STAFF PAPER

IFRS Interpretations Committee meeting

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

CONTACT(S)			
	Chalani Mohotti	cmohotti@ifrs.org	+44(0) 20 7246 0552
	Gustavo Olinda	golinda@ifrs.org	+44(0) 20 7246 6481
	Jawaid Dossani	jdossani@ifrs.org	+44(0) 20 7332 2742

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This paper will be discussed at the IFRS Interpretations Committee meeting in September 2018.

Introduction

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 proposed amendments to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* aim to help entities distinguish accounting policies from accounting estimates. More specifically, the proposed amendments would clarify:

   (a) how accounting policies and accounting estimates relate to each other, by:

      (i) explaining that an entity uses accounting estimates in applying accounting policies; and

      (ii) making the definition of accounting policies clearer and more concise.

(b) that selecting an estimation technique, or valuation technique, used when an item in the financial statements cannot be measured with precision, constitutes making an accounting estimate; and

(c) 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.

3. At the Board's March 2018 meeting, we presented a paper summarising feedback on the Exposure Draft. Several respondents said the proposed amendments would help clarify the distinction between accounting policies and accounting estimates. However, several respondents also (a) raised concerns on particular aspects of the proposed amendments; (b) suggested providing additional clarity in particular areas; and (c) suggested adding illustrative examples. Some respondents also asked whether finalising the proposed amendments would lead to benefits that outweigh the cost.

4. At the Board's July 2018 meeting, we advised the Board that we would provide an analysis of the feedback to the IFRS Interpretations Committee (Committee) at a future meeting to obtain the Committee's advice on the project. We will present the Committee's advice to the Board at a future meeting.

5. The objective of this paper is to:

(a) provide the Committee with an analysis of the feedback on the Exposure Draft; and

(b) obtain advice from the Committee on the next steps for this project.

6. Within this paper, we analyse what we consider to be the key matters for redeliberation and outline our recommended approach to address these matters. In addition, Appendix A to this paper summarises other matters together with our recommended approach to address those matters.

Structure of the paper

7. This paper includes:

(a) summary of staff recommendations on key matters;

(b) staff analysis and recommendations on key matters:

   (i) proposed definition of accounting estimates (Issue I);

   (ii) proposed definition of accounting policies (Issue II);

   (iii) proposed amendment regarding inventory cost formulas (Issue III); and

   (iv) the proposed deletion of IE3 and request for additional examples (Issue IV).

(c) consideration of whether finalising the proposed amendments would lead to benefits that outweigh the cost.

8. There are three appendices to this paper:

   (a) Appendix A—Analysis of other matters;

   (b) Appendix B—Extract from the Exposure Draft: Proposed amendment to IAS 8; and

   (c) Appendix C— Extract from Agenda Paper 4 of the April 2018 Accounting Standards Advisory Forum (ASAF) meeting and summary of feedback.

Summary of the staff recommendations on key matters

9. Based on our analysis of the feedback as outlined in this paper, we expect to recommend that the Board:

   (a) proceed with finalising the amendments (modified by our recommendations as outlined in paragraphs 9(b)–9(e) of this paper)—we think this would lead to benefits that outweigh the cost.

   (b) with respect to the proposed definition of accounting estimates:

      (i) revise the definition to specify that:

         1. accounting estimates are monetary amounts in the financial statements that are subject to measurement uncertainty;

         2. these monetary amounts are outputs of measurement techniques used in applying accounting policies; and

3. an entity uses judgements and assumptions in selecting and applying the applicable measurement techniques.

(ii) 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.

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

(c) not amend the definition of accounting policies (ie retain the existing definition of accounting policies in IAS 8);

(d) not add discussion of whether selecting an inventory cost formula constitutes selecting an accounting policy (thus not adding material proposed in paragraph 32B of the Exposure Draft—see Appendix B to this paper for an excerpt from the Exposure Draft); and

(e) confirm deletion of Example 3 in the Guidance on Implementing IAS 8 and not develop additional illustrative examples.

Staff analysis and recommendations on key matters

Proposed definition of accounting estimates (Issue I)

Proposed amendment

10. The Exposure Draft proposed adding a definition of accounting estimates and removing the definition of a change in accounting estimate. It also proposed clarifying how accounting policies and accounting estimates relate to each other by explaining that an entity uses accounting estimates in applying accounting policies.

11. The Exposure Draft also proposed clarifying that when an item in the financial statements cannot be determined with precision, selecting an estimation technique or valuation technique constitutes making an accounting estimate.

12. Appendix B to the paper reproduces the definition of accounting estimates proposed in the Exposure Draft.

Key matters raised

13. 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 the selection of 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 (Issue I-1);

    (b) use of the terms 'estimation uncertainty' and 'precision' (Issue I-2)

    (c) deleting the definition of a 'change in accounting estimate' (Issue I-3); and

    (d) limiting accounting estimates to measurement (Issue I-4).

Role of judgements and assumptions (Issue I-1)

14. 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 (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'.

[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.'

15. 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.

Use of the terms 'estimation uncertainty' and 'precision' (Issue I-2)

16. Some respondents said using the term 'estimation uncertainty' in defining accounting estimates introduces an element of circularity in the definition and the term should be deleted.

17. 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.

