



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Accounting Manual for Departments

Accounting Policies, Estimates and Errors

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1 Overview

The purpose of this Chapter is to provide guidance on the criteria for selecting and changing of accounting policies, the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and correction of errors.

The Office of the Accountant-General has compiled a Modified Cash Standard (MCS) and this manual serves as an application guide to the MCS which should be used by departments in the preparation of their financial statements.

Any reference to a "Chapter" in this document refers to the relevant chapter in the MCS and / or the corresponding chapter of the Accounting Manual.

Explanation of images used in the manual:

	Definition
	Take note
	Management process and decision making
	Example

2 Key Learning Objectives

- Understand what an accounting policy is and how to apply a new accounting policy or a change in an existing accounting policy;
- Understand what is an estimate and how to apply a change in an existing estimate; and
- Understand what an error is and how to correct an error.

3 Accounting Policies



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

3.1 Selection of accounting policies

The MCS sets out accounting policies that the Office of the Accountant General (OAG) has concluded result in financial statements containing relevant and reliable information about the transactions, other events and conditions to which they apply.

Those policies contained in the MCS (and the Accounting Manual) only provide for a single option, there will therefore not be situations where two policies are available for a particular transaction, other event or condition of which the department can choose to apply either one (as is sometimes the case in the accrual environment).

Accounting 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 the MCS to achieve a particular presentation of a department's financial position, financial performance or cash flows.

3.2 Chapter does not specifically apply to a transaction

In cases where a chapter (in the MCS) does not specifically apply to a transaction, other event or condition, management must use its judgement in determining and applying an accounting policy that results in information that is:

Relevant to economic decision-making needs of users

Reliable financial statements which:

- represent faithfully the financial position, financial performance and cash flow;
- reflect the economic substance of transaction, not only the legal form;
- are free from bias; and
- are prudent.

Are complete in all material aspects

In making the judgement described above, management is encouraged to seek guidance from the OAG in order to ensure consistent treatment on consolidation, and should refer to and consider the applicability of, the definitions, recognition criteria and measurement concepts for assets, liabilities, revenue and expenses set out in the MCS and the *Chapter on Concepts and Principles*.


3.3 Consistent application of accounting policies


Users of financial statements should be able to compare the current period information presented to previous periods. It is therefore crucial that the accounting policies are consistent from period to period. Accounting policies must also be applied consistently for similar transactions. The only

exception is if the MCS specifically requires or permits items to be split into categories and a separate accounting policy is applicable for each category.

3.4 Changes in accounting policies

An accounting policy may only be changed if the change is required by the MCS. Where a change is required, the relevant chapter in the MCS, supplemented by the Accounting Manual, will clarify how the current and historical information should be amended to effect the change.

	<p>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.</p>
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	<p>A change from one basis of accounting to another basis of accounting is a change in accounting policy, therefore if a department moves from the modified cash basis to the accrual basis of accounting, it will be a change in accounting policy and the Standard of GRAP on Accounting Policies, Changes in Accounting Estimates and Changes in Accounting Estimates and Errors should be applied.</p>
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The following are however not considered to be changes in accounting policies:

- The application of an accounting policy for events or transactions, other events or conditions that **differ in substance** from those previously occurring. In this case another accounting policy will be used that is applicable to the specific type of transaction, or substance of the transaction.
- The application of a new accounting policy for transactions, other events or conditions that **did not occur previously**. In this case a new accounting policy will be applied to a new type of transaction, event or condition.
- The application of a new accounting policy for transactions, other events or conditions that **were immaterial**. In this case a new accounting policy will be applied to a new type of transaction, event or condition.
- **Change in classification** where the method of recognition and measurement remains the same.

3.4.1 Is the change to differentiate consumables from inventory a change in accounting policy?

No. It is a change in classification.

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

Classifying items that were previously classified as inventory to the new class of items called consumables is a classification change and not change in accounting policy because the method of recognition and measurement of the expense in the statement of financial performance remains the same.




3.4.2 Is the change to reclassify assets held for distribution from capital assets to inventory a change in accounting policy?

No. Similar to 2.4.1 above, it is a change in classification.

A change in accounting policy is a change in the accounting treatment, recognition or measurement of a transaction, event or condition to what was previously applied.

Classifying assets held for distribution that were previously classified as capital assets to inventory as these assets meet the definition of inventory, is a classification change and not change in accounting policy.

These four scenarios are explained below by way of examples.

