Educational Material on Indian Accounting Standard (Ind AS) 8, Accounting Policies, Changes in Accounting Estimates and Errors

The Institute of Chartered Accountants of India

(Set up by an Act of Parliament)

New Delhi

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This Educational Material has been formulated in accordance with the Ind AS notified by the Ministry of Corporate Affairs (MCA) as Companies (Indian Accounting Standards) Rules, 2015 vide Notification dated February 16, 2015 and other amendments finalised and notified till March 2019.

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Foreword

In this era of globalised economies, the Institute of Chartered Accountants of India (ICAI) has been at the forefront of ensuring high quality accounting standards in India. Financial reporting has got new dimensions after the implementation of Indian Accounting Standards (Ind AS). The Ind AS Implementation Committee of ICAI is playing a pivotal role in providing guidance to the members and other stakeholders so as to enable them to implement these Standards in the same spirit in which these have been formulated.

Moving forward in this direction, the Ind AS Implementation Committee has brought out this Educational Material covering Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. The purpose of this Educational Material is to provide guidance by way of Frequently Asked Questions (FAQs) and illustrations explaining the principles enunciated in the Standard. This publication will provide guidance to the stakeholders in understanding 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.

At this juncture, I wish to place my appreciation for CA. Nihar Niranjan Jambusaria, Chairman, CA. Dayaniwas Sharma, Vice-Chairman as well as convenor of the Study Group and other members of the Ind AS Implementation Committee for their valuable technical contribution and cooperation in bringing out this publication.

I am sure that membership at large will benefit immensely from this publication.

New Delhi
June 24, 2019

CA. Prafulla P. Chhajed
President, ICAI

Preface

In India, Ind AS has become a reality now as Ind AS are being implemented by specified class of companies. It is a business imperative for Indian companies today and has become new benchmark of accounting excellence. Ind AS Implementation Committee of the Institute of Chartered Accountants of India (ICAI) has been instrumental in making the transition to Ind AS smooth. The Committee is working to provide guidance to the members and other stakeholders by issuing Educational Materials on Ind AS, issuing timely clarifications on issues being faced by the members through Ind AS Technical Facilitation Group (ITFG) Clarification Bulletins, addressing queries through Support-desk for implementation of Ind AS, conducting Certificate Course on Ind AS, developing e-learning modules on Ind AS, workshops, seminars, awareness programmes on Ind AS and series of webcasts on Ind AS etc.

I am pleased to share that the Committee has brought out the Educational Material on Indian Accounting Standard (Ind AS) 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. The 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. The Standard is intended to enhance the relevance and reliability of an entity's financial statements and the comparability of those financial statements over time and with the financial statements of other entities. This Educational Material on Ind AS 8 addresses all relevant aspects envisaged in the Standard by way of brief summary of the Standard and Frequently Asked Questions (FAQs) which are being/expected to be encountered while implementing the Standard.

I may mention that the views expressed in this publication are the views of the Ind AS Implementation Committee and are not necessarily the views of the Council of the Institute. The purpose of this publication is to provide guidance for implementing this Ind AS effectively by explaining the principles enunciated in the Standard with the help of examples. However, while applying Ind AS in a practical situation, reference should be made to the full text of the Standards.

I would like to convey sincere gratitude to the Hon'ble President, CA. Prafulla P. Chhajed and Vice-President, CA. Atul Kumar Gupta for providing this opportunity of bringing out implementation guidance on Ind AS in the form of Educational Materials. I sincerely appreciate the untiring efforts put in by the members of the

Group CA. Sumit Seth, CA. Abhay Mehta, CA. Manish Sampat, CA. Shriraj Bhandari, CA. Yagnesh Desai, CA. Archana Bhutani, CA.Gandharv Tongia and CA.Vikas Bagaria for preparing the draft of this Educational Material. I would also like to thank all the members of the Ind AS Implementation Committee for their valuable & technical contributions in finalising this publication.

I also acknowledge CA. Geetanshu Bansal, Secretary, Ind AS Implementation Committee and CA. Prachi Jain, Executive Officer for their technical and administrative support in bringing out this publication. I would also like to thank CA. Vidhyadhar Kulkarni, Head, Technical Directorate, for his guidance.

I am sure that, our stakeholders, particularly the preparers and auditors of financial statements, will find this Educational Material useful in the practical implementation of the Standard.

CA. Nihar Niranjan Jambusaria
Chairman
Ind AS Implementation Committee

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Educational Material on Indian Accounting Standard (Ind AS) 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

Indian Accounting Standard (Ind AS) 8, Accounting Policies, Changes in Accounting Estimates and Errors, was notified as part of the Companies (Indian Accounting Standards) Rules, 2015 issued by the Ministry of Corporate Affairs, Government of India, vide notification no. G.S.R. 111(E) dated February 16, 2015. These Rules came into force w.e.f. April 1, 2015. Ind AS 8 has been subsequently amended in some minor respects by the Companies (Indian Accounting Standards) (Amendment) Rules, 2018 issued vide notification no. G.S.R. 310(E) dated March 28, 2018.

I Ind AS 8 – Summary

[*The purpose of this summary is to help the reader gain a broad understanding of the principal requirements of Ind AS 8 (or 'the Standard'). Reference should be made to the complete text of the Standard for a complete understanding of these requirements or in dealing with a practical situation.*]

Objective

Ind AS 8 specifies 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. The Standard is intended to enhance the relevance and reliability of an entity's financial statements, and the comparability of those financial statements over time and with the financial statements of other entities.

The disclosures required in respect of changes in accounting policies are set out in Ind AS 8. Other disclosure requirements for accounting policies are laid down in Ind AS 1, *Presentation of Financial Statements*.

Selection and Application of Accounting Policies

Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

This Standard requires that 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.

In the absence of an Ind AS that specifically applies to a transaction, other event or condition, management shall use its judgment in developing and applying an accounting policy. The accounting policy should be such as results in information that is:

- relevant to the economic decision-making needs of users; and
- reliable, in that the financial statements:
  - represent faithfully the financial position, financial performance and cash flows of the entity;
  - reflect the economic substance of transactions, other events and conditions, and not merely the legal form;
  - are neutral, i.e., free from bias;
  - are prudent; and
  - are complete in all material respects.

  In making the aforesaid 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.

  Further, 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 referred to in the preceding paragraph.

Consistency of Accounting Policies

An entity shall select and apply the 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. If an Ind AS requires or permits such categorisation, 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.

Subject to the exception discussed below, a change in an accounting policy shall be applied as follows:

- A change in accounting policy resulting from the initial application of an Ind AS shall be applied as per the specific transitional provisions in that Ind AS. If that Ind AS does not contain any transitional provisions, the change shall be applied retrospectively.
- A voluntary change in accounting policy shall be applied retrospectively. The Standard clarifies that an early application of an Ind AS is not a voluntary change in accounting policy.

Retrospective application of a change in accounting policy involves adjustment to 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.

An exception to giving retrospective effect to a change in accounting policy applies where it is impracticable to determine either the period-specific effects or the cumulative effect of the change.

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, and shall make a corresponding adjustment to the opening balance of each affected component of equity for that period.

