Indian Accounting Standard (Ind AS) 8

Accounting Policies, Changes in Accounting Estimates and Errors

Objective

1. criteria for selecting and changing accounting policies, together with the accounting treatment
2. disclosure of changes in accounting policies, changes inaccounting estimates and corrections of errors.

What are accounting policies?

Specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements

Selection and application of accounting policies

When an Ind AS specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the Ind AS.

if specific policy is covered under any Ind AS → Such Ind AS shall be applicable

Ind ASs set out accounting policies that result in financial statements containing relevant and reliable information about the transactions, other events and conditions to which they apply.

Are accounting policies applied to all transactions?

Those policies **need not be applied** when the effect of applying them is **immaterial**.

However, it is inappropriate to make, or leave uncorrected, immaterial departures from Ind ASs to achieve a particular presentation of an entity's financial position, financial performance or cash flows

effect of application of Ind AS is immaterial → need not be applied → should not lead to window framing

How to apply accounting policies?

Ind ASs are accompanied by guidance to assist entities in applying their requirements. All such guidance states whether it is an integral part of Ind ASs.

- Guidance that is an integral part of the Ind ASs is mandatory.
- Guidance that is not an integral part of the Ind ASs does not contain requirements for financial statements.

In the absence of an Ind AS that specifically applies to a transaction, other event or condition, 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, i.e. free from bias;
(iv) are prudent; and
(v) are complete in all material respects.

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

(a) the requirements in Ind ASs dealing with similar and related issues; and
(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.

In making the judgement, management may also first consider the most recent pronouncements of International Accounting Standards Board and in absence thereof those of the other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources above.

Consistency of accounting policies

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

Changes in accounting policies

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

(a) is required by an Ind AS; 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.

Users of financial statements need to be able to compare the financial statements of an entity over time to identify trends in its financial position, financial performance and cash flows. Therefore, the same accounting policies are applied within each period and from one period to the next unless a change in accounting policy meets one of the criteria specified above.

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; and
(b) the application of a new accounting policy for transactions, other events or conditions that did not occur previously or were immaterial.

1. **ABC Ltd. was making provision for non-moving stocks based on no issues for the last 12 months up to 31.3.2011. The company wants to provide during the year ending 31.3.2012 based on technical evaluation:**

Total value of stock	**Rs.100 lakhs**
Provision required based on 12 months issue	**Rs.3.5 lakhs**
Provision required based on technical evaluation	**Rs.2.5 lakhs**

Solution

The decision of making provision for non-moving stocks on the basis of technical evaluation does not amount to change in accounting policy. Accounting policy of a company may require that provision for non-moving stocks should be made. The method of estimating the amount of provision may be changed in case a more prudent estimate can be made

In the given case, considering the total value of stock, the change in the amount of required provision of non-moving stock fromRs.3.5 lakhs toRs.2.5 lakhs is also not material. The disclosure can be made for such change in the following lines by way of notes to the accounts in the annual accounts of ABC Ltd. for the year 2011-12

"The company has provided for non-moving stocks on the basis of technical evaluation unlike preceding years. Had the same method been followed as in the previous year, the profit for the year and the corresponding effect on the year end net assets would have been higher byRs.1 lakh."

The initial application of a policy to revalue assets in accordance with Ind AS 16 Property, Plant and Equipment or Ind AS 38 Intangible Assets is a change in an accounting policy to be dealt with as a revaluation in accordance with Ind AS 16 or Ind AS 38, rather than in accordance with this Standard.

Example

An entity has classified as investment property, an owner occupied property previously classified as part of property, plant and equipment where it was measured after initial recognition on a revaluation model. Ind AS 40 on investment property permits only cost model. The entity now measures this investment property at cost. This is not a change in accounting policy

Example

An entity was only trading in computer equipments and softwares. The revenue of sale of goods is recognised as per paragraph 14 of Ind AS 18, Revenue. It now decides to develop customised software. For this activity it wants to adopt paragraph 20 of Ind AS 18. This is not a change in accounting policy as development of customised software is a new business

Date of application of change in accounting policy

Subject to impracticability discussed later:

(a) an entity shall account for a change in accounting policy resulting from the initial application of an Ind AS in accordance with the specific transitional provisions, if any, in that Ind AS; and

(b) when an entity changes an accounting policy upon initial application of an Ind AS that does not include specific transitional provisions applying to that change, or changes an accounting policy voluntarily, it shall apply the **change retrospectively**.

For the purpose of this Standard, **early application of an Ind AS is not a voluntary change in accounting policy**.

RETROSPECTIVE APPLICATION	is applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.
RETROSPECTIVE RESTATEMENT	is correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.
IMPRACTICABLE	Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if: (a) the effects of the retrospective application or retrospective restatement are not determinable; (b) the retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or (c) the retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that: (i) provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognized, measured or disclosed; (ii) would have been available when the financial statements for that prior period were approved for issue from other information
PROSPECTIVE APPLICATION	of a change in accounting policy and of recognizing the effect of a change in an accounting estimate, respectively, are: (a) applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed; and (b) recognizing the effect of the change in the accounting estimate in the current and future periods affected by the change.

