

# accounting for changes in estimates

## Accounting for Changes in Estimates: A Practical Guide

Author: Evelyn Reed, CPA, CMA, CGMA

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Abstract: This article explores the complexities of accounting for changes in estimates, a crucial aspect of financial reporting. We'll delve into the principles, practical applications, and potential pitfalls, illustrated through real-world examples and personal anecdotes from a seasoned CPA. The article emphasizes the importance of proper judgment, materiality assessment, and adherence to relevant accounting standards in handling these changes.

### 1. Understanding the Nature of Estimates in Accounting

Accounting is not an exact science. Many transactions and events require estimations, inherently introducing uncertainty into the financial statements. Examples abound: the useful life of an asset for depreciation, the collectability of accounts receivable, the ultimate cost of a long-term project, and the useful life of intangible assets. Accurate financial reporting relies heavily on the reliability of these estimates. However, new information or changed circumstances might necessitate revising these estimates, leading to the critical process of accounting for changes in estimates.

During my early days as an auditor, I encountered a case involving a manufacturing company that had significantly underestimated the useful life of its specialized machinery. Initially, the depreciation expense was low, leading to inflated profits. However, after a thorough inspection and expert consultation, it became clear that the machinery would require replacement much sooner than initially projected. Accounting for changes in estimates necessitated a recalculation of depreciation expense, impacting both the current year's and future years' financial statements. This experience underscored the importance of diligent estimation and the potential repercussions of inaccurate projections.

## 2. The Principles of Accounting for Changes in Estimates

Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS) dictate that changes in accounting estimates should be handled prospectively. This means that the effect of the change is recognized in the current and future periods, not retrospectively altering prior periods' financial statements. This approach ensures consistency and avoids the complexities of restating past results. The change is accounted for by adjusting the current and future periods' financial statements. However, if the change arises from an error in prior periods, the correction is dealt with differently.

For example, consider a situation where a company initially estimated the bad debt expense to be 2% of credit sales. However, due to a change in the economic climate, they revised this estimate to 5%. Accounting for changes in estimates in this scenario would involve increasing the bad debt expense in the current and future periods to reflect the higher percentage. This will reduce the net income in the current and subsequent years.

## 3. Materiality and its Impact on Accounting for Changes in Estimates

The materiality principle plays a crucial role in accounting for changes in estimates. A change is deemed material if it could influence the decisions of users of the financial statements. If a change is immaterial, it may not require adjustment. The determination of materiality is a matter of professional judgment, considering both the quantitative and qualitative aspects of the change. A small change in the estimate for a low-value asset might be immaterial, while a similar change for a significant asset could be material.

In one instance, a client of mine revised the estimated useful life of a building. The quantitative impact on depreciation expense was minimal. However, due to the building being a significant asset for the company, the change was considered material, requiring adjustments to the financial statements and disclosures. This illustrates that accounting for changes in estimates isn't solely a numerical exercise; qualitative factors are also crucial.

## 4. Specific Examples of Changes in Estimates

**Depreciation:** Changes in the estimated useful life or salvage value of an asset directly impact the annual depreciation expense.

**Impairment:** A change in the estimated recoverable amount of an asset can lead to an impairment loss.

**Revenue Recognition:** Changes in estimates related to the timing or amount of revenue to be recognized affect the income statement.

**Warranty Expense:** Changes in the estimated warranty claims necessitate adjusting the warranty expense.

**Allowance for Doubtful Accounts:** Changes in estimates concerning the collectibility of accounts receivable affect the bad debt expense and net accounts receivable.

Each of these scenarios requires careful consideration of accounting for changes in estimates to ensure

accurate financial reporting.

## 5. Disclosure Requirements

Proper disclosure is essential when dealing with accounting for changes in estimates. Companies should clearly explain the nature of the change, the reasons for the change, and the impact of the change on the financial statements. This transparency enhances the understandability and reliability of the financial information presented to stakeholders.

## 6. Case Study: The Impact of Changing Economic Conditions

A retail company experienced a significant downturn in sales due to an unexpected recession. This prompted a revision of its estimate for inventory obsolescence. Previously, a low obsolescence rate was assumed. However, with the decrease in sales, the company recognized the need to increase the estimated percentage of obsolete inventory. Accounting for changes in estimates in this situation involved recording an additional expense related to the write-down of obsolete inventory, resulting in a lower net income for the period. This example demonstrates the dynamic nature of accounting for changes in estimates and the need for ongoing monitoring and adjustments based on evolving circumstances.

