

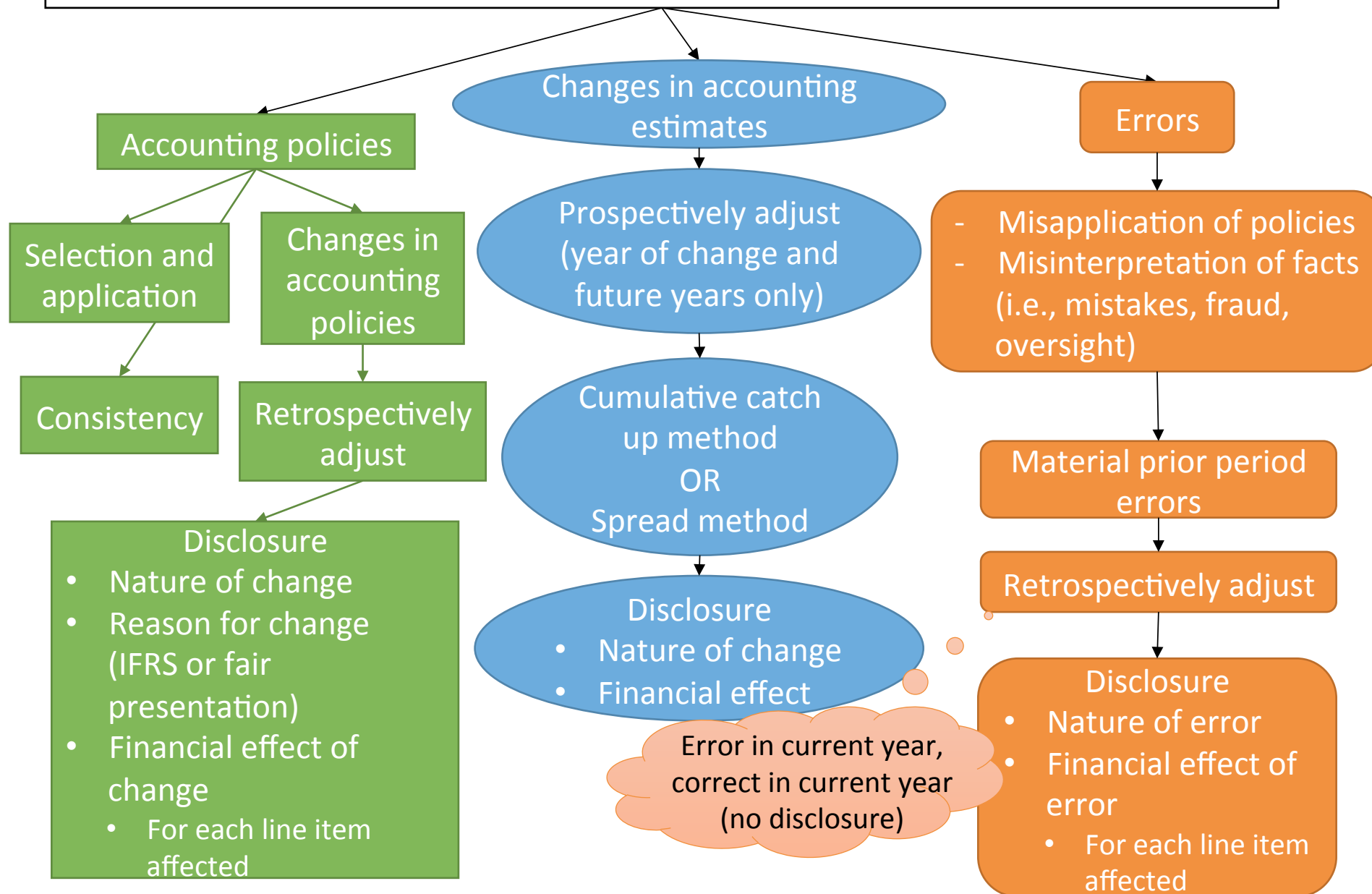
IAS 8

Accounting Policies, Changes in Estimates and Errors

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OVERVIEW – STANDARD ON A PAGE (SOAP)

IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

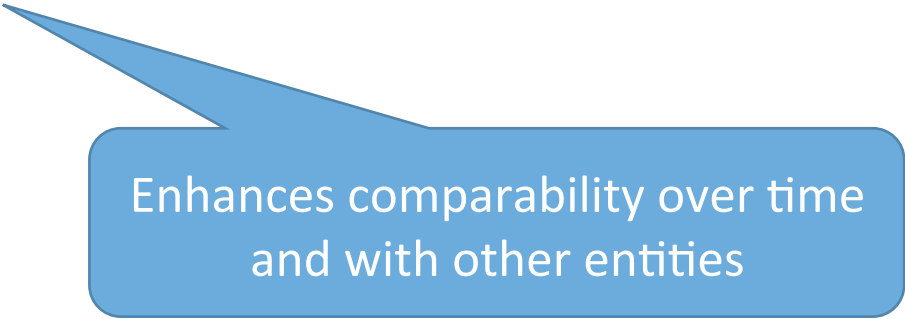


IAS 8 Accounting Policies, Changes in Estimates and Errors

OBJECTIVE AND SCOPE (READ ONLY)

Objective

- Prescribes criteria for
 - selecting and changing accounting policies
 - accounting treatment of
 - changes in accounting policies
 - accounting estimates
 - errors



Enhances comparability over time
and with other entities

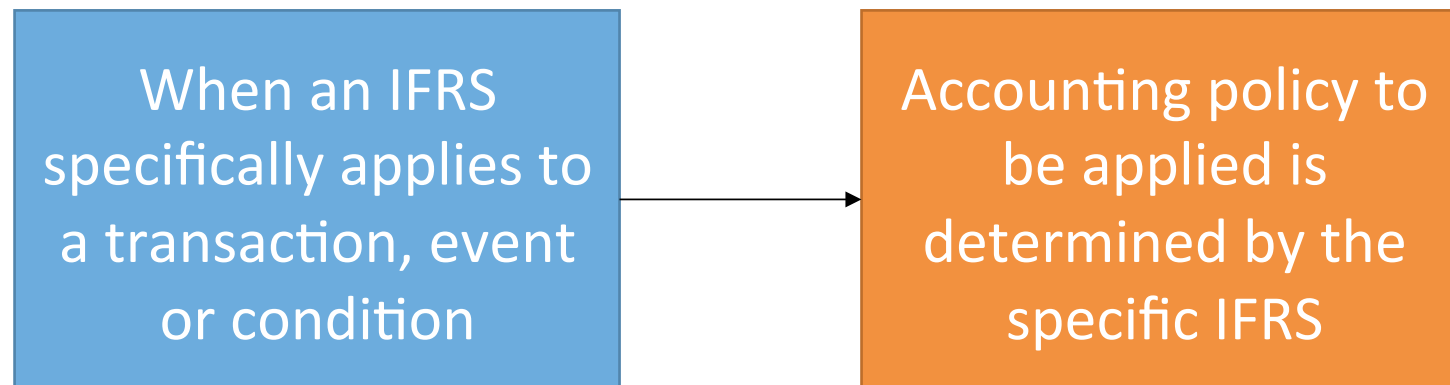
Scope

- IAS 8 applies to
 - Selecting and applying accounting policies
 - Accounting for changes in
 - accounting policies
 - accounting estimates
 - Correction of prior period errors

IAS 8 Accounting Policies, Changes in Estimates and Errors

ACCOUNTING POLICIES THEORY

Selection and Application of Accounting Policies



For example, equipment is discussed in IAS 16 Property, Plant and Equipment, ∴ accounting policy to be derived from IAS 16

Selection and Application of Accounting Policies

- Hierarchy for selection of accounting policies
 1. Standard and mandatory appendices
 2. Interpretations
 3. Non-mandatory appendices (eg. Illustrative Examples)
 4. Implementation guidance
 5. Framework
 6. Pronouncements by other standard setters with similar framework

Selection and Application of Accounting Policies

- In the absence of Standard or Interpretation
 - Use judgment in developing and applying an accounting policy that result in information that is
 - Relevant
 - Reliable
 - Faithful representation
 - Substance over form
 - Neutral
 - Prudent
 - complete

Consistency of Accounting Policies

- Select and apply accounting policies consistently for similar transactions
- If categorisation is permitted or required
 - Apply accounting policy for each category consistently

Changes in Accounting Policies

- Only if
 - Required by a standard or an interpretation
 - Change results in the financial statements providing
 - reliable and
 - more relevant information



Fair presentation!