Presentation of retrospective adjustment

When a change in accounting policy is applied retrospectively, the entity shall **adjust the opening balance** of each affected component of equity 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.

2. **An entity starts a business in July 2X05. The business was small in nature and therefore the entity did not follow any specific accounting standards for valuation**

of inventory. Over the decade the entity flourishes, becomes a big company and decided to apply Ind AS 2 on inventories from the financial year 2X16- 2X17. It decided to follow the weighted average method for valuation of inventory. Now following questions will arise.

i. Shall entity do such valuation retrospectively or prospectively?

i. What is meant by retrospective application?

iii. If it is to be applied as if it was applied from July 2X05, then what about the accounts already presented? Does entity need to change all the accounts?

iv. How would the effect be given?

Solution

(i) It will depend upon whether the company is following the standard as per the new guidelines of Institute or is it applying voluntarily? In the above case, the entity itself is taking the decision to apply the standard and therefore it will be treated as voluntary application. If it falls under voluntary application then, the Ind AS 8 states that the policy should be applied retrospectively.

(ii)As per definition, retrospective application assumes that the policy had always been applied. It does not state any specific period. 'Had always been applied' indicates that policy was applied right from the day 1, i.e. from July 2X05.

(iii)The entity is not supposed to change the accounts which are already presented. However, it needs to give the effect of the change in policy while presenting the accounts for the year in which new policy is adopted. In the current case, the new policy is adopted from the F.Y. 2X16-2X17. Therefore, the effect will be given to the concerned items, in the financial statements of F.Y. 2X16-2X17.

(iv) Ind AS 8 states that the entity shall adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented

Limitations on retrospective application

1. When retrospective application is required, a change in accounting policy shall be applied retrospectively except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the change.
2. When it is impracticable to determine the period-specific effects of changing an 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.

3. When it is impracticable to determine the cumulative effect, at the beginning of the current period, of applying a new accounting policy to all prior periods, the entity shall adjust the comparative information to apply the new accounting policy prospectively from the earliest date practicable.

When an entity applies a new accounting policy retrospectively, it applies the new accounting policy to comparative information for prior periods as far back as is practicable. Retrospective

application to a prior period is not practicable unless it is practicable to determine the cumulative effect on the amounts in both the opening and closing balance sheets for that period. The amount of the resulting adjustment relating to periods before those presented in the financial statements is made to the opening balance of each affected component of equity of the earliest prior period presented. Usually the adjustment is made to retained earnings.
However, the adjustment may be made to another component of equity (for example, to comply with an Ind AS). Any other information about prior periods, such as historical summaries of financial data, is also adjusted as far back as is practicable.

3. **Continuing the above illustration, assume that company might be following the weighted average method of valuation of stock right from July 2X05. In reality, company might have applied other methods like specific identification, LIFO or FIFO etc. Company might have changed also the method during the period as it was not following any specific standard at that time. However, now, in F.Y. 2X16-2X17, the company decided to follow Ind AS and accordingly decides the weighted average method of valuation. Analyse**

Solution

The company needs to calculate the closing inventory of every year since 2X05-2X06 assuming that it was following the said method from day 1.
This will change the figure of gross profit and net profit as inventory valuation will make direct impact on the profits of the company. Net profits will affect the equity as well. Similarly, the closing balances of inventory from year to year will also change. Thus, company will make the calculations from the year 2X05-2X06 to 2X15-2X16.
The provisions further state that company will adjust the opening balances of equity and other related amounts for the earliest prior period presented. It means, if company is presenting the accounts for F.Y.2X16-2X17, it need to give comparative figures for F.Y.2X15-2X16 also. Therefore, the earliest prior period presented will be F.Y. 2X15-2X16 in the above mentioned case. Thus the net effect on profit of last 11 years (from F.Y. 2X05-2X06 to F.Y. 2X15-2X16) will be adjusted through the equity and inventory balances of the year 2X15-2X16.
Thereafter the new policy will be continued and every year the valuation of inventory will be done using weighted average method

When it is impracticable for an entity to apply a new accounting policy retrospectively, because it cannot determine the cumulative effect of applying the policy to all prior periods, the entity applies the new policy prospectively from the start of the earliest period practicable. It therefore disregards the portion of the cumulative adjustment to assets, liabilities and equity arising before that date.
Changing an accounting policy is permitted even if it is impracticable to apply the policy prospectively for any prior period.

Example

The company has been established 25 years ago. Now, is it supposed to incorporate the changes in accounting policy for last 25 years? Will it be practically possible? Will it be worth doing it? Will it be material? All these questions arise when one wants to change the accounting policy.

Example

An entity changed in 2X12 its accounting policy with respect to valuation of its inventory from

FIFO to weighted average cost formula. This being a voluntary change, it has to be applied retrospectively. The entity had commenced operation in 2X06. The records of all years are available except for 2X09 when due to floods, the same were washed away. It is not possible to recreate the records. It is therefore, impracticable to determine the period- specific impact for 2X09. The entity will apply the change in accounting policy from 2X10
Example An entity changed in 2X12 its accounting policy with respect to valuation of its inventory from FIFO to weighted average cost formula. This being a voluntary change, it has to be applied retrospectively. The entity had commenced operation in 2X06. No records of earlier years are available as a virus attack on server in 2X12 had wiped off all past records. It is not possible to recreate the records. It is therefore impracticable to determine the cumulative effect of change. The entity will apply the change in accounting policy from 2X12 only.

