STAFF PAPER

REG IASB Meeting

Project	**Review of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors***
Paper topic	Distinction between changes in accounting policies and changes in accounting estimates

CONTACT(S)	Nadia Chebotareva	nchebotareva@ifrs.org	+44 (0) 20 7246 6457
	Leonardo Piombino	lpiombino@fondazioneoic.it	+39 06 6976 6834

Purpose of the paper

1. The purpose of this paper is to:

   (a) recommend how to clarify the existing distinction between a change in an accounting policy and a change in an accounting estimate in IAS 8; and

   (b) recommend including this clarification in the next Exposure Draft of Annual Improvements.

2. Agenda Paper 25B considers whether any disclosure requirements should be added to IAS 8 for changes in accounting estimates.

3. The rest of this paper discusses:

   (a) why the distinction matters—paragraph 5

   (b) background to the paper—paragraphs 6-11

   (c) approach to the recommended amendments to IAS 8—paragraphs 12-16

   (d) current recommendations—paragraphs 17-18

   (e) whether the recommendations would result in sufficient improvement—paragraphs 19-24

   (f) process for an Exposure Draft—paragraphs 25-28.

4. The paper also has the following Appendices:

   (a) Appendix A—Comparison of the recommended wording in this paper to the current wording in IAS 8

   (b) Appendix B—Comparison of IFRS 13 to the recommended wording in IAS 8

   (c) Appendix C—Two specific issues.

Why the distinction matters

5. The distinction between a change in an accounting policy and a change in an accounting estimate is important, because:

   (a) Entities apply voluntary changes in accounting policy retrospectively (ie comparative amounts are restated as if the new accounting policy had always been applied); on the other hand, changes in accounting estimates are applied prospectively (ie in the period of change).[1]

   (b) A change in accounting policy is only allowed if the change is required by an IFRS Standard or results in financial statements providing reliable and more relevant information. There is no such explicit requirement in IAS 8 for changes in accounting estimates. Changes in accounting estimates result from new information or new developments.[2]

[1] Paragraphs 5, 36 and 37 of IAS 8.

[2] Paragraphs 5 and 14 of IAS 8.

Background

6. In September 2014 the IFRS Interpretations Committee informed the Board about divergent practices in assessing whether a change constitutes a change in an accounting policy, or a change in an accounting estimate, in applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.* At that time the Board decided to add this issue to its agenda, as part of the *Disclosure Initiative*.[3]

7. During outreach performed by the staff of the Italian Standard Setter (OIC staff) in early 2015, we heard from preparers that the definition of accounting policies was too broad and that it appeared to overlap with the definition of a change in accounting estimate.

8. In May 2015 the Board discussed a paper prepared by the OIC staff about possible amendments to IAS 8 (Agenda Paper 11A).[4] The paper recommended that the Board should amend the existing definitions of accounting policies and of changes in accounting estimates in order to clarify that:

   (a) changes in the measurement bases that are specified in relevant Standards are changes in accounting policies;

   (b) changes in the measurement bases include changes in cost measures and, therefore, changes in the methods used to determine different cost measures are changes in accounting policies; and

   (c) changes in inputs, assumptions and methods that are used to make an accounting estimate are changes in accounting estimates.

9. The Board asked the staff to further develop the recommendations considered in the paper. In other words, the Board agreed with the direction but believed that the wording of the recommended amendments should be improved to be workable in practice.

---

[3] http://media.ifrs.org/2014/IASB/September/IASB-Update-September-2014.pdf

[4] http://www.ifrs.org/Meetings/MeetingDocs/IASB/2015/May/AP11A-Disclosure-Initiative.pdf

10. The Board also tentatively decided that when the recommended amendments are fully developed they should be published as an Exposure Draft and not as part of the forthcoming *Principles of Disclosure* Discussion Paper. [5] This is because Board members did not believe that the amendments needed two rounds of consultation with constituents.

