FAR-1 — FINANCIAL ACCOUNTING & REPORTING 1

Topic: IAS 8 — ACCOUNTING POLICIES, CHANGES IN ESTIMATES & ERRORS

1 TOPIC OVERVIEW

WHAT IS IT?
IAS 8 prescribes the criteria for selecting/applying accounting policies, and the treatment and disclosure of changes in policies, changes in estimates, and correction of material prior period errors.

WHY IMPORTANT?
Getting the classification right (policy vs estimate vs error) completely changes the accounting treatment — retrospective restatement vs simple prospective adjustment — and drives comparability across periods.

CORE PRINCIPLE
Policy changes and error corrections are applied **retrospectively** (as if always applied/no error occurred); changes in estimate are applied **prospectively** (current and future periods only) — never restated into the past.

2 KEY DEFINITIONS [IAS 8:5, 32 & 35; IAS 1:7]

Accounting policies: Specific principles, bases, conventions, rules and practices applied in preparing and presenting financial statements (recognition, measurement basis, or presentation choices).

Accounting estimates: Monetary amounts subject to measurement uncertainty — e.g. bad debt expense, inventory NRV, fair value of an asset/liability, depreciation (useful life/method/residual value), warranty provisions.

Prior period errors: Omissions/misstatements in prior period financial statements from failing to use, or misusing, reliable information that was available and could reasonably have been obtained at the time — includes maths mistakes, misapplied policies, oversights, misinterpretation, and fraud.

Materiality: Information is material if omitting, misstating, or obscuring it could reasonably be expected to influence users' decisions.

Retrospective application: Applying a new accounting policy to transactions/events as if it had always been applied.

Retrospective restatement: Correcting recognition, measurement and disclosure as if a prior period error had never occurred.

Prospective application: Applying a new policy, or recognising a change in estimate, only to transactions/events occurring/periods affected **after** the change date.

Impracticable: A requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.

3 CLASSIFICATION — POLICY, ESTIMATE, OR ERROR? [Worked check — Example 01]

Scenario	Classification
Land & buildings changed from cost model to revaluation model	**Change in accounting policy**
Useful life of plant revised downward following impairment	**Change in accounting estimate**
Depreciation method changed from straight line to reducing balance	**Change in accounting estimate**
Inventory cost formula changed from FIFO to weighted average	**Change in accounting policy**
Prior year's inventory sheets discovered to be under-cast	**Prior period error**
Actual inventory NRV discovered to be much lower than expected	**Change in accounting estimate**
SFP presentation changed from current/non-current to order of liquidity	**Change in accounting policy**

When it is difficult to distinguish a change in policy from a change in estimate, the change is **treated as a change in accounting estimate** (prospective — simpler treatment).

4 COMPARATIVE INFORMATION [IAS 1:10, 38, 38A & 40A]

Minimum: **two** of each — SFP, SPL & OCI, separate P&L (if presented), statement of cash flows, and SOCE, with related notes. A **third** SFP (at the start of the preceding period) is required when an entity: (a) applies an accounting policy retrospectively; (b) makes a retrospective restatement; or (c) reclassifies items in its financial statements.

SELECTING POLICIES & CHANGES IN ACCOUNTING ESTIMATES

5 SELECTION & APPLICATION OF ACCOUNTING POLICIES [IAS 8:7, 10–13]

IFRS specifically applies to the transaction/event?

YES
Apply that IFRS's policy directly

NO
Management uses judgement to develop a policy giving relevant + reliable info (faithful, substance over form, neutral, prudent, complete)

Judgement sources (in order): (a) IFRS on similar/related issues; (b) the Conceptual Framework; (c) recent pronouncements of other standard-setters, other literature, accepted industry practice (if not conflicting). **Consistency:** apply the same policy to similar transactions and across periods unless a change is required or permitted [Example 02: IAS 16 allows cost OR revaluation model, but once chosen, must apply consistently to the **entire class** of PPE].

6 CHANGE IN ACCOUNTING POLICY — WHEN ALLOWED? [IAS 8:14 & 16]

✔ **ALLOWED WHEN**

- Required by an IFRS, OR
- Results in more relevant and reliable information (voluntary change)

✘ **NOT a change in policy**

- Applying a policy to transactions that differ in substance from those previously occurring
- Applying a new policy to transactions that did not occur previously, or were immaterial

SPECIAL APPLICATION RULE

Initial application of the **revaluation model** under IAS 16/38 (from cost model) is dealt with under IAS 16/38 **directly** — NOT under IAS 8.

