

Accounting Policies, Changes in Accounting Estimates and Errors (IAS 8)

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1. Objective and scope of IAS 8

IAS 8 sets out:

- **Objective:** To prescribe how an entity:
 - selects and applies accounting policies;
 - accounts for changes in accounting policies;
 - accounts for changes in accounting estimates; and
 - corrects prior period errors.
- **Purpose:**
 - **Enhance relevance and reliability** of financial statements.
 - **Improve comparability** over time and between entities.
- **Scope:** IAS 8 applies to all entities preparing financial statements under IFRS, for:
 - **Accounting policies** (selection, consistency, changes).
 - **Accounting estimates** (revision and effect).
 - **Errors** (identification and correction).

2. Key definitions

- **Accounting policies:** The specific principles, bases, conventions, rules and practices applied in preparing and presenting financial statements.
- **Change in accounting policy:** When an entity adopts a different principle, basis, convention, rule or practice from the one previously used (e.g. changing from cost model to revaluation model for a class of PPE, if permitted).
- **Accounting estimates:** Monetary amounts in financial statements that are subject to measurement uncertainty and are determined using judgement and latest available information (e.g. useful lives, residual values, expected credit losses, provisions).
- **Change in accounting estimate:** An adjustment of the carrying amount of an asset or liability, or the amount of periodic consumption of an asset, resulting from reassessment of its present status and expected future benefits/obligations (e.g. revising useful life of machinery).
- **Errors:** Omissions or misstatements in financial statements of prior periods arising from:
 - mathematical mistakes;
 - mistakes in applying accounting policies;
 - oversights or misinterpretations of facts;
 - fraud.

3. Accounting policies

3.1 Selecting accounting policies

- **When an IFRS specifically applies:**
 - The accounting policy must follow that IFRS (including any relevant guidance).

- **When no IFRS specifically applies:** Management uses judgement to develop a policy that produces **relevant and reliable** information, referring in descending order to:
 - **Requirements and guidance in IFRSs** dealing with similar or related issues.
 - **Conceptual Framework** definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses.
 - **Other sources** (other standard-setting bodies, accepted industry practice, other literature) provided they do not conflict with IFRS.
- **Consistency:**
 - **Policies must be applied consistently** for similar transactions, events and conditions, unless an IFRS permits or requires categorisation with different policies per category.
- **Fair presentation and faithful representation:**
 - Policies must result in financial statements that fairly present financial position, performance and cash flows.
 - Inappropriate policies cannot be “fixed” by disclosure alone—measurement and recognition must be correct.

Example — Selecting a policy when no specific IFRS exists

Scenario: An entity develops a new type of digital asset that does not fall clearly under existing IFRSs.

Approach under IAS 8:

- **Step 1:** Look for IFRSs with similar issues (e.g. IAS 38 Intangible Assets).
- **Step 2:** Use the Conceptual Framework to decide whether the asset meets the definition of an asset and when to recognise it.
- **Step 3:** Consider industry practice and other standard-setter guidance, ensuring no conflict with IFRS.
- **Result:** A policy is developed that treats the digital asset as an intangible asset measured at cost, amortised over its useful life, with appropriate impairment testing.

4. Changes in accounting policies

4.1 When may an accounting policy be changed?

An entity changes an accounting policy only if:

- **Required by an IFRS:**
 - e.g. adoption of a new standard or amendment.
- **Voluntary change that improves information:**
 - The new policy provides **more reliable and more relevant** information about the effects of transactions, events or conditions on financial position, performance or cash flows.

Applying a policy to **new or substantively different transactions** is **not** a change in accounting policy (it is simply applying an existing policy to new circumstances).

4.2 Retrospective application

- **General rule:** Changes in accounting policies are applied **retrospectively** unless another IFRS specifically requires or permits a different treatment.
- **Retrospective application means:**
 - **Restate comparative amounts** for prior periods as if the new policy had always been applied.
 - **Adjust opening balances** of each affected component of equity for the earliest period presented.
 - Recognise the **cumulative effect** of the change in retained earnings at the beginning of the earliest period presented (not in current profit or loss).
- **Impracticability exception:** Retrospective application is not required if it is **impracticable** to determine either:
 - the period-specific effects; or
 - the cumulative effect of the change. In such cases, the entity applies the new policy from the earliest practicable date and explains the circumstances.

