

What Are Accounting Estimates?

Worksheet

An accounting estimate is a reasoned approximation of an item's value (like depreciation or bad debts); when it changes, the new estimate is applied going forward only, not retrospectively.

Questions

1. How should a change in accounting estimate be applied?

- A) Retrospectively, restating prior years
- B) Prospectively, in current and future periods
- C) It should be ignored
- D) Only disclosed, never applied

2. Which of these is an example of an accounting estimate?

- A) Correcting a mathematical error in last year's accounts
- B) The useful life of a delivery van
- C) A change from FIFO to weighted average
- D) Restating comparative figures

3. A machine's remaining book value is \$50,000 with 5 years of revised useful life left. What is the new annual depreciation?

- A) \$5,000
- B) \$10,000
- C) \$50,000
- D) \$25,000

4. What standard covers changes in accounting estimates?

- A) IAS 37
- B) IAS 8
- C) IAS 40
- D) IFRS 16

5. A machine has a remaining book value of \$80,000. Originally it had 8 years of useful life left, but engineers now estimate only 4 years remain. Find the new annual depreciation.

6. A company's allowance for doubtful debts was 2% of receivables (\$1,000,000), based on history. New data shows actual default rates are 5%. What is the revised allowance?

7. A retailer's warranty provision estimate changes from 3% to 4% of \$2,000,000 in annual sales. Find the new warranty expense.

8. Define: What is an accounting estimate?

9. Define: How is a change in accounting estimate applied?

10. Define: Give two common examples of accounting estimates.

Answer Key

1. B) Prospectively, in current and future periods - IAS 8 requires estimate changes to be applied prospectively, not retrospectively.
2. B) The useful life of a delivery van - Useful life is a judgment-based estimate; the others involve corrections or policy changes.
3. B) $\$10,000 - 50,000 / 5 = \$10,000$ per year.
4. B) IAS 8 - IAS 8 governs accounting policies, estimates and errors.
5. Remaining book value = $\$80,000$ Revised remaining useful life = 4 years New depreciation = $80,000 / 4 = \$20,000$ per year
6. New estimate rate = 5% Allowance = $5\% \$1,000,000 = \$50,000$ (up from $\$20,000$, recognized in current period only)
7. New rate = 4% Warranty expense = $4\% \$2,000,000 = \$80,000$ recognized this period, no restatement of prior years
8. A judgment-based approximation used to measure an item, like useful life, bad debts, or warranty costs, when exact figures are unknown.
9. Prospectively - only in the current and future periods, never by restating prior years.
10. Useful life of depreciable assets and the allowance for doubtful debts (or warranty provisions).

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