NEPAL ACCOUNTING STANDARDS ON ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES & ERRORS

CONTENTS **Paragraphs**

Nepal Accounting Standard, 02 Accounting Policies, Changes in Accounting Estimates & Errors (NAS 02) is set out in paragraphs 1-56 and Appendix A. All the paragraphs have equal authority. Paragraphs in **bold italic type** state the main principles. NAS 02 should be read in the context of its objective, the *Preface to Nepal Accounting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. NAS 02 *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors. The Standard is intended to enhance the relevance and reliability of an entity's financial statements and the comparability of those financial statements over time and with the financial statements of other entities.

2. Disclosure requirements for accounting policies, except those for changes in accounting policies, are set out in NAS 01 *Presentation of Financial Statements.*

Scope

3. This Standards applies to all companies including public sector business entities 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 NAS 09 *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 adopted 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 obligations associated with, assets and liabilities. Changes in accounting

estimates result from new information or new developments and accordingly, are not corrections 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 effort 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 where authorized for issue from other information.

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

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

(a) was available when financial statements for those periods were authorized for issues; 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 changes; 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.

6. Assessing whether an omission or misstatement could influence economic decisions of users, and so be material, requires consideration of the characteristics of those users. The *Framework for the Preparation and Presentation of Financial Statements* states in paragraph 25 that 'users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence.' Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making economic decisions.

Accounting policies

Selection and application of accounting policies

7. ***When a Standard 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 and considering any relevant Implementation Guidance issued by the Nepal Accounting Board for the Standard.

8. Nepal Accounting Standards if set out accounting policies that the Accounting Board 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 Standards to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

9. Implementation Guidance for Standards issued by the ASB does not form part of those Standards, and therefore does not contain requirements for financial statements.

10. In the absence of a Standard 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 economic decision – making needs of users; and

(b) reliable, in that the financial statements;

(i) represent faithfully the financial position, financial performance and cash flows of the entity;

(ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;

(iii) are neutral, i.e. free from bias;

(iv) are prudent; and

(v) are complete in all material respect.

11. ***In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order:***

(a) the requirements and guidance in Standards dealing with similar and related issues; and

(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.

12. In making the judgement described in paragraph 10, management may also consider the most recent pronouncements of other Standard – setting bodies that use a similar conceptual framework to develop accounting Standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 11.

Consistency of accounting policies

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

Changes in accounting policies

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

(a) is required by a Standard; or

(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 need to be able to compare the financial statements of an entity over a period of time to identify trends in its financial position, performance and cash flows. Therefore, the same accounting policies are normally adopted in 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 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 NAS 06 Property, Plant and Equipment or NAS 27 Intangible Assets is a change in an accounting policy to be dealt with as a revaluation in accordance with NAS 06 or NAS 27, rather than in accordance with this Standard.***

18. ***Paragraphs 19–31 do not apply to the change in accounting policy described in paragraph 17.***

Applying changes in accounting policies

19. ***Subject to paragraph 23***

   (a) an entity shall account for a change in accounting policy resulting from the initial application of a Standard 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 a Standard that does not include specific transitional provisions applying to that change, or changes an accounting policy voluntarily, it shall apply the change retrospectively.

20. A change in accounting policy which is made on the adoption of a Nepal Accounting Standard shall be accounted for in accordance with the specific transitional provisions, if any, in the Nepal Accounting Standard.

21. In the absence of a Standard or an Interpretation that specifically applies to a transaction, other event or condition, management may, in accordance with paragraph 12, apply an accounting policy from the most recent pronouncements of other Standard-setting bodies that use a similar conceptual framework to develop accounting Standards. If, following an amendment of such a pronouncement, the entity chooses to change an accounting policy, that change is accounted for and disclosed as a voluntary change in accounting policy.

Retrospective application

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

Limitation 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 it 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, comply with a Standard). 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. Paragraph 50-53 provides guidance on when it is impracticable to apply a new accounting policy to one or more prior periods.