	<p>Example: Application of an accounting policy to a transaction that differs in substance from the previous transaction</p> <p>The department leases equipment which, after taking substance over form into account, qualifies as an operating lease. The lease contract expires and management decides to change the contract with the lessor. After considering the substance of the new lease contract, the lease now qualifies as a finance lease. The transaction is consequently different in substance, from the previous transaction and the accounting policy for finance leases will now be applied. This will not result in a change in accounting policy.</p>
	<p>Example: Application of a new accounting policy</p> <p>The department acquires a property in the current period which qualifies as an immovable asset. The department previously never had immovable assets. Other capital assets owned by the department qualify as movable assets, therefore the accounting policy for movable assets were used. Consequently this situation qualifies as an adoption of a new accounting policy, i.e. policy for immovable assets, not a change in accounting policy.</p>
	<p>Example: Application of a new accounting policy for transactions, other events or conditions that were immaterial</p> <p>In the previous financial year the department assessed its financial assets for indication of impairment. The department carried out the necessary assessment of impairment and found impairment to be immaterial qualitatively and quantitatively. When the department carried out the impairment assessment in the current year it was determined that conditions had changed from the previous financial year which led to material impairment of financial assets. Consequently the department applied the impairment of financial assets accounting policy for the first time and this is not a change in accounting policy.</p>

**Example: Application of change in classification**

In the previous financial years the department classified stationery as inventory. Stationery meets the definition of consumables and should be classified as such. Therefore in the current year the department reclassified stationery to be consumables.

In the previous financial years the department reclassified assets held for distribution from capital assets to inventory.

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

Reclassifying items to a new class of items is a classification change and not change in accounting policy because the method of recognition and measurement of the expense in the statement of financial performance remains the same.

4 Changes in Accounting Estimates



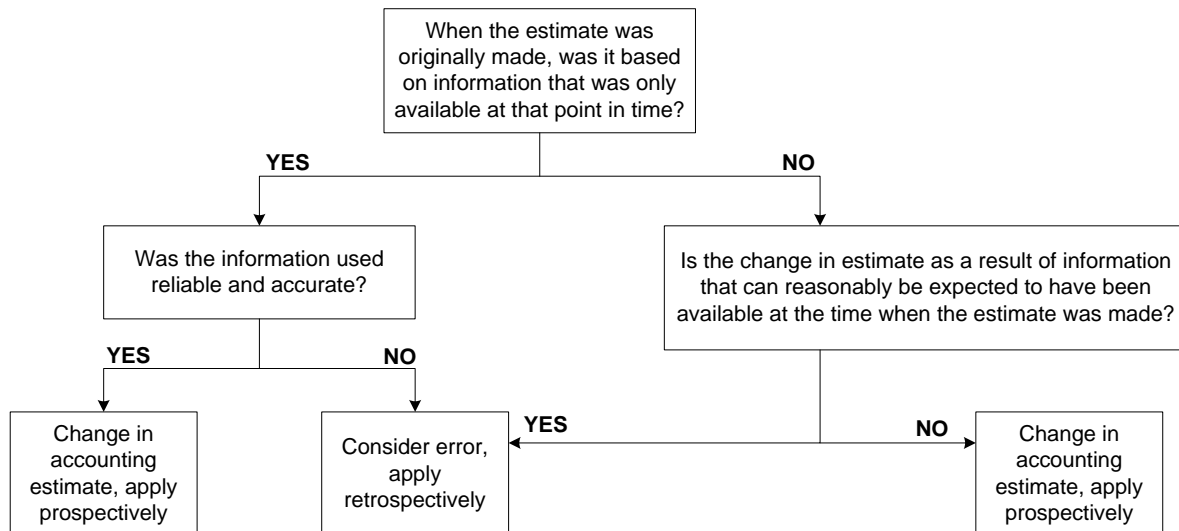
A **change in accounting estimate** is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.

As a result of the uncertainties inherent in delivering services, conducting trading or other activities, some items recorded in the notes (secondary financial information) cannot be measured with precision but can only be estimated. Estimation involves judgements based on the latest available, reliable information.

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.


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. Examples of changes in accounting estimates are provisions for leave or other types of similar liabilities.

The diagram below illustrates the distinction between a change in accounting estimate and correction of an error:



A change in accounting estimate will be recorded **prospectively**, i.e. for in the current period and in the future periods if it affects the future periods.

