IPSAS 3 – Accounting Policies, Changes in Accounting Estimates and Errors

IPSAS 3 Accounting Policies, Changes in Accounting Estimates and Errors

Objective

- 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 errors.***

IPSAS 3 Accounting Policies, Changes in Accounting Estimates and Errors

- In the absence of an IPSAS that specifically applies to a transaction, other event or condition, management shall ***use judgment in developing and applying an accounting policy*** that results in information that is:

- Relevant to the decision-making needs of users

IPSAS 3 Accounting Policies, Changes in Accounting Estimates and Errors

- Reliable, in that the financial statements:
  - Represent ***faithfully*** the **financial position**, financial **performance**, and **cash flows** of the entity
  - Reflect the ***economic substance of transactions***, other events and conditions, and not merely the legal form
  - Are neutral, i.e., **free from bias**
  - Are ***prudent***
  - Are ***complete in all material aspects***

IPSAS 3 Accounting Policies, Changes in Accounting Estimates and Errors

- IPSAS 3 prescribes a hierarchy for choosing accounting policies:
  - ***IPSAS,*** taking into account any relevant implementation guidance.
  - In the ***absence of a directly applicable IPSAS***, look at the requirements and guidance in IPSAS dealing with ***similar and related issues***; and the definitions, recognition, and measurement criteria for assets, liabilities, revenue, and expenses described in other IPSASs.

IPSAS 3 Accounting Policies, Changes in Accounting Estimates and Errors

- Management may also consider the most ***recent pronouncements of other standard-setting bodies*** and accepted ***public and private sector practices.***

- Apply accounting policies ***consistently to similar transactions.***
- Make a ***change*** in accounting policy ***only if it is required by an IPSAS***, or it ***results in reliable and more relevant information.***

IPSAS 3 Accounting Policies, Changes in Accounting Estimates and Errors

- If a change in accounting policy is required by an IPSAS, follow that ***pronouncement 's transition requirements***.
- If **none** are specified, or if the change is **voluntary**, ***apply the new accounting policy retrospectively by restating prior periods***.
- If restatement is **impracticable**, include the **cumulative effect of the change in net assets/equity.**
- If the cumulative effect **cannot be determined, apply the new policy prospectively.**

IPSAS 3 Accounting Policies, Changes in Accounting Estimates and Errors

- Changes in **accounting estimates** (for example, change in useful life of an asset) are accounted for in the current period, or the current and future periods ***(no restatement).***

- In the situation a **distinction** between a change in accounting policy and a change in accounting estimate is **unclear**, the **change is treated as a change in an accounting estimate.**

IPSAS 3 Accounting Policies, Changes in Accounting Estimates and Errors

- All **material prior-period errors** shall be **corrected retrospectively** in the first set of financial statements authorised for issue after their discovery, **by restating comparative prior-period amounts** or, if the **error occurred before the earliest period presented, by restating the opening statement of financial position.**

IPSAS 3 Accounting Policies, Changes in Accounting Estimates and Errors

Practical Examples of restatement:

1. *Retrospective Restatement of Errors.*
2. *Change in Accounting policies with Retrospective Application.*
3. *Prospective application of a change in an Accounting Policy where Retrospective Application is not Applicable*

ILLUSTRATIVE EXAMPLES

IPSAS 3

Illustrative Example 1: Retrospective Restatement of Errors

During 2015, an entity discovered that revenue from income taxes was incorrect. Income taxes of KShs. 65,000 that should have been recognized in 2014 were incorrectly omitted and recognised as revenue in 2015.

The entity's accounting records for 2015 show revenue from taxation of KShs. 600,000 (including taxation that should have been recognised in the opening balances), and expenses of KShs. 865,000.

Illustrative Example (Contd.)

In 2014, the entity reported;

		KShs.
Revenue from taxation		340,000
User charges		30,000
Other operating revenue		300,000
Total Revenue		670,000
Expenses		(600,000)
Surplus		70,000

Illustrative Example (Contd.)

The 2014 opening accumulated surplus was KShs. 200,000, and closing accumulated surplus was Kshs. 270,000.

The entity had no other revenue or expenses.

The entity had Kshs. 50,000 of contributed capital throughout, and no other components of net assets/equity except for accumulated surplus.

Illustrative Example (Contd.)

Public Sector Entity Statement of Financial Performance:

		2015		2014 (restated)
		Kshs.		Kshs.
Revenue from taxation		535,000		405,000
User charges		40,000		30,000
Other operating revenue		400,000		300,000
Total Revenue		975,000		735,000
Expenses		(865,000)		(600,000)
Surplus		110,000		135,000

Illustrative Example (Contd.)

