STAFF PAPER

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IASB® meeting

Project	**IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*—Accounting policies and accounting estimates**
Paper topic	Analysis of feedback—definition of accounting estimates

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Introduction

1. As explained in Agenda Paper 26A for this meeting, Agenda Paper 26B and 26C for this meeting present our analysis of, and preliminary views on, feedback on the Exposure Draft *Accounting Policies and Accounting Estimates*—Proposed amendments to IAS 8 (Exposure Draft). This paper analyses feedback on the proposed definition of accounting estimates and Agenda Paper 26C analyses feedback on other aspects of the Exposure Draft.

Structure of the paper

2. This paper includes:
   (a) summary of staff preliminary views; and
   (b) staff analysis and preliminary views—proposed definition of accounting estimates.
3. There are two appendices to this paper:
   (a) Appendix A—analysis of other matters; and
   (b) Appendix B—summary and analysis of feedback from Committee and ASAF members.

Summary of staff preliminary views

4. On the basis of our analysis, our preliminary view is that the Board should:

   (a) revise the definition of accounting estimates to specify that:

      (i) accounting estimates are monetary amounts in the financial statements that are subject to measurement uncertainty;

      (ii) these monetary amounts are outputs of measurement techniques used in applying accounting policies; and

      (iii) an entity uses judgements and assumptions in selecting and applying the applicable measurement techniques.

   (b) 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.

   (c) specify that estimation techniques and valuation techniques are examples of measurement techniques an entity uses to develop an accounting estimate.

Staff analysis and preliminary views—proposed definition of accounting estimates

Proposed amendment

5. The Exposure Draft proposed:

   (a) 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.

   (b) 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.

6. Appendix A to Agenda Paper 26A of this meeting reproduces the definition of accounting estimates proposed in the Exposure Draft.

Key matters raised

7. Several respondents said providing a definition of accounting estimates is helpful—it would help clarify the distinction between accounting policies and accounting estimates. Several respondents also said it was helpful to clarify that an entity uses accounting estimates in applying accounting policies and that selecting an estimation technique or valuation technique is a change in accounting estimate. However, some respondents expressed concerns about:

(a) the role of judgements and assumptions—see paragraphs 8–13;

(b) use of the terms 'estimation uncertainty' and 'precision'—see paragraphs 14–23;

(c) deleting the definition of a 'change in accounting estimate'—see paragraphs 24–30; and

(d) limiting the definition of accounting estimates to measurement—see paragraphs 31–32.

The following paragraphs consider specific comments raised by respondents.

Role of judgements and assumptions

Summary of feedback

8. Some respondents said accounting estimates are not judgements or assumptions themselves, but rather the output (ie a numerical or monetary amount) of a measurement technique (such as a valuation technique or an estimation technique) that requires an entity to use judgements and assumptions. Some respondents said accounting estimates should be defined as monetary amounts. This is because:

(a) other standards (such as IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*) suggest that an estimate is a monetary amount;[1] and

(b) the International Auditing and Assurance Standards Board recently approved IAS 540 (Revised) which defines an accounting estimate as

[1] For example, paragraph 36 of IAS 37 states that 'the amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.'

(emphasis added) 'a *monetary amount* for which the measurement, in accordance with the requirements of the applicable financial reporting framework, is subject to estimation uncertainty'.

9. Some respondents also said defining accounting estimates as judgements and assumptions could be confusing because in the process of applying accounting policies entities also make judgements and assumptions about matters other than determining accounting estimates. In their view, this is demonstrated by the fact that paragraph 122 of IAS 1 *Presentation of Financial Statements* requires an entity to disclose (emphasis added) '…the judgements, *apart from those involving estimations*…, that management has made in the process of applying the entity's accounting policies...'. Some respondents said it is not clear how an entity accounts for changes to judgements, other than those involving estimates, that the entity makes in the process of applying accounting policies. Some also said additional guidance would be needed to clarify whether a judgement made by management is an accounting estimate.