Changes in Accounting Policies

- Change in accounting policy made on the adoption of a Standard should be accounted for
 - in accordance with specific transitional provisions in that Standard
 - if no transitional provisions → *retrospective application*
- Voluntary change in accounting policy should be applied retrospectively
 - Early adoption of new IFRS is not a voluntary change

Changes in Accounting Policies

- Retrospective Application
 - Adjust opening balance of
 - each affected component of equity for earliest prior period presented and
 - other comparative amounts disclosed for each period presented
 - As if new accounting policy had always been applied
 - If impracticable, restate prospectively from earliest date practicable

Undue cost and effort

IAS 8 Accounting Policies, Changes in Estimates and Errors

DISCLOSURES – CHANGES IN ACCOUNTING POLICIES

Changes in Accounting Policies Significant Disclosures

Not repeated in
subsequent periods

- Title of Standard
- State that made in accordance with the transitional provisions, if applicable
- Nature of the change
- Amount of adjustment for current and each prior period presented
 - For each line item affected
 - For basic and diluted earnings (if IAS 33 Earnings Per Share applicable)
- Amount of adjustment related to periods prior to those presented

Changes in Accounting Policies

Significant Disclosures

- Standards issued but not yet effective
 - Disclose:
 - Such fact and
 - Impact of adoption on financial statements
 - Include in disclosure:
 - Title of Standard
 - Nature of impending change
 - Date by which application is required
 - Date on which entity plans to initially apply

Illustration (basic) – *don't worry about the maths yet*

	Current year	Prior year 1	Prior year 2
Financial Position			
Decrease in asset	(1,800)	(1,500)	(1,000)
Decrease in deferred tax liability	540	450	300
Net decrease in equity	(1,260)	(1,050)	(700)
Opening effect on retained earnings			(140)
<i>(200 – tax 60)</i>			
Financial Performance (Profit or loss)			
Decrease in revenue	(300)	(500)	n/a
Decrease in tax expense	90	150	n/a
Net decrease in profit	(210)	(350)	n/a

IAS 8 Class Example

CHANGE IN ACCOUNTING POLICY – INVENTORY VALUATION

Change in Accounting Policy Example

- Entity X Ltd decides to change its accounting policy for inventory in 20X4
- It previously applied the weighted average method
- It now applies the first in-first out method
- The change in inventory value will not be accepted retrospectively by the tax authority
 - (that is the previously submitted tax returns will NOT be re-opened).

Example (Cont.)

	20X4 CU	20X3 CU	20X2 CU
FIFO (new value)	10,000	9,300	6,000
Weighted Average (old value)	9,000	8,500	4,000
Difference	1,000	800	2,000

- Assume that the tax rate is 30%

Required: Prepare the journals and disclosure for the above change in accounting policy.

Solution

	20X4	20X3	20X2
FIFO (new)	10,000	9,300	6,000
WA (old)	9,000	8,500	4,000
Difference	1,000	800	2,000

Change in Accounting Policy Example

- Before prior year (20X2)

Dr Inventory (FP) Cr Retained earnings (Eq) <i>Increase in inventory due to policy change</i>
Dr Retained earnings (Eq) Cr Deferred tax (FP) <i>Tax effect of increase in inventory</i>

If tax authority does not reopen

OR

Dr Retained earnings (Eq) Cr Current tax liability (FP) <i>Tax effect of increase in inventory</i>
--

If tax authority does reopen

Change in Accounting Policy Example

- Prior year (20X3)

Dr Inventory (FP)

Cr Cost of sales (PL)

Increase in inventory due to policy change


Dr Cost of sales (PL)

Cr Inventory (FP)


Reversal of prior year increase (inventory sold)

Change in Accounting Policy Example

- Prior year (20X3)

