

IAS 8: CHANGE IN ACCOUNTING POLICIES AND ESTIMATES

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LEARNING OUTCOMES

At the end of the lesson, students should be able to:

Define accounting policy

Explain the guidance on the selection of accounting policies

Account for changes in accounting policy

Distinguish between accounting policy and accounting estimate

Account for changes in accounting estimates



The aim of *IAS 8*

- *Accounting policies, changes in accounting estimates and errors* is to enhance comparability of the entity's financial statements to previous periods and to the financial statements of other entities. It does this by prescribing:
  - changes in accounting policies;
  - changes in accounting estimates; and
  - errors.
- Much of IAS 8 is concerned with how changes or corrections should be reported in the financial statements.

Accounting policies

- IFRSs set out accounting policies that 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.
- 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
- **Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.**



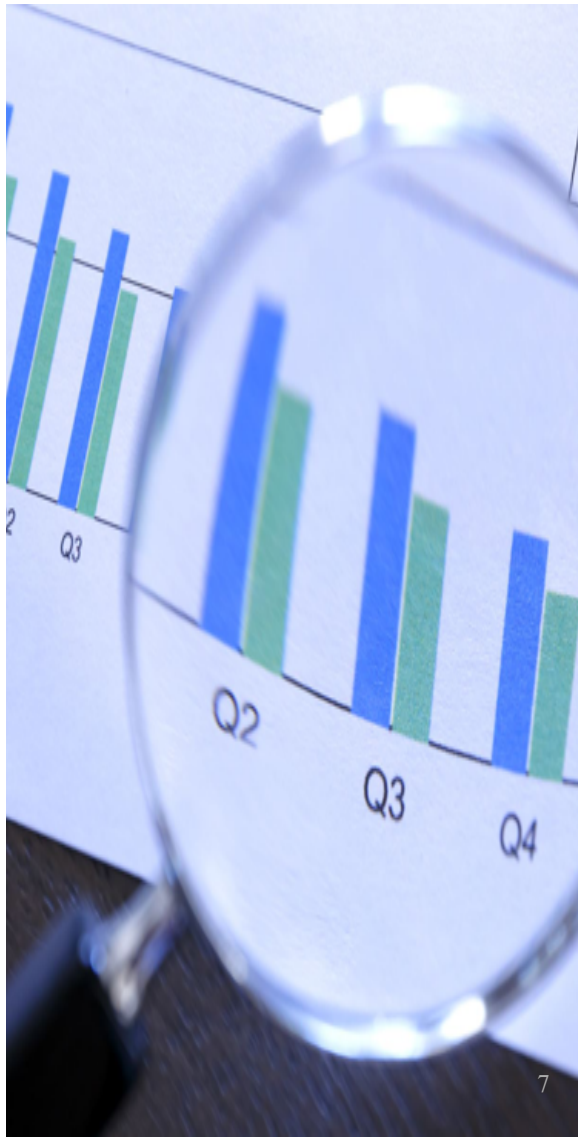
Selection of accounting policies – Areas covered by IFRS

- If an IFRS (or an Interpretation) applies to an item in the financial statements, the accounting policy or policies applied to that item must be determined by applying the Standard or Interpretation and any relevant implementation guidance issued.



