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Amendments to IAS 8

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The International Accounting Standards Board (IASB) has issued amendments to Internal Accounting Standard (IAS) 8: Accounting Policies, Changes in Accounting Estimates and Errors. These amendments come as a result of the key concept of "*accounting estimate*" not finding a verbatim or substance-driven definition within the framework. In the course of this article, we discuss the newly-prescribed definition of the term "accounting estimate" by throwing light on the following matters:

- Need for guidance and impact on Indian reporting
- Maintaining consistency with standards on auditing and assurance
- Responsibilities of the management while making and reporting accounting estimates
- Responsibilities of the auditor while auditing accounting estimates

The need for Guidance and Impact on Indian Reporting

IAS 8 prescribes guidance on accounting policies, changes in accounting estimates, and errors. While IAS 8 prescribes guidance on these standards, the standard does not define "accounting estimates." Interestingly, IAS 8 defines changes in accounting estimates but does not define the core term "accounting estimates."

This gap in the standard leads to application issues, as reporting entities find it challenging to demarcate changes in accounting policies from changes in accounting estimates. Here, it is imperative to distinguish between changes in accounting policies and estimates due to the methodology of their application, which has been summarized below:

Changes in accounting estimates	Changes in accounting policies	Impact of not being able to distinguish between accounting policies and estimates
Prospectively applied	Retrospectively applied	Inconsistent financial reporting leads to misleading financial statements.

Hence, the IASB issued a clarification on the definition of the term "accounting estimates" to iron out the challenge of distinguishing between accounting estimates and policies.

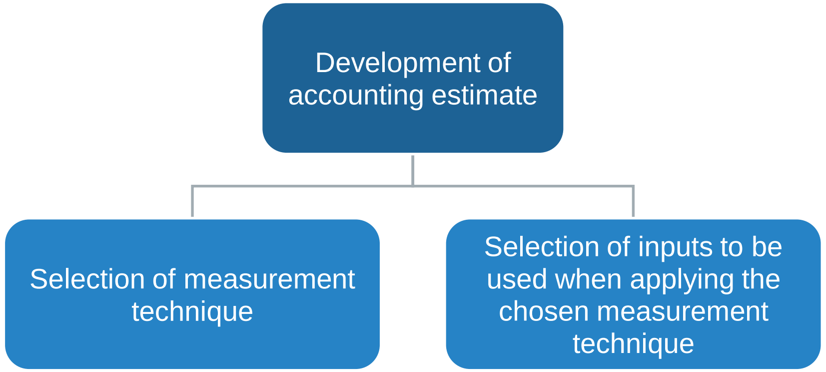
Indian Accounting Standards (Ind AS) draw direct guidance from the International Financial Reporting Standards (IFRS). The Institute of Chartered Accountants of India (ICAI) issued an exposure draft containing corresponding amendments to Ind AS 8, the Ind AS counterpart of IAS 8. This exposure draft is effective from 1 April 2023.

Link to ICAI exposure draft: https://resource.cdn.icai.org/64954asb52213.pdf

The new definition of "accounting estimates" under IAS 8 is given below:

"Accounting estimates are monetary amounts in financial statements that are subject to measurement uncertainty."

This now clarifies that accounting estimates are developed to achieve the objectives of the accounting policy. The process of developing an accounting estimate is driven by management judgment that encompasses the following:



The amendments to IAS 8 now list examples of estimates that can be made by the management. This prescribed list covers:

- The net realizable value of an item of inventory, applying IAS 2: Inventories
- Loss allowance for expected credit losses, applying IFRS 9: Financial Instruments
- The fair value of an asset or liability, applying IFRS 13: Fair Value Measurement
- The depreciation expense for an item of property, plant, and equipment, applying IAS 16: Property, Plant, and Equipment.

The erstwhile definition of accounting policies mentioned as "The specific principles, bases, conventions, rules, and practices applied by an entity in preparing and presenting financial statements" stays unchanged under the amended IAS 8.

Consistency of New Definition with International Standards on Audit (ISA)

International Standard on Auditing (ISA) 540

ISA 540: Auditing Accounting Estimates and Related Disclosures, including fair value accounting estimates, defines accounting estimates as "*An approximation of a monetary amount in the absence of a precise means of measurement. This term is used for an amount measured at fair value where there is estimation uncertainty, as well as for other amounts that require estimation.*"

IAS 8

The amended IAS 8 defines an accounting estimate as "*Accounting estimates are monetary amounts in financial statements that are subject to measurement uncertainty.*"

Our Comments

- The revised definition of accounting estimates in the amended IAS 8 is on similar lines as that of ISA 540, thereby maintaining consistency between the definition for both reporting as well as assurance purposes.
- ISA 540 uses the term accounting estimates in the following light:
  - As an approximation of a monetary sum of money in the absence of a precise means of measurement
  - For amounts to be measured at fair value where there is an estimation uncertainty.
  - For other amounts that need estimation.
- From an Indian assurance perspective, SA 540 (the Indian counterpart of ISA 540) has adopted the word-for-word definition from ISA 540. Hence, from 1 April 2023 onwards, the definition of "accounting estimate" under Ind AS 8 and SA 540 will be synonymous.
- Reporting accounting estimates are subject to "estimation uncertainty" and this will result in inherent limitations while auditing the information based on such estimates.
- The application of ISA 540/SA 540 clearly prescribes the management's responsibility while making and reporting accounting estimates as well as the auditor's responsibility while auditing the same. This has been discussed in the next section.

