THE FINANCIAL REPORTING WORKSHOP

25TH AND 26TH JUNE 2015

HILTON HOTEL, NAIROBI

- **IAS 8 ACCOUNTING POLICIES, CHANGE IN ACC. ESTIMATES AND ERRORS**

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Coverview

- IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* is applied in selecting and applying accounting policies, accounting for changes in estimates and reflecting corrections of prior period errors.
- International Accounting Standard 8 *Accounting Policies, Changes in Accounting Estimates and Errors (IAS 8) replaces IAS 8 Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies (revised in 1993) and should be applied for* annual periods beginning on or after 1 January 2005.

Definitions

a). Accounting policies

Are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

Definitions

- **(b). <u>A change in accounting estimate</u>**

  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.

- **<u>(c). Materiality.</u>**

  Omissions or mis-state-ments of items are material if they could, by their size or nature, in-di-vid-u-ally or col-lec-tively, influence the economic decisions of users taken on the basis of the financial state-ments.

Definitions

- (a) the accounting policies in IFRSs need not be applied when the effect of applying them is immaterial.
- (b) financial statements do not comply with IFRSs if they contain material errors.
- (c) material prior period errors are to be corrected retrospectively in the first set of financial statements authorised for issue after their discovery.

Definitions

- **(d). Prior period errors**

are omissions from, and mis-state-ments in, an entity's financial state-ments for one or more prior periods arising from a failure to use, or misuse of, reliable in-for-ma-tion that was available and could rea-son-ably be expected to have been obtained and taken into account in preparing those state-ments. Such errors result from math-e-mat-i-cal mistakes, mistakes in applying accounting policies, over-sights or mis-in-ter-pre-ta-tions of facts, and fraud.

Selection of policies

When an IFRS specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the IFRS.

Selection of policies continued

If there is no IFRS use judgment and present information that is

(i) relevant to the economic decision-making needs of users; and

(ii) reliable, in that the financial statements are objective, prudent, faithfully represented.

Selection of policies continued

- In making that judgment, management must refer to, and consider the applicability of, the following sources:

  the requirements and guidance in IASB standards and interpretations dealing with similar and related issues; and

  the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.

Consistency in applying policies

An entity shall select and apply its accounting policies consistently unless a change is required by IFRS or results in the financial statements providing reliable and more relevant information

Disclosures relating to changes in accounting policies

- When caused by new standard, disclose:
  - 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)

Disclosure continued

- 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.

Changes in accounting policy

- The Standard requires retrospective application of voluntary changes in accounting policies and retrospective restatement to correct prior period errors.
- 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.

Definition

A *change in accounting estimate* is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments.

Examples

(a) bad debts;

(b) inventory obsolescence;

(c) the fair value of financial assets or financial liabilities;

(d) the useful lives of, or expected pattern of consumption of the future economic benefits embodied in, depreciable assets; and

(e) warranty obligations.

Accounting treatment

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

(a) the period of the change, if the change affects that period only; or

(b) the period of the change and future periods, if the change affects both.

Definition

Prior period errors are 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:

(a) was available when financial statements for those periods were authorized for issue; and

(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Examples

Such errors include :

1. The effects of mathematical mistakes,
2. Mistakes in applying accounting policies,
3. Oversights or misinterpretations of facts, and
4. Fraud (misstatement resulting from fraud)

Accounting treatment

An entity shall correct material prior period errors retrospectively in the first set of financial statements authorized for issue after their discovery by:

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

(b) 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.

Correction of errors

In correcting errors, an entity should disclose the reasons for restating the financial statements and the nature of the error.

Correction of errors

Finally for changes in accounting policies and correction of errors, there may be limitations in retrospective application, so where necessary you can adjust only the recent set.