

# AASB 108 'Accounting Policies, Changes in Accounting Estimates and Errors' Summary

## OVERVIEW

- Accounting Standard AASB 108 will replace Accounting Standard AAS 6/AASB 1001 'Accounting Policies' and the provisions in AASB 1018 'Statement of Financial Performance' and AAS 36/AASB 1040 'Statement of Financial Position' relating to changes in accounting estimates and the correction of errors. AASB 108 adopts IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' with AASB added material to address application in Australia.
- The most significant differences between AASB 108 and the existing requirements are in accounting for voluntary changes in accounting policy and the correction of errors. There are also differences in the selection and application of accounting policies and in the disclosures required.
- AASB 108 requires a voluntary change in accounting policy to be applied retrospectively and adjustments to be made against the opening balance of equity in the earliest prior period presented in the financial statements. AASB 1001 also requires changes to be applied retrospectively. However, the cumulative financial effect of the change up to the end of the preceding year must be recognised in the Statement of Financial Performance in the current year (the year in which the change is made).
- AASB 108 requires all material prior period errors to be adjusted by restating the comparatives to reflect changes for all the prior periods as if the error had never occurred. The current requirements in AASB 1018 and AASB 1040 allow errors to be corrected by reissuing the financial report relating to the preceding reporting period or by recognising the adjustments required in the current financial statements.
- AASB 1018 and AASB 1040 distinguish between errors and fundamental errors (errors that render financial reports unreliable). There are specific disclosure requirements in both AASB 1018 and AASB 1040 for fundamental errors. AASB 108 does not identify fundamental errors. The disclosure requirements cover all material errors.
- The requirement in AASB 1001 to disclose a summary of accounting policies is now addressed in AASB 101 'Presentation of Financial Statements'.
- The changes to the accounting requirements for changes in voluntary accounting policies and adjustment of prior period errors may impact on the profit and loss under the current requirements. Under AASB 108 there will be no impact on the current profit and loss.

- Consequently, the AASB 108 requirements will have an impact on the financial statements for all entities where accounting policies are changed or prior period errors corrected. No material impact is expected on Financial Targets. Limited impact is expected on the whole of government financial statements.

## **INTRODUCTION**

AASB 108 will replace Accounting Standard AAS 6/AASB 1001 'Accounting Policies' and the provisions in AASB 1018 'Statement of Financial Performance' and AAS 36/AASB 1040 'Statement of Financial Position' relating to changes in accounting estimates and the correction of errors. AASB 108 adopts IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' with AASB added material to address application in Australia. The AASB 1001 requirement to disclose a summary of accounting policies is now included in AASB 101 'Presentation of Financial Statements'.

AASB 108 prescribes the requirements for selecting and changing accounting policies and accounting for changes in accounting policies, changes in estimates and correction of material errors.

## **APPLICATION DATE**

The AASB intends to make the Standard applicable from the first reporting period beginning on or after 1 January 2005.

## **TRANSITIONAL PROVISIONS**

Under AASB 1, agencies with a 30 June year end must produce an opening balance sheet at 1 July 2004 (unpublished) that is compliant with Australian International Financial Reporting Pronouncements (AIFRPs). Accounting policies used in the opening balance sheet may differ from those used under existing GAAP at the same date. Any resulting adjustments required are to be taken direct to the balance sheet. Paragraph 7 of AASB 1 requires entities to use the same accounting policies in this opening balance sheet and throughout all periods presented in its first AIFRP financial report.

AASB 1 provides some exceptions (listed in paragraph 13) to the requirement to the principle that the opening balance sheet must be compliant with each AIRFP. The key exemption is the deeming of fair value or revaluation as deemed cost for property, plant and equipment.

## **KEY DIFFERENCES FROM THE EXISTING AUSTRALIAN STANDARD**

### **Selection of accounting policies**

AASB 1001 (paragraph 4.1) requires accounting policies to be selected and applied in a manner to ensure relevance and reliability. Commentary states that where policies to be applied in particular circumstances are not specified in the Standard or a UIG Consensus View, the entity should consider the following pronouncements in this order:

- the requirements or guidance in another AASB dealing with similar or related issues;
- the requirements or guidance in a UIG Consensus View dealing with similar or related issues;
- SAC 4 'Definition and Recognition of the Elements of Financial Statements';
- IAS and interpretations of the Standing Interpretations Committee (of the IASC); and
- the pronouncements of other national accounting standard setting bodies.

