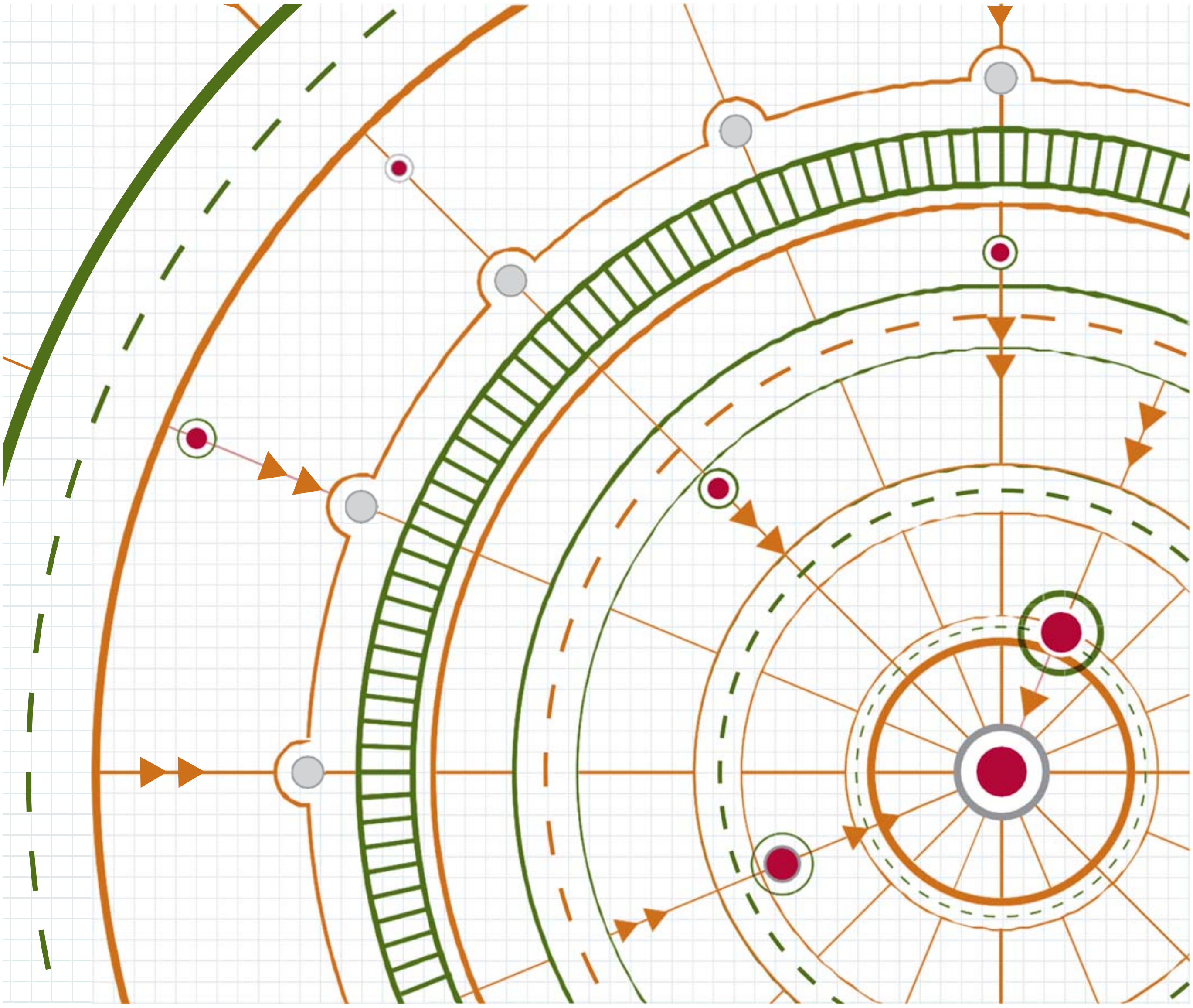
Module 10—Accounting Policies, Estimates and Errors



IFRS® Foundation
Supporting Material
for the *IFRS for SMEs*® Standard

including the full text of
Section 10 *Accounting Policies, Estimates and Errors*
of the IFRS for SMEs Standard
issued by the International Accounting Standards Board in October 2015

with extensive explanations, self-assessment questions and case studies

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This module has been prepared by IFRS Foundation (Foundation) education staff. It has not been approved by the International Accounting Standards Board (Board). The module is designed to assist users of the *IFRS for SMEs®* Standard (Standard) to implement and consistently apply the Standard.

Contents

Module 10–Accounting Policies, Estimates and Errors

The accounting requirements applicable to small and medium-sized entities (SMEs) discussed in this module are set out in the *IFRS for SMEs* Standard, issued by the International Accounting Standards Board (Board) in October 2015.
This module has been prepared by IFRS Foundation education staff.
The contents of Section 10 *Accounting Policies, Estimates and Errors* of the *IFRS for SMEs* Standard are set out in this module and shaded grey. The Glossary of terms of the *IFRS for SMEs* Standard (Glossary) is also part of the requirements. Terms defined in the Glossary are reproduced in **bold type** the first time they appear in the text of Section 10. The notes and examples inserted by the education staff are not shaded. These notes and examples do not form part of the *IFRS for SMEs* Standard and have not been approved by the Board.

INTRODUCTION

Which version of the *IFRS for SMEs*® Standard?

When the *IFRS for SMEs* Standard was first issued in July 2009, the Board said it would undertake an initial comprehensive review of the Standard to assess entities' experience of the first two years of its application and to consider the need for any amendments. To this end, in June 2012, the Board issued a Request for Information: *Comprehensive Review of the IFRS for SMEs*. An Exposure Draft proposing amendments to the *IFRS for SMEs* Standard was subsequently published in 2013, and in May 2015 the Board issued *2015 Amendments to the IFRS for SMEs* Standard.

The document published in May 2015 only included amended text, but in October 2015, the Board issued a fully revised edition of the Standard, which incorporated additional minor editorial amendments as well as the substantive May 2015 revisions. This module is based on that version.

The *IFRS for SMEs* Standard issued in October 2015 is effective for annual periods beginning on or after 1 January 2017. Earlier application was permitted, but an entity that did so was required to disclose the fact.

Any reference in this module to the *IFRS for SMEs* Standard refers to the version issued in October 2015.

This module

This module focuses on the guidance for selecting and applying accounting policies in preparing financial statements and also covers changes in accounting estimates and corrections of errors in prior period financial statements applying Section 10 *Accounting Policies, Estimates and Errors* of the *IFRS for SMEs* Standard. It introduces the subject and reproduces the official text along with explanatory notes and examples designed to enhance your understanding of the requirements. The module identifies the significant judgements that are required in selecting and applying accounting policies in preparing financial statements as well as the judgements required in accounting and disclosing changes in accounting estimates and corrections of errors. In addition, the module includes questions designed to test your understanding of the requirements, and case studies that provide a practical opportunity to apply the requirements of the *IFRS for SMEs* Standard.

Module 10—Accounting Policies, Estimates and Errors

Upon successful completion of this module, you should, within the context of the *IFRS for SMEs* Standard, be able to:

- distinguish between a change in accounting estimate, the correction of a prior period error, and a change in accounting policy;
- develop an accounting policy for a transaction, other event or condition not specifically addressed in the *IFRS for SMEs* Standard;
- account for and disclose a change in accounting policy in financial statements (including demonstrating an understanding of the adjustments required under retrospective application and prospective application of an accounting policy);
- account for and disclose a change in accounting estimate in financial statements;
- account for and disclose the correction of a prior period error in financial statements;
- demonstrate an understanding of the significant judgements that are required in determining and applying accounting policies, changing accounting policies and estimates and correcting prior period errors.

IFRS for SMEs Standard

The *IFRS for SMEs* Standard is intended to apply to the general purpose financial statements of entities that do not have public accountability (see Section 1 *Small and Medium-sized Entities*).

The *IFRS for SMEs* Standard is comprised of mandatory requirements and other non-mandatory material.

The non-mandatory material includes:

- a preface, which provides a general introduction to the *IFRS for SMEs* Standard and explains its purpose, structure and authority;
- implementation guidance, which includes illustrative financial statements and a table of presentation and disclosure requirements;
- the Basis for Conclusions, which summarises the Board's main considerations in reaching its conclusions in the *IFRS for SMEs* Standard issued in 2009 and, separately, in the 2015 Amendments; and
- the dissenting opinion of a Board member who did not agree with the issue of the *IFRS for SMEs* Standard in 2009 and the dissenting opinion of a Board member who did not agree with the 2015 Amendments.

In the *IFRS for SMEs* Standard, Appendix A: Effective date and transition, and Appendix B: Glossary of terms, are part of the mandatory requirements.

In the *IFRS for SMEs* Standard, there are appendices to Section 21 *Provisions and Contingencies*, Section 22 *Liabilities and Equity* and Section 23 *Revenue.* These appendices provide non-mandatory guidance.

The *IFRS for SMEs* Standard has been issued in two parts: Part A contains the preface, all the mandatory material and the appendices to Section 21, Section 22 and Section 23; and Part B contains the remainder of the material mentioned above.

Further, the SME Implementation Group (SMEIG), which assists the Board with supporting implementation of the *IFRS for SMEs* Standard, publishes implementation guidance as 'questions and answers' (Q&As). These Q&As provide non-mandatory, timely guidance on specific accounting questions raised with the SMEIG by entities implementing the *IFRS for SMEs* Standard and other interested parties. At the time of issue of this module (December 2018) the SMEIG has not issued any Q&As relevant to this module.

Introduction to the requirements

The objective of general purpose financial statements of a small or medium-sized entity is to provide information about the entity's financial position, performance and cash flows that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs. Such users include, for example, owners who are not involved in managing the business, existing and potential creditors and credit rating agencies.

The objective of Section 10 is to prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of prior period errors.

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

Once an entity has adopted an accounting policy for a specific type of transaction, other event or condition, it should change that policy only if the *IFRS for SMEs* Standard is amended or the entity concludes that a new policy results in reliable and more relevant information.

Except in circumstances specified in the *IFRS for SMEs* Standard, changes in accounting policies and corrections of prior period errors are accounted for retrospectively. This means that comparative information in financial statements is restated to reflect transactions and events in accordance with a new accounting policy as if that policy had always been applied, and that prior period errors are corrected in the period in which they occurred. Retrospective application of accounting policies and retrospective restatement of prior period errors enhances the relevance and reliability of an entity's financial statements by making them comparable over time with the financial statements of other entities.

Prior period errors are omissions from and misstatements in the entity's financial statements for one or more prior periods. They arise from a failure to use reliable information that was available when financial statements for those periods were authorised for issue, provided that such information could reasonably be expected to have been obtained and used in the preparation and presentation of those financial statements. They also arise from the misuse of such information.

A change in accounting estimate is an adjustment that results from assessing the present status of, and expected future benefits and obligations associated with, assets and liabilities. The adjustment may be to the carrying amount of an asset or a liability, or the expense that reflects the consumption of the asset. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.

