

STAFF PAPER

March 2018

IASB Meeting

| Project | Accounting policies and accounting estimates | | |
|-------------|---|-----------------------|---------------------|
| Paper topic | Feedback summary: Accounting Policies and Accounting Estimates (Proposed amendments to IAS 8) | | |
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Purpose of the paper

1. The International Accounting Standard Board (Board) published the Exposure Draft *Accounting Policies and Accounting Estimates* (Proposed amendments to IAS 8) (Exposure Draft) in September 2017.
2. The Exposure Draft was open for comment for 120 days, the comment period ended on 15 January 2018. The Board received 82 comment letters and staff held one outreach meeting with the Global Preparers Forum (GPF).
3. This paper summarises comment letters and other feedback on the Exposure Draft. In this paper, we refer to some representative examples of comment letters in case Board members want to read more.
4. The purpose of the discussion is to enable Board members to ask for any additional information that they will need to enable them to decide on the direction of the project at a future meeting.
5. The Board did not receive any comment letters from users of financial statements. The staff believe that this is because users perceive the proposed amendments as providing limited clarifications that will have little, if any, direct effect on users. We do not believe that the lack of responses from users of financial statements has any implications for this project.

Structure

6. The agenda paper is structured as follows:
 - (a) Executive summary (paragraphs 9–12)
 - (b) Proposals in the Exposure Draft (paragraph 13):
 - (i) Clarification of the definition of accounting policies (paragraphs 14–23)
 - (ii) Introduction of the definition of accounting estimates (paragraphs 24–27)
 - (iii) Clarification that when an item in the financial statements cannot be measured with precision, selecting an estimation technique or valuation technique constitutes making an accounting estimate (paragraphs 28–30)
 - (iv) Clarification that, in applying IAS 2 *Inventories*, selecting the first-in, first-out (FIFO) cost formula or the weighted average cost formula for interchangeable inventories constitutes selecting an accounting policy (paragraphs 31–36)
 - (v) Other comments (paragraphs 37–52)
 - (c) Work of the International Auditing and Assurance Standards Board (IAASB) on the revised International Standard on Auditing (ISA) 540 *Auditing Accounting Estimates and Related Disclosures* (paragraphs 53–55).
7. Appendix A of this paper sets out summary statistics about the comment letters received by type of respondent and geographical region.
8. Appendix B contains notes of the outreach meeting with the GPF.

Executive summary

9. Almost all respondents state that the proposals in the Exposure Draft would provide more clarity on how accounting policies relate to accounting estimates.

10. Some respondents, however, question whether the proposals would result in sufficient improvements to make it appropriate for the Board to finalise the proposals.
11. Many respondents state that having more illustrative examples would provide more clarity on the distinction between accounting policies and accounting estimates, which in itself is a conceptual matter.
12. Some respondents would like to have more guidance on various matters. Many of these matters relate to the use of existing terminology.

Proposals

13. The purpose of the proposals in Exposure Draft was to help entities to distinguish accounting policies from accounting estimates.

Definition of accounting policies

14. The existing definition of accounting policies in IAS 8 includes five terms—‘principles’, ‘bases’, ‘conventions’, ‘rules’ and ‘practices’. The Board did not propose substantially revising the definition of accounting policies. Instead, to make the definition clearer and more concise, the Board proposed:
 - (a) removing from the definition the terms ‘conventions’ and ‘rules’. By doing this, the Board did not intend to make the definition narrower or broader; instead it wished to provide more clarity;
 - (b) referring to ‘measurement bases’ instead of ‘bases’; and
 - (c) keeping the term ‘practices’. This is because the Board thought that referring to ‘principles’ only might be perceived as making the definition of accounting policies too narrow.
15. Many respondents agree overall with the proposal. The main comments relate to:
 - (a) keeping the definition of accounting policies at a high conceptual level;
 - (b) keeping the term ‘measurement bases’ in the definition of accounting policies;

- (c) having undefined terms in IAS 8; and
- (d) addressing practical expedients.