Disclosure

28. When initial application of a Standard has an effect on the current period or any prior period, would have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:

(a) the title of the Standard

(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:

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

(h) the amount of the adjustment relating to periods before those presented, to the extent practicable; and

(i) if retrospective application required by paragraph 19(a) or (b) is impracticable for 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

(d) the amount of the adjustment relating to periods before those presented, to the extent practicable; and

(e) if retrospective application is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

Financial statements of subsequent periods need not repeat these disclosures.

30. When an entity has not applied a new Standard 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.

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

(a) the title of the new Standard;

(b) the nature of the impending change or change 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 estimate

32. As a result of the uncertainties inherent in business activities, many financial statement items cannot be measured with precision but can only be estimated. The estimation involves judgments based on the latest information available. 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 or expected pattern of consumption of economic benefits of depreciable assets.

(e) Warranty obligation.

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 have to be revised if changes occur regarding the circumstances on which the estimate was based or as a result of new information, more experience or subsequent developments. By its nature, the revision of the estimate does not bring the adjustment within the definitions of an extraordinary item or a fundamental 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 shall be included in the determination of net profit or loss 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.

37. To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or related 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.

38. Prospective recognition of the effect of a change in an accounting estimate means that the change is applied to transactions, other

event 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 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 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 period, 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 NAS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are authorised for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period (see paragraphs 42–47).

42. ***Subject to paragraph 43, and entity shall correct material prior period errors retrospectively in the first set of financial statements authorized for issue after their discovery by:***

   (a) restarting 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 an 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 effort on all prior periods, the entity shall restate the comparative information to correct the error prospectively from the earliest date practicable.***

46. The correction of a prior period error is excluded from profit or loss for the period in which the error is discovered. Any information presented about prior periods, including any historical summaries of financial data, is restated as far back as is practicable.

47. When it is impracticable to determine the amount of an error (e.g. a mistake in applying an accounting policy) for all prior periods, the entity, in accordance with paragraph 45, restates the comparative information prospectively from the earliest date practicable. It therefore disregards the portion of the cumulative restatement of assets, liabilities and equity arising before that date.

Paragraphs 50-53 provide guidance on when it is impracticable to correct an error for one or more prior periods.

48. Corrections of errors are distinguished from changes in accounting estimates. Accounting estimates by their nature are approximations that may need revision as additional information becomes known. For example, the gain or loss recognized 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 fundamental error;

(b) For each prior period presented, to the extent practicable, the amount of the correction:

(i) 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

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 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 or correcting a prior period error requires distinguishing information that

(a) provides evidence of circumstances that existed on the date(s) as 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 (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 shall 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 calculating its liability for

employees' accumulated sick leave in accordance with NAS 14 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 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.

Compliance with International Accounting Standards

54. Compliance with this NAS ensures compliance in all material respects with IAS 08, Accounting Policies, Changes in Accounting Estimates & Errors.

Effective date

55. This Nepal Accounting Standard becomes operative for financial statements covering periods beginning on or after 01 Shrawan 2065 corresponding to 17 July 2008.

Withdrawal of other pronouncement

56. This Standard supersedes NAS 02 Accounting Policies, Changes in Accounting Estimates & Errors.

Appendix A

The appendix is illustrative only and does not form part of the Standard. The purpose of the appendix is to illustrate the application of the Standard to assist in clarifying its meaning Extracts from income statements and statements of retained earnings are provided to show the effects on these financial statements of the transactions described below. These extracts do not necessarily conform with all the disclosure and presentation requirements of other Nepal Accounting Standards.