Disclosure relating to accounting policy

When initial application of an Ind AS has an effect on the current period or any prior period, would have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:

(a) the title of the Ind AS;
(b) when applicable, that the change in accounting policy is made in accordance with its transitional provisions;
(c) the nature of the change in accounting policy;
(d) when applicable, a description of the transitional provisions;
(e) when applicable, the transitional provisions that might have an effect on future periods;
(f) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:
    (i) for each financial statement line item affected; and
    (ii) if Ind AS 33 Earnings per Share applies to the entity, for basic and diluted earnings per share;
(g) the amount of the adjustment relating to periods before those presented, to the extent practicable; and
(h) if retrospective application required is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied. Financial statements of subsequent periods need not repeat these disclosures.

When a voluntary change in accounting policy has an effect on the current period or any prior period, would have an effect on that period except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:

(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) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:

i. for each financial statement line item affected; and
ii. if Ind AS 33 applies to the entity, for basic and diluted earnings per share;

(d) the amount of the adjustment relating to periods before those presented, to the extent practicable; and
(e) if retrospective application is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied. Financial statements of subsequent periods need not repeat these disclosures.

When an entity has not applied a new Ind AS that has been issued but is not yet effective, the entity shall disclose:

(a) this fact; and
(b) known or reasonably estimable information relevant to assessing the possible impact that application of the new Ind AS will have on the entity's financial statements in the period of initial application.

In complying with paragraph 30, an entity considers disclosing:

(a) the title of the new Ind AS;
(b) the nature of the impending change or changes in accounting policy;
(c) the date by which application of the Ind AS is required;
(d) the date as at which it plans to apply the Ind AS initially; and
(e) either:
    a. a discussion of the impact that initial application of the Ind AS is expected to have on the entity's financial statements; or
    b. if that impact is not known or reasonably estimable, a statement to that effect.

4. A Limited company has been including interest in the valuation of closing stock. In 2011-12, the management of the company decided to follow Ind AS 2 and accordingly interest has been excluded from the valuation of closing stock. This has resulted in a decrease in profits by Rs. 3,00,000. Is a disclosure necessary? If so draft the same.

Solution:

As per Ind AS 8, change in accounting policy can be made for many reasons, one of these is for compliance with an accounting standard. In the instant case, the company has changed its accounting policy in order to conform with the Ind AS 2 on Valuation of Inventories. Therefore, a disclosure is necessary in the following lines by way of notes to the annual accounts for the year 2011-2012.

"To be in conformity with the Accounting Standard on Valuation of Inventories issued by ICAI, interest has been excluded from the valuation of closing stock and similar effect has been carried out in preceding years."

5. During the year 2011-12, a medium size manufacturing company wrote down its inventories to net realizable value by Rs. 5,00,000. Is a separate disclosure necessary?

Solution

The nature and amount of such item may be relevant to users of financial statements in understanding the financial position and performance of an enterprise and in making projections about financial position and performance. Ind AS 8 states that:

"When items of income and expense within profit or loss from activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of theenterprise for the period, the nature and amount of such items should be disclosed separately."

Circumstances which may give to separate disclosure of items of income and expense in accordance withInd AS 8 include the write-down of inventories to net realisable value as well as the reversal of such write-downs.

6. **A company deals in petroleum products. The sale price of petrol is fixed by the government. After the Balance Sheet date, but before the finalisation of the company's accounts, the government unexpectedly increased the price retrospectively. Can the company account for additional revenue at the close of the year? Discuss.**

According to Ind AS 10, the unexpected increase in sale price of petrol by the government after the balance sheet date cannot be regarded as an event occurring after the Balance Sheet date, which requires an adjustment at the Balance Sheet date, since it does not represent a condition present at the balance sheet date. The revenue should be recognized only in the subsequent year with proper disclosures. The retrospective increase in the petrol price should not be considered as a prior period item because there was no error in the preparation of previous period's financial statements.

7. **XYZ Ltd. is in the process of finalizing its account for the year ended 31st March, 2016. The company seeks your advice on the following:**
   (i) The company's sale tax assessment for assessment year 2013-14 has been completed on 14th February, 2016 with a demand of 5.40 crore. The company paid the entire due under protest without prejudice to its right of appeal. The company files its appeal before the appellate authority wherein the grounds of appeal cover tax on additions made in the assessment order for a sum of 3.70 crore.
   (ii) The company has entered into a wage agreement in May 2016 whereby the labour union has accepted a revision in wage from June 2015. The agreement provides that the hike till May 2016 will not be paid to the employees but will be settled to them at the time of retirement. The company agrees to deposit the arrears in Government Bonds by September 2016. Assume that the negotiations for hike in wages had already started in the year 2015-16 i.e. before the balance sheet date

Since the company is not appealing against the addition of 1.70 crore (5.40 crore less 3.70 crore), therefore, the same should be provided/ expensed off in its accounts for the year ended on 31st March, 2016. However, the amount paid under protest can be kept under the heading 'Long- term Loans & Advances / Short-term Loans and Advances' as the case may be along with disclosure as contingent liability of 3.70 crore. The arrears for the period from June, 2015 to March, 2016 are required to be provided for in the accounts of the company for the year ended on 31st March, 2016.

