IPSAS 3 Accounting Policies, Changes in Accounting Estimates & Errors

Guidelines

IPSAS Implementation Team

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Introduction

1. IPSAS 3 Accounting Policies, Changes in Accounting Estimates & Errors – as adopted by the Maltese Government

1.1 These guidelines refer to the Accounting Policies, Changes in Accounting Estimates & Errors accounting standard **as adopted by the Maltese Government**. This version is based on the original IPSAS 3 developed by the International Public Sector Accounting Standards Board (IPSASB). Modifications were made to the original standard to make it more applicable to the local context.

2. Scope

2.1 These guidelines were prepared to enable the users to:

2.2 Develop a working-level knowledge of the principles contained in the accounting standard; and

2.3 Understand and appreciate the major challenges and benefits resulting from the implementation of IPSAS 3[1].

3. Target Audience

3.1 These guidelines are designed for finance and non-finance employees employed in Ministries and Departments of the Government of Malta.

4. Guidelines Structure

4.1 These guidelines shall provide a detailed overview of all the principles contained in the standard. The objective of this Standard is to prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and the corrections of errors.

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

A. Accounting Policies

1. Selection and Application of Accounting Policies

1.1 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.

1.2 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:

1.2.1. Relevant to the decision-making needs of users; and

1.2.2. Reliable, in that the financial statements:

1.2.2.1. Represent faithfully the financial position, financial performance and cash flows of the entity;

1.2.2.2. Reflect the economic substance of transactions, other events and conditions and not merely the legal form;

1.2.2.3. Are neutral i.e., free from bias;

1.2.2.4. Are prudent; and

1.2.2.5. Are complete in all material respects.

1.3 In making the judgment, described in the above paragraph, management shall refer to, and consider the applicability of, the following sources in descending order:

1.3.1. The requirements and guidance in IPSASs dealing with similar and related issues; and

1.3.2. The definitions, recognition and measurement criteria for assets, liabilities, revenue and expenses described in other IPSASs.

1.4 In making the judgment described in paragraph 1.2 above, management may also consider the most recent pronouncements of other standard-setting bodies and accepted public or private sector practices to the extent, but only to the extent, that these do not conflict with the sources in paragraph 1.3.

2. Consistency of Accounting Policies:

2.1 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 a Standard requires or permits such categorization, an appropriate accounting policy shall be selected and applied consistently to each category.

3. Changes in Accounting Policies: An entity shall change an accounting policy only if the change:

3.1 Is required by an IPSAS; or

3.2 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.

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

3.4 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.

3.5 The following are **not** changes in accounting policies:

3.5.1. The application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring; and

3.5.2. The application of a new accounting policy for transactions, other events or conditions that did not occur previously or that were immaterial.

4. Applying Changes in Accounting Policies. [Subject to paragraph 4.4]

4.1 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

4.2 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.

4.3 **Retrospective Application**: Subject to paragraph 4.4, when a change in accounting policy is applied retrospectively in accordance with paragraph 4.1 or 4.2 above, 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.

4.4 **Limitations on Retrospective Application**: When retrospective application is required by paragraph 4.1 or 4.2, 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.

4.4.1. 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.

4.4.2. 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.

B. Disclosure (accounting policies)

1. When initial application of an IPSAS has an effect on the current period or any prior or future period, except where it is impracticable to determine the amount of the adjustment an entity shall disclose:

1.1 The title of the Standard;

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

1.3 The nature of the change in accounting policy;

1.4 When applicable, a description of the transitional provisions;

1.5 When applicable, the transitional provisions that might have an effect on future periods;

1.6 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;

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

1.8 If retrospective application required by paragraph 4.1 or 4.2 above 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.

1.9 Financial statements of subsequent periods need not repeat these disclosures.

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

2.1 The nature of the change in accounting policy;

2.2 The reasons why applying the new accounting policy provides reliable and more relevant information;

2.3 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;

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

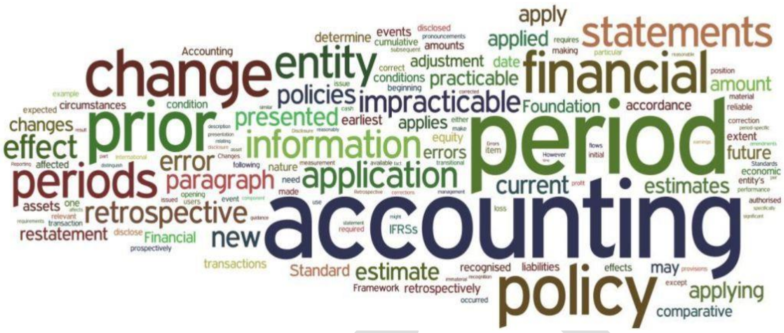
2.5 If retrospective application is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

2.6 Financial statements of subsequent periods need not repeat these disclosures.

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

3.1 This fact; and

3.2 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.



