IFRS Training

IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors

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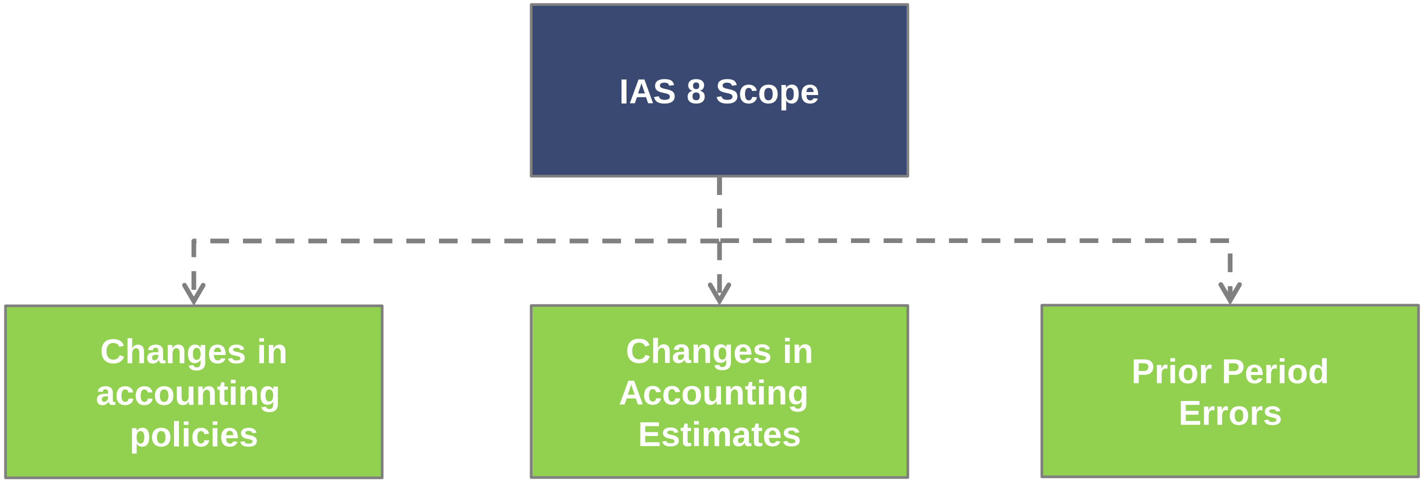
Section 1

Overview

Overview


IAS 8 Scope
Changes in accounting policies
Changes in Accounting Estimates
Prior Period Errors

Overview

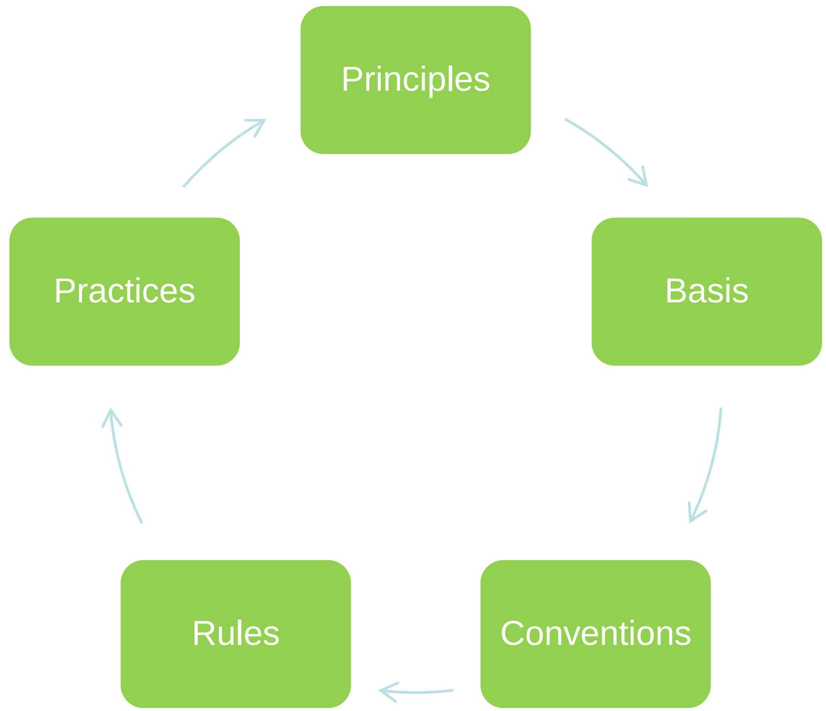
- ✓ IAS 8 sets out:

1	Criteria for selecting and applying accounting policies
2	Classification of material items
3	How to account for: changes in accounting policies, changes in accounting estimates and the correction of errors

Section 2

Accounting Policies

Definition



Applied in Preparing and Presenting Financial Statements

Selection and Application

- ✓ The IAS accounting 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 IFRS to achieve a particular **presentation** of any entity's financial position, financial performance or cash flows