8. **Explain whether the following will constitute a change in accounting policy or not as**

per Ind AS 8.

(i) Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement.

(ii) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organisation. Such employees will get pension of ` 20,000 per month. Earlier there was no such scheme of pension in the organization.

Solution

As per Ind AS 8, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy.

(i)Accordingly, introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is not a change in an accounting policy.

(ii) Similarly, the adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial will not be treated as a change in an accounting policy

9. **A Ltd. was formed on 1.4.2014. It used to value its inventory using FIFO method. On 31.3.2017 it decided to shift to weighted average method of valuation of stock. Following details are available**

Particulars	**31.3.2015**	**31.3.2016**	**31.3.2017**
C/s as per FIFO	**45**	**47**	**50**
C/s as per weighted average	**42**	**48**	**52**

Tax rate is 30%. Determine impact of change in policy

Answer

Particulars	**31.3.2015**	**31.3.2016**	**31.3.2017**
C/s as per FIFO	45	47	50
C/s as per weighted average	42	48	52
Gain / (loss) due to change in policy	(3)	1	2
Gain / (loss) related to opening stock	-	3	(1)
Net affect I P&L	(3)	4	1
DTA / (DTL) @ 30% on closing stock	0.9	(0.3)	(0.6)

(assumed that closing stock of a year is sold in next financial year and accordingly DTA / DTL created is reversed is the financial year of sale

What are changes in accounting estimates?

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.

Changes in accounting estimates

As a result of the uncertainties inherent in business activities, many items in financial statements cannot be measured with precision but can only be estimated. Estimation involves judgments based on the latest available, reliable information. For example, estimates may be required of:

(a) bad debts;

(b) inventory obsolescence;
(c) the fair value of financial assets or financial liabilities;
(d) the useful lives of, or expected pattern of consumption of the future economic benefits embodied in, depreciable assets; and
(e) warranty obligations.

The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

An estimate may need revision if changes occur in the circumstances on which the estimate was based or as a result of new information or more experience. By its nature, the revision of an estimate does not relate to prior periods and is not the correction of an error.

A change in the measurement basis applied is a change in an accounting policy, and is not a change in an accounting estimate. 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.

The effect of change in an accounting estimate shall be recognised 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.

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, it shall be recognized by adjusting the carrying amount of the related asset, liability or equity item in the period of the change.

Prospective recognition of the effect of a change in an accounting estimate means that the change is applied to transactions, other events and conditions from the date of the change in estimate. A change in an accounting estimate may affect only the current period's profit or loss, or the profit or loss of both the current period and future periods. For example, a change in the estimate of the amount of bad debts affects only the current period's profit or loss and therefore is recognised in the current period. However, a change in the estimated useful life of, or the expected pattern of consumption of the future economic benefits embodied in, a depreciable asset affects depreciation expense for the current period and for each future period during the asset's remaining useful life. In both cases, the effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods is recognised as income or expense in those future periods.

Example A new retail entity provides for warranty obligation 2% of its sales. After being in trade for 3 years because of its stringent quality control processes, the actual warranty obligations is at 1%. It has now revised and provides for warranty obligations @ 1%. It is a change in accounting estimate
Example 1. A change in the estimate of the amount of bad debts affects only the current period's profit or loss and therefore is recognised in the current period. 2. A change in the estimated useful life of, or the expected pattern of consumption of the future economic benefits embodied in a depreciable asset affects depreciation expense for the current period and for each future period during the asset's remaining useful life.

In both the aforesaid examples, the effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods is recognised as income or expense in those future periods

Disclosure

An entity shall disclose the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods, except for the disclosure of the effect on future periods when it is impracticable to estimate that effect.

If the amount of the effect in future periods is not disclosedbecause estimating it is impracticable, an entity shall disclose thatfact.

10. In the previous year Y Ltd. has made a provision of 10% of the contract value on an ongoing project. The actual loss on completion of the contract in the subsequent year was 11%. The management adjusted the difference in the previous year's account.

Answer

Making provision for 10% of contract value constitutes accounting estimate. Increase in provision from 10% to 11% constitute change in accounting estimate. As per Ind AS 8, change in accounting estimate is included in P&L in the period of change. Adjusting in previous year is not proper.

11. While preparing its final accounts for the year ended 31st March, 2012 Rainbow Limited created a provision for Bad and Doubtful debts are 2% on trade debtors. A few weeks later the company found that payments from some of the major debtors were not forthcoming. Consequently, the company decided to increase the provision by 10% on the debtors as on 31st March, 2012 as the accounts were still open awaiting approval of the Board of Directors. Is this to be considered as an extra-ordinary item or prior period item ? Comment.