11. Since the Board meeting in May 2015, we have further developed our thinking and recommendations. The purpose of this paper is to ask for your views on our current recommendations for the amendments.

Approach to recommended amendments

12. The focus of the recommended amendments has changed from identifying whether there has been a change in a measurement basis to clarifying—in a more principle-based way—how accounting policies and accounting estimates relate to each other. We recommend this change because after our investigation we concluded that it would be difficult to describe what a measurement basis is in terms that would apply effectively to all Standards. This is because existing Standards describe their requirements for measurement in various ways using differing terminology.

13. For this reason, we have now concluded that we could describe the distinction in IAS 8 more clearly, and in a more principle-based way, by clarifying that accounting estimates are means of applying accounting policies. In other words, an accounting policy is the end, and making an accounting estimate is the means of achieving that end.

14. After having considered various approaches, we recommend to the Board that it should amend IAS 8 as follows:

    (a) clarify the definitions of accounting policies and of changes in accounting estimates with the objective of making them more concise and distinctive;

    (b) clarify how accounting policies and estimates relate to each other;

[5] http://media.ifrs.org/2015/IASB/May/IASB-Update-May-2015.pdf

(c) add guidance about whether changes in valuation techniques and in estimation techniques are changes in accounting estimates; and

(d) update examples of estimates provided in IAS 8.

15. The next section of the paper (*Current recommendations*) includes the recommended wording (as compared to the current wording in IAS 8). Appendix A provides explanations for the recommended amendments.

16. As can be seen from Appendix A, the recommended amendments are based to a significant extent on the guidance that exists elsewhere in IFRS Standards (eg IFRS 13 *Fair Value Measurement* and IAS 1 *Presentation of Financial Statements*) and, in this sense, the recommended amendments aim to bring together in IAS 8 relevant guidance about accounting policies and changes in accounting estimates.

Current recommendations

17. The amended definitions in paragraph 5 of IAS 8 would now read as follows (mark-up is from IAS 8; the clean text is provided below). Paragraphs A1- A2 of Appendix A explain the reasons for the recommended amendments.

> *Accounting policies* are the specific principles~~, bases, conventions, rules and other practices~~ applied by an entity in preparing and presenting financial statements.
>
> *A change in accounting estimate* is an adjustment of the carrying amount of an asset or a liability, ~~or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates~~ resulting from new information (or some other new development~~s~~)~~,~~ that causes a change in judgements or assumptions used in applying the accounting policy for that asset or liability ~~and, accordingly, are not corrections of errors~~.

Clean text
Accounting policies are the specific principles applied by an entity in preparing and presenting financial statements. *A change in accounting estimate* is an adjustment of the carrying amount of an asset or a liability, resulting from new information (or some other new development) that causes a change in judgements or assumptions used in applying the accounting policy for that asset or liability.

18. The existing IAS 8 text provides in paragraphs 32–35 some guidance on the distinction. We recommend making the following amendments to this guidance:

    (a) to clarify the relationship between accounting policies and accounting estimates in paragraph 32 of IAS 8, as explained in paragraph A2b of Appendix A;

(b) to amend one example in paragraph 32 of IAS 8, as explained in paragraph A5 of Appendix A; and

(c) to add some further guidance about changes in estimation techniques in paragraph 34A of IAS 8 with the objective of making the guidance consistent with IFRS 13, as explained in paragraphs A6 - A14 of Appendix A.

The amended text in paragraphs 32-35 of IAS 8 would now read as follows (mark-up is from IAS 8):

Changes in accounting estimates

32 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~~. <u>Thus, entities may need to use accounting estimates in applying their accounting policies for some of those items.</u> Estimation involves making judgements <u>or assumptions</u> based on the latest available, reliable information. For example, estimates may be required of:

(a) bad debts;

(b) inventory obsolescence;

(c) the fair value of ~~financial~~ assets or ~~financial~~ liabilities<u>, if not determined by using a quoted price (unadjusted) in an active market for identical assets or liabilities;</u>

(d) the useful lives of, or expected pattern of consumption of the future economic benefits embodied in depreciable assets; and

(e) warranty obligations.