When it is impracticable to determine the cumulative effect at the beginning of the current period, of applying the new policy to all prior periods, the entity shall apply the new policy prospectively from the start of the earliest period practicable. Thus, in such a situation, the entity 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.

The application of an accounting policy for transactions, other events or conditions that (a) differ in substance from those previously occurring or (b) are applied to transactions, other events or conditions that did not occur previously or were immaterial are not change in accounting policy.

The Standard clarifies that 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 Ind AS 8.

Changes in Accounting Estimates

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

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 recognised by adjusting the carrying amount of the related asset, liability or equity item in the period of the change.

The effects of other changes in accounting estimates shall be recognised prospectively by including them 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.

Prior Period Errors

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.

Except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of an error, the Standard requires an entity to correct material prior period errors retrospectively in the first set of financial statements approved for issue after their discovery by:

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

(b) 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.

Potential current period errors discovered during the period are corrected before the financial statements are approved for issue

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.

II. Frequently Asked Questions

Accounting Policies

Selection and application of accounting policies

Question 1

Are individual entities within a group required to adopt uniform accounting policies in their stand-alone financial statements?

Response

Ind ASs do not require accounting policies followed by group entities in their stand-alone financial statements to be the same as those applied in the group's consolidated financial statements. Each entity within the group should select and apply the appropriate accounting policies in accordance with Ind AS 8 in its stand-alone financial statements.

However, the following requirement of Ind AS 110, *Consolidated Financial Statements*, may be noted:

"**Uniform accounting policies**

B87 If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to that group member's financial statements in preparing the consolidated financial statements to ensure conformity with the group's accounting policies."

Thus, where accounting policies followed in stand-alone financial statements of any group entity are different from those adopted in the consolidated financial statements, appropriate adjustments have to be made in preparing consolidated financial statements to achieve conformity with the group's accounting policies.

Changes in accounting policies

Question 2

What are examples of changes in accounting policies?

Response

Changes in accounting policies may relate to recognition, measurement or presentation of an item in financial statements. The following are some illustrative examples:

Change in recognition policy	Paragraph 5 of Ind AS 116, *Leases,* provides that a lessee can elect not to apply Ind AS 116's recognition and measurement requirements to short-term leases and/or leases for which the underlying asset is of low value ('low value leases'). If an entity changes its policy with respect to applying Ind AS 116's recognition and measurement requirements to short-term leases and/or low value leases, this constitutes a change in accounting policy.
Changes in measurement basis	1. Paragraph 63 of Ind AS 115, *Revenue from Contracts with Customers,* provides that as a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less. An entity that previously applied the practical expedient may decide to no longer apply the practical expedient and instead segregate the finance component. This constitutes a change in accounting policy. 2. Change in policy of measuring a class of property, plant and equipment (PPE) from cost model to revaluation model. [It may be

	noted that such a change is dealt with prospectively in accordance with Ind AS 16, *Property, Plant and Equipment* rather than retrospectively as per Ind AS 8.]
Changes in presentation	1. Paragraph 91 of Ind AS 1, *Presentation of Financial Statements*, provides a choice regarding manner of presentation of tax effects of items of other comprehensive income (OCI). An entity may present items of OCI either (a) net of related tax effects, or (b) before related tax effects, with one amount shown for the aggregate amount of income tax relating to these items. A change in the manner of presentation of tax effects of items of OCI is a change in accounting policy. 2. Paragraph 24 of Ind AS 20 provides a choice of presenting government grants related to assets in the balance sheet either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset. A change in the manner of presentation of grants related to assets is a change in accounting policy. 3. Paragraph 29 of Ind AS 20 provides a choice of presenting grants related to income as a part of profit or loss, either separately or under a general heading such as 'Other income' or by deducting such a grant in reporting the related expense. A change in the manner of presentation of government grants related to income is a change in accounting policy.

It may be noted that a change in composition of reportable segments as a result of changes in the structure of entity's internal organisation is not a change in accounting policy. The resultant restatement of previously reported segment

information is dealt with in accordance with paragraphs 29 and 30 of Ind AS 108, Operating Segments.

Question 3

Whether a change in inventory cost formula is a change in accounting policy or a change in accounting estimate?

Response

Ind AS 8 defines 'accounting policies' as follows:

> "*Accounting policies* are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements."

Paragraph 36(a) of Ind AS 2, *Inventories,* specifically requires disclosure of 'cost formula used' as a part of disclosure of accounting policies adopted in measurement of inventories.

Accordingly, a change in cost formula is a change in accounting policy.

Question 4

Entity ABC acquired a building for its administrative purposes and presented the same as property, plant and equipment (PPE) in the financial year 2017-18. During the financial year 2018-19, it relocated the office to a new building and leased the said building to a third party. Following the change in the usage of the building, Entity ABC reclassified it from PPE to investment property in the financial year 2018-19. Should Entity ABC account for the change as a change in accounting policy?

Response

Paragraph 16(a) of Ind AS 8 provides that the application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring are not changes in accounting policies.

Ind AS 16, *Property, Plant and Equipment,* defines the term 'property, plant and equipment' as follows:

> *"Property, plant and equipment* are tangible items that:
>
> (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) are expected to be used during more than one period."

Ind AS 40, *Investment Property*, defines the term 'investment property' as follows:

> "*Investment property* is property (land or a building—or part of a building—or both) held (by the owner or by the lessee as a right-of-use asset) to earn rentals or for capital appreciation or both, rather than for:
>
> (a) use in the production or supply of goods or services or for administrative purposes; or
>
> (b) sale in the ordinary course of business."

As per the above definitions, whether a building is an item of property, plant and equipment (PPE) or an investment property for an entity depends on the purpose for which it is held by the entity. It is thus possible that due to a change in the purpose for which it is held, a building that was previously classified as an item of property, plant and equipment may warrant reclassification as an investment property, or vice versa.

Whether a building is in the nature of PPE or investment property is determined by applying the definitions of these terms from the perspective of that entity. Thus, the classification of a building as an item of property, plant and equipment or as an investment property is not a matter of an accounting policy choice. Accordingly, a change in classification of a building from property, plant and equipment to investment property due to change in the purpose for which it is held by the entity is not a change in an accounting policy.

Question 5

Whether change in functional currency of an entity represents a change in accounting policy?

Response

Paragraph 16(a) of Ind AS 8 provides that the application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring are not changes in accounting policies.

Ind AS 21, *The Effects of Changes in Foreign Exchange Rates,* defines functional currency as the currency of the primary economic environment in which the entity operates.

Paragraphs 9-12 of Ind AS 21 list factors to be considered by an entity in determining its functional currency. It is recognised that there may be cases where the functional currency is not obvious. In such cases, Ind AS 21 requires the management to use its judgement to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and conditions.

Paragraph 13 of Ind AS 21 specifically notes that an entity's functional currency reflects the underlying transactions, events and conditions that are relevant to it. Accordingly, once determined, the functional currency is not changed unless there is a change in those underlying transactions, events and conditions. Thus, functional currency of an entity is not a matter of an accounting policy choice.

