

October 2019 ASAF Meeting
Agenda paper 6A

A Revisit to the Definition of Accounting Estimates

KASB

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Korea Accounting Standards Board

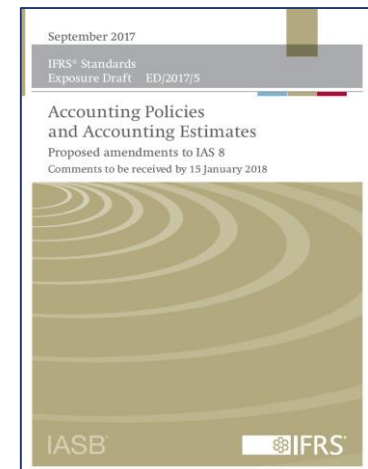
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I. Purpose and scope of ASAF discussion



Purpose

- **To shed some light on the definition of 'accounting estimates':**
 - **by proposing an alternative route to articulating it, focusing on the concept of 'accounting estimation' and 'measurement uncertainty'**



I. Purpose and scope of ASAF discussion



Scope

- **Covers:**
 - **the concept of accounting estimation;**
 - **the typology of measurement uncertainty**

- **Does not cover:**
 - **the argument about distinguishing changes in accounting policies and changes in accounting estimates;**
 - **the definition of accounting policies**

II. 'Estimation' and 'uncertainty' in accounting



Prevails in the Standards and practice

- The use of 'estimation' and 'uncertainty' in the Standards

Term	Number of Use	
	Currently active IFRS Standards	IFRS 17
Estimation	511	109
Uncertainty	125	34

Term	Number of Use	
	CF (2010)	CF (2018)
Estimation	22 →	60
Uncertainty	7 →	71

II. 'Estimation' and 'uncertainty' in accounting



Prevails in the Standards and practice

- **Moreover, a multitude of estimates are embedded in most financial statement items**
 - **From the simplest level such as 'average' to the most complicated level such as 'manufacturing cost';**
 - **Practically, all accruals are based on estimates**

II. 'Estimation' and 'uncertainty' in accounting



No explicit definition in the Standards

- 'Estimation' in accounting is critical and prevalent in practice, yet not explicitly defined anywhere in the IFRS Standards

- The Conceptual Framework (2018)

2.19 When monetary amounts in financial reports cannot be observed directly and must instead be estimated, measurement uncertainty arises. The use of reasonable estimates is an essential part of the preparation of financial information and ...

III. Exploration into 'measurement uncertainty'

- **Basically, we focus on 'measurement uncertainty' to lay a foundation for how best 'accounting estimation' and 'accounting estimates' can be defined**

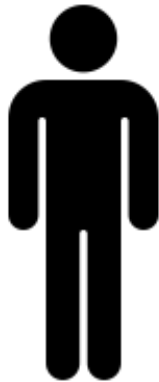
✓ **Even though ED IAS 8 attempts to define 'accounting estimates' for the distinction between 'accounting policies' and 'accounting estimates,' we believe that 'estimation' in accounting is a much more fundamental concept**

- **The Exposure Draft (ED/2017/5) – IAS 8**

5 Accounting estimates are judgements or assumptions *used in applying an accounting policy* when, because of *estimation uncertainty*, an item in financial statements cannot be measured with precision