4.3 Disclosure requirements for changes in accounting policies

For each change in accounting policy, the entity discloses:

- **Nature of the change.**
- **Reasons** why the new policy provides more reliable and relevant information (for voluntary changes).
- **Title of the IFRS** causing the change (if applicable).
- **Transitional provisions** applied, if any.
- **Amount of the adjustment** for each line item affected in current and prior periods.
- **Impact on basic and diluted earnings per share**, if applicable.
- **If retrospective application is impracticable:**
 - the circumstances; and
 - how and from when the change has been applied.

Example — Retrospective change in accounting policy

Scenario: Entity A previously expensed development costs as incurred. It now concludes that certain development costs meet the criteria in IAS 38 and should be capitalised.

Treatment under IAS 8:

- **Step 1:** Identify all qualifying development costs in prior periods.
- **Step 2:** Capitalise those costs retrospectively as intangible assets.
- **Step 3:** Restate comparative financial statements as if the costs had been capitalised from the start.

- **Step 4:** Adjust opening retained earnings of the earliest period presented for the cumulative effect (costs capitalised less accumulated amortisation).
- **Step 5:** Disclose the nature of the change, reasons, amounts per line item, and EPS impact.

5. Changes in accounting estimates

5.1 Nature of accounting estimates

Accounting estimates arise because many items cannot be measured with precision and require judgement, such as:

- **Useful lives and residual values** of PPE and intangible assets.
- **Expected credit losses** on receivables.
- **Provisions** for warranties, litigation, environmental obligations.
- **Fair value measurements** where observable market data is limited.

Estimates are based on **latest available, reliable information** and may change as new information emerges.

5.2 Distinguishing changes in estimates from changes in policies

- **Change in policy:**
 - A change in the underlying principle or basis (e.g. from cost model to revaluation model).
- **Change in estimate:**
 - A revision of the amount resulting from new information or developments (e.g. revising useful life from 10 years to 8 years).

IAS 8 emphasises that **changes in estimates are not changes in accounting policies**.

5.3 Prospective application of changes in estimates

- **General rule:** Changes in accounting estimates are applied **prospectively**.
- **Prospective application means:**
 - The change affects:
 - **current period profit or loss**, and
 - **future periods' profit or loss**, if the change affects both.
 - No restatement of prior period comparatives.

Example — Change in useful life of an asset

Scenario: A machine costing R100 000 has a useful life of 10 years and no residual value. Straight-line depreciation is used. After 3 years, new information suggests the total useful life is 8 years (i.e. 5 years remaining).

Original depreciation:

- Annual depreciation: $R100\,000 \div 10 = R10\,000$.
- Accumulated depreciation after 3 years: R30 000.
- Carrying amount: R70 000.
- Note that this carrying amount now becomes the **new depreciable amount**.

Revised estimate:

- Remaining useful life: 5 years.
- New annual depreciation: $R70\,000 \div 5 = R14\,000$ per year.

Accounting under IAS 8:

- No restatement of prior years.
- From year 4 onwards, depreciation expense is R14 000 per year.
- Disclose the nature and amount of the change if it is material.

5.4 Disclosure of changes in estimates

When a change in estimate has a **material effect**, the entity discloses:

- **Nature of the change.**
- **Amount of the effect** on current period.
- **Amount of the effect on future periods**, if practicable to estimate.

6. Errors and their correction

6.1 Types of errors

Errors may arise from:

- **Mathematical mistakes** (e.g. incorrect summation).
- **Mistakes in applying accounting policies** (e.g. misclassifying an item).
- **Oversights or misinterpretations of facts** (e.g. ignoring a contract clause).
- **Fraud** (intentional misstatement or omission).

6.2 Prior period errors

A **prior period error** is an error in financial statements of one or more prior periods discovered in the current period.