## Conclusion

Accounting for changes in estimates is an integral aspect of financial reporting that necessitates careful consideration, professional judgment, and adherence to accounting standards. A thorough understanding of the principles involved, coupled with a practical approach to materiality assessment, is crucial for ensuring the accuracy and reliability of financial statements. The examples and case studies presented highlight the complexities involved and the importance of proactive monitoring and timely adjustments.

## FAQs

1. What is the difference between a change in accounting estimate and a change in accounting principle? A change in estimate is a correction of prior estimates based on new information, while a change in principle represents a shift in how a transaction is accounted for.
1. How do I determine if a change in estimate is material? Materiality is assessed based on both quantitative (monetary impact) and qualitative (impact on decision-making) factors.

1. What is the impact of not properly accounting for changes in estimates? Failure to properly account for changes in estimates can result in misstated financial statements, leading to inaccurate financial reporting and potential legal repercussions.
  
1. Are there specific disclosures required for changes in estimates? Yes, companies must disclose the nature of the change, the reason for the change, and the impact on the financial statements.
  
1. How frequently should estimates be reviewed? Estimates should be reviewed regularly, ideally at least annually, or more frequently if significant changes in circumstances occur.
  
1. Who is responsible for making judgments about changes in estimates? Management is primarily responsible for making judgments about changes in estimates, subject to oversight by the board of directors and external auditors.
  
1. Can changes in estimates be made retrospectively? No, changes in accounting estimates are generally accounted for prospectively, affecting current and future periods only.
  
1. How does accounting for changes in estimates relate to auditing? Auditors play a crucial role in reviewing management's estimates and assessing the appropriateness of their accounting for changes.
  
1. What role does professional judgment play in accounting for changes in estimates? Professional judgment is critical in determining materiality, assessing the reasonableness of estimates, and applying the appropriate accounting treatment.

1. Revenue Recognition Under ASC 606: Discusses the complexities of revenue recognition and the impact of estimates on revenue recognition.
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3. Accounting for Leases (ASC 842/IFRS 16): Explores the accounting for leases and the estimates involved in determining lease classifications and payments.
4. Allowance for Doubtful Accounts: A Practical Guide: Focuses on estimating and accounting for bad debts.
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6. The Materiality Principle in Financial Reporting: Delves into the concept of materiality and its application in accounting.
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9. Using Data Analytics to Improve Estimation Accuracy: Explores the use of data analytics in enhancing the accuracy and reliability of accounting estimates.

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graphical representations Understand the operations of the IPSASB, as well as new and ongoing projects The International Public Sector Accounting Standards Board is engaged in the ongoing process of bringing public sector accounting in line with the IPSAS, which largely align with the IFRS model: where an IFRS exists, it is either adopted directly or adjusted to be suitable for the public sector; where no relevant IFRS exists, the IPSASB issues an IPSAS. IPSAS Explained condenses and clarifies each IPSAS, providing context, background and practical guidance to help practitioners find the answers they need to comply.

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effective controller - the person responsible for all accounting operations. The New Controller Guidebook covers every aspect of being a controller, including the management of accounts payable, cash, credit, collections, inventory, payroll, and more. The book also shows you how to close the books, which reports to issue to the management team, how to create a budget, and how to select and install an accounting computer system. In short, this book provides the accountant with the most essential information needed to be a successful controller.

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*A Revisit to the Definition of Accounting Estimates - IFRS*

of ‘accounting estimation’ and ‘uncertainty.’ 2. Our discussion covers the concept of accounting estimation and the typology of measurement uncertainty; while the argument about ...

**CMAC Discussions 27 February 2015 27 AP4A OIC STAFF ...**

Reporting Changes in Accounting Policies - Information needs of investors that was also submitted to CMAC members. 2. IAS 8 Accounting Policies, Changes in Accounting Estimates ...

Definition of Accounting Estimates - efrag.org

Definition of Accounting Estimates is issued by the International Accounting Standards Board (Board).

Disclaimer: To the extent permitted by applicable law, the Board and the IFRS ...

*Changes in Accounting Estimates: Managerial Opportunism ...*

3Alternatively, if changes in accounting estimates are used as tools to manage earnings, which in turn increases the auditors’ exposure to potential future lawsuits (Boone et al. 2011, Heninger ...

**Accounting Changes and Error Corrections - Kral Ussery**

Changes in accounting estimates result from new information. Common examples of such changes include changes in the useful lives of property and equipment and estimates of ...

**and Errors Policies, Estimates Accounting - National Treasury**

Standard of GRAP on Accounting Policies, Changes in Accounting Estimates and Changes in Accounting Estimates and Errors should be applied. Chapter 4: Accounting Policies, Estimates ...