In view of the above, a change in functional currency of an entity does not represent a change in accounting policy and Ind AS 8, therefore, does not apply to such a change. Ind AS 21 requires that when there is a change in an entity's functional currency, the entity shall apply the translation procedures applicable to the new functional currency prospectively from the date of the change.

Question 6

Whether a change in an accounting policy is always required to be applied retrospectively? If not, what are the exceptions?

Response

Paragraph 19 of Ind AS 8 states as follows:

" Subject to paragraph 23:

(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."

In accordance with the above, a change in an accounting policy that results from the initial application of an Ind AS should be accounted for in accordance with the specific transitional provisions, if any, of that Ind AS.

Those transitional provisions may or may not require retrospective application of the new accounting policy. In the absence of specific transitional provisions, or when an entity changes an accounting policy voluntarily, it is required to apply the change retrospectively. However, as per paragraph 17 of Ind AS 8, retrospective application of a change in accounting policy is subject to the following exceptions:

(i) 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 accounted for as a revaluation under Ind AS 16 /Ind AS 38 rather than under Ind AS 8.

(ii) Where it is impracticable to determine the period-specific effect or the cumulative effects of changing an accounting policy.

Paragraph 22 of Ind AS 8 provides that 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."

For example, if an accounting policy change is made in financial year ended 31 March 2019, the entity shall adjust the comparative information for the year ended 31 March 2018. The cumulative adjustment for periods up to 31 March 2017 shall be adjusted in the retained earnings balance or other affected component of equity as at 1 April 2017.

Question 7

Whether an entity can change its accounting policy of subsequent measurement of property, plant and equipment (PPE) from revaluation model to cost model?

Response

Paragraph 29 of Ind AS 16, *Property, Plant and Equipment* provides that an entity shall choose either the cost model or the revaluation model as its accounting policy for subsequent measurement of an entire class of PPE.

Paragraph 14 of Ind AS 8 states as follows: –

" 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."

Thus, a change from revaluation model to cost model for a class of PPE can be made only if it meets the condition specified in Ind AS 8 paragraph 14(b) i.e. the change results in the financial statements providing reliable and more relevant information to the users of financial statements. For example, an unlisted entity planning IPO may change its accounting policy from revaluation model to cost model for some or all classes of PPE to align the entity's accounting policy with that of listed markets participants within that industry so as to enhance the comparability of its financial statements with those of other listed market participants within the industry. Such a change – from revaluation model to cost model is not expected to be frequent.

Where the change in accounting policy from revaluation model to cost model is considered permissible in accordance with Ind AS 8 paragraph 14(b), it shall be accounted for retrospectively, in accordance with Ind AS 8.

Question 8

Can an entity voluntarily change one or more of its accounting policies? What could be an example of a voluntary change?

Response

A change in an accounting policy can be made only if the change is required or permitted by Ind AS 8. Regarding the circumstances in which an accounting policy should, or can, be changed, paragraphs 14-15 of Ind AS 8 state as follows:

"14 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.

15 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 in paragraph 14."

Further, paragraph 19 of Ind AS 8 states as follows:

" Subject to paragraph 23:

(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."

A change in accounting policy other than a change required by an Ind AS can be made by an entity only if it is permitted to do so under paragraph 14(b) of Ind AS 8. According to paragraph 14(b), a voluntary change in an accounting policy can be made only if the change "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. Thus, paragraph 14(b) lays down two requirements that must be complied with in order to make a voluntary change in an accounting policy. First, the information resulting from application of the changed (i.e., the new) accounting policy must be reliable. Second, the changed accounting policy must result in "more relevant" information being presented in the financial statements.

Whether a changed accounting policy results in reliable and more relevant financial information is a matter of assessment in the particular facts and circumstances of each case. In order to ensure that such an assessment is made judiciously (such that a voluntary change in an accounting policy does

not effectively become a matter of free choice), paragraph 29 of Ind AS 8 requires an entity making a voluntary change in an accounting policy to disclose, *inter alia*, "the reasons why applying the new accounting policy provides reliable and more relevant information."

The following is an example of a voluntary change in accounting policy:

As per Ind AS 27*, Separate Financial Statements*, investments in subsidiaries, associates and joint ventures are accounted for in an entity's separate financial statements at cost or in accordance with Ind AS 109 (i.e., at fair value). The same accounting is required to be applied for each category of investments[1]. Assume that an entity decides to change its policy of measuring investments in subsidiaries (or associates or joint ventures) from cost to fair value in accordance with Ind AS 109, as this will result in the financial statements providing reliable and more relevant information. This would constitute a voluntary change in accounting policy.

Question 9

An entity developed one of its accounting policies by considering a pronouncement of an overseas national standard-setting body in due accordance with Ind AS 8. Would it be permissible for the entity to change the said policy to reflect a subsequent amendment in that pronouncement?

Response

Paragraphs 10-12 of Ind AS 8 state as follows:

> "10 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) ……….
>
> 11 In making the judgement described in paragraph 10, 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

[1] For meaning of 'category of investments', reference may be made to Educational Material on Ind AS 27 *Separate Financial Statements* & Ind AS 28 *Investments in Associates and Joint Ventures*.

(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.

12 In making the judgement described in paragraph 10, 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 in paragraph 11."

In accordance with paragraph 12 above, an entity might develop an accounting policy by considering the pronouncements of other standard-setting bodies in the absence of pronouncement of International Accounting Standards Board on the relevant subject.

Paragraph 21 of Ind AS 8 states as follows:

> "In the absence of an Ind AS that specifically applies to a transaction, other event or condition, management may, in accordance with paragraph 12, apply an accounting policy from 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. If, following an amendment of such a pronouncement, the entity chooses to change an accounting policy, that change is accounted for and disclosed as a voluntary change in accounting policy."

It would be noted from the above that paragraph 21 of Ind AS 8 specifically deals with change in an accounting policy that is based on a pronouncement of IASB/other standard-setting body when the relevant pronouncement is amended by the standard-setting body. As such a change is a voluntary change in accounting policy, it can be made only if it results in information that is reliable and more relevant (and does not conflict with the sources in Ind AS 8 paragraph 11).

Question 10

How should an entity account for the income-tax effects of retrospective application of changes in accounting policies (or correction of prior period errors)?

Response

Paragraph 4 of Ind AS 8 states as follows:

> "The tax effects of corrections of prior period errors and of retrospective adjustments made to apply changes in accounting policies are accounted for and disclosed in accordance with Ind AS 12, *Income Taxes*."

Paragraphs 61A and 62A of Ind AS 12 state as follows:

> "61A Current and deferred tax shall be recognised outside profit or loss if the tax relates to items that are recognised, in the same or a different period, outside profit or loss. Therefore, current tax and deferred tax that relates to items that are recognised, in the same or a different period:
>
> (a) in other comprehensive income, shall be recognised in other comprehensive income (see paragraph 62).
>
> (b) directly in equity, shall be recognised directly in equity (see paragraph 62A)."
>
> "62A Indian Accounting Standards require or permit particular items to be credited or charged directly to equity. Examples of such items are:
>
> (a) an adjustment to the opening balance of retained earnings resulting from either a change in accounting policy that is applied retrospectively or the correction of an error (see Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*); and…."

