IFRS Accounting Standards discussion fora: Accounting policies, estimates and errors

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WORLD BANK GROUP

AABE

Accounting and Audit Board of Ethiopia

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Applicable version of IFRS Accounting Standards

Unless specified otherwise, the accounting requirements that are the subject matter of this discussion forum are IFRS Accounting Standards as issued by the International Accounting Standards Board that are applicable for annual period beginning on or after 1 January 2023 without early applying new and amended IFRS Accounting Standards that have a later mandatory application date.

Aims

» Develop a more cohesive understanding in Ethiopia of IFRS accounting and reporting for error corrections, changes of accounting policies, and changes in accounting estimates.

» Enhance capacity in Ethiopia to apply IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* more consistently.

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Distinguishing errors from changing accounting policies and changing accounting estimates and accounting for the change

Index of classification issues

» Issue 1: identifying errors and the accounting to fix them

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» Issue 3: identifying changes in accounting estimates and accounting for such changes

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» Issue 5: adopting the revaluation model for fully depreciated in-use items of PPE

Issue 1: identifying errors and the accounting to fix them

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Characteristics of errors and accounting for fixing them
What do you think?

Errors must be identified because the accounting or reporting, or both, specified for their correction is different from that specified for accounting policy changes, accounting estimate changes and reclassifications.

What are the characteristics of errors?

What accounting is specified for the correction of errors?

Characteristics of errors
Summary of discussion

What are the characteristics of errors? Discussants' consensus view:

- Errors are omissions from, and misstatements in, the entity's financial statements arising from failure to, or misuse of, reliable information that (IAS 8.5):
  - was available when financial statements for those periods were authorised for issue; and
  - could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.
- Errors can arise in respect of the recognition, measurements, presentation or disclosure of elements of financial statements. (IAS 8.41)
- Examples of errors include mathematical mistakes in calculating accounting numbers, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud. (IAS 8.5)

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Correcting prior period errors
Summary of discussion

What accounting is specified for the correction of errors?
Discussants' consensus view:

- Subject to the impracticability exception (IAS 8.50 –.53), material prior period errors must be corrected by retrospective restatement of the comparative amounts for the prior period(s) presented. (IAS 8.42)
- The effects of correcting immaterial prior period errors are typically accounted for in the financial performance of the year in which they are corrected.

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Issue 2: identifying changes of accounting policy and accounting for such changes

Characteristics of changes of accounting policies and accounting for such changes

What do you think?

Changes of accounting policies must be identified because the accounting or reporting, or both, specified for their application is different from that specified for the correction of errors, accounting estimate changes and reclassifications.

What are the characteristics of changes of accounting policies?

What accounting is specified for changes of accounting policies?

Characteristics of changes of accounting policies
Summary of discussion

What are the characteristics of changes of accounting policies?
Discussants' consensus view:

- Accounting policies are "the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements." (IAS 8.5)
- An entity can voluntarily change an accounting policy only if the change results in the financial statements providing reliable and more relevant information. (IAS 8.14(b))
- An entity must change an accounting policy when it is required to do so to give effect to a new or amended IFRS Accounting Standard. (IAS 8.14(a))

Accounting for changes of accounting policies
Summary of discussion

What accounting is specified for changes of accounting policies? Discussants' consensus view:

- Subject to the impracticability exception (IAS 8.50–.53), a mandatory change of accounting policy must be accounted for in accordance with the specific transitional provisions specified for its initial application, if any. (IAS 8.19(a))
  - However, if no transitional provisions are specified, account for the mandatory change of accounting policy by retrospective application (ie restate comparative figures as if the new accounting policy had always been applied). (IAS 8.19(b))
- Subject to the impracticability exception, a voluntary change of accounting policy must be accounted for by retrospective application. (IAS 8.19(b))
  - However, by way of exception (a rule), initial application of an accounting policy to use the revaluation model for a class of PPE or qualifying intangible assets must be dealt with as a revaluation in the period that the accounting policy changes from the cost model to the revaluation model. (IAS 8.17)

Issue 3: identifying changes in accounting estimates and accounting for such changes

Characteristics of changes in accounting estimates and accounting for such changes

What do you think?

Changes in accounting estimates must be identified because the accounting or reporting, or both, specified for their application is different from that specified for the correction of errors, accounting policy changes and reclassifications.

What are the characteristics of changes in accounting estimates?

