Accounting (Basics) - Lecture 3

Accounting policy, estimates and errors

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Selection and application of accounting policies

- Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.
- If IFRS for SMEs specifically address a transaction, other event or condition, an entity shall apply these IFRS. However, the entity need not follow a requirement in these IFRS if the effect of doing so would not be material.
- If IFRS for SMEs does not specifically address a transaction, other event or condition, an entity's management shall use its judgements in developing and applying an accounting policy that results in information that is:
  a) relevant to the economic decision-making needs of users, and
  b) reliable, in that the financial statements:

Selection and application of accounting policies

i. represent faithfully the financial position, financial performance and cash flows of the entity;
ii. reflect the economic substance of transactions, other events and conditions, and not merely the legal form;
iii. are neutral, i.e. free from bias;
iv. are prudent; and
v. are complete in all material respects.

- An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless IFRS for SMEs specifically require or permit categorization of items for which different policies may be appropriate. If IFRS for SMEs require or permit such categorization, an appropriate accounting policy shall be selected and applied consistently to each category.

Changes in accounting policies

- An entity shall change an accounting policy only if the change:
  a) is required by changes to IFRS for SMEs, or
  b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.
- The following are not changes in accounting policies:
  a) the application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring.
  b) the application of a new accounting policy for transactions, other events or conditions that did not occur previously or were not material.
  c) a change in cost model when a reliable measure of fair value is no longer available for an asset that these IFRS would otherwise require or permit to be measured at fair value.

Changes in accounting policies

- If this IFRS allows a choice of accounting treatment (including the measurement basis) for a specified transaction or other event or condition and an entity changes its previous choice, that will be a change in accounting policy.
- When a change in accounting policy is applied retrospectively, 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.

Changes in accounting policies

- When a voluntary change in accounting policy has an effect on the current period or any prior period, an entity shall disclose the following:
  a) the nature of the change in accounting policy.
  b) the reasons why applying the new accounting policy provides reliable and more relevant information.
  c) to the extent practicable, the amount of the adjustment for each financial statement line item affected, shown separately:
     i. for the current period;
     ii. for each prior period presented; and
     iii. in the aggregate for periods before those presented.
     iv. an explanation if it is impracticable to determine the amounts to be disclosed in (c) above.

Financial statements of subsequent periods need not repeat these disclosures.

Changes in accounting estimates

- 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.
- An entity shall recognize the effect of a change in an accounting estimate 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.

Corrections of prior period errors

- 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.
- Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.
- To the extent practicable, an entity shall correct a material prior period error retrospectively in the first financial statements authorized for issue after its discovery by:
  a) restating the comparative amounts for the prior period(s) presented in which the error occurred, or

Corrections of prior period errors

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.

- When it is impracticable to determine the period-specific effects of an error on comparative information for one or more prior periods presented, the entity shall restate the opening balances of assets, liabilities and equity for the earliest period for which retrospective restatement is practicable (which may be the current period). An entity shall disclose the following about prior period errors:
  a) the nature of the prior period error.
  b) for each prior period presented the amount of the correction for each financial statement line item affected.
  c) 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.