Staff analysis and preliminary views

10. We agree with respondents who said that accounting estimates are defined most helpfully not as judgements or assumptions themselves, but rather as the output of measurement techniques (such as estimation techniques or valuation techniques) that require an entity to use judgments and assumptions. This would also be more consistent with the use of the term 'estimate' in IAS 8 and other Standards. For example:

    (a) paragraph 32 of IAS 8 provides examples of estimates (monetary and non-monetary). These include bad debts, fair value of financial assets and liabilities, warranty obligations, useful lives of depreciable assets and the expected pattern of their consumption, etc.

    (b) paragraph 30(a) and other paragraphs of IAS 36 *Impairment of Assets* refer to estimates of future cash flows;

    (c) paragraph 21(a)(i) of IFRS 15 *Revenue from Contracts with Customers* refers to an estimate of the transaction price; and

(d) paragraph 57(a)(i) of IAS 19 *Employee Benefits* requires an entity to make a reliable estimate of the ultimate cost to the entity of the benefit that employees have earned in return for their service.

11. We think the definition of accounting estimates should refer to monetary amounts in the financial statements. We considered whether the definition should also refer to non-monetary amounts (eg useful life of depreciable assets, estimate of the number of equity instruments expected to vest, timing or uncertainty of future cash flows, etc). However, we think entities use non-monetary amounts as inputs to estimate monetary amounts in the financial statements. For example, an entity estimates the useful life of an asset (a non-monetary amount) in estimating the depreciation charge for that asset (a monetary amount). If accounting estimates are defined as outputs of measurement techniques, it follows that changes in inputs used, and in measurement techniques applied, to determine those outputs would result in a change in accounting estimate. Accordingly, we think it is not necessary to include non-monetary amounts in the definition of accounting estimates.

12. We think defining accounting estimates as monetary amounts and not as judgements or assumptions would also avoid any perceived conflict with other judgements that an entity may use in the process of applying accounting policies.

13. Paragraph 32 of IAS 8 includes some examples of accounting estimates which are non-monetary in nature, including inventory obsolescence and the useful lives of, or expected pattern of consumption of the future economic benefits embodied in, depreciable assets. If the Board defines accounting estimates as monetary amounts, in drafting, we would consider making amendments to paragraph 32 of IAS 8 to conform with the revised definition. We would also consider whether consequential amendments are required to other paragraphs of IAS 8 or to other IFRS Standards.

Use of the terms ‘estimation uncertainty’ and ‘precision’

Summary of feedback

14. Some respondents said using the term ‘estimation uncertainty’ in defining accounting estimates would introduce an element of circularity in the definition and the term should be deleted.

15. Some respondents said paragraph 32 of IAS 8 states that, because of uncertainties inherent in business activities, many items in the financial statements cannot be measured with precision but can only be estimated. For consistency, these respondents suggested that the Board use the same phrase (ie uncertainties inherent in business activities) when defining accounting estimates. However, another respondent suggested amending paragraph 32 of IAS 8 because, in the respondent's view, accounting estimates are required not just because of uncertainties inherent in business activities but also because of other uncertainties.

16. Some respondents also suggested the Board clarify when an item in the financial statements cannot be measured with precision—for example, whether a fair value measurement categorised in Level 1 of the fair value hierarchy is not an estimate because it is more precise than those categorised in Level 2 or Level 3 of the fair value hierarchy.

17. One respondent said entities sometimes do not measure items with precision because of cost-benefit reasons, rather than because of estimation uncertainty. The respondent suggested expanding the definition to also include such estimates.

Staff analysis and preliminary views

18. We agree the terms 'estimation uncertainty' and 'precision' are not defined in IFRS Standards. We think the definition could be improved by using the term 'measurement uncertainty' instead of the terms 'estimation uncertainty' and 'precision'.