- ✓ When a standard or interpretation applies to a transaction, the accounting policy or policies applied to that transaction shall be determined by applying the relevant standard or interpretation along with any relevant implementation guidance issued by the IASB

- ✓ If there is **no** applicable IFRS, management **should** use its judgment in developing and applying an accounting policy that results in information that is:

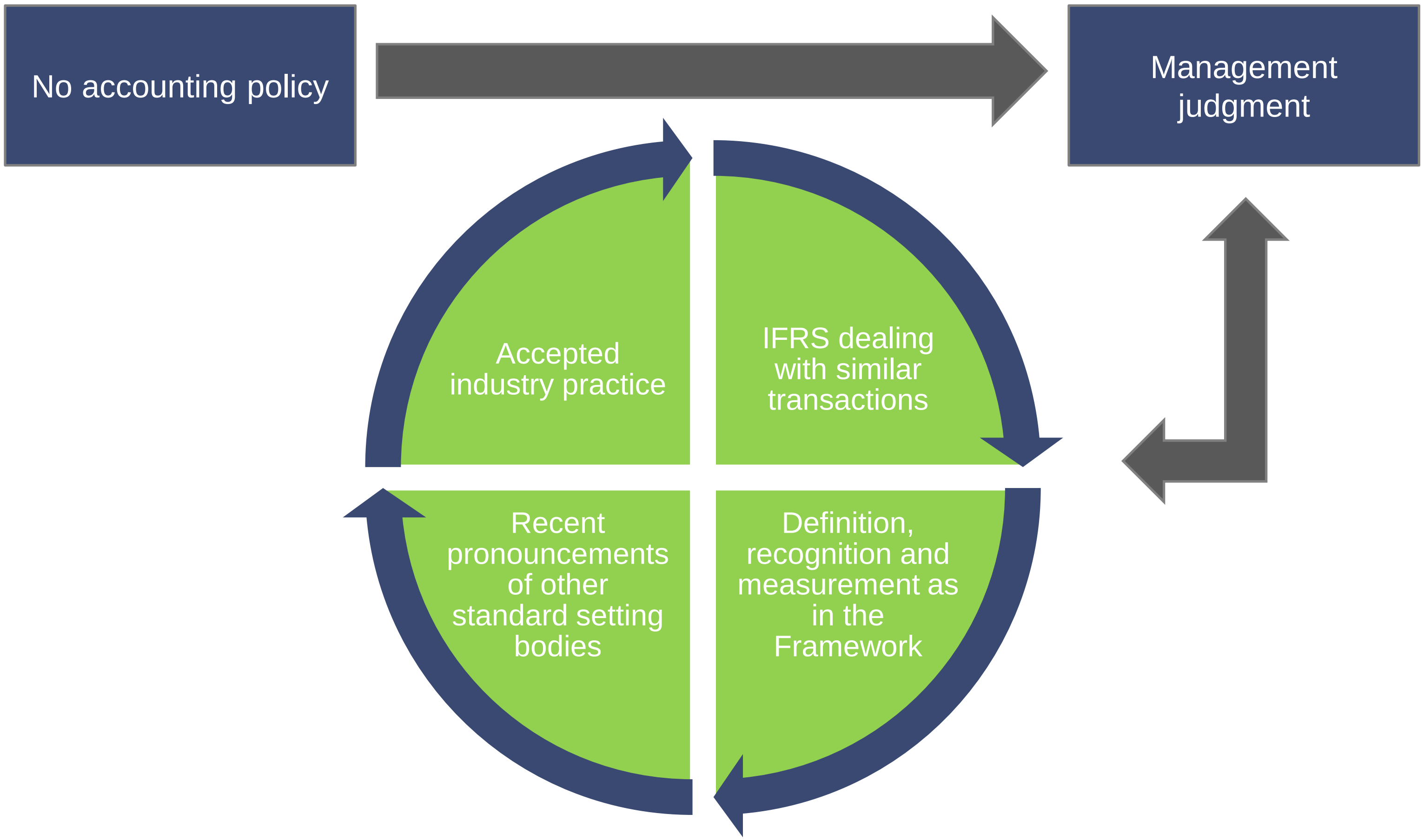
Selection and Application

- **Relevant** to the economic decision making needs for users

- **Reliable**

  - Representation faithfulness of the financial position, financial performance and cash flows of the entity
  - Substance over form
  - Neutrality (free from bias)
  - Prudence
  - Completeness

Selection and Application



Consistency of Accounting Policies

- ✓ Accounting policies **must be applied consistently** for **similar** items unless IFRS requires or permits categorization (Airplane)
- ✓ IAS 2 Inventories:
  - ❑ The same cost formula must be applied to similar items
  - ❑ A different cost formula can be applied to a different classification
- ✓ IAS 23 Borrowing Costs allows certain borrowing costs to be included in the cost of a qualifying asset. If the capitalization policy is selected then borrowing costs relating to **ALL** qualifying assets must be capitalized