Public Sector Entity Statement of Changes in Equity:

	Contributed Capital	Accumulated Surpluses	Total
	KShs.	KShs.	KShs.
Balance as at 31 December 2013	50,000	200,000	250,000
Surplus for the year ended December 31 2014 as restated	-	135,000	135,000
Balance as at 31 December 2014	50,000	335,000	385,000
Surplus for the year ended December 31 2015	-	110,000	110,000
Balance as at 31 December 2015	50,000	445,000	495,000

Illustrative Example (Contd.)

Extracts from Notes to the Financial Statements

1. Revenue from taxation of KSHs. 65,000 was incorrectly omitted from the financial statements of 2014. The financial statements of 2014 have been restated to correct this error. The effect of the restatement on those financial statements is summarised below. There is no effect in 2015.

Illustrative Example (Contd.)

Tabulated effect on the financial statements

		Effect on 2014
		Kshs.
Increase revenue		65,000
		________
Increase in surplus		65,000
		________
Increase in debtors		65,000
		________
Increase in net assets/equity		65,000
		======

Illustrative Example 2: A change of accounting policy with retrospective application

During 2015, an entity changed its accounting policy for the treatment of borrowing costs that are directly attributable to the acquisition of a hydro-electric power station that is under construction.

In previous periods, the entity had capitalized such costs. The entity has now decided to expense, rather than capitalize them.

Management judges that the new policy is preferable, because it results in a more transparent treatment of finance costs and is consistent with local industry practice, making the entity's financial statement more comparable

Illustrative Example 2 (Contd.)

The entity capitalized borrowing costs incurred of KShs. 26,000 during 2014 and KShs. 52,000 in periods prior to 2014.

All borrowing costs incurred in previous years with respect to the acquisition of the power station were capitalized.

The accounting records for 2015 show surplus before interest of Kshs. 300,000 and interest expense of KShs. 30,000 (which relates to 2015)

Illustrative Example 2 (Contd.)

The entity has not recognized any depreciation on the power station because it is not yet in use.

In 2014, the entity reported;

		KShs.
Surplus before interest		180,000
Interest expense		-
Surplus		180,000

Illustrative Example 2 (Contd.)

2014 opening accumulated surpluses was KShs. 200,000 and closing accumulated surpluses was KShs. 380,000.

The entity had KShs. 100,000 of Contributed capital throughout, and no other components of net assets/equity except for accumulated surplus.

Illustrative Example (Contd.)

Public Sector Entity Statement of Financial Performance:

		2015		**2014 (restated)**
		Kshs.		Kshs.
Surplus before interest		300,000		180,000
Interest Expense		30,000		26,000
Surplus		270,000		154,000

Illustrative Example (Contd.)

Public Sector Entity Statement of Changes in

	Contributed Capital KShs.	Accumulated Surpluses KShs.	Total KShs.
Balance as at 31 December 2013 as previously reported	100,000	200,000	300,000
Change in accounting policy with respect to the capitalisation of interest	-	(52,000)	(52,000)
Balance as at 31 December 2013	100,000	148,000	248,000
Surplus for the year ended 31 December 2014 (restated)	-	154,000	154,000
Balance as at 31 December 2014	100,000	302,000	402,000
Surplus for the year ended December 31 2015	-	270,000	270,000
Balance as at 31 December 2015	100,000	572,000	672,000

Illustrative Example (Contd.)

Extracts from Notes to the Financial Statements

1. During 2015, the entity changes its accounting policy for the treatment of borrowing costs related to a hydro-electric power station. Previously, the entity capitalised such costs. They are now written off as expenses as incurred. Management judges that this policy provides reliable and more relevant information, because it results in a more transparent treatment of finance costs and is consistent with local industry practice, making the financial statements more comparable.

Illustrative Example (Contd.)

Tabulated effect on the financial statements

		Kshs.
Effect on 2014		
(Increase) in interest expense		26,000
		________
(Decrease) in surplus		26,000
		________
Effect on periods prior to 2014		
(Decrease) in surplus		52,000
		________
(Decrease) in assets in the course of construction and in accumulated surplus		78,000
		======

Illustrative Example 3: Prospective Application of a Change in Accounting Policy when Retrospective Application is not applicable

During 2015, an entity changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a components approach, while at the same time adopting the revaluation model.

In years before 2015, the entity's asset records were not sufficiently detailed to apply a components approach fully.