19. Paragraph 2.19 of the *Conceptual Framework for Financial Reporting* issued by the Board in March 2018 (*Conceptual Framework*) states that measurement uncertainty arises when 'monetary amounts in financial reports cannot be observed directly and must instead be estimated…' Paragraph 6.60 of the *Conceptual Framework* expands on what 'observed directly' means. It states (emphasis added) 'when a measure cannot be *determined directly by observing prices in an active market* and must instead be estimated, measurement uncertainty arises…'

20. We think using the term 'measurement uncertainty' in the definition of an accounting estimate would bring greater clarity to the definition. It would also:

    (a) be consistent with the *Conceptual Framework*;

(b) remove any element of perceived circularity that could have arisen from using the term ‘estimation uncertainty’ in the definition (see paragraph 14 of this paper);

(c) remove any perceived ambiguity of the term ‘precision’ (see paragraph 16 of this paper); and

(d) apply consistently to all monetary amounts in the financial report, including amounts disclosed in the notes.

21. The term ‘estimation uncertainty’ is also used in paragraph 125 of IAS 1 which requires an entity to disclose information about assumptions the entity makes about the future and other major sources of estimation uncertainty. We recommend not changing the requirements in paragraph 125 of IAS 1 to also refer to ‘measurement uncertainty’—this is because the focus of the requirements in IAS 1 is different from the focus of the requirements in IAS 8 for changes in accounting estimates. We think amending IAS 1 in this respect would go beyond the scope of the amendments.

22. We considered whether the definition should state that accounting estimates are required because of uncertainties inherent in business activities (see paragraph 15 of this paper). This would be consistent with paragraph 32 of IAS 8 which states:

> As a result of the uncertainties inherent in business activities, many items in financial statements cannot be measured with precision but can only be estimated…

However, some respondents said using the phrase ‘uncertainties inherent in business activities’ could be seen as limiting the scope of accounting estimates. For reasons outlined in paragraph 20 of this paper, we think the use of the term ‘measurement uncertainty’ is more appropriate. When drafting the final amendments, we will consider whether conforming amendments should be made to paragraph 32 and other related paragraphs of IAS 8.

23. As outlined in paragraph 17 of this paper, one respondent said entities sometimes do not measure items with precision because of cost-benefit reasons, rather than because of estimation uncertainty. We think entities might, in some situations, not measure monetary amounts with precision because of materiality considerations rather than for cost-benefit reasons. In our view, the definition of accounting estimates should not

capture such estimates. We think expanding the definition to include these amounts would broaden the scope of accounting estimates and could have unintended consequences. Accordingly, we think the definition should cover only those monetary amounts that are subject to measurement uncertainty.

Deleting the definition of a 'change in accounting estimate'

Summary of feedback

24. While several respondents said providing a definition of accounting estimates is helpful, some respondents said the definition of a change in accounting estimate was useful in distinguishing between the correction of an error and a change in accounting estimate. This is because the definition of a change in accounting estimate stated '…changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.' These respondents suggest the Board retain this portion of the definition.

25. Paragraph BC16 of the Exposure Draft explains the Board's rationale for deleting this portion of the definition of a change in accounting estimate. It states that paragraph 34 of IAS 8 already contains the same requirement. However, some respondents said the wording in paragraph 34 of IAS 8 uses language which is not prescriptive and accordingly, deleting this portion of the definition of a change in accounting estimate could have unintended consequences.

Staff analysis and preliminary views

26. Based on feedback from several respondents, we continue to think the Board should define accounting estimates and that this definition should continue to clarify that an entity uses accounting estimates in applying accounting policies.

27. The Exposure Draft proposed deleting from paragraph 5 of IAS 8 the statement that '…changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.' This is because paragraph 34 of IAS 8 already contains similar language. Paragraph 34 of IAS 8 states:

> 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.

28. Paragraph 5 of IAS 8 identified situations in which an entity would account for a change as a change in accounting estimate. However, the wording in paragraph 34 of IAS 8 could be perceived as suggesting that, in addition to the situations identified in that paragraph, there could be other situations in which an entity might revise an accounting estimate. Accordingly, we agree that paragraph 34 of IAS 8 may not help an entity adequately distinguish a change in accounting estimate from the correction of an error.

