Move Forward International

IFRS Training

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

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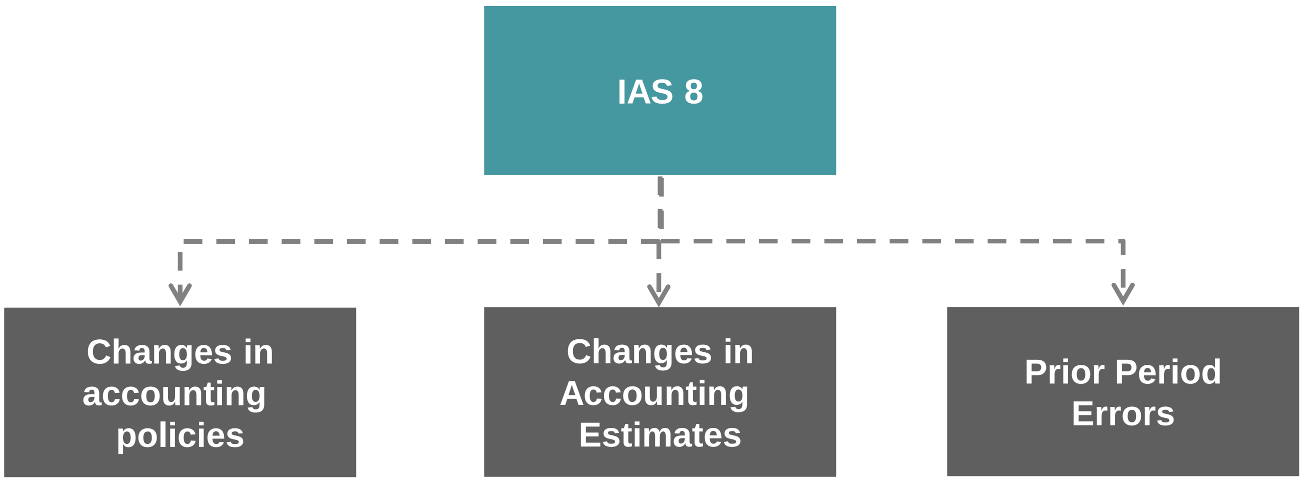
Overview

Overview


IAS 8
Changes in accounting policies
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Overview

- ✓ IAS 8 sets out:

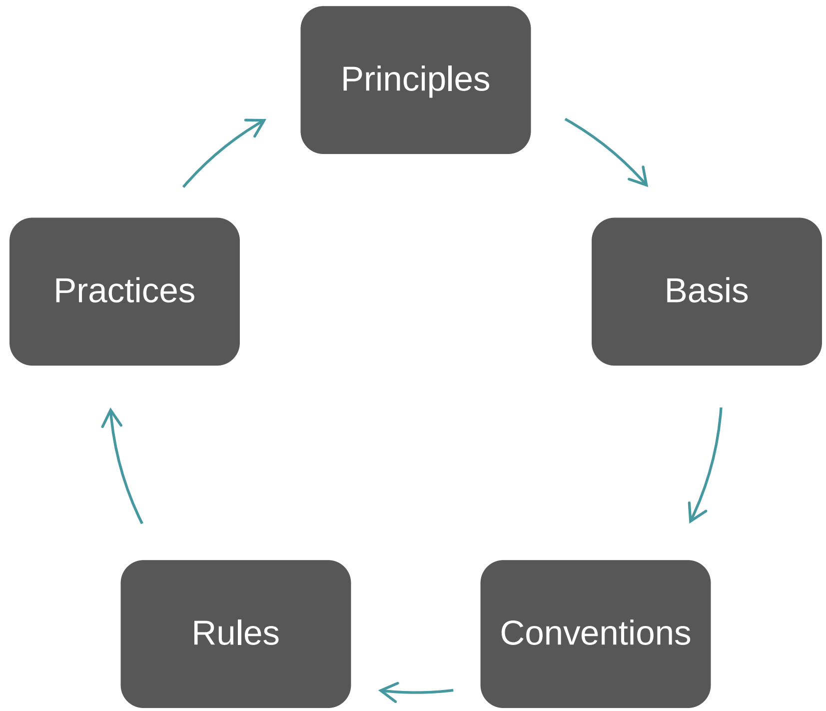
1	Criteria for selecting and applying accounting policies
2	Classification of material items
3	How to account for: changes in accounting policies, changes in accounting estimates and the correction of errors