7 CHANGE IN ACCOUNTING ESTIMATE [IAS 8:32–34, 36, 37, 39, 40]

Arises from new information/experience about circumstances, NOT correction of an error. Recognised **prospectively**.

Effect	Treatment
Profit or loss	Include in the period of change (if it affects that period only) OR the period of change AND future periods (if both affected).
Assets/liabilities/equity	Adjust the carrying amount of the related item in the period of change.
Disclosure	Nature and amount of effect on current period, and expected future effect (unless impracticable to estimate — disclose that fact instead).

WORKED CHECK [Example 03]

Asset cost Rs.200,000, original life 10 yrs, nil residual — depreciation Rs.20,000/yr. At start of Yr3, CA = Rs.160,000 (200,000−40,000). Useful life revised to **total 6 years** (4 years remaining). New depreciation = **160,000/4 = Rs.40,000/yr** from Yr3 onward — prior years' Rs.20,000/yr charges are NOT restated.

8 CALCULATION ROADMAP — CLASSIFY, THEN APPLY

1. Identify: policy, estimate, or error?
2. Policy/error → retrospective; Estimate → prospective
3. Compute periodic effect per year
4. Compute cumulative effect (if retrospective)
5. Restate comparatives / adjust opening RE
6. Disclose per IAS 8

RETROSPECTIVE APPLICATION OF A POLICY CHANGE

9 RETROSPECTIVE APPLICATION — 3 STEPS [IAS 8:19, 22, 23]

1. Apply new policy in the current period → 2. Apply new policy in the comparative period as if always applied → 3. Adjust opening balances of the earliest comparative period presented

Applies unless impracticable to determine period-specific or cumulative effects. [Example 04: a company normally shows only 2 years of SFP — but a retrospective policy change forces it to also present a **third SFP**, as at the start of the earliest comparative period, restated as if the new policy had always applied.]

10 FULL WORKED EXAMPLE — COST TO FAIR VALUE MODEL [Example 05/06 pattern]

Investment property (building, cost Rs.150m, 60% building component, 20-yr life, Rs.10m residual) — change from **cost model to fair value model**. FV increases 6% per year since 2021 acquisition. Depreciation reversed: [(150×60%−10)/20] = Rs.4m/year.

Rs. million	2021	2022	2023	2024
FV gain @6%	9	9.54	10.11	10.72
Reversal of depreciation	4	4	4	4
Periodic effect	13	13.54	14.11	14.72
Cumulative effect	**13**	**26.54**	**40.65**	**55.37**

SFP/SOCE extracts, Rs.m	2022 (restated)	2023 (restated)	2024
Investment property [reported + cumulative]	168.54	178.65	189.37
Retained earnings [reported + cumulative]	302.54	414.65	513.37
Net profit [reported + periodic]	112.11	—	98.72

SOCE shows: opening RE (as reported) + effect of policy change = **restated opening RE**; then add each year's (restated) profit forward. The cumulative effect at the start of the earliest period presented adjusts **opening retained earnings only** — never routed through the current year's P&L.

11 LIMITATIONS & DISCLOSURE — POLICY CHANGES [IAS 8:23–25, 28, 29]

LIMITATIONS

- Period-specific effects impracticable → apply retrospectively from the **earliest practicable date**
- Cumulative effect impracticable → adjust comparatives **prospectively** from the earliest practicable date

DISCLOSURE (both IFRS-required & voluntary changes, key items)

- Nature of the change (+ title of IFRS, if required by one)
- Reason it gives more reliable/relevant info (voluntary changes only)
- Amount of adjustment per line item and EPS, for current + prior periods, to the extent practicable
- Adjustment relating to periods before those presented

13 LIMITATIONS & DISCLOSURE — ERROR CORRECTION [IAS 8:44, 45, 49]

LIMITATIONS

- Period-specific effects impracticable → restate opening balances of the **earliest period practicable** (may be the current period)
- Cumulative effect impracticable → correct **prospectively** from the earliest practicable date

DISCLOSURE

- Nature of the prior period error
- Amount of correction per line item and EPS, for each prior period presented (to the extent practicable)
- Amount of correction at the start of the earliest period presented
- If impracticable for a period: circumstances + how/from when correction was applied

CORRECTING PRIOR PERIOD ERRORS & QUICK RECAP

12 PRIOR PERIOD ERRORS — RETROSPECTIVE RESTATEMENT [IAS 8:41–43]

Current period errors are corrected before the statements are authorised for issue. Material **prior period** errors are corrected retrospectively (unless impracticable) in the first statements authorised after discovery, by: restating the comparative amounts for the period the error occurred in; OR, if the error is from before the earliest period presented, restating the **opening balances** of assets, liabilities and equity for that earliest period.

