

ED /2017/5 Accounting Policies and Accounting Estimates (Proposed amendments to IAS 8)

Feedback to constituents – EFRAG Final Comment Letter

January 2018

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

Introduction

Objective of this feedback statement

EFRAG published its final comment letter on ED /2017/5 *Accounting Policies and Accounting Estimates (Proposed amendments to IAS 8)* (‘the ED’) on [Date]. This feedback statement summarises the main comments received by EFRAG on its draft comment letter and explains how those comments were considered by EFRAG during its technical discussions leading to the publication of EFRAG’s final comment letter.

Background to the ED

In September 2014, the IFRS Interpretations Committee informed the IASB about divergent practices regarding the assessment of whether a change represents a change in an accounting policy, or in an accounting estimate, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

In September 2017, the IASB published the exposure draft (ED/2017/5 *Accounting policies and Accounting Estimates*). The exposure draft proposes to:

- clarify the definitions of accounting policies and of changes in accounting estimates with the objective of making them more concise and distinctive;
- clarify how accounting policies and estimates relate to each other;
- add guidance about whether changes in valuation techniques and in estimation techniques are changes in accounting estimates; and

- add guidance about changes in the cost formulas of IAS 2 *Inventories* in determining the cost of interchangeable inventories.

Further details are available on the EFRAG [website](#).

EFRAG’s draft comment letter

EFRAG published a [draft comment letter](#) on the proposals on 29 September 2017. In the letter, EFRAG:

- Supported the IASB’s initiative to clarify the definition of accounting policies and to provide a definition of accounting estimates but considered that the proposals may not deliver sufficient clarification unless supported by additional illustrative examples.
- Agreed with the proposed clarification that, when an item in the financial statements cannot be measured with precision, selecting an estimation technique or valuation technique constitutes making an accounting estimate.
- Acknowledge the need to address the diversity in practice in the application of IAS 2 *Inventories* and, on that basis, supported the IASB’s proposed guidance. However, EFRAG regretted that the proposed changes to the principles in IAS 8 were not considered sufficient to address the issue without recourse to a specific rule.
- Lastly, EFRAG recommended, that the proposed Amendments are delayed and then grouped with other amendments to IAS 8 tentatively approved by the IASB on accounting policy changes; to avoid repeated changes to IAS 8 in a very short period of time,

Comments received from constituents

EFRAG has received and considered five comment letters from constituents. These comment letters are available on the EFRAG [website](#).

The comment letters received came from national standard setters, and one professional organisation.

A majority of respondents:

- Supported, like EFRAG, the IASB’s objective of clarifying the criteria for distinguishing between accounting policy and accounting estimate, to encourage more consistent application of the requirements of IAS 8.
- Supported providing a direct definition of ‘accounting estimates’ and changing the definition of accounting policies while concurring with EFRAG that the proposed changes may not deliver sufficient clarification and further clarifications and illustrative examples could help to reduce confusion.
- Supported the IASB’s objective of providing further guidance regarding changes in an estimation technique or valuation technique.
- Concurred with EFRAG, that the revised principles and definitions in IAS 8 should be clear enough to enable entities to make the determination without recourse to specific rules such as the proposed guidance in relation to the treatment of cost formulas applied to ordinarily interchangeable inventories.

Two respondents suggested that the proposed (guidance on changes to cost formula of inventories is placed in IAS 2 (in its draft comment letter, EFRAG suggested that it is placed in both IAS 8 and IAS 2).

One respondent did not agree with the IASB’s assessment that the selection of a cost formula for inventories is an accounting policy. Rather it considered that the measurement base (i.e. that inventory accounted for at the lower of cost and net realisable value) is the accounting policy and the cost formula is an accounting estimate selected to be used in applying that policy.

One respondent considered that the amendments should be finalised as proposed.

EFRAG’s final comment letter

Considering the feedback received, EFRAG retained the main view expressed in its draft comment letter with limited drafting changes to suggest that:

- (a) the proposed guidance on changes to cost formula of inventories is placed in IAS 2 (in its draft comment letter, EFRAG suggested that it is placed in both IAS 8 and IAS 2); and
- (b) paragraph 54F on transition requirements be drafted more concisely by stating simply that the requirements are to be applied prospectively from the effective date, with early application permitted.

