included in the "Improvements to IFRSs" issued by the IASB in May 2008 and generally concurred with the IASB's reasons for revising the standard. The IPSASB concluded that there was no public sector specific reason for not adopting the amendments.

## Implementation Guidance

*This guidance accompanies, but is not part of, IPSAS 3.*

### Retrospective Restatement of Errors

- IG1. During 20X2, the entity discovered that revenue from income taxes was incorrect. Income taxes of CU<sup>3</sup>6,500 that should have been recognized in 20X1 were incorrectly omitted from 20X1 and recognized as revenue in 20X2.
- IG2. The entity's accounting records for 20X2 show revenue from taxation of CU60,000 (including the CU6,500 taxation that should have been recognized in opening balances), and expenses of CU86,500.
- IG3. In 20X1, the entity reported:

	CU
Revenue from taxation	34,000
User charges	3,000
Other operating revenue	30,000
Total revenue	<u>67,000</u>
Expenses	<u>(60,000)</u>
Surplus	<u><u>7,000</u></u>

- IG4. 20X1 opening accumulated surplus was CU20,000, and closing accumulated surplus was CU27,000.
- IG5. The entity had no other revenue or expenses.
- IG6. The entity had CU5,000 of contributed capital throughout, and no other components of net assets/equity except for accumulated surplus.

### Public Sector Entity Statement of Financial Performance

	20X2	(restated) 20X1
	CU	CU
Revenue from taxation	53,500	40,500
User charges	4,000	3,000
Other operating revenue	40,000	30,000
Total revenue	<u>97,500</u>	<u>73,500</u>
Expenses	<u>(86,500)</u>	<u>(60,000)</u>
Surplus	<u><u>11,000</u></u>	<u><u>13,500</u></u>

<sup>3</sup> In these examples, monetary amounts are denominated in "currency units" (CU).

**Public Sector Entity X Statement of Changes in Equity**

	Contributed capital	Accumulated Surpluses	Total
	CU	CU	CU
Balance at 31 December 20X0	5,000	20,000	15,000
Surplus for the year ended December 31, 20X1 as restated	–	13,500	13,500
Balance at 31 December 20X1	5,000	33,500	38,500
Surplus for the year ended 31 December 20X2	–	11,000	11,000
Balance at 31 December 20X2	5,000	44,500	49,500

*Extracts from Notes to the Financial Statements*

1. Revenue from taxation of CU6,500 was incorrectly omitted from the financial statements of 20X1. 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 revenue	6,500
Increase in surplus	6,500
Increase in debtors	6,500
Increase in net assets/equity	6,500

**Change in Accounting Policy with Retrospective Application**

- IG7. During 20X2, the entity changed its accounting policy for the treatment of borrowing costs that are directly attributable to the acquisition of a hydro-electric power station that is under construction. In previous periods, the entity had capitalized such costs. The entity has now decided to 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 the entity's financial statements more comparable.
- IG8. The entity capitalized borrowing costs incurred of CU2,600 during 20X1 and CU5,200 in periods prior to 20X1. All borrowing costs incurred in previous years with respect to the acquisition of the power station were capitalized.
- IG9. The accounting records for 20X2 show surplus before interest of CU30,000; and interest expense of CU3,000 (which relates only to 20X2).

IG10. The entity has not recognized any depreciation on the power station because it is not yet in use.

IG11. In 20X1, the entity reported:

	CU
Surplus before interest	18,000
Interest expense	–
Surplus	<u>18,000</u>

IG12. 20X1 opening accumulated surpluses was CU20,000 and closing accumulated surpluses was CU38,000.

IG13. The entity had CU10,000 of contributed capital throughout, and no other components of net assets/equity except for accumulated surplus.

### Public Sector Entity Statement of Financial Performance

	20X2	(restated) 20X1
	CU	CU
Surplus before interest	30,000	18,000
Interest expense	(3,000)	(2,600)
Surplus	<u>27,000</u>	<u>15,400</u>

### Public Sector Entity Statement of Changes in Net Assets/Equity

	Contributed capital	(restated) Accumulated Surplus	Total
	CU	CU	CU
Balance at 31 December 20X0 as previously reported	10,000	20,000	30,000
Change in accounting policy with respect to the capitalization of interest (Note 1)	–	(5,200)	(5,200)
Balance at 31 December 20X0 as restated	10,000	14,800	24,800
Surplus for the year ended 31 December 20X1 (restated)	–	15,400	15,400
Balance at 31 December 20X1	<u>10,000</u>	<u>30,200</u>	<u>40,200</u>
Surplus for the year ended 31 December 20X2	–	27,000	27,000
Closing at 31 December 20X2	<u>10,000</u>	<u>57,200</u>	<u>67,200</u>

#### *Extracts from Notes to the Financial Statements*

- During 20X2, the entity changed its accounting policy for the treatment of borrowing costs related to a hydro-electric power station. Previously, the entity 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 the entity'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 accumulated surpluses for 20X1 have been reduced by CU5,200, which is the amount of the adjustment relating to periods prior to 20X1.

<i>Effect on 20-1</i>	CU
(Increase) in interest expense	(2,600)
(Decrease) in surplus	(2,600)
<i>Effect on periods prior to 20-1</i>	
(Decrease) in surplus	(5,200)
(Decrease) in assets in the course of construction and in accumulated surplus	(7,800)

### **Prospective Application of a Change in Accounting Policy When Retrospective Application is not Practicable**

- IG14. During 20X2, the entity changed its accounting policy for depreciating property, plant, and equipment, so as to apply much more fully a components approach, while at the same time adopting the revaluation model.
- IG15. In years before 20X2, the entity's asset records were not sufficiently detailed to apply a components approach fully. At the end of year 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.
- IG16. 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 the entity's new policy prospectively from the start of 20X2.

## IG17. Additional information:

	CU
Property, plant and equipment	
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 assets life (years)	7
Depreciation expense on existing property, plant and equipment for 20X2 (new basis)	2,000

*Extracts from Notes to the Financial Statements*

- From the start of 20X2, the entity changed its accounting policy for depreciating property, plant, and equipment, so as to apply much more fully a components approach, while 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 adopting of the new policy has no effect on prior periods. The effect on the current year is to (a) increase the carrying amount of property, plant, and equipment at the start of the year by CU6,000, (b) create a revaluation reserve at the start of the year of CU6,000, and (c) increase depreciation expense by CU500.

### **Comparison with IAS 8**

IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors,” is drawn primarily from IAS 8 (2003), “Accounting Policies, Changes in Accounting Estimates and Errors” and includes amendments made to IAS 8 as part of the “Improvements to IFRSs” issued in May 2008. The main differences between IPSAS 3 and IAS 8 are as follows:

- Commentary additional to that in IAS 8 has been included in IPSAS 3 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 3 uses different terminology, in certain instances, from IAS 8. The most significant examples are the use of the terms “statement of financial performance,” “accumulated surplus or deficit,” and “net assets/equity” in IPSAS 3. The equivalent terms in IAS 8 are “income statement,” “retained earnings,” and “equity.”
- IPSAS 3 does not use the term “income,” which in IAS 8 has a broader meaning than the term “revenue.”
- IPSAS 3 contains a different set of definitions of technical terms from IAS 8 (paragraph 7).
- IPSAS 3 has a similar hierarchy to IAS 8, except that the IPSASB does not yet have a conceptual framework.
- IPSAS 3 does not require disclosures about adjustments to basic or diluted earnings per share. IAS 8 requires disclosure of amount of adjustment or correction for basic or diluted earnings per share.