Keeping the definition of accounting policies at a high conceptual level

16. Some respondents say:

While the amendments focus primarily on the definition of accounting estimates, the proposed definition of accounting policies continues to use terms that contribute to existing diversity because they are ambiguous and open to differing interpretations.¹

17. However, none of the respondents provided a recommendation for a new definition of accounting policies. The *Adding illustrative examples* section below further discusses the definition of accounting policies.

Keeping the term 'measurement bases' in the definition of accounting policies

18. Some respondents disagree with the addition of 'measurement bases' to the definition of an accounting policy because they believe it is unnecessary. They argue that the terms 'principle' and 'practice' are already sufficient to capture measurement bases.²
19. In addition, some constituents are concerned that the inclusion of 'measurement' may be perceived as narrowing the definition of accounting policies, inappropriately, to only measurement.³

Undefined terms in IAS 8

20. IAS 8 includes undefined terms, for example 'practices' and 'measurement basis'. Some respondents think that it will be necessary to define them.
21. Some respondents indicate that the term 'practices' should be understood as referring only to those accounting policies that are developed in the absence of

¹ Comment letter from KPMG.

² Comment letter from BDO.

³ Comment letter from the Financial Reporting Standards Council (FRSC) of South Africa.

specific guidance within Standards, as set out in paragraphs 10-12 of IAS 8.⁴ These respondents also believe that the Board should clarify this.

22. Some respondents, including a regulator and some large accounting firms, believe that there might be some confusion in practice between the term ‘practices’ and the terms ‘valuation techniques’ and ‘estimation techniques’ if the term ‘practices’ is not defined.⁵ A few respondents question whether valuation techniques and estimation techniques (identified in the Exposure Draft as a form of accounting estimate) are one form of practices.

Practical expedients

23. Neither IAS 8 nor the Exposure Draft address practical expedients. Some constituents question whether adopting a practical expedient should be regarded as an accounting policy.

Definition of accounting estimates

24. The central clarification the Board proposed was to state explicitly that accounting estimates are used in applying an accounting policy. In addition, to make it easier to compare the definitions used to distinguish accounting policies from accounting estimates, the Board proposed removing the definition of a *change* in accounting estimate and, instead, providing a definition of accounting estimates.
25. Almost all respondents agree with the proposal to replace the definition of a *change* in accounting estimate with the definition of accounting estimates.
26. Most respondents agree with the proposed wording of the definition of accounting estimates. A few respondents noted that the definition identifies accounting estimates as the inputs used in determining an amount; they question whether it would be more appropriate to identify accounting estimates as the outputs of that process (for example, a carrying amount), rather than as the inputs.
27. A few respondents suggest removing the phrase ‘because of estimation uncertainty’ from the proposed definition of accounting estimates. This is because, although

⁴ Comment letter from the European Financial Reporting Advisory Council (EFRAG).

⁵ Comment letter from PricewaterhouseCoopers.

this term is used in IFRS Standards, it is not defined. These respondents believe that it will be sufficient for the definition to retain the phrase ‘cannot be measured with precision’.⁶

Estimation techniques and valuation techniques

28. The Board proposed clarifying that when an item in the financial statements could not be measured with precision, selecting an estimation technique or valuation technique constituted making an accounting estimate.
29. Almost all respondents agree with this proposal.
30. As explained in paragraph 22 of this paper, some respondents question how the term ‘estimation techniques’ and ‘valuation techniques’ reconciles with the term ‘practices.’

Cost formulas for interchangeable inventories

31. The Board proposed clarifying that, for ordinarily interchangeable inventories, selecting a cost formula (ie first-in, first-out (FIFO) or weighted average cost) in applying IAS 2 constituted selecting an accounting policy.
32. Most respondents agree that selecting a cost formula constitutes selecting an accounting policy. The main comments relate to:
 - (a) whether cost formulas for interchangeable inventories are estimations of the flow of interchangeable inventories; and
 - (b) placement of amendments.

Cost formulas for interchangeable inventories

33. Some respondents continue to believe that the cost formulas attempt to estimate the flow of interchangeable inventories.

⁶ Comment letter from the Accounting Standards Board of Japan (ASBJ).