Section 3

Changes in Accounting Policies

Changes in Accounting Policies

Consistency of accounting policies and presentation is a basic principle in both IAS 1 and IAS 8. Accordingly, IAS 8 permits a change in accounting policies if the change:

- Is required by IFRS → Mandatory
- Results in the financial statements providing reliable and more relevant information → Voluntary

Changes in Accounting Policies

- As users of financial statements will wish to see trends in an entity's financial statements **it would not be appropriate** for an entity to change its accounting policy whenever it wishes
- The first time application of an accounting policy to newly occurring items **is not a change**
- Examples of changes in accounting policy:
  - Changing the presentation of profit or loss items from the nature of expenses method to the function of expense method
  - IAS 16 adopting the revaluation model after using cost method
- Revaluations with respect to IAS 16 **is not a change in accounting policy** and accordingly, it is not necessary to restate prior periods for the carrying value and depreciations

Changes in Accounting Policies

- ✓ When it is **difficult to distinguish** a change in an accounting policy from a change in accounting estimate, the standard requires it to be treated **as a change in an accounting estimate**

- ✓ IAS 8 **addresses change of accounting policy** arising from three sources:

  - The initial application of an IFRS containing specific **transitional provisions**
  - The initial application of an IFRS **which does not** contain specific transitional provisions
  - Voluntary change in accounting policy

Should be applied retrospectively as if it had always been applied; refer to illustrative page 47

Changes in Accounting Policies

- ✓ When a change is applied **retrospectively**, an entity shall adjust the **opening balance** of each affected part of equity for the earliest period presented and the comparative amounts disclosed for each prior period as if the new policy had always been applied

- ✓ If it is **not practicable** to apply the effects of a change in policy to prior periods then the standard allows the change of policy to be made from the earliest period for which retrospective application is **practicable**

Changes in Accounting Policies

1	2	3
• As if the policy had always been applied	• The opening balance of each affected component of equity is adjusted for the earliest prior period presented and the comparative amounts disclosed as if the policy had always been applied	• If it is not practicable to apply the effects of a change in policy to prior periods IAS 8 allows the change to be made from the earliest period for which retrospective application is practicable (reasonable efforts have been made)

Changes in Accounting Policies

1- Nature of the change in policy

2- For the current period and each period presented the amount of the adjustment for each line item affected within the financial statements

3- The amount of the adjustment relating to periods before those presented

If retrospective restatement is not practicable, disclose:
- The circumstances that led to the existence of the condition
- A description of how and from when the change has been applied

Additionally

(i) New standard: Title of the new standard or interpretation

(ii) Voluntary change: Reasons why the new policy provides more relevant and reliable information

Section 4

Changes in Accounting Estimates

Changes in Accounting Estimates

- ✓ IAS 8 notes that the use of reasonable estimates **is an essential part** of the preparation of financial statements and it does not undermine their reliability
- ✓ Example of estimates given by the standard, including but not limited to:
  - Receivables may be **measured after allowing** for a general bad debt provision
  - Inventory is measured at **lower of cost or NRV** but must provide for obsolescence
  - A provision under IAS 37 by its very nature may be an **estimation of future economic benefits** to be paid out
  - Non-current assets have depreciation provisions made against them; these provisions will take into account the expected pattern of consumption of the asset and its expected useful life. The consumption pattern and expected life are estimates
- ✓ **Estimates will need revision as changes occur**

Changes in Accounting Estimates

- ✓ IAS 8 observes that the revision of estimate does not relate to prior periods and is not a correction of an error; accordingly, should be accounted for prospectively (therefore does not impact upon prior period statements)

- ✓ If the change in estimate affects the measurement of assets or liabilities then the change shall be recognized by adjusting the carrying amount of the asset or liability

Section 5

Correction of Errors

Correction of Errors

- ✓ Error can arise in respect of the **recognition, measurement, presentation or disclosures** of elements of financial statements
- ✓ Omissions and misstatements in previous period(s) financial statements. Arising from failure to use/misuse information that:
  - ❑ Was available
  - ❑ Could reasonably be expected to have been obtained
- ✓ IAS 8 states that financial statements do not comply with IFRS if they contain errors that are:
  - ❑ Material
  - ❑ Immaterial but are made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows

Correction of Errors

- ✓ Examples

Mathematical mistakes	Mistakes in accounting policies	Misinterpretation of facts	Fraud	Oversights

- ✓ Material prior period errors are **corrected retrospectively** in the first set of financial statements authorized for issue after their discovery by restating comparative information for the prior period(s) presented in which the error occurred

- ✓ The current period financial statements are presented **as if the error had been corrected** in the period in which it was originally made. However, an entity **does not reissue** the financial statements of prior periods

- ✓ If it is **not practicable** to determine the period-specific effects of an error on comparative information the opening balances are restated for the **earliest period practicable**