6.3 Correction of prior period errors

- **General rule:** Correct prior period errors **retrospectively** by:
 - **Restating comparative amounts** for the prior period(s) presented in which the error occurred; or

- **Restating opening balances** of assets, liabilities and equity for the earliest prior period presented, if the error occurred before that period.
- **Impracticability exception:** If it is impracticable to determine the period-specific or cumulative effects of an error, the entity corrects it from the earliest practicable date and explains the circumstances.
- **Recognition of correction:**
 - The cumulative effect is adjusted against **opening retained earnings** of the earliest period presented.
 - The correction is **not recognised in current period profit or loss** as a “catch-up” expense or income.

6.4 Disclosure of prior period errors

For each material prior period error, the entity discloses:

- **Nature of the error.**
- **Amount of the correction** for each line item affected in:
 - each prior period presented; and
 - at the beginning of the earliest prior period presented.
- **Impact on basic and diluted EPS**, if applicable.
- **If retrospective restatement is impracticable:**
 - the circumstances; and
 - how and from when the error has been corrected.

Example — Correction of a prior period error

Scenario: In 20X4, Entity B discovers that revenue of R500 000 was recognised in 20X3 without satisfying IFRS 15 criteria. The 20X3 financial statements are being presented as comparatives in the 20X4 statements.

Original 20X3 figures (simplified):

- Revenue: R5 000 000 (includes the erroneous R500 000).
- Profit before tax: R1 200 000.

Correction under IAS 8:

- **Step 1:** Reverse the R500 000 revenue in the 20X3 comparative figures.
- **Step 2:** Adjust profit before tax and retained earnings for 20X3 accordingly.
- **Step 3:** Restate opening retained earnings at 1 January 20X4 to reflect the corrected 20X3 figures.
- **Step 4:** Disclose the nature of the error, the amounts by line item, and EPS impact.

7. Distinguishing policies, estimates and errors

7.1 Why the distinction matters

- **Accounting policies:**
 - Changes → generally **retrospective**.
- **Accounting estimates:**
 - Changes → **prospective**.
- **Errors:**
 - Corrections → generally **retrospective**.

Correct classification determines whether prior periods are restated and how equity is adjusted.

7.2 Quick comparison

- **Change in accounting policy:**
 - **Cause:** New IFRS or voluntary improvement in relevance/reliability.
 - **Treatment:** Retrospective (unless impracticable or specific transitional provisions).
 - **Impact:** Restated comparatives; opening retained earnings adjusted.
- **Change in accounting estimate:**
 - **Cause:** New information or re-assessment of existing information.
 - **Treatment:** Prospective.
 - **Impact:** Current and future profit or loss only; no restatement of comparatives.
- **Prior period error:**
 - **Cause:** Mistake or fraud in prior period financial statements.
 - **Treatment:** Retrospective correction.
 - **Impact:** Restated comparatives; opening retained earnings adjusted.

Short illustrative scenarios

- **Scenario 1 — Policy or estimate?** Entity changes depreciation method from straight-line to diminishing balance because it better reflects the pattern of consumption of economic benefits.
 - This is generally treated as a **change in estimate** (pattern of consumption), applied **prospectively**.
- **Scenario 2 — Error or estimate?** Entity discovers that a provision for warranty was calculated using an incorrect formula (a clear mathematical mistake).
 - This is a **prior period error**, corrected **retrospectively**.
- **Scenario 3 — Policy change:** Entity adopts a new IFRS that requires a different measurement basis for financial instruments.
 - This is a **change in accounting policy**, applied **in accordance with the transitional provisions** of the new IFRS (often retrospective).

8. Summary of IAS 8 for exam and practice

- **Objective:** Ensure **relevance, reliability and comparability** by prescribing how to select and change policies, revise estimates and correct errors.
- **Policies:**
 - Select using IFRS, Conceptual Framework and other guidance.
 - Apply consistently.
 - Change only if required by IFRS or to improve relevance/reliability.
 - Generally, apply changes **retrospectively**.
- **Estimates:**
 - Reflect measurement uncertainty and judgement.
 - Changes arise from new information.
 - Apply changes **prospectively** to current and future periods.
- **Errors:**
 - Include mistakes and fraud.
 - Correct **retrospectively** by restating comparatives and opening balances.