Selection of accounting policies – Areas NOT covered by IFRS

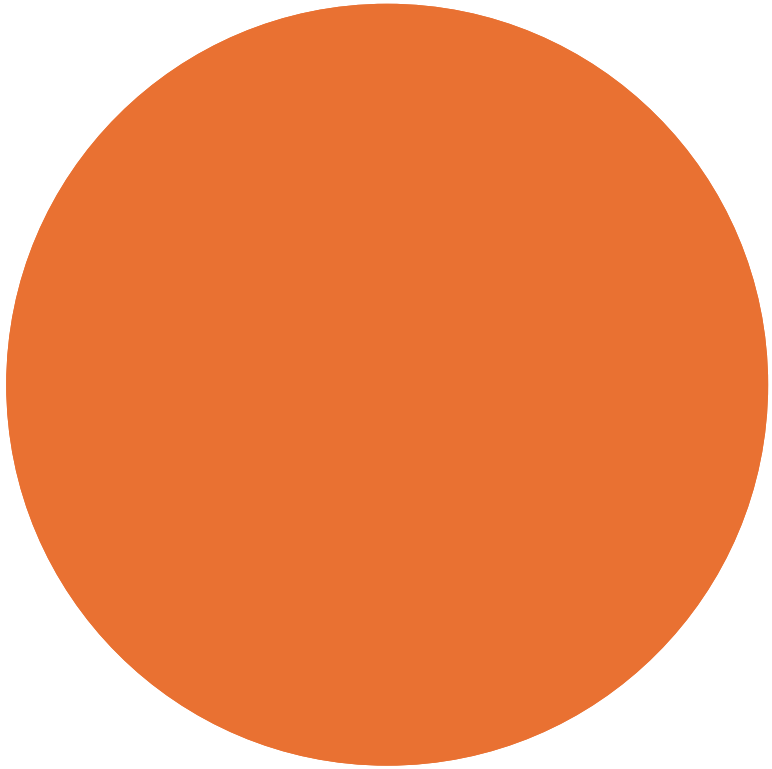
- If there is no rule in IFRS that specifically applies to an item in the financial statements, management must use its judgement to develop and apply an accounting policy that results in information that is:
- x relevant to the decision-making needs of users; and
- x reliable in that the financial statements;
- x represent faithfully the results and financial position of the entity;
- x reflect the economic substance of transactions and other events and not merely the legal form;
- x are neutral, i.e. free from bias;
- x are prudent; and
- x are complete in all material respects.



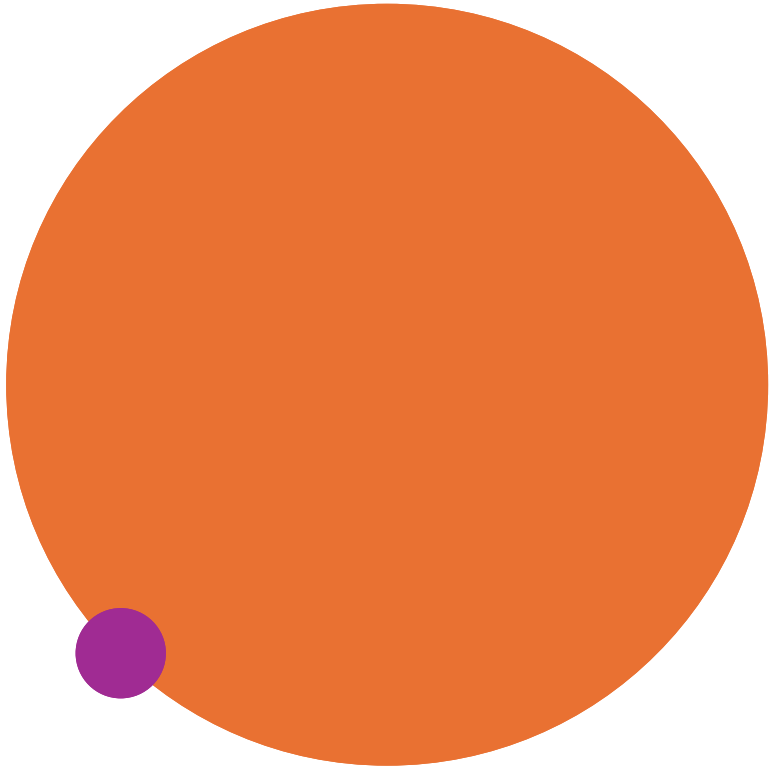
MANAGEMENT JUDGEMENT

Consistency of accounting policies

- An entity must apply consistent accounting policies in a period to deal with similar transactions, and other events and circumstances, unless IFRS specifically requires or permits categorisation of items for which different policies may be appropriate.



- Users of financial statements need to be able to compare financial statements of an entity over time, so that they can identify trends in its financial performance or financial position.
- Frequent changes in accounting policies are therefore undesirable because they make comparisons with previous periods more difficult.
- The same accounting policies must be applied within each period and from one period to the next unless a change in accounting policy meets one of the following criteria.

