THE FINANCIAL REPORTING WORKSHOP- A FOCUS ON SMEs

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IFRS for SMEs Section 10 – Accounting Policies, estimates & Errors

Learning objectives

- to **distinguish** between a change in accounting estimate, the correction of a prior period error and a change in accounting policy

- to **disclose** accounting policies and account for and disclose a change in accounting policy

- to **account for and disclose** a change in accounting estimate in financial statements

- to **account for and disclose** the correction of a prior period error in financial statements

1. Background

The objective of Section 10 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 prior period errors.

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

1. Background. Cont…

Once an entity has adopted an accounting policy for a specific type of transaction, other event or condition, it should change that policy only if the *IFRS for SMEs is amended or the entity* concludes that a new policy results in reliable and more relevant information.

1. Background. Cont…

Except in circumstances specified in the *IFRS for SMEs, all changes in accounting policies and* corrections of prior period errors are accounted for retrospectively.

This means that comparative information in financial statements is restated to reflect transactions and events in accordance with the new accounting policy as if that policy had always been applied, and that prior period errors are corrected in the period in which they occurred.

1. Background. Cont…

Retrospective application of accounting policies changes and retrospective restatement of prior period errors enhances the relevance and reliability of an entity's financial statements by making them comparable over time and with the financial statements of other entities.

2. Prior Period Errors

- These **are omissions from, and misstatements** in, the entity's financial statements for one or more prior periods.

- Arise from a failure to use reliable information that was available when financial statements for those periods were authorised for issue, provided that such information could reasonably be expected to have been obtained and used in the preparation and presentation of those financial statements.

- They also arise from the misuse of such information.

3. Change in accounting estimate

Is an adjustment that results from assessing the present status of, and expected future benefits and obligations associated with, assets and liabilities.

The **adjustment may be to the carrying amount of an asset or a liability, or the expense that reflects the consumption of the asset.**

Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.

3. Change in accounting estimate. (Cont…)

Changes in accounting estimates are, except in clearly defined circumstances, **applied prospectively**.

This means that the effect of a change is included in profit or loss in the period of the change, if the change affects that period only, and in the period of the change and future periods if the change affects both

4. Materiality consideration

Omissions or misstatements of items are material if they could, individually or collectively, **influence the economic decisions of users** made on the basis of the financial statements.

Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, is the determining factor.

5. Applying changes in A/C Policy

An entity shall account for changes in accounting policy as follows:

•An entity shall account for a change in accounting policy resulting from a change in the requirements of this IFRS in accordance with the transitional provisions, if any, specified in that amendment.

•An entity shall account for all changes in accounting policy **retrospectively.** Except where IFRS for SMEs specifies otherwise.

6. A/C Policy change - Retrospective Application

When a change in accounting policy is applied retrospectively in accordance with paragraph 10.11, the entity shall apply the new accounting policy to comparative information for prior periods to the earliest date for which it is practicable, as if the new accounting policy had always been applied.

When it is **impracticable to determine the** individual-period effects of a change in accounting policy on comparative information for one or more prior periods presented, the entity shall apply the new accounting policy to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable, which may be the current period, and shall make a corresponding adjustment to the opening balance of each affected component of equity for that period.

7. Disclosure of a change in accounting policy

When an accounting policy is changed voluntarily or due to an amendment to this IFRS with an effect on the current period or any prior period, or might have an effect on future periods, an entity shall disclose the following:

(a) the nature of the change in accounting policy.

(b) 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.

(c) the amount of the adjustment relating to periods before those presented, to the extent practicable.

(d) an explanation if it is impracticable to determine the amounts to be disclosed in (b) or (c) above.

Financial statements of subsequent periods need not repeat these disclosures

8.0 Changes in accounting estimates

10.15 - 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 and, accordingly, are not corrections of errors. When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate.

8.1 Example: - Change in A/C estimate

An entity provides warranties at the time of sale to purchasers of its products. On 31 December 20X5 an entity assessed its warranty obligation for products sold before 31 December 20X5 at CU100,000. Immediately before the 31 December 20X5 annual financial statements were approved for issue the entity discovered a latent defect in one of its products (i.e a defect that was not discoverable by reasonable or customary inspection).

As a result of the discovery the entity revised its estimate of its warranty obligation at 31 December 20X5 to CU150,000

8.2 Example 2 – Change in an A/C estimate

Ex 28 An entity acquired a yacht for CU1,000,000 on 1 January 20X1 and appropriately assessed its useful life at 30 years from the date of acquisition with a residual value of CU100,000. The entity decided that the straight-line method is the most appropriate method on which to depreciate the yacht.