33 The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

34 An estimate may need revisions 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 a correction of an error.

34A <u>If an entity uses estimation techniques or valuation techniques in making accounting estimates, a change in those techniques is a change in an accounting estimate. A change in an estimation technique or in a valuation technique is appropriate if, in the circumstances, the resulting measurement is equally or more representative of the amount being estimated. This may be the case if, for example, any of the following events take place:</u>

<u>(a)</u> <u>new markets develop;</u>

<u>(b)</u> <u>new information becomes available;</u>

<u>(c)</u> <u>information previously used is no longer available;</u>

<u>(d)</u> <u>estimation techniques or valuation techniques improve; or</u>

<u>(e)</u> <u>market conditions change.</u>

35 A change in the measurement basis applied is a change in an accounting policy, and it is not a change in an accounting estimate. When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate.

Question 1

Do you have any comments on the wording? In particular:

a. Do you agree with the changes to the definition of accounting policies?

b. Do you agree with the changes to the definition of a change in accounting estimate?

c. Do you agree with the amendments to paragraph 32 of IAS 8? This paragraph deals with examples of situations in which accounting estimates may be required.

d. Do you agree with adding paragraph 34A to IAS 8? This paragraph deals with changes in estimation techniques and is based on paragraphs 65-66 of IFRS 13.

Would the recommendations result in sufficient improvement?

19. We have performed some informal outreach with members of the IFRS IC, specialists of major accounting firms and regulatory authorities on:

    (a) whether the recommendations would be helpful in practice (ie result in improvement); and

    (b) whether the improvement would be sufficient to justify issuing an Exposure Draft (ED).

20. In summary, almost everyone who we spoke to believed that the recommendations provide more clarity than the current guidance in IAS 8. Respondents especially liked that:

    (a) the relationship between accounting policies and accounting estimates would become clearer;

    (b) the definitions would become more concise; and

    (c) the recommended paragraph 34A would provide guidance—which currently does not exist in IAS 8—about changes in estimation techniques and changes in valuation techniques.

21. However, some respondents believed that the recommendations might not provide definitive answers in all situations.

22. On the basis of this outreach and the work performed, staff believe unanimously that the recommendations would result in an improvement to the existing guidance in IAS 8. Staff, however, have a split view on whether the recommendations would provide a sufficient improvement for the Board to go ahead with the ED.

23. Those staff who believe that the recommended amendments would provide a sufficient improvement believe so for the following reasons:

    (a) we tested the recommendations on a number of situations and we believe that the recommended amendments would apply and be helpful in most situations. (The two most frequently discussed situations are described in Appendix C *Two specific issues*[6]);

(b) the issue of the distinction is important because—besides the reasons stated in paragraph 5 of the paper—the use of estimates is widespread in practice;

(c) the recommended amendments clarify in a principle-based way how accounting policies and accounting estimates relate to each other; and

(d) during our work we have tried to identify any potential unintended consequences of the recommended amendments, and we have not identified any: the recommended amendments are based to a significant extent on the guidance that exists elsewhere in IFRS Standards, they also aim to clarify (ie not to change) IAS 8.

24. Those staff who believe that the recommended amendments would not provide sufficient improvement believe that:

(a) any change creates a risk of unintended consequences; and

(b) the improvement is too minor to justify the costs to all concerned of issuing, understanding and responding to the ED, developing and issuing final amendments resulting from the ED, going through any local endorsement process that may be required, and understanding and implementing the amendments.

Those staff also believe that it is not possible to develop any other amendments that would provide sufficient improvement to make it worth issuing an ED.