Extraordinary item

Alpha Co

Extract from the income statement

	2002	**2001**
Profit from ordinary activities before Income Tax	12,000	10,000
Income taxes	(3,600)	(3,000)
Profit form ordinary activities	8,400	7,000
Extraordinary item - loss on exprooriation of car engine value manufacturing operation in country R (Net of income taxes of 1,350) (Note 1)	(3,150)	-
Net Profit	5,250	7,000

Extracts from notes to the financial statements

1. On 1 October 2002, Alpha's car engine valve manufacturing operations in country R were expropriated, without compensation, by the Government. The results of this operation had previously been reported in the valve manufacturing industry segment and the Pacific geographical segment. The loss arising from the expropriation has been accounted for as an The loss arising from the expropriation is the net carrying amount of the assets and liabilities of the operation at the date of expropriation. The revenues recognised relating to this operation from 1 January 2002 until 1 October 2002 were 10,000 and the profits before tax were 2,000.

Fundamental Errors

During 2002, Rama Co discovered that certain products that had been sold during 2001 were incorrectly included in inventory at 31 December

2001 at 6,500. Rama's accounting records for 2002 show sales of 104,000, cost of goods sold of 86,500 (including 6,500 for error in opening inventory), and income taxes of 5,250.

In 2001, Rama reported:

Sales	73,500
Cost of goods sold	**(53,500)**
Income taxes	(6,000)
Net Profit	14,000

2001 opening retained earning was 20,000 and closing retained earnings was 34,000.

Rama's income tax rate was 30% for 2002 and 2001.

Rama Co

Extract from the income statement under the benchmark treatment

	2002	2001 (restated)
Sales	104,000	73,500
Cost of goods sold	(80,00)	(60,000)
Profit from ordinary activities before income taxes	24,000	13,500
Income taxes	(7,200)	(4,050)
Net Profit	**16,800**	**9450**

Rama Co
Statement of retained earnings under the benchmark treatment

	2002	2001 (restated)
Opening retained earnings as previously reported	34,000	20,000
Correction of fundamental error	(4,550)	–
(Net of income taxes of 1,950) (Note 1)		
Opening retained earnings as rested	29,450	20,000
Net profit	16,800	9,450
Closing Retained Earnings	**46,250**	**29,450**

Extracts from notes to the financial statements

1. Certain products that had been sold in 2001 were incorrectly included in inventory at 31 December 2001 at 6,500. The financial statements of 2001 have been restated to correct this error.

Rama Co
Extract from the income statement under the allowed alternative treatment proforma

	2002	2001	2002 (restated)	2001 (restated)
Sales	104,000	73,500	104,000	73,500
Cost of goods sold (Note 1)	(86,500)	(53,500)	(80,000)	(60,000)
Profit from ordinary activities	17,500	20,000	24,000	13,500
before income taxes Income taxes (includes theeffects of the correction of a fundamental error)	(5,250)	(6,000)	(7,200)	(4,050)
	12,250	**14,000**	**16,800**	**9,450**

Rama Co
Statement of retained earnings under the allowed alternative Treatment Proforma

	2002	2001	2002 (restated)	2001 (restated)
Opening retained earnings as previously reported	34,000	20,000	34,000	20,000
Correction of fundamental error (Net of income taxes of 1,950)	-	-	(4,550)	-
Opening retained earnings as restated				
Net profit	34,000	20,000	29,450	20,000
Closing Retained Earnings	12,250	14,000	16,800	9,450
	46,250	**34,000**	**46,250**	**29,450**

Extracts from notes to the financial statements

1. Cost of goods sold for 2002 includes 6,500 for certain products that had been sold in 2001 but were incorrectly included in

inventory at 31 December 2001. Restated pro forma information for 2002 and 2001 is presented as if the error had been corrected in 2001.

Changes in accounting policy

During 2002, Shyama Co changed its accounting policy with respect to the treatment of borrowing costs that are directly attributable to the acquisition of a hydro-electric power station which is in course of construction for use by Shyama. In previous periods, Shyama had capitalised such costs, net of income taxes. Shyama has now decided to expense, rather than capitalise, these costs in order to voluntarily conform with the benchmark treatment in Shyama chose this policy in the absence of a NAS.

