



HM TREASURY

Financial Reporting Advisory Board Paper

IAS 8: Accounting Policies, Changes in Accounting Estimates and Errors

Issue:	Applying IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i> in the context of resource accounts covered by the Government Financial Reporting Manual
Impact on guidance:	The proposed text in Annex A relates to the IFRS-based FReM.
IAS/IFRS adaptation?	No
IPSAS compliant?	No; IPSAS 3 <i>Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies</i> and IAS 8 are now out-of-line following the 2004 revision of IAS 8.
Interpretation for the public sector context?	No
Impact on budgetary regime?	No
Alignment with National Accounts	N/A
Impact on Estimates?	None
Recommendation:	That the Board agree that IAS 8 applies in full to entities covered by the IFRS-based FReM
Timing:	Not yet known: depends on future decision on date for moving to EU-adopted IFRS.

DETAIL

Background

1. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* was issued so as to be effective for all periods beginning on or after 1 January 2005. It replaces the previous version of IAS 8 *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policy* (revised in 1993).

Objective of IAS 8

2. The objective of the Standard 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 treatment and correction of errors.

Main features of IAS 8

3. The Standard has three main sections: Accounting Policies, Changes in Accounting Estimates, and Errors. The main features of each are considered in turn.

Accounting Policies

4. Where a transaction, event or condition falls within a Standard or Interpretation issued by the IASB the accounting policy or policies applied to that item shall be determined by applying the Standard or Interpretation and considering any relevant Implementation Guidance.

5. In the absence of a Standard or Interpretation that specifically applies to a transaction, event or condition judgement should be used to develop an accounting policy that is relevant and reliable.

6. In making the judgement necessary to develop an accounting policy that is relevant and reliable consideration should be given to the requirements and guidance in Standards and Interpretations dealing with similar and related issues; and the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the IASB's *Framework for the Preparation and Presentation of Financial Statements*.

7. In making the judgement described above consideration may also be given to the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to that of the IASB to develop accounting standards.

8. Entities shall select and apply accounting policies consistently.

9. Entities shall change accounting policies only if the change is required by a Standard or Interpretation or results in 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.

10. The application of an accounting policy for transactions that differ in substance from previous transactions or the application of a new accounting policy for transactions that have not previously occurred (or were not previously material) are not changes in accounting policy.

11. Where a change in accounting policy results from the initial application of a Standard or Interpretation the change should be accounted for using the specific transitional provisions in the Standard or Interpretation. Where a Standard or Interpretation includes no transitional provisions or a change is made voluntarily it shall be applied retrospectively.

12. A change in accounting policy is applied retrospectively by adjusting the opening balance of each affected component of equity (reserves) for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.

13. A change in accounting policy should be applied retrospectively except where it is impracticable to determine the period specific events or the cumulative effect of the change. Where it is impracticable to determine period specific events or the cumulative effect the new accounting policy should be applied as at the beginning of the earliest practicable accounting period, which may be the existing period. Where it is not practicable to effect the new accounting policy retrospectively it should be applied prospectively from the earliest date practicable.

Changes in Accounting Estimates

14. A change in an accounting estimate shall be recognised prospectively by including it in the profit or loss in the period of the change and future periods, as appropriate, or to the extent that a change in estimates gives rise to a change in assets, liabilities or equity it should be recognised by adjusting the relevant carrying amount.

Errors

15. Entities shall correct all material prior period errors retrospectively except where it is impracticable to determine the period specific events or the cumulative effect of the change (the rules on impracticability being the same as those relating to the retrospective application of changes in accounting policy).

Comparison with requirements of UK GAAP

16. The guidance contained in IAS 8 is provided across 2 UK standards, FRS 18 *Accounting Policies* and FRS 3 *Reporting Financial Performance*, which, amongst other things, provides guidance on prior period adjustments. The requirements of IAS 8 are similar to those of the relevant extracts of FRS 18 and FRS 3 but with the following differences:

17. IAS 8 provides detailed guidance on the circumstances under which retrospective application of changes in accounting policies or the correction of errors is impracticable (which the Standard refers to as the 'impracticability criterion'). Similar guidance is not provided in FRS 3.

18. FRS 3 requires that prior period adjustments are only made for accounting policy changes and fundamental errors. The requirements of IAS 8 are similar in respect of accounting policy changes but in relation to errors the requirement is that all material errors are retrospectively corrected. FRS 3 defines a fundamental error as being of such significance as to destroy the true and fair view of the financial statements. IAS 8 states errors are material if they could individually or collectively

influence the economic decisions of users. IAS 8 would therefore appear to set a lower threshold for the correction of prior period errors than does FRS 3.