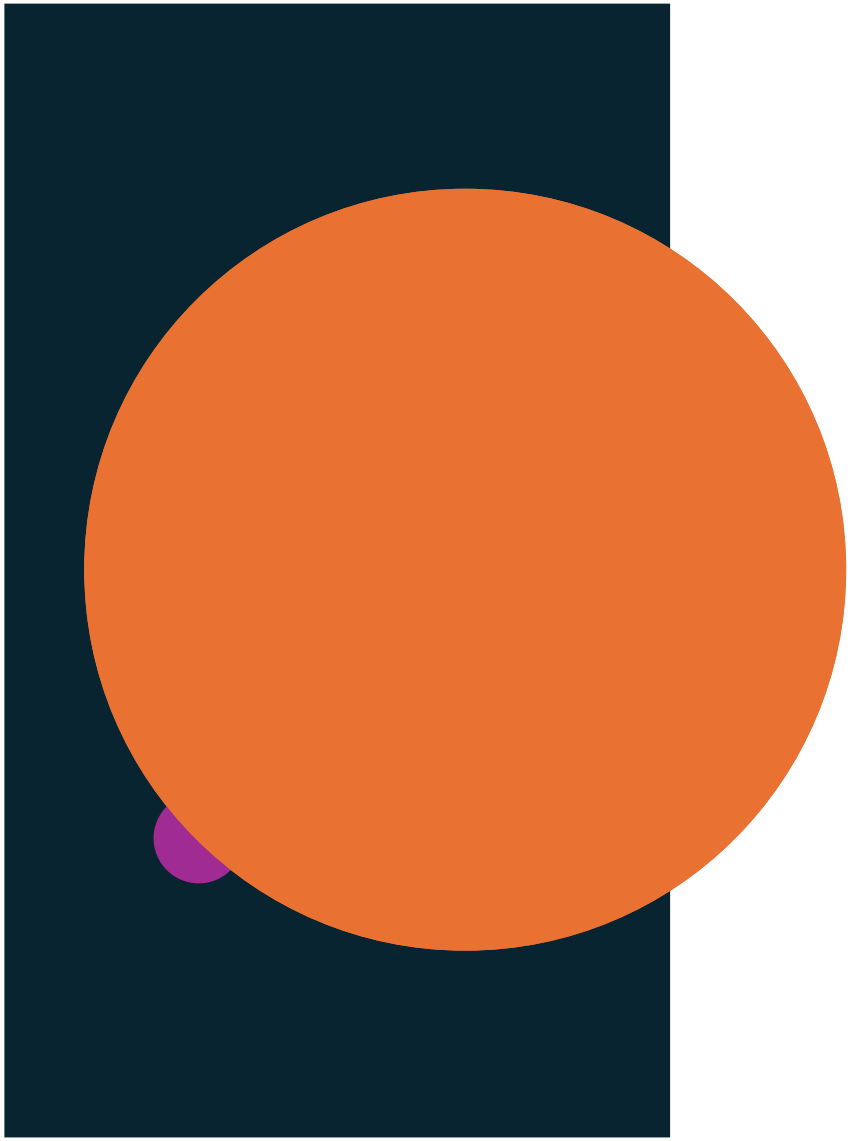


- **A change in accounting policy is permitted only if the change is:**

▪ **required by IFRS; or**

▪ **results in the financial statements providing reliable and more relevant financial information**.