What has changed since the 2009 *IFRS for SMEs* Standard

There are consequential changes to Section 10 (see paragraph 10.10A) relating to changes to Section 17 *Property, Plant and Equipment*. This is the addition of an option to use the revaluation model (see paragraphs 17.15–17.15D, 17.31(e)(iv) and 17.33). There are also minor editorial changes. All changes are covered in this module.

Module 10—Accounting Policies, Estimates and Errors

REQUIREMENTS AND EXAMPLES

Scope of this section

10.1 This section provides guidance for selecting and applying the **accounting policies** used in preparing **financial statements**. It also covers **changes in accounting estimates** and corrections of **errors** in prior period financial statements.

Selection and application of accounting policies

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

10.3 If this Standard specifically addresses a transaction, other event or condition, an entity shall apply this Standard. However, the entity need not follow a requirement in this Standard if the effect of doing so would not be **material**.

Notes

Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions users make on the basis of financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, is the determining factor (see paragraph 3.16).

Users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence (see paragraph 2.4). The providers of capital are concerned with the risk inherent in, and return provided by, their investments. They need information to help them determine whether they should buy, hold or sell. Shareholders are also interested in information that enables them to assess the entity's ability to pay dividends.

An entity need not provide a specific disclosure required by this Standard if the information is not material. Moreover, an entity need not apply its accounting policies when the effect of not applying them is immaterial.

Examples—*IFRS for SMEs* Standard addresses a transaction, event or condition

Ex 1 **Contrary to the requirements of Section 20 *Leases,* a manufacturing entity does not capitalise finance leases that it enters into as a lessee. The entity accounts for all leases (operating leases and finance leases) applying paragraphs 20.15 and 20.16 which set out the requirements for operating leases. The only finance lease the entity has entered into is for the use of a photocopying machine with a fair value of CU1,000[1] at the inception of the lease (in the current, 20X8 reporting period). At the end of the current reporting period, the carrying amount of the entity's property, plant and equipment exceeds CU90,000,000 and its liabilities exceed CU40,000,000. For the year ended 31 December 20X8, the entity reported profit of CU30,000,000.**

It is highly unlikely that the error of failing to capitalise a finance lease worth CU1,000 could influence the economic decisions users make on the basis of the entity's financial statements. Because the effect of the entity's accounting policy for finance leases is not material, the entity need not capitalise the finance lease.

Ex 2 **Contrary to the requirements of Section 20 *Leases* an executive jet operator does not capitalise finance leases that it enters into as a lessee. The entity's sole business is operating two executive jet airplanes, both of which it leases under a finance lease. The entity accounts for all leases (operating leases and finance leases) applying paragraphs 20.15 and 20.16 which set out the requirements for operating leases.**

Because the entity's sole business is operating two executive jet planes, failing to capitalise either of the two finance leases could influence the economic decisions users make on the basis of the financial statements. Therefore, the entity must adopt an accounting policy of capitalising finance leases applying the requirements of Section 20.

Ex 3 **The facts are the same as those in Example 1. However, in this example, the entity also enters into many other individually immaterial finance leases.**

The effect of not capitalising finance leases must be assessed on a collective basis. If considered collectively it could influence the economic decisions of users made on the basis of the financial statements, then the effect would be regarded as material and the entity must therefore adopt an accounting policy of capitalising finance leases applying the requirements of Section 20.

Ex 4 **To lease an item of factory equipment, a lessee used the services of an agency to find a suitable lessor. The lease is a finance lease. The *IFRS for SMEs* Standard does not specifically mention agency fees on leases. However, it does discuss initial direct costs that the lessee incurs.**

The agency fees are a type of initial direct cost (incremental costs that are directly attributable to negotiating and arranging a lease) to the lessee. Paragraph 20.9

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[1] In this example, and in all other examples in this module, monetary amounts are denominated in 'currency units (CU)'.

requires any initial direct costs to be added to the amount recognised as an asset (part of the cost of the leased factory equipment).

10.4 If this Standard does not specifically address a transaction, other event or condition, an entity's management shall use its judgement 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:

  (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, ie free from bias;

  (iv) are prudent; and

  (v) are complete in all material respects.

10.5 In making the judgement described in paragraph 10.4, management shall refer to, and consider the applicability of, the following sources in descending order:

(a) the requirements and guidance in this Standard dealing with similar and related issues; and

(b) the definitions, **recognition** criteria and **measurement** concepts for **assets**, **liabilities**, **income** and **expenses** and the pervasive principles in Section 2 *Concepts and Pervasive Principles*.

10.6 In making the judgement described in paragraph 10.4, management may also consider the requirements and guidance in **full IFRS** dealing with similar and related issues.

Notes

When the *IFRS for SMEs* Standard does not specifically address a transaction, other event or condition, an entity must find an accounting policy that results in relevant and reliable information. In making that judgement, an entity considers, first, the requirements and guidance in the *IFRS for SMEs* Standard dealing with similar and related issues and, second, the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles in Section 2 *Concepts and Pervasive Principles*. If that does not provide guidance, the entity may look to the requirements and guidance in full IFRS Standards, including Interpretations of IFRS Standards, dealing with similar and related issues.

Module 10—Accounting Policies, Estimates and Errors

<u>**Q&A 2012/02 - Jurisdiction requires fallback to full IFRSs**</u>

As part of the 2012 Comprehensive Review of the *IFRS for SMEs* Standard the Board decided that the then existing Q&As should be deleted, with the content either incorporated into the *IFRS for SMEs* Standard or IFRS Foundation education material. Q&A 2012/2 was not incorporated into the *IFRS for SMEs* Standard, and only a summary is presented.

Issue

A jurisdiction permits all entities meeting the definition of an SME to follow the *IFRS for SMEs* Standard. However, the jurisdiction adds a requirement that, where the recognition and measurement requirements for a particular transaction, other event or condition are not specifically covered by the *IFRS for SMEs* Standard, but are covered in full IFRS Standards, an SME must follow the recognition and measurement requirements in full IFRS Standards for that transaction, event or condition. May SMEs in that jurisdiction state compliance with the *IFRS for SMEs* Standard?

Response

Whether an SME can assert compliance with the *IFRS for SMEs* Standard in such a case will depend on management's assessment of relevance and reliability as required by paragraph 10.4 of Section 10 *Accounting Policies, Estimates and Errors*. In the absence of specific requirements in the IFRS for SMEs, paragraph 10.4 requires management to use its judgement in developing an accounting policy that is reliable and results in information that is relevant to the economic decision-making needs of users. Paragraph 10.5 establishes the following hierarchy for an entity to follow in deciding on the appropriate accounting policy:

(a) the requirements and guidance in the *IFRS for SMEs* Standard dealing with similar and related issues; and

(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles in Section 2 *Concepts and Pervasive Principles*.

Paragraph 10.6 notes that, in making the judgement described in paragraph 10.4, management may also consider the requirements and guidance in full IFRS Standards that deal with similar and related issues.

Taken together, paragraphs 10.4 to 10.6 allow the IFRS Standard principles to be used in the absence of specific guidance in the *IFRS for SMEs* Standard, provided that they do not conflict with requirements in the hierarchy in paragraph 10.5.

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This scenario is different from allowing a free choice to follow IFRS Standard requirements when specific requirements exist in the *IFRS for SMEs* Standard for a transaction, other event or condition. Where there are such specific requirements in the *IFRS for SMEs* Standard, they must be applied even if they differ from full IFRS Standards. If the entity follows a requirement in full IFRS Standards for that transaction, other event or condition for which the *IFRS for SMEs* Standards contains different guidance, it will not be able to state compliance with the *IFRS for SMEs* Standard unless the effect is not material.

Example—developing an accounting policy

Ex 5 **On 1 January 20X7, as part of a scheme to support projects to help rural communities, a non-government development agency announced a plan whereby during 20X7–20X9, entities can apply for a grant to set up farming operations in a specified rural area. Qualifying entities will receive an upfront cash payment of CU50,000 to set up farming operations in the specified area.**

The *IFRS for SMEs* Standard does not specify how to account for a grant from a non-government development agency. However, it does specify how to account for government grants (see Section 24 *Government Grants*). The entity should determine its accounting policy for grants from non-government development agencies. The entity may analogise that it could similarly apply the requirements of Section 24 to this transaction. Therefore, the entity could apply the requirements of Section 24.

Module 10—Accounting Policies, Estimates and Errors

Consistency of accounting policies

10.7 An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless this Standard specifically requires or permits categorisation of items for which different policies may be appropriate. If this Standard requires or permits such categorisation, an appropriate accounting policy shall be selected and applied consistently to each category.

Examples—consistency of accounting policies

Ex 6 **An entity's accounting policy is to measure investments in jointly controlled entities using the fair value model. However, it is unable to measure reliably the fair value of its investment in one of its jointly controlled entities (JV B) without undue cost or effort. Therefore it measures its investment in JV B using the cost model.**

Section 15 *Investments in Joint Ventures* requires an entity to account for all of its investments in jointly controlled entities using one of the following: (i) the cost model in paragraph 15.10; (ii) the equity method in paragraph 15.13; or (iii) the fair value model in paragraph 15.14. An entity that opts to use the fair value model must, after initial recognition, measure all of its investments in jointly controlled entities at fair value. However, the entity should use the cost model for any investment in a jointly controlled entity for which it cannot measure fair value reliably without undue cost or effort (see paragraph 15.15). The entity is applying the requirements of Section 15 correctly and its accounting policy is acceptable; it is measuring its investment in JV B using the cost model only because it is unable to measure reliably the fair value of its investment in JV B without undue cost or effort.

Ex 7 **An entity's accounting policy is to measure investments in associates using the fair value model. However, it is unable to measure reliably the fair value of its investment in one of its associates (Associate B) without undue cost or effort. Therefore, it measures its investment in Associate B using the cost model.**

Section 14 *Investments in Associates* requires an entity to account for all of its investments in associates using one of the following: (i) the cost model in paragraph 14.5; (ii) the equity method in paragraph 14.8; or (iii) the fair value model in paragraph 14.9. An entity that opts to use the fair value model must, after initial recognition, measure all of its investments in associates at fair value. However, the entity should use the cost model for any investment in an associate for which it cannot measure fair value reliably without undue cost or effort (see paragraph 14.10). The entity is applying the requirements of Section 14 correctly and its accounting policy is acceptable; it is measuring Associate B using the cost model only because it is unable to measure reliably the fair value of Associate B without undue cost or effort.

Ex 8 **An entity's accounting policy is to measure investments in associates using the cost model. It therefore measures its investments in associates A and B using the cost model. However, because the equity instruments of one of its associates (Associate C) are listed on the national securities exchange, it measures its investment in Associate C using the fair value model.**

Section 14 *Investments in Associates* requires an entity to account for all of its investments in associates using one of the following: (i) the cost model in paragraph 14.5; (ii) the equity method in paragraph 14.8; or (iii) the fair value model in paragraph 14.9. An entity that opts to use the cost model must, after initial recognition, measure all of its investments in associates at cost less any accumulated impairment losses unless there is a published price quotation for one or more associates (see paragraph 14.5). The entity must use the fair value model for any investments in associates for which there is a published price quotation (see paragraph 14.7). Consequently, the entity is applying the requirements of Section 14 correctly and its accounting policy is acceptable; it is measuring Associate C using the fair value model only because Associate C's equity instruments are listed on the national securities exchange.