---

[6] These issues are:

(a) a change in the basket of high quality corporate bonds used to determine the discount rate for defined benefit pension obligations; and

(b) a change in the cost formula used for inventories (ie FIFO and weighted average cost)

Question 2

A. Do you believe that the Board should go ahead with an Exposure Draft (ED)?

B. If you believe that the Board should *not* go ahead with an Exposure Draft, should we:

   a. develop these recommendations further; or

   b. take the project in a different direction [please specify]; or

   c. stop the project.

Process

25. If the Board issues the recommended amendments, there are two ways of doing this:

    (a) as a separate ED or

    (b) within the ED for the next cycle of Annual Improvements.

26. Annual Improvements need to meet the following criteria in the Due Process Handbook (paragraphs 6.10-6.15):[7]

Criteria for annual improvements	
Criterion	Is the criterion met?
An annual improvement should: • replace unclear wording; • provide missing guidance; or • correct minor unintended consequences, oversights or conflict.	**Yes.** As noted by the OIC staff paper in May 2015, there is a perceived lack of clarity in the wording of the definitions of paragraph 5 of IAS 8. The recommended amendment clarifies how accounting policies and accounting estimates relate to each other.
Not change an existing principle or propose a new principle	**Yes.** We think that the recommendation would not change an existing principle or propose a new principle. Instead, we think that the proposal is clarifying existing principles in IAS 8.
Not be so fundamental that the Board will have to meet several times to conclude	**Yes.** We think that the Board can conclude without repeated discussion.

[7] http://www.ifrs.org/DPOC/Documents/2013/Due_Process_Handbook_Resupply_28_Feb_2013_WEBSITE.pdf

27. On the basis of this assessment we think that the recommended amendments meet the criteria for Annual Improvements. We have also heard from constituents that they would prefer the Board to issue proposals for amendments in a 'package' (not separately). On the basis of these two factors staff recommend that the Board should issue these amendments as part of the next cycle of Annual Improvements.

28. Currently this project is classified in the Work Plan as an Implementation project; it also forms part of the *Disclosure Initiative*. We recommend that going forward this project will continue to be classified as an Implementation project but it will no longer form part of the *Disclosure Initiative.*

Question 3

If the Board decides to go ahead with an Exposure Draft, do you agree with the staff recommendation that the recommended amendments should be issued as part of the next cycle of the Annual Improvements ED?

Appendix A

Comparison of the recommended wording in this paper to the current wording in IAS 8

Definition of 'accounting policies'

A1 The recommended wording of the definition of 'accounting policies' differs from IAS 8 in the following two respects:

a. We removed 'bases', 'conventions', 'rules' because the meaning of these terms is not clear and they are not used in IFRSs.

b. We removed 'other practices' for the same reason. Besides, it might be misunderstood as including estimation techniques and valuation techniques that entities use in making their estimates.

Definition of 'a change in accounting estimate'

A2 The recommended wording for the definition of 'a change in accounting estimate' differs from the wording in IAS 8 in the following four respects:

a. We recommend removing the middle part of the existing definition that talks about adjustments to 'the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with assets and liabilities', because it was considered as being too specific (relating solely or mainly to IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*) and not adding much to the rest of the definition.

b. We recommend clarifying what 'new information, or another new development' would refer to in the context of the definition, ie those that 'cause a change in judgements or assumptions used in applying the accounting policy for that asset or liability'.

c. By clarifying this in this way, we also recommend explaining the link between accounting policies and accounting estimates, ie accounting estimates are used in applying accounting policies. The same point is further made in the recommended amendments to paragraph 32 of IAS 8 (new second sentence).

d. We recommend removing the last part that says that changes in accounting estimates 'are not corrections of errors'. This part points out a consequence of the definition of a change in accounting estimate, this part is not a necessary part of that definition. Moreover, paragraphs 34 and 48 of IAS 8 already point out this consequence explicitly.[8]

Definition of 'accounting estimates'

A3 During our work we heard suggestions to include a definition of 'accounting estimates' (vs 'a change in accounting estimate') in IAS 8 because IAS 8 already contains the definition of 'accounting policies'.