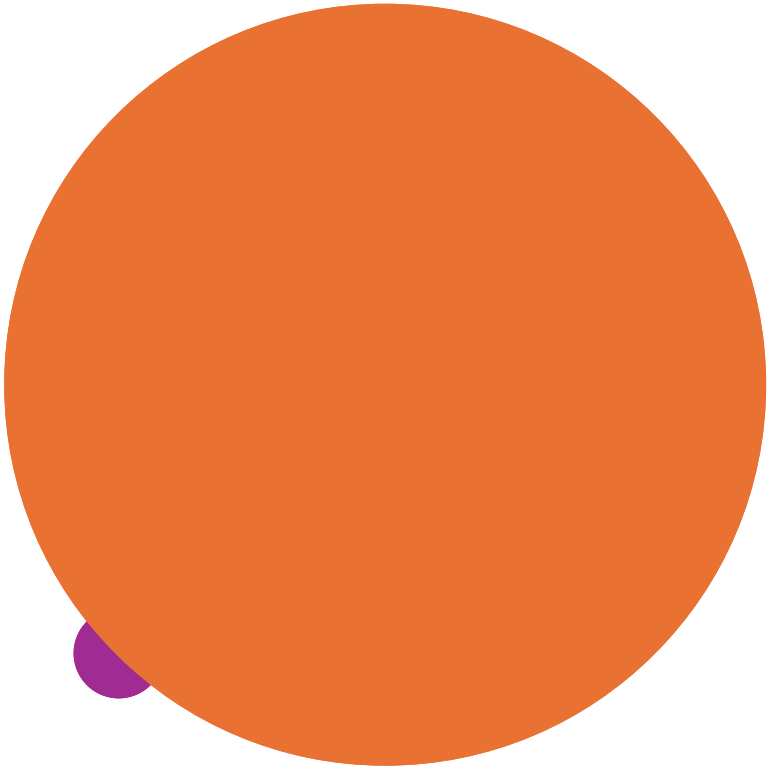
- A new or revised standard usually includes: specific ***transitional provisions*** to explain how the change required by the new rules should be introduced.
- In the absence of specific transitional provisions, **a change in policy should be applied retrospectively**. This is explained shortly



- The accounting policies chosen by an entity should reflect transactions and events through:
- – recognition (e.g., capitalising or writing off certain types ofexpenditure)
- – measurement (e.g., measuring non-current assets at cost orvaluation)
- – presentation (e.g., classification of costs as cost of sales or administrative expenses)
- **If at least one of these criteria is changed, then there is a change in accounting policy**

Illustration 1

- X Ltd has previously used the cost model to measure investment properties (IAS 40). X Ltd decides to use the fair value model instead because it is believed that this will provide reliable and more relevant information. This is a change in accounting policy affecting measurement.
- IAS 8 specifies that the application of a new accounting policy to transactions or events that did not occur previously or differ in substance from those that occurred previously, is **not** a change of accounting policy. It is simply the application of a suitable accounting policy to a new type of transaction.



- The initial application of a policy to revalue assets in accordance with IAS 16 Property, Plant and Equipment or IAS 38 Intangible Assets is a change in an accounting policy. However, it is accounted for in accordance with the guidance in those standards rather than in accordance with IAS 8.

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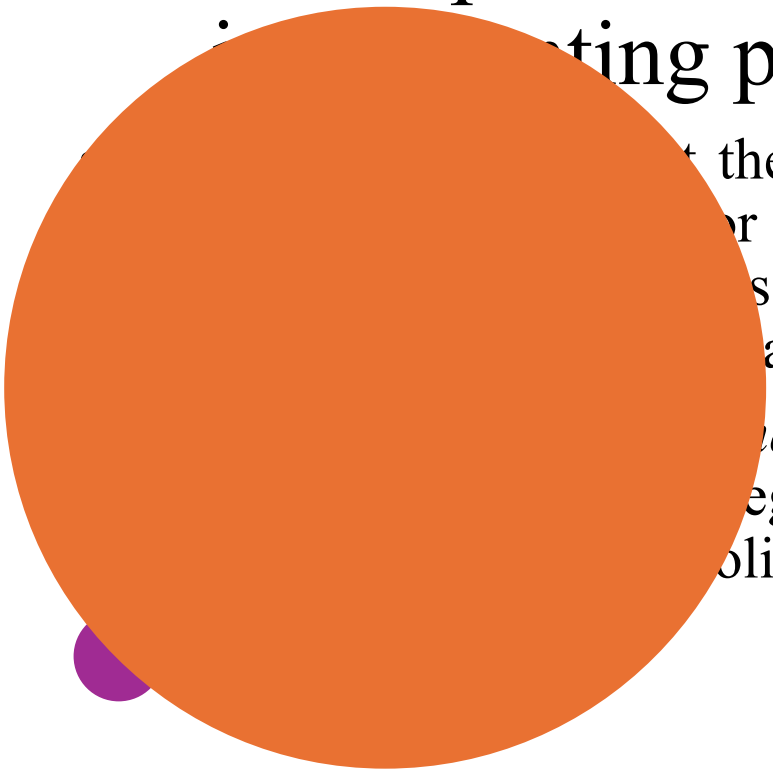
Retrospective application of a change in accounting policy