Ex 9 **An entity's accounting policy is to measure its investments in associates using the fair value model. However, the entity follows an accounting policy of measuring its investments in jointly controlled entities using the cost model. None of the entity's investments are traded in a public securities market.**

The entity's accounting policy for investments in associates need not be the same as its accounting policy for investments in jointly controlled entities. Consequently, the entity's accounting policies are acceptable.

Ex 10 **An entity's accounting policy is to measure investments in associates using the fair value model. However, it has been unable to measure reliably the fair value of its investment in one of its associates (associate B) without undue cost or effort, and therefore it measures its investment in Associate B using the cost model. In 20X7 the entity, for the first time, was able to measure reliably the fair value of Associate B without undue cost or effort. However, because it had an established practice of measuring the investment in Associate B using the cost model, it continued to do this in its 20X7 financial statements.**

Section 14 *Investments in Associates* requires an entity to account for all of its investments in associates using one of the following: (i) the cost model in paragraph 14.5; (ii) the equity method in paragraph 14.8; or (iii) the fair value model in paragraph 14.9. An entity that opts to use the fair value model must, after initial recognition, measure all of its investments in associates at fair value. However, the entity shall use the cost model for any investment in an associate for which it cannot measure fair value reliably without undue cost or effort (see paragraph 14.10).

Until 20X7, the entity was applying the requirements of Section 14 correctly and its accounting policy was acceptable; it was measuring Associate B using the cost model only because it was unable to measure reliably the fair value of Associate B without undue cost or effort.

In 20X7, the entity is not applying the requirements of Section 14 correctly; when an entity chooses to apply the fair value model it shall measure all associates at their fair value and can only use the cost model for any associate for which it cannot measure fair value reliably without undue cost or effort. In 20X7 the entity will not be able to state compliance with the *IFRS for SMEs* Standard.

Module 10—Accounting Policies, Estimates and Errors

Changes in accounting policies

10.8 An entity shall change an accounting policy only if the change:

(a) is required by changes to this Standard; 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.

Notes

An entity applies accounting policies consistently from one period to another. A change in accounting policy may be required or voluntary. It is required if it is necessitated by changes in the *IFRS for SMEs* Standard. Other than this, a voluntary change in accounting policy is only allowable if it will result in financial statements providing reliable and more relevant information on the entity's financial position, financial performance or cash flows. For example, one of the 2015 amendments in the *IFRS for SMEs* Standard is the addition of an option to use the revaluation model (see paragraphs 17.15–17.15D, 17.31(e)(iv) and 17.33 of Section 17 *Property, Plant and Equipment*). If an entity believes that measuring a class of its property, plant and equipment will provide its users with reliable and more relevant information in its financial statements it may change its accounting policy from the cost model to the revaluation model. It is inappropriate to make a voluntary change in accounting policies to achieve a particular presentation in the financial position, financial performance or cash flows.

Examples—change in accounting policies

Ex 11 **An entity that measures its investments in associates after initial recognition using the cost model changes its accounting policy to adopt the fair value model because its management believes that measurement at fair value, as well as being reliable, provides more relevant information.**

The entity's change in accounting policy is acceptable. Using the fair value model to measure investments in associates results in the financial statements providing reliable and more relevant information about the effects of its investments in associates on the entity's financial position, financial performance or cash flows.

Ex 12 **An entity changed its presentation of total comprehensive income from a two-statement approach to a single-statement approach (see paragraph 5.2 *Statement of Comprehensive Income and Income Statement*). The entity changed its presentation because management decided that the single-statement approach might bring greater emphasis to its items of other comprehensive income. The entity restated its statement of comprehensive income for the comparable prior period because it regarded the change of presentation of total comprehensive income as a change in accounting policy.**

The entity's treatment is correct. Accounting policies include not only the principles for recognising and measuring assets, liabilities, income and expenses but also the principles and practices for presenting them in financial statements. A change from the single-statement approach to the two-statement approach, or vice versa, is a change in accounting policy (see paragraph 5.3).

10.9 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; or
(c) a change to the cost model when a reliable measure of **fair value** is no longer available (or vice versa) for an asset that this Standard would otherwise require or permit to be measured at fair value.

Examples—no change in accounting policy

Ex 13 **An entity acquired an investment in an associate in the current reporting period and adopted the cost model to measure the investment after initial recognition. It had never before held an investment in an associate.**

The adoption of the cost model to measure its first investment in an associate does not constitute a change in accounting policy. The accounting policy is for a transaction in which the entity had not previously engaged.

Ex 14 **An entity acquired an investment in an associate in the current reporting period and adopted the fair value model to measure its investment in all of its associates after initial recognition. Before this investment, the entity accounted for its sole other investment in an associate as an item of inventory. Management justified the treatment of its investment in this associate as inventory because its cost and value were immaterial to the entity's financial statements.**

Provided that the original investment in the associate was immaterial to the entity's financial statements, the use of the fair value model for the measurement of all of its investments in associates is not a change in accounting policy. The accounting policy is for a transaction that was previously not material. Refer also to paragraph 10.3.

Ex 15 **In the current reporting period, when a reliable measure of the fair value of an entity's only investment property became available without undue cost or effort, the entity changed the accounting for its sole investment property from the cost model in Section 17 to the fair value model.**

The transfer in this case is due to a change in circumstances and therefore is not a change in accounting policy (see paragraphs 16.1 and 16.8 of Section 16 *Investment Property*).

Ex 16 **In the current reporting period, when an entity began redeveloping its previously owner-occupied building to rent to tenants under operating leases, it transferred the property from property, plant and equipment (where it was accounted for using the cost model) to investment property measured using the fair value model.**

The transfer is due to a change in use of the property. It is therefore not a change in accounting policy.

Ex 17 **An entity whose functional currency became hyperinflationary in the current reporting period applied Section 31 *Hyperinflation* in preparing and presenting its financial statements, for the first time, in the current reporting period.**

The application of Section 31, for the first time, in preparing and presenting the financial statements is not a change in accounting policy; it is a change resulting from a change in the entity's circumstances. The new accounting policy is applied for a condition that did not occur previously.

Although the application of Section 31 for the first time is not a change in accounting policy, the restatement process required by Section 31 (paragraphs 31.3 and 31.4) is similar to the process required for retrospective application of a change in accounting policy.

10.10 If this Standard 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 is a change in accounting policy.

Notes

An entity can change its accounting policy voluntarily only if the change 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 (see paragraph 10.8(b)).

10.10A The initial application of a policy to revalue assets in accordance with Section 17 *Property, Plant and Equipment* is a change in an accounting policy to be dealt with as a revaluation in accordance with Section 17. Consequently, a change from the cost model to the revaluation model for a class of **property, plant and equipment** shall be accounted for prospectively, instead of in accordance with paragraphs 10.11–10.12.

Ex 18 **Entity X owns only one building within property, plant and equipment. At the end of 20X1 Entity X changes its accounting policy in measuring its buildings from the cost model to the revaluation model. The building has a historical cost of CU100,000 and a current balance in accumulated depreciation of CU70,000. It is revalued to a fair value of CU130,000.**

The entire revaluation gain of CU100,000 (fair value of CU130,000 minus the carrying amount of CU30,000) is recorded in the current period within other comprehensive income (OCI) with no retrospective restatement of prior year financial statements for comparative purposes.

One way to record the revaluation is as follows:

Dr Asset––PPE: accumulated depreciation	CU70,000	
Dr Asset––PPE: building	CU30,000	
Cr Equity––OCI: revaluation gain		CU100,000

To recognise revaluation of the building.

No retrospective restatement is required for revaluations under Section 10 of the *IFRS for SMEs* Standard. An extract of the statement of financial position at 31 December 20X1 follows:

Statement of financial position (extract)

	20X1	20X0
	CU	*CU*
Buildings, net of accumulated depreciation	130,000	30,000

Applying changes in accounting policies

10.11 An entity shall account for changes in accounting policy as follows:

(a) an entity shall account for a change in accounting policy resulting from a change in the requirements of this Standard in accordance with the transitional provisions, if any, specified in that amendment;

(b) when an entity has elected to follow IAS 39 *Financial Instruments: Recognition and Measurement* instead of following Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues* as permitted by paragraph 11.2, and the requirements of IAS 39 change, the entity shall account for that change in accounting policy in accordance with the transitional provisions, if any, specified in the revised IAS 39; and

(c) an entity shall account for all other changes in accounting policy **retrospectively** (see paragraph 10.12).

Notes

Appendix A of the *IFRS for SMEs* Standard discusses the effective date and transitional provisions of the 2015 amendments to the *IFRS for SMEs* Standard. All amendments (amended paragraphs and Glossary of terms of the *IFRS for SMEs* Standard (Glossary), revised Section 29 and added paragraphs) are effective for annual periods beginning on or after 1 January 2017. Amendments to Sections 2–34 are required to be applied retrospectively applying this Section except as stated in paragraph A2.

Paragraph A2 states that if it is impracticable for an entity to apply any new or revised requirements in the amendments to Sections 2–34 retrospectively, the entity shall apply those requirements in the earliest period for which it is practicable to do so. In addition an entity:

(a) may elect to apply the revised Section 29 prospectively from the beginning of the period in which it first applies 2015 Amendments to the *IFRS for SMEs* Standard.

(b) shall apply the amendments to paragraph 19.11 prospectively from the beginning of the period in which it first applies 2015 Amendments to the *IFRS for SMEs* Standard. This paragraph is only applicable if the entity has business combinations within the scope of Section 19.

(c) shall apply the amendments to paragraphs 2.49–2.50, 5.4, 17.15, 27.6, 27.30–27.31 and 31.8–31.9 and new paragraphs 10.10A, 17.15A–17.15D and 17.33 prospectively from the beginning of the period it first applies 2015 Amendments to the *IFRS for SMEs* Standard. These paragraphs are only applicable if the entity applies the revaluation model to any classes of property, plant and equipment in accordance with paragraph 17.15.

Finally, the entity shall identify which amounts in the financial statements have not been restated as a result of applying paragraph A2 (see paragraph A3).

Examples—applying changes in accounting policies

Ex 19 **In the current reporting period the entity was required to comply with an amendment to the *IFRS for SMEs* Standard. The transitional provisions in the amended *IFRS for SMEs* Standard required the change in accounting policy to be accounted for as an adjustment to retained earnings at the beginning of the current reporting period. The entity calculated that CU80,000 of the CU100,000 decrease in retained earnings at the beginning of the current reporting period, resulting from the change in accounting policy, is attributable to years before the preceding reporting period.**

Paragraph 10.11(a)–(c) does not provide 'free choices' but rather a sequential hierarchy of how to account for changes in accounting policy. Paragraph 10.11(a) requires the entity to follow the transitional provisions of the amended *IFRS for SMEs* Standard, that is, the effect of the change in accounting policy—a decrease of CU100,000—is presented as a restatement of retained earnings at the beginning of the current reporting period and the comparative figures are not restated.