Dr Deferred tax (PL) Cr Deferred tax (FP) <i>Tax effect of increase in inventory</i>	
Dr Deferred tax (FP) Cr Deferred tax (PL) <i>Tax effect of reversal (inventory sold)</i>	

OR

Dr Current tax (PL) Cr Tax authority (FP) <i>Tax effect of increase in inventory</i>	
Dr Tax authority (FP) Cr Current tax (PL) <i>Tax effect of reversal (inventory sold)</i>	

Change in Accounting Policy Example

- Current year (20X4)

Dr Inventory (FP) Cr Cost of sales (PL) <i>Increase in inventory due to policy change</i>
Dr Cost of sales (PL) Cr Inventory (FP) <i>Reversal of prior year increase (inventory sold)</i>
Dr Deferred tax (FP) Cr Deferred tax (PL) <i>Tax effect of reversal (inventory sold)</i>
Dr Current tax (PL) Cr Tax authority (FP) <i>Tax effect of increase in inventory</i>

If tax authority does not reopen

Change in Accounting Policy

Inventory valuation

- Example disclosure

8. During the year Co X Ltd decided to change the accounting policy for inventory from weighted average method to first in-first out method. This was done to more appropriately determine cost of inventory. The change in accounting policy was accounted for retrospectively and comparative amounts have been restated accordingly. The effect of the change is as follows:

Example disclosure (continued)

	20X4	20X3	20X2
<u>Statement of Profit or Loss</u>	CU	CU	CU
Decrease/(increase) in cost of sales			
Decrease/(increase) in income tax expense			
Increase/(decrease) in profit			
<hr/>			
<u>Statement of Financial Position</u>			
Increase/(decrease) in inventory			
Decrease/(increase) in deferred tax liability			
Decrease/(increase) in current tax liability			
Increase/(decrease) in equity			
<hr/>			

Example disclosure (continued)

	20X4	20X3	20X2
<u>Statement of Profit or Loss</u>	CU	CU	CU
Decrease/(increase) in cost of sales	200	(1 200)	n/a
Decrease/(increase) in income tax expense	(60)	360	n/a
Increase/(decrease) in profit	140	(840)	n/a
<u>Statement of Financial Position</u>			
Increase/(decrease) in inventory	1 000	800	2 000
Decrease/(increase) in deferred tax liability	-	(240)	(600)
Decrease/(increase) in current tax liability	(300)		-
Increase/(decrease) in equity	700	560	1 400

IAS 8 Accounting Policies, Changes in Estimates and Errors

ACCOUNTING ESTIMATES THEORY

Changes in Accounting Estimates

- Accounting estimates are required to prepare financial statements
 - Bad debts
 - Inventory obsolescence
 - Fair values of financial assets and financial liabilities
 - Warranty obligations
 - Useful life of assets
 - Change in depreciation method
 - Change in residual value of asset
 - Change in estimated value of provision

Changes in Accounting Estimates

- Changes can occur as a result of
 - Changes in circumstances and judgments used in estimates and
 - Uncertainties inherent in business activities
- Revision of estimate does not apply to prior periods
 - ∴ not correction of error
- When difficult to distinguish between change in accounting policy and change in estimate
 - Change is treated as change in accounting estimate

Changes in Accounting Estimates

- Effect of change is recognised prospectively
 - included in profit or loss
 - In period of the change and
 - Future periods (if change affects future periods)
- If change affects asset, liability or equity
 - Adjust carrying amount of asset, liability or equity in period of change

Changes in Accounting Estimates Significant Disclosures

- Nature of change
 - Amount of change
- } which has effect in
current or future period
- If amount of effect in future period is not disclosed because estimating is impracticable
 - Disclose such fact