Solution: The preparation of financial statements involve making estimates which are based on the circumstances existing at the time when the financial statements are prepared. It may be necessary to revise an estimate in a subsequent period if there is a change in the circumstances on which the estimate was based.

In the given case, Rainbow Limited created a provision for bad and doubtful debts at 2% on trade debtors while preparing its final accounts for the year ended 31st March, 2012. Subsequently, the company decided to increase the provision by 10%. As per Ind AS 8, this change in estimate.

However, Ind AS 8, a change in accounting estimate which has a material effect in the current period should be disclosed and quantified. Any change in an accounting estimate which is expected to have a material effect in later periods should also be disclosed

Errors

MATERIAL OMISSIONS OR MISSTATEMENTS	of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the 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, could be the determining factor
PRIOR PERIOD ERRORS	are omissions from, and misstatements in, the 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 approved 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. Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind ASs if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue.

Example

The following arithmetical error occurred in preparation of A Limited financial statement of immediately preceding financial year –

(a) Depreciation on plant and machinery understated by an amount equal to 0.30% of sales;

(b) Warranty provisions understated by an amount equal to 0.15% of sales; (c) Allowance for bad debts understated by an amount of 0.25% of sales.

Individually none of these errors may be material but could collectively influence the economic decision of the users of the financial statements. These are material prior period errors.

However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are **corrected in the comparative information** presented in the financial statements for that subsequent period

An entity shall **correct material prior period errors retrospectively** in the first set of financial statements approved for issue after their discovery by:

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

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

Example

While preparing the financial statement for the F.Y.20X2-20X3, the latest prior period presented would be F.Y. 20X1-20X2. If the mistake is discovered for the year 20X1-20X2,

then it will be rectified, immediately while presenting the statements for the year 20X2-20X3
Example While preparing the financial statements for the F.Y. 20X4-20X5, if the mistake has been discovered for the year 20X1-20X2, i.e. for the period which was earlier than the latest prior period presented, then the corrected opening balances as on 1st April 20X3 of equities, assets and liabilities will be restated
Example A material error in creation of a depreciation provision of the preceding year ended March 31, 20X2 was discovered when preparing the financial statements for March 31, 20X3. The amount recognised in statement of profit and loss of March 31, 20X2 was `1,00,000 instead of `50,000. In this case, when presenting the financial statements of March 31, 20X3, figures for March 31, 20X2 will be restated at `50,000 instead of `1,00,000
Example Continuing with the aforesaid example, assume the error related to March 31, 20X1 and March 31, 20X1 is not the earliest period for which comparative information is presented. In this case, the figures of retained earnings in statement of changes in equity will be restated.

Limitations on retrospective restatement

A prior period error shall be corrected by retrospective restatement except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the error.

When it is impracticable to determine the period-specific 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).

When it is impracticable to determine the cumulative effect, at the beginning of the current period, of an error on all prior periods, the entity shall restate the comparative information to correct the error prospectively from the earliest date practicable.

The correction of a prior period error is excluded from profit or loss for the period in which the error is discovered. Any information presented about prior periods, including any historical summaries of financial data, is restated as far back as is practicable.

When it is impracticable to determine the amount of an error (e.g. a mistake in applying an accounting policy) for all prior periods, the entity restates the comparative information prospectively from the earliest date practicable. It therefore disregards the portion of the cumulative restatement of assets, liabilities and equity arising before that date. Paragraphs 50–53 provide guidance on when it is impracticable to correct an error for one or more prior periods.

Corrections of errors are distinguished from changes in accounting estimates. Accounting estimates by their nature are approximations that may need revision as additional information becomes known. For example, the gain or loss recognised on the outcome of a contingency is not the correction of an error.

Disclosure of prior period errors

In applying paragraph 42, an entity shall disclose the following:

(a) the nature of the prior period error;
(b) for each prior period presented, to the extent practicable, the amount of the correction:
    a. for each financial statement line item affected; and
    b. if Ind AS 33 applies to the entity, for basic and diluted earnings per share;
(c) the amount of the correction at the beginning of the earliest prior period presented; and
(d) if retrospective restatement is impracticable for a particular prior period, the circumstances that led to the existence of that condition and a description of how and from when the error has been corrected. Financial statements of subsequent periods need not repeat these disclosures.

12. A company signed an agreement with the Employees Union on 1.9.2011 for revision of wages with retrospective effect from 30.9.2010. This would cost the company an additional liability of Rs. 5,00,000 per annum. Is a disclosure necessary for the amount paid in 2011-12?

Solution: It is given that revision of wages took place on 1st September, 2012 with retrospective effect from 30.9.2011. Therefore wages payable for the half year from 1.10.2011 to 31.3.2012 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item.

