***IAS 8 ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS***

The objective of IAS 8 is to prescribe the criteria for selecting and changing accounting policies together with the disclosure and accounting treatment of changes in a reporting entity’s accounting policies, accounting estimates and corrections of errors.

***Key Definitions***

* **Accounting policies** are the specific principles, bases, conventions, rules and practices applied 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 liability, or related expense, resulting from reassessing the expected future benefits and obligations associated with that asset or liability.
* **International Financial Reporting Standards** are standards and interpretations adopted by the International Accounting Standards Board (IASB). They comprise:
  + International Financial Reporting Standards (IFRSs);
  + International Accounting Standards (IASs); and
  + Interpretations developed by the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC) and approved by the IASB.
* **Materiality.** Omissions or misstatements of items are material if they could, by their size or nature, individually or collectively, influence the economic decisions of users taken on the basis of the financial statements.
* **Prior period errors** are omissions from, and misstatements in, an entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that was available and could reasonably be expected to have been obtained and taken into account in preparing those statements. Such errors result from mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

***Differences- Accounting policies and Accounting estimates***

**Example 1**   
***Capitalised finance costs***   
A company which had previously capitalised interest in connection with the construction of fixed assets decides to write it off immediately in the profit and loss account. A change of policy, because the interest is to be recognised as a loss rather than as part of the cost of an asset.

**Example 2**   
***Depreciation***   
A company decides to change its depreciation method for motor vehicles because it believes that the new method better reflects the pattern of consumption of economic benefits. A change in estimation technique, because the vehicles are being recognised and presented in the same way, using the same measurement basis, namely historical cost.

The only change is to the estimation technique used to measure the unexpired portion of each vehicle’s economic benefits.

**Example 3**   
***Classification of overheads***   
A company has previously shown certain overheads as part of cost of sales. It now proposes to include them in administrative expenses.

A change of policy, because presentation has changed.

**Example 4**   
***Listed investments***   
A company proposes to change the basis of valuation of investments held as current assets from offer price (i.e., replacement cost) to bid price (i.e., net realisable value). A change of policy, because the measurement basis is changed.

So what general principles determine whether a change is to an accounting policy or to an estimation technique? There are three questions, and if the answer to any one of them is ‘yes’, the change is to an accounting policy. The three questions are:

 Does the change affect recognition?

 Presentation?

 Measurement basis?

Applying these questions to the four examples, we see:

**Example 1** — change in recognition, hence a change in policy.   
**Example 2** — no change to recognition, presentation or measurement basis, therefore a change in estimation technique.  
**Example 3** — change in presentation, therefore a change in policy   
**Example 4** — a change in measurement basis, therefore a change in accounting policy.

***Selection and Application of Accounting Policies***

Reporting entities should apply the most appropriate standard if it applies specifically to a transaction. In the absence of an IFRS, management must use their own judgement in developing and applying an accounting policy that results in information that is;

\* relevant to the economic decision making needs of users; and

\* reliable as it purports faithfully the financial statements, reflects their substance, is neutral, prudent and complete in all material respects

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Management must consider the IFRS/IASs initially and then, if necessary, apply the principles in the Framework for the Preparation and Presentation of Financial Statements in deciding the most appropriate policies. They are also encouraged to look to other standard setters having the same framework, accounting literature and accepted industry practice in making their choice.

***Consistency of Accounting Policies***

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

***Changes in Accounting Policies***

An entity is permitted to change an accounting policy only if the change:

* is required by a standard or interpretation; or
* 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.

Note that changes in accounting policies do not include applying an accounting policy to a kind of transaction or event that did not occur previously or were immaterial.

If a change in accounting policy is required by a new IASB standard or interpretation, the change is accounted for as required by that new pronouncement or, if the new pronouncement does not include specific transition provisions, then the change in accounting policy is applied retrospectively.

Retrospective application means adjusting 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.

* However, if it is impracticable to determine either the period-specific effects or the cumulative effect of the change 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.
* Also, if 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.

