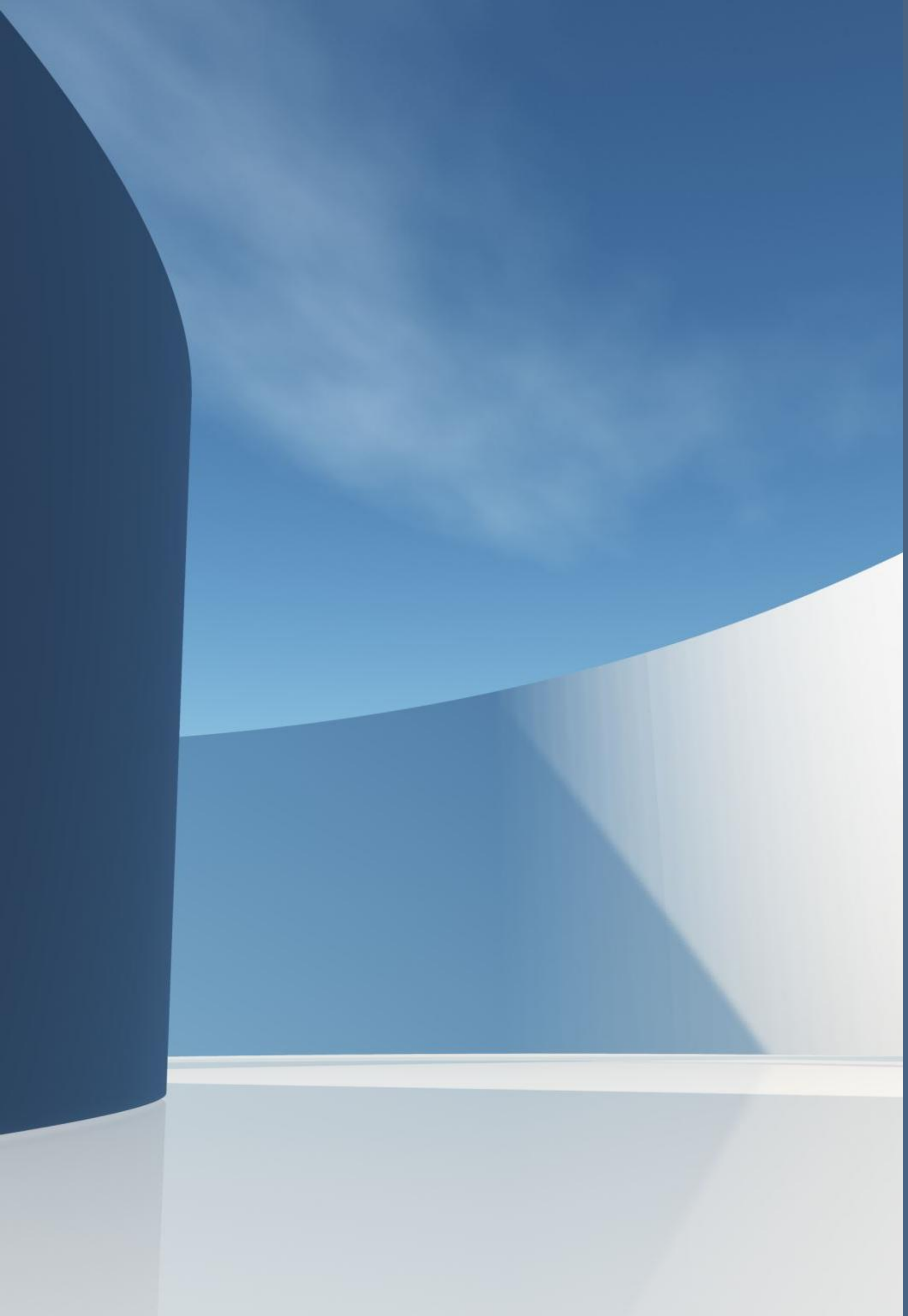

FINANCIAL REPORTING

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

OBJECTIVE OF THE STANDARD

The objective of this Standard is to prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors. So that to enhance relevance, reliability and comparability of the entity’s financial statements.