Ex 20 **In compliance with the only option in the *IFRS for SMEs* Standard to use full IFRS Standards, an entity applies the requirements of IAS 39 *Financial Instruments: Recognition and Measurement*. In the current reporting period IAS 39 was amended. The transitional provisions for the amendment required the change in accounting policy to be accounted for as an adjustment to retained earnings at the beginning of the current reporting period. The entity calculated that of the CU100,000 decrease in retained earnings at the beginning of the current reporting period, as a result of the change in accounting policy, CU80,000 is attributable to years before the preceding reporting period.**

The effect of the change in accounting policy—the decrease of CU100,000—must be presented as a restatement of retained earnings at the beginning of the current reporting period. In accordance with the transitional provisions specified in the amendment to IAS 39 the comparative figures must not be restated.

Ex 21 **In the current reporting period an entity voluntarily changed an accounting policy. The cumulative effect of the change in accounting policy on the retained earnings of the entity was a decrease of CU100,000 at the beginning of the current reporting period, CU80,000 of which was attributable to years before the preceding reporting period.**

In accordance with paragraph 10.11(c) the effect of the change in accounting policy must be presented as a restatement of retained earnings (decrease of CU80,000) at the beginning of the preceding reporting period and a CU20,000 decrease in the profit for the preceding reporting period. The cumulative effect of these restatements is a decrease of CU100,000 in retained earnings at the beginning of the current reporting period.

Retrospective application

10.12 When a change in accounting policy is applied retrospectively in accordance with paragraph 10.11, 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.

Notes

It is impracticable to apply a requirement if the entity cannot apply it after making every reasonable effort to do so (see Glossary).

'Impracticable' is a high hurdle. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively if:

(a) the effects of retrospective application are not determinable;

(b) retrospective application requires assumptions about what management's intention would have been in that period; or

(c) retrospective application requires significant estimates of amounts and it is impossible to distinguish objectively, from other information, information about those estimates that:

  (i) provides evidence of circumstances that existed on the date(s) at which those amounts are to be recognised, measured or disclosed; and

  (ii) would have been available when the financial statements for that prior period were authorised for issue.

Examples—retrospective application

Ex 22 **In 20X7, the entity voluntarily changed an accounting policy. In accordance with paragraph 10.11(c) the entity must account for the change in accounting policy retrospectively. The cumulative effect of the change in accounting policy is a decrease of CU100,000 in retained earnings at 1 January 20X7—the beginning of the current reporting period. The entity presents two years of comparative information and has calculated that the effect of the change in accounting policy is CU25,000 less profit for each of the past four years.**

The effect of the change in accounting policy must be presented as a restatement of: retained earnings at 1 January 20X5 (reduction of CU50,000); profit for the year ended 31 December 20X5 (reduction of CU25,000); and profit for the year ended 31 December 20X6 (reduction of CU25,000). The cumulative effect of these restatements is a CU100,000 downward restatement of retained earnings at 1 January 20X7 (the beginning of the current reporting period).

Ex 23 **The facts are the same as those in Example 22. However, in this example, because retrospective application requires significant estimates of amounts and it is not possible to distinguish objectively information about those estimates, it is impracticable for the entity to determine the individual-period effects of the change in accounting policy on the prior periods presented.**

The effect of the change in accounting policy must be presented as a CU100,000 downward restatement of retained earnings at 1 January 20X7 (the beginning of the current reporting period). The entity would disclose the information required in paragraph 10.14(d).

Ex 24 **The facts are the same as those in Example 22. However, in this example, assume that it is impracticable for the entity to determine the individual-period effects of the change in accounting policy on the periods before 20X6.**

The effect of the change in accounting policy must be presented as a restatement of retained earnings at 1 January 20X6 (reduction of CU75,000) and a restatement of profit for the year ended 31 December 20X6 (reduction of CU25,000). The cumulative effect of these restatements is a CU100,000 downward restatement of retained earnings at 1 January 20X7 (the beginning of the current reporting period). The entity does not restate the (comparative) information presented for the year ended 31 December 20X5 because it is impracticable to do so. However, the entity has to disclose why it is impracticable to do so (see paragraph 10.14(d)).

Ex 25 **The facts are the same as those in Example 22. However, in this example, assume that the entity would be required to engage an outside valuer to determine the individual-period effects of the change in accounting policy on the prior periods presented. The entity decides that, because of the cost that would be involved in engaging the outside valuer, it is impracticable to determine the individual-period effects of changing an accounting policy for one or more prior periods presented. Therefore, it adjusts the opening balance of retained earnings relating to the period in which the accounting policy is changed for the entire cumulative effect of the change in accounting policy.**

The cost of engaging an outside valuer does not make the restatement of prior periods impracticable (as that term is defined in the *IFRS for SMEs* Standard). The prior periods must be restated. The restatement would be the same as in Example 22.

Disclosure of a change in accounting policy

10.13 When an amendment to this Standard has an effect on the current period or any prior period, or might have an effect on future periods, an entity shall disclose the following:

(a) the nature of the change in accounting policy;
(b) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected;
(c) the amount of the adjustment relating to periods before those presented, to the extent practicable; and
(d) an explanation if it is impracticable to determine the amounts to be disclosed in (b) or (c).

Financial statements of subsequent periods need not repeat these disclosures.

Example—disclosure of a change in accounting policy

Ex 26 **In 20X2, SME A was required to comply with an amendment to the *IFRS for SMEs* Standard. The cumulative effect of the change in accounting policy on the retained earnings of the entity at the beginning of 20X1 is a decrease of CU80,000. The effect on profit before tax for 20X1 is a decrease of CU25,000, with a corresponding decrease in income tax expense of CU6,250.**

As a result of the change in accounting policy, the following disclosures will be made in SME A's 20X2 financial statements.

Extract from SME A statement of income and retained earnings for the year ended 31 December 20X2

	Notes	*20X2*	*20X1*
			Restated
		CU	*CU*
…			
Employee benefit expense (20X1: previously stated CU75,000)		124,000	100,000
…			
Profit before tax (20X1: previously stated CU185,000)		200,000	160,000
Income tax expense (20X1: previously stated CU42,250)		(40,000)	(36,000)
Profit for the year (20X1: previously stated CU142,750)		160,000	124,000
Retained earnings at the beginning of the year:			
- as previously reported		422,750	280,000
- effect of the change in accounting policy	12	(98,750)	(80,000)
		324,000	200,000
Retained earnings at the end of the year		484,000	324,000

SME A
Notes to the financial statements for the year ended 31 December 20X2 (extract)

Note 12 Change in accounting policy

In 20X2 in accordance with an amendment to Section X ... of the *IFRS for SMEs* Standard the entity changed its accounting policy for .... Previously, the entity had .... The entity now .... This change in accounting policy has been accounted for retrospectively, and the comparative information for 20X1 has been restated. Had there been no change of accounting policy, employee benefit expense would have been lower by CU35,000 (with a tax effect of CU8,000) for the year ended 31 December 20X2, as presented in the statement of income and retained earnings.

Note: The effect of the restatement on the statement of financial position (and other statements) must also be presented. This example assumes that the entity presents its analysis of expenses in the income statement by nature of expense; consequently, employee benefit expense will be a line item on the face of the income statement.

10.14 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.
(d) an explanation if it is impracticable to determine the amounts to be disclosed in (c).

Financial statements of subsequent periods need not repeat these disclosures.

Notes

Disclosure requirements of paragraph 10.14 is similar with that of paragraph 10.13 except for the requirement to disclose the reasons why applying the new accounting policy provides reliable and more relevant information.

Changes in accounting estimates

10.15 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.

Examples—change in accounting estimate

Ex 27 **An entity provides warranties at the time of sale to purchasers of its products. On 31 December 20X5 an entity assessed its provision for warranty obligation for products sold before 31 December 20X5 at CU100,000. After the 31 December 20X5 annual financial statements were authorised for issue the entity discovered a latent defect in one of its products (a defect that was not discoverable by reasonable or customary inspection). As a result of the discovery the entity revised its estimate of its provision for warranty obligation at 31 December 20X5 to CU150,000.**

The additional CU50,000 obligation (not provided for at 31 December 20X5) is a change in accounting estimate for the year ended 31 December 20X6. The warranty obligation (provision) was appropriately measured and reported at CU100,000 in the entity's 31 December 20X5 financial statements. This estimate was found to be inadequate in 20X6, after the 20X5 financial statements were approved for issue. The CU50,000 is recognised as an expense in determining the profit or loss for the year ending 31 December 20X6 (see paragraph 10.16).

Ex 28 **An entity acquired a yacht for CU1,000,000 on 1 January 20X1 and appropriately assessed its useful life at 30 years from the date of acquisition with a residual value of CU100,000. The entity decided that the straight-line method was the most appropriate method on which to depreciate the yacht.**

In 20X9 the entity was informed by the yacht manufacturer that it has discontinued the production of one of its major parts. As a result, on 31 December 20X9 the entity reduced the useful life of the yacht to 20 years from the date of acquisition, the residual value remains the same. It also assessed a fair value for the yacht as at 31 December 20X9 at CU800,000. It continued to believe that the straight-line method was the most appropriate method of depreciation for the yacht.

The revision of the yacht's useful life and its residual value were changes in accounting estimates. The revised estimates are appropriately made on the basis of new information that only became available in the current reporting period—20X9.

Ex 29 **The facts related to the acquisition of the yacht are the same as those in Example 28. In this example however, information that the useful life of the yacht was 20 years had been publicly available prior to the acquisition as the manufacturer had announced in 20X0 that it intended ceasing manufacture of the part in 20X9. The entity disregarded the information until 20X9 when it reassessed and adjusted the yacht's useful life to reflect its correct useful life.**

The reassessment in 20X9 of the yacht's useful life and its residual value are not changes in accounting estimates. They represent prior period errors in the entity's financial information since 20X1. The financial statements must be restated to correct the effects of the errors in the periods to which they relate, if those effects are material.

Ex 30 **An entity has been depreciating its buildings over a 25-year life, which is what is allowed by the entity's national tax laws. In the current year, the tax law is changed to allow depreciation of buildings over 20 years. The entity makes this change for financial reporting purposes and treats it as a change in accounting estimate.**

Paragraph 17.18 requires an entity to allocate the depreciable amount of an asset on a systematic basis over its useful life. Unless the useful life of the entity's buildings actually is 25 years, the entity has not been complying with paragraph 17.18, which requires the depreciable amount to be allocated over the entire period in which the entity expects to use the asset. Most buildings have useful lives significantly longer than 25 years. However, others may not have such long lives; the useful life will depend on a number of factors, including the materials used to construct the building, and the age of the building at the time of purchase by the reporting entity. If the entity has not been using the correct useful life, it should treat this as the correction of an error and make a retrospective restatement.