29. Accordingly, we think it would be helpful to 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.

30. We also think it would be helpful to specify that estimation techniques and valuation techniques are examples of measurement techniques an entity uses to develop accounting estimates. This is to avoid any ambiguity on whether a change in estimation techniques or valuation techniques are changes in accounting policies. Accordingly, an entity would account for the effects of a change in selecting and applying an estimation technique or a valuation technique as a part of the change in accounting estimate if that change results from new information or new developments.

Limiting the definition of accounting estimates to measurement

Summary of feedback

31. Some respondents said it is not clear why the proposed definition of accounting estimates focuses only on measurement whereas an entity might also need to use estimates in other aspects of applying accounting policies, such as determining whether to recognise an item. For example, an entity could need to use estimates to determine the probability of outflow of resources when assessing whether to recognise a provision in accordance with IAS 37.

Staff analysis and preliminary views

32. We think the definition of accounting estimates should be limited to monetary amounts which are subject to measurement uncertainty. We acknowledge that an entity could use inputs that are similar in nature to those used in developing accounting estimates when assessing whether to recognise an item in the financial statements. IAS 8 specifies how an entity accounts for changes in amounts reported in the financial statements that result from changes in accounting estimates. Accordingly, we think the definition of accounting estimates in IAS 8 should focus on measurement and should not refer to inputs used in other aspects of applying accounting policies such as recognition and derecognition. Accordingly, we think the Board should not amend the proposed definition of accounting estimates to address this matter.

Other matters

33. Appendix A to this paper sets out our analysis on other matters raised by respondents on the proposed definition of accounting estimates. Our preliminary view is that no changes are needed in respect of those matters.

Feedback from Committee and ASAF members on our analysis and preliminary views

34. Appendix B to this paper analyses feedback from Committee and ASAF members. Based on our analysis of this feedback, we think no change is needed to our preliminary views.

Summary of staff preliminary views

35. Based on our analysis, our preliminary view is that the Board should revise the proposed definition of accounting estimates to specify that:

    (a) accounting estimates are monetary amounts in the financial statements that are subject to measurement uncertainty;

    (b) these monetary amounts are outputs of measurement techniques used in applying accounting policies; and

(c) an entity uses judgements and assumptions in selecting and applying the applicable measurement techniques.

36. We also think the Board should:

(a) 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

(b) specify that estimation techniques and valuation techniques are examples of measurement techniques an entity uses to develop accounting estimates.

Illustrative example

37. Appendix C to Agenda Paper 26C for this meeting presents an example illustrating the application of the staff's preliminary views on the definition of accounting estimates.

Question for the Board
Does the Board have any comments or questions on our analysis and preliminary views set out in this paper?

Appendix A—analysis of other matters

A1. The following table summarises other matters raised by respondents regarding the proposed definition of accounting estimates together with our analysis and preliminary views on those matters.

Issue	**Staff analysis and preliminary views**
1. Suggested changes to proposed definition	
Some respondents made the following suggestions to change the definition of accounting estimates: (a) one respondent suggested using the term 'accuracy' rather than 'precision' in defining an accounting estimate – this is because a precise measurement may not necessarily be relevant or faithfully representative. (b) one respondent suggested specifying in the definition that estimates are inputs used to achieve objectives (ie include in the definition the discussion which is in the Basis for Conclusions to the Exposure Draft). (c) one respondent said the definition could imply that all inputs used in selecting and applying an accounting policy are estimates—this is because the Basis for Conclusions to the Exposure Draft states that an accounting policy is the overall objective and accounting estimates are inputs used in achieving that objective.	*We recommend no change.* We will consider wording suggestions when drafting the final amendments. Nonetheless, applying our recommendations in paragraph 35 of this paper, the definition would no longer use the term 'precision'. We also think the definition should not be amended to specify that an accounting estimate is an input to achieve an objective—this discussion is better placed in the Basis for Conclusions as it explains the rationale for the definition. We think the definition proposed in the Exposure Draft and the related discussion in the Basis for Conclusions does not imply that all inputs in selecting and applying accounting policies are estimates. The proposed definition simply notes that estimates are inputs to achieving an objective (accounting policy).
2. Estimation techniques and valuation techniques	
(a) Some respondents said IFRS 13 *Fair Value Measurement* allows an entity to change its valuation technique only if the change results in a measurement that is equally or more representative of fair value in the circumstances. They suggested introducing similar requirements in	*We recommend no change* The Board considered introducing this requirement when it developed the Exposure Draft. However, at its meeting in September 2016 the Board decided not to do so. This is because introducing such a threshold could prevent preparers of financial statements from switching to a measurement technique that is less costly but still results in a measurement that is sufficiently representative of the