Additional wages liability of Rs.7,50,000 (for $1\frac{1}{2}$ years @ Rs. 5,00,000 per annum) should be included in current year's wages.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extraordinary item. However, as per Ind AS 8, when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

13. M/s Dinesh & Company signed an agreement with workers for increase in wages with retrospective effect. The out-flow on account of arrears was for 2006-07—Rs. 10.00 lakhs, for 2007-08—Rs. 12.00 lakhs and for 2008-09—Rs. 12.00 lakhs. This amount is payable in September, 2009. The accountant wants to charge Rs. 22.00 lakhs as prior period charges in financial statement for 2009-10. Discuss.

According to Ind AS 8, the term prior period item refers only to income or expenses which arise in the current period as a result of errors or omission in the preparation of the financial statements of one or more prior periods. The term does not include other adjustments necessitated by circumstances, which though related to prior periods are determined in the current period. The full amount of wage arrears paid to workers will be treated as an expense of current year and it will be charged to profit and loss account as current expenses and not as prior period expenses.

It may be mentioned that additional wages is an expense arising from the ordinary activities of the company. Although abnormal in amount, such an expense does not qualify as an extraordinary item. However, when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

14. In preparing the financial statements of R Ltd. for the year ended 31st March, 2012, you come across the following information. State with reasons, how would you deal with them in the financial statements:

There was a major theft of stores valued at Rs. 10 lakhs in the preceding year which was detected only during the current financial year 2011-12.

Solution

Due to major theft of stores in the preceding year (2010-2011) which was detected only during the current financial year (2011–2012), there was overstatement of closing stock of stores in the preceding year. This must have also resulted in the overstatement of profits of previous year, brought forward to the current year. The adjustments are required to be made in the previous year as per Ind AS 8. Accordingly, the adjustments relating to both opening stock of the current year and profit brought forward from the previous year in the statement of profit and loss together with their nature and amount in a manner that their impact on the current profit or loss can be perceived.

15. A Limited Company finds that the stock sheets as on 31.3.2011 had included twice an item the cost of which was Rs. 20,000.

You are asked to suggest, how the error would be dealt with in the accounts of the year ended 31.3.2012.

Solution

Ind AS 8, defines Prior Period items as "income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods".

Rectification of error in stock valuation is a prior period item videInd AS 8.Rs.14.5 lakhs must be added to the opening stock of 1.4.2011. It is also necessary to show Rs. 14.5 lakhs as adjustment in comparative closing stock of PY in the Profit and loss. Separate disclosure of this item as a prior period item is required as per AS 5.

16. Fuel surcharge is billed by ht State Electricity Board at provisional rates. Final bill for fuel surcharge of Rs. 5.30 lakhs for the period October, 2007 to September, 2011 has been received and paid in February, 2012

Solution

The final bill having been paid in February, 2012 should have been accounted for in the annual accounts of the company for the year ended 31st March, 2012. However it seems that as a result of error or omission in the preparation of the financial statements of prior period i.e., for the year ended 31st March 2012, this material charge has arisen in the current period i.e., year ended 31st March, 2013. Therefore, it should be treated as 'Prior period item' as Ind AS 8.Prior period items are adjusted in the net profit or loss for the previous years, .i.e. retained earnings

17. **The company finds that the stock sheets of 31.3.2007 did not include two pages containing details of inventory worth Rs. 20 lakhs. State, how will you deal with this matter in the accounts of A Ltd., for the year ended 31st March, 2008 with reference to AS 5.**

As per Ind AS 8, omission of two pages containing details of inventory worth Rs.20 lakhs in31.3.2007 is a prior period item. Prior period items are normallyincluded in the determination of net profit or loss for the previous year. Accordingly, Rs.20 lakhs mustbe added to closing stock of 31.3.2007.

18. As an auditor state your views on the following situation:

Y Ltd. provided Rs. 25 lakhs for inventory obsolescence in 1998-99. In the subsequent year, it was determined that 50% of such stock was usable. The company wants to adjust the same through prior period adjustment account as the provision was made in the earlier year.

Answer

Written back provision made in earlier year does not constitute prior period adjustment. It merely involves making estimates based on prevailing circumstances when these financial statements were being prepared. Being material, it has to be disclosed separately

19. There was a raid in the premise and following was found

Particulars	**Related to PY**	**Related to earlier years**
Cash received from various parties	**40**	**80**
Payment made to various parties	**30**	**60**
Income tax	**1**	**3**
Interest and penalty	**1**	**5**

Determine Accounting treatment as per Ind AS 8

Answer

For previous year, we will restate the comparatives

Particulars	**Amount**
Sales Less: COGS Less: Other Expenses	40 (30) (1)
PBT Tax PAT	9 (1) 8

For entries related to earlier years adjustments shall be made in R&S

Cash dr.(80 – 60) 20

To Tax payable 3

To Interest and Penalty payable 5

To General reserves 12

Impracticability in respect of retrospective application and retrospective restatement

In some circumstances, it is impracticable to adjust comparative information for one or more prior periods to achieve comparability with the current period. For example, data may not have been collected in the prior period(s) in a way that allows either retrospective application of a new accounting policy or retrospective restatement to correct a prior period error, and it may be impracticable to recreate the information.

It is frequently necessary to make estimates in applying an accounting policy to elements of financial statements recognised or disclosed in respect of transactions, other events or conditions.