Placement of amendments

34. Some respondents think that the discussion of changes in cost formulas for interchangeable inventories should be included not in IAS 8, as proposed in the Exposure Draft, but instead in IAS 2. They argue that inclusion of this guidance in IAS 8 could lead to inappropriate analogies being drawn in other circumstances.
35. Some other respondents see merit in having this discussion in IAS 8.
36. Other potential approaches for the placement of this amendment are:
 - (a) to place the discussion of cost formulas in IAS 8, with cross-references to and from IAS 2; or
 - (b) to place the discussion with illustrative examples in, or accompanying, IAS 8, if the Board decides to create them.

Other comments

37. Other comments relate to:
 - (a) adding illustrative examples of accounting policies and accounting estimates in IAS 8;
 - (b) whether paragraph 35 of IAS 8 is still relevant;
 - (c) distinction between accounting estimates and errors;
 - (d) deletion of Example 3 from the *Guidance on Implementing IAS 8*;
 - (e) applying changes prospectively and retrospectively; and
 - (f) effective date of amendments.

Adding illustrative examples

38. Adding to IAS 8 illustrative examples of accounting policies and accounting estimates was a common request. Many respondents believe that adding further illustrative examples of accounting policies and accounting estimates will further improve the distinction between accounting policies and accounting estimates. Some respondents express doubts about whether the Standard will be understandable without illustrative examples.
39. A few respondents ask for examples covering particular problematic areas.

40. In our opinion, if the Board decides to proceed with the amendments, it will need to address the following questions about illustrative examples:
- (a) whether to provide illustrative examples; and,
 - (b) if yes, in what format?
41. We plan to discuss this matter with members of the Accounting Standards Advisory Forum (ASAF) in April 2018. We will report key messages from the discussion to the Board.
42. Two constituents provided the following recommendation for the Board's future standard-setting activities:

Where ... standards permit more than one method for determining the amounts reported in the financial statements, it would be helpful if those standards stated which are policy choices and which are estimation methods.⁷

Whether paragraph 35 of IAS 8 is still relevant

43. Paragraph 35 says that 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.
44. Given that the proposed amendments clarified the distinction between accounting policies and accounting estimates, some respondents question whether this paragraph is still necessary and / or whether it should be revised.

Distinction between accounting estimates and errors

45. IAS 8 contains guidance on accounting estimates and errors. The proposed amended paragraph 34 of IAS 8 says:

An entity may need to change an accounting estimate ~~may need revision~~ if changes occur in the circumstances on which the accounting estimate was based or as a result of new information or new experience. By its nature, a ~~revision~~

⁷ Comment letters from PricewaterhouseCoopers and the Malaysian Accounting Standards Board (MASB).

of change in an accounting estimate does not relate to prior periods and is not a correction of an error.

46. It is not always clear in practice whether a change results from new information (a change in estimate) or the information that was available in a prior period (correction of an error). A few respondents, including a regulator, a national standard setter and a large accounting firm, think that the Board should provide more guidance for drawing the distinction between changes in accounting estimates and corrections of error. These respondents think that it may be difficult to define estimates clearly enough without addressing errors as well. This issue was not in the scope of the project.

Deletion of Illustrative Example 3

47. Example 3 from the Guidance on Implementing IAS 8 illustrates prospective application of a change in accounting policy when retrospective application is not practicable. The Board believed that the example risked causing confusion about the distinction between accounting policies and accounting estimates, and possibly about how to identify accounting errors and about materiality. The Board therefore proposed to delete this example from IAS 8.⁸
48. Some respondents say that some preparers, especially first-time adopters of IFRS Standards, rely on Example 3 in assessing how to account for changes that result from applying a components approach more fully for depreciation of property, plant and equipment.

Applying changes prospectively and retrospectively

49. One respondent proposes removing the existing requirement in IAS 8 to distinguish between a change in accounting policy and a change in accounting estimate and instead requiring that all changes are applied prospectively. The respondent says that the benefit of this proposal lies in “removing the need to classify a change as one type or another”.⁹ The respondent, however, did not address the fact that

⁸ Paragraphs BC25 and BC28 of the Exposure Draft.

⁹ Comment letter from Huawei.

accounting policies and accounting estimates also have different thresholds in their respective changes.¹⁰

50. Another respondent recommends “developing principle-based guidance on the circumstances in which retrospective adjustments to prior periods are required (if any)”.¹¹ Currently IAS 8 requires retrospective application for changes in accounting policies and corrections of prior period errors.