Detailed analysis of issues, comments received, and changes made to EFRAG’s final comment letter

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

EFRAG’s response to constituents’ comments

Changes to the definition of accounting policies

Proposals in the ED

The ED proposes to change the definition of accounting policies to “accounting policies are the specific principles, measurement bases, ~~conventions~~, rules and practices applied by an entity in preparing and presenting financial statements”.

EFRAG’s tentative position

EFRAG supported the IASB’s initiative to clarify the definition of accounting policies and agreed with removing the references to ‘convention’ and ‘rules’ while keeping the term ‘practices’ in the definition as it clarifies that accounting policies also cover those that are developed in the absence of specific guidance, as set out in IAS 8. However, EFRAG considered that the proposals may not deliver sufficient clarification unless supported by additional guidance and recommended that more guidance and examples are added to IAS 8 in order to address the diversity that has been identified in this area effectively.

Constituents’ comments

A majority of respondents supported the IASB’s initiative to clarify the definition of accounting policies but concurred with EFRAG that the proposals may not deliver sufficient clarification unless supported by additional illustrative examples. One respondent, did not support EFRAG’s suggestion that the IASB should include additional guidance and examples. This respondent considered that IAS 8 worked best if kept as a principles-based standard.

EFRAG final position

Considering the feedback received, EFRAG retained its initial views supporting the IASB’s initiative to clarify the definition of accounting policies while considering that the proposals may not deliver sufficient clarification unless supported by additional illustrative examples.

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

One respondent considered that the amendments should be finalised as proposed.

Clarifying the relationship between accounting policies and accounting estimates

Proposals in the ED

The ED proposes to remove the definition of changes in accounting estimates and to define accounting estimates as *‘judgements or assumptions used in applying an accounting policy when, because of estimation uncertainty, an item in financial statements cannot be measured with precision’*.

The ED also clarifies that an accounting estimate is used in applying an accounting policy. In other words, the accounting policies are the overall objective and the accounting estimates are inputs used as a means of achieving that objective.

EFRAG’s tentative position

EFRAG supported adding a definition of ‘accounting estimates’ to IAS 8 and removing the definition of ‘change in an accounting estimate’.

EFRAG however considered that the IASB should further clarify the interaction between an accounting estimate and an accounting policy by providing illustrative examples. EFRAG recognised that, in distinguishing between a change in accounting policy or a change in accounting estimate in particular circumstances, certain ‘grey areas’ may remain and that professional judgement will continue to be required. However, in EFRAG’s opinion, the distinction between an accounting policy and an accounting estimate can nonetheless be improved by eliminating what is perceived to be an overlap

EFRAG’s response to constituents’ comments

EFRAG final position

Considering the feedback received, EFRAG retained the views expressed in its draft comment letter supporting the addition of a definition of ‘accounting estimates’ to IAS 8 (and removing the definition of a ‘change in an accounting estimate’). EFRAG also reiterated its concerns that the IASB should further clarify the interaction between an accounting estimate and an accounting policy and how the amended definition should be applied in practice by providing illustrative examples. EFRAG referred in particular to ESMA’s initial submission to the IFRS Interpretations Committee which identified a number of issues, some of which would still be relevant:

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

between the existing definitions and by adding supporting guidance and illustrative examples.

Constituents’ comments

A majority of respondents agreed with EFRAG’s initial assessment supporting the proposed definition of ‘accounting estimates’ and calling for further clarifications on the interaction between an accounting estimate and an accounting policy by providing illustrative examples.

One respondent, however, considered that it: was unnecessary, and potentially confusing, to introduce in the definition of ‘accounting estimates a form of subordination to accounting policy’ by stating that accounting policies are the overall objective and accounting estimates are inputs used to achieve that objective.

One respondent considered that the amendments should be finalised as proposed.

EFRAG’s response to constituents’ comments

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

Classification when selecting an estimation technique or valuation technique

Proposals in the ED

The ED proposes to add paragraph 32A to state that when an item in the financial statements cannot be measured with precision, selecting an estimation technique or valuation technique, is selecting an accounting estimate

EFRAG’s tentative position

EFRAG welcomed the IASB’s proposal to provide further guidance about changes in estimation techniques or valuation techniques. EFRAG further observes that the proposed change to IAS 8 is similar to the existing guidance in paragraphs 65 and 66 of IFRS 13 *Fair Value Measurement* concerning changes in valuation techniques.

Constituents’ comments

All respondents agreed, like EFRAG, with the proposed clarification that, when an item in the financial statements cannot be measured with precision, selecting an estimation technique or valuation technique constitutes making an accounting estimate.

