OIC STAFF PAPER prepared for the CMAC Meeting

Project	**Review of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors***
Paper topic	Illustrative example: different ways to represent an accounting change

Introduction and purpose of the paper

1. This paper provides an example illustrating different ways to represent an accounting change. It should be read in conjunction with the slide pack called *Reporting Changes in Accounting Policies - Information needs of investors* that was also submitted to CMAC members.

2. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* currently distinguishes between changes in accounting policies, changes in accounting estimates and corrections of errors.

3. Because of the reasons explained in the slides, we are tentatively proposing introducing a different distinction to the IASB[1]. Our possible solution distinguishes between the accounting for:

   - changes relating to measurement, including changes in measurement basis, changes in the methods used to make an estimate and changes in inputs and assumptions; and
   - other changes, including:
     (i) changes in the criteria for recognition and derecognition;
     (ii) changes in the classification of financial statements items;
     (iii) changes in the presentation of financial statements items; and
     (iv) changes in the disclosure of financial statements items.

[1] Note that this has not yet been discussed with the IASB.

4. On the basis of this proposed distinction, we are exploring the following potential ways to represent (ie account for or disclose) these changes:

- full retrospective application, in accordance with IAS 8: restatement of all comparative financial statements;
- limited retrospective application: the change is applied retrospectively starting from the beginning of the earliest comparative period presented (ie only one comparative is restated);
- catch-up adjustment[2] with enhanced disclosures: comparative financial statements are not restated, rather, a 'catch-up adjustment' is recognised in the opening balance of retained earnings of the current period and the entity would disclose information for the current period financial statement line items that are affected, using both the old accounting policy and the new one ; and
- prospective application with enhanced disclosures: an entity would be required to account for the change prospectively and to disclose information for the current period financial statement line items that are affected, using both the old accounting policy and the new one.

5. In this paper we provide an illustrative example illustrating these different potential approaches.

[2] This approach is akin to the limited retrospective, but it applies starting from the beginning of the current period.

Example

Fact pattern

6. An entity used to treat some specific costs (borrowing costs) as expenses ('old policy'). Starting from 1 January 20X9, it decides to change its accounting policy and to capitalise these costs ('new policy'). The effect of this change is material. The entity owns only four machines (its Property, Plant and Equipment), which it depreciates using the straight-line method. There are no revenues and no other costs. There are no tax effects. The entity presents one or two comparative periods in the balance sheet, depending on whether there is a restatement[3]; the entity presents only one year of comparatives for P&L. Note: in all the tables in this paper, all currency amounts are denominated in 'currency units' (CU).

Property Plant and Equipment (PPE)	Cost	Borrowing costs on acquisition	Acquisition date	'Derecognition' date	Useful life	Depreciable amount		Annual depreciation	
						Old policy	New policy	Old policy	New policy
Machine 1	200	50	01/01/X5	31/12/X14	**10**	200	250	20	25
Machine 2	120	20	01/01/X5	31/12/X8	**4**	120	140	30	35
Machine 3	100	50	01/01/X8	31/12/X12	**5**	100	150	20	30
Machine 4	60	9	01/01/X9	31/12/X11	**3**		69		23
Total	**480**	**129**				**480**	**609**	**90**	**113**

PPE	Year 3		Year 4		Year 5	
	NBV @ 31/12/X7	NBV @ 31/12/X7	NBV @ 31/12/X8	NBV @ 31/12/X8	NBV @ 31/12/X9	NBV @ 31/12/X9
	Old policy	New policy	Old policy	New policy	Old policy	New policy
Machine 1	140	175	120	150	100	125
Machine 2	30	35				
Machine 3			80	120	60	90
Machine 4					40	46
Total	**170**	**210**	**200**	**270**	**200**	**261**

[3] In accordance with IAS 1.40A.

Historical financial statements

7. These are the summarised financial statements of the entity, prepared using the *old* accounting policy, recognising the borrowing costs as expenses in P&L when they have been incurred, respectively (ie in 20X5 and 20X8), as of 31 December **20X8**.

FINANCIAL STATEMENTS	31/12/X7 Old policy	31/12/X8 Old policy
BS—PPE	170	200
P&L—Depreciation	50	70
P&L - Borrowing costs-Machine 3	-	50
BS—Equity	220	340

Full retrospective application

8. These are the summarised financial statements of the entity as of 31 December 20X9, applying the *new* policy (ie capitalisation of borrowing costs) retrospectively **as if the entity had always applied it**.