Where an entity applies a change in accounting policy retrospectively or corrects prior period errors, it should include the related tax effect as part of the prior period adjustments.

Therefore, income-tax effects of adjustments to the opening balance of retained earnings (or another component of equity) as at the beginning of the earliest prior period presented, resulting from either a change in

accounting policy that is applied retrospectively or the correction of an error, shall be recognised directly in such component of equity. Similarly, income-tax effects of adjustments to the comparative amounts for the prior period(s) presented shall be included in the comparative amount of tax expense for the prior period(s) in accordance with paragraph 61A of Ind AS 12.

Question 11

When is an entity required to present a third balance sheet as at the beginning of the preceding period?

Response

As per paragraph 40A of Ind AS 1, *Presentation of Financial Statements,* an entity shall present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements required by paragraph 38A of the standard if:

(a) it applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements or reclassifies items in its financial statements; and

(b) the retrospective application, retrospective restatement or the reclassification has a material effect on the information in the balance sheet at the beginning of the preceding period.

Annexure A to this Educational Material provides an illustration of presentation of a third balance sheet.

Question 12

Is a third balance sheet required in condensed interim financial statements when there is a change in accounting policy?

Response

As per Ind AS 34, *Interim Financial Reporting,* interim financial report means a financial report containing either a complete set of financial statements (as described in Ind AS 1, *Presentation of Financial Statements*), or a set of condensed financial statements (as described in Ind AS 34) for an interim period.

As per paragraph 10 of Ind AS 1, a complete set of financial statements includes, *inter alia*, a balance sheet as at the beginning of the preceding period when an entity applies an accounting policy retrospectively or makes

a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements in accordance with paragraphs 40A–40D of Ind AS 1.

Ind AS 34 does not include the requirements of Ind AS 1 in respect of comparative information. As a consequence, in condensed interim financial statements, it is not necessary to provide an additional balance sheet as at the beginning of the earliest comparative period presented where an entity has made a retrospective change in an accounting policy (or a retrospective restatement or a retrospective reclassification).

However, an entity may present a third balance sheet on a voluntary basis.

Question 13

What are the disclosures required when an accounting policy is changed voluntarily?

Response

Paragraph 29 of Ind AS 8 states that, "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, *Earnings per Share* 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."

The above disclosures are not required to be repeated in the financial statements of subsequent periods.

Illustration of the above disclosure requirements

(Tax effects are ignored for the purpose of this illustration)

During the financial year ended 31 March 2019, the entity has changed the cost formula applied in measuring the cost of materials consumed from First-in-First out (FIFO) to weighted average cost. This change aligns the entity's accounting policy with the general industry practice, thereby enhancing the comparability of the entity's financial statements with those of other market participants within the industry. This voluntary change in accounting policy has been accounted for by restating the comparative information for the preceding period. The entity has also presented a third balance sheet as at the beginning of the preceding period. The change in accounting policy has impacted the financial statements as follows:

Balance sheet	31 March 2019 (without considering the effect of change in accounting policy)	Increase/ (decrease) due to change in accounting policy	31 March 2019 (after considering the effect of change in accounting policy)	31 March 2018 (as previously reported)	Increase/ (decrease) due to change in accounting policy	31 March 2018 (re-stated)	1 April 2017 (as previously reported)	Increase/ (decrease) due to change in accounting policy	1 April 2017 (re-stated)
Inventory	700	(100)	600	600	(170)	430	700	(200)	500
Total current assets	1,000	(100)	900	1,500	(170)	1,330	1,700	(200)	1,500
Total assets	3,000	(100)	2,900	4,000	(170)	3,830	5,000	(200)	4,800
Retained earnings	1,300	(100)	1,200	1,100	(170)	930	1,000	(200)	800
Total equity	1,800	(100)	1,700	1,600	(170)	1,430	1,500	(200)	1,300

Statement of profit and loss	31 March 2019 (without considering the effect of change in accounting policy)	Increase/ (decrease) due to change in accounting policy	31 March 2019 (after considering the effect of change in accounting policy)	31 March 2018 (as previously reported)	Increase/ (decrease) due to change in accounting policy	31 March 2018 (restated)
Cost of materials consumed	500	(70)	430	500	(30)	470
Profit for the year	200	70	270	100	30	130

Earnings per share (basic as well as diluted) for the current year and the preceding year increased by ₹0.70 per share and ₹0.30 per share respectively consequent to the change in accounting policy.

Question 14

What disclosures are required for new or revised Ind ASs which have been notified by the Ministry of Corporate Affairs but are not yet effective?

Response

Paragraphs 30 and 31 of Ind AS 8 state as follows:

> "30 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.
>
> 31 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:

(i) a discussion of the impact that initial application of the Ind AS is expected to have on the entity's financial statements; or

(ii) if that impact is not known or reasonably estimable, a statement to that effect."

In accordance with the above requirements, where a new standard or an amendment to an existing standard has been notified by the Ministry of Corporate Affairs but the standard or the amendment has not yet come into effect, entities are required to make certain disclosures if they have not applied the standard or the amendment in the financial statements. The disclosures are intended to enable the user to assess the possible effects of the new accounting pronouncements or of the revisions to existing ones on the entity's financial statements. Judgement may be required in determining whether a new accounting pronouncement or a revision is expected to have a material effect. Some new pronouncements provide accounting alternatives that could have an effect on the entity. Management can consider disclosing its expectation on the use of accounting alternatives.

Entities can consider making these disclosures even if the new accounting pronouncement is issued after the balance sheet date but before the date of approval of the financial statements.

As an example, Ind AS 116, which was notified under the Companies (Indian Accounting Standards) (Amendments) Rules, 2019 issued vide MCA notification dated 30 March, 2019 is applicable for annual reporting periods beginning on or after 1 April, 2019. Accordingly, an entity is required to make disclosures concerning the possible impact of Ind AS 116 in the financial statements for the year ended 31 March, 2019.

Changes in accounting estimates

Question 15

What are the examples of changes in accounting estimates?

Response

Ind ASs do not define the term 'accounting estimate'. However, the term 'change in accounting estimate' is defined in Ind AS 8 as follows:

> "A change in accounting estimate is an 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."

Further, paragraphs 32 and 33 of Ind AS 8, *inter alia*, state as follows:

> "32 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 judgements based on the latest available, reliable information."

> "33 The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability."

Paragraph 32 of Ind AS 8 further provides the following examples of matters requiring estimates:

(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.

Apart from the above, other examples of estimates include recoverability of deferred tax assets and actuarial assumptions relating to defined benefit pension schemes.

Question 16

How are changes in accounting estimates accounted for?

Response

Paragraphs 36-38 of Ind AS 8 state the following with regard to recognition of effects of changes in accounting estimates:

> "36 The effect of change in an accounting estimate, other than a change to which paragraph 37 applies, 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.

37 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 recognised by adjusting the carrying amount of the related asset, liability or equity item in the period of the change."

38 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 warranty provision 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."

The following example illustrates how the effects of changes in accounting estimates are accounted for:

During the financial year ended 31 March, 2018, Entity ABC introduced a new range of electric motors. It sold the motors with a standard warranty of two years. Warranty provides assurance that a product will function as expected and in accordance with certain specifications and it has been assessed that it is not a separate performance obligation under Ind AS 115.

