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A Digital Learning Platform for Generation Z: Passport to IFRS®

IAS® Standard 8 Accounting Policies, Changes in Accounting Estimates and Errors

Co-funded by the Erasmus+ Programme of the European Union

OBJECTIVE AND SCOPE

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- Account for a change in estimate

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- Identify the types of accounting changes
- Account for a change in accounting principle
- Account for a change in estimate
- Account for a correction of an error

KEY DEFINITIONS

Accounting Policies

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Changes in a Reporting Entity

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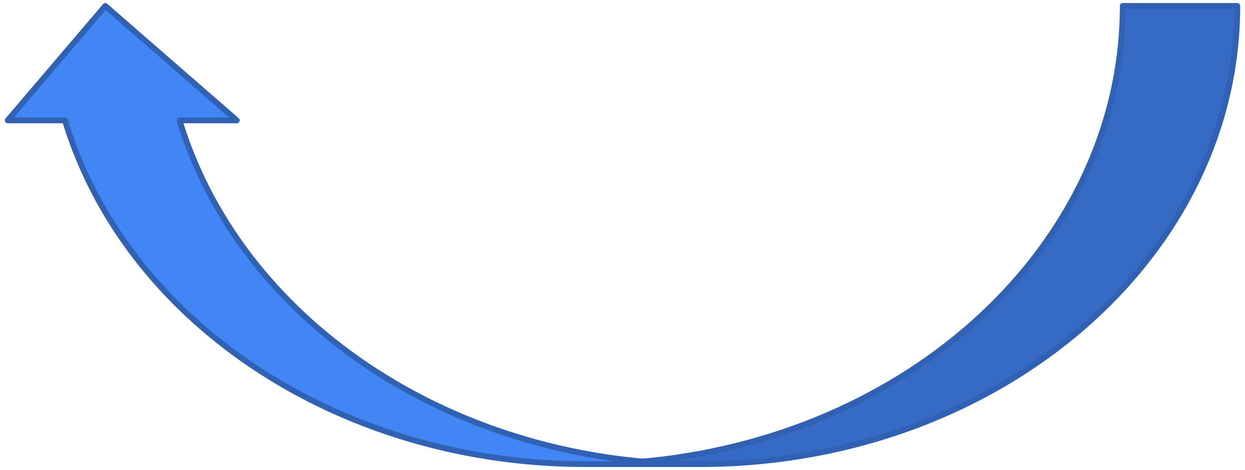
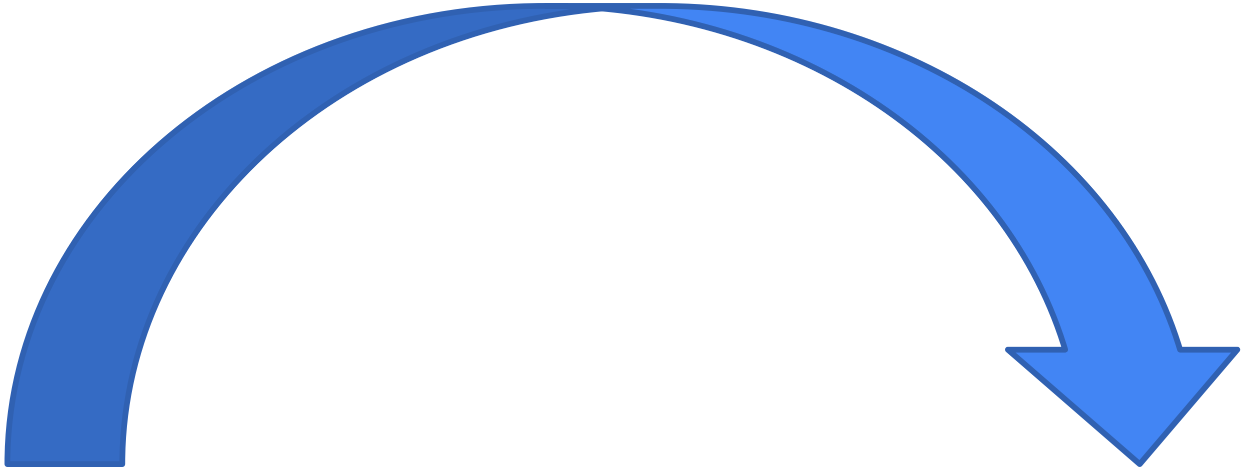
Changes in a Reporting Entity	• a change in the type of entity being reported. Many companies operate in a consolidated manner in that the parent company owns many subsidiaries. If a company acquires a subsidiary or sells off a subsidiary, the reporting entity has changed.
Errors	• the result of mathematical mistakes, mistakes in the application of accounting policies, or the oversight or misuse of facts that existed when the financial statements were prepared.

ACCOUNTING POLICIES AND CORRECTIONS OF ERRORS



Retrospectively

ACCOUNTING ESTIMATES



Prospectively

CHANGE 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.

EXAMPLE ON CHANGES IN ACCOUNTING POLICY

A German corporation has found that it would be better to switch the inventory valuation approach via FIFO to weighted-average. Balances of inventory for each approach were:

	FIFO	Weighted Average
Dec 31, 2019	CU 174,000	
Dec 31, 2020	CU 181,000	
In its financial statements, what amount should it report as the cumulative effect of this accounting change?		