At the end the year 2014, management commissioned an engineering survey.

Illustrative Example (Contd.)

The survey provided information on the components held and their fair value, useful lives, estimated residual values, and depreciable amounts at the beginning of 2015.

It however did not provide a sufficient basis for reliably estimating the cost of those components that had not previously been accounted for separately, and the existing records before the survey did not permit this information to be reconstructed.

Illustrative Example (Contd.)

Management considered how to account for each of the two aspects of the accounting change.

They determined that it was not practicable to account for the change to a fuller components approach retrospectively, or to account for that change prospectively from any earlier date than the start of 2015.

Also, the change from a cost model to a revaluation model is required to be accounted for prospectively.

Therefore, management concluded that it should apply the entity's new policy prospectively from the start of 2015.

Illustrative Example (Contd.)

Additional Information:

		Kshs.	
Property, plant and equipment			
Cost		**250,000**	
Depreciation		**(140,000)**	
		________	
Net Book Value		**110,000**	
		________	
Prospective depreciation expense for 2015		**15,000**	

Illustrative Example (Contd.)

Prospective depreciation expense for 2015 (old basis):

Some results of the engineering survey			
Valuation			170,000
Estimated residual value			30,000
Average remaining assets life (years)			
			7
Depreciation expense on existing property, plant and equipment for 2015			20,000

Illustrative Example (Contd.)

Extracts from Notes to the Financial Statements

1. From the start of 2015, the entity changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a components approach, while at the same time adopting the revaluation model.

Management takes the view that this policy provides reliable and more relevant information, because it deals more accurately with the components of property, plant and equipment and is based on up-to-date values.

Illustrative Example (Contd.)

Extracts from Notes to the Financial Statements

The policy has been applied prospectively from the start of 2015, because it was not practicable to estimate the effects of applying the policy either retrospectively or prospectively from any earlier date.

Accordingly, the adopting of the new policy has no effect on prior periods.

Illustrative Example (Contd.)

Extracts from Notes to the Financial Statements

The effect on the current year is to:

a) Increase in the carrying amount of property, plant and equipment as the start of the year by KShs. 60,000

b) Create a revaluation reserve at the start of the year of KShs. 60,000

c) Increase depreciation expense by Kshs. 5,000

Illustrative Example 4

IAS 8/IPSAS 3 specifies disclosure requirements "[w]hen an entity has not applied a new IFRS/IPSAS that has been issued but is not yet effective".

Q. Is the application of this paragraph limited to IFRSs/IPSAS issued before the end of the reporting period, or are the disclosures also required in respect of IFRSs/IPSAS issued between the end of the reporting period and the date when the financial statements are authorized for issue?

Solution

- The disclosures required by IAS 8/IPSAS 3 should be made in respect of all IFRSs/IPSAS issued before the date of issue of the financial statements that are not yet effective.
- It will be helpful if the relevant note to the financial statements either specifies the date at which the details are given or refers explicitly to them being as at the date of authorization of the financial statements.

Illustrative Example 5

Should an entity consider applying the requirements of IFRSs/IPSAS even when the effect is not material?

Solution

- IAS 8/IPSAS 3 states that the accounting policies required under IFRSs/IPSAS “need not be applied when the effect of applying them is immaterial”.
- However, the Standard also clarifies that this does not mean that immaterial departures from IFRSs/IPSAS can be made, or left uncorrected, in order to achieve a particular presentation of an entity’s financial positions, performance or cash flows.

Solution

- In practice, an entity will sometimes wish to consider applying the requirements of IFRSs/IPSAS even when the effect is immaterial.
- This is in part because materiality is subject to judgement based on both quantitative and qualitative factors, but also because items that are not material in the current period may become material in a subsequent period.

Illustrative Example 6

How should a change in accounting estimate be presented in profit or loss?

Solution

- When a change in an accounting estimate is recognised in profit or loss, the change should be recognised in the same line item as the underlying item except when an IFRS/IPSAS requires a different treatment.
- For example, if the best estimate of a provision for a legal claim is reduced, the credit in profit or loss should be included within the same expense heading as the original expense was recognised.
- This ensures that the cumulative expense recognised under that heading is correct.

Solution

- The disclosure requirements of IAS 8/IPSAS 3 should be complied with.
- In addition, if the change in accounting estimate causes a material distortion in a particular expense heading, additional disclosure may be required in accordance with of IAS 1/IPSAS 1 Presentation of Financial Statements.

Deloitte Q&A