Based on results of testing of the motors during trials prior to commercial production, Entity ABC made a provision for warranty costs amounting to ₹1,00,000 for motors sold during the year ended 31 March, 2018.

During financial year 2018-19, a defect was discovered in the motors that had not come to light during the trials. The defect resulted in the entity

incurring an amount of ₹2,00,000 during the financial year 2018-19 on repairs of motors sold during the financial year 2017-18. Besides, the entity expects to incur ₹1,50,000 as costs during the year 2019-20 on meeting its warranty obligations in respect of motors sold during the financial year 2017-18.

In preparing its financial statements for the year ended 31 March, 2019, the entity would carry forward a warranty provision of ₹1,50,000 in respect of motors sold during the financial year 2017-18. It would recognise an amount of ₹2,50,000 (₹2,00,00 plus ₹1,50,000 minus ₹1,00,000) in respect of motors sold during the financial year 2017-18 as an expense in profit or loss for the financial year 2018-19. The warranty provision included in the comparatives for financial year ended 31 March, 2018 would not be adjusted. The provision for warranty costs in respect of motors sold during the financial year 2018-19 would be made by considering the information concerning the defect in motors that came to light during the financial year.

Question 17

Is change in the depreciation method for an item of property, plant and equipment a change in accounting policy or a change in accounting estimate?

Response

Paragraphs 60 and 61 of Ind AS 16, *Property, Plant and Equipment,* state as follows:

> "60 The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.
>
> 61 The depreciation method applied to an asset shall be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method shall be changed to reflect the changed pattern. Such a change is accounted for as a change in an accounting estimate in accordance with Ind AS 8."

As per the above, depreciation method for a depreciable asset has to reflect the expected pattern of consumption of future economic benefits embodied in the asset. Determination of depreciation method thus involves an accounting estimate; depreciation method is not a matter of an accounting policy.

Accordingly, Ind AS 16 requires a change in depreciation method to be accounted for as a change in an accounting estimate, i.e., prospectively.

Question 18

Whether a parent entity needs to align the depreciation method(s) applied by its subsidiaries in their stand-alone financial statements with its own depreciation method(s) in the consolidated financial statements?

Response

Paragraph 19 and paragraph B87 of Ind AS 110, *Consolidated Financial Statements*, state as follows:

> "19 A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances."
>
> "B87 If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to that group member's financial statements in preparing the consolidated financial statements to ensure conformity with the group's accounting policies."

It may be noted that the above mentioned paragraphs require an entity to apply uniform accounting policies for like transactions and events in similar circumstances in consolidated financial statements. These paragraphs do not apply to accounting estimates used in preparing consolidated financial statements.

As discussed in Question 17 of this Educational Material depreciation method for an item of property, plant and equipment is an accounting estimate and not an accounting policy. Each member of a group determines an appropriate depreciation method(s) in accordance with the requirements of Ind AS 16 to be applied in preparing its stand-alone financial statements.

The method(s) so determined is(are) not changed while consolidating the subsidiaries in the consolidated financial statements.

Question 19

What are the disclosures to be made in respect of changes in accounting estimates?

Response

Paragraphs 36 and 37 of Ind AS 8 state as follows:

> "36 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.
>
> 37 If the amount of the effect in future periods is not disclosed because estimating it is impracticable, an entity shall disclose that fact."

Illustration of disclosures for changes in accounting estimates

Change in accounting estimate

During the financial year ended 31 March 2019, the management of XYZ Limited performed an operational review of its plant in Gujarat, India, which resulted in changes in expected usage of certain items of property, plant and equipment. Certain machinery, which was expected to be used in production for period of seven years from the date of acquisition, is now expected to be used in production for a period of five years from the date of acquisition, considering the introduction of new technology in the market. This has resulted in decrease in useful life of the machinery. The effect of this change on actual and expected depreciation expense, in current and future years, is as follows:

	2018-19	2019-20	2020-21
Increase in depreciation expense	150	60	11

Correction of prior period errors

Question 20

How is a material prior period error corrected?

Response

Paragraph 41 of Ind AS 8, *inter alia*, states that errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements.

Paragraph 42 of Ind AS 8 provides that except where it is impracticable to do so, an entity shall correct material prior period errors retrospectively in the first set of financial statements approved for issue after their discovery by:

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

(b) 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.

In accordance with the above, if an error discovered is material, the entity should correct it in the first set of financial statements approved for issue after its discovery restating the comparative amounts for the prior period(s) presented, as if the error had never occurred.

Question 21

What disclosures are required by an entity in relation to corrections of prior period errors?

Response

Paragraph 49 of Ind AS 8 requires an entity to 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:

  (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;

(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.

(e) Financial statements of subsequent periods need not repeat these disclosures.

Annexure A to this Educational Material provides an illustration of the disclosures pursuant to the above requirements.

Question 22

An entity has presented certain material liabilities as non-current in its financial statements for periods upto 31 March 2018. While preparing annual financial statements for the year ended 31 March 2019, management discovers that these liabilities should have been classified as current. The management intends to restate the comparative amounts for the prior period presented (i.e., as at 31 March 2018). Would this reclassification of liabilities from non-current to current in the comparative amounts be considered to be correction of an error under Ind AS 8? Would the entity need to present a third balance sheet?

Response

Paragraph 41 of Ind AS 8 states as follows:

"*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. *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.*" [Emphasis added]

In accordance with the above, the reclassification of liabilities from non-current to current would be considered as correction of an error under Ind AS 8. Accordingly, in the financial statements for the year ended March 31, 2019, the comparative amounts as at 31 March 2018 would be restated to reflect the correct classification.

Ind AS 1 requires an entity to present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements, if, *inter alia,* it makes a retrospective restatement of items in its financial statements and the restatement has a material effect on the information in the balance sheet at the beginning of the preceding period. Accordingly, the entity should present a third balance sheet as at the beginning of the preceding period, i.e., as at 1 April 2017 in addition to the comparatives for the financial year 2017-18.

Question 23

An entity charged off certain expenses as finance costs in its financial statements for the year ended 31 March 2018. While preparing annual financial statements for the year ended 31 March 2019, management discovered that these expenses should have been classified as other expenses instead of finance costs The error occurred because the management inadvertently misinterpreted certain facts. The entity intends to restate the comparative amounts for the prior period presented in which the error occurred (i.e., year ended 31 March 2018). Would this reclassification of expenses from finance costs to other expenses in the comparative amounts be considered to be correction of an error under Ind AS 8? Would the entity need to present a third balance sheet?

Response

Paragraph 41 of Ind AS 8 states as follows:

"*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. 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.*" [Emphasis added]

In accordance with the above, the reclassification of expenses from finance costs to other expenses would be considered as correction of an error under Ind AS 8. Accordingly, in the financial statements for the year ended 31 March, 2019, the comparative amounts for the year ended 31 March 2018 would be restated to reflect the correct classification.

Ind AS 1 requires an entity to present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements if, *inter alia*, it makes a retrospective restatement of items in its financial statements and the restatement has a material effect on the information in the balance sheet at the beginning of the preceding period.