**Accounting Changes and Error Corrections - Apex CPE**

4 calculation of a number of different earnings figures. The only adjustment required may be to restate the opening inventory to a cost basis from a lower-of-cost-or-market-value approach.

Accounting Policies, Changes in Accounting Estimates and...

Policies, Changes in Accounting Estimates and Errors issued by the International Accounting Standards Board (IASB). Australian-specific paragraphs (which are not included in IAS 8) are ...

### **Accounting Policies, Changes in Accounting Estimates and ...**

changes in accounting policies, are set out in LKAS1 Presentation of Financial Statements. Scope 3 This Standard shall be applied in selecting and applying accounting policies, and accounting ...

### **AP26A: Distinction between changes in accounting policies ...**

IAS 8—Distinction between changes in accounting policies and changes in accounting estimates Page 3 of 13  
(c) introducing thresholds might be perceived as intending to change the existing ...

### **Ind AS Accounting and disclosure guide - KPMG**

Accounting Policies, Changes in Accounting Estimates and Errors 296 19 Ind AS 10 Events after the Reporting Period 305 20 Ind AS 11 Construction Contracts 314 21 Ind AS 12 Income Taxes ...

### **Understanding the Auditing Requirements for Accounting ...**

Auditing Accounting Estimates The nature of accounting estimates varies from company to company and depends on a number of factors including the nature of the company's business, ...

### **TOPIC 14: ACCOUNTING FOR CHANGES IN ACCOUNTING ...**

in accounting policies, changes in accounting estimates and corrections of prior period errors. Section 1.4.2 Accounting policies can only be changed if accounting standards are changed or ...

### *Accounting Changes and Error Corrections - PDH Academy*

in accounting principles, changes in accounting estimates, as well as changes of a reporting entity. The course also provides an overview of the accounting requirements of correcting ...

### **AP11A: Accounting Policies and Accounting Estimates ...**

accounting estimate are changes in accounting estimates; and (c) changes in the methods used to determine different amounts of cost are changes in accounting policies. 10. Consequently, ...

### *Accounting Policies, Changes in Accounting Estimates and ...*

changes in accounting policies, are set out in LKAS 1 Presentation of Financial Statements. Scope 3 This Standard shall be applied in selecting and applying accounting policies, and ...

### Net Profit or Loss for the Period, Prior Period Items and...

prior period items, changes in accounting estimates, and changes in accounting policies for which appropriate adjustments will have to be made depending on the circumstances. Definitions 4. ...

### IPSAS 3 Accounting Policies, Changes in Accounting...

Accounting Policies, Changes in Accounting Estimates and Errors Presentation by: CPA Anthony M. Njiru November 2019 Uphold public interest 1. Effective date Annual periods beginning on ...

### **MFRS Practice Statement 2 was amended to provide guidance ...**

changes in accounting estimates. The amendments clarify that effects of a change in an input or measurement technique used to develop an accounting estimate is a change in accounting ...

## **Click to edit Master title style - CA Sri Lanka**

Changes in accounting estimates cont... Power Ltd is a household electronics manufacturer and retailer. In the past the entity had created a provision of 5% on total sales for the year. Due to ...

### **International Accounting Standard 8 Accounting Policies, ...**

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 ...

### **Accounting Policies, Changes in Accounting Estimates and ...**

changes in accounting policies, are set out in LKAS 1 Presentation of Financial Statements. Scope 3 This Standard shall be applied in selecting and applying accounting policies, and ...

### **Accounting policies, changes in Accounting Estimates and ...**

Changes in accounting estimates As a result of the uncertainties inherent in business activities, many items in financial statements cannot be measured with precision but can only be ...

### **IAS 8 Accounting Policies, Changes in Accounting ...**

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 ...

### **Accounting Policies, Changes in Accounting Estimates and ...**

SB-FRS 8 3 Statutory Board Financial Reporting Standard 8 Accounting Policies, Changes in Accounting Estimates and Errors (SB-FRS 8) is set out in paragraphs 1–56 and the Appendix. ...

### **Accounting Policies, Changes in Accounting Estimates and ...**

Sri Lanka Accounting Standard LKAS 8 Accounting Policies, Changes in Accounting Estimates and Errors is set out in paragraphs 1–54E. All the paragraphs have equal authority. LKAS 8 ...

## **STAFF GUIDANCE**

Aug 22, 2019 · accounting estimates in three ways. Understanding Processes Used to Develop Estimates. When obtaining an understanding of a company's information system, auditors are ...

### **Accounting Policies, Changes in Accounting Estimates and ...**

The Standard includes extensive changes to the previous version of IAS 8. The Board's intention was not to reconsider all of the previous Standard's requirements for selecting and applying ...