9. Practice Question Pack

A. Multiple-Choice Questions (MCQs)

MCQ 1

A change from the **cost model to the revaluation model** for property, plant and equipment is:

- A. A change in accounting estimate
- B. A change in accounting policy
- C. A prior period error
- D. Neither a policy nor an estimate change

➤ **Correct answer: B**

➤ **Reason:** It changes the measurement basis — this is a change in accounting policy.

MCQ 2

A revision of the **useful life** of a machine due to new information is:

- A. A change in accounting policy
- B. A change in accounting estimate
- C. A prior period error
- D. A change in classification

➤ **Correct answer: B**

MCQ 3

Changes in accounting policies are generally applied:

- A. Prospectively
- B. Retrospectively
- C. Only in the current period
- D. Only when approved by auditors

➤ **Correct answer: B**

MCQ 4

Which of the following is **NOT** a prior period error?

- A. Mathematical mistakes
- B. Fraud
- C. Misinterpretation of facts
- D. Change in depreciation method

➤ **Correct answer: D**

➤ **Reason:** Changing the depreciation method is treated as a change in estimate.

MCQ 5

A change in accounting estimate must be applied:

- A. Retrospectively
- B. Prospectively
- C. By restating comparatives
- D. By adjusting opening retained earnings

➤ **Correct answer: B**

MCQ 6

Which of the following is **true** regarding voluntary changes in accounting policies?

- A. They are prohibited
- B. They must provide more reliable and relevant information
- C. They must be approved by shareholders
- D. They are treated as changes in estimates

➤ **Correct answer: B**

MCQ 7

An error discovered from two years ago must be corrected:

- A. Prospectively
- B. Retrospectively
- C. In current profit or loss
- D. Only if material

➤ **Correct answer: B** (If immaterial, disclosure may be limited — but correction is still retrospective.)

MCQ 8

Which of the following is **NOT** an accounting policy?

- A. Inventory valuation method
- B. Depreciation method
- C. Useful life of an asset
- D. Revenue recognition basis

➤ **Correct answer: C** → Useful life is an estimate, not a policy.

MCQ 9

If retrospective application of a new accounting policy is **impracticable**, the entity must:

- A. Not apply the new policy
- B. Apply it prospectively from the earliest practicable date
- C. Apply it only to future transactions
- D. Disclose nothing

➤ **Correct answer: B**

MCQ 10

Which of the following is **required** when correcting a prior period error?

- A. Adjust current year profit
- B. Restate comparatives
- C. Change accounting policies
- D. Apply prospective treatment

➤ **Correct answer: B**

B. Scenario-Based Questions (with solutions)

Scenario 1 — Change in Estimate

A machine cost R120 000, useful life 12 years, no residual value. After 4 years, management revises the total useful life to 10 years.

Required: Calculate the new annual depreciation and explain the IAS 8 treatment.

Solution:

- Original depreciation: $R120\,000 \div 12 = R10\,000$ per year
- Accumulated depreciation after 4 years: R40 000
- Carrying amount: R80 000
- Remaining useful life: 6 years (10 total – 4 elapsed)
- New depreciation: $R80\,000 \div 6 = \mathbf{R13\,333}$ per year

IAS 8 treatment: Prospective application — no restatement of prior periods.

Scenario 2 — Change in Accounting Policy

Entity W previously used FIFO for inventory valuation. It now switches to weighted average because it provides more reliable and relevant information.

Required: Explain how the change is applied.

Solution:

- This is a **change in accounting policy**.
- Apply **retrospectively**:
 - Restate prior period inventory and cost of sales.
 - Adjust opening retained earnings of the earliest period presented.
- Disclose nature, reason, and quantitative effects.

Scenario 3 — Prior Period Error

In 20X5, Entity X discovers that R300 000 of revenue was incorrectly recognised in 20X3. Financial statements for 20X4 are being presented as comparatives.

Required: Explain how the error is corrected.

Solution:

- Restate 20X3 comparative figures in the 20X4 financial statements.
- Reduce revenue and profit for 20X3 by R300 000.
- Adjust opening retained earnings at 1 January 20X4.
- Disclose nature, amount, and EPS impact.

Scenario 4 — Policy vs Estimate

Entity Y changes depreciation method from straight-line to diminishing balance because it better reflects consumption of economic benefits.