SCOPE OF THE STANDARD

Applied in:

- selecting accounting policies
- applying accounting policies
- accounting for changes in accounting policies
- Accounting for changes in accounting estimates and;
- corrections of prior period errors.

The standard is not applied in accounting for tax effects of corrections of prior period errors and of retrospective adjustments made to apply changes in accounting policies accounted for in accordance with IAS 12.

ACCOUNTING POLICIES

Definition: Accounting policies are specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

Selection of an appropriate accounting policy

IAS 8 requires an entity to select and apply appropriate accounting policies complying with International Financial Reporting Standards that result in information that is;

- Relevant to the economic decision-making needs of users
- Reliable in that the financial statements;
  - represent faithfully the financial position, financial performance and cash flows of the entity
  - reflect the economic substance of transactions, other events and conditions and not merely the legal form
  - are neutral
  - are prudent
  - are complete in all material respects.

ACCOUNTING POLICIES CONTINUED

When selecting an appropriate accounting policy to any transaction, an entity shall follow the following procedure:

a) If there is a specific IFRS that applies to a transaction, management is required to select/determine the accounting policy or policies to that transaction or item by applying that IFRS.

b) In the absence of an IFRS that specifically applies to a transaction, management is required to use its judgement in developing and applying an accounting policy to the transaction, item or event. When making the judgement, IAS 8 requires management to consider the following sources in order:

   1) requirements in IFRSs dealing with similar and related issues.

   2) definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Conceptual Framework for Financial Reporting.

   3) most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices to the extent they do not conflict (1) and (2) above.

Application of accounting policies

IAS 8 requires an entity to select and apply its accounting policies consistently for similar transactions, other events and conditions.

ACCOUNTING POLICIES CONTINUED

Changes in accounting policies

IAS 8 allows an entity's accounting policies to be changed only if the change:

- is required by an IFRS; or
- results in the financial statements providing reliable and more relevant information.

A change in an accounting policy occurs if there has been a change in:

- **recognition:** such as recognition as revenue expenditure instead of capital expenditure.
- **measurement:** such as stating assets at replacement cost rather than historical cost.
- **presentation:** such as including depreciation in cost of sales rather than administrative expenses.

Accounting for changes in an accounting policy

a) If the change in an accounting policy is as a result of an initial application of a new IFRS, then the change in accounting policy is applied by following the specific transitional provisions in that standard (if any).

b) In any other case, the change in accounting policy should be applied **retrospectively**. This is in otherwards referred to as the **retrospective application**.

Retrospective application means applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.

ACCOUNTING POLICIES CONTINUED

- When a change in accounting policy is applied retrospectively, the entity is required to adjust the:
  - ✓ opening balance of each affected component of equity for the earliest prior period presented; and
  - ✓ other comparative amounts disclosed for each prior period presented

  as if the new accounting policy had always been applied. This retrospective application should be done by the entity except if it is impracticable to do so.
- If it is impracticable, the entity is required to apply the new accounting policy to the carrying amounts of assets and liabilities and each affected component of equity as at the beginning of the earliest period for which retrospective application is practicable (this may be the current period).
- If it is still impracticable, an entity is allowed by IAS 8 to apply the new accounting standard prospectively from the earliest date practicable.

Note: The initial application of a policy to revalue assets (in IAS 16 and IAS 38) is a change in accounting policy which should be dealt with in accordance with those standards but not IAS 8. This means that, the change between the cost model and the revaluation model is applied prospectively.

ACCOUNTING ESTIMATES

Definition: Accounting estimates are monetary amounts in financial statements that are subject to measurement uncertainty. These are methods adopted by an entity to arrive at estimated amounts for the financial statements.

An accounting policy may require items in financial statements to be measured in a way that involves measurement uncertainty which may cause estimations. This gives rise to accounting estimates where management has to adopt a method to arrive at such amounts. Examples of changes in accounting estimates may include changes in:

- the useful life of an item of PPE
- method of depreciating an item of PPE
- residual values of an item of PPE
- Fair value of an asset or liability

Changes in accounting estimates

A change in accounting estimate refers to 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.

