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

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CASE STUDY – IAS 8 ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS

Introduction

Companies should ensure constant control and take necessary precautions to changing situations to continue their activities. When a change is required, showing the effects of this change helps the financial statements to meet the principle of relevance and faithful presentation. The aim of International Accounting Standard 8 Accounting Policies, Changes in Accounting Estimates and Errors 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.

With this case study, it is aimed to show the effects of estimate and policy change on financial statements.

The Case Information

Act&Count Company has been operating in the furniture sector and they have a high-tech production line. Act&Count Company has a considerable property, plant and equipment especially production machines. The Company has been using First-In-First-Out (FIFO) for their inventory valuation. Act&Count Company has been preparing their financial statements in line International Accounting/Financial Reporting Standards (IAS/IFRS). Kevin IRVING has been working on the Accounting Department of Act&Count Company. When he examined the 2022 financial statements, he found the following results:

- In the beginning of 2019, the company purchased a machine with CU200,000 which has a estimated 10 year useful live and CU 10,000 residual value. In 2023, the company re-estimated the useful life and residual value and found that the machine has a 15 year useful life and CU 4,000 residual value. Act&Count Company has been using straight-line method for depreciation.
- The Company has been using First-In-First-Out (FIFO) for their inventory valuation. In 2022, they switched to weighted-average method. If the FIFO method is used ending inventory is worth CU 2,500 whereas based on the weighted-average method the ending inventory is worth CU 1,500 as of 31.12.2022. Act&Count Company's beginning inventory for both valuation methods is CU 1,500. In addition, the sales revenue is CU 10,000, yearly purchases are CU 5,000 and other expenses for period is CU 750.

Discussion Questions

a) How should Kevin IRVING calculate the depreciation in line with changing useful life and residual value? How will this change affect the financial statements? Based on IAS 8 is this an error or is it a policy or estimate change?

b) How Kevin IRVING reflect the change of inventory valuation method to the financial statements? How will this change appear in the comprehensive income statement? Based on IAS 8 is this an error or is it a policy or estimate change?

SOLUTION OF CASE STUDY – IAS 8 ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS

a) According to IAS 8, change of useful life and residual value on a machine is considered change in accounting estimates and required recordings are made prospectively. Kevin IRVING should make the following calculations:

Yearly depreciation for 2019= 200,000 – 10,000 = 190,000 / 10 years = CU19,000

Cumulative depreciation expense by 2023 =19,000*4 = CU 76.000

Depreciated amount due to change in forecast in 2023 = 200,000 – 76,000 = CU 124,000

Yearly depreciation for 2023= 124,000 – 4,000 =120,000/15 = CU 8,000

Yearly depreciation expense is CU 19,000 while it is decreased to CU 8,000 after the change in accounting estimates. Therefore, on the comprehensive income statement depreciation expense is reported CU 11,000 less.

b) According to IAS 8, change of inventory valuation is considered change in accounting policy and required recordings are made retrospectively. As a result of policy change, ending inventory information is as follows:

FIFO	Weighted-Average Cost
CU 2,500	CU 1,500

Based on both calculation method, the comprehensive income statement is as follows:

	FIFO	Weighted-Average Cost
Revenue	10,000	10,000
Cost of Sales	4,000	5,000
Beginning Inventory (+)	1,500	1,500
Purchases (+)	5,000	5,000
Ending Inventory (-)	2,500	1,500
Gross Profit	6,000	5,000
Other Expenses	750	750
Income Before Tax	**5,250**	**4,250**

With the change of inventory valuation from FIFO to weighted-average cost method, gross profit and income before tax amount decreased CU1,000 compared to FIFO method.