Shyama capitalised borrowing costs incurred of 2,600 during 2001 and 5,200 in periods prior to 2001. All borrowing costs incurred in previous years in respect to the acquisition of the power station were capitalised.

Shyama's accounting records for 2002 show profit from ordinary activities before interest and income taxes of 30,000; interest expense of 3,000 (which relates only to 2002); and income taxes of 8,100.

Shyama has not yet recognised any depreciation on the power station because it is not yet in use.

In 2001, Shyama reported:

Profit from ordinary activities before interest and income taxes	18,000
Interest expenses	-
Profit from ordinary activities before income taxes	18,000
Income taxes	(5,400)
Net profit	**12,600**

2001 opening retained earnings was 20,000 and closing retained earnings was 32,600.

Shyama's tax rate was 30% for 2002 and 2001.

Shyama Co
Extract from the income statement under the benchmark treatment

	2002	2001 (restated)
Profit from ordinary activities before interest and income taxes Interest expenses	30,000	18,000
	(3,000)	(2,600)
Profit from ordinary activities before income taxes	27,000	15,400
Income taxes	(8,100)	(4,620)
Net Profit	**18,900**	**10,780**

Shyama Co
Statement of Retained Earnings under the Benchmark Treatment

	2002	2001 (restated)
Opening retained earnings as previously reported	32,600	20,000
Change in accounting policy with respect to the capitalisation of interest (Net of income taxes of 2,340 for 2002 and 1,560 for 2001) (Note 1)	(5,460)	(3,640)
Opening retained earnings as restated	27,140	16,360
Net profit	18,900	10,780
Closing retained earnings	**46,040**	**27,140**

Extracts from notes to the financial statements

1. During 2002, Shyama changed its accounting policy with respect to the treatment of borrowing costs related to a hydro-electric power station which is in course of construction for use by Shyama. The entity now expenses rather than capitalises such costs. This change in accounting policy has been accounted for retrospectively. The comparative statements for 2001 have been restated to conform to the changed policy. The effect of the change is an increase in interest expense of 3,000 (2002) and 2,600 (2001). Opening retained earnings for 2001 have been reduced by 5,200 which is the amount of the adjustment relating to periods prior to 2001.

Shyama Co
Extract from the income statement under the allowed alternative treatment proforma

	2002	2001	2002 (restated)	2001 (restated)
Profit from ordinary activities before interest and income taxes	30,000	18,000	30,000	18,000
Interest expenses	(3,000)	-	(3,000)	(2,600)
Cumulative effect of change in accounting policy	(7,800)	-	-	-
Profit from ordinary activities before income tax	19,200	18,000	27,000	15,400
Income taxes (includes the effects of a change in accounting policy	(5,760)	(5,400)	(8,100)	(4,620)
Net Profit	**13,440**	**12,600**	**18,900**	**10,780**

Shyama Co
Statement of retained earning under the allowed alternative treatment

	2002	2001	2002 (restated)	2001 (restated)
Opening retained earnings as previously reported	32,600	20,000	32,600	20,000
Change in accounting policy with respect to the capitalisation of interest (Net of income taxes of 2,340 for 2002 and 1,560 for 2001) (Note 1)	-	-	(5,460)	(3,640)
Opening retained earnings as restated	32,600	20,000	27,140	16,360
Net profit	13,440	12,600	18,900	10,780
Closing Retained Earnings	**46,040**	**32,600**	**46,040**	**27,140**

Extracts from notes to the financial statements

1. An adjustment of 7,800 has been made in the income statement for 2002 representing the effect of a change in accounting policy

with respect to the treatment of borrowing costs related to a hydro-electric power station which is in course of construction for use by Shyama. The borrowing costs are booked as expenses instead of being capitalised. This change in accounting policy has been accounted for retrospectively.