Required: Classify the change and explain the treatment.

Solution:

- Although depreciation method appears like a “policy”, IAS 8 treats this as a **change in estimate**.
- Apply **prospectively**.
- Disclose nature and amount of the change.

Scenario 5 — Impracticability

Entity Z adopts a new IFRS requiring retrospective application. However, data for years before 20X2 is unavailable.

Required: Explain how IAS 8 deals with this.

Solution:

- If retrospective application is **impracticable**, apply the new policy from the **earliest practicable date** (here: 1 January 20X2).
- Disclose:
 - Why retrospective application was impracticable
 - How and from when the new policy was applied

Scenario 6 — Estimate or Error?

The entity discovers that last year’s warranty provision was calculated using the wrong formula.

Required: Classify and explain the correction.

Solution:

- This is a **prior period error** (mathematical mistake).
- Correct **retrospectively**.
- Restate comparatives and adjust opening retained earnings.

Scenario 7 — New Transaction Type

An entity begins selling digital licences for the first time. It develops a new accounting policy for these licences.

Required: Is this a change in accounting policy?

Solution:

- No — applying a policy to **new transactions** is not a change in accounting policy.
- No retrospective adjustments required.

Scenario 8 — Disclosure Requirements

The entity changes its policy for capitalising development costs but cannot quantify the effect on prior periods.

Required: Explain disclosure requirements.

Solution:

- Disclose:
 - Nature of the change
 - Reason for the change
 - Why retrospective application is impracticable
 - How and from when the new policy was applied
- No numerical restatement required if genuinely impracticable.

C. Short-Form Exam-Style Questions (with answers)

Q1:

Why are changes in accounting estimates applied prospectively?

A: Because they arise from new information and do not relate to prior periods.

Q2:

What is the key difference between an error and a change in estimate?

A: Errors arise from mistakes made; estimates arise from new information.

Q3:

What is adjusted when correcting a prior period error?

A: Opening retained earnings of the earliest period presented.

Q4:

What must be disclosed for a material change in estimate?

A: Nature and amount of the change, and future impact if practicable.

10. Case-Study Assignment

Case Study 1 — The Phoenix Manufacturing Group

Phoenix Manufacturing Group (PMG) produces industrial machinery and prepares financial statements under IFRS. You are the financial reporting manager, reviewing several issues identified during the year-end process for 20X6.

Issue 1 — Change in Depreciation Method

PMG has historically depreciated its machinery using the straight-line method. Due to changes in production patterns and more intensive early-life usage, management decides that the **diminishing balance method** better reflects the consumption of economic benefits.

Issue 2 — Revision of Useful Life

One machine (cost R600 000) was originally expected to last **10 years**. After 3 years of use, new engineering assessments indicate the machine will last **only 6 years in total**.

Issue 3 — Inventory Valuation Policy Change

PMG previously used **FIFO** for inventory valuation. Management now wishes to adopt **weighted average cost**, arguing that it better reflects the flow of inventory in its automated warehouse.

Issue 4 — Prior Period Error

During the audit, PMG discovered that a **R1 200 000 warranty provision** was omitted from the 20X4 financial statements due to a spreadsheet error. The provision should have been recognised under IAS 37. The 20X5 financial statements (comparatives for 20X6) did not correct this error.

Required:

1. **Classify each issue** as a change in accounting policy, change in accounting estimate, or prior period error.
2. **Explain the correct IAS 8 treatment** (retrospective vs prospective) for each issue.
3. **Calculate the revised depreciation** for Issue 2.
4. **Explain the disclosure requirements** for each issue.
5. Prepare a **concise memo** to the CFO summarising the IAS 8 implications.

Solution — Case Study 1

1. Classification

<u>Issue</u>	<u>Classification</u>	<u>Reason</u>
1	Change in accounting estimate	Change in depreciation method reflects a revised pattern of consumption, not a change in policy.
2	Change in accounting estimate	Revision of useful life due to new information.
3	Change in accounting policy	Change in inventory valuation method is a change in measurement basis.
4	Prior period error	Omission of warranty provision due to spreadsheet mistake.