10.16 An entity shall recognise the effect of a change in an accounting estimate, other than a change to which paragraph 10.17 applies, **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.

10.17 To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, the entity shall recognise it by adjusting the carrying amount of the related asset, liability or equity item in the period of the change.

Examples—prospective recognition

Ex 31 **At 31 December 20X1 an entity measured one of its trade debtors at CU200,000 (that is, CU600,000 gross minus CU400,000 provision for doubtful debts). The estimate of the amount of the doubtful debt was appropriately made on the basis of all of the available information.**

On 31 December 20X2 the entity received notification from the liquidator of the debtor that it would shortly receive CU250,000 in full and final settlement of the debt.

The entity may reduce a portion of its allowance for doubtful debts by CU50,000 (trade debtors of CU250,000 at 31 December 20X2 minus trade debtors of CU200,000 at 31 December 20X1). This change in accounting estimate causes as an increase in profit for the year ended 31 December 20X2.

Ex 32 **The facts are the same as those in Example 28.**

Depreciation of CU55,000 will be deducted in determining profit or loss for the year ended 31 December 20X9 and for each of the next 11 years of remaining useful life of the yacht (that is, the remaining depreciable amount will be recognised as an expense evenly over the remaining useful life (12 years, including 20X9) calculated as follows (CU760,000 carrying amount minus CU100,000 residual value) ÷ 12 years' remaining useful life).

Ex 33 **On 1 January 20X1, an entity paid a systems developer CU50,000 for an on-line system through which its customers can place orders. The entity estimated that the system would have a useful life of five years and amortised the cost accordingly. Unfortunately, the system never worked as anticipated and customer use declined considerably after the first year because of ongoing system problems resulting in incorrect orders. At the end of the first year, after charging amortisation for the year of CU10,000, the entity undertook an impairment review and reduced the carrying amount to CU30,000. Consequently, in 20X1 the impairment loss was CU10,000. The entity assessed the useful life as being unchanged. At the end of Year 2, the entity decided to scrap the custom-developed system and replace it with a generic software package available in the market.**

The entity accounts for the change in useful life of the customer order system as a change in an accounting estimate applying paragraphs 10.15–10.18. The amortisation in the first two years during which the custom-developed system was used was based on an assessment of future economic benefits coming from that system.

Paragraph 10.10 states that a prior period error results from failure to take into account information that was available at the time the financial statements are prepared. Until the end of the second year, the best available information was that the system would provide future economic benefits. The change in the useful life of the system is a change of accounting estimate, and not a correction of a prior period error. Because there are indicators present at both 31 December 20X1 and 31 December 20X2 that future economic benefits were likely to be lower than expected, an impairment test would be carried out on both dates applying Section 27 *Impairment of Assets*.

Disclosure of a change in estimate

10.18 An entity shall disclose the nature of any change in an accounting estimate and the effect of the change on assets, liabilities, income and expense for the current period. If it is practicable for the entity to estimate the effect of the change in one or more future periods, the entity shall disclose those estimates.

Examples—disclosure of a change in accounting estimate

Ex 34 **An entity acquired a yacht for CU1,000,000 on 1 January 20X1 and appropriately assessed its useful life at 30 years from the date of acquisition with a residual value of CU100,000. The entity decided that the straight-line method was the most appropriate method by which to depreciate the yacht.**

In 20X9 the entity was informed by the yacht manufacturer that it has discontinued production of one of its major parts. As a result, at 31 December 20X9 the entity reduced the useful life of the yacht to 20 years from the date of acquisition with a residual value of CU100,000. It also assessed a fair value for the yacht as at 31 December 20X9 at CU800,000. It continued to believe that the straight-line method was the most appropriate method of depreciation for the yacht.

SME X
Notes to the financial statements for the year ended 31 December 20X9

Note 3 Operating profit

Change in accounting estimate

At 31 December 20X9, as a result of being given new information by the yacht manufacturer, the entity revised the estimate of the yacht's useful life to 20 years (previously 30 years). The residual value of the yacht remains at CU100,000. This had the effect of increasing the depreciation expense for the year ended 31 December 20X9 by CU25,000 (previously CU30,000 per year, now CU55,000 per year). Depreciation for each of the next 11 years is expected to be similarly affected by these changes in accounting estimates.

In this example, tax effects have been ignored.

Corrections of prior period errors

10.19 Prior period errors are omissions from, and misstatements in, an 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 authorised 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.

10.20 Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts and fraud.

Examples—prior period errors

Ex 35 **In 20X4, after the entity's 20X3 financial statements were approved for issue, the entity discovered that, as a result of a computational error, depreciation expense for 20X3 was understated by CU10.**

The CU10 understatement of depreciation expense in the 20X3 financial statements is a prior period error—the misstatement in the entity's 20X3 financial statements arose from the misuse (mathematical error) of reliable information that was available when financial statements for those periods were authorised for issue. However, if it is not material it need not be corrected retrospectively. Instead the additional CU10 could be recognised as an expense in 20X4.

Ex 36 **In 20X4, after the entity's 20X3 financial statements were approved for issue, the entity discovered that, because of a computational error, depreciation expense for 20X3 was understated by CU36,000.**

The CU36,000 understatement of depreciation expense in the 20X3 financial statements is a prior period error—the misstatement in the entity's 20X3 financial statements arose from the misuse (mathematical error) of reliable information that was available when financial statements for those periods were authorised for issue. See Example 39 for details of the restatement.

Ex 37 **In 20X4, after the entity's 31 December 20X3 annual financial statements were approved for issue, a latent defect in the composition of a new product manufactured by the entity was discovered (that is, a defect that was not discoverable by reasonable or customary inspection). As a result of the latent defect the entity incurred CU100,000 in unanticipated costs for fulfilling its warranty obligation in respect of sales made before 31 December 20X3. An additional CU20,000 was incurred to rectify the latent defect in products sold during 20X4 before the defect was detected and the production process rectified, CU5,000 of which relates to items of inventory at 31 December 20X3. The defective inventory was reported at cost (CU15,000) in the 20X3 financial statements when its selling price less costs to complete and sell was estimated at CU18,000. The accounting estimates made in preparing the 31 December 20X3 financial statements were appropriately made using all reliable information that the entity could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.**

The defect was neither known nor reasonably possible to detect at 31 December 20X3 or before the financial statements were authorised for issue, so the CU100,000 understatement of the warranty provision and CU2,000[2] overstatement of inventory in the 31 December 20X3 financial statements is not a prior period error. The effects of the latent defect that relate to the entity's financial position at 31 December 20X3 are changes in accounting estimates (see paragraph 10.13). In preparing its 31 December 20X3 financial statements the entity made the warranty provision and inventory valuation appropriately using all reliable information that the entity could reasonably be expected to have obtained and taken into account in the preparation and presentation of those financial statements. Consequently, the additional costs are expensed in calculating profit or loss for 20X4.

Ex 38 **An entity acquired a machine for CU140,000 on 1 January 20X0. It estimated that the machine would have a 10-year useful life, no residual value, and annual depreciation of CU14,000. In 20X4 (carrying amount of the machine is now CU84,000), a month after the 20X3 financial statements were authorised for issue, the entity estimates that the machine has a remaining useful life, measured from 1 January 20X4, of 10 years. Had the entity estimated a 14-year useful life originally, depreciation in years 20X0 to 20X3 would have been only CU10,000 per year (CU140,000/14 years). Should the entity restate its financial statements for those four years and disclose a correction of a prior period error?**

If the original estimate of a 10-year useful life was reasonable, this is not a correction of a prior period error but, rather, a change in accounting estimate that should be accounted for prospectively starting in 20X4. Financial statements for the prior years would not be restated. The CU84,000 carrying amount of the asset is depreciated over the 10 remaining years of useful life, with disclosure of the change in accounting estimate.

10.21 To the extent practicable, an entity shall correct a material prior period error retrospectively in the first financial statements authorised for issue after its discovery by:

(a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or

(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.

Examples—retrospective recognition

Ex 39 **In 20X4, after the entity's 20X3 financial statements were approved for issue, the entity discovered that, because of a computational error, depreciation expense for 20X3 was understated by CU36,000.**

The effect of correcting the prior period error must be presented as a restatement of profit for the year ended 31 December 20X3 (that is, a reduction of CU36,000) and a CU36,000 downward restatement of retained earnings at 1 January 20X4 (the beginning of the current reporting period).

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[2] Inventory is measured at the lower of cost (ie CU 15,000) and fair value less costs to complete and sell (ie CU18,000 originally estimated minus CU5,000 costs to rectify latent defect = CU13,000) (see paragraph 13.4).

For example, if the entity analysed its expenses by function and the error related to the calculation of depreciation on a building used for administration, the comparative (20X3) figure for administration expenses would be CU36,000 higher than originally reported in the 20X3 financial statements.

In this example, tax effects have been ignored.

Ex 40 **In 20X9 the entity discovered a programming error in its costing system that causes random errors in the costing of the entity's main product. In accordance with paragraph 10.21(b) the entity must account for the correction of the prior period error retrospectively, that is, through retrospective restatement. The cumulative effect of the error is a decrease of CU200,000 in retained earnings at 1 January 20X9 (the beginning of the current reporting period). The entity presents two years of comparative information and has calculated that the effect of the error is CU50,000 less profit for each of the past four years.**

The effect of correcting the prior period error must be presented as a restatement of: retained earnings at 1 January 20X7 (reduction of CU100,000); profit for the year ended 31 December 20X7 (reduction of CU50,000); and profit for the year ended 31 December 20X8 (reduction of CU50,000). The effect of these restatements is a CU200,000 downward restatement of retained earnings at 1 January 20X9 (the beginning of the current reporting period).

Assuming the entity analysed its expenses by function, its cost of sales for 20X8 and 20X7 would both be higher by CU50,000 than was originally reported in the 20X8 financial statements.

10.22 When it is impracticable to determine the 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).

Example—impracticable to determine the effects on prior periods

Ex 41 **The facts are the same as those in Example 40. However, in this example, assume that it is impracticable for the entity to determine the individual-period effects of the error on the periods before 20X8.**

The effect of correcting the prior period error must be presented as a restatement of: retained earnings (and inventories—asset) at 1 January 20X8 (reduced by CU150,000); and profit for the year ended 31 December 20X8 (reduced by CU50,000). The effect of these restatements is a CU200,000 downward restatement of retained earnings (and inventories—asset) at 1 January 20X9 (the beginning of the current reporting period). It is impracticable to restate the (comparative) information presented for the year ended 31 December 20X7.

Assuming the entity analysed its expenses by function, its cost of sales for 20X8, but not 20X7, would be higher by CU50,000 than was originally reported in the 20X8 financial statements.

