IPSAS 3 — ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS
as adopted by the Maltese Government

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CONTENTS Paragraph

International Public Sector Accounting Standard 3, *Accounting Policies, Changes in Accounting Estimates And Errors, as adopted by the Maltese Government*, is set out in paragraphs 1–61. All the paragraphs have equal authority. IPSAS 3[1] should be read in the context of its objective.

[1] References to IPSAS 3 or any other IPSAS shall be taken as meaning 'as adopted by the Maltese Government'

Objective

1. The objective of this Standard is to prescribe the criteria for selecting and changing accounting policies, together with the (a) accounting treatment and disclosure of changes in accounting policies, (b) changes in accounting estimates and, (c) the corrections of errors. This 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.

2. Disclosure requirements for accounting policies, except those for changes in accounting policies, are set out in IPSAS 1, *Presentation of Financial Statements*.

Scope

3. **This Standard shall be applied in selecting and applying accounting policies, and accounting for changes in accounting policies, changes in accounting estimates and corrections of prior period errors.**

4. The tax effects of corrections of prior period errors and of retrospective adjustments made to apply changes in accounting policies are not considered in this Standard as they are not relevant for Central Government entities. International or national accounting standards dealing with income taxes contain guidance on the treatment of tax effects.

5. **[Deleted]**

6. [Deleted]

Definitions

7. **The following terms are used in this Standard with the meanings specified:**

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

   <u>Central Government Entities</u> means Government Ministries and Departments.

   A <u>change in accounting estimate</u> 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 correction of errors.

   <u>Impracticable.</u> Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:

   (a) The effects of the retrospective application or retrospective restatement are not determinable;

   (b) The retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or

   (c) The retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:

   (i) Provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognized, measured or disclosed; and

   (ii) Would have been available when the financial statements for that prior period were authorized for issue;

   from other information.

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 authorized 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.

Prospective application of a change in accounting policy and of recognizing the effect of a change in an accounting estimate, respectively, are:

(a) Applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed; and

(b) Recognizing the effect of the change in the accounting estimate in the current and future periods affected by the change.

Retrospective application is applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.

Retrospective restatement is correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.

Terms defined in other IPSASs are used in this Standard with the same meaning as in those other Standards, and are published separately.

Materiality

8. Assessing whether an omission or misstatement could influence decisions of users, and so be material, requires consideration of the characteristics of those users. Users are assumed to have a reasonable knowledge of the public sector and economic activities and accounting and a willingness to study the information with reasonable diligence. Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making and evaluating decisions.

Accounting Policies

Selection and Application of Accounting Policies

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

10. IPSASs set out accounting policies that the IPSASB has concluded result in financial statements containing relevant and reliable information about the transactions, other events and conditions to which they apply. Those policies need not be applied when the effect of applying them is immaterial. However, it is inappropriate to make, or leave uncorrected, immaterial departures from IPSASs to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

11. [Not used].

12. **In the absence of an IPSAS that specifically applies to a transaction, other event or condition, management shall use its judgment in developing and applying an accounting policy that results in information that is relevant to the accountability and decision-making needs of users, faithfully represents the financial position, financial performance, and cash flows of the entity, meets the qualitative characteristics of understandability, timeliness, comparability, verifiability and takes account of the constraints on information included in general purpose financial reports and the balance between the qualitative characteristics.**

13. **[Deleted]**

14. **In making the judgment, described in paragraph 12, management shall refer to, and consider the applicability of, the following sources in descending order:**

- **(a) The requirements in IPSASs dealing with similar and related issues; and**
- **(b) The definitions, recognition and measurement criteria for assets, liabilities, revenue and expenses described in the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities.**

15. **In making the judgment described in paragraph 12, management may also consider (a) the most recent pronouncements of other standard-setting bodies, and (b) accepted public or private sector practices to the extent, but only to the extent, that these do not conflict with the sources in** paragraph **14. Examples of such pronouncements include pronouncements of the IASB, including IFRSs and Interpretations issued by the IASB's International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).**

Consistency of Accounting Policies

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

Changes in Accounting Policies

17. **An entity shall change an accounting policy only if the change:**
    - **(a) Is required by an IPSAS; or**
    - **(b) Results in the financial statements providing reliable and more relevant information about the effects of transactions, other events and conditions on the entity's financial position, financial performance or cash flows.**

18. 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, 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 17.