***Disclosures Relating to Changes in Accounting Policies***

Disclosures relating to changes in accounting policy caused by a new standard or interpretation include:

* the title of the standard or interpretation causing the change
* the nature of the change in accounting policy
* a description of the transitional provisions, including those that might have an effect on future periods
* for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:
  + for each financial statement line item affected, and
  + for basic and diluted earnings per share (only if the entity is applying IAS 33)
* the amount of the adjustment relating to periods before those presented, to the extent practicable
* if retrospective application is impracticable, an explanation and description of how the change in accounting policy was applied.

Financial statements of subsequent periods need not repeat these disclosures.

Disclosures relating to voluntary changes in accounting policy include:

* the nature of the change in accounting policy
* the reasons why applying the new accounting policy provides reliable and more relevant information
* for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:
  + for each financial statement line item affected, and
  + for basic and diluted earnings per share (only if the entity is applying IAS 33)
* the amount of the adjustment relating to periods before those presented, to the extent practicable
* if retrospective application is impracticable, an explanation and description of how the change in accounting policy was applied.

Financial statements of subsequent periods need not repeat these disclosures.

If an entity has not applied a new standard or interpretation that has been issued but is not yet effective, the entity must disclose that fact and any and known or reasonably estimable information relevant to assessing the possible impact that the new pronouncement will have in the year it is applied.

***Changes in Accounting Estimate***

Many items in financial statements cannot be measured with precision and must be estimated.

These involve judgements based on the latest available information. Examples where this would be applied include bad debts, inventory obsolescence, useful lives, warranty obligations etc. Estimates need to be revised if circumstances change as a result of new information or experience. A change in measurement base is, however, a change in policy. If it is difficult to distinguish between a policy and an estimate change, the change should be treated as a change in estimate. A change in estimate is charged prospectively in the income statement in the current and future years. Any related asset/liability should equally be adjusted in the period of change.

Estimation techniques include, for example:

1. Methods of depreciation, such as straight-line and reducing balance, applied in the context of a particular measurement basis, used to estimate the proportion of the economic benefits of a tangible fixed asset consumed in a period;
2. Methods used to estimate the present value of a provision, such as the discounting of expected cash flows; and
3. Estimates of the proportion of trade debts that will not be recovered, particularly where such estimates are made by considering a population as a whole rather than individual balances.

The effect of a change in an accounting estimate shall be recognised prospectively by including it in profit or loss in:

* the period of the change, if the change affects that period only, or
* the period of the change and future periods, if the change affects both.

However, to the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, it is recognised by adjusting the carrying amount of the related asset, liability, or equity item in the period of the change.

***Disclosures Relating to Changes in Accounting Estimate***

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 periods
* if the amount of the effect in future periods is not disclosed because estimating it is impracticable, an entity shall disclose that fact.

***Errors***

The general principle in IAS 8 is that an entity must correct all material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery by:

* restating the comparative amounts for the prior period(s) presented in which the error occurred; or
* 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.

However, if it is impracticable to determine the period-specific effects of an error on comparative information for one or more prior periods presented, the entity must restate the opening balances of assets, liabilities, and equity for the earliest period for which retrospective restatement is practicable (which may be the current period).

Further, if it is impracticable to determine the cumulative effect, at the beginning of the current period, of an error on all prior periods, the entity must restate the comparative information to correct the error prospectively from the earliest date practicable.

***Disclosures Relating to Prior Period Errors***

Disclosures relating to prior period errors include:

* the nature of the prior period error
* for each prior period presented, to the extent practicable, the amount of the correction:
  + for each financial statement line item affected, and
  + for basic and diluted earnings per share (only if the entity is applying IAS 33)
* the amount of the correction at the beginning of the earliest prior period presented
* if retrospective restatement is impracticable, an explanation and description of how the error has been corrected.

Financial statements of subsequent periods need not repeat these disclosures.