In the given case, the retrospective restatement of relevant items in statement of profit and loss has no effect on the information in the balance sheet at the beginning of the preceding period (1 April 2017). Therefore, the entity is not required to present a third balance sheet.

Question 24

While preparing the annual financial statements for the year ended 31 March 2019, an entity discovers that a provision for constructive obligation for payment of bonus to selected employees in corporate office (material in amount) which was required to be recognised in the annual financial statements for the year ended 31 March 2017 was not recognised due to oversight of facts. The bonus was paid during the financial year ended 31 March 2018 and was recognised as an expense in the annual financial statements for the said year. Would this situation require retrospective restatement of comparatives considering that the error was material?

Response

Paragraph 41 of Ind AS 8 states as follows:

"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. *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.*" [Emphasis added]

As per paragraph 40A of Ind AS 1, an entity shall present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements if, *inter alia*, it makes a retrospective restatement of items in its financial statements and the retrospective restatement has a material effect on the information in the balance sheet at the beginning of the preceding period.

In the given case, expenses for the year ended 31 March 2017 and liabilities as at 31 March 2017 were understated because of non-recognition of bonus expense and related provision. Expenses for the year ended 31 March 2018,

on the other hand, were overstated to the same extent because of recognition of the aforesaid bonus as expense for the year. To correct the above errors in the annual financial statements for the year ended 31 March 2019, the entity should:

(a) restate the comparative amounts (i.e., those for the year ended 31 March 2018) in the statement of profit and loss; and

(b) present a third balance sheet as at the beginning of the preceding period (i.e., as at 1 April 2017) wherein it should recognise the provision for bonus and restate the retained earnings.

Question 25

An entity recognised a material amount of expenditure on development of an intangible item as an expense in its financial statements for the year ended 31 March 2018. During the financial year 2018-19, the management discovers that the expenditure should have been capitalised. The error occurred as the management inadvertently failed to use certain reliable (and relevant) information that was available when financial statements for the year ended 31 March 2018 were approved for issue and that ought to have been taken into account in preparation of those financial statements.

The management intends to correct prior period error by restating the comparative amounts for the year ended 31 March 2018. However, it notes that paragraph 71 of Ind AS 38, *Intangible Assets*, prohibits an entity from subsequently recognising an expenditure on an intangible item that was initially recognised as an expense as part of the cost of an intangible asset.

Whether the requirements of Ind AS 38 would override Ind AS 8?

Response

Ind AS 38 requires expenditure on research (or on the research phase of an internal project) to be recognised as an expense when it is incurred. Likewise, it requires expenditure on development (or on the development phase of an internal project) to be recognised as an expense when it is incurred except where an entity can demonstrate compliance with the criteria laid down in the standard for inclusion of the expenditure in the cost of an internally generated intangible asset.

Paragraph 71 of Ind AS 38 states as follows:

> "Expenditure on an intangible item that was initially recognised as an expense shall not be recognised as part of the cost of an intangible asset at a later date."

Paragraph 71 of Ind AS 38 applies to those items of expenditure on an intangible item that were correctly recognised initially as an expense in accordance with the requirements of the standard. If an item is incorrectly recognised initially as an expense, the correction of the error in a later period in accordance with Ind AS 8 by including the expenditure in the cost of an intangible asset is not inconsistent with, and therefore does not tantamount to non-compliance of paragraph 71 of Ind AS 38.

In the given case, in determining the treatment of the relevant expenditure, the management made a mistake in using reliable information that was already available when the financial statements for the year ended 31 March 2018 were approved for issue. Had the management not made the mistake, the said expenditure would have been capitalised rather than being expensed. The expensing of the expenditure in the financial statements for the year ended 31 March 2018 thus represents a prior period error. Ind AS 8 requires correction of material prior period errors by retrospectively adjusting the comparative financial information. When an entity retrospectively restates its comparative information under Ind AS 8, it corrects the error in such a way as if the prior period error had never occurred.

Thus, in the given case, the relevant expenditure would be retrospectively included in the cost of the relevant intangible asset.

Question 26

Entity A acquired Entity B on 15 April 2017. While preparing annual financial statements for the year ended 31 March 2019, Entity A noted a material error in the purchase price allocation relating to acquisition of Entity B which would have reduced the goodwill recognised on acquisition of Entity B as at the date of acquisition and consequently at 31 March 2018. How should this material error be corrected?

Response

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, paragraph 45 of Ind AS 103, *Business Combinations*, requires the acquirer to report provisional amounts for

the items for which the accounting is incomplete. Retrospective adjustments are required to be made to provisional amounts during the 'measurement period'. Paragraph 46 of Ind AS 103 states that the measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognised for a business combination. The measurement period provides the acquirer with a reasonable time to obtain the information necessary to identify, and measure the following as of the acquisition date in accordance with the requirements of Ind AS 103:

(a) the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquiree.

(b) the consideration transferred for the acquiree (or other amount used in measuring goodwill).

(c) in a business combination achieved in stages, the equity interest in the acquiree previously held by the acquirer.

(d) the resulting goodwill or gain on a bargain purchase.

Paragraph 45 of Ind AS 103, *inter alia*, states that, the measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date.

Paragraph 41 of Ind AS 8 states as follows:

"*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. 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.*" [Emphasis added]

Although the measurement period for Entity A under Ind AS 103 has ended not later than 14 March, 2018, Entity A would still be required to comply with the requirements of Ind AS 8 relating to correction of material prior period errors. The error in goodwill computation should be corrected as if the error

had never occurred, i.e. by retrospectively adjusting the comparative financial information as of and for the year ended 31 March 2018. It would also need to be examined whether the correction has any additional implications, e.g., with regard to initial or subsequent measurement of another asset or liability, tax effects or impairment.

Question 27

While preparing interim financial statements for the half-year ended 30 September 2018, an entity discovers a material error (an improper expense accrual) in the interim financial statements for the period ended 30 September 2017 and the annual financial statements for the year ended 31 March 2018. The entity does not intend to restate the comparative amounts for the prior period presented in the interim financial statements as it believes it would be sufficient to correct the error by restating the comparatives in the annual financial statements for the year ended 31 March 2019. Is this acceptable?

Response

Paragraph 42 of Ind AS 8*, inter alia*, states that 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.

Paragraph 28 of Ind AS 34 requires an entity to apply the same accounting policies in its interim financial statements as are applied in its annual financial statements (except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements).

Paragraph 15B of Ind AS 34 cites 'corrections of prior period errors' as an example of events or transactions which need to be explained in an entity's interim financial report if they are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period.

Paragraph 25 of Ind AS 34, *Interim Financial Statements,* states as follows:

"While judgement is always required in assessing materiality, this Standard bases the recognition and disclosure decision on data for the interim period by itself for reasons of understandability of the interim figures. Thus, for

example, unusual items, changes in accounting policies or estimates, and *errors* are recognised and disclosed on the basis of materiality in relation to interim period data to avoid misleading inferences that might result from non-disclosure. The overriding goal is to ensure that an interim financial report includes all information that is relevant to understanding an entity's financial position and performance during the interim period." [Emphasis added]

In view of the above, the entity is required to correct the error and restate the comparative amounts in interim financial statements for the half-year ended 30 September 2018.