- ✓ The standard intention is to enhance the relevance and reliability of the financial statements

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

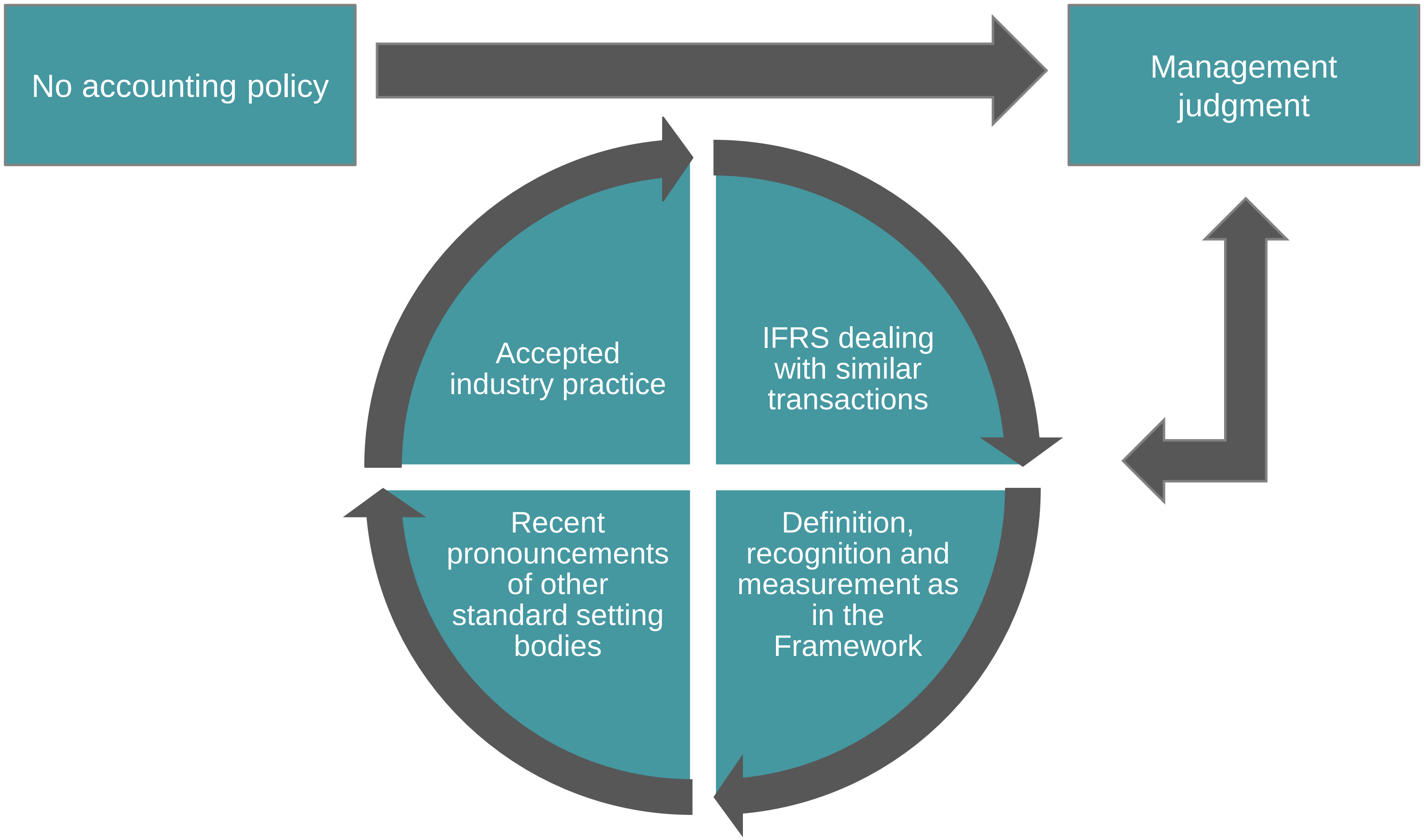
- ✓ When a standard or interpretation applies to a transaction, the accounting policy or policies applied to that transaction shall be determined by applying the relevant standard or interpretation along with any relevant implementation guidance issued by the IASB

- ✓ 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

- 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**

Changes in Accounting Policies

- ✓ 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

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

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

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

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