EFRAG’s response to constituents’ comments

EFRAG final position

Considering the feedback received, EFRAG retained the views expressed in its draft comment letter.

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

[Proposed] EFRAG’s response to constituents’ comments

Selection of cost formula in IAS 2 *Inventories*

EFRAG final position

Proposals in the ED

The ED proposes to clarify that, for ordinarily interchangeable inventories, selecting a cost formula (i.e. first-in, first-out (FIFO) or weighted average cost) in applying IAS 2 Inventories is selecting an accounting policy.

EFRAG’s tentative position

EFRAG agreed with the need to address the diversity in practice in the application of IAS 2 and, on that basis, supported the IASB’s proposal. However, EFRAG regretted that the principles in IAS 8 had not been clarified enough to address the issue without recourse to a specific rule.

Constituents’ comments

Most respondents agreed with EFRAG’s initial assessment that guidance was needed to address the diversity in practice.

One respondent disagreed with the IASB’s assessment as it considered that the measurement base (i.e. that inventory accounted for at the lower of cost and net realisable value) is the accounting policy and the cost formula is an accounting estimate selected to be used in applying that policy. This respondent noted that Paragraph 32B appeared to conflict with paragraph 35 insofar as paragraph 35 seemed to imply that a change in cost formula should always be treated as a change in accounting estimate.

Two respondents recommended that the requirement, if proceeded with, be included in IAS 2 because its inclusion in IAS 8 could lead to inappropriate analogies being drawn in other circumstances.

Considering the input received from constituents, EFRAG retained its preliminary views welcoming the provision of guidance to address the diversity in practice in the application of IAS 2.

EFRAG however recommended that the guidance, if proceeded with, is included in IAS 2 because its inclusion in IAS 8 could lead to inappropriate analogies being drawn in other circumstances. (in its draft comment letter, EFRAG suggested that it is placed in both IAS 8 and IAS 2).

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

Other Issues

Proposals in the ED

Not applicable.

EFRAG’s tentative position

EFRAG recommended that :

- The name of IAS 8 is updated to reflect the amendments proposed in the ED (i.e. remove the reference to ‘changes’ in accounting policies or estimates).
- The proposed changes are delayed and then grouped with other amendments on accounting policy change tentatively approved by the IASB (these amendments are aimed at lowering the 'impracticability threshold' regarding retrospective application of voluntary changes in accounting policies that result from the IFRS Interpretations Committee's agenda decisions).
- IAS 8 should reflect that when an accounting estimate is changed it can, in some cases, be the result of correcting an error and should be treated as such. Although estimates are based on judgement, there are cases where, for example, a material calculation error has been made and the change in accounting estimate is the correction of an error. IAS 8 should contain guidance to assist entities in making this distinction.

Constituents’ comments

Most respondents agreed with EFRAG’s recommendations and in particular that the proposed changes are delayed and then grouped with other

EFRAG’s response to constituents’ comments

EFRAG final position

Considering the feedback received, EFRAG retained its initial recommendations about the naming Of IAS 8 the timing of the amendments and the need for additional guidance to assist entities in making the distinction between changes in estimated and corrections of errors.

In addition, EFRAG reflected the suggestion that if the proposed amendments are proceeded with on a stand-alone basis, paragraph 54F could be drafted more clearly and concisely by stating simply that the requirements are to be applied prospectively from the effective date, with early application permitted.

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

amendments to IAS 8 and that further guidance is needed to assist entities in assessing when a change in accounting estimate is the correction of an error material calculation error has been made.

One respondent, while agreeing with the above, also suggested that the IASB takes the opportunity while amending IAS 8, to improve the requirements for reporting the effect of changes in estimates and, in particular that paragraph 39 is amended to require the disclosure of the financial statement line items that are affected. This respondent also suggested to draft paragraph 54F more concisely by stating simply that the requirements are to be applied prospectively from the effective date, with early application permitted.

One respondent considered that the amendments should be finalised as proposed with no further changes.

EFRAG’s response to constituents’ comments

Appendix 1: List of respondents

Table 1: List of respondents

Name of constituent	Country	Type / Category
UK Financial Reporting Council (UK FRC)	United Kingdom	Standard Setter
Dutch Accounting Standard Board (DASB)	The Netherlands	Standard Setter
Danish Accounting Standards Committee (DASC)	Denmark	Standard Setter
Insurance Europe	Europe	Professional Organisation
Organismo Italiano di Contabilità – OIC	Italy	Standard Setter