### **Accounting Policies, Changes in Accounting Estimates and ...**

Estimates and Errors. SB-FRS 8 Accounting Policies, Changes in Accounting Estimates and Errors was operative for Statutory Boards' financial statements for annual periods beginning on ...

## **JUNE 2022 Governmental Accounting Standards Series**

This Statement defines accounting changes as changes in accounting principles, changes in accounting estimates, and changes to or within the financial reporting entity and describes the ...

### *Handbook: Accounting changes and error corrections*

Title: Handbook: Accounting changes and error corrections Author: KPMG LLP Subject: Latest edition: Our in-depth guide to the accounting and presentation requirements ...

### Accounting Policies, Changes in Accounting Estimates and...

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{÷`à£ Ä,o`Hi"ÄÄ,AgÑif7n\_Ö}ÐÈôX[Yr\$9îüü R wÛ è <sup>2</sup>= ù]Îw¾ ý•pÂðZ» 8ÖÚD INäkü, ...

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- Changes in accounting standards, + Recent changes in Public Company Accounting Oversight Board (PCAOB) and international auditing standards, + Observations from AICPA peer ...

### SCOPE CHANGES IN ACCOUNTING ESTIMATES - MNP.ca

together with the accounting treatment and disclosure of: (1) Changes in accounting policies (2) Changes in accounting estimates, and (3) Corrections of errors • The tax effect of corrections ...

### **ASPE 1506 Accounting Changes - MNP.ca**

(1) Changes in accounting policies (2) Changes in accounting estimates (3) Corrections of prior period errors  
Does NOT cover accounting policy disclosures, and tax effects of corrections of ...

### **Accounting policies, judgments and estimates - KPMG**

Accounting policies, judgments and estimates Author: Audit Committee Institute Subject: Accounting policies, judgments and estimates Keywords: Accounting policies, judgments and ...

### **Accounting Policies, Changes in Accounting Estimates**

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 ...

### **HKSA 540 (Clarified) Auditing Accounting Estimates, ...**

Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures Hong Kong Standard on Auditing 540 HKSA 540 ... of management about ...

### IPSAS 3—ACCOUNTING POLICIES, CHANGES IN...

ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS 107 IPSAS 3  
Introduction PUBLIC SECTOR IN1. IPSAS 3, “Accounting Policies, Changes in Estimates ...

### Accounting Changes and Error Corrections - Viewpoint

changes proposed in the ED and believe they will enhance the consistency and understandability of governmental financial reporting. However, we have concerns regarding the proposed ...

### **CONGRESSIONAL BUDGET OFFICE Phillip L. Swagel, Director ...**

Jun 4, 2025 · 2025. The following estimates for the 2025–2035 period reflect the effects relative to the budget and economic projections that CBO published on January 17, 2025, which ...

### **Material changes in accounting estimates and the ...**

impact of material changes in accounting estimates (MCEs) on the usefulness of earnings. We find that MCEs, on average, increase the usefulness of earnings measured by the predictive ability ...

### Exposure Draft: Accounting Policies and Accounting ...

accounting estimates. That distinction has consequences because IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors contains different requirements on how to ...

### **ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ...**

Policies, Changes in Accounting Estimates and Errors and is applicable for annual reporting periods commencing on or after 1 January 2005. REDUCED DISCLOSURE REQUIREMENTS ...

### The KPMG Guide

zDisclosure of changes in accounting policies, changes in accounting estimates and correction of errors have been improved. FRS 108 now requires an entity to disclose impending changes in ...

### **Audit Guidance Auditing Accounting Estimates**

6.0 Changes to the Testing of Accounting Estimates ISA 540 (R) addresses the challenges that auditors face by providing more guidance and objective-based requirements that allow for ...

### *Snapshot - New MFRS effective on or after 1 Jan 2023 - PwC*

Jan 1, 2023 · Estimates and Errors aim to improve accounting policy disclosures and to help users of the financial statements to distinguish between changes in accounting estimates and ...

### *IPSAS 3 ACCOUNTING POLICIES, CHANGES IN ...*

IPSAS 3 as adopted by the Maltese Government 3 1 References to IPSAS 3 or any other IPSAS shall be taken as meaning ‘as adopted by the Maltese Government’ International Public Sector ...

### **CHAPTER 4**

Changes in Accounting Estimates and Errors should be applied. A change in accounting policy is a change in the accounting treatment, recognition or measurement of a transaction, event or ...

### **IAS 8 Summary Notes - Kashif Adeel**

Accounting for changes in accounting estimates 4. Accounting for correction of prior period errors  
DEFINITIONS Accounting Policies Change in accounting estimates Prior Period errors are the ...

# **Accounting For Changes In Estimates**

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