IFRS

STAFF PAPER

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Accounting Standards Advisory Forum

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

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Purpose of the paper

1. The purpose of this paper is to obtain feedback from ASAF members on the draft amendments to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.[1] .The draft amendments aim to clarify the distinction between a change in an accounting policy and a change in an accounting estimate.

2. The Board discussed the draft amendments at its meeting in April 2016 and tentatively decided to issue an Exposure Draft (ED) containing the draft amendments.[2] The exact wording of the amendments is subject to change.

3. Specifically, we would like to discuss whether ASAF members believe that the draft amendments will provide sufficient improvement to justify publishing an ED.

4. Staff will report feedback from the ASAF discussion to a future Board meeting before the staff seek permission to draft and ballot an ED.

[1] That paper was a joint paper prepared by the staff of the IASB and the staff of OIC (Italian standard-setter): http://www.ifrs.org/Meetings/MeetingDocs/IASB/2016/April/AP25A-Disclosure-Initiative-accounting-estimates.pdf

[2] https://s3.amazonaws.com/ifrswebcontent/2016/IASB/April/IASB_April_Update.pdf

5. The rest of this paper discusses:

   (a) background to the issue—paragraphs 7-9

   (b) approach to the draft amendments to IAS 8—paragraphs 10-13

   (c) draft amendments—paragraphs 14-15

   (d) whether the draft amendments would result in sufficient improvement—paragraphs 16-21

   (e) process for an Exposure Draft—paragraphs 22-23

6. The paper also has the following Appendices:

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

   (b) Appendix B—Comparison of IFRS 13 to the draft wording for IAS 8.

Background

7. 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).[3]

   (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.[4]

8. 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.[5]

9. 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.

Approach to the draft amendments

10. The objective of the amendments is to clarify—in a principle-based way—how accounting policies and accounting estimates relate to each other. For this reason, the draft amendments describe the distinction in IAS 8 by clarifying that accounting estimates are means of applying accounting policies. In other words, an accounting

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

[4] Paragraphs 5 and 14 of IAS 8.

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

policy is the end, and making an accounting estimate is the means of achieving that end.

11. More specifically, the draft amendments would 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;

    (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.

12. The next section of the paper (*Draft amendments*) includes the draft wording (as compared to the current wording in IAS 8).

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

Draft amendments

14. The amended definitions in paragraph 5 of IAS 8 would now read as follows (mark-up is by comparison with IAS 8; the clean text is provided below). Paragraphs A1- A2 of Appendix A explain the reasons for the draft 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.

15. The existing IAS 8 text provides in paragraphs 32–35 some guidance on the distinction. The draft amendments would amend this guidance as follows:

    (a) to clarify the relationship between accounting policies and accounting estimates in paragraph 32 of IAS 8, as explained in paragraph A2c of Appendix A;

(b) to amend one example in paragraph 32 of IAS 8, as explained in paragraph A3 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 A4 - A13 of Appendix A.

The amended text in paragraphs 32-35 of IAS 8 would now read as follows (mark-up is by comparison with 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~~. Thus, entities may need to use accounting estimates in applying their accounting policies for some of those items. Estimation involves making judgements or assumptions 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, if not determined by using a quoted price (unadjusted) in an active market for identical assets or liabilities;

(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 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:

(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.

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.

Would the amendments result in sufficient improvement?

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

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

    (b) whether the improvement would be sufficient to justify publishing an ED.

17. Almost everyone who we spoke to believed that the draft amendments 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) draft paragraph 34A would add guidance—not currently in IAS 8—about changes in estimation techniques and changes in valuation techniques.

18. Some respondents believed that the draft amendments might not provide definitive answers in all situations. However, other respondents thought that the application of judgement is already present in IAS 8 and that the draft amendments will assist entities in making those judgements.

19. In summary, many respondents believed that the amendments would improve the existing guidance in IAS 8. There was, however, a split view on whether the amendments would provide a sufficient improvement for the Board to go ahead with the ED.

20. Those people who believe that the draft amendments would provide a sufficient improvement believe so for the following reasons:

    (a) the amendments were tested on a number of situations and it appears that they would apply and be helpful in many of these situations where currently there may be doubt;

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

(c) it is not expected that the draft amendments would have significant unintended consequences because the draft amendments are based largely on guidance that exists elsewhere in IFRS Standards; they also aim to clarify (ie not to change) IAS 8.

21. Those people who believe that the draft 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 publishing, 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.

Moreover, those people also believe that it is not possible to develop any other amendments for this issue that would provide sufficient improvement to make it worth publishing an ED.

Question 1
Do you believe that the amendments would provide sufficient improvement to justify publishing an ED?