18. 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.

19. 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.

Deleting the definition of a 'change in accounting estimate' (Issue I-3)

20. 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.

21. 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.

Limiting accounting estimates to measurement (Issue I-4)

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

Staff Analysis

23. As explained in paragraph 13 of this paper, several respondents said it was helpful to provide a definition of accounting estimates. Several respondents also said it was helpful to clarify that an entity uses accounting estimates in applying accounting policies. Accordingly, 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. The following paragraphs consider specific comments raised by respondents.

Role of judgements and assumptions (Issue I-1)

24. 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) 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.

25. 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.

26. 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.

27. 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 conforming amendments to paragraph 32 of IAS 8 to remove these non-monetary examples. 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' (Issue I-2)

28. 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'.

29. 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…'

30. 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 16 of this paper);

(c) remove any perceived ambiguity of the term ‘precision’ (see paragraph 18 of this paper); and

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

31. 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 proposed amendments.

32. We considered whether the definition should state that accounting estimates are required because of uncertainties inherent in business activities (see paragraph 17 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 say using the phrase ‘uncertainties inherent in business activities’ could be seen as limiting the scope of accounting estimates. For reasons outlined in paragraph 30 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.

33. As outlined in paragraph 19 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' (Issue I-3)

34. 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.

35. Paragraph 5 of IAS 8 identified the 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.

36. 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.

37. 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 use of accounting estimates to measurement (Issue I-4)

38. As discussed in paragraph 22 of this paper, some respondents said it is not clear why the 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.

39. 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 to include explicit references 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 explicitly.

Staff recommendation

40. Based on our analysis, we recommend revising 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; and

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

41. We also recommend the Board:

    (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.

42. In drafting, we will consider whether it is necessary to make conforming amendments to paragraph 32 (for example, to remove the reference to non-monetary examples of accounting estimates), other related paragraphs in IAS 8 and other IFRS Standards.

Proposed definition of accounting policies (Issue II)

Proposed amendment

43. The Exposure Draft proposed clarifying the definition of accounting policies by removing the terms ‘conventions’ and ‘rules’ and replacing the term ‘bases’ with ‘measurement bases’. Proposed paragraph 5 of IAS 8 in the Exposure Draft states:

> *Accounting policies* are the specific principles, measurement bases, ~~conventions, rules~~ and practices applied by an entity in preparing and presenting financial statements.

Key matters raised

44. Some respondents said it was helpful to amend the definition of accounting policies to remove terms such as ‘conventions’ and ‘rules’ that were not clear. However, some respondents questioned whether the proposed changes would improve the definition. This is because the remaining terms in the definition are also not defined and are open to differing interpretations.

45. Respondents raised the following key matters in this respect:

(a) clarity of the term ‘practices’ and overlap with accounting estimates (Issue II-1);

(b) clarity of the term ‘measurement bases’ (Issue II-2);

(c) the nature of practical expedients (Issue II-3); and

(d) deletion of the terms ‘conventions’ and ‘rules’ (Issue II-4)

Clarity of the term ‘practices’ and overlap with accounting estimates (Issue II-1)

46. Some respondents asked the Board to define the term ‘practices’ and asked whether the inclusion of that term is intended only to cover accounting policies that an entity develops in the absence of an IFRS Standard that applies specifically to a particular transaction, event or condition (ie those policies that an entity develops when it

applies the requirements in paragraphs 10-12 of IAS 8). One respondent asked whether the term refers to industry practices (as used in paragraph 12 of IAS 8).

47. Some respondents said many accounting estimates are also based on 'practices', therefore, retaining the term in the definition of accounting policies without providing a definition could suggest that all practices, including those used in developing an accounting estimate are accounting policies.

48. Some respondents also said it is unclear how an estimation technique or valuation technique differs from a 'practice'. For example, one respondent said the proposed definition does not make it clear whether the method of allocating overheads in determining the cost of inventories would constitute an estimation technique or whether it would constitute an accounting policy (ie a practice).

Clarity of the term 'measurement bases' (Issue II-2)

49. Some respondents said replacing 'bases' with 'measurement bases' could unintentionally narrow the scope of an accounting policy. In their view, the term 'bases' in the original definition included not just measurement bases, but also for example, the basis for recognising or presenting items in the financial statements.

50. Some respondents also suggested the Board define 'measurement bases'. They said it was not clear whether the Board intended the term to be interpreted in a manner consistent with its use in the *Conceptual Framework*[2] (ie at the level of historical cost or current value for example), or whether it also includes, for example, the use or non-use of the going concern concept or the choice between an accrual approach and a cash-based approach.

51. Some respondents said the term 'measurement bases' is not needed within the definition of accounting policies. This is because, in their view, measurement bases are a subset of principles and paragraph 35 of IAS 8 already states that a change in the measurement basis applied is a change in an accounting policy.

[2] Paragraph 6.1 of the *Conceptual Framework* says that 'A measurement basis is an identified feature—for example, historical cost, fair value or fulfilment value—of an item being measured'.

The nature of practical expedients (Issue II-3)

52. Some respondents said it was not clear from the proposed definitions of accounting policies and accounting estimates whether practical expedients, whether permitted or required by an IFRS Standard, or those applied by an entity on materiality grounds, would