Issue	Staff analysis and preliminary views
IAS 8 for changes in estimation techniques and valuation techniques.	measurement basis. We continue to think the Board should not introduce this requirement.
(b) One respondent said paragraph 66 of IFRS 13 does not state that a change in valuation technique is a change in accounting estimate, only that such a change be accounted for as a change in accounting estimate. Further, they said paragraph BC147 of the Basis for Conclusion accompanying IFRS 13 can be read as suggesting that if it had been easier to distinguish between a change in technique and a change in inputs, the Board would have characterised the change in technique as a change in accounting policy.	*We recommend no change.* On the basis of our preliminary view in paragraph 36 of this paper, changes in inputs and/or measurement techniques used to develop an accounting estimate would be part of the change in accounting estimate and not the correction of an error if the change results from new information or new developments. This clarification would also specify that estimation techniques and valuation techniques are examples of measurement techniques an entity uses to develop an accounting estimate. We think this clarification would not conflict with the requirements in IFRS 13.
(c) Some respondents said an entity uses judgements and assumptions not just in selecting an estimation or valuation technique but also in applying that technique. Accordingly, the amendments should also specify that changes in the application of an estimation or valuation technique would be a change in an accounting estimate. In addition, one respondent suggested clarifying why judgement is required in selecting an estimation or valuation technique.	*We partially agree.* Based on our preliminary view in paragraph 35 of this paper, the definition of accounting estimates would clarify that an entity uses judgements and assumptions not just in selecting, but also in applying the measurement technique used to develop an accounting estimate. We think exercising judgement is an integral part of selecting an appropriate estimation or valuation technique and it is not necessary to specify why an entity uses judgement in selecting an estimation or valuation technique.
(d) Some respondents suggested explaining the terms estimation techniques and valuation techniques.	*We recommend no change* We think these terms are well understood in practice. We think defining these terms could have unintended consequences because these terms are also used in other IFRS Standards.
(e) One respondent asked whether the reference to an estimation or valuation technique limits accounting estimates to only techniques within the conventional valuation methodologies.	*We recommend no change* We think the proposed definition does not limit accounting estimates to techniques within conventional methodologies. It simply identifies estimation techniques and valuation techniques as examples of measurement techniques used to develop accounting estimates.

Appendix B—summary and analysis of feedback from Committee and ASAF members

B1. Many Committee and ASAF members expressed support for our preliminary views on the proposed definition of accounting estimates. Nonetheless, some expressed concerns about:

(a) using the term ‘monetary amount’;

(b) limiting the definition to measurement; and

(c) applying the revised definition to fair value measurements.

The following paragraphs present a summary of the feedback, together with our analysis.

Using the term ‘monetary amount’

Summary of comments

B2. One ASAF member suggested considering whether the definition should be limited to monetary amounts or whether it should also include non-monetary amounts (see paragraph 35 of this paper for our preliminary view).

B3. Some ASAF members said they were not convinced of the need to use the term ‘monetary amounts’ as proposed in our recommendation. Some committee members said stakeholders might confuse the term ‘monetary amount’ in the staff proposal with the term ‘monetary item’ in IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

B4. Some Committee members said the explanation of why the definition is limited to monetary amounts and how that interacts with non-monetary items (see paragraph 11 of this paper) is helpful and should be included in the Basis for Conclusions to the amendments. One Committee member suggested the Board amend paragraph 32 of IAS 8 to explain how the examples of non-monetary items in that paragraph would relate to accounting estimates.