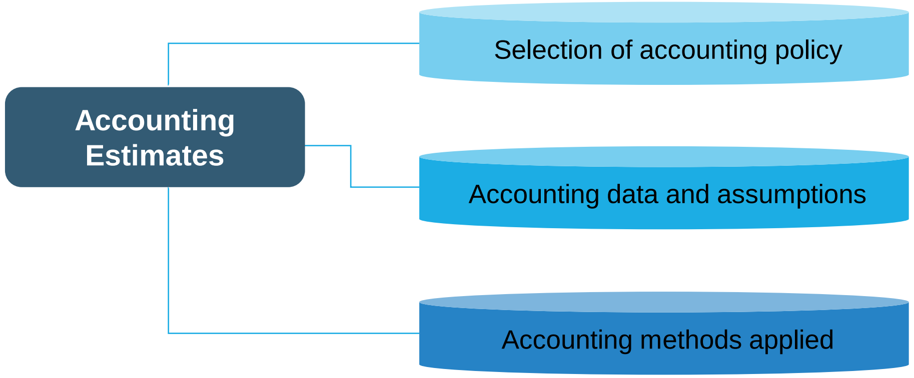
Responsibilities of the Management while making and Reporting Accounting Estimates

Financial statements are a structured accumulation of management assertions, generally made on an annual basis. While reporting sums are based on an estimate, the foremost step is to identify all those events and transactions that would require an estimate to be used.

A balanced combination of the following factors will play a crucial role in reporting and presenting accounting estimates in the financial statements:

- Prior experience on the part of the management while reporting events and transactions that require estimates
- The management's understanding of the nature of reporting and business of the entity, along with the industry in which it operates.

Accounting estimates are based on three fundamental aspects illustrated below:



Here, it must be appreciated that internal controls play a key role in making appropriate assumptions.

The management is required to establish a robust process that acts as a filter to ensure that estimates are made in a fair manner that clearly reflects accuracy. Financial statements are at risk of being grossly misleading if estimates are inaccurately based. The management has to install appropriate measures to avert this risk of misstatement.
This can be achieved by:

Selection of appropriate accounting policies

The management will have to stay true to the prescriptions of the applicable GAAPs in developing estimates. Guidance will have to be drawn from how GAAP prescribes estimates to be presented in the case of items such as expected credit losses.

Developing or identifying relevant data and assumptions that affect accounting estimates

The assumptions used to base the estimates must be supported by purported sources of information, which could be both internal as well as external to the entity. Internal information can be drawn from the entity's accounting data and trends, while external information can be based on industry trends and practices. Estimates for one-off events, complicated technical issues, and unusual transactions are better supported by expert inputs.

Periodic monitoring and review

Re-estimation of existing estimates, re-examination of conditions on which estimates were based, and a technical review of reported figures help ensure sound and fair reporting on the part of the management. Estimates will always be prone to risk and questionable precision. Here, the account controllers have to wholistically evaluate alternate assumptions as per the circumstances and situation at hand.

Auditor's Responsibility

Both ISA 540 and SA 540 require the auditor to perform audit procedures that enable a thorough understanding of the management's process of developing estimates and reporting based on those estimates. This would require the auditor to examine whether controls monitoring the construction of these estimates are:

- Sufficient overall
- Effectively operating with zero or minimal exceptions such as a management over-ride in special cases

The process of assurance is primarily driven by the auditor's professional judgment, and this plays a key role in the auditor assessing how the management has evaluated the impact of estimation uncertainty. All data, up to the date of the audit report, has to be carefully subjected to audit procedures in order to minimize audit risk, which inherently exists while dealing with accounting estimates.

Also, communicating with those charged with governance regarding the following matters would be essential to:

- The qualitative aspect of estimates
- Any indications of bias on the part of the management while building estimates and reporting based on the same
- Deficiencies in internal controls, especially with respect to processes that are applied in reporting based on estimates
- Auditor's reservations about the estimates reported

The synonymity between SA 540 and ISA 540 ensures that Indian assurance meets globally required levels of quality.

Conclusion

The ICAI adopting international amendments in its guidance to accounting framework in India ensures that Indian accounting qualitatively navigates the tides of international changes. Ind AS is not just an accounting framework but rather a means to ensure uniformity with global practices. These timely changes ensure that Indian reporting and assurance match global developments in the sphere. It is needless to say that this immensely benefits reporting and communication of financial information with global audiences who have an interest in Indian markets.

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