A4 If we were to propose a definition of 'an accounting estimate' it would be *something like* this: 'Accounting estimates are judgements or assumptions used in applying accounting policies in situations when items in financial statements cannot be measured with precision (ie estimation uncertainty exists)'.[9] However, we do not recommend adding a definition of 'an accounting estimate' to IAS 8 because we believe that this would go beyond the scope of this project, which aims to clarify and not to change IAS 8. Instead, we recommend clarifying the relationship between accounting policies and accounting estimates by amending the definition of 'a change in accounting estimate' and paragraph 32 of IAS 8.

Examples of estimates

A5 Paragraph 32 of IAS 8, which provides examples of situations in which estimates may be required. In that paragraph, we recommend amending the existing example (paragraph 32(c)) that deals with estimates in fair value, with the objective of clarifying that no

---

[8] Paragraph 34 of IAS 8 says: 'An estimate may need revision if changes occur in 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.'

Paragraph 48 of IAS 8 says: 'Corrections of errors are distinguished from changes in accounting estimates. Accounting estimates by their nature are approximations that may need revision as additional information becomes known. For example, the gain or loss recognised on the outcome of a contingency is not a correction of an error.'

[9] IAS 8 (paragraph 32) uses the term 'items in financial statements cannot be measured with precision'. IAS 1 uses the term 'estimation uncertainty'.

estimates are involved in Level 1 measurements of fair value. This would also help to align the existing example with paragraph 128 of IAS 1. This paragraph points out that, for assets and liabilities measured at fair value, disclosures about estimation uncertainty are not required when no such uncertainty exists. In addition, we recommend deleting the term financial from paragraph 32(c), because there is no reason to restrict this example to financial assets and financial liabilities.[10]

Changes in estimation techniques and valuation techniques

A6 We recommend adding some further guidance in the main body of IAS 8 (paragraph 34A) about changes in estimation technique and valuation techniques. This guidance is largely aligned with the existing guidance in paragraphs 65 and 66 of IFRS 13 concerning changes in valuation techniques.

A7 However, we do not recommend repeating in IAS 8 the explicit requirement from IFRS 13 that valuation techniques shall be applied consistently. This is because we believe that this requirement is implicit in the recommended paragraph 34A of IAS 8, which identifies when a change is appropriate.

A8 In addition, paragraph 65 of IFRS 13 talks about changes not only in valuation techniques but also in their application (eg a change in weighting when multiple valuation techniques are used or a change in an adjustment applied to a valuation technique). We do not recommend specifying in IAS 8 that changes in application of valuation techniques are one type of changes in accounting estimates. This is because we believe that it would be more appropriate to keep the amendments to IAS 8 at a high level and to talk about changes in estimation techniques and valuation techniques in general.

A9 The full wording comparison between paragraphs 65 and 66 of IFRS 13 and recommended paragraph 34A of IAS 8 is provided in Appendix B.

[10] Paragraph 128 of IAS 1 says: 'The disclosures in paragraph 125 [about major sources of estimation uncertainty] are not required for assets and liabilities […] if, at the end of the reporting period, they are measured at fair value based on quoted price in an active market for an identical asset or liability. Such fair values might change materially within the next financial year but these changes would not arise from assumptions or other sources of estimation uncertainty at the end of the reporting period.'

A10 We do not recommend including definitions of estimation techniques[11] and valuation techniques[12] [13]. These terms have been in existence for some time now; they have not been defined anywhere in IFRS Standards, and we are not aware of any practical concerns in this area.

Thresholds for changes in accounting estimates

A11 As stated in paragraph 5(b) of the paper, a change in accounting policy is allowed only if the change is required by an IFRS Standard or results in financial statements providing reliable and more relevant information. There is no such explicit requirement in IAS 8 for changes in accounting estimates. Changes in accounting estimates result from new information or new developments.