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Reported Amount (FIFO)	CU 174,000	
Weighted Average Method	CU 177,000	
Net Difference	+CU 3,000	

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Weighted Average Method	CU 177,000	CU 183,000
Net Difference	+CU 3,000	+CU 2,000

EXAMPLE ON CHANGES IN ACCOUNTING POLICY

Dr. Inventories	CU 2,000	
Dr. Cost of Sales	CU 1,000	
Cr. Retained Earnings		CU 3,000

ACCOUNT FOR A CHANGE IN ESTIMATE

The application of IAS Standard 8 requires a company to make estimates for items such as uncollectible accounts receivable, inventory obsolescence, service lives and residual values of depreciable assets, recoverable mineral reserves, warranty costs, pension costs, and the periods that it expects to be benefited by a deferred cost.

EXAMPLE ON CHANGE IN ACCOUNTING ESTIMATE

On January 1, 2019, company X bought a fixed asset with a cost of CU 100,000 and a useful life of 20 years. Also, its salvage value was CU 2,000. In 2022, a change occurred in the total useful life from 20 to 16 years with a salvage value of CU 2,200.

EXAMPLE ON CHANGE IN ACCOUNTING ESTIMATE

Considering the usage of the straight-line depreciation approach, the depreciation expense is:

(CU 100,000 – CU 2,000 / 20 years = CU 4,900)

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Book value on January 01, 2019 (Initial cost) CU 100,000

Less: accumulated depreciation

(CU 100,000 – CU 2,000 / 20 years = CU 4,900 x 3 years) = CU 14,700

Net Book value = CU 100,000 – CU 14,700 = **CU 85,300**

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Less: accumulated depreciation

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Net Book value = CU 100,000 – CU 14,700 = **CU 85,300**

Less: new salvage value CU 2,200

New Balance = CU 85,300 – CU 2,200 = **CU 83,100**

Depreciable cost / New life = CU 83,100 / 13 years = CU 6,392.30

Depreciation expense CU 6,392.30

ACCOUNT FOR A CORRECTION OF AN ERROR

Errors can arise in respect of the:

- Recognition
- Measurement, or
- Disclosure of elements of financial statements

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Sun Corporation purchased Sweet Company on January 1, 2016. Patents were recorded in the amount of CU 100,000 and have not been amortized. The useful life of these patents was estimated at 20 years.

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* (CU 100,000/20 years = CU 5,000 x 1 year for 2018)
** (CU 5,000 x 2 years for 2016 and 2017)

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Sun Corporation purchased Sweet Company on January 1, 2016. Patents were recorded in the amount of CU 100,000 and have not been amortized. The useful life of these patents was estimated at 20 years. The error correction at the end of 2018 is:

Dr. Amortization expense CU 5,000*

Dr. Retained earnings CU 10, 000**

Cr. Patents CU 15,000

* (CU 100,000/20 years = CU 5,000 x 1 year for 2018)

** (CU 5,000 x 2 years for 2016 and 2017)

EXAMPLE ON ERRORS IN CLOSING ENTRIES

A Manufacturing Company prepares the following three closing entries at the end of the year:

#1 Dr. Retained Earnings	CU 65,350		
		Cr. Service Revenue	CU 65,350

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ERRORS IN CLOSING ENTRIES

A Manufacturing Company prepares the following three closing entries at the end of the year:

#1	Dr. Retained Earnings	CU 65,350	
	Cr. Service Revenue		CU 65,350
#2	Dr. Retained Earnings	CU 39,200	
	Cr. Advertising Expense	CU 10,400	
	Cr. Rent Expense		CU 4,500
	Cr. Salaries Expense		CU 18,800
	Cr. Supplies Expense		CU 4,500

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#3 Dr. Retained Earnings	CU 2,000		
	Cr. Dividends Payable	CU 2,000	

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Solution:

1. This entry is backward. The correct entry would be:

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2.The debits do not equal the credits in this entry. Retained earnings should be debited for CU 38,200, not CU 39,200.

#2 Dr. Retained Earnings CU 38,200
Cr. Advertising Expense CU
10,400
Cr. Rent Expense
CU 4,500
Cr. Salaries Expense CU
18,800
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	Cr. Retained Earnings	CU 65,350	

2.The debits do not equal the credits in this entry. Retained earnings should be debited for CU 38,200, not CU 39,200.

3. This entry is incorrect. Dividends Payable is not closed out at the end of the year. Only the normal Dividends account is credited in a closing entry.

SUMMARY OF PROCEDURES FOR REPORTING ACCOUNTING CHANGES AND ERROR CORRECTIONS

I. Change in estimate

Accounting Procedures:

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2. If an IFRS Standard requires or permits such categorisation, an appropriate accounting policy shall be selected and applied consistently to each category.

SUMMARY OF PROCEDURES FOR REPORTING ACCOUNTING CHANGES AND ERROR CORRECTIONS

III. Pro Forma Disclosures after a Business Combination

Accounting Procedures:

1. Provide a supplemental disclosure for the year of the combination and the preceding year of revenues and net income as if the combination had occurred at the beginning of both the combination year and the preceding year.

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1. If an error is detected during a period, correct accounts through normal accounting cycle adjustments.
2. If an error is detected in a subsequent period, adjust for effect of material errors by making prior-period adjustments directly to the Retained Earnings balance for the years affected by those errors. If the error relates to a year that has not been presented in the financial statements, the Retained Earnings balance for the earliest year presented is adjusted. Also correct each item presented in comparative financial statements.

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3. Once an error is discovered in previously issued financial statements, the nature of the error, its effect on the financial statements, and its effect on the current period's income and EPS should be disclosed.

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