Effective date of amendments

51. Some respondents say that it will be useful for national standard-setters and preparers if the effective date of this amendment is aligned with any other planned amendments to IAS 8, for example, with the effective date of the proposed amendment to the definition of ‘material’ and of the proposed amendment for accounting policy changes.
52. The Board might also want to consider whether it could issue all the planned amendments to IAS 8 as one amendment.

Work of the IAASB on revised ISA 540

53. The IAASB has proposed revisions to ISA 540 *Auditing Accounting Estimates and Related Disclosures*, “establishing more robust requirements and appropriately detailed guidance to foster audit quality by driving auditors to perform appropriate procedures in relation to accounting estimates and related disclosures. It is anticipated that these revisions would also seek to emphasize the importance of the appropriate application of professional scepticism when auditing accounting estimates”.¹²
54. It is worth mentioning that IAASB’s proposals are much more comprehensive in scope; they are also more detailed. They also include more definitions of various

¹⁰ Paragraph 14 of IAS 8 deals with changes in accounting policies and paragraph 34 of IAS 8 deals with changes in accounting estimates.

¹¹ Comment letter from the Accounting Standards Committee of Germany (DRSC).

¹² <https://www.iaasb.org/projects/accounting-estimates-isa-540>

terms, including ‘estimation uncertainty’, ‘measurement bases’ and ‘valuation techniques’.

55. We have been discussing proposals in the Exposure Draft with the IAASB’s project team with the aim of informing the Board of any areas where the Board’s proposals might not be consistent with the proposals of the IAASB. We believe that proposals in the Exposure Draft are generally consistent with proposals of the IAASB. We will continue to monitor the IAASB’s activities in this area.

Questions for the Board members

Question

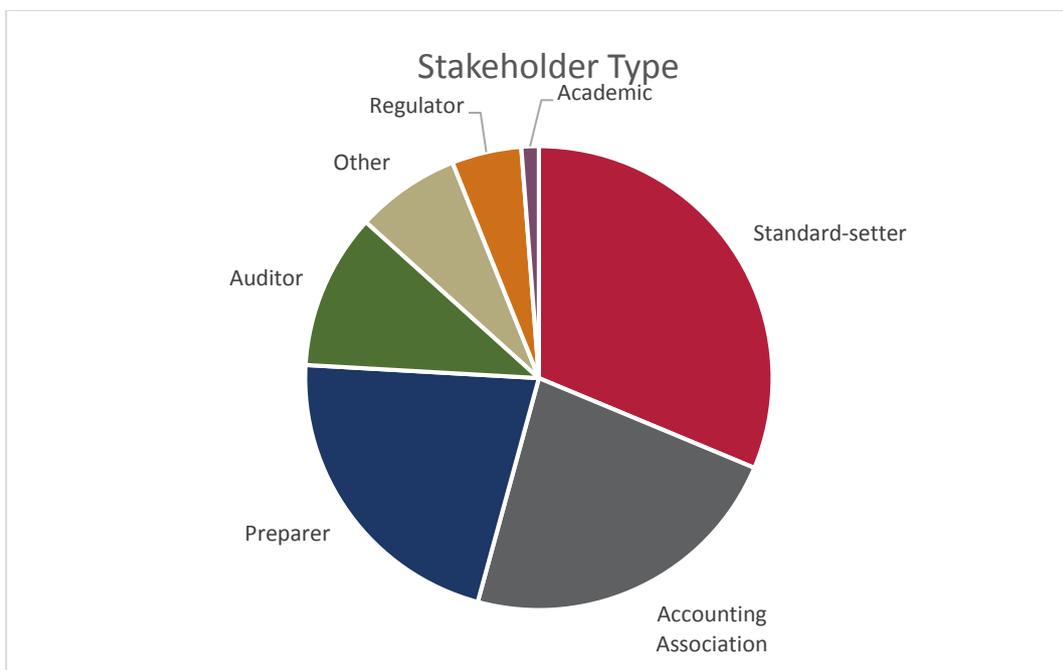
1. Do you have any questions or comments about the feedback summarised in this paper?
2. Do you need any additional information that will enable you to decide on the direction of the project at a future meeting?