III. Exploration into 'measurement uncertainty'

- **Measurement in a certain world**
→ **Direct observation**

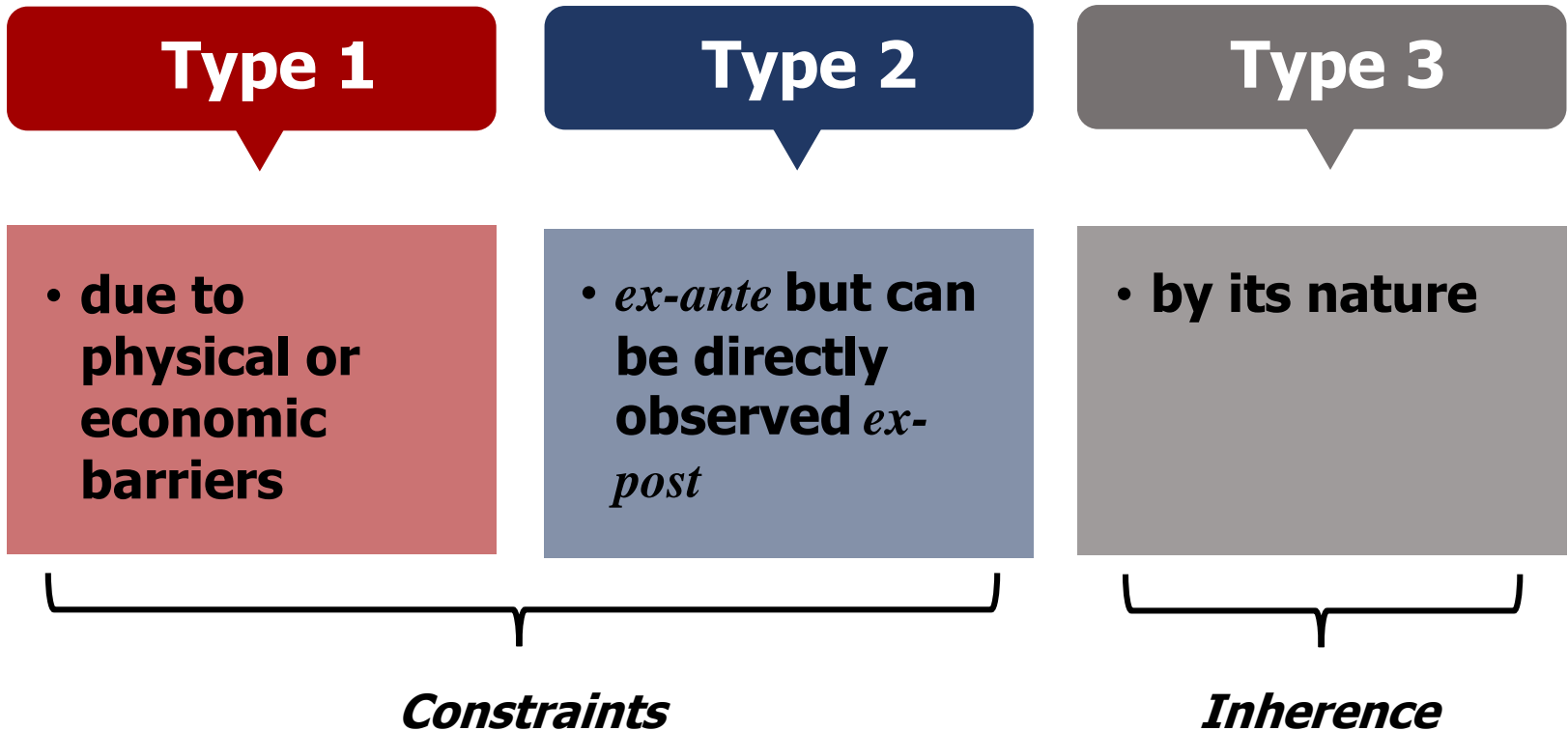


- **Measurement in an uncertain world**
→ **Estimation**



III. Exploration into 'measurement uncertainty'

- **Why measurement uncertainty exists?**
 - ✓ **Monetary amounts cannot be directly observed:**



III. Exploration into 'measurement uncertainty'

- **Why measurement uncertainty exists? – Type 1**
 - ✓ **Monetary amounts cannot be directly observed:**

Type 1

- **due to physical or economic barriers**

- **Oil reserve**
- **Fire damage**
- **Inventories in a disputed area**
- **Inventories with incomplete or missing documents**

III. Exploration into 'measurement uncertainty'

- **Why measurement uncertainty exists? – Type 2**
 - ✓ **Monetary amounts cannot be directly observed:**

Type 2

- *ex-ante* but can be directly observed *ex-post*

- **Warranty obligations**
- **Bad debts**
- **Law suits**
- **Inventory obsolescence**

III. Exploration into 'measurement uncertainty'

- **Why measurement uncertainty exists? – Type 3**
 - ✓ **Monetary amounts cannot be directly observed:**