A12 In addition, paragraph 65 of IFRS 13 says a change in a valuation technique or its application is appropriate if, in the circumstances, the change results in a measurement that is equally or more representative of fair value in the circumstances.

A13 The question arises about whether any similar thresholds should be introduced in IAS 8 for changes in accounting estimates. We do not recommend introducing any such thresholds for changes in accounting estimates because:

a. IAS 8 already says that estimates should be reasonable and they should be based on the latest available, reliable information;[14]

b. introducing thresholds might be perceived as intending to change the existing guidance in IAS 8, which was not the intention of this project; and

c. introducing thresholds would require additional effort from preparers of financial statements because changes in accounting estimates are much more frequent than changes in accounting policies.

A14 However, we recommend that the ‘equally or more representative’ criterion would apply for changes in estimation techniques and valuation techniques (as recommended in

---

[11] This term is used in IFRS 7 (paragraph 35G).

[12] This term is used in IFRS 13. See Appendix B of this paper.

[13] They include option pricing models in IFRS 2 (Appendix B).

[14] See paragraphs 32 and 33 of IAS 8.

paragraph 34A of IAS 8); it would not apply to other changes in accounting estimates.[15] There are two reasons for this recommendation:

a. consistency with IFRS 13 for changes in valuation techniques; and

b. the choice of an estimation technique or a valuation technique is likely to involve more judgement by an entity than other changes in accounting estimates, because other changes in accounting estimates are derived more directly from external information.

A15 The effect of our recommendations is summarised as follows (recommended amendments to IAS 8 are highlighted in Grey):

An entity can make a change in:

ACCOUNTING POLICY	**ACCOUNTING ESTIMATE**	**ESTIMATION OR VALUATION TECHNIQUE** **(which is a sub-set of an accounting estimate)**
If change results in reliable and more relevant information	No explicit threshold for the change However, estimates should be reasonable and they should be based on the latest available, reliable information	If the resulting measurement is equally or more representative of the amount being estimated

[15] We, however, do not recommend including additional disclosure requirements in IAS 8 for *reasons* for changes in those techniques, as explained in paper 25B.

Appendix B

Comparison of IFRS 13 to the recommended wording in IAS 8

The new paragraph 34A of IAS 8 would now read as follows; mark-up is from paragraphs 65 and 66 of IFRS 13.

65 ~~Valuation techniques used to measure fair value shall be applied consistently.~~ If an entity uses estimation techniques or valuation techniques in making accounting estimates, a change in those techniques is a change in an accounting estimate. ~~However, a~~ A change in an estimation technique or a valuation technique ~~or its application (eg a change in its weighting when multiple valuation techniques are used or a change in an adjustment applied to a valuation technique)~~ is appropriate if, in the circumstances, ~~the change results in a measurement that~~ the resulting measurement is equally or more representative ~~of fair value in the circumstances~~ the amount being estimated. This may be the case if, for example, any of the following events take place:

(a) new markets develop;

(b) new information becomes available;

(c) information previously used is no longer available;

(d) estimation techniques or valuation techniques improve; or

(e) market conditions change.

66 ~~Revisions resulting from a change in the valuation technique or its application shall be accounted for as a change in accounting estimate in accordance with IAS 8. However, the disclosures in IAS 8 for a change in accounting estimate are not required for revisions resulting from a change in a valuation technique or its application.~~[16]

[16] Please note that disclosures about changes in accounting estimates are addressed in a separate paper.

Appendix C

Two specific issues

C1 During the course of this project people often referred to the following two specific issues where they had found it difficult to draw a distinction between a change in an accounting policy and a change in an estimate:

(a) a change in the basket of high quality corporate bonds used to determine the discount rate for defined benefit pension obligations; and

(b) a change in the cost formula used for inventories (ie FIFO and weighted average cost).

For this reason, we assessed these two situations in this Appendix with the objective of testing our recommendations.