The entity must disclose an explanation of the reasons why it is impracticable to determine the amounts to be disclosed for the period before 1 January 20X8 (see paragraph 10.23(d)).

Ex 42 **The facts are the same as those in Example 41. However, in this example, assume that it is impracticable for the entity to determine the individual-period effects of the error on any of the prior periods presented.**

The effect of correcting the error must be presented as a downward restatement of retained earnings at 1 January 20X9 (a reduction of CU200,000) because it is impracticable to restate the comparative information.

Assuming the entity analysed its expenses by function, its cost of sales for 20X8 and 20X7 would be identical to that originally reported in the 20X8 financial statements.

The entity must disclose an explanation of the reasons why it is impracticable to determine the amounts to be disclosed for the periods before 1 January 20X9 (see paragraph 10.23(d)).

Disclosure of prior period errors

10.23 An entity shall disclose the following about prior period errors:

(a) the nature of the prior period error;

(b) for each prior period presented, to the extent practicable, the amount of the correction for each financial statement line item affected;

(c) to the extent practicable, the amount of the correction at the beginning of the earliest prior period presented; and

(d) an explanation if it is not practicable to determine the amounts to be disclosed in (b) or (c).

Financial statements of subsequent periods need not repeat these disclosures.

Notes

Disclosure of the correction of a prior period error must be made even when the disclosure might result in adverse consequences for the entity. For example, an entity that discovers a prior period error must disclose the correction of that error even if it is worried that disclosure could result in a lawsuit. Similarly, if the correction of a prior period error would reveal that the entity violated its borrowing covenants, it must nevertheless be disclosed.

Example–disclosure of prior period errors

Ex 43 **In 20X5, after the Entity C’s 20X4 financial statements were approved for issue, the entity discovered a long-standing computational error in the calculation of depreciation expense. The cumulative effect of the error on the retained earnings of the entity at the beginning of 20X4 is a CU100,000 overstatement. The error resulted in profit before tax for the year ended 31 December 20X4 being overstated by CU40,000, with a corresponding decrease in income tax expense of CU8,000.**

As a result of correction of prior period errors, the following disclosures will be made in Entity C’s 20X5 financial statements.

Extract from Entity C's statement of income and retained earnings for the year ended 31 December 20X5

	Notes	*20X5*	*20X4*
			Restated
		CU	*CU*
Profit before tax (20X4: previously stated CU220,000)		263,000	180,000
Income tax expense (20X4: previously stated CU36,000)		(52,000)	(28,000)
Profit for the year (20X4: previously stated CU184,000)		211,000	152,000
Retained earnings at the beginning of the year:			
- as previously reported		481,000	297,000
- correction of prior period error	12	(132,000)	(100,000)
		349,000	197,000
Retained earnings at the end of the year		560,000	349,000

Entity C
Notes to the financial statements for the year ended 31 December 20X5

Note 12 Correction of prior period error

In 20X5, the entity corrected mathematical mistakes that resulted in the understatement of depreciation expense over the past [four] years. The correction of the error has been accounted for retrospectively, and the comparative information for 20X4 has been restated. The correction resulted in higher depreciation expense, amounting to CU40,000, as presented in the statement of income and retained earnings. The income tax was reduced by CU8,000. Consequently, profit after taxes was reduced by CU32,000 for the year ended 31 December 20X4. Furthermore, opening retained earnings for 20X4 have been reduced by CU100,000, the amount of the error relating to periods before 20X4.

Note: The effect of the restatement on the statement of financial position (and other statements) must also be presented. This example assumes that the entity presents its analysis of expenses in the income statement by nature of expense; consequently, depreciation expense will be a line item on the face of the income statement.

SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the *IFRS for SMEs* Standard to transactions and other events often requires judgement. Information about significant judgements and key sources of estimation uncertainty is useful in assessing an entity's financial position, performance and cash flows. Consequently, in accordance with paragraph 8.6 an entity must disclose the judgements that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements. Furthermore, in accordance with paragraph 8.7, an entity must disclose information about key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Other sections of the *IFRS for SMEs* Standard require disclosure of information about particular judgements and estimation uncertainties.

Accounting policies

Determining accounting policies

In many cases little difficulty is encountered in determining accounting policies. However, in some cases significant judgement is required in determining an accounting policy. In particular, where the *IFRS for SMEs* Standard does not specifically address a transaction, other event or condition, management must use its judgement in developing an accounting policy for that transaction, other event or condition in accordance with paragraphs 10.4 and 10.5 of the *IFRS for SMEs* Standard. In making the judgement described in paragraph 10.4, management may, but is not required to, consider the requirements and guidance in full IFRS Standards dealing with similar and related issues.

Applying accounting policies

In some cases management must make significant judgements in applying its accounting policies. For example, in certain circumstances, management must make judgements in determining:

- the degree of influence the entity exerts over another entity, for example, significant influence, control etc;
- whether certain properties are investment properties, inventory or property, plant and equipment;
- whether, in substance, particular sales of goods are financing arrangements and therefore do not give rise to revenue; and
- whether the substance of the relationship between the entity and a special purpose entity indicates that the special purpose entity is controlled by the entity.

The judgements made in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements must be disclosed (see paragraph 8.6).

Change of accounting policies

An entity can voluntarily change an accounting policy only if the change 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 (see paragraph 10.8(b)). Judgements about the relevance and reliability of information must be made before voluntarily changing an accounting policy.

A change in accounting policy is applied retrospectively. Sometimes, an entity might find it impracticable to determine the individual-period effects of a change in accounting policy on comparative information for one or more prior periods presented. 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 new policy is applied to the carrying amount of assets and liabilities at the beginning of the earliest period for which retrospective application is practicable. An entity, in making such judgement, must consider that retrospective application is impracticable only when the entity cannot apply the requirement after making every reasonable effort to do so (see the definition of impracticable in the Glossary). In effect the entity must assess what constitutes 'every reasonable effort'.

Judgement might be required to distinguish a change in accounting estimate from a change in accounting policy. When it is difficult to make that distinction, the change is treated as a change in an accounting estimate (paragraph 10.15).

Accounting estimates

Accounting estimates

Determining the carrying amounts of some assets and liabilities requires estimation of the effects of uncertain future events on those assets and liabilities at the end of the reporting period. For example, estimating the expected condition of an item of property, plant and equipment is necessary to measure its residual value, and, when impairment is indicated, estimating expected future cash flows to measure its recoverable amount. Other examples include the effect of technological obsolescence on inventories and the effect of the future outcome of litigation in progress on the amount of provisions. An entity must disclose in the notes information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year (see paragraph 8.7).

Changes in accounting estimates

When significant accounting estimates are applied in determining the carrying amount of an asset or liability it follows that those estimates will probably require adjustment as new information becomes available or new developments occur. 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, is a change in accounting estimate (see paragraph 10.15). Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.

Judgement might be required to distinguish a change in accounting estimate from a change in accounting policy. When it is difficult to make that distinction, the change is treated as a change in an accounting estimate (see paragraph 10.15).

Correction of material prior period errors

To the extent practicable, an entity corrects a material prior period error retrospectively (see paragraph 10.21). In certain cases an entity might find it impracticable to determine the individual-period effects of the prior period error on one or more prior periods presented (see paragraph 10.22). In making that judgement, an entity must consider that retrospective restatement is impracticable only when the entity cannot apply the requirement after making every reasonable effort to do so (see the definition of impracticable in the Glossary).

Module 10—Accounting Policies, Estimates and Errors

COMPARISON WITH FULL IFRS STANDARDs

When preparing financial statements for periods beginning on 1 January 2017, the main differences between the requirements of full IFRS Standards (see IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*) and the *IFRS for SMEs* Standard (see Section 10 *Accounting Policies, Estimates and Errors*) are:

- The IFRS for SMEs Standard is drafted in simpler language than that used in full IFRS Standards and includes less guidance on how to apply the principles.

Module 10—Accounting Policies, Estimates and Errors

TEST YOUR KNOWLEDGE

Test your knowledge of the requirements for selecting, applying and changing accounting policies and for revising accounting estimates and correcting errors applying the *IFRS for SMEs* Standard by answering the following questions.

You should assume that all amounts mentioned are material.

Once you have completed the test check your answers against those set out beneath it.

Mark the box next to the most correct statement.

Question 1

Prospective application of a change in accounting policy means:

☐ (a) applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the financial statements are authorised for issue.

☐ (b) applying the new accounting policy to transactions, other events and conditions occurring between the date as at which the policy is changed and the date when the financial statements are authorised for issue.

☐ (c) applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed.

☐ (d) applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.

Question 2

Retrospective application of a change in accounting policy means:

☐ (a) applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the financial statements are authorised for issue.

☐ (b) applying the new accounting policy to transactions, other events and conditions occurring between the date as at which the policy is changed and the date when the financial statements are authorised for issue.

☐ (c) applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed.

☐ (d) applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.

Module 10—Accounting Policies, Estimates and Errors

Question 3

Which of the following statements is true?

- ☐ (a) The effect of a change in accounting estimate is recognised retrospectively.
- ☐ (b) To the extent practicable, an entity must correct a prior period error prospectively in the first financial statements authorised for issue after its discovery.
- ☐ (c) When an entity discovers an error in its financial statements of a prior period, it must immediately withdraw those financial statements and reissue them with the error corrected.
- ☐ (d) To the extent practicable, an entity must correct a prior period error retrospectively in the first financial statements authorised for issue after its discovery.

Question 4

On 25 March 20X4 an entity discovered that, as a result of a computational error, depreciation expense for 20X3 is overstated by CU29,000. The entity's 31 December 20X3 financial statements were authorised for issue on 1 March 20X4. The entity must:

- ☐ (a) reissue its 31 December 20X3 financial statements with the correct depreciation expense.
- ☐ (b) reduce depreciation for the year ended 31 December 20X4 by CU29,000 (that is, prospective allocation—a change in accounting estimate).
- ☐ (c) restate (correct) the depreciation expense reported for the year ended 31 December 20X3 in the comparative figures of its 20X4 financial statements (that is, retrospective restatement of a prior period error).

Question 5

The facts are the same as in Question 4. However, the entity's 31 December 20X3 financial statements were authorised for issue on 1 April 20X4. The entity must:

- ☐ (a) correct its 31 December 20X3 financial statements before issuing them.
- ☐ (b) reduce depreciation for the year ended 31 December 20X4 by CU29,000 (that is, prospective allocation—a change in accounting estimate).
- ☐ (c) restate (correct) the depreciation expense reported for the year ended 31 December 20X3 in the comparative figures of its 20X4 financial statements (that is, retrospective restatement of a prior period error).

Question 6

On 2 February 20X5, before an entity's 31 December 20X4 financial statements were authorised for issue, a court ordered the entity to pay CU120,000 damages in full and final settlement of a patent infringement lawsuit brought against the entity by one of its competitors. The patent infringement occurred in 20X3. The amount of damages awarded to the competitor was significantly higher than the CU10,000–CU30,000 that the entity had justifiably expected to pay throughout the duration of the case. The entity will not contest the judgement.