Staff Analysis

B5. The use of the term 'monetary amount' in the revised definition of accounting estimates is consistent with its use in the definition of 'measurement uncertainty'—measurement uncertainty is used in, and is central to, our proposed definition of accounting estimates (see paragraphs 18–21 of this paper). We therefore continue to think the definition should refer to 'monetary amounts' and propose no change to our preliminary views in this respect. We will consider other suggestions when drafting the amendments.

Limiting the definition to measurement

Summary of comments

B6. Like some respondents to the Exposure Draft (see paragraph 31 of this paper), some Committee members asked why the definition of accounting estimates only addresses measurement and does not extend to other aspects such as recognition and derecognition. These Committee members said there could be unintended consequences because other IFRS Standards use the term estimates in respect of these other aspects.

B7. One ASAF member said limiting the definition of accounting estimates to measurement could create an additional category of change in accounting estimates that would not be addressed in IAS 8 (eg changes in estimates involved in recognition decisions).

Staff Analysis

B8. As explained in paragraph 32 of this paper, we think IAS 8 addresses only changes in accounting estimates related to measurement. Accordingly, we think using the term 'measurement uncertainty' to define accounting estimates is consistent with the existing requirements in IAS 8. We think extending the scope could result in unintended consequences. Consequently, we propose no changes to our preliminary view as a result of this matter.

Applying the revised definition of accounting estimates to fair value measurement

Summary of comments

B9. One ASAF member asked whether, applying our preliminary views, a change from measuring fair value using level 1 inputs to using level 2 inputs would be accounted for as a change in accounting estimates.

Staff Analysis

B10. IFRS 13 states that 'the objective of a fair value measurement is (emphasis added) '… *to estimate* the price at which an orderly transaction to sell the asset or to transfer the liability *would* take place'. This is regardless of whether that fair value is determined using observable inputs. Accordingly, we think any fair value measurement (whether that measurement uses level 1 inputs) in the financial statements is an accounting estimate. This is because an may *use* observable inputs in determining a fair value but cannot *observe* the fair value itself.

B11. Accordingly, we think in applying our preliminary views (see paragraphs 35–36 of this paper), a change from measuring fair value using level 1 inputs to using level 2 inputs would be a change in accounting estimate.

Other comments from Committee and ASAF members

B12. The table below summarises other comments from Committee and ASAF members together with our analysis and preliminary views on those matters.

Feedback	**Staff analysis and preliminary views**
(a) One ASAF member said the Board should clarify what constitutes new information and new developments. Some Committee members also said entities sometimes change accounting estimates for reasons other than new information or new developments and the wording in the staff proposals would not address these situations. One Committee member suggested using the term 'more experience'.	*We recommend no change.* The existing definition of a 'change in accounting estimate' in paragraph 5 of IAS 8 explains that changes in accounting estimates results from new information or new developments and, accordingly, are not correction of errors. Paragraph 34 of IAS 8 also uses the term 'more experience' in that same context. We are not aware of significant difficulties in applying these requirements.

(b) One ASAF member suggested the Board define the process of accounting estimation, and then define an accounting estimate as an output of the process of accounting estimation.	*We recommend no change.* We think defining the process of accounting estimation would add unnecessary complexity to the amendments.
(c) One Committee member suggested the Board amend the requirement in paragraph 35 of IAS 8 so that when it is difficult to distinguish a change in accounting policy from a change in accounting estimate, the change is treated as a change in accounting policy, not as a change in accounting estimate. This is because the proposed amendment would clarify the definition of accounting estimates.	*We recommend no change.* We think the Board should not amend the requirements in paragraph 35. The amendments would help entities distinguish accounting estimates from accounting policies. However, the requirements in paragraph 35 of IAS 8 would still apply when it is difficult to make such distinction.
(d) One Committee member suggested the Board explain how the proposed definition of accounting estimates interacts with the requirements in IAS 1.	*We recommend no change* Paragraph 21 of this paper documents our considerations in this respect.
(e) One Committee member said it would be helpful to ensure the staff proposal is consistent with the definition used in the International Auditing Standards issued by IAASB.	*We recommend no change.* Paragraphs 8–13 of this paper document our considerations in this respect.