19. The process for determining accounting policies in IAS 8 is broadly the same as in FRS 18. However, FRS 18 provides greater guidance on the objectives against which the appropriateness of accounting policies should be judged than that given in IAS 8. FRS 18 additionally requires that comparability and understandability are taken into account, however both concepts are key components of the Qualitative Characteristics of Financial Statements section of the IASB's Framework for the Preparation and Presentation of Financial Statements.

20. FRS 18 states that 'going concern' and 'accruals' have a pervasive role in financial statements and hence the selection of accounting policies. This direct linkage of these concepts with accounting policies does not form part of IAS 8. The IASB cover these concepts in IAS 1 *Presentation of Financial Statements* as part of its discussion of the 'overall considerations' when preparing financial statements.

21. In the absence of a Standard or Interpretation that specifically applies to a transaction, event or condition, in addition to considering the requirements and guidance given in Standards and Interpretations dealing with similar and related issues, IAS 8 allows entities to consider the pronouncements of other standard setters where these do not conflict with International Standards or Interpretations. There is no similar allowance in FRS 18.

22. IAS 8 states that when it is difficult to distinguish a change in accounting policy from a change in accounting estimate, it is treated as a change in an accounting estimate. FRS 18 makes no similar statement.

Impact of IAS 8 on public sector accounts

23. The differences between IAS 8 and the relevant parts of FRS 3 and FRS 18 are not great and have little practical effect on the underlying accounting.

24. The FReM requires (at 7.4.18) that where entities need to make prior period adjustments they should contact the relevant authority to ensure that the budgeting implications have been properly considered. As IAS may result in an increase in prior period adjustments due to the lower threshold set by IAS 8 for such adjustments when compared to FRS 3 (material rather than fundamental errors), this requirement should be retained.

Impact on disclosures in resource and other accounts

25. The disclosure requirements of IAS 8 are similar to the relevant disclosure requirements of FRS 3 and FRS 18. However, IAS 8 requires the disclosure of impending changes in accounting policy with an estimate of the impact of the change. IAS 8 also requires detailed disclosure of the result of changes in accounting policy and corrections of errors on financial statement line items.

IAS/IFRS compliance

26. The proposal in this paper is that IAS 8 is applied without adaptation or interpretation.

IPSAS compliance

27. No. Coverage is provided in IPSAS 1 *Presentation of Financial Statements* and IPSAS 3 *Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies*. The selection of accounting policy requirements in IPSAS 1 mirrors those in IAS 8. However, IPSAS 3 is now out of step with some of the prior period correction requirements of IAS 8 following its 2004 revision. Specifically, IPSAS 3 only allows for prior period corrections in relation to fundamental errors and also allows the alternative treatment, which has been removed from IAS 8, for prior periods adjustment; taking the adjustment to profit and loss in the current periods.

Proposed text for the IFRS-based Government Financial Reporting Manual

28. See Annex A for the proposed amendments to IFRS-based FReM.

Impact on the budgetary regime

29. There is no change in the underlying accounting and therefore there should be no change in the budgeting regime. However the lower threshold for the correction of prior period adjustments in IAS 8 should be noted.

Summary and recommendation

30. While there are some differences in the factors to be taken into account when selecting accounting policies and in the definition of errors that should be subject to retrospective correction as compared to UK GAAP IAS 8 does not materially change any of the underlying accounting. The Board is invited to approve the proposed text for the IFRS-based FReM at Annex A.

**HM Treasury
December 2006**

ANNEX A

**PROPOSED TEXT FOR THE IFRS-BASED GOVERNMENT FINANCIAL
REPORTING MANUAL**

IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

Applicability

IAS 8 applies in full.

Objectives of IAS 8

The objective of the Standard 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 treatment and correction of errors.

Other requirements

The following requirements should be observed.

- a) Preparers should consult the relevant authorities (through sponsoring bodies where appropriate) about any novel or contentious accounting policies they might propose to adopt to reflect their specific circumstances.
- b) Where preparers consider it necessary to adjust retrospectively for changes in accounting policies or material errors, they should first contact the relevant authority (through sponsoring bodies where appropriate) to ensure that the budgeting and Estimates implications have been properly considered.