

## IAS 8/IPSAS 3

# Accounting Policies, Changes in Accounting Estimates and Errors

## Golf Hotel Kakamega

Uphold public interest

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# Objective



To prescribe the criteria for:

- Selection and application of accounting policies
- Changes in accounting policies
- Errors

# 1. Introduction - Scope



- IAS 8 applies to entities complying with general IFRSs

# Introduction - Scope



- Tax prior period adjustments are made in line with IAS 12 Income taxes



# Accounting policies



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

# Selection and application of accounting policies



- When a Standard or an Interpretation specifically applies to a transaction, other event or condition- apply the Standard or Interpretation and consider any relevant Implementation guidance by IASB

In the absence of a Standard or an Interpretation that specifically applies to a transaction, other event or condition -  
Management must use its judgment in developing and applying an accounting policy that results in information that is relevant and reliable.

# Managerial Considerations In Selection Of Policies



- Similar and related issues
- Conceptual framework
- Most recent pronouncements of other standard-setting bodies



# Consistency of accounting policies



An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless a Standard or an Interpretation specifically requires or permits categorization of items for which different policies may be appropriate

If a Standard or an Interpretation requires or permits categorization, an appropriate accounting policy shall be selected and applied consistently to each category

# Changes in accounting policies



An entity is permitted to change an accounting policy only if the change:

1. is required by a standard or interpretation;
2. or results in the financial statements providing reliable and more relevant information

# Exclusions



- Transaction or event that did not occur previously
- or were immaterial



# Treatment of Change In Accounting Policies



- If a change in accounting policy is required by a new standard or interpretation- as per that standard
- If the new pronouncement does not include specific transition provisions, then the change in accounting policy is applied retrospectively.

# Disclosures relating to changes in accounting policies



- Title of the standard or interpretation causing the change
- The nature of the change in accounting policy
- Description of the transitional provisions
- To the extent practicable, the amount of the adjustment: for each financial statement line item affected

# Disclosures relating to changes in accounting policies



- 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.

# Disclosures For Voluntary Changes In Policies



- ☐ Nature
- ☐ Amount
- ☐ Description

*If an entity has not applied a new standard or interpretation that has been issued but is not yet effective, the entity must disclose that fact*



# Changes in accounting estimates



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

# Treatment of Change In Accounting Estimate



- Prospectively by including it in profit or loss in:
- ❖ The period of the change, if the change affects that period only,
  - ❖ or the period of the change and future periods, if the change affects both.

# Disclosures On Change In Accounting Estimate



- Nature and amount of a change in an accounting estimate
- If the amount of the effect in future periods is not disclosed because estimating it is impracticable, an entity shall disclose that fact

# Prior Period Errors



Omissions from, and misstatements in, an entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that was available and could reasonably be expected to have been obtained and taken into account in preparing those statements.



# Causes Of Errors



Errors result from mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud

Mainly errors emanate from non system based accounting

# Treatment of Errors



Correct all material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery by:

- ✓ restating the comparative amounts for the prior period(s) presented in which the error occurred
- ✓ or if the error occurred before the earliest prior period presented, restating the opening balances for the earliest prior period presented

# Disclosures relating to prior period errors

- Nature of the prior period error
- Amount of the correction at the beginning of the earliest prior period presented
- If retrospective restatement is impracticable, an explanation and description of how the error has been corrected.

*Financial statements of subsequent periods need not repeat these disclosures*

## IPSAS 3

# Accounting Policies, Changes in Accounting Estimates and Errors Presentation



# Scope



IPSAS 3 applies to all public organizations

# Scope



- ☐ The standard does not cover the tax effects of corrections of prior period errors and
- ☐ Retrospective adjustments made to apply changes in accounting policies are as they are not relevant for many public sector organization

# Selection and Application of Accounting Policies

In selection and application of accounting policies

- An entity shall apply the relevant IPSAS
- If no specific IPSAS the management shall use its discretion in coming up with policies



# Changes in Accounting Policies



An organization should only change its accounting policy only if the change:

- (a) Is required by an IPSAS; or
- (b) Results in the financial statements providing reliable and more relevant information.

# Disclosures



- Title of the standard
- Transitional provisions, their nature and effect on the future
- The nature of the change in accounting policy
- Adjustments in the current period
- In case of impracticability, then the situation that led to that.