What accounting is specified for changes in accounting estimates?

Characteristics of changes in accounting estimates
Summary of discussion

What are the characteristics of changes in accounting estimates? Discussants' consensus view:

» Accounting estimates are "monetary amounts in financial statements that are subject to measurement uncertainty." (IAS 8.5)

» As a result of the uncertainties inherent in business activities, many items in financial statements cannot be measured with precision but can only be estimated. Estimation involves judgements based on the latest available, reliable information (IAS 8.32). Consequently the "use of reasonable estimates is an essential part of the preparation of financial statements..." (IAS 8.33).

» Therefore, it is to be expected that estimates will need revision when changes occur in the circumstances on which the estimate was based or as a result of new information or more experience.

» "By its nature, a change in an accounting estimate does not relate to prior periods and is not the correction of an error." (IAS 8.34).

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Accounting for changes in accounting estimates
Summary of discussion

What accounting is specified for changes in accounting estimates? Discussants' consensus view:

» The effect of a change in an accounting estimate, must be accounted for prospectively, ie by including it in profit or loss of the period of the change, and future periods (if the change also affects future periods, for example the allocation of depreciation). (IAS 8.36)

  » However, to the extent that a change in an accounting estimate simultaneous changes assets and liabilities, or relates directly to an item of equity, it does not affect profit or loss and must be adjusting the carrying amount of the related asset, liability or equity item in the period of the change in estimate. (IAS 8.37)

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Issue 4: fully depreciated in-use items of PPE

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Fully depreciated in-use items of PPE
What do you think?

Because measuring depreciation involves many estimates, that must be reconsidered periodically (IAS 16.51 and .61), it is difficult to envisage how in-use items of PPE could become fully depreciated.

How to account for a fully depreciated in-use item of PPE?

Fully depreciated in-use items of PPE
Summary of discussion

How to account for fully depreciated in-use items of PPE?

Discussants' consensus view:

» Depreciation estimates (deprecation method, useful life, residual value etc) must be reviewed at least at annually (at year-end) (IAS 16.51 and .61)

» Consequently, it is difficult to envisage how an in-use item of PPE could become fully depreciated. Therefore, one should consider whether a prior period error has occurred in the accounting for the depreciation of the item.

» If a **material** prior period error is identified, the error must be corrected by retrospective restatement of the comparative amounts for the prior period/s (IAS 8.42).

Issue 5: adopting the revaluation model for fully depreciated in-use items of PPE

Adopting the revaluation model for fully depreciated in-use items of PPE
What do you think?

Because measuring depreciation involves many estimates, that must be reconsidered periodically (IAS 16.51 and .61), it is difficult to envisage how in-use items of PPE could become fully depreciated.

Can one 'fix' the accounting for fully depreciated items of PPE by accounting for the fix as a change of accounting policy from the cost model to the revaluation for PPE?

Adopting the revaluation model for fully depreciated in-use items of PPE
Summary of discussion

Can one 'fix' the accounting for fully depreciated items of PPE by accounting for the fix as a change of accounting policy from the cost model to the revaluation for PPE? Discussants' consensus view:

» No, although one can voluntarily change a class of PPE from the cost model to the revaluation model (IAS 8.14(b)), one would first need to correct the prior period error by retrospective restatement of the comparative amounts for the prior period/s (IAS 8.42).

» After accounting for the correction of the prior period error, the change in accounting policy from the cost model to the revaluation model would be accounted for as a revaluation in the current reporting period (in accordance with the rule specified in IAS 8.17).

Accounting for changes in accounting estimates

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- » Issue 1: accounting for changes in useful life
- » Issue 2: accounting for a change in depreciation method

Issue 1: accounting for changes in useful life

Accounting for changes in useful life of PPE
What do you think?

Because measuring depreciation involves many estimates, that must be reconsidered periodically (IAS 16.51 and .61), it is expected that entities will disclose changes in their depreciation estimates when they occur (IAS 16.76).

How to account for a change in the useful life of an item of PPE?

Accounting for changes in useful life of PPE
Summary of discussion

How to account for a change in the useful life of an item of PPE?

Discussants' consensus view:

» Depreciation estimates (deprecation method, useful life, residual value etc) must be reviewed at least at annually (at year-end) (IAS 16.51 and .61)

» Material changes in such estimates, if not the correction of a prior period error, must be accounted for as a change in an accounting estimate, ie prospectively—in the period of the change and future periods (IAS 8.38(b)).