5 Errors

	<p>Prior period errors are omissions from, and misstatements in, the department's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:</p> <ul style="list-style-type: none"> • was available when financial statements for those periods were authorised for issue; and • could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.
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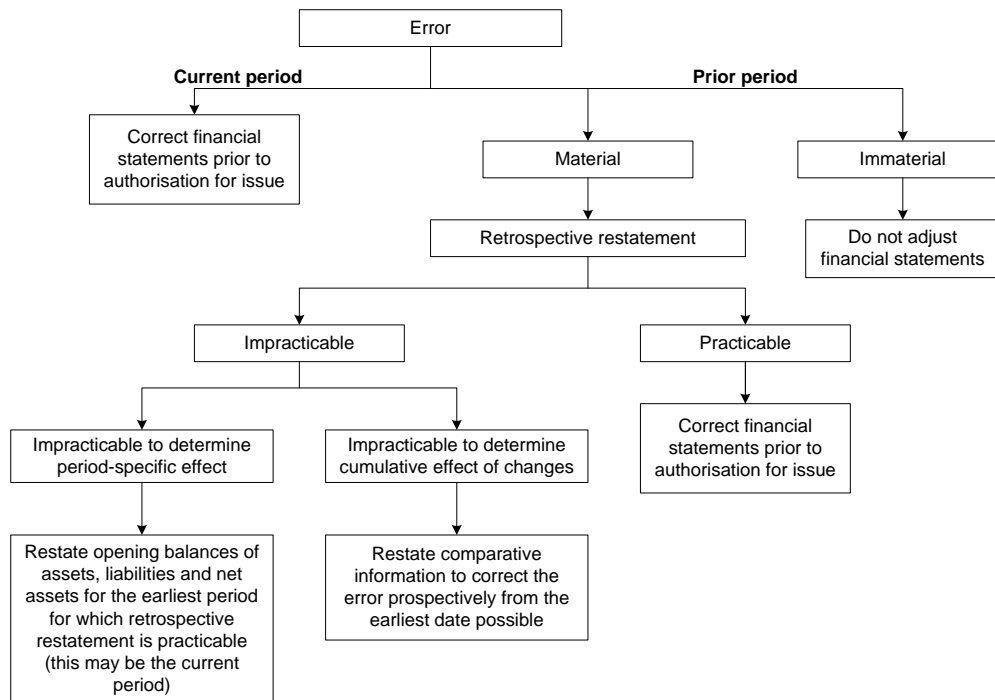
Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud. When an error is discovered it should be corrected in that relevant year before the financial statements are authorised for issue. Errors in the current period can be corrected before the financial statements are issued, therefore they are not relevant in this case.

Sometimes an error is only discovered in a subsequent period, i.e. after the financial statements have been published. In such cases the department should correct the error **retrospectively**, i.e. the relevant prior period(s) should be corrected in the comparative information presented in the financial statements for that subsequent period.

Therefore all errors must be corrected in the financial statements of the department, unless it is impracticable to do so. Retrospective adjustment is done either by:


- restating the comparative amounts for the prior period(s) presented in which the error occurred; or
- if the error occurred before the earliest period presented, restating the opening balances of the earliest period's assets, liabilities and net assets.


The diagram below summarises the correction of an error:



5.1 Correction of errors

5.1.1 Timing of correction of prior period errors

	<p>Example: Timing of correction of prior period errors</p> <p>On 5 May 20x3 the department discovered that they have not processed the bank statements from 25 March up to 29 March in the accounting records. This has resulted in a material cut-off error at year-end. The department will process the transactions on the bank statements and perform a bank reconciliation from 25 March up to 31 March 20x3 and update the financial statements for the year ending 31 March 20x3 before they are authorised for issue.</p>
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	<p>Example: Timing of correction of prior period errors</p> <p>On 5 March 20x3 the department discovered that interest receivable on all outstanding accounts for all employees has been incorrectly calculated for the period from 1 March 20x1 to 28 February 20x2. It can be assumed that this error is material. The department will have to correct the prior period, i.e. the 20x1/20x2 year, relating to interest received and receivables - staff debtors. Therefore the 20x1/20x2 comparative figures presented in the current year's notes to the financial statements for the year ending 31 March 20x3 will have to be restated. This is called "retrospective restatement".</p>
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5.1.2 Do prior period errors need to be disclosed in the specific note and also in the “Errors” note?


For errors affecting surplus and deficit and thus primary financial information, additional disclosure including narrative information of the prior period error is provided for as a sub-note to the following:


- Unauthorised Expenditure;
- Voted funds to be surrendered to the Revenue Fund note;
- Departmental revenue and NRF Receipts to be surrendered to the Revenue Fund note; and
- Aid assistance.