# IAS 8/ IPSAS 3



In all other aspects IPSAS 3 will mirror IAS 8  
and in summary

Accounting policies- Retrospective  
application or adjustment

Errors - Retrospective adjustment

Changes in estimates – prospective  
application

# IFRS 16 Leases

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November 2019

# Preamble



## Superseded Standards

IFRS 16 replaces the following standards and interpretations:

- [IAS 17](#) *Leases*
- [IFRIC 4](#) *Determining whether an Arrangement contains a Lease*
- [SIC-15](#) *Operating Leases - Incentives*
- [SIC-27](#) *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*

# Objective



IFRS 16 establishes principles for the recognition, measurement, presentation and disclosure of leases, with the objective of ensuring that lessees and lessors provide relevant information that faithfully represents those transactions

# Scope



IFRS 16 Leases applies to all leases, including subleases, except for:

- leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources;
- leases of biological assets held by a lessee (see IAS 41 Agriculture);
- service concession arrangements (see IFRIC 12 Service Concession Arrangements);



licences of intellectual property granted by a lessor (see IFRS 15 Revenue from Contracts with Customers); and

rights held by a lessee under licensing agreements for items such as films, videos, plays, manuscripts, patents and copyrights within the scope of IAS 38

# Long-term leases of land

The IASB considered, but decided against, a scope exclusion for long-term leases of land

Therefore, such leases should be accounted for in accordance with IFRS 16.

# Leases of investment property



If a lessee applies IAS 40's fair value model to its owned investment property, it is also required to apply that fair value model to right-of-use assets that meet the definition of investment property.

# Derivatives embedded in a lease



The IASB noted that the lease accounting model in IFRS 16 was not developed with derivatives in mind and, consequently, IFRS 16 would not provide an appropriate basis on which to account for derivatives.

# Recognition exemptions



Instead of applying the recognition requirements of IFRS 16 described below, a lessee may elect to account for lease payments as an expense on a straight-line basis over the lease term or another systematic basis for the following two types of leases:



- leases with a lease term of 12 months or less and containing no purchase options – this election is made by class of underlying asset; and
- leases where the underlying asset has a low value when new

# Identifying a lease



A contract is, or contains, a lease if it conveys the right to control the use of an identified asset for a period of time in exchange for consideration

Control is conveyed where the customer has both the right to direct the identified asset's use and to obtain substantially all the economic benefits from that use

**Is it a lease?**



**Identified  
asset**

**Right to control  
the use of an  
identified asset**

**Right to obtain substantially all  
economic benefits from use**

**Right to direct  
the use**

# Identification of an asset – general



The asset that is the subject of a lease must be specifically identified. This will be case if either of the following applies:

- the asset is explicitly specified in the contract (e.g. a specific serial number); or
- the asset is implicitly specified at the time that it is made available for use by the customer (e.g. when there is only one asset that is capable of being used to meet the contract terms).



# Substantive Substitution Rights



Even if an asset is specified a customer is not considered to have the right to use an identified asset (and, therefore, the contract is not a lease) if the supplier has a substantive right to substitute the asset throughout the period of use.

The 'period of use' is “the total period of time that an asset is used to fulfil a contract with a customer (including any non-consecutive periods of time)

If a substitution clause is not substantive because it does not change the substance of the contract, a substitution clause does not affect an entity's assessment as to whether a contract contains a lease.



# Asset Portion



A capacity portion of an asset is still an identified asset if it is physically distinct (e.g. a floor of a building).

A capacity or other portion of an asset that is not physically distinct (e.g. a capacity portion of a fibre optic cable) is not an identified asset, unless it represents substantially all the capacity such that the customer obtains substantially all the economic benefits from using the asset.

# Separating components of a contract

For a contract that contains a lease component and additional lease and non-lease components, such as the lease of an asset and the provision of a maintenance service, lessees shall allocate the consideration payable on the basis of the relative stand-alone prices

# Lease vs 'in-substance' sale or purchase



When assessing the nature of a contract, an entity should consider whether the contract transfers control of the underlying asset itself (as opposed to conveying the right to control the use of the underlying asset for a period of time). If so, the transaction is a sale or purchase within the scope of other Standards



# Leases vs service contracts



If a customer controls the use of an identified asset for a period of time, then the contract contains a lease.