» However, if an inappropriate useful life was in error used in prior periods, and this resulted in material misstatement in the entity's prior period financial statements, the error must be corrected by retrospective restatement, ie by restating the comparative information presented in the financial statements of the year in which the prior error is discovered.

Issue 2: accounting for a change in depreciation method

Accounting for changes a change in depreciation method
What do you think?

Because measuring depreciation involves many estimates, that must be reconsidered periodically (IAS 16.51 and .61), it is expected that entities will disclose changes in their depreciation estimates when they occur (IAS 16.76).

How to account for a change in the depreciation method applied to an item of PPE?

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Accounting for changes a change in depreciation method
Summary of discussion

How to account for a change in the depreciation method used for an item of PPE? Discussants' consensus view:

» Depreciation estimates (deprecation method, useful life, residual value etc) must be reviewed at least annually (at year-end) (IAS 16.51 and .61)

» Material changes in such estimates, if not the correction of a prior period error, must be accounted for as a change in an accounting estimate, ie prospectively—in the period of the change and future periods (IAS 8.38(b)).

» However, if an inappropriate depreciation method was in error used in prior periods, and this resulted in material misstatement in the entity's prior period financial statements, the error must be corrected by retrospective restatement, ie by restating the comparative information presented in the financial statements of the year in which the prior error is discovered.

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Issue 1: correcting discounting errors in the prior period accounting for leases

Correcting prior period lease accounting errors
What do you think?

At the commencement of the lease, the lessee measures the lease liability at the present value of the unpaid lease payments discounted using the interest rate implicit in the lease (or if indeterminable) the lessee's incremental borrowing rate. (IFRS 16.26)

How to account for a correction in the formula used by a lessee when discounting future lease payments in the initial accounting for a lease?

Correcting prior period lease accounting errors
Summary of discussion

How to account for a correction in the formula used by a lessee when discounting future lease payments in the initial accounting for a lease? Discussants' consensus view:

» Subject to the impracticability exception (IAS 8.50 –.53), if material the prior period error must be corrected by retrospective restatement of the comparative amounts for the prior period(s) presented. (IAS 8.42)

» However, if immaterial the effects of the correction of the prior period error may be accounted for in the year in which they are discovered and corrected (ie prospectively).

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Accounting for the change of an accounting policy

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» Issue 1: voluntary changing from cost model to the revaluation model

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Issue 1: voluntary changing from cost model to revaluation model

Change from cost model to revaluation model
What do you think?

Accounting policy choice: a First-time Adopter of IFRS Accounting Standards must choose separately for each class of PPE (and those intangible assets the fair value of which can be determined with reference to an active market) either: (i) the cost model; or (ii) the revaluation model.

How must an entity account for a change of its accounting for a class of PPE from the cost model to the revaluation model?

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Change from cost model to revaluation model
Summary of discussion

How must an entity account for a change of its accounting for a class of PPE from the cost model to the revaluation model?

Discussants' consensus view:

» Because the revaluation model typically provides more relevant information than the cost model an entity can usually justify voluntarily changing from the cost model to the revaluation model for a class of PPE. (IAS 8.14(b))

» By way of exception (a rule) from the retrospective application principle, initial application of an accounting policy to use the revaluation model for a class of PPE or qualifying intangible assets must be dealt with as a revaluation in the period that the accounting policy changes from the cost model to the revaluation model. (IAS 8.17)

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New IFRS Accounting Standards that are not yet effective

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Issue 1: objective of disclosing the anticipated impacts of new IFRS Accounting Standards that are not yet effective

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New IFRS Accounting Standards that are not yet effective
What do you think?

An entity must disclose reasonably estimable information relevant to assessing the possible impact that application of a new IFRS Accounting Standard will have on the entity's financial statements in the period of initial application. (IAS 8.30 and .31)

What is the objective of disclosing the anticipated impacts of new IFRS Accounting Standards that are not yet effective?

New IFRS Accounting Standards that are not yet effective
Summary of discussion

What is the objective of disclosing the anticipated impacts of new IFRS Accounting Standards that are not yet effective?

Discussants' consensus view:

- Consistently with the objective of IFRS Accounting Standards, this disclosure aims to provide inputs for primary users to use:
  - in making their own estimates of the reporting entity's future net cash inflows; and
  - in holding management to account.