In 20X9 the entity undertook substantial research into the yachting industry. As a result, at 31 December 20X9 the entity assessed the useful life of the yacht at 20 years from the date of acquisition with a residual value of nil. It also assessed a fair value for the yacht as at 31 December 20X9 at CU800,000.
believe that the straight-line method the most appropriate method of depreciation for the yacht.

The reassessment of the yacht's useful life and its residual value are changes in accounting estimates. The revised assessments are appropriately made on the basis of new information that arose from research performed in the current reporting period— 20X9.

8.3 Prospective application – Change in A/C Estimate

10.16 An entity shall recognise the effect of a change in an accounting estimate, except where IFRS states otherwise, **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.

8.4 Disclosure of a change in estimate

10.18 An entity shall disclose the nature of any change in an accounting estimate and the effect of the change on assets, liabilities, income and expense for the current period. If it is practicable for the entity to estimate the effect of the change in one or more future periods, the entity shall disclose those estimates.

8.5 Example of disclosure note – Change in A/C Estimate

Note 3 Operating profit Change in accounting estimate

At 31 December 20X9, as a result of research undertaken about the yachting industry, the entity reassessed the useful life of its yacht at 20 years (previously 30 years) from the date of acquisition; and the residual value of its yacht at CU500,000 (previously CU100,000).

This had the effect of decreasing the depreciation expense for the year ended 31 December 20X9 by CU8,333 (previously CU30,000 per year, now CU21,667 per year). Depreciation for each of the next 11 years is expected to be similarly affected by these changes in accounting estimates.

9.0 Corrections of prior period errors

10.19 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 authorised 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.

10.20 Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

9.1 Example 1- Prior period error

In 20X4, after the entity's 20X3 financial statements were approved for issue, the entity discovered that, as a result of a computational error, depreciation expense for 20X3 was understated by CU10.

The CU10 understatement of depreciation expense in the 20X3 financial statements is a prior period error—the **misstatement** in the entity's 20X3 financial statements **arose from the misuse** (mathematical error) **of reliable information that was available** when financial statements for those periods were authorised for issue. However, it is probably not material. If so, it can be ignored.

9.2 Example 2- Prior period error

In 20X4, after the entity's 20X3 financial statements were approved for issue, the entity discovered that, as a result of a computational error, depreciation expense for 20X3 was understated by CU36,000.

The CU36,000 understatement of depreciation expense in the 20X3 financial statements is a prior period error—the misstatement in the entity's 20X3 financial statements arose
from the misuse (mathematical error) of reliable information that was available when financial statements for those periods were authorised for issue.

9.3 Retrospective application - Errors

10.21 To the extent practicable, an entity shall correct a material prior period error retrospectively in the first financial statements authorised for issue after its 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.

9.4 Example1 - Retrospective application - Errors

(In 20X4, after the entity's 20X3 financial statements were approved for issue, the entity discovered that, as a result of a computational error, depreciation expense for 20X3 was understated by CU36,000.)

The effect of correcting the prior period error must be presented as a restatement of profit for the year ended 31 December 20X3, reduction of CU36,000, and a CU36,000 downward restatement of retained earnings at 1 January 20X4 (the beginning of the current reporting period).

9.5 Example 2 - Retrospective application - Errors

In 20X7 the entity discovered a programming error in its costing system that causes random errors in the costing of the entity's main product. In accordance with paragraph 10.21(b) the entity must account for the correction of the prior period error retrospectively, ie retrospective restatement. The cumulative effect of the error is a decrease of CU100,000 in retained earnings at 1 January 20X7—the beginning of the current reporting period. The entity presents two years of comparative information and has calculated that the effect of the error is CU25,000 less profit for each of the past four years.

The effect of correcting the prior period error must be presented as a restatement of retained earnings at 1 January 20X5—reduction of CU50,000; profit for the year ended 31 December 20X5—reduction of CU25,000; and profit for the year ended 31 December 20X6—reduction of CU25,000. The effect of these restatements is a CU100,000 downward restatement of retained earnings at 1 January 20X7 (the beginning of the current reporting period).

9.6 - Disclosure of prior period errors

10.23 An entity shall disclose the following about prior period errors:
(a) the nature of the prior period error.
(b) for each prior period presented, to the extent practicable, the amount of the correction for each financial statement line item affected.
(c) to the extent practicable, the amount of the correction at the beginning of the earliest prior period presented.
(d) an explanation if it is not practicable to determine the amounts to be disclosed in (b) or (c) above.

Financial statements of subsequent periods need not repeat these disclosures.

10. Interactive Session

Thank you

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