t the opening balance for each item of equity
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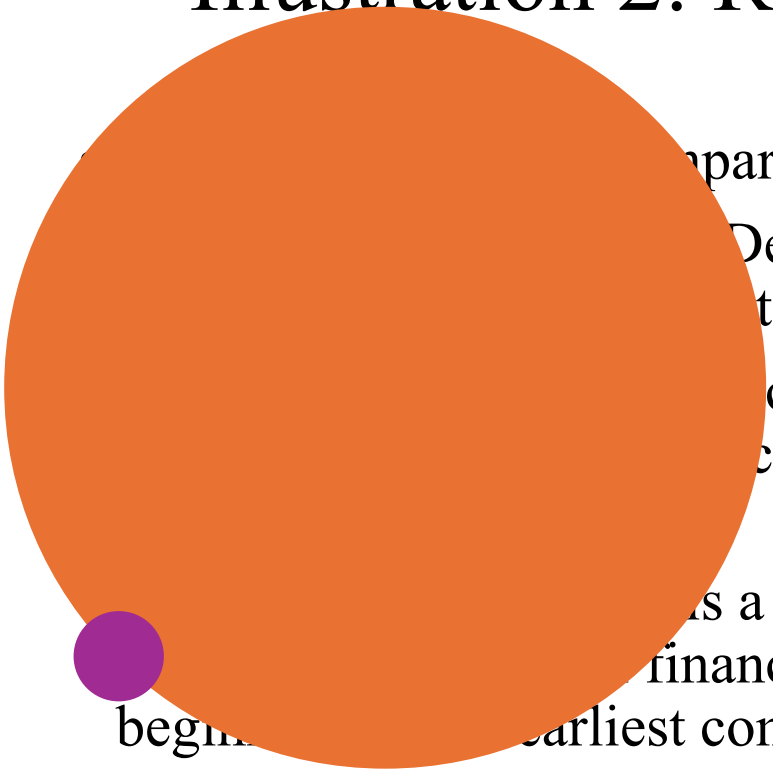
Illustration 2: Retrospective



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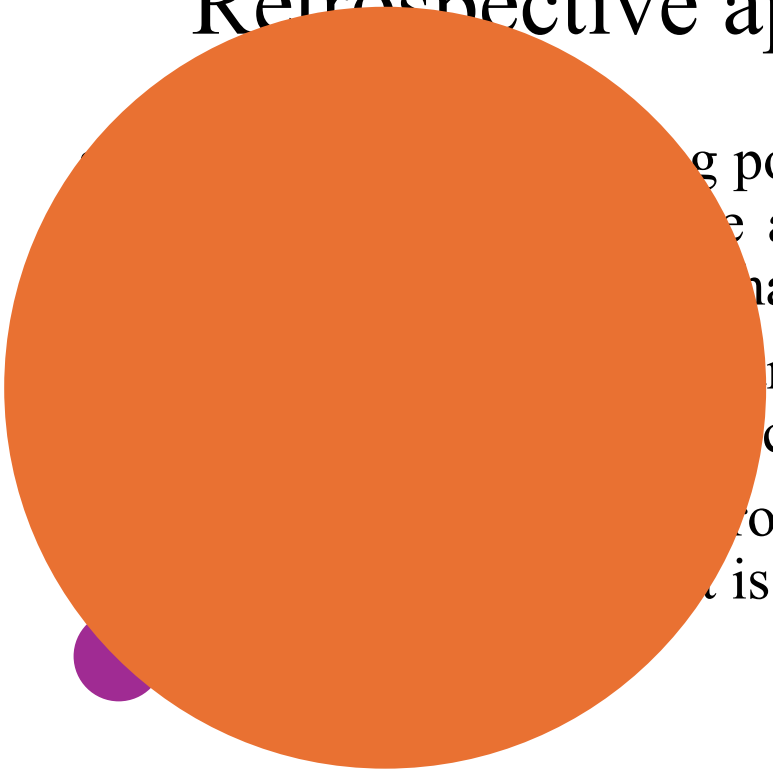
Retrospective application