Change in the basket of high quality corporate bonds used to determine the discount rate for defined benefit pension obligations

C2 The discount rate is one of the actuarial assumptions (and, therefore, an estimate[17]) used in measuring a pension obligation under IAS 19 *Employee Benefits*. Paragraph 83 of IAS 19 says that the rate used to discount pension obligations should be determined by reference to the market yields on high quality corporate bonds (HQCBs).

C3 The question that arises in the context of this paper is: if an entity were to change the basket of the HQCBs for the purpose of determining a discount rate for its pension obligations—would this be considered a change in an accounting policy or a change in an accounting estimate?

C4 In the staff's view, although IAS 19 provides quite specific guidance about how the discount rate should be determined, the appropriate basket of HQCBs cannot be determined with precision because there is usually a range of acceptable outcomes that an entity can use in practice (eg different indexes of corporate bonds). This situation is

[17] Paragraph 76 of IAS 19 says: Actuarial assumptions are an entity's best estimates of the variables that will determined the ultimate cost of providing post-employment benefits.

unlike the discount rate that is based, for example, on the published interest rate of a Central Bank and, therefore, can be measured with precision. Consequently, the change in the basket of HQCBs involves estimation uncertainty and constitutes a change in accounting estimate.

C5 Please note that in 2013 the IFRS Interpretations Committee addressed a different question of whether an entity can make a change in the basket of the HQCBs to the HQCBs with a lower rating. In other words, the issue was about which bonds can be considered to be HQCBs. In a rejection notice issued in November 2013, the IFRS Interpretations Committee explained its reasons for not adding to its agenda a project to clarify which bonds qualify as HQCB.[18]

Change in the cost formula used for inventories (ie FIFO and weighted average cost)

C6 Inventories are measured at the lower of cost or net realisable value. For subsequent measurement, when inventories are used, IAS 2 distinguishes between items that are not ordinarily interchangeable and those that are. For inventories that are ordinarily interchangeable paragraph 24 of IAS 2 states that a specific identification approach is not appropriate for determining the remaining cost amount. For those inventories, IAS 2 permits a free choice between the FIFO and weighted average cost formulas (paragraph 25 of IAS 2).

C7 The question that arises in the context of this paper is: if an entity were to change the cost formula from FIFO to weighted average cost, or vice versa, for the used inventories and the remaining inventories—would this be considered a change in an accounting policy or a change in an accounting estimate?

C8 In the staff's view, if the inventories are interchangeable, their actual flow is irrelevant in a sense that there is no difference whether you pick one item of inventory or another.

[18] http://media.ifrs.org/2013/IFRIC/November/IFRIC-Update-November-2013.html#3

Consequently, the accounting result as well should not depend on which item you actually pick. Therefore, the decision on which cost formula to use (ie FIFO or weighted average cost) is not based on an attempt to estimate the actual flow of the inventories. That decision is the selection of an accounting policy.

C9 This conclusion is further supported by the disclosure requirement in paragraph 36(a) of IAS 2. This states that an entity 'shall disclose *accounting policies* adopted in measuring inventories, including the cost formulas used'. [Italics added]

C10 Although the *selection* of a cost formula (ie FIFO or weighted average cost) is not the making of an accounting estimate, the *application* of that cost formula will sometimes involve estimates of, for example, overhead absorption or net realisable value.

Summary

C11 We recommend not giving guidance on those two specific issues as part of this project. This is because the objective of this project is to clarify the distinction between accounting policies and accounting estimates in a principle-based way.

C12 Besides, as mentioned above:

(c) the IFRS IC issued a rejection notice for the issue about the basket of HQCBs and we understand that in practice changes in the basket of HQCBs are treated as changes in accounting estimates; and

(d) the issue about the change in the cost formulas used for inventories is not new and there has been an established practice to treat the change as a change in accounting policies (as evidenced by our review of publications by major accounting firms and of other GAAPs[19]).

[19] For example, US GAAP, UK GAAP and Japanese GAAP.