IASB documents published to accompany

IAS 8

Accounting Policies, Changes in Accounting Estimates and Errors

The text of the unaccompanied standard, IAS 8, is contained in Part A of this edition. Its effective date when issued was 1 January 2005. The text of the Basis for Conclusions on IAS 8 is contained in Part C of this edition. This part presents the following document:

IMPLEMENTATION GUIDANCE

Guidance on implementing
IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

This guidance accompanies, but is not part of, IAS 8.

Example 1 – Retrospective restatement of errors

1.1	During 20X2, Beta Co discovered that some products that had been sold during 20X1 were incorrectly included in inventory at 31 December 20X1 at CU6,500.[1]
1.2	Beta's accounting records for 20X2 show sales of CU104,000, cost of goods sold of CU86,500 (including CU6,500 for the error in opening inventory), and income taxes of CU5,250.
1.3	In 20X1, Beta reported:

	CU
Sales	73,500
Cost of goods sold	(53,500)
Profit before income taxes	20,000
Income taxes	(6,000)
Profit	14,000

1.4	20X1 opening retained earnings was CU20,000 and closing retained earnings was CU34,000.
1.5	Beta's income tax rate was 30 per cent for 20X2 and 20X1. It had no other income or expenses.
1.6	Beta had CU5,000 of share capital throughout, and no other components of equity except for retained earnings. Its shares are not publicly traded and it does not disclose earnings per share.

Beta Co Extract from the statement of comprehensive income

		(restated)
	20X2	20X1
	CU	CU
Sales	104,000	73,500
Cost of goods sold	(80,000)	(60,000)
Profit before income taxes	24,000	13,500
Income taxes	(7,200)	(4,050)
Profit	16,800	9,450

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1   In these examples, monetary amounts are denominated in 'currency units (CU)'.

Beta Co Statement of changes in equity

	Share capital	Retained earnings	Total
	CU	CU	CU
Balance at 31 December 20X0	5,000	20,000	25,000
Profit for the year ended 31 December 20X1 as restated		9,450	9,450
Balance at 31 December 20X1	5,000	29,450	34,450
Profit for the year ended 31 December 20X2		16,800	16,800
Balance at 31 December 20X2	5,000	46,250	51,250

Extracts from the notes

1   Some products that had been sold in 20X1 were incorrectly included in inventory at 31 December 20X1 at CU6,500. The financial statements of 20X1 have been restated to correct this error. The effect of the restatement on those financial statements is summarised below. There is no effect in 20X2.

	Effect on 20X1
	CU
(Increase) in cost of goods sold	(6,500)
Decrease in income tax expense	1,950
(Decrease) in profit	(4,550)
(Decrease) in inventory	(6,500)
Decrease in income tax payable	1,950
(Decrease) in equity	(4,550)

Example 2 – Change in accounting policy with retrospective application

[Deleted]

Example 3 – Prospective application of a change in accounting policy when retrospective application is not practicable

[Deleted]

Example 4 – Applying the definition of accounting estimates—Fair value of an investment property

Fact pattern

4.1 Entity A owns an investment property that it accounts for by applying the fair value model in IAS 40 *Investment Property*. Since it acquired the investment property, Entity A has been measuring the investment property's fair value using a valuation technique consistent with the income approach described in IFRS 13 *Fair Value Measurement*.

4.2 However, because of changes in market conditions since the previous reporting period, Entity A changes the valuation technique it uses to a valuation technique consistent with the market approach described in IFRS 13. Entity A has concluded that the resulting measurement is more representative of the investment property's fair value in the circumstances existing at the end of the current reporting period and, therefore, that IFRS 13 permits such a change. Entity A has also concluded that the change in the valuation technique is not a correction of a prior period error.

Applying the definition of accounting estimates

4.3 The fair value of the investment property is an accounting estimate because:

(a) the fair value of the investment property is a monetary amount in the financial statements that is subject to measurement uncertainty. Fair value reflects the price that would be received or paid in a hypothetical sale or purchase transaction between market participants—accordingly, it cannot be observed directly and must instead be estimated.

(b) the fair value of the investment property is an output of a measurement technique (a valuation technique) used in applying the accounting policy (fair value model).

(c) in developing its estimate of the fair value of the investment property, Entity A uses judgements and assumptions, for example, in:

(i) selecting the measurement technique—selecting the valuation technique that is appropriate in the circumstances; and

(ii) applying the measurement technique—developing the inputs that market participants would use in applying the valuation technique, such as information generated by market transactions involving comparable assets.

4.4 In this fact pattern, the change in the valuation technique is a change in the measurement technique applied to estimate the fair value of the investment property. The effect of this change is a change in an accounting estimate because the accounting policy—to measure the investment property at fair value—has not changed.

Example 5 – Applying the definition of accounting estimates—Fair value of a cash-settled share-based payment liability

Fact pattern

5.1   On 1 January 20X0, Entity A grants 100 share appreciation rights (SARs) to each of its employees, provided the employee remains in the entity's employment for the next three years. The SARs entitle the employees to a future cash payment based on the increase in the entity's share price over the three-year vesting period starting on 1 January 20X0.

5.2   Applying IFRS 2 *Share-based Payment,* Entity A accounts for the grant of the SARs as cash-settled share-based payment transactions—in doing so it recognises a liability for the SARs and measures that liability at its fair value (as defined by IFRS 2). Entity A applies the Black–Scholes–Merton formula (an option pricing model) to measure the fair value of the liability for the SARs at 1 January 20X0 and at the end of the reporting period.

5.3   At 31 December 20X1, because of changes in market conditions since the end of the previous reporting period, Entity A changes its estimate of the expected volatility of the share price—an input to the option pricing model—in estimating the fair value of the liability for the SARs at that date. Entity A has concluded that the change in that input is not a correction of a prior period error.

Applying the definition of accounting estimates

5.4   The fair value of the liability is an accounting estimate because:

(a)   the fair value of the liability is a monetary amount in the financial statements that is subject to measurement uncertainty. That fair value is the amount for which the liability could be settled in a hypothetical transaction—accordingly, it cannot be observed directly and must instead be estimated.

(b)   the fair value of the liability is an output of a measurement technique (option pricing model) used in applying the accounting policy (measuring a liability for a cash-settled share-based payment at fair value).

(c)   to estimate the fair value of the liability, Entity A uses judgements and assumptions, for example, in:

(i)   selecting the measurement technique—selecting the option pricing model; and

(ii)   applying the measurement technique—developing the inputs that market participants would use in applying that option pricing model, such as the expected volatility of the share price and dividends expected on the shares.

5.5   In this fact pattern, the change in the expected volatility of the share price is a change in an input used to measure the fair value of the liability for the SARs at 31 December 20X1. The effect of this change is a change in accounting estimate because the accounting policy—to measure the liability at fair value —has not changed.