AASB 108 requires that in the absence of an AASB, accounting policy is determined on the basis of relevance and reliability. Reference is to be made to:

- the requirements or guidance in another AASB dealing with similar or related issues; and
- the Framework.

AASB 108 states that policies set out in AASBs need not be applied if the effect of applying them is immaterial. However, it is inappropriate to make immaterial departures to achieve a particular result (paragraph 8).

Apart from these differences, the attribute of prudence is included in the concept of reliability in AASB 108.

### **Consistency of accounting policies**

AASB 1001 requires accounting policies to be applied in a manner that ensures comparability and understandability. AASB 108 (paragraph 13) requires an entity to apply consistent policies for similar transactions unless an AASB requires or permits categorisation of transactions to which different policies may be appropriate. Where this occurs, accounting policy must be applied consistently to each category.

## **Accounting for voluntary changes in accounting policy**

Under AASB 1001 two types of changes in accounting policy are permitted. A mandatory change in accounting policy is made when an AASB or an UIG Consensus View requires it. A voluntary change in accounting policy can be made when no specific AASB applies, or an AASB permits alternative accounting policies, **and** the change will result in more relevant and reliable information.

AASB 1001 currently requires voluntary changes in accounting policy to be applied retrospectively. The cumulative financial effect to the end of the preceding financial year, calculated as if the policy had always applied, must be recognised as a **revenue or expense** in the Statement of Financial Performance in the current year, ie, in the year in which the change is made. Comparative information on the face of the financial statements must not be changed. Disclosure of restated comparative is required in the notes.

AASB 108 (paragraph 19(b)) requires a voluntary change in accounting policy (and a change in accounting policy upon initial application of an AASB that does not include transitional provisions) to be applied retrospectively. Paragraph 22 requires retrospective adjustments to be made against the **opening balance of equity** in the earliest prior period (comparatives) presented in the financial statements. Other amounts disclosed in the comparatives are also adjusted as if the policy had always applied.

Note that the paragraph 22 requirements also apply to a change in accounting policy upon initial application of an AASB where retrospective application is prescribed in the transitional provisions.

*This change in requirements can impact on the profit and loss. For example, where an agency increases their capitalisation threshold, all existing assets under the threshold will need to be written-off under both the current and new requirements. However, under the current requirements the total write-off would be recognised as an expense in the statement of financial performance for the current financial year. Under AASB 108, the asset values and accumulated profit or loss would be adjusted (to reflect the write-off) in the comparatives included in the current year's financial statements.*

## **Accounting for voluntary changes in accounting policy where it is impractical to determine the cumulative financial effect**

Where it is not practical to determine the cumulative financial effect up to the end of the preceding financial year of a change in accounting policy, AASB 1001 currently requires the new policy to be applied from the beginning of the current financial year.

AASB 108 (paragraph 25) requires new policy to be applied prospectively from the earliest practical date where it is impractical to determine the cumulative financial effect of all prior periods. The comparative information is adjusted to reflect the cumulative financial effect from this date. Cumulative adjustments to assets, liabilities and equity arising before this date are disregarded.

AASB 108 provides guidance on determining the impracticality of retrospective application (paragraphs 50 to 53).

In summary, where it is not practical to determine the cumulative financial effect of all prior periods, retrospective application is not required under AASB 1001, whereas AASB 108 requires retrospective application from the start of the earliest period practicable.

*This difference will not impact on the profit and loss.*

### **Disclosing changes in accounting policies**

AASB 108 (paragraph 28) prescribes the disclosures required on initial application of an AASB where this has a financial effect on the current or any prior period or might have an effect on future periods. The disclosure requirements for voluntary changes in accounting policies are prescribed in paragraph 29 of AASB 108.

AASB 1001 (paragraph 8.4) prescribes the disclosure requirements for all changes in accounting policy made in the current financial year where there is an effect on the current or any prior financial years or is expected to have an effect on a subsequent financial year.