Type 3

- **by its nature**

- **Fair value**
- **Impairments**
- **Depreciation**

IV. An alternative approach to the definition of 'accounting estimates'

- **Hence, we consider that:**

- ✓ **accounting estimation is:**

“ to measure an item in financial statements using measurement techniques* when, in the presence of measurement uncertainty, monetary amounts cannot be observed directly ”

*** Judgments and assumptions are used in selecting and applying measurement techniques**

- ✓ **accounting estimate is:**

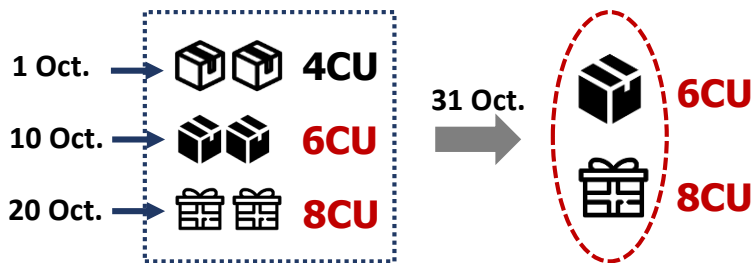
“ an output of accounting estimation ”

IV. An alternative approach to the definition of 'accounting estimates'

• (Case) Measurement of per-unit inventory cost:

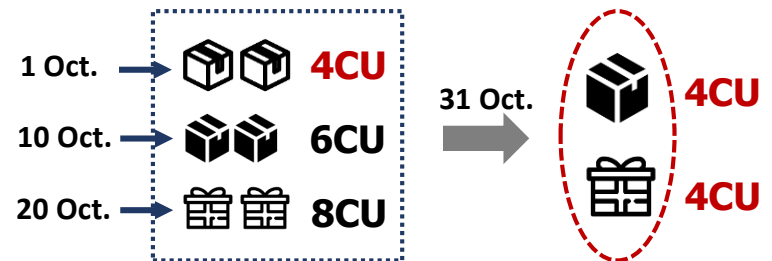
 in a certain world
→ Direct observation

✓ Specific identification

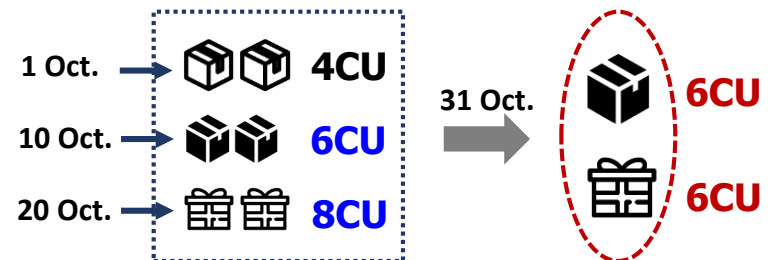


???
 in an uncertain world
→ **Estimation**

✓ FIFO



✓ Weighted average method



V. Suggestions

● Short-term

- **The use of terms in finalizing the ED IAS 8 should be in line with the revised Conceptual Framework (2018) – i.e., measurement uncertainty, etc.**
- **The circumstances when a change in accounting estimate can be permitted should be thoroughly discussed**

V. Suggestions

● Long-term

- **Accounting estimation in light of measurement uncertainty should be explicitly defined in the Conceptual Framework**

Questions for the ASAF members

- 1. What is your thought on our approach to the concept of 'estimation' in accounting?**
- 2. Do you agree with the proposed typology of measurement uncertainty? Do you think this can be helpful to better understand the concept of 'estimation' in accounting?**
- 3. Which do you think would be the circumstances when a change in accounting estimate can be permitted?**

Appendix A. Estimation and measurement bases

Measurement bases	Types of measurement
Historical cost	Direct observation Estimation
Current value <ul style="list-style-type: none">• Fair value• Value in use and fulfilment value• Current cost	Estimation

Appendix B. Summary of feedback from Big 4 in Korea

Q. The typology of measurement uncertainty

- **Most respondents agreed with the proposed typology of measurement uncertainty**

Q. The definition of accounting estimates

- **Some respondents said that the proposed definition of accounting estimates is helpful and clear to understand**
- **Some respondents said that defining accounting estimates does not seem to be fully sufficient to distinguish a change in accounting policy and a change in accounting estimate in practice**