Question 28

While preparing interim financial statements for the half-year ended 30 September 2018, an entity notes that there has been an under-accrual of certain expenses in the interim financial statements for the first quarter ended 30 June 2018. The amount of under accrual is assessed to be material in the context of interim financial statements. However, it is expected that the amount would be immaterial in the context of the annual financial statements. The management is of the view that there is no need to correct the error in the interim financial statements considering that the amount is expected to be immaterial from the point of view of the annual financial statements. Whether the management's view is acceptable?

Response

Paragraph 41 of Ind AS 8, *inter alia*, states that 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.

As regards the assessment of materiality of an item in preparing interim financial statements, paragraph 25 of Ind AS 34, *Interim Financial Statements,* states as follows:

"While judgement is always required in assessing materiality, this Standard bases the recognition and disclosure decision on data for the interim period by itself for reasons of understandability of the interim figures. Thus, for example, unusual items, changes in accounting policies or estimates, and errors are recognised and disclosed on the basis of materiality in relation to interim period data to avoid misleading inferences that might result from non-disclosure. The overriding goal is to ensure that an interim financial report

includes all information that is relevant to understanding an entity's financial position and performance during the interim period."

As per the above, while materiality judgements always involve a degree of subjectivity, the overriding goal is to ensure that an interim financial report includes all the information that is relevant to an understanding of the financial position and performance of the entity during the interim period. It is therefore not appropriate to base quantitative assessments of materiality on projected annual figures when evaluating errors in interim financial statements.

Accordingly, the management is required to correct the error in the interim financial statements since it is assessed to be material in relation to interim period data.

Others

Question 29

Ind AS 8 requires changes in accounting policies and corrections of prior period errors to be carried out retrospectively but makes an exception where it is impracticable to do so. Similarly, the standard does not require an entity to disclose the effect of a change in an accounting estimate on future periods when it is impracticable to estimate that effect. What is the meaning of the term 'impracticable' in the above context?

Response

Paragraph 5 of Ind AS 8 defines 'impracticable' as follows:

> "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 recognised, measured or disclosed; and

(ii) would have been available when the financial statements for that prior period were approved for issue from other information."

Paragraphs 50-53 of Ind AS 8 provide further guidance on meaning of 'impracticable'. For example, paragraph 50 of Ind AS 8 notes that in some circumstances, it may be impracticable to adjust comparative information for one or more prior periods to achieve comparability with the current period as data may not have been collected in the prior period(s) in a way that allows 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.

Another example, given in paragraph 52 of Ind AS 8, of a situation of impracticability of retrospectively applying a new accounting policy or correcting a prior period error is where retrospective application or correction 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 and it is impossible to distinguish these two types of information.

Question 30

Can hindsight be applied when applying a change in an accounting policy retrospectively or correcting a prior period error?

Response

Paragraph 53 of Ind AS 8 states as follows:

"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 in a 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 calculating its liability for employees' 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."

Another example of application of paragraph 53 of Ind AS 8 is given below-:An entity made a material error in the previous financial statements in relation to measurement of a financial asset which was classified as at amortised cost as per Ind AS 109, *Financial Instruments* (as the asset was held within a business model to hold financial assets to collect contractual cash flows and the contractual terms of the financial asset gave rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding). During the current financial year, the asset was sold off due to some reasons that were not previously foreseen. Paragraph B4.1.3 of Ind AS 109, *inter alia*, states that although the objective of an entity's business model may be to hold financial assets in order to collect contractual cash flows, the entity need not hold all of those instruments until maturity. Accordingly, while correcting the prior period error in its financial statements for the current year, the entity shall disregard the fact of sale of the asset during the current year for amortised cost measurement purposes.

Question 31

Paragraph 41 of Ind AS 1, *Presentation of Financial Statements*, *inter alia*, states that if an entity changes the presentation or classification of items in its financial statements, it shall reclassify comparative amounts unless reclassification is impracticable. What could be an example of changes in the presentation or classification of items envisaged in Ind AS 1?

Response

Paragraph 45 of Ind AS 1, *inter alia*, states as follows:

"An entity shall retain the presentation and classification of items in the financial statements from one period to the next unless:

(a) it is apparent, following a significant change in the nature of the entity's operations or a review of its financial statements, that another presentation or classification would be more appropriate having regard to the criteria for the selection and application of accounting policies in Ind AS 8; or

(b) an Ind AS requires a change in presentation."

Further, paragraph 46 of Ind AS 1, *inter alia*, states that "an entity changes the presentation of its financial statements only if the changed presentation provides information that is reliable and more relevant to users of the financial statements and the revised structure is likely to continue, so that comparability is not impaired. When making such changes in presentation, an entity reclassifies its comparative information in accordance with paragraphs 41 and 42."

The following is an example of changes in the presentation or classification of items envisaged in Ind AS 1:

In previous financial years, an entity included derivatives in the aggregate of 'other financial assets' presented on the face of the balance sheet. The amount of derivatives as at 31 March 2019 is significantly higher than the amounts reported in previous balance sheets. The management expects the amounts of derivatives in succeeding periods too to be significant. The management intends to present derivatives separately on face of the balance sheet as it believes that such presentation is relevant to an understanding of the entity's financial position.

Neither Ind AS 1 nor Division II of Schedule III to the Companies Act, 2013 which contains general instructions and formats for preparation of financial statement of a company required to comply with Ind ASs requires presentation of derivatives on the face of the balance sheet. However, paragraph 55 of Ind AS 1 states that an entity shall present additional line items (including by disaggregating the line items listed in paragraph 54 of the standard), headings and sub-totals in the balance sheet when such presentation is relevant to an understanding of the entity's financial position.

Similarly, Division II of Schedule III to the Companies Act, 2013 states that line items, sub-line items and sub-totals shall be presented as an addition or substitution on the face of the financial statements when such presentation is relevant to an understanding of the company's financial position or performance or to cater to industry or sector-specific disclosure requirements or when required for compliance with the amendments to the Companies Act, 2013 or under the Indian Accounting Standards.

In view of the above, it would be appropriate to present derivatives separately on the face of the balance sheet on the basis of the management's assessment that the changed presentation provides information that is reliable and more relevant to users of the financial statements.

The entity will have to reclassify the comparative amounts in accordance with paragraph 41 of Ind AS 1.

Paragraph 40A of Ind AS 1 requires an entity to present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements if, *inter alia,* it reclassifies items in its financial statements and the reclassification has a material effect on the information in the balance sheet at the beginning of the preceding period.

In the given case, if the reclassification of items has a material effect on the information in the balance sheet at the beginning of preceding period, the entity would be required to present a third balance sheet as at the beginning of the preceding period, i.e., 01 April, 2017.

Annexure A - Retrospective restatement: Correction of errors

ABC Ltd has an investment property with an original cost of ₹1,00,000 which it inadvertently omitted to depreciate in previous financial statements. The property was acquired on 1 April 2016. How should the error be corrected in the financial statements for the year ended 31 March 2019, assuming the impact of the same is considered material? The property has a useful life of 10 years and is depreciated using straight line method. Estimated residual value at the end of 10 year is Nil. For simplicity, ignore tax effects.

