

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG-CFSS. 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-CFSS. 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.

Accounting Policies and Accounting Estimates

Issues paper

Objective

- 1 To ask members' views on the IASB Staff's course of action in response to the feedback received to its Exposure Draft ED/2017/5 *Accounting Policies and Accounting Estimates (Proposed amendments to IAS 8)* ('the ED').

Background

- 2 The ED, issued in September 2017, aimed to help entities distinguish accounting policies from accounting estimates. The distinction is relevant because changes in accounting estimates are applied prospectively, while changes in accounting policies need to be applied retrospectively and comparative figures need to be restated.
- 3 The ED proposed adding a definition of accounting estimates and removing the definition of a change in accounting estimate. It also proposed clarifying how accounting policies and accounting estimates relate to each other by explaining that an entity uses accounting estimates in applying accounting policies. The Exposure Draft also proposed clarifying that when an item in the financial statements cannot be determined with precision, selecting an estimation technique or valuation technique constitutes making an accounting estimate.
- 4 At the IASB's July 2018 meeting, it was decided that the IASB staff would provide an analysis of the feedback to the IFRS IC at a future meeting to obtain the Committee's advice on the project, and present that advice to the IASB at a future meeting.

Feedback received by the IASB from the ED consultation and IFRS IC analysis

- 5 Several respondents, including EFRAG, agreed that it was helpful to provide a definition of accounting estimates and clarify that an entity uses accounting estimates in applying accounting policies. Several respondents also considered that accounting estimates would be defined more helpfully not as judgements or assumptions themselves (as proposed in the ED), but rather as the output of measurement techniques.
- 6 Regarding the proposed changes to the definition of 'accounting policies', the IASB received mixed views. Some respondents (including EFRAG) considered that it was helpful to remove terms such as 'conventions' and 'rules' that were not defined by

IFRS Standards and not clear. However, some questioned whether the proposed changes would improve the definition. This is because the remaining terms in the definition were also not defined and are open to differing interpretations and some respondents suggested the IASB to define terms such as 'measurement bases'.

- 7 A specific application issue of the distinction between accounting estimates and accounting policy concern the choice of a cost formula for inventories under IAS 2. IAS 2 allows to use both FIFO and weighted average cost, but there are seemingly different views about whether changing the formula used is a change in estimates or in policy.
- 8 The ED proposed to clarify that selecting a cost formula constitutes selecting an accounting policy, and several respondents (including EFRAG) agreed with the IASB conclusion. Some noted that paragraph 36(a) of IAS 2 already implicitly states that selecting a cost formula constitutes selecting an accounting policy as this paragraph requires an entity to disclose (emphasis added) '*the accounting policies adopted in measuring inventories, including the cost formula used*'.
- 9 However, others did not agree and noted that the IASB's conclusion did not clearly align with the new proposed definitions of accounting policy and accounting estimate.

IFRS IC analysis and recommendations to the IASB

- 10 Based on the feedback received, the IASB staff expected recommendations to the IASB are summarised in the following paragraphs.

Definition of accounting estimates

- 11 Proceed with the amendments but revise the proposed definition of accounting estimates to specify that:
 - (a) accounting estimates are 'monetary amounts' (rather than 'judgements and assumptions') in the financial statements that are subject to measurement uncertainty. This is to highlight that the estimates are not judgements or assumptions themselves, but rather the output of a measurement technique, such as a valuation technique or an estimation technique, that requires an entity to use judgements and assumptions;
 - (b) these monetary amounts are outputs of measurement techniques used in applying accounting policies;
 - (c) clarify that the effects of a change in an input and/or measurement technique used to develop an accounting estimate are part of the change in accounting estimate and not the correction of an error if that change results from new information or new developments; and
 - (d) specify that estimation techniques and valuation techniques are examples of measurement techniques an entity uses to develop accounting estimates.

Definition of accounting policies

- 12 Considering the mixed feedback received, the IASB staff assessed that amending the definition of accounting policies could have unintended consequences; in particular, stakeholders could see the changes as narrowing the scope of what constitutes accounting policies while others could see the changes as broadening the scope whereas the main purpose of the proposed amendments to IAS 8 was to clarify, and not change, the definition.
- 13 Accordingly, the IASB staff is suggesting that the IASB should not amend the definition of accounting policies. It also considers that defining the remaining terms in the definition of accounting policies (ie principles, measurement bases and

practices) is not necessary, would be difficult to achieve and would broaden the scope of the project and could have unintended consequences.