9. Columns highlighted in grey represent information that the entity reports as of 31 December **20X9**.

FINANCIAL STATEMENTS	31/12/X7 Old policy *Historical*	Adjust-ment	01/01/X8 New policy *Restated*	31/12/X8 New policy *Restated*	31/12/X9 New policy
BS - PPE	170	40	210	270	261
P&L - Depreciation	50		-	90	78
BS - Equity	220	(40)	180	270	348

10. The adjustment to the opening balance of equity (CU40) is the difference between the borrowing costs attributable to Machines 1 and 2 (CU70) and the higher (accumulated) depreciation that the entity would have recognised in the period 20X5-20X7 (CU30)[4].

[4] Under the old policy the annual depreciation in the period 20X5-20X7 is CU50; while under the new policy the annual depreciation is CU60 (an additional CU10). Consequently, CU30 = CU10 × 3 years.

Limited retrospective application

11. Under this approach the *new* policy is applied retrospectively only from the beginning of the earliest comparative period presented (ie 1 January 20X8). Consequently, only comparative information as of 31 December 20X8 is restated; the entity is not required to present the restated balance sheet as of 1 January 20X8.

12. These are the summarised financial statements of the entity as of 31 December 20X9; columns highlighted in grey represent information that the entity reports as of 31 December **20X9**.

FINANCIAL STATEMENTS	**31/12/X7 Old policy** ***Historical***	**Adjust-ment**	**01/01/X8**	**31/12/X8 New policy** ***Restated***	**31/12/X9 New policy**
BS - PPE	170	40	210	270	261
P&L - Depreciation	50			90	78
BS - Equity	220	(40)	180	270	348

13. The adjustment of CU40 is calculated as explained in paragraph 10 of this paper. The net book value of PPE as of 31/12/20X8 (CU270) is equal to:

- the net book value as of 31/12/20X7, which was determined under the old policy => CU170, plus
- the adjustment => CU40, plus
- the cost under the new policy of Machine 3 => CU150, less
- the depreciation for Machines 1-3 determined under the new policy => CU90.

Catch-up adjustment

14. This approach is akin to the previous approach, but under this approach the *new* accounting policy is applied (retrospectively) only to items that are still recognised on the balance sheet at the beginning of the current period (ie 20X9). In this example, Machine 1 and Machine 3 are the only machines that are still recognised as of 1 January 20X9, because the useful life of Machine 2 ends at 31 December 20X8.

15. As a result, the entity does not restate comparatives (ie they are presented using the *old* policy) and recognises a catch-up adjustment in the opening balance of retained earnings as of 1 January 20X9.

16. These are the summarised financial statements of the entity as of 31 December 20X9; columns highlighted in grey represent information that the entity reports as of 31 December **20X9**.

FINANCIAL STATEMENTS	**31/12/X8 Old policy** ***Historical***	**Adjustment**	**01/01/X9 New policy**	**31/12/X9 New policy**
BS - PPE	200	70	270	261
P&L - Depreciation	70			78
P&L - Borrowing costs-Machine 3	50			
BS - Equity	340	(70)	270	348

17. The adjustment to the opening balance of equity (CU70) is the difference between the borrowing costs attributable to Machine 1 and Machine 3 (CU100) and the higher (accumulated) depreciation that the entity would have recognised in the period 20X5-20X8 for Machine 1 (CU30[5]).

18. Because under this approach the entity does not restate comparative information in its financial statements, the information provided in the financial statements could be enhanced with additional disclosures which are described in paragraphs 23-26 of this paper.

Prospective application starting from the beginning of current period

19. Under this approach the *new* policy **is applied only to transactions or events occurring after 1 January 20X9** (ie only to Machine 4). Comparatives are not restated and the effect of the change is recognised in P&L of the current period (ie 20X9).

[5] Under the old policy the annual depreciation of Machine 1 in the period 20X5-20X8 is CU20, while under the new policy the annual depreciation is CU25. Consequently CU20 = CU5 × 4 years. The remaining CU10 is the difference between the annual depreciation of Machine 3 under the new policy (CU30) and the old policy (CU20).

20. Under this approach, during 20X9 the entity uses a mixture of the *old* policy (to Machines 1 and 3) and the *new* policy (to Machine 4); Machine 2 was derecognised (ie its useful life ended) as of 31 December 20X8. The entity will continue to use this mixture of policies until Machines 1 and 3 are fully derecognised.

21. These are the summarised financial statements of the entity as of 31 December 20X9, applying the new policy prospectively; columns highlighted in grey represent information that the entity reports as of 31 December **20X9**.