In contrast, in a service contract, the supplier controls the use of any assets used to deliver the service

# Accounting by lessees

# Accounting by lessees

Upon lease commencement a lessee recognises a right-of-use asset and a lease liability

The right-of-use asset is initially measured at the amount of the lease liability plus any initial direct costs incurred by the lessee.

# Right To Use

After lease commencement, a lessee shall measure the right-of-use asset using a cost model, unless:

- i) the right-of-use asset is an investment property and the lessee fair values its investment property under [IAS 40](#); or
- ii) the right-of-use asset relates to a class of PPE to which the lessee applies [IAS 16](#)'s revaluation model

# Cost Model



Under the cost model a right-of-use asset is measured at cost less accumulated depreciation and accumulated impairment.



# Lease Liability Measurement



The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease if that can be readily determined.

If that rate cannot be readily determined, the lessee shall use their incremental borrowing rate

# Variable Lease Payments - Index



Variable lease payments that depend on an index or a rate are included in the initial measurement of the lease liability and are initially measured using the index or rate as at the commencement date.

Amounts expected to be payable by the lessee under residual value guarantees are also included.

# Subsequent Variable Costs



Variable lease payments that are not included in the measurement of the lease liability are recognised in profit or loss in the period in which the event or condition that triggers payment occurs, unless the costs are included in the carrying amount of another asset under another Standard

# Subsequent Measurement Lease Liability



The lease liability is subsequently remeasured to reflect changes

- In the lease term (using a revised discount rate);
- In the assessment of a purchase option (using a revised discount rate)

- the amounts expected to be payable under residual value guarantees (using an unchanged discount rate); or
- future lease payments resulting from a change in an index or a rate used to determine those payments (using an unchanged discount rate).



# Treatment Remeasurement



The remeasurements are treated as adjustments to the right-of-use asset

# Accounting by lessors



- Lessors shall classify each lease as an operating lease or a finance lease
- A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. Otherwise a lease is classified as an operating lease

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# Accounting by lessors

Upon lease commencement, a lessor shall recognise assets held under a finance lease as a receivable at an amount equal to the net investment in the lease



# Accounting by lessors

A lessor recognises finance income over the lease term of a finance lease, based on a pattern reflecting a constant periodic rate of return on the net investment



# Operating lease

A lessor recognises operating lease payments as income on a straight-line basis or, if more representative of the pattern in which benefit from use of the underlying asset is diminished, another systematic basis.

# Transition



**Retrospective application or cumulative catch-up approach? This is a single choice that must be applied to all leases**

## **Option 1 – Retrospective**

**Restate comparatives as if IFRS 16 always applied**

# Option 2 – Cumulative catch-up



- Leave comparatives as previously reported
- Any difference between asset and liability recognised in opening retained earnings at transition
- Carry forward existing finance lease liabilities
- Calculate outstanding liability for existing operating leases using incremental borrowing rate at date of transition
- Choose how to measure asset on lease-by-lease basis:

## Option 2A –

Measure asset as if IFRS 16 had been applied from lease commencement (but using incremental borrowing rate at date of transition)

## Option 2B –

Measure asset at amount equal to liability (adjusted for accruals and prepayments)

**Judgement:** Identifying a lease will sometimes require a significant amount of judgement based on the elements of the definition of a lease

**Judgement:** Determining whether it is reasonably certain that an extension or termination option will be exercised

**Judgement:** Identifying the appropriate rate to discount the lease payments may involve significant judgement

**Exemption:** Exemptions may be taken for short-term leases (by class of asset) or low-value asset leases (lease-by-lease basis)

**Policy choice: Requirements of IFRS 16 can be applied to a portfolio of similar leases provided that such aggregation is not expected to have a material effect**

**Policy choice: Lessee may elect not to separate non-lease components from lease components by class of asset**

**Policy choice: Lessee may, but is not required to, apply IFRS 16 to leases of intangible assets**

**Policy choice: The transition choices available are: full retrospective approach or cumulative catch-up approach, all or none, initial direct costs in measurement of right-of-use asset – choice lease-by-lease, and other practical expedients on transition**



# Questions & comments



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**GOD BLESS YOU ALL**

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