g policy is applied retrospectively. This means
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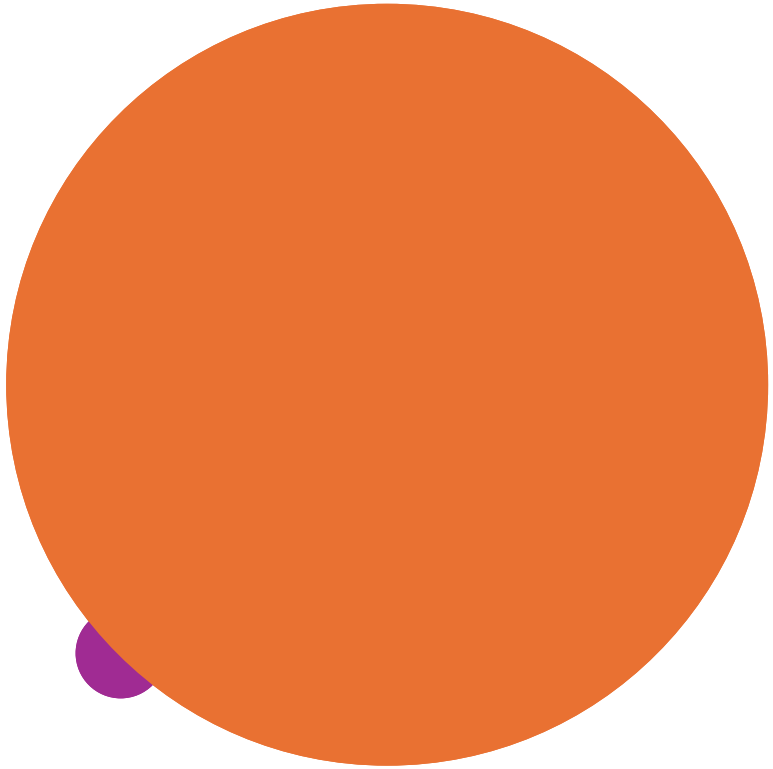