FINANCIAL STATEMENTS	**31/12/X8 Old policy** ***Historical***	**31/12/X9 Old AND new policies**
BS - PPE	200	206
P&L - Depreciation	70	63
P&L - Borrowing costs- Machine 3	50	-
BS - Equity	340	403

22. As under this approach the entity does not restate comparative information in its financial statements, the information provided in the financial statements could be enhanced with additional disclosures which are described in paragraphs 23-26 of this paper.

Enhanced disclosures **(in the notes)**

23. If the entity uses the catch-up approach or applies the *new* policy prospectively, it would also disclose the following information in the notes of its financial statements as of 31 December **20X9**:

DISCLOSURES	**31/12/X9**	
	Old policy	**New policy (eg Catch-up approach)**
BS - PPE	200	261
P&L—Depreciation	60	78
P&L - Borrowing costs—Machine 4	9	0
BS - Equity	400	348

24. The entity determines the net book value and the depreciation of its Machines 1, 3 and 4 using both the *old* accounting policy and the *new* one.

25. The entity would also need to explain in more detail reasons for differences in amounts which were calculated using the old and the new accounting policies.

26. This disclosure provides users with comparable information for the prior (ie 20X8) and current (ie 20X9) periods using the *old* policy without having to use restated financial statements. During the subsequent period they will have comparable information for the prior (ie 20X9) and current (ie 20X0) periods using the *new* policy for both.

Summary – results of the different approaches

27. In the table below, we summarise the financial statement results of the different approaches presented in this paper.

FINANCIAL STATEMENTS	**01/01/X8**	**31/12/X8**	**31/12/X9**			
Full retrospective						
BS—PPE	210	270	261			
P&L—Depreciation	-	90	78			
BS—Equity	180	270	348			
Limited retrospective						
BS—PPE	n/a	270	261			
P&L—Depreciation	n/a	90	78			
BS—Equity	n/a	270	348			
Catch up adjustment				**NOTE DISCLOSURES - 31/12/X9**		
					Old policy	**New policy**
BS—PPE	n/a	200	261	BS - PPE	200	261
P&L—Depreciation	n/a	70	78	P&L—Dep'n	60	78
P&L—Borrowing costs	n/a	50	-	P&L—Borr.	9	-
BS—Equity	n/a	340	348	BS - Equity	400	348
Prospective				**NOTE DISCLOSURES - 31/12/X9**		
					Old policy	**New policy**
BS—PPE	n/a	200	206	BS - PPE	200	206
P&L—Depreciation	n/a	70	63	P&L—Dep'n	60	63
P&L—Borrowing costs	n/a	50		P&L—Borr.	9	-
BS—Equity	n/a	340	403	BS - Equity	400	403

Appendix I –Calculation table for information only

	Old Policy -31/12/X7					New Policy -31/12/X7			
	Machine Costs	Borrowing costs	Dep'n	Accumulated Dep'n	NBV	Machine costs (incl. borrowing costs)	Dep'n	Accumulated Dep'n	NBV
Machine 1	**200**		20	60	**140**	**250**	25	75	**175**
Machine 2	**120**		30	90	**30**	**140**	35	105	**35**
Machine 3									
Machine 4									
Totals	**320**	**-**	**50**	**150**	**170**	**390**	**60**	**180**	**210**

	Old Policy -31/12/X8					New Policy-31/12/X8			
	Machine Costs	Borrowing costs	Dep'n	Accumulated Dep'n	NBV	Machine costs (incl. borrowing costs)	Dep'n	Accumulated Dep'n	NBV
Machine 1	**200**		20	80	**120**	**250**	25	100	**150**
Machine 2	**120**		30	120	**-**	**140**	35	140	**-**
Machine 3	**100**	**50**	20	20	**80**	**150**	30	30	**120**
Machine 4									
Totals	**420**	**50**	**70**	**220**	**200**	**540**	**90**	**270**	**270**

	Old Policy- 31/12/X9					New Policy - 31/12/X9			
	Machine Costs	Borrowing costs	Dep'n	Accumulated Dep'n	NBV	Machine costs (incl. borrowing costs)	Dep'n	Accumulated Dep'n	NBV
Machine 1	**200**		20	100	**100**	**250**	25	125	**125**
Machine 2				-					
Machine 3	**100**		20	40	**60**	**150**	30	60	**90**
Machine 4	**60**	**9**	20	20	**40**	**69**	23	23	**46**
Totals	**360**	**9**	**60**	**160**	**200**	**469**	**78**	**208**	**261**