There are some differences in disclosure that are consequent to the differences between AASB 1001 and AASB 108 in the manner of accounting for the cumulative effect of a change in accounting policy. For example, where retrospective application is impractical for a particular prior period(s), AASB 108 requires the disclosure of the circumstances and details of how and when the change is applied. There is no retrospective application in AASB 1001 where it is not practicable to determine the cumulative financial effect of a change in accounting policy. Apart from such differences, there are no significant differences between paragraphs 28 and 29 of AASB 108 and paragraph 8.4 of AASB 1001.

AASB 1001 (paragraph 8.5) prescribes disclosure requirements where a change that was made in the preceding financial year and did not have a material effect in that year but has a material effect in the current year. AASB 108 does not specifically address such changes, but arguably this requirement could be read into AASB 108 paragraphs 28 and 29.

Note that paragraph 30 of AASB 108 prescribes the disclosures required regarding the possible impact of application where an entity has not applied a new AASB that has been issued but is not yet effective. AASB 1001 only encourages similar disclosures.

### **Accounting for changes in estimates**

AASB 1018 requires a revision in accounting estimates to be recognised as a revenue or expense in the period in which the estimate is revised (and future reporting periods where relevant). The revision must be included in the same category within the Statement of Financial Performance.

AASB 108 (paragraph 36) requires changes in accounting estimates to be recognised in the same manner. AASB 108 does not specify that the revision must be included in the same category within the Income Statement.

### **Disclosure of changes in estimates**

AASB 1018 and AASB 108 both require the nature and amount of a revision to be disclosed. The effect on the current and future periods is required. Where it is impractical to determine the effect on future periods, AASB 108 requires the entity to disclose this fact while AASB 1018 does not.

### **Accounting for errors**

The current requirements in AASB 1018 and AASB 1040 allow errors to be corrected by reissuing the financial report relating to the preceding reporting period or by recognising the adjustments required in the current financial statements.

AASB 108 (paragraph 43) requires all material prior period errors to be adjusted by restating the comparatives. If the error occurred before the comparative period presented, only the opening assets, liabilities and equity of the comparatives will be adjusted. Note that paragraph 45 of AASB 108 requires an error to be corrected prospectively from the earliest practical date where it is impractical to determine the cumulative financial effect of all prior periods. The comparative information is adjusted to reflect the cumulative financial effect of the error from this date. Cumulative adjustments to assets, liabilities and equity arising before this date are disregarded.

*Under the current requirements, material errors may impact on profit and loss. Under AASB 108 there is no impact on the current profit and loss from the adjustment of prior period errors.*

### **Disclosing errors**

AASB 1018 and AASB 1040 distinguish between errors and fundamental errors - errors that render financial reports unreliable. There is no difference in accounting for fundamental errors but there are specific disclosure requirements in both AASB 1018 and AASB 1040 for fundamental errors where the reissue of a financial report has not rectified the error. AASB 108 does not identify fundamental errors. The disclosure requirements in AASB 108 cover all material errors.

The key disclosures required by AASB 108 are:

- the nature of the prior period error;
- the amount of the correction for each line item in the comparatives;
- the amount of the correction at the beginning of the comparative period; and
- if full retrospective correction is impractical - the reasons why and how and from when the error has been corrected.

These requirements are similar to the requirements under the current standards.

### **General disclosure requirements**

The general disclosure requirements detailed in AASB 1001 paragraphs 8.1 to 8.3 are now included in AASB 101 “Presentation of Financial Statements”. These include the requirement to disclose a summary of accounting policies and the disclosures required regarding the going concern basis.

## **IMPACT OF DIFFERENCES**

### **Effect on general reporting in the Public Sector**

The cumulative effect of applying a voluntary change in accounting policy retrospectively and correcting errors, currently impacts on the profit and loss of the period in which the change is made or error corrected. Under AASB 108 the cumulative financial effect of a voluntary change in accounting policy and the correction of errors are adjusted against the opening balance sheet for the earliest prior period presented in the financial statements. Consequently, where the correction of an error or a change in accounting policy has a material financial effect, the adoption of AASB 108 will have a material impact. The changes may allow some changes in accounting policy that in the past have been restricted because of impact on the profit and loss. Overall however, as the impact is limited to specific circumstances, the initial and ongoing impact is expected to be limited.