In its 31 December 20X3 annual financial statements the entity reported its liability for the lawsuit at CU20,000; this estimate was appropriately made taking account of all available evidence at the time the financial statements were authorised for issue.

In its 31 December 20X4 financial statements the entity must:

☐ (a) restate the comparative information at 31 December 20X3 (that is, retrospective restatement of a prior period error).

☐ (b) measure the provision at 31 December 20X4 at CU120,000 (comparative information 20X3: CU20,000), that is, account prospectively for the change in accounting estimate in its 20X4 financial statements.

☐ (c) measure the provision at 31 December 20X4 at CU20,000 (comparative information 20X3: CU20,000) and record the effect of the higher-than-expected settlement in profit or loss for the year ended 31 December 20X5 (that is, account prospectively for the change in accounting estimate in the period during which the final settlement amount was determined).

Question 7

On 20 February 20X5, before an entity's 31 December 20X4 financial statements were authorised for issue, a court ordered the entity to pay CU120,000 damages in full and final settlement of a patent infringement lawsuit brought against the entity by one of its competitors. The patent infringement occurred in 20X3. The amount of damages awarded to the competitor was consistent with similar cases settled in that jurisdiction since 20X2.

In its 31 December 20X3 annual financial statements the entity reported its liability for the lawsuit at CU20,000. The entity deliberately understated the amount presented, because it did not want to make public its true estimate, believing that doing so would be detrimental to its defence.

In its 31 December 20X4 financial statements the entity must:

☐ (a) restate the comparative information at 31 December 20X3 (that is, retrospective restatement of a prior period error).

☐ (b) measure the provision at 31 December 20X4 at CU120,000 (comparative information 20X3: CU20,000), that is, account prospectively for the change in accounting estimate in its 20X4 financial statements.

☐ (c) measure the provision at 31 December 20X4 at CU20,000 (comparative information 20X3: CU20,000) and record the effect of the higher-than-expected settlement in profit or loss for the year ended 31 December 20X5 (that is, account prospectively for the change in accounting estimate in the period during which the final settlement amount was determined).

Question 8

In 20X5, in accordance with an entity's newly formulated equity remuneration scheme, the entity issued, to each of its 6,000 employees, options to acquire 100 of its own shares. This is the only share-based payment transaction into which the entity has ever entered.

In its 31 December 20X5 annual financial statements, the entity accounted for the equity-settled share-based payment transaction in accordance with Section 26 *Share-based Payment*. Must the entity account for this new transaction as a change in accounting policy in its 20X5 financial statements?

☐ (a) Yes

☐ (b) No

Question 9

Which of the following statements is true?

☐ (a) Financial statements of subsequent periods need not repeat the disclosures required for a change in accounting policy and the correction of a prior period error.

☐ (b) Financial statements of subsequent periods must repeat the disclosures required for a change in accounting policy and the correction of a prior period error.

☐ (c) Financial statements of subsequent periods must repeat the disclosures required for a change in accounting policy and the correction of a prior period error unless it is impracticable to identify the period to which they relate.

Question 10

Which of the following is not a change in accounting policy?

☐ (a) In the current reporting period an entity changed the basis on which it measures a building that is an investment property from the fair value model to the cost model because fair value can no longer be measured reliably on an ongoing basis without undue cost or effort.

☐ (b) An entity measures its only investment property at fair value. In the current reporting period, the entity acquired a second investment property which it measures using the cost model because the fair value of the second investment property cannot be measured reliably on an ongoing basis without undue cost or effort. It continues to account for the first investment property using the fair value model.

☐ (c) In the current reporting period the entity changed the method on which it calculates depreciation of buildings classified as property, plant and equipment from the reducing balance method to the straight-line method.

☐ (d) All of (a)–(c).

Module 10—Accounting Policies, Estimates and Errors

Question 11

Which of the following changes in accounting policy is NOT a correct treatment in accordance with Section 10 (assume all judgement surrounding the change in accounting policy is appropriate)?

- ☐ (a) In 20X3, SME A changed its accounting policy so that it now recognises all actuarial gains and losses in profit or loss. Previously it recognised them in other comprehensive income (OCI). Actuarial gains in 20X2 recognised in OCI are recognised in profit or loss in the comparative period of 20X3's financial statements.
- ☐ (b) In 20X4, SME B changed its accounting policy so that it now measures all of its buildings using the revaluation model. Previously, they were accounted for using the cost model. In its 20X4 financial statements, SME B restated its 20X3 equity balances to recognise the revaluation surplus arising in 20X3; to do this it used an appraisal report conducted earlier in 20X3.
- ☐ (c) In 20X5, SME C, in its consolidated financial statements, voluntarily changed its accounting policy for its investments in associates from the fair value model to the equity method. For an investment in associate—SME D acquired in 20X3—SME C in its 20X5 consolidated financial statements, reduced the opening retained earnings at the beginning of 20X5 by the amount it previously recognised in profit or loss arising from fair valuation of its investment in Associate D. SME C also adjusted its 20X5 retained earnings' opening balance by its share of Associate D's profit or loss (calculated using the equity method) in 20X3 and 20X4.

Question 12

The following statements are true about a change in accounting estimate except for:

- ☐ (a) A change in accounting estimate resulting from a failure to use, or misuse of, reliable information that was available and could reasonably be expected to have been obtained and considered in the preparation and presentation of the financial statements of an earlier period.
- ☐ (b) If it is practicable for the entity to estimate the effect of the change in one or more future periods, the entity shall disclose those estimates.
- ☐ (c) Depending on the relevant facts, an entity shall recognise the effect of a change in an accounting estimate by including it in profit or loss either in the period of the change, if the change affects that period only, or in the period of the change and future periods, if the change affects both.
- ☐ (d) When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as the latter.

Module 10—Accounting Policies, Estimates and Errors

Answers

Q1 (c)—see definition in the Glossary
Q2 (d)—see definition in the Glossary
Q3 (d)—see paragraph 10.21
Q4 (c)—see paragraph 10.21(a)
Q5 (a)—This question is not about the application of Section 10 *Accounting Policies, Estimates and Errors*—the error in the entity's financial statements for the year ended 31 December 20X3 was detected before the financial statements were authorised for issue (that is, before the period relevant to the application of the requirements of Section 10). The question is about how to account for an event after the end of the reporting period (see paragraphs 32.2 and 32.4 of Section 32 *Events After the End of the Reporting Period*).
Q6 (b)—see paragraphs 10.15-10.17 and 32.5(a)
Q7 (a)—see paragraphs 10.19–10.21
Q8 (b)—see paragraph 10.9(b)
Q9 (a)—see paragraphs 10.13, 10.14 and 10.23
Q10 (d)—see paragraphs 10.9(c) and 10.15
Q11 (b)—see paragraph 10.10A Generally, changes in accounting policies are accounted for retrospectively unless expressly stated by the *IFRS for SMEs* Standard. This is one of the exceptions where the change in accounting policy is accounted for prospectively.
Q12 (a)—see paragraph 10.19. Choice (a) will result in a correction of prior period error. See also paragraphs 10.15, 10.16 and 10.18.

Module 10—Accounting Policies, Estimates and Errors

APPLY YOUR KNOWLEDGE

Apply your knowledge of the requirements for selecting, applying and changing accounting policies and for revising accounting estimates and correcting errors applying the *IFRS for SMEs* Standard by completing the case studies provided.

Once you have completed the case studies, check your answers against those set out beneath it.

Case study 1

On 1 January 20X1 SME Z paid CU600,000 to acquire a new barge. In the belief that it was entitled to a refund of purchase taxes on the acquisition of the barge, SME Z claimed and was refunded CU60,000 by the local government. However, in late 20X7 SME Z repaid the refund when it became apparent that it had made an error in making the claim to the local government as it had not been entitled to the refund of purchase taxes on acquisition of the barge.

From the date of acquisition to 31 December 20X6, SME Z had the following assessments:

- the useful life of the barge is 15 years from the date of acquisition;
- the residual value of the barge is nil; and
- the entity will consume the barge's future economic benefits evenly over 15 years from the date of acquisition.

In 20X7, in the light of the development of new barge preservation treatments, the period over which the barge is expected to be economically usable by one or more users increased from 15 years to 26 years. SME Z now expects to dispose of its barge after using it for 20 years from the date of acquisition (that is, a further 14 years). At 31 December 20X7, SME Z assessed the residual value of the barge at CU70,000.

Prepare accounting entries to record the transactions relating to the barge in the accounting records of SME Z for the year ended 31 December 20X7.

Module 10—Accounting Policies, Estimates and Errors

Answer to Case study 1

31 December 20X7

Dr	Cost—property, plant and equipment	CU60,000	
	Cr Cash		CU60,000

To recognise the repayment of the purchase taxes claimed in error.

Dr	Retained earnings at beginning of year	CU24,000[a]	
	Cr Accumulated depreciation—PPE		CU24,000

To correct recorded depreciation of the barge from 20X1 to 20X6 for the correction of the purchase taxes claimed in error.

Dr	Profit or loss (depreciation)	CU20,714[c]	
	Cr Accumulated depreciation—PPE		CU20,714

To recognise depreciation of the barge for the year ended 31 December 20X7

The calculations and explanatory notes below do not form part of the answer to this Case study:

(a) CU4,000[b] × 6 years (ie 20X1 to 20X6) = CU24,000.

(b) CU60,000 increase in the cost ÷ 15 years = CU4,000 additional depreciation per year (20X1 to 20X6).

(c) [CU360,000[d] minus CU70,000 residual value] ÷ 14 years remaining useful life = CU20,714 depreciation for the year ended 31 December 20X7.

(d) CU600,000 cost minus (CU40,000[e] depreciation × 6 years) accumulated depreciation = CU360,000 corrected carrying amount at 31 December 20X6.

(e) CU600,000 carrying amount ÷ 15 year useful life = CU40,000 corrected depreciation per year (20X1 to 20X6).

Module 10—Accounting Policies, Estimates and Errors

Case study 2

In its financial statements for the year ended 31 December 20X1, SME Y reported CU73,500 revenue (sales), CU53,500 cost of sales, CU6,000 income tax expense, CU20,000 retained earnings at 1 January 20X1 and CU34,000 retained earnings at 31 December 20X1.

In 20X2, after the 20X1 financial statements were approved for issue, SME Y discovered that some products sold in 20X1 were incorrectly included in inventories at 31 December 20X1 at their cost—CU6,500.

In 20X2, SME Y changed its accounting policy for the measurement of investments in associates after initial recognition from the cost model to the fair value model. It acquired its only investment in an associate for CU3,000 many years ago. The associate's equity is not traded on a securities exchange (that is, a published price quotation is not available). The fair value of the investment was determined reliably using an appropriate equity valuation model on 31 December 20X2 at CU25,000 (20X1: CU20,000 and 20X0: CU18,000).