Question 2

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

a. Do you think the changes to the definition of accounting policies are appropriate?

b. Do you think the changes to the definition of a change in accounting estimate are appropriate?

c. Do you think it is appropriate to add paragraph 34A to IAS 8? This paragraph is based on paragraphs 65-66 of IFRS 13. It deals with changes in estimation techniques and valuation techniques. It also introduces a threshold (ie 'equally or more representative') that entities would have to pass in order to justify changes in estimation techniques and valuation techniques.

Process

22. If the Board publishes an ED on this topic, there are two ways it could do this:

(a) as a separate ED or

(b) as a separate ED but at the same time as one or more other consultation documents, for example, with the ED for the next cycle of Annual Improvements or with the Discussion Paper on *Principles of Disclosure*.

23. We have heard that national standard-setters and other constituents would prefer the Board to publish consultation documents in a 'package' (not separately). National standard-setters appeared to be particularly concerned about 'consultation fatigue' for respondents.

Question 3

If the Board decides to publish an ED, do you believe that this ED should be published at the same time as one or more other consultation documents?

If yes, do you have any specific suggestions?

Appendix A

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

Definition of 'accounting policies'

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

a. The terms 'bases', 'conventions', 'rules' have been removed because their meanings are not clear and they are not used in IFRS Standards.

b. The term 'other practices' has been removed 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 draft definition of 'a change in accounting estimate' differs from the wording in IAS 8 in the following four respects:

a. The middle part of the existing definition has been removed. This 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. Clarification is provided of 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. This clarification also helps explain 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 draft amendments to paragraph 32 of IAS 8 (new second sentence).

d. The last part currently says that changes in accounting estimates 'are not corrections of errors'. This part has been removed. This part points out a consequence of the definition of a change in accounting estimate, but this part is not a necessary part of that definition. Moreover, paragraphs 34 and 48 of IAS 8 already point out this consequence explicitly.[6]

Examples of estimates

A3 Paragraph 32 of IAS 8 provides examples of situations in which estimates may be required. In that paragraph, the draft amendments amend the existing example (paragraph 32(c)) that deals with estimates in fair value, with the objective of clarifying that no 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, the draft amendments would delete the term financial from paragraph 32(c), because there is no reason to restrict this example to financial assets and financial liabilities.[7]

Changes in estimation techniques and valuation techniques

A4 The draft amendments would add in the main body of IAS 8 (paragraph 34A) some further guidance 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.

[6] 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.'

[7] 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.'

A5 However, the draft amendments would not repeat in IAS 8 the explicit requirement from IFRS 13 that valuation techniques shall be applied consistently. This is because this requirement is implicit in draft paragraph 34A of IAS 8, which identifies when a change is appropriate.

A6 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). The draft amendments do not specify in IAS 8 that changes in application of valuation techniques are one type of changes in accounting estimates. This is in order to keep the amendments to IAS 8 at a high level and to talk about changes in estimation techniques and valuation techniques in general.

A7 The full wording comparison between paragraphs 65 and 66 of IFRS 13 and draft paragraph 34A of IAS 8 is provided in Appendix B.

A8 The draft amendments would not add definitions of estimation techniques[8] and valuation techniques[9] [10]. These terms have been in existence for some time now; they have not been defined anywhere in IFRS Standards, and staff were not aware of any practical concerns in this area.

Thresholds for changes in accounting estimates

A9 As stated in paragraph 7(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.

A10 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.

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

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

[10] Valuation techniques include option pricing models in IFRS 2 (Appendix B).

A11 The draft amendments would not introduce in IAS 8 any similar 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;[11]

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.

A12 However, the draft amendments would extend the ‘equally or more representative’ criterion so that it would apply for changes in estimation techniques and valuation techniques (see draft paragraph 34A of IAS 8); that criterion would not apply to other changes in accounting estimates.[12] There were two reasons for these two proposals:

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.

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

[12] The draft amendments would not add additional disclosure requirements in IAS 8 for *reasons* for changes in those techniques, as explained in paper 25B for the Board’s meeting in April 2016.

A13 The effect of the draft amendments is summarised as follows (draft amendments to IAS 8 are highlighted in Grey):

An entity can make a change in:

ACCOUNTING POLICY	ACCOUNTING ESTIMATE	ESTIMATION OR VALUATION TECHNIQUE
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

Appendix B

Comparison of IFRS 13 to the draft wording for IAS 8

The new paragraph 34A of IAS 8 would now read as follows; mark-up is by comparison with 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.~~[13]

[13] Please note that disclosures about changes in accounting estimates were addressed in a separate Agenda paper 25B in April 2016.