19. **A change from one basis of accounting to another basis of accounting is a change in accounting policy.**

20. **A change in the accounting treatment, recognition or measurement of a transaction, event or condition within a basis of accounting is regarded as a change in accounting policy.**

21. **The following are not changes in accounting policies:**
    - **(a) The application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring; and**
    - **(b) The application of a new accounting policy for transactions, other events or conditions that did not occur previously or that were immaterial.**

22. **The initial application of a policy to revalue assets in accordance with IPSAS 17, "Property, Plant and Equipment" or IPSAS 31, Intangible Assets, is a change in accounting policy to be dealt with as a revaluation in accordance with IPSAS 17 or IPSAS 31, rather than in accordance with this Standard.**

23. Paragraphs 24-36 do not apply to the change in accounting policy described in paragraph 22.

Applying Changes in Accounting Policies

24. **Subject to paragraph 28:**
    - **(a) An entity shall account for a change in accounting policy resulting from the initial application of an IPSAS in accordance with the specific transitional provisions, if any, in that Standard; and**

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

25. For the purpose of this standard, early application of a Standard is not a voluntary change in accounting policy.

26. In the absence of an IPSAS that specifically applies to a transaction, other event or condition, management may, in accordance with paragraph 15, apply an accounting policy from (a) the most recent pronouncements of other standard setting bodies and, (b) accepted public or private sector practices to the extent, but only to the extent, that these are consistent with paragraph 14. Examples of such pronouncements include pronouncements of the IASB, including the *Framework for the Preparation and Presentation of Financial Statements,* IFRSs and Interpretations issued by the IFRIC or the former SIC. 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.

Retrospective Application

27. **Subject to paragraph 28, when a change in accounting policy is applied retrospectively in accordance with paragraph 24(a) or (b), the entity shall adjust the opening balance of each affected component of net assets/equity for the earliest period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.**

Limitations on Retrospective Application

28. **When retrospective application is required by paragraph 24(a) or (b), a change in accounting policy shall be applied retrospectively except to the extent that it is impracticable to determine either the period specific effects or the cumulative effect of the change.**

29. **When it is impracticable to determine the period specific effects of changing an accounting policy on comparative information for one or more prior periods presented, the entity shall apply the new accounting policy to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable, which may be the current period, and shall make a corresponding adjustment to the opening balance of each affected component of net assets/equity for that period.**

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

31. When an entity applies a new accounting policy retrospectively, it applies the new accounting policy to comparative information for prior periods as far back as is practicable. Retrospective application to a prior period is not practicable unless it is practicable to determine the cumulative effect on the amounts in both the opening and closing statement of financial positions for that period. The amount of the resulting adjustment relating to periods before those presented in the financial statements is made to the opening balance of each affected component of net assets/equity of the earliest prior period presented. Usually the adjustment is made to accumulated surpluses or deficits. However, the adjustment may be made to another component of net assets/equity (for example, to comply with an IPSAS). Any other information about prior periods, such as historical summaries of financial data, is also adjusted as far back as is practicable.

32. When it is impracticable for an entity to apply a new accounting policy retrospectively, because it cannot determine the cumulative effect of applying the policy to all prior periods, the entity, in accordance with paragraph 30, applies the new policy prospectively from the start of the earliest period practicable. It therefore disregards the portion of the cumulative adjustment to assets, liabilities and net assets/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. Paragraphs 55-58 provide guidance when it is impracticable to apply a new accounting policy to one or more prior periods.

Disclosure

33. **When initial application of an IPSAS (a) has an effect on the current period or any prior period, (b) would have such an effect except that it is impracticable to determine the amount of the adjustment, or (c) might have an effect on future periods, an entity shall disclose:**

    (a) The title of the Standard;

    (b) When applicable, that the change in accounting policy is made in accordance with its transitional provisions;

    (c) The nature of the change in accounting policy;

    (d) When applicable, a description of the transitional provisions;

    (e) When applicable, the transitional provisions that might have an effect on future periods;

    (f) For the current period and each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected;

    (g) The amount of the adjustment relating to periods before those presented, to the extent practicable; and

    (h) If retrospective application required by paragraph 24(a) or (b) is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

Financial statements of subsequent periods need not repeat these disclosures.

34. **When a voluntary change in accounting policy (a) has an effect on the current period or any prior period, (b) would have an effect on that period except that it is impracticable to determine the amount of the adjustment, or (c) 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 for each financial statement line item affected;

    (d) The amount of the adjustment relating to periods before those presented, to the extent practicable; and

    (e) If retrospective application is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

Financial statements of subsequent periods need not repeat these disclosures.

35. **When an entity has not applied a new IPSAS 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 Standard will have on the entity's financial statements in the period of initial application.

36. In complying with paragraph 35, an entity considers disclosing:

    (a) The title of the new IPSAS;

    (b) The nature of the impending change or changes in accounting policy;

    (c) The date by which application of the Standard is required;

(d) The date as at which it plans to apply the Standard initially; and

(e) Either:

(i) A discussion of the impact that initial application of the Standard 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.

Changes in Accounting Estimates

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

(a) Tax revenue due to government;

(b) Bad debts arising from uncollected taxes;

(c) Inventory obsolescence;

(d) The fair value of financial assets or financial liabilities;

(e) The useful lives of, or expected pattern of consumption of future economic benefits or service potential embodied in depreciable assets, or the percentage completion of road construction; and

(a) Warranty obligations.

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

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

40. A change in the measurement basis applied is a change in an accounting policy, and is not a change in an accounting estimate. When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate.