2. IAS 8 Treatment

<u>Issue</u>	<u>IAS 8 Treatment</u>	<u>Explanation</u>
1	Prospective	Depreciation method changes are treated as estimate changes.
2	Prospective	Useful life revisions affect current and future periods only.
3	Retrospective	Changes in accounting policy require restatement unless impracticable.
4	Retrospective	Prior period errors must be corrected by restating comparatives.

3. Calculation — Revised Depreciation (Issue 2)

- Cost: R600 000
- Original useful life: 10 years
- Depreciation for first 3 years: $R600\,000 \div 10 = R60\,000/\text{year}$
- Accumulated depreciation after 3 years: R180 000
- Carrying amount: R420 000
- Revised total useful life: 6 years
- Remaining life: 3 years

New depreciation: $R420\,000 \div 3 = R140\,000$ per year

4. Disclosure Requirements

Issue 1 & 2 — Changes in Estimates

Disclose:

- Nature of the change
- Reason for the change
- Amount of the effect on current period
- Estimated effect on future periods (if practicable)

Issue 3 — Change in Accounting Policy

Disclose:

- Nature of the change
- Reason why weighted average provides more reliable and relevant information
- Amount of retrospective adjustments for each line item
- Impact on EPS
- If impracticable: explanation + earliest practicable date

Issue 4 — Prior Period Error

Disclose:

- Nature of the error
- Amount of correction for each affected line item
- Impact on opening retained earnings
- EPS impact
- If impracticable: explanation + earliest practicable date

5. Memo to CFO (Concise)

To: CFO, Phoenix Manufacturing Group **From:** Financial Reporting Manager **Subject:** IAS 8 Implications for Year-End Adjustments

This memo summarises the IAS 8 treatment of four issues identified during the 20X6 year-end review:

1. **Depreciation method change** — This is a change in accounting estimate. IAS 8 requires **prospective application**. No restatement of comparatives.
2. **Useful life revision** — Also a change in estimate. Depreciation will increase to **R140 000 per year** for the remaining 3 years. Prospective application.
3. **Inventory valuation change (FIFO → weighted average)** — This is a change in accounting policy. IAS 8 requires **retrospective restatement** unless impracticable. Full disclosure required.
4. **Omitted warranty provision (20X4)** — This is a prior period error. IAS 8 requires **retrospective correction**, restating 20X4 and adjusting opening retained earnings for 20X5.

These adjustments will improve compliance with IFRS and enhance comparability and reliability of PMG's financial statements.

Case Study 2 — DigitalWave Ltd

DigitalWave Ltd develops software and digital content. During 20X7, the following matters arise:

Issue A — Development Costs

DigitalWave previously expensed all development costs. In 20X7, management concludes that certain projects meet IAS 38 criteria for capitalisation.

Issue B — Fair Value Estimate Revision

A digital asset previously valued at R5 million is now valued at R3.8 million due to market changes.

Issue C — Misclassification Error

A R900 000 software licence purchased in 20X6 was incorrectly classified as an expense instead of an intangible asset.

Required:

1. Classify each issue.
2. Explain the IAS 8 treatment.
3. Identify disclosure requirements.
4. Discuss how these adjustments affect comparability.

Solution — Case Study 2

1. Classification

<u>Issue</u>	<u>Classification</u>
A	Change in accounting policy
B	Change in accounting estimate
C	Prior period error

2. IAS 8 Treatment

- **Issue A:** Retrospective application — restate prior periods and capitalise qualifying development costs.
- **Issue B:** Prospective — fair value changes are estimate revisions.
- **Issue C:** Retrospective — restate 20X6 and adjust opening retained earnings.

3. Disclosure Requirements

- **Issue A:** Nature, reason, quantitative effects, EPS impact.
- **Issue B:** Nature, amount of current period effect, future impact if practicable.
- **Issue C:** Nature, correction amounts, EPS impact, opening retained earnings adjustment.

4. Comparability Discussion

- Retrospective adjustments (Issues A & C) enhance comparability across periods.
 - Prospective adjustments (Issue B) do not affect comparatives but ensure current and future periods reflect updated information.
 - Overall, IAS 8 ensures users can distinguish between policy changes, estimate changes and error corrections.
-