Estimation is inherently subjective, and estimates may be developed after the reporting period. Developing estimates is potentially more difficult when retrospectively applying an accounting policy or making a retrospective restatement to correct a prior period error, because of the longer period of time that might have passed since the affected transaction, other event or condition occurred. However, the objective of estimates related to prior periods remains the same as for estimates made in the current period, namely, for the estimate to reflect the circumstances that existed when the transaction, other event or condition occurred.
Therefore, retrospectively applying a new accounting policy or correcting a prior period error requires distinguishing information that
(a) provides evidence of circumstances that existed on the date(s) as at which the transaction, other event or condition occurred, and
(b) would have been available when the financial statements for that prior period were approved for issue from other information. For some types of estimates (e.g. an estimate of fair value not based on an observable price or observable inputs), itis impracticable to distinguish these types of information. When retrospective application or retrospective restatement would require making a significant estimate for which it is impossible to distinguish these two types of information, it is impracticable to apply the new accounting policy or correct the prior period error retrospectively.
Hindsight should not be used when applying a new accounting policy to, or correcting amounts for, a prior period, either in making assumptions about what management's intentions would have been ina prior period or estimating the amounts recognised, measured or disclosed in a prior period. For example, when an entity corrects a prior period error in measuring financial assets previously classified as held to-maturity investments in accordance with Ind AS 109 Financial Instruments: Recognition and Measurement, it does not change their basis of measurement for that period if management decided later not to hold them to maturity. In addition, when an entity corrects a prior period error in calculating its liability for employee's accumulated sick leave in accordance with Ind AS 19 Employee Benefits, it disregards information about an unusually severe influenza season during the next period that became available after the financial statements for the prior period were approved for issue. The fact that significant estimates are frequently required when amending comparative information presented for prior periods does not prevent reliable adjustment or correction of the comparative information.

1. During 20X2, Beta Ltd. discovered that some products that had been sold during 20X1 were incorrectly included in inventory at March 31, 20X1 at `6,500.
2 Beta's accounting records for 20X2 show sales of `1,04,000, cost of goods sold of `86,500
(including `6,500 for the error in opening inventory), and income taxes of `5,250.
3. In 20X1, Beta Ltd. reported:
- **Sales of `73,500**
- **Cost of goods sold of `53,500**
- **Profit before income taxes of `20,000**
- **Income taxes of `6,000**
- **Profit of `14,000**

4. 20X1 opening retained earnings was `20,000 and closing retained earnings was `34,000.
5. Beta's income tax rate was 30 percent for 20X2 and 20X1. It had no other income or expenses.
6. Beta Ltd. had `5,000 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.

Solution

You are required to prepare relevant extract from the statement of profit and loss and statement of changes in equity. Also what should be disclosed in the notes.

Beta Ltd. Extract from the statement of profit and loss

(Amount in `)

	20X2	Restated 20X1
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

Beta Ltd. Statement of changes in equity

(Amount in `)

	Share Capital	**Retained Earnings**	**Total**
Balance as at March 31, 20X0	5000	20,000	25,000
Profit for the year ended March 31, 20X1, as restated		9450	9,450
Balance as at March 31, 20X1	5000	29,450	34,450
Profit for the year ended March 31, 20X2		16800	16,800
Balance as at March 31, 20X2	5000	46,250	51,250

Extract from the notes:

Some products that had been sold in 20X0-20X1 were incorrectly included in inventory at March 31, 20X1 at `6,500. The financial statements of March 31, 20X1 have been restated to correct this error. The effect of the restatement on those financial statements is as summarised above. There is no effect in March 31, 20X2

Particulars	**Ind AS 8**	**AS 5**
Objective	Objective of Ind AS 8 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 errors. Ind AS 8 intends to enhance the relevance and reliability of an entity's financial	Objective of AS 5 is to prescribe the classification and disclosure of certain items in the statement of profit and loss for uniform preparation and presentation of financial statements

	statements and the comparability of those financial statements over time and with the financial statements of other entities	
Extraordinary Items	Keeping in view that Ind AS 1, 'Presentation of Financial Statements', prohibits the presentation of any items of income or expense as extraordinary items, Ind AS 8 does not deal with the same	AS 5 deals with the concept of extra-ordinary item
Definition of Accounting Policies	Ind AS 8 broadens the definition to include bases, conventions, rules and practices (in addition to principles) applied by an entity in the preparation and presentation of financial statements.	AS 5 restricts the definition of accounting policies to specific accounting principles and the methods of applying those principles
Change in Accounting Policies	Ind AS 8 does not mention to change the accounting policy on the basis of the requirement by the statute	AS 5 allows change in accounting policy if required by statute
Accounting for Changes in Accounting Policies	IndAS 8 specifically states that an entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless an Ind AS specifically requires or permits categorisation of items for which different policies may be appropriate	Neither AS 5 nor any other AS specifically requires accounting policies to be consistent for similar transactions, other events and conditions
Exceptions in Retrospective Accounting of Changes in Accounting Policies	Ind AS 8 requires that changes in accounting policies should be accounted for with retrospective effect subject to limited exceptions viz., where it is impracticable to determine the period specific effects or the cumulative effect of applying a new accounting policy.	AS 5 does not specify how change in accounting policy should be accounted for
Prior Period Items	Ind AS 8 uses the term 'errors' and relates it to errors or omissions arising from a failure to use or misuse of reliable information (in addition to mathematical mistakes, mistakes in application of accounting policies etc.) that was available when the financial statements of the prior periods were approved for issuance and could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. Ind AS 8 specifically states that errors include frauds,	AS 5 defines prior period items as incomes or expenses which arise in the current period as a result of errors or omissions in the preparation of financial statements of one or more prior periods. This is not covered in AS 5
Rectification of Material	Ind AS 8 requires rectification of material prior period errors with retrospective effect	AS 5 requires the rectification of prior period