IAS 8 Class Example

ACCOUNTING POLICIES VS ACCOUNTING ESTIMATES

Changes in Accounting Policies vs Changes in Accounting Estimates

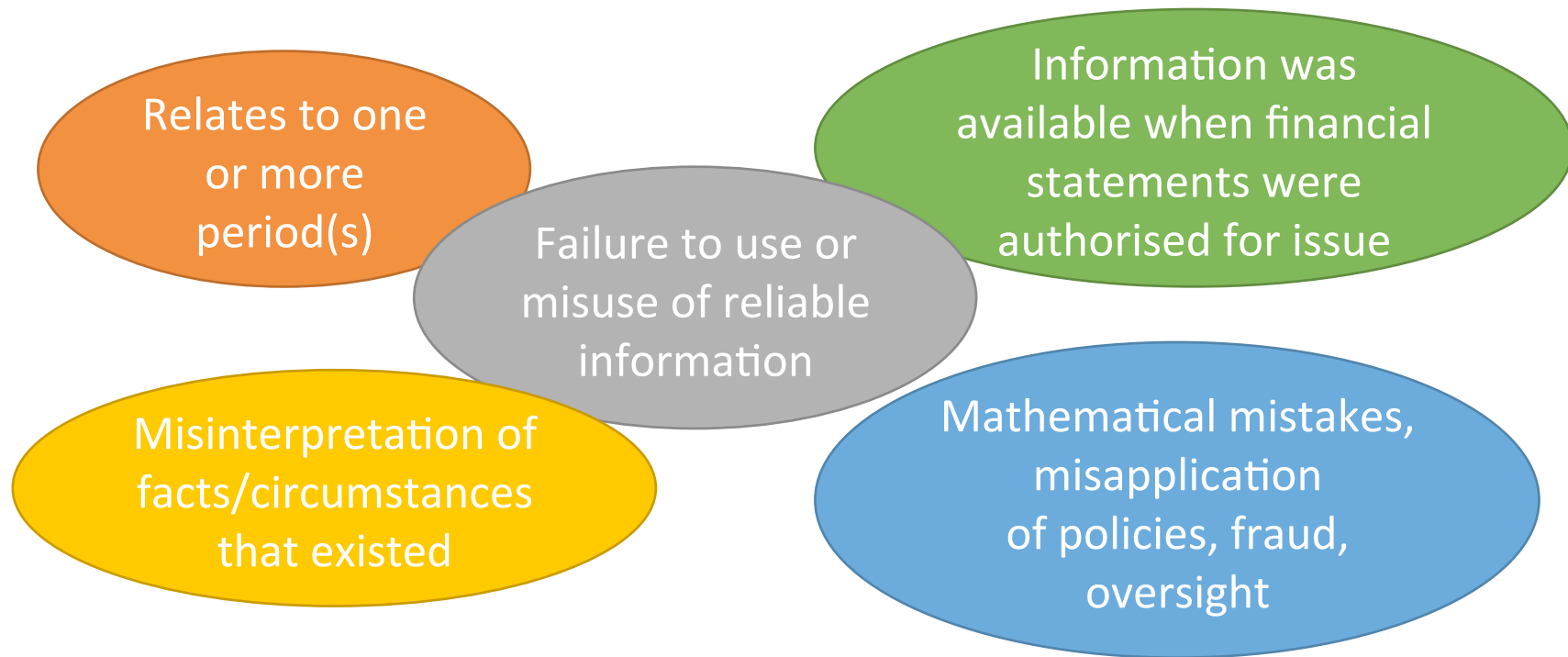
	Scenario	AE	AP
1	<ul style="list-style-type: none"> Management of a hotel changed its strategic plans and as a result the rooms had to be refurbished within 2 years instead of 4. Thus, period over which 7 year refurbishment is depreciated has decreased. 		
2	<ul style="list-style-type: none"> Co X decided to change calculation of its allowance for bad debts. In prior years the calculation of the allowance for bad debts was based on fixed % multiplied by total outstanding balance over 90 days. Now, X calculates the allowance for bad debts on a review of individual balances. 		
3	<ul style="list-style-type: none"> Co B decides to change its valuation of inventories from FIFO to weighted average. 		
4	<ul style="list-style-type: none"> The depreciation method of machine Y is changed from the straight-line method to the units of production method to better reflect use. 		