Appendix A–Statistics about feedback

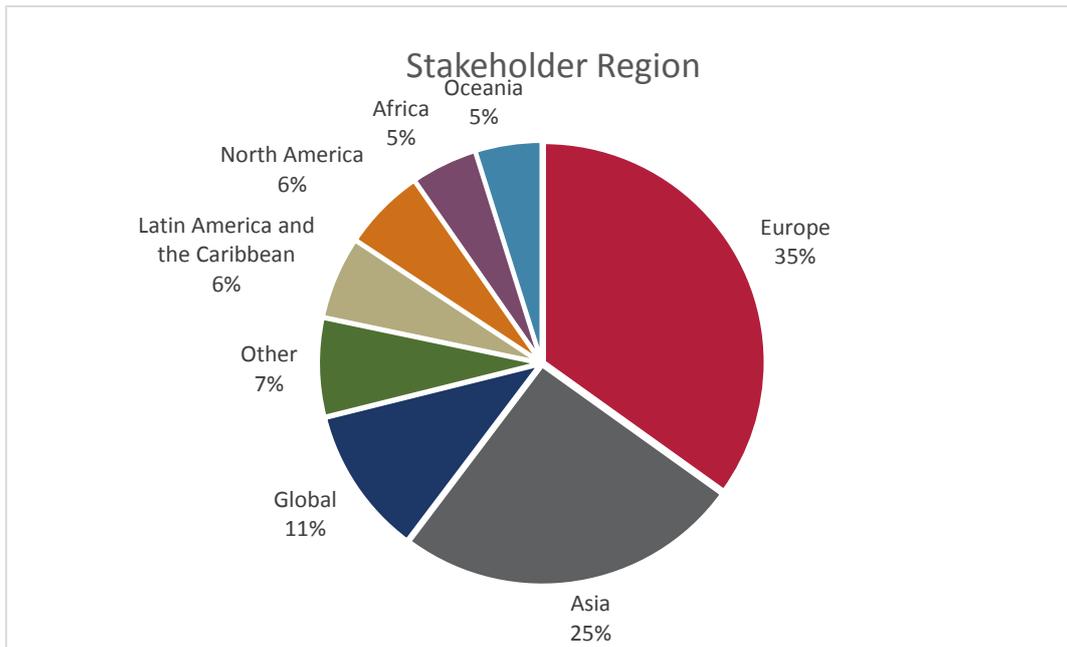
- A1. The Board received 82 comment letters.
- A2. Staff held a public meeting with members of the Global Preparers Forum (GPF) in October 2017. Appendix B includes notes from the meeting.

Views expressed in comment letters and during meetings often are collective views of various groups of individuals or organisations. These groups vary in sizes.

- A3. This chart demonstrates which types of respondents provided their feedback:



A4. This chart demonstrates geographical regions of respondents:



Appendix B—Notes from the GPF meeting held in October 2017

- B1. The purpose of the discussion with GPF members was to gather their initial feedback on the proposals in the Exposure Draft.
- B2. Overall, GPF members tentatively supported the proposals in the Exposure Draft and said that it would provide clarity on the distinction between accounting policies and accounting estimates.
- B3. However, GPF members raised the following detailed points:
- a. the discussion of changes in cost formulas for interchangeable inventories could be included not in IAS 8, as proposed in the Exposure Draft, but in IAS 2 Inventories. The staff suggested one approach could be to place the discussion of cost formulas in IAS 8, with cross-references to and from IAS 2;
 - b. IAS 8 includes undefined terms, for example ‘practices’ and ‘measurement basis’. It would be useful to define them;
 - c. deleting Example 3 from the Guidance on Implementing IAS 8 might have unintended consequences. Some preparers, especially first-time adopters of IFRS Standards, rely on Example 3 in assessing how to account for changes that result from applying a components approach more fully for depreciation purposes; and
 - d. it would be useful for national standard-setters and preparers if the effective date of this amendment was aligned with any other planned amendments to IAS 8, for example, with the effective date of the proposed amendment to the definition of ‘material’.