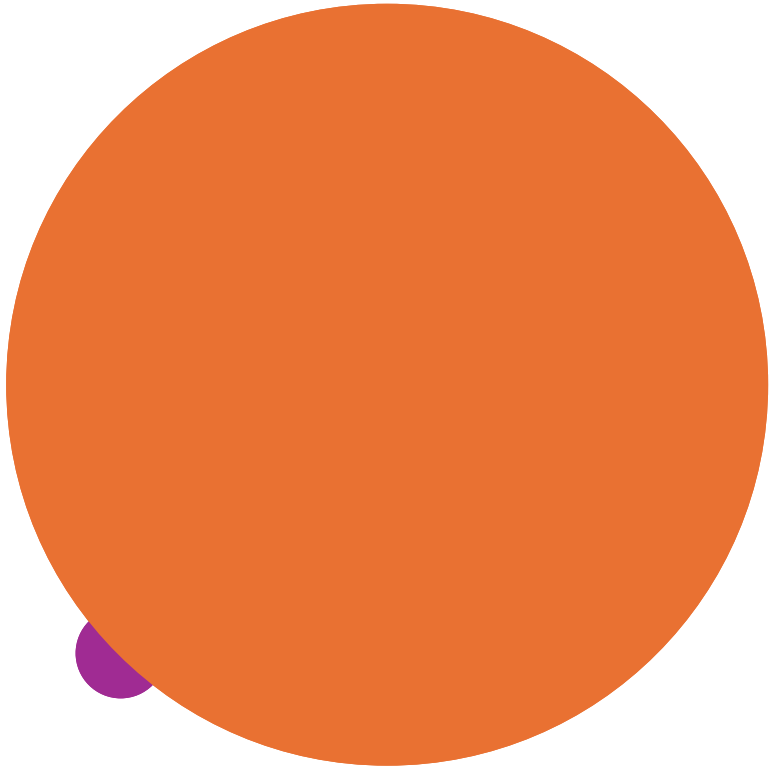
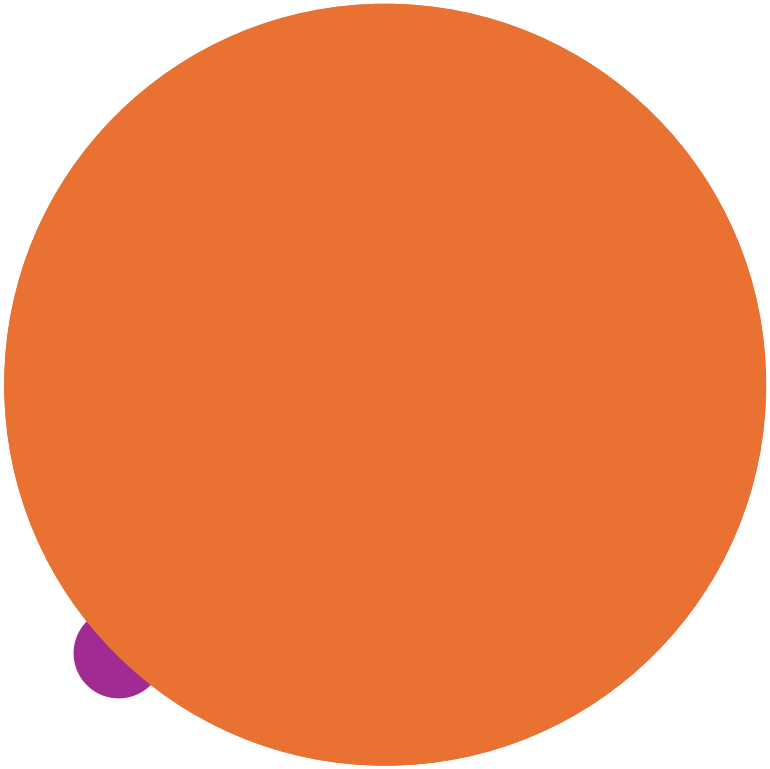
is practicable.