Prior Period Errors	subject to limited exceptions viz., where it is impracticable to determine the period specific effects or the cumulative effect of applying a new accounting policy	items with prospective effect

20. During 20X2, Delta Co. changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a components approach, whilst at the same time adopting the revaluation model.

In years before 20X2, Delta's asset records were not sufficiently detailed to apply a components approach fully. At the end of 20X1, management commissioned an engineering survey, which provided information on the components held and their fair values, useful lives, estimated residual values and depreciable amounts at the beginning of 20X2. However, the survey 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.

Delta's 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 20X2. 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 Delta's new policy prospectively from the start of 20X2.

Additional information:

(i) Delta's tax rate is 30 percent

(ii) Particulars Property, plant and equipment at the end of 20X1:

Cost		**`25,000**
Depreciation	**`14,000**	
Net book value		**`11,000**
(iii) Prospective depreciation expense for 20X2 (old basis)	**`1,500**	
(iv) Some results of the engineering survey:		
Valuation		**`17,000**
Estimated residual value		**`3,000**
Average remaining asset life		**7 years**
Depreciation expense on existing property, plant and Equipment for 20X2 (new basis)	**`2,000**	

You are required to prepare relevant note for disclosure in accordance with Ind AS 8.

Answer

Extract from the notes

From the start of 20X2, Delta Co. changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a components approach, whilst atthe 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.

The policy has been applied prospectively from the start of 20X2 because it was not practicable to estimate the effects of applying the policy either retrospectively, or prospectively from any earlier date.

Accordingly, the adoption of the new policy has no effect on prior years. The effect on the current year is to increase the carrying amount of property, plant and equipment at the start of the year by `6,000; increase the opening deferred tax provision by `1,800; create a revaluation surplus at the start of the year of `4,200; increase depreciation expense by `500; and reduce tax expense by `150.

21. ABC is a construction contract company involved in building commercial properties. Its current policy for determining the percentage of completion of its contracts is based on the proportion of cost incurred to date compared to the total expected cost of the contract. One of ABC's contracts has an agreed price of `250 crores and estimated total costs of `200 crores. The cumulative progress of this contract is:

Year ended	31st March 20X1	31st March 20X2
Cost incurred	80	145
Work certified and billed	75	160
Amount received against bills	70	150

ABC prepared and published its financial statements for the year ended 31st March 20X1.

Relevant extracts are:	`in Crores
Revenue [(80/200) x 250]	100
Cost of sales	(80)
Profit	20

Balance Sheet (Extracts)	`Crores
Current assets	
Amount due from customers	
Contract cost to date	80
Profit recognized	20
	100
Progress billing to date	(75)
Billing to be done	25
Contract asset (amount receivable) (75-70)	5

ABC has received some adverse publicity in the financial press for taking its profit too early in the contract process, leading to disappointing profits in the later stages of contracts. Most of ABC's competitors take profit based on the percentage of completion as determined by the work certified compared to the contract price.

Required

(a) Assume that ABC changes its method of determining the percentage of completion of contracts to that used by its competitors, as this would represent a change in an accounting estimate. Prepare equivalent extracts to the above for the year ended 31st March 20X2.

(b) Identify, whether the above change represents a change in accounting estimate or a

change in accounting policy and why? (RTP May 18)

Answer

(i) ABC's income statement (extracts) for the year ended:

	31 March 20X2
	` Crores
Revenue (based on work certified) (160-100)	60
Cost of sales (balanceing figure)	(48)
Profit [(160/250) x (250-200)]-20	12

Statement of financial position (extracts) as on 31 March 20X2	` Crores
Current assets	
Amount due from customers	
Contract cost to date	145
Profit recognized (20+12)	32
	177
Progress billing	(160)
Billing to be done	17
Contract assets (amount receivable) (160-150)	10

(ii) The relevant issue here is what constitutes the accounting policy for construction contracts. Where there is uncertainty in the outcome of a contract, the appropriate accounting policy would be the completed contract basis (i.e. no profit is taken until the contract is completed). Similarly, any expected losses should be recognised immediately.

Where the outcome of a contract is reasonably foreseeable, the appropriate accounting policy is to accrue profits by the percentage of completion method. If this is accepted, it becomes clear that the different methods of determining the percentage of completion of construction contracts are different accounting estimates. Thus the change made by ABC in the year to 31 March 20X2 represents a change of accounting estimate.