Accounting for changes in accounting estimates

The effect of the change in accounting estimate should be applied **prospectively** by including the effect in the statement of profit or loss in the period of the change and, if subsequent periods are affected, in those subsequent periods as well.

ACCOUNTING ESTIMATES CONTINUED

Example: The policy of depreciating all non-current assets (writing off the depreciable amount of non-current assets over their useful lives) is an accounting policy whereas the choice of whether to depreciate them using a straight-line method or a reducing balance method is an accounting estimate (because the methods represent the estimation techniques).

Therefore: To be able to tell whether a particular change is a change in an accounting policy or an accounting estimate, we ask ourselves whether the change leads to a change in; the recognition, presentation or measurement criteria of a transaction or an item. If the answer is yes, then the change shall be a change in an accounting policy, otherwise, an accounting estimate.

PRIOR PERIOD ERRORS

Definition: Prior period errors refer to omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

- was available when the financial statements for those periods were authorized for issue, and;
- could reasonably be expected to have been taken into account in preparing those financial statements.

Errors include mathematical mistakes, mistakes in applying accounting policies, oversights and fraud. IAS 8 requires that current period errors that are discovered in that accounting period should be corrected before the financial statements are authorized for issue.

Correction of prior period errors

Material prior period errors are corrected retrospectively **(retrospective restatement)** in the first set of financial statements authorized for issue after their discovery by restating the:

a) comparative amounts for the prior period(s) presented in which the error occurred.

b) opening balances of assets, liabilities and equity for the earliest prior period presented if the error occurred before the earliest prior period presented. This would require disclosing within the accounts a statement of financial position at the beginning of the earliest comparative period. This means that three statements of financial position will be presented within a set of financial statements i.e., SFP at the end of the current year, SFP at the end of the previous year and SFP at the beginning of the previous year.

PRIOR PERIOD ERRORS CONTINUED

Limitations of a retrospective restatement

- All prior period errors are corrected by retrospective restatement except in circumstances when it is impracticable to determine the period-specific effects or the cumulative effect of the error.
- If it is impracticable to determine the period-specific effects of an error on comparative information for one or more prior periods presented then restate the opening balances of assets, liabilities and equity for the earliest period for which retrospective restatement is practicable.
- If it is impracticable to determine the cumulative effect of the error on prior periods, then correct the error prospectively.

Retrospective restatement means correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.

IMPRACTICABILITY

Definition: Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.

Circumstances under which it is impracticable to do a retrospective application or a retrospective restatement

A change in an accounting policy retrospectively or a retrospective restatement to correct an error is impracticable if the:

- effects of the retrospective application or retrospective restatement are not determinable
- retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period.
- retrospective application or retrospective restatement requires significant estimates of amounts, and it is impossible to distinguish objectively information about those estimates.

DISCLOSURES

For a change in accounting policy the entity discloses;

- the nature of the change in accounting policy
- the reasons why applying the new accounting policy provides reliable and more relevant information
- the amount of the adjustment relating to periods before those presented, to the extent practicable

For a change in an accounting estimate the entity discloses;

- the nature and amount of a change in an accounting estimate
- disclose if the amount of the effect in future periods is not disclosed due to impracticability.

For prior period errors the entity discloses;

the nature of the prior period error

the amount of the correction at the beginning of the earliest prior period presented

TRIAL QUESTIONS

During the year ended 30th June 2023 a company discovered that certain items had been included in inventory at 30th June 2022 at a value of Ush. 2.5 million but they had in fact been sold before the year end.

The original figures reported for the year ended 30th June 2022 and for the current year ending 30th June 2023 are given below:

	2023	**2022**
	Ush 000	Ush 000
Sales	52,100	48,300
Cost of sales	(33,500)	(30,200)
Gross profit	18,600	18,100
Tax	(4,600)	(4,300)
Net profit	14,000	13,800

The retained earnings at 1st July 2021 were Ush. 11.2 million. The cost of goods sold for the year ended 30th June 2023 includes the Ush. 2.5 million error in opening inventory.

Required:

Show the statement of profit or loss with comparative figures for the year ended 30th June 2023 and the retained earnings for each year. Assume that the adjustment will have no effect on the tax charge.

March 2021 question 2

August 2016

November 2016,