IAS 8
Accounting policies, changes in accounting estimates and errors

1. Objective

IAS 8 prescribes the criteria for determining the accounting policies applicable in the event of:

- changes in accounting policies;
- changes in accounting estimates;
- corrections of errors relating to prior periods.

The objective is to enhance the relevance and comparability of the information presented in the financial statements. The Standard should be applied in all cases except when specific provisions in another Standard require otherwise.

2. Scope

2.1 Accounting policies

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

The methods provided for in specific International Financial Reporting Standards (IFRS) must be applied. However, in the absence of an IFRS or related Interpretation for the treatment of a transaction, the management of the entity in question must implement a method that results in information that is relevant, reliable and faithfully represents the entity's financial position. To achieve this aim, management may also consider referring to standards set by other standard-setting bodies that use a similar accounting framework.

The **most appropriate accounting policies** shall be chosen and must be applied consistently at all times.

2.2 Changes in accounting policies

An entity may not change its accounting policies unless this is required under a new Standard, or if the change is intended to result in **more reliable** and **relevant information** regarding certain transactions, events or cash flows. Changes in accounting policies should be restricted to only those that have a material impact.
Changes in rules must be applied retrospectively to ensure relevant comparability of the financial statements. Therefore, the entity must adjust the opening balance of the affected components by charging or crediting the difference to equity.

If the impact of the implementation of the new accounting rules cannot be quantified for the prior periods, the policy is then applied prospectively from the date of the change.

2.3 Changes in accounting estimates

Such changes may occur, when a change of circumstances or new information requires certain accounting estimates to be revised, for example, estimates relating to bad debts, obsolete inventory, and fair value of financial assets or liabilities.

By its nature, the revision of an estimate does not relate to prior periods. Therefore changes may only be applied **prospectively**. The impact of this modification is recognized directly in the **profit and loss statement (income statement)** of the period during which the change in estimate occurs.

When it is difficult to distinguish between a change in an accounting method and a change in an accounting estimate, the change is considered to be a change in an accounting estimate.

Example 1: In N–1, company X booked a 100,000 provision to cover a customer's insolvency risk. On 31 December N, a re-assessment of the risk resulted in the conclusion that a provision of only 60,000 would be sufficient.
This is a change in an accounting estimate that must be wholly recognized in the profit and loss statement for the annual period N. The expenses recognized in N–1 are not affected. The adjustment of the provision in N would be recognized as follows:

	Debit	Credit
Provision for customer depreciation (B/S)	40,000	
Recovery of provision (P&L)		40,000

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Example 2: Company Y owns a machine purchased on 1 July N–3 in the amount of 120,000. At the time of purchase, the useful life of this item was estimated at 8 years. Consequently, the following depreciation expenses were used:

– in N–3: (120,000/8) × 6/12	7,500
– in N–2: (120,000/8)	15,000
– in N–1: (120,000/8)	15,000
	37,500

At the beginning of the annual period N, due to more intensive use of the machine, it is likely that its remaining useful life will be limited to 2.5 years.

In this case, the accounting estimate is also corrected. The depreciation expenses prior to the annual period N are not affected. The net carrying value on 31 December N–1
(120,000 – 37,500 = 82,500) must therefore be depreciated over the remaining useful life (2.5 years).

The depreciation schedule:

– in N:	82,500/2.5 =	33,000	instead of	15,000
– in N+1:	82,500/2.5 =	33,000	instead of	15,000
– in N+2:	[(82,500/2.5) x 6/12] =	16,500	instead of	15,000
– in N+3:		0	instead of	15,000
– in N+4:		0	instead of	15,000
– in N+5:		0	instead of	7,500
		82,500		82,500

2.4 Correction of errors relating to prior periods

Errors are omissions and misstatements that have a material impact and which result in an inaccurate presentation of an entity’s financial situation.
The entity must **retrospectively** correct material errors arising from a prior period, by restating the comparative amounts of the opening balances of the affected assets and liabilities, with the difference being charged or credited to **equity**. This rule applies except when it is impossible or impracticable to assess the effects of an error on the opening amounts at the beginning of the current reporting period, such as when an estimate of fair value cannot be made on a sufficiently reliable basis (IFRS 13).

Example 3:

On 31 December N–1, in its inventories, company Z calculated the value of an inventory held in a foreign country (at 300,000) but due to a lack of communication, did not include the write-down of 50% of its value, a write-down of 150,000. Given the company's size and low revenues, this adjustment is of a material nature and has an impact on the relevance of the financial statements prepared in N–1.

Since the error can be measured reliably, it should be corrected retrospectively:

BALANCE SHEET N–1 before correction of the error

Inventories (net value)	500,000	Equity	125,000
		Reserves	50,000
		Result	225,000
Other assets	725,000	Other liabilities	825,000
TOTAL	**1,225,000**	**TOTAL**	**1,225,000**

PROFIT AND LOSS N–1 before correction of the error

Revenue	1,500,000
Cost of sales	500,000
Gross profit	**1,000,000**
Other expenses	**700,000**
Pre-tax profit	**300,000**
Tax (25%)	**75,000**
Net profit	**225,000**

To adjust for the error, the financial statements must be corrected as follows:

Inventory net value: 500,000 – 150,000 =	350,000
Corporate income tax: 150,000 × 25% =	37,500
Deferred tax assets 37,500	

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In comparison to the annual period N, the financial statements N–1 are presented as follows:

BALANCE SHEET N–1 after correction of the error				**PROFIT AND LOSS N–1 after correction of the error**	
Inventories	350,000	Equity	125,000	Revenue	1,500,000
		Reserves	50,000	Cost of sales	500,000
		Result	112,500		
				Gross profit	1,000,000
Other assets	725,000	Other liabilities	825,000	**Other expenses**	700,000
Deferred tax assets	37,500			**Inventory write-down**	150,000
TOTAL	1,112,500	TOTAL	1,112,500	**Pre-tax profit**	**150,000**
				Tax (25%)	**37,500**
				Net profit	**112,500**

The following amounts will be recognized in N-1:

Reserves (B/S)	112,500	
Deferred tax assets (B/S)	37,500	
Provision for inventory depreciation (B/S)		150,000

3. Disclosure

Changes in accounting policies must give rise to disclosure of information related to:

- reference to particular Standards or related Interpretations generating the change in policy;
- The implementation of transitional provisions;
- The nature of the changes and the resulting adjustments to the current annual period and the prior periods;
- The reasons for restating prospectively and the amount of the impact.

Changes in accounting estimates require the entity to disclose information on the nature and the amount of these modifications for the current period and future periods.

The errors must be clearly explained and their impact measured for each accounting item affected, as well as the impact on the revenue of the entity. If retrospective application is impracticable, the reasons for not using it must be justified.