WORKED CHECK — COMBINED ERROR + ESTIMATE CHANGE [Example 07/08]

(i) Error: Rs.36.75m installation cost wrongly expensed as maintenance in 2014 (asset available 1 Jul 2014, 4-yr SL life) → should have been capitalised. **(ii) Estimate change:** equipment depreciation method changed from 27.5% reducing balance to straight line (cost Rs.80m, 5-yr life, Rs.16m residual, bought 1 Jul 2015) due to a genuine change in expected benefit pattern.

Error correction, Rs.m	2015	2016	2017
Reversal of maintenance expense	36.75	—	—
Depreciation [36.75/4]	(9.19)	(9.19)	(9.19)
Periodic effect	27.56	(9.19)	(9.19)
Cumulative effect	**27.56**	**18.37**	**9.18**

Estimate change (separate, prospective only): 2016 dep. @27.5% RB = Rs.22m. 2017 depreciation under old method would be Rs.15.95m [(80−22)×27.5%]; under new SL method = Rs.10.50m [(58−16)/4]. **Depreciation reduced by Rs.5.45m** in 2017 (and future years) — this estimate change is NEVER restated into 2015/2016.

Combined SOCE effect: opening RE (as reported) + error correction (cumulative, restated) = restated opening RE; then each year's restated profit (error periodic effect ± estimate change in the year it applies) rolls forward — dividends are deducted separately as normal.

14 FINANCIAL STATEMENT IMPACT

STATEMENT OF PROFIT OR LOSS

- Policy change/error: only the **current** year's periodic effect hits current P&L; prior years shown as restated comparatives
- Estimate change: current + future periods' expense adjusted prospectively

STATEMENT OF FINANCIAL POSITION / SOCE

- Opening retained earnings restated for the cumulative effect of a policy change or error (never through current P&L)
- Related asset/liability restated to the amount as if the new policy/no error had always applied

! ⚠ EXAM TRAPS — COMMON MISTAKES

- Applying a **change in accounting estimate retrospectively** — estimates are always prospective, never restated into prior years.
- Routing the **cumulative effect** of a policy change or error correction through the current year's **profit or loss** — it must adjust opening retained earnings instead.
- Forgetting the **third SFP** requirement when a retrospective adjustment affects the earliest period presented.
- Treating the initial adoption of the **revaluation model** as an IAS 8 policy change — it's dealt with under IAS 16/38 directly.
- Confusing a genuine **change in estimate** (new information) with a **prior period error** (information that was already available and should have been used).
- Forgetting that when it's hard to tell a policy change from an estimate change, it must be treated as an **estimate change** (simpler, prospective).
- Mixing up the **periodic effect** (that year's P&L impact) with the **cumulative effect** (balance sheet/opening RE impact) in restatement workings.
- Forgetting that dividends declared in a restated SOCE are **not** part of the retrospective adjustment — they're recognised in their own year as usual.
- Applying full retrospective restatement when it is genuinely **impracticable** — the correct fallback is the earliest practicable date, not skipping restatement altogether.
- Confusing **capital vs revenue** treatment — e.g. wrongly expensed installation costs (Example 07) must be capitalised and depreciated, not just reversed as a one-off credit to profit.

15 QUICK DECISION TREE — ANSWERING ANY IAS 8 QUESTION

1. Question given
2. Policy, estimate, or error?
3. Retrospective (policy/error) or prospective (estimate)?
4. Calculate periodic & cumulative effects
5. Restate SFP/SPL/SOCE + disclose

✔ Final answer

IAS 8 — ACCOUNTING POLICIES, ESTIMATES & ERRORS IN 60 SECONDS

Policy = principles/bases/rules used; **Estimate** = amount subject to measurement uncertainty; **Error** = misuse of info that was already available.

Unclear policy vs estimate? Treat as an estimate change.

Policy change/error → retrospective: current period + restate comparatives + adjust opening balances of earliest period.

Estimate change → prospective only: current period, and future periods if affected.

Revaluation model adoption → IAS 16/38 directly, not IAS 8.

Impracticable? Apply/restate from the earliest practicable date instead (retrospective) or prospectively (if even that's impracticable).

Cumulative effect → adjusts opening retained earnings, never current P&L.

Third SFP needed when retrospective application/restatement/reclassification affects the earliest period presented.

Disclose: nature, amount per line item/EPS, and impracticability circumstances if relevant.