The error shall be corrected by retrospectively restating the comparatives. A third balance sheet as at the beginning of the earliest period shall also be presented. Relevant extracts of balance sheet, statement of profit and loss and statement of changes in equity are reproduced below:

Balance sheet		Restated	Restated
	31 March 2019	31 March 2018	1 April 2017
	₹	₹	₹
Non-current assets			
Property, plant and equipment	60,500	64,500	70,000
Investment property (refer note 1 below)	70,000	80,000	90,000
Total non-current assets	**130,500**	**144,500**	**160,000**
Current Assets			
Cash	50,000	40,000	60,000
Trade receivables	80,000	100,000	90,000
Total current assets	**130,000**	**140,000**	**150,000**
Total assets	**260,500**	**284,500**	**310,000**
Equity and liabilities			
Equity			
Equity share capital	50,000	50,000	50,000

Other equity			
Reserves and surplus	80,500	60,500	40,000
Total equity	**130,500**	**110,500**	**90,000**
Liabilities			
Current liabilities			
Financial liabilities			
Trade payables	100,000	135,000	122,000
Other financial liabilities	30,000	39,000	98,000
Total Equity and Liabilities	**260,500**	**284,500**	**310,000**

Statement of profit and loss		Restated
	31 March 2019	31 March 2018
	₹	₹
Revenue from operations	48,000	50,000
Other income	2,000	3,000
Total Income	**50,000**	**53,000**
Expenses		
Purchases of stock-in-trade	15,500	16,700
(Increase)/Decrease in inventories of Stock-in-Trade	500	300
Depreciation expense (refer note 1 below)	14,000	15,500
Total expenses	**30,000**	**32,500**
Profit for the year	**20,000**	**20,500**

Statement of changes in equity		Restated
	Equity share capital	Retained earnings
	₹	₹
Balance as at 1 April 2017 as previously reported	**50,000**	**50,000**
Impact of the depreciation on investment property for FY 2016-17 (Refer note 1)	-	(10,000)
Restated balance as at 1 April 2017	**50,000**	**40,000**
Profit for the FY 2017-18 (restated)	-	20,500
Balance as at 31 March 2018	**50,000**	**60,500**
Profit for the FY 2018-19	-	20,000
Balance as at 31 March 2019	**50,000**	**80,500**

Note 1:

During the year ended 31 March 2019, the management undertook a detailed review of its accounting policies and observed that investment property had not been depreciated in previous financial statements due to oversight. As a consequence, the investment property had been incorrectly measured at the original historical cost instead of the depreciated carrying value.

Due to this error, the investment property and retained earnings as at 1 April 2017 were overstated by ₹10,000 each. The error also affected the profit for the year ended 31 March 2018 which was overstated by ₹10,000. The investment property and retained earnings as at 31 March 2018 were overstated by ₹20,000 each.

The error has been corrected by restating each of the affected financial statement line items for the prior periods as follows:

(All figures in ₹)

Balance sheet	**31 March 2018 (as previously reported)**	**Increase/ (decrease) due to correction of error**	**31 March 2018 (restated)**	**1 April 2017 (as previously reported)**	**Increase/ (decrease) due to correction of error**	**1 April 2017 (restated)**
Invest-ment property	100,000	(20,000)	80,000	100,000	(10,000)	90,000
Total Non-current assets	164,500	(20,000)	144,500	170,000	(10,000)	160,000
Total assets	304,500	(20,000)	284,500	320,000	(10,000)	310,000
Retained earnings	80,500	(20,000)	60,500	50,000	(10,000)	40,000
Total equity	130,500	(20,000)	110,500	100,000	(10,000)	90,000

Statement of profit and loss	**31 March 2018 (as previously reported)**	**Increase/ (decrease) due to correction of error**	**31 March 2018 (restated)**
Depreciation	5,500	10,000	15,500
Total expenses	22,500	10,000	32,500
Profit for the year	30,500	(10,000)	20,500

Basic and diluted earnings per share for the prior year have also been restated. The amount of the correction for both basic and diluted earnings per share was a decrease of ₹0.20 per share.

The correction of the error had no impact on previously reported cash flows from operating, investing and financing activities.

Appendix I

Major differences between Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors* and AS 5, *Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies*

(i) There are some differences in the scope of the two standards. For example, unlike AS 5, Ind AS 8 also deals with the criteria for selection of accounting policies. Under ASs, selection of accounting policies is dealt with in AS 1, *Disclosure of Accounting Policies*.

(ii) Under Ind ASs, presentation of any items of income or expense as extraordinary items is explicitly prohibited by Ind AS 1. AS 5, on the other hand, requires separate presentation of extraordinary items in the statement of profit and loss. AS 5 defines extraordinary items as income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly. As per AS 5, extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

(iii) Ind AS 8 requires that, subject to limited exceptions, changes in accounting policies should be accounted for retrospectively by restatement of comparative information. In addition, a third balance sheet as of the beginning of the preceding period is also required to be presented by an entity where it applies an accounting policy retrospectively and the retrospective application has a material effect on the information in the balance sheet at the beginning of the preceding period. While AS 5 does not clearly specify how changes in accounting policies other than those dealt with by specific transitional provisions of an accounting standard should be accounted for (i.e., whether retrospectively or prospectively), it requires that the impact of, and the adjustments resulting from, a change in an accounting policy, if material, should be shown in the financial statements of the period in which the change is made.

(iv) AS 5 defines the term '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. Ind AS 8 instead uses the term 'errors'.

(v) Ind AS 8 requires, subject to limited exception, retrospective correction of material prior period errors, i.e., restatement of comparative information and presentation of a third balance sheet as in case of a retrospective change in an accounting policy where the retrospective correction has a material effect on the information in the balance sheet at the beginning of the preceding period. Thus, under Ind AS 8, material prior period errors are corrected by correcting the recognition, measurement and disclosure of amounts of elements of financial statements retrospectively as if the prior period errors had never occurred. Unlike Ind AS 8, AS 5 requires the correction of prior period items by including the required adjustments in the determination of net profit or loss for the current period, though the standard also permits an alternative approach under which the adjustments are included in the statement of profit and loss after determination of current net profit or loss.

(vi) Disclosure requirements of Ind AS 8 are more detailed as compared to the disclosure requirements of AS 5, e.g. in case of a voluntary change in accounting policy, an entity is required to disclose the reasons why applying the new accounting policy provides reliable and more relevant information.

Appendix II

Major differences between Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors* and IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*

Some of the IFRSs are accompanied by guidance to assist entities in applying their requirements. All such guidance states whether or not it is an integral part of IFRSs. Guidance that is an integral part of the IFRSs is mandatory. Guidance that is not an integral part of the IFRSs does not contain requirements for financial statements. The above position has been explained in paragraph 9 of IAS 8. Only guidance that is an integral part of IFRSs has been included in corresponding Ind ASs. Accordingly, paragraph 9 of Ind AS 8 has been suitably reworded.