Other issues

- 14 The IASB staff is also recommending :
- (a) not adding discussion of whether selecting an inventory cost formula constitutes selecting an accounting policy; and
 - (b) confirming deletion of Example 3 in the Guidance on Implementing IAS 8 and not develop additional illustrative examples (as it was considered difficult to develop useful example that would not confuse further stakeholder).
- 15 These IASB staff recommendations are further detailed in ASAF agenda paper 07A (paper presented at the IFRS Interpretations Committee on 11 September 2018 contained in CFSS paper 08-03).

IFRS IC discussion at its meeting on 10 September 2018

- 16 At its meeting on 11 September, the IFRS Interpretations Committee was generally supportive of the proposed changes suggested by the IASB staff.
- 17 However, several members reiterated the view the inclusion of illustrative examples (aiming at illustrating the thought process on how to distinguish accounting policies from accounting estimates) would be helpful. Such guidance would preferably be placed within the amendments (although some members stated that if examples are added to the guidance, re-exposure might be necessary) or, alternatively a placement in educational material could be considered.

EFRAG Secretariat analysis

- 18 In its comment letter issued in 2017, EFRAG supported the proposed changes to the definition of accounting policies and estimates; although we considered that the overall proposals may not deliver sufficient clarification unless supported by additional illustrative examples. EFRAG also supported, in its letter the guidance on change in cost formula of inventories but suggested that it is placed within IAS 2 and not IAS 8, to avoid application by analogy to other circumstances.
- 19 Therefore, the EFRAG Secretariat is concerned that the IASB staff's suggestion to remove the proposed clarification to the definition of accounting policies and the selection of a cost formula for inventories would significantly reduce the benefits and improvements expected from the amendments and it would be questionable whether the remaining guidance would improve enough the existing guidance to warrant publication. For instance, we consider that, absent the initially proposed guidance, the appropriate accounting for changes in cost formula for inventories would not be easily derived from the revised definition of accounting estimates and accounting policies suggested by the IASB staff.
- 20 Regarding the definition of accounting estimates, EFRAG Secretariat agrees that introducing a reference to 'measurement uncertainty' (instead of the existing terms 'estimation uncertainty' and 'precision') and to 'monetary amounts' would better align the language used in IAS 8 with that in the Conceptual Framework which states that '**measurement uncertainty arises when *monetary amounts* in financial reports cannot be observed directly and must instead be estimated...**'.
- 21 We also observe that the reference to 'monetary amounts' would be consistent with the recently issued International Auditing Standard IAS 540 (Revised) which defines an accounting estimate as 'a **monetary amount** for which the **measurement**, in accordance with the requirements of the applicable financial reporting framework, is subject to estimation uncertainty'.

- 22 However, we observe that a number IFRS Standards currently refer to accounting estimates that are non-monetary in nature (for instance inventory obsolescence, useful lives, vesting periods are referred to as examples of accounting estimates) and would need to be consequentially amended (if the amendments were finalised as proposed).
- 23 We also welcome the reinstatement of the reference to ‘new information or new developments’ when distinguishing changes in accounting estimates from the correction of an error. In its comment letter, EFRAG encouraged the IASB to reconsider whether some additional clarifications on the distinction between a change in accounting policy and correction of an error would be useful.
- 24 Lastly, we observe that the IASB is not considering re-exposure of the proposed amendments despite the extent of some the proposed changes (in particular the implications of the inclusion of a reference to ‘monetary amounts’ rather than ‘judgements and assumptions’).

Questions for EFRAG TEG and EFRAG CFSS

- 25 Do members have any comments on the analysis of the feedback received by the IASB and the recommendations made by IASB staff on the definition of **accounting policies**?
- 26 Do members have any comments on the analysis of the feedback and the IASB staff recommendation on the definition of **accounting estimates**?
- 27 Do members have any other comments on the matters included in ASAF agenda paper 7A (contained in paper 08-03)?

Agenda Papers

- 28 In addition to this cover note, agenda papers for this session are:
- (a) Agenda paper 08-02 – ASAF paper 07 Cover note; and
 - (b) Agenda paper 08-03 – ASAF paper 07 A – IFRIS IC 11 September 2018 - for background only.