For errors affecting secondary financial information, additional disclosure including narrative information of the prior period error is specifically provided for as a sub-note to the following:

- Irregular Expenditure;
- Fruitless and Wasteful Expenditure;
- Movable Tangible Capital Assets;
- Minor Assets;
- Intangible Capital Assets; and
- Immovable Tangible Capital Assets

A single Prior Period Errors note has been provided to summarise all the errors affecting **both primary financial information and secondary financial information** including those not elaborated on in the specific sub-notes..

	<p>Example: Correction of error (primary financial information)</p> <p>On 5 March 20x3 the department discovered a large amount paid to contractors during the previous financial year (20x1/20x2) was incorrectly classified as transfers and subsidies. It can be assumed that this error is material. The department will have to correct the prior period, i.e. the 20x1/20x2 year, relating to the incorrect classification of the payment. Therefore the 20x1/20x2 comparative figures presented in the current year's statement of financial performance for the year ending 31 March 20x3 will have to be restated. This is called “retrospective restatement”.</p> <p>Note that no actual accounting entry is made in the general ledger since the correction of the error relates to a classification adjustment.</p>
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	<p>Example: Correction of error (secondary financial information)</p> <p>On 5 March 20x3 the department discovered that certain accruals have been incorrectly shown as commitments during the previous financial year (20x1/20x2). It can be assumed that this error is material. The department will have to correct the prior period, i.e. the 20x1/20x2 year, relating to the incorrect classification of the accruals. Therefore the 20x1/20x2 comparative figures presented in the current year's notes to the financial statements for the year ending 31 March 20x3 will have to be restated. This is called “retrospective restatement”.</p> <p>Note that no actual accounting entry is made in the general ledger since the correction of the error relates to secondary financial information.</p>
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5.2 Limitations to retrospective restatement

In some cases it may not be practical to adjust the prior periods in the event of a correction of a prior period error. This can however be difficult to prove as the department must be able to provide evidence that all efforts have been made to obtain the figures for prior periods.

If impracticability can be proven, the department should adjust the opening balance of the effected line item in the earliest period possible, which could be the current period, e.g. if the department's financial year end is 31 March 20x3, the opening balance (1 April 20x2) will be adjusted. Should it not be possible to determine the cumulative effect on the opening balance of a line item, the department will restate the comparative information prospectively from the earliest date practicable.



Applying a requirement is impracticable when the department cannot apply it after making every reasonable effort to do so.

The only instance(s) where a change in accounting policy cannot be applied retrospectively is/(are) when:

The effects of retrospective restatement are not determinable

Assumptions about what management's intent would have been in that period aren't known

Significant estimates of amounts is required and it is impossible to distinguish objectively information about estimates that:

- provide evidence of circumstances that existed on the prior date(s);
- would have been available when the financial statements for that period were authorised for issue.

It may happen that the information required for retrospective restatement (for prior period errors) was not kept in the prior periods as it was not required to do so in those periods. In situations where retrospective restatement is not possible, a department will have to provide sufficient evidence to prove impracticability.

6 Summary of Key Principles

This document provides guidance on the criteria for selecting and changing of accounting policies, the accounting treatments and disclosure of changes in accounting policies, changes in accounting estimates and correction of errors.

6.1 Change in accounting policy

Compulsory change – New standard or amendment to standard	<ul style="list-style-type: none"> • Apply in accordance with the MCS, i.e. either prospectively or retrospectively
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6.2 Change in accounting estimate

Relates only to secondary information	<ul style="list-style-type: none"> • Disclosed in notes to the financial statements
Change in estimate	<ul style="list-style-type: none"> • Record change prospectively in the current period only, or current and future periods, depending on the period affected

6.3 Prior period error

Correct retrospectively, unless:	<ul style="list-style-type: none"> • Impracticable to determine period specific effects: correct from the earliest date practicable
	<ul style="list-style-type: none"> • Impracticable to determine cumulative effect: correct from the earliest date practicable

6.4 Difference between prospective and retrospective

Prospective	<ul style="list-style-type: none"> • The change or correction is applied to transactions, other events and conditions from the date of the change or correction
Retrospective	<ul style="list-style-type: none"> • Correction of the recognition, measurement and disclosure of items of financial statements as if a prior period error had never occurred