IAS 8 Accounting Policies, Changes in Estimates and Errors

ACCOUNTING ERRORS THEORY

Errors

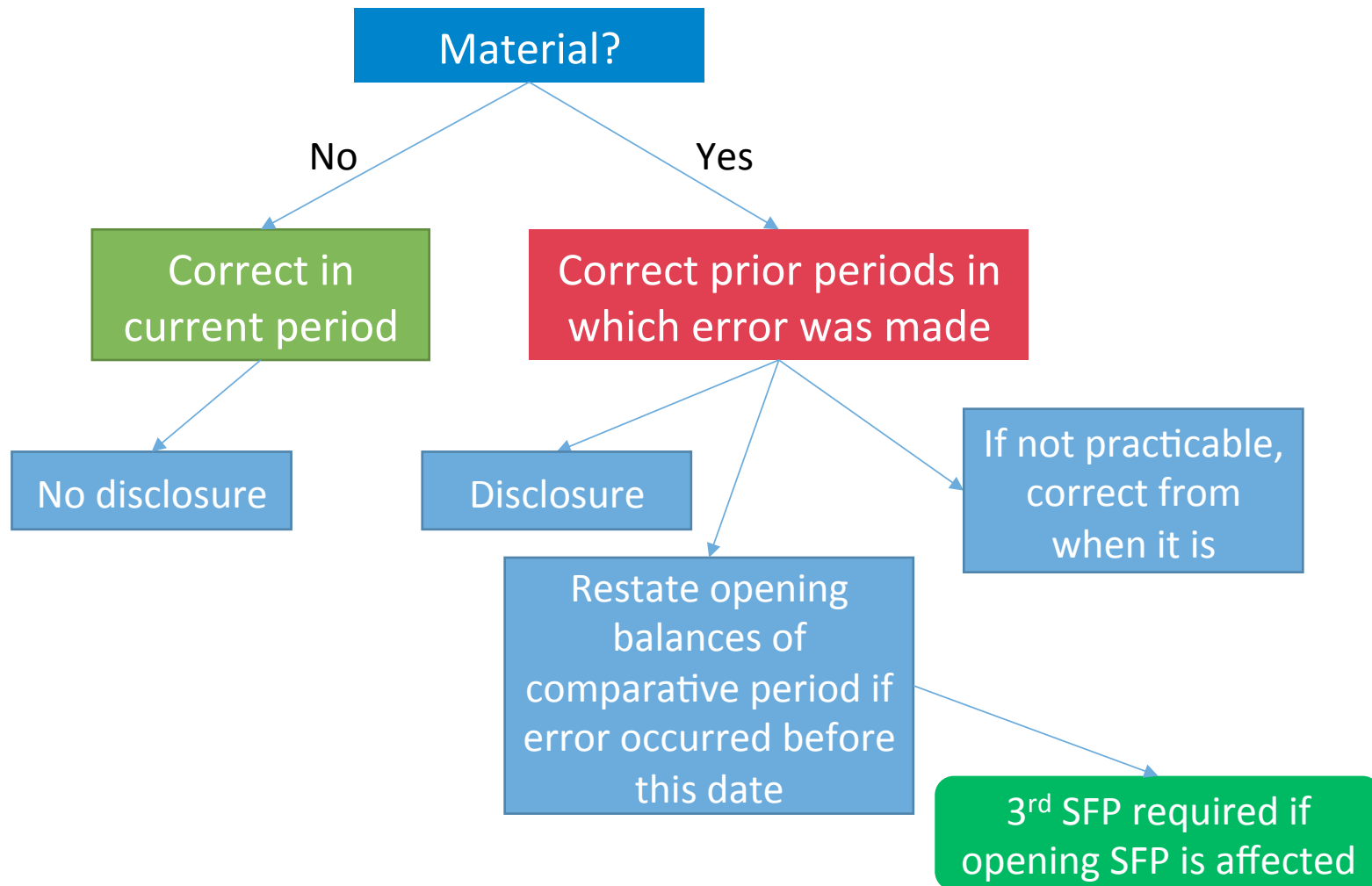
- Omission from OR misstatement in financial statements



Errors

- *Material* prior period errors are retrospectively corrected in the 1st set of financial statements authorised for issue after discovery
- Restate either:
 - Comparative amounts for prior period(s) presented in which error occurred
 - OR
 - Opening balances of assets, liabilities and equity for earliest period presented (if error occurred before the earliest prior period presented)

Correction of prior period errors



IAS 8 Class Example

ACCOUNTING ERRORS

Errors Examples

	Scenario	Error? Yes/No
1	During the annual year-end inventory count, a mistake was made in calculating the quantity of a certain item.	
2	The bookkeeper accidentally captured some invoices with the wrong amounts in the previous year.	
3	Co X bought an asset 2 years ago. The VAT was incorrectly accounted for in the financial records.	