41. **The effect of a change in an accounting estimate, other than a change to which paragraph 42 applies, shall be recognized prospectively by including it in surplus or deficit in:**

(a) The period of the change, if the change affects the period only; or

(b) The period of the change and future periods, if the change affects both.

42. **To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of net assets/equity, it shall be recognized by adjusting the carrying amount of the related asset, liability or net assets/equity item in the period of change.**

43. 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 surplus or deficit, or the surplus or deficit of both the current period and future periods. For example, a change in the estimate of the amount of bad debts affects only the current period's surplus or deficit and therefore is recognized in the current period. However, a change in the estimated useful life of, or the expected pattern of consumption of economic benefits or service potential embodied in a depreciable asset affects the 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 recognized as revenue or expense in the current period. The effect, if any, on future periods is recognized in future periods.

Disclosure

44. **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 on future periods, except for the**

disclosure of the effect on future periods when it is impracticable to estimate that effect.

45. **If the amount of the effect in future periods is not disclosed because estimating it is impracticable, the entity shall disclose that fact.**

Errors

46. Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with IPSASs 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 authorized 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 (see paragraphs 47-52).

47. **Subject to paragraph 48, an entity shall correct material prior period errors retrospectively in the first set of financial statements authorized for issue after their discovery by:**

(a) Restating the comparative amounts for 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 net assets/equity for the earliest prior period presented.

Limitations of Retrospective Restatement

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

49. **When it is impracticable to determine the period specific effects of an error on comparative information for one or more prior periods presented, the entity shall restate the opening balances of assets, liabilities and net assets/equity for the earliest period for which retrospective restatement is practicable (which may be the current period).**

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

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

52. When it is impracticable to determine the amount of an error (e.g., a mistake in applying an accounting policy) for all prior periods, the entity, in accordance with paragraph 50, restates the comparative information prospectively from the earliest date practicable. It therefore disregards the portion of the cumulative restatement of assets, liabilities and net assets/equity arising before that date. Paragraphs 55-58 provide guidance on when it is impracticable to correct an error for one or more prior periods.

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

Disclosure of Prior Period Errors

54. **In applying paragraph 47, an entity shall disclose the following:**

(a) The nature of the prior period error;

(b) For each prior period presented, to the extent practicable, the amount of the correction for each financial statement line item affected;

(c) The amount of the correction at the beginning of the earliest prior period presented; and

(d) If retrospective restatement is impracticable for a particular prior period, the circumstances that led to the existence of that condition and a description of how and from when the error has been corrected.

Financial statements of subsequent periods need not repeat these disclosures.

Impracticability in Respect of Retrospective Application and Retrospective Restatement

55. In some circumstances, it is impracticable to adjust comparative information for one or more prior periods to achieve comparability with the current period. For example, data may not have been collected in the prior period(s) in a way that allows either retrospective application of a new accounting policy (including, for the purpose of paragraphs 56-58, its prospective application to prior periods) or retrospective restatement to correct a prior period error, and it may be impracticable to recreate the information.

56. It is frequently necessary to make estimates in applying an accounting policy to elements of financial statements recognized or disclosed in respect of transactions, other events or conditions. Estimation is inherently subjective, and estimates may be developed after the reporting date. Developing estimates is potentially more difficult when retrospectively applying an accounting policy or making a retrospective restatement to correct a prior period error, because of the longer period of time that might have passed since the affected transaction, other event or condition occurred. However, the objective of estimates related to prior periods remains the same as for estimates made in the current period, namely, for the estimate to reflect the circumstances that existed when the transaction, other event or condition occurred.

57. Therefore, retrospectively applying a new accounting policy or correcting a prior period error requires distinguishing information that:

(a) Provides evidence of circumstances that existed on the date(s) as at which the transaction, other event or condition occurred, and

(b) Would have been available when the financial statements for that prior period were authorized for issue.

from other information. For some types of estimates (e.g., an estimate of fair value not based on an observable price or observable inputs), it is impracticable to distinguish these types of information. When retrospective application or retrospective restatement would require making a significant estimate for which it is impossible to distinguish these two types of information, it is impracticable to apply the new accounting policy or correct the prior period error retrospectively.

58. 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 recognized, measured or disclosed in a prior period. For example, when an entity corrects a prior period error in classifying a government building as an investment property (the building was previously classified as property, plant and equipment), it does not change the basis of classification for that period, if management decided later to use that building as an owner occupied office building. In addition, when an entity corrects a prior period error in calculating its liability for provision of cleaning costs of pollution resulting from government operations in accordance with IPSAS 19, *"Provisions, Contingent Liabilities and Contingent Assets,"* it disregards information about an unusually large oil leak from a naval supply ship during the next period that became available after the financial statements for the prior period were authorized 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.

Effective Date

59 – 60 [Not used]

60A. Central Government entities shall apply this Standard for annual financial statements covering periods beginning or after DD/MM/YY. Earlier application is not permitted.

Withdrawal of IPSAS 3 (2000)

61. [Not used]