- **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 recognised, measured or disclosed; and
- (ii) would have been available when the financial statements for that prior period were authorized for issue from other information.



- When a change in accounting policy has an effect on the current period or any prior period (or 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 the following must be disclosed:

Disclosure of a change in accounting policy

Disclosure:	Change due to IFRS	Voluntary change
The title of the Standard or Interpretation	"	
The nature of the change in accounting policy	"	"
A description of any transitional provisions	"	
The reason why the new accounting policy provides reliable and more relevant information		"
For the current and previous period(s), to the extent practicable, the amount of the adjustment to each item in the financial statements.	"	"
To the extent practicable, the adjustment relating to accounting periods before those presented in the financial statements	"	"
If retrospective application is impracticable, an explanation of how the accounting policy change	"	"

Accounting estimates

- An accounting estimate is made for an item in the financial statements when the item cannot be measured with precision, and there is some uncertainty about it.
- An estimate is therefore based, to some extent, on management's judgement. Management estimates might be required, for example, for the following items:
- inventory obsolescence;
- ▪ the fair value of financial assets or liabilities;
- ▪ the useful lives of non-current assets;
- ▪ the most appropriate depreciation pattern (depreciation method, for example straight line or reducing balance) for a category of non-current assets

Accounting policy vs. accounting estimate

- The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability
- Sometimes it can be difficult to distinguish between changes in accounting policy from changes in accounting estimate. In such cases any change is treated as a change in accounting estimate.
- For example whether to use the straight line method of depreciation or the reducing balance method is a choice of accounting estimate.
- change in the measurement basis applied is a change in an accounting policy, and is not a change in an accounting estimate.
- IAS 16: Property, plant and equipment allows the use of the cost model or the revaluation model for measurement after recognition. Should a company choose the revaluation model, this is a change of accounting

Change in accounting estimate

- 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 corrections of errors**.
- A change in accounting estimate may be needed if changes occur in the circumstances on which the estimate was based or if new information becomes available. A

Prospective application of a change in estimate

- A change in accounting estimate is accounted for prospectively not retrospectively. This means that the effect of the change is recognised in the current period and the future periods affected by the change.
- The effect of a change in accounting estimate should be recognised prospectively, by including it:
- – in profit or loss for the period in which the change is made, if the change affects that period only, or
- in profit or loss for the period of change and future periods, if the change affects both.
- To the extent that a change in estimate results in a change in assets and liabilities, it should be recognised by adjusting the carrying amount of the affected assets or liabilities in the period of change.

Example: Change in accounting estimate

- A non-current asset was purchased for N200,000 two years ago, when its expected economic life was ten years and its expected residual value was nil. The asset is being depreciated by the straight-line method.
- A review of the non-current assets at the end of year 2 revealed that due to technological change, the useful life of the asset is only six years in total, and the asset therefore has a remaining useful life of four years.
- The original depreciation charge was N20,000 per year(N200,000/10years) and at the beginning of Year 2, its carrying value was N180,000 (N200,000 - N20,000).

Example contd.

- The change in the estimate occurs in Year 2. The change in estimate should be applied prospectively, for years 2 onwards (years 2 – 6). From the beginning of year 2, the asset has a revised useful remaining life of five years.
- The annual charge for depreciation for year 2 (the current year) and for the future years 3 – 6 will be changed from N20,000 to N36,000 (N180,000/5years).



Disclosures

- The following information must be disclosed:
- – 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 periods, except for the effect on future periods when it is impracticable to estimate that effect.
- – The fact that the effect in future periods is not disclosed because estimating it is impracticable (if this is the case).
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QUIZ

1. IAS 8 _____ disclosure of an impending change in accounting policy when an entity has yet to implement a new IFRS that has been issued but not yet come into effect.

A. prohibits

B. requires

C. encourages

D. Allows

2. Under which of the following circumstance is IAS 8 applicable?

E. Selecting and applying accounting policies

F. Accounting for changes in accounting policies

3. Which, if any, of the following statements is correct? Statement 1 - An entity cannot change from applying straight line depreciation to reducing balance depreciation, or Statement 2 - A change in where depreciation is charged in the statement of profit or loss is a change in accounting estimate?

A. Statement 2 only is correct

B. Neither statement is correct

C. Statement 1 only is correct

D. Both statements are correct

4. IAS 8 _____ disclosure of an impending change in accounting policy when an entity has yet to implement a new IFRS that has been issued but not yet come into effect.

A. prohibits

B. requires

C. encourages

D. allows

5. It is _____ to make, or leave uncorrected, immaterial departures from IFRSs to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

A. prohibited

B. inappropriate

C. permissible

D. advisable

6. What shall management consider first in order to exercise its judgement in the absence of an IFRS that specifically applies to a transaction, other event or condition?

E. The principles IASB Conceptual Framework

7. Which, if any, of the following statements is/are correct? Statement 1 - Many respondents believe that further illustrative examples are required in IAS 8, or Statement 2 - There is also a proposed change to an auditing standard around accounting estimates?

A. Neither statement

B. Both statements

C. Statement 2 only

D. Statement 1 only

8. Which of the following is not a proposed change in relation to IAS 8?

E. None of the above

QUIZ

9. How should a change in accounting estimate be accounted for?

A. As a non-adjusting event per IAS 10

B. Retrospectively with restated comparative financial statements

C. Retrospectively with an adjustment to opening retained earnings

D. Prospectively

Any question

1. D
2. B
3. B
4. B
5. B
6. B
7.B
8.B
9. D

THE END