C. Changes in Accounting Estimates

Estimation involves judgments based on the latest available, reliable information.

1. 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:

1.1. Tax revenue due to government;
1.2. Bad debts arising from uncollected taxes;
1.3. Inventory obsolescence;
1.4. The fair value of financial assets or financial liabilities;
1.5. 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
1.6. Warranty obligations.

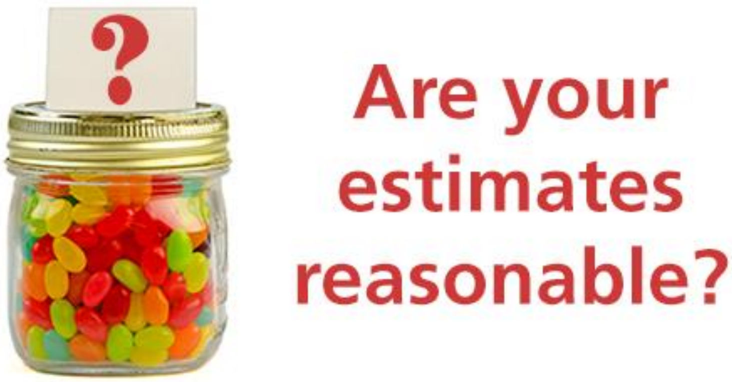
2. An estimate may need revision if changes occur in the circumstances on which the estimate was based or as a result of new information or more experience. By its nature, the **revision of an estimate** does **not** relate to **prior periods** and is not the **correction of an error**.

3. 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.

4. 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:

4.1. The period of the change, if the change affects the period only; or
4.2. The period of the change and future periods, if the change affects both.

5. 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. 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.



D. Disclosure (accounting estimates' changes)

1. 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.

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

E. Errors

1. **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

2. Subject to paragraph 3 below, an entity shall correct material prior period errors retrospectively in the first set of financial statements authorized for issue after their discovery by:
   2.1 Restating the comparative amounts for prior period(s) presented in which the error occurred; or
   2.2 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.

3. **Limitations of Retrospective Restatement**
   3.1 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.
   3.2 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).
   3.3 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.
   3.4 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.
   3.5 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.

4. Impracticability in Respect of Retrospective Application and Retrospective Restatement

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

4.2 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.

4.3 Therefore, retrospectively applying a new accounting policy or correcting a prior period error requires distinguishing information from other information that:

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

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

F. Disclosure of Prior Period Errors

1. In applying paragraph 2 above, an entity shall disclose the following:

1.1 The nature of the prior period error;

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

1.3 The amount of the correction at the beginning of the earliest prior period presented; and

1.4 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.

G. Examples

1. Example 1—Retrospective Restatement of Errors

1.1 Department X incorrectly understated revenue in 2017 and these were recorded in 2018. Revenue in 2018 amounted to €80,000, expenses €60,000 with a surplus of €20,000. €5,000 of the 2018 revenue represented the 2017 revenue recorded in 2018.

1.2 In 2017 the department reported €45,000 revenue, against expenses of €30,000, with a surplus of €15,000.

1.3 2017 opening accumulated surplus was €90,000 and closing accumulated surplus was €105,000.

1.4 The error was restated retrospectively and therefore 2018 revenue was decreased by €5,000 (now amounting to €75,000) and the 2017 revenue increased to €50,000.

STATEMENT OF FINANCIAL PERFORMANCE		
	2018	2017 [RESTATED]
Revenue	€75,000	€50,000
Expenses	(€60,000)	(€30,000)
Surplus	**€15,000**	**€20,000**

STATEMENT OF CHANGES IN EQUITY		
	Accumulated Surpluses	Total
	[RESTATED]	
Balance as at 31/12/2016	€90,000	€90,000
Surplus for Y/E 31/12/2017	€20,000	€20,000
Balance as at 31/12/2017	**€110,000**	**€110,000**
Surplus for Y/E 31/12/2018	€15,000	€15,000
Balance as at 31/12/2018	**€125,000**	**€125,000**

Extract from Notes to the Financial Statements
Revenue amounting to €5,000 was incorrectly omitted in 2017 financial statements and these have now been restated to correct the error. In 2017 revenue and accumulated surpluses increased by €5,000, with a corresponding decrease in revenue in 2018. Closing accumulated surpluses at the end of 2018 remain unchanged.