At 31 December 20X2, as a result of the invention of improved lubricants, SME Y reassessed the useful life of Machine A from four years to seven years. Machine A is depreciated on the straight-line method to a nil residual value. It was acquired for CU6,000 on 1 January 20X0. Inventories of the type manufactured by Machine A were immaterial at the end of each reporting period.

SME Y's accounting records for the year ended 31 December 20X2, before accounting for the change in accounting policy and before accounting for the change in accounting estimate, record CU104,000 revenue (sales), CU86,500 cost of sales (including CU6,500 for the error in opening inventory and CU1,500 depreciation for Machine A) and CU5,250 income tax expense.

SME Y presents financial statements with one year of comparative information.

For simplicity, the tax effect of all items of income and expenses should be assumed to be 30% of the gross amount.

Draft an extract showing how the correction of the prior period error, change in accounting policy and change in accounting estimate could be presented in the statement of income and retained earnings and disclosed in the notes of SME Y for the year ended 31 December 20X2.

Module 10—Accounting Policies, Estimates and Errors

Answer to Case study 2

Extract from SME Y statement of income and retained earnings for the year ended 31 December 20X2

	Notes	***20X2***		***20X1***	
				Restated	
		CU		***CU***	
Revenue		104,000		73,500	
Cost of sales (20X1 previously CU53,500)		(79,100)	(a)	(60,000)	(d)
Gross profit		24,900		13,500	
Other income—change in the fair value of investment in associate (20X1 previously CU0)		5,000	(b)	2,000	(e)
Profit before tax		29,900		15,500	
Income tax expense (20X1 previously CU6,000)		(8,970)	(c)	(4,650)	(f)
Profit for the year (20X1 previously CU14,000)		20,930		10,850	
Retained earnings, as restated—beginning of the year					
- as previously stated		34,000		20,000	
- effect of the correction of a prior period error		(4,550)	(g)	-	
- effect of a change in accounting policy		11,900	(m)	10,500	(l)
		41,350		30,500	
Retained earnings—end of the year		62,280		41,350	

SME Y

Notes to the financial statements for the year ended 31 December 20X2 (extract)

Note 9 Profit before tax

Change in accounting estimate

In response to the advent of superior lubricants that prolong the life of the machine used to produce … the estimated useful life of the machine was increased from four years to seven years. The effect of the change in the useful life of the machine is to reduce the depreciation allocation by CU900 in 20X2 and 20X3. The after-tax effect is an increase in profit for the year of CU630 for each of the two years.

Depreciation expense in 20X4–20X6 is increased by CU600 because of the useful life revision, as under the initial estimate, the asset would have been fully depreciated at the end of 20X3. The after-tax effect for these three years is a decrease in profit for the year of CU420 per year.

Note 11 Correction of prior period error

In 20X2 the entity identified that CU6,500 products that had been sold in 20X1 were included erroneously in inventory at 31 December 20X1. The financial statements of 20X1 have been restated to correct this error. The effect of the restatement is a CU6,500 increase in the cost of sales and a CU4,550 decrease in profit for the year ended 31 December 20X1 after decreasing income tax expense by CU1,950. This resulted in a CU4,550 (decrease) restatement of retained earnings at 31 December 20X1.

Note 12 Change in accounting policy

In 20X2 the entity changed its accounting policy for the measurement of investments in associates after initial recognition from the cost model to the fair value model. Management judged that this policy provides reliable and more relevant information because dividend income and changes in fair value are inextricably linked as integral components of the financial performance of an investment in an associate and measurement at fair value is necessary if that financial performance is to be reported in a more meaningful way. This change in accounting policy has been accounted for retrospectively. The comparative information has been restated. A new line item, 'Other income—change in the fair value of investment in associate', has been added in the statement of income and retained earnings. The effect of the restatement has been to add income of CU2,000 as a result of the increase in value of the associate during the year ended 31 December 20X1 which resulted in a CU1,400 increase in profit for the year (after including a resulting increase in income tax expense of CU600). This, together with the CU10,500 (increase) restatement of retained earnings at 31 December 20X0, resulted in a CU11,900 increase in retained earnings at 31 December 20X1. Furthermore, profit for the year ended 31 December 20X2 was CU3,500 higher (after deducting the CU1,500 tax effect) as a result of recording a further CU5,000[b] increase in the fair value of the investment in an associate.

The calculations and explanatory notes below do not form part of the answer to this Case study:

(a) CU86,500 given minus CU6,500 correction of error (now recognised as an expense in 20X1) minus CU900[i] effect of the change in accounting estimate.

(b) CU25,000 fair value (20X2) minus CU20,000 fair value (20X1) = CU5,000 (the effect of applying the new accounting policy (fair value model) in 20X2).

(c) CU5,250 + CU1,950[h] + 30% (CU900[i] reduction in depreciation resulting from the change in accounting estimate) + 30% (CU5,000 increase in the fair value of investment property—change in accounting policy) = CU8,970.

(d) CU53,500 as previously stated + CU6,500 (products sold and incorrectly included in closing inventory in 20X1) = CU60,000 (that is, the prior period error is corrected retrospectively by restating the comparative amounts, in accordance with paragraph 10.21(a)).

(e) CU20,000 fair value (20X1) minus CU18,000 fair value (20X0) = CU2,000 (the effect in 20X1 of the change in accounting policy for investments in associates from the cost model to the fair value model).

(f) CU6,000 as previously stated minus CU1,950[h] correction of prior period error + 30% (CU2,000 change in accounting policy) = CU4,650.

(g) CU6,500 (products sold and incorrectly included in inventory in 20X1) – CU1,950[h] (tax overstated in 20X1) = CU4,550.

(h) CU6,500 (products sold and incorrectly included in inventory in 20X1) × 30% (income tax rate) = CU1,950.

(i) CU1,500 depreciation (using old estimate, that is, CU6,000 cost ÷ 4 years) minus CU600[j] (using new estimate of useful life) = CU900.

(j) CU3,000[k] carrying amount ÷ 5 years remaining useful life = CU600 depreciation per year.

(k) [CU6,000 cost minus (CU1,500 depreciation × 2 years)] = CU3,000 carrying amount at 31 December 20X1.

(l) (CU 18,000 fair value of investment in associates at 31 December 20X0 minus CU3,000 carrying amount based on the cost model at the same date) × 0.7 (to reflect 30% income tax rate) = CU10,500 (effect of a change in accounting policy (from cost model to fair value model)).

(m) CU10,500[l] + [CU2,000[e] × 0.7 (to reflect 30% income tax rate)] = CU11,900.

Module 10—Accounting Policies, Estimates and Errors

Case study 3

A cheese manufacturer accounts for property, plant and equipment using the cost model on 31 December 20X0 and 31 December 20X1. The cheese manufacturer uses a parcel of land to graze cows (that is, the land is used in producing cheese). In 20X2, because of rapidly increasing land prices in its surrounding area, the cheese manufacturer changes its accounting policy for land from the cost model to the revaluation model in order to present a more relevant depiction of land value in its statement of financial position.

The table below depicts the fact pattern at 31 December 20X2 regarding the parcel of land:

Asset	*Cost basis*	*Fair value (appraised by valuer)*
PPE (Land)	CU100,000	CU1,000,000 (31 December 20X2)
		CU900,000 (31 December 20X1)
		CU750,000 (31 December 20X0)

The cheese manufacturer will continue to use the cost model for buildings and equipment (separate classes of PPE).

Part A

Why is prospective application appropriate for reporting this change in policy?

Part B

Prepare the journal entry for 20X2 relating to the revaluation.

Part C

Prepare extracts of the relevant sections in the financial statements including comparatives (excluding the notes to the financial statements).

Part D

Does the change to the revaluation model provide reliable and more relevant information?

Module 10—Accounting Policies, Estimates and Errors

Answer to Case study 3—Part A

Why is prospective application appropriate for reporting this change in policy?

According to paragraph 10.10A of the *IFRS for SMEs* Standard, the initial application of a policy to revalue assets in accordance with Section 17 *Property, Plant, and Equipment* is a change in an accounting policy to be dealt with as a revaluation in accordance with Section 17. Consequently, a change from the cost model to the revaluation model for a class of property, plant and equipment shall be accounted for prospectively, instead of in accordance with paragraphs 10.11–10.12

The land is classified as property, plant and equipment and thus no retrospective restatement for prior years is required (that is, the increase is recognised in OCI, not profit or loss, in the period of the revaluation). The prospective application allowed in paragraph 10.10A is an exception to retrospective restatement specified for changes in accounting policies.

Answer to Case study 3—Part B

Prepare the journal entry in 20x2 for the revaluation

The financial effect of the revaluation of the land is reported *prospectively* as illustrated below:

The following journal entry illustrates the revaluation:

Debit Asset—non-financial asset: land	CU900,000	
Credit Equity—OCI: revaluation surplus		CU900,000
To recognise the revaluation of land resulting from a change in accounting in policy from cost model to revaluation model.		

Answer to Case study 3—Part C

Prepare extracts of the relevant sections in the financial statements including comparatives (excluding the notes to the financial statements)

	20X2	*20X1*
	CU	*CU*
Statement of Financial Position (extract)		
PPE—Land	1,000,000	100,000
Equity—OCI (revaluation surplus)	900,000	-

	20X2	*20X1*
	CU	*CU*
Statement of Comprehensive Income (extract)		
Net profit after taxes	……	……
OCI		
Revaluation surplus	900,000	-

	20X2	20X1
	CU	CU
Statement of Changes in Equity (extract)		
Revaluation surplus	900,000	-

Answer to Case study 3—Part D

Does the change to the revaluation model provide reliable and more relevant information?

Paragraph 10.8(b) states that an entity shall change an accounting policy if the change 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. Based on the fact pattern, land prices rapidly increase in the surrounding area, resulting in the land owned by the entity with an original cost of CU100,000 being appraised at CU1,000,000. In the absence of management's intention to dispose the property, the revaluation is unlikely to have any impact on its future cash flows.

The objective of an SME's financial statements is to provide information about the financial position, performance and cash flows of the entity that is useful for economic decision-making by a broad range of users of the financial statements who are not in a position to demand reports tailored to meet their particular information needs (see paragraph 2.2 of Section 2 *Concepts and Pervasive Principles*). These users may include but are not limited to: owners who are not involved in managing the business, existing and potential creditors and credit rating agencies. The revaluation of land to its current market value that is materially different from its original costs is relevant information for users as this presents a clearer financial position. From the perspective of its owners, the significant increase in value shows the results of management's stewardship and their accountability for the resources entrusted to them (see paragraph 2.3). Creditors will find this information useful, particularly for assessing the entity's financial position, as it gives them a picture of the entity's resources, with the land being potentially regarded as collateral.

Finally, this information is only reliable (affecting the financial statements as a whole) if it is free from material error and bias and represents faithfully that which it either purports to represent or could reasonably be expected to represent. If there were too many uncertainties involved in measuring the fair value of the land, the fair value information may not satisfy the requirement of reliability. The change to the revaluation model brought along with it a requirement that the entity should be able to perform the revaluation with sufficient regularity.