ANNEXURE 1: Examples of Errors

The following example indicates how errors should be corrected in the AFS Template issued by the OAG. However detailed examples on errors are in the *Guide on Specific AFS Template Changes* and the *Guide on Specific IFS Template Changes* available on the OAG website:

Office of the Accountant-General > Publications > 01. Annual Financial Statements > 03. For Prov. And Nat. Departments > GRAP for National and Provincial Departments > Illustrative guides

Accounting for an Error in the Primary Financial Information

In the AFS Template:

- The error is corrected in the Prior Yr TB (*using the journal column*) for the line item affected (i.e. the primary financial statement line and the related note line). *This will automatically adjust the primary financial statement prior year amounts as well as the related note.*
- The error must also be corrected in the relevant notes where surplus/deficit is affected: i.e. either Unauthorised expenditure, Voted funds to be surrendered or Departmental revenue to be surrendered.
- An explanation of the error is required in their sub-notes.

Department ABC incurred expenditure of R100,000 on specialised computer services in 20x1. At the end of the financial year, the department erroneously identified this expenditure as unauthorised expenditure (incurred not in accordance with the purpose of the vote or main division)

	Debit	Credit
	R	R
Computer services	100 000	
Bank Account		100 000

Original accounting entries

In 20X3 (the current financial year) it was determined that the expenditure was in fact irregular and not unauthorised expenditure.

(a) Accounting entries

The accounting entry to recognise the unauthorised expenditure in the statement of financial position was as follows:

	Debit	Credit
	R	R
Unauthorised expenditure	100 000	
Exchequer Grant Account (Voted funds to be surrendered to the Revenue Fund)		100 000

The R100 000 would have increased the voted funds to be surrendered to the Revenue Fund

The accounting entry (in the 20x3 financial year) to correct the error is as follows:

	Debit	Credit
	R	R
Exchequer Grant Account (Voted funds to be surrendered to the Revenue Fund)	100 000	
Unauthorised expenditure		100 000

The R100 000 would decrease the voted funds to be surrendered to the Revenue Fund in 20x3

Unauthorised expenditure note

Note	20X3	20X2 (as restated)	20x2
	R'000	R'000	R'000
Opening balance	10 400	7 200	7 200
Prior year error		(100)	-
As restated	10 400	7 100	-
Unauthorised expenditure – discovered in current year (as restated)	-	3 300	3 300
Less: Amounts approved by Parliament/Legislature with funding	-	-	-
Less: Amounts approved by Parliament/Legislature without funding and written off in the Statement of Financial Performance	-	-	-
Capital	-	-	-
Current	-	-	-
Transfers and subsidies	-	-	-
Less: Amounts transferred to receivables for recovery	-	-	-
15	-	-	-
Unauthorised expenditure awaiting authorisation / written off	10 400	10 400	10 500

Adjusting the opening balance for the error that occurred in 20x1
(Credit leg of entry)

Remains the same, unless another error also identified in 20x2

(b) Voted funds to be surrendered to the Revenue Fund note:

	Note	20X3	20X2 (as restated)	20x2
		R'000	R'000	R'000
Opening balance		750	140	140
Prior period error (20x1)	18.2		(100)	-
As restated		750	40	140
Transfer from statement of financial performance (as restated)		500	(2 450)	(2 450)
Add: Unauthorised expenditure for current year	11	-	3 300	3 300
Voted funds not requested/not received	1.1	-	-	-
Transferred to retained revenue to defray excess expenditure (PARLIAMENT/LEGISLATURES ONLY)	18.1	-	-	-
Paid during the year		(850)	(140)	(140)
Closing balance		400	750	850

The R100k owed by the revenue fund reduces the liability for 20x3

Adjusting the opening balance for the error that occurred in 20x1
(Debit leg of entry)

(c) Prior period error sub-note:

	Note	20X2
		R'000
Nature of prior period error	11	
Relating to 20X1		100
		100
Relating to 20X2		-
		-
Total		100

In 20X1 Department ABC incurred specialised computer services costs without obtaining the appropriate approval. The department erroneously allocated these specialised computer services costs to Unauthorised Expenditure due to the department's misinterpretation of definitions of Unauthorised Expenditure and Irregular Expenditure. In 20x3 it was clarified that the expenditure incurred is in fact Irregular Expenditure and not Unauthorised Expenditure. Necessary adjustments have been made to the primary and secondary information.

- The error is corrected in the Prior Yr TB for the line item affected (*this will automatically adjust the relevant secondary information note*)
- The error is explained in the Note 44: Prior period errors.