2. Example 2— Change in Accounting Policy with Retrospective Application

2.1 Department Y changed its accounting policy on capitalising borrowing costs. It has decided that borrowing costs, previously capitalised when incurred during the construction of a plant, will now be treated as expenditure. €1,000 were previously capitalised in 2017, and a further €2,000 had been capitalised before 2017.

2.2 Surplus amounted to €20,000 in 2017 and €25,000 in 2018.

2.3 In 2018 the department incurred a borrowing interest expense of €1,500.

2.4 2016 opening accumulated surpluses were €90,000 and closing accumulated surpluses were €95,000.

STATEMENT OF FINANCIAL PERFORMANCE		
	2018	2017 [RESTATED]
Surplus before interest	€25,000	€20,000
Interest Expense	(€1,500)	(€1,000)
Surplus	**€23,500**	**€19,000**

STATEMENT OF CHANGES IN EQUITY		
	Accumulated Surpluses	Total
	[RESTATED]	
Balance as at 31/12/2016 (previously reported)	€90,000	€90,000
Policy change - interest now expensed	(€2,000)	(€2,000)
Balance as at 31/12/2016 (restated)	**€88, 000**	**€88,000**
Surplus for Y/E 31/12/2017 (restated)	€19,000	€19,000
Balance as at 31/12/2017	**€107,000**	**€107,000**
Surplus for Y/E 31/12/2018	€23,500	€23,500
Balance as at 31/12/2018	**€130,500**	**€130,500**

Extract from Notes to the Financial Statements
The department changed the accounting policy for borrowing costs on the basis of providing more transparent information, and decided to expense instead of capitalising borrowing interest expenses. The change in policy has had an effect on the accumulated surpluses and the value of the asset of the department for the years 2016 and 2017, as these had to be restated. The total restated amount was €3,000. In 2018 the interest was expensed in accordance with the revised policy.

3. Example 3— Prospective Application of a Change in Accounting Policy When Retrospective Application is not Practicable

3.1 In 2017 Government decided that buildings should be valued using the revaluation model instead of the cost model, as this gave a fairer representation of the value of its property at balance sheet date. As it would have been very difficult to adopt this approach retrospectively, Government decided to apply it prospectively from the start of 2018, applying the value of the buildings at fair value as from 2018.

3.2 Information on buildings (cost model):

Cost	€100,000,000
Accumulated Depreciation	€10,000,000
Net Book Value	€90,000,000

Prospective Depreciation expense (2018) €2,000,000

New information on buildings:

Valuation (2018) (Revaluation model)	€150,000,000
Useful life	50 years
Depreciation expense (2018)	€3,000,000

Extract from Notes to the Financial Statements
In 2017 Government decided that measuring the value of buildings using the revaluation model (instead of the cost model) would give a fairer representation of the value of property held by Government at balance sheet date. The policy has been applied prospectively from the start of 2018 because it was not practicable to estimate the effects of applying the policy either retrospectively or prospectively from any earlier date. Accordingly, the adopting of the new policy has no effect on prior periods. The effect on the current year is to increase the carrying amount of property at the start of the year by €60,000,000 [€150,000,000 - €90,000,000], create a revaluation reserve at the start of the year of €60,000,000; and increase depreciation expense by €1,000,000.

Glossary

''Accruals-based accounting'' Accruals-based accounting is a system of accounting based on the accrual principal, under which revenue is recognised (recorded) when earned, and expenses are recognised when incurred.

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

'Borrowing Costs'' Borrowing costs are interest and other expenses incurred by an entity in connection with the borrowing of funds.

''Central Government Entities (CGEs)'' The term CGEs refers only to ministries and departments of the Government of Malta.

''Change in accounting estimate'' 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 correction of errors.

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

- The effects of the retrospective application or retrospective restatement are not determinable;
- The retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or
- The retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information from other information about those estimates that:
    - Provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognized, measured or disclosed; and
    - Would have been available when the financial statements for that prior period were authorized for issue

‘’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:

- Was available when financial statements for those periods were authorized for issue; and
- 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’’ Prospective application of a change in accounting policy and of recognizing the effect of a change in an accounting estimate, respectively, are:

- Applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed; and
- Recognizing the effect of the change in the accounting estimate in the current and future periods affected by the change.

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

‘’Retrospective restatement’’ 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.