IAS 8 Accounting Policies, Changes in Estimates and Errors

DISCLOSURES FOR ERRORS

Errors Disclosure



Not repeated in
subsequent periods

- Nature of prior period error
- Amount of correction for each prior period presented
 - For each line item affected
 - For basic and diluted earnings (if IAS 33 Earnings Per Share applicable)
- Amount of correction at beginning of earliest period presented
- If retrospective restatement impracticable, describe such

Illustration (basic) – *don't worry about the maths yet*

	Current year	Prior year 1	Prior year 2
Financial Position			
Decrease in asset	n/a	(1,500)	(1,000)
Decrease in deferred tax liability	n/a	450	300
Net decrease in equity	n/a	(1,050)	(700)
Opening effect on retained earnings			(140)
<i>(200 – tax 60)</i>			
Financial Performance (Profit or loss)			
Decrease in revenue	n/a	(500)	n/a
Decrease in tax expense	n/a	150	n/a
Net decrease in profit	n/a	(350)	n/a

IAS 8 Class Example

CORRECTING ACCOUNTING ERRORS

Example

Correcting an error

- During 20X4, Co X discovered that prepayments of CU400 made during 20X2 had not been recognised in profit or loss as related expenses were incurred.
- The prepayments should have been recognised as follows:
 - 20X2 = CU100 expense
 - 20X3 = CU250 expense
 - 20X4 = CU50 expense
- The misstatement is material and assume a tax rate of 28% (and that the expense was tax deductible at the earlier of payment or accrual)

Journals – what was recorded

Extract from draft 20X4 financial statements before correction of error

	Draft 20X4	20X3	20X2
<i>Extract from statement of profit or loss and comprehensive income</i>			
Revenue	6,000	4,000	2,000
Expenses	<u>(3,500)</u>	<u>(2,600)</u>	<u>(1,000)</u>
Profit before tax	2,500	1,400	1000
Tax expense	(700)	(392)	(280)
- Current tax expense (assume only TD is prepayment)	(700)	(392)	(168)
- Deferred tax expense	0	0	(112)
Net profit after tax	<u>1,800</u>	<u>1,008</u>	<u>720</u>
<i>20X2 CT exp = 1,000 – 400 = 600 x 28% = 168</i>			

Extract from draft 20X4 financial statements before correction of error

	Draft 20X4	20X3	20X2
<u>Extract from statement of financial position</u>			
Assets – Prepaid expense	400	400	400
Liabilities – Deferred Tax Liability	0	0	112
Liabilities – Current Tax Liability	700	392	168
<u>Extract from statement of changes in equity</u>			
Opening retained earnings	11,728	10,720	10,000
Current year net profit	1,800	1,008	720
Closing retained earnings	13,528	11,728	10,720

Journals to correct error 20X2

Journals to correct error 20X3

Journals to correct error 20X4

Example

Correcting an error

- Extracts from the notes
 8. During the year Co X discovered that prepayments had not been recognised in profit or loss as the related expenses were incurred. The prepayments should have been recognised as expenses of CU100 in 2012; CU250 in 2013 and CU50 in 2014. The financial statements of 2013 have been restated to correct this error. The effect of the restatement is summarised below.

Example disclosure (continued)

	20X4	20X3	20X2
<u>Statement of Profit or Loss</u>	CU	CU	CU
Decrease/(increase) in expense	n/a	(250)	n/a
Decrease/(increase) in income tax expense	n/a	70	n/a
Increase/(decrease) in profit	n/a	180	n/a
<u>Statement of Financial Position</u>			
Increase/(decrease) in prepaid expense	n/a	(250)	(100)
Decrease/(increase) in deferred tax liability	n/a	70	28
Decrease/(increase) in current tax liability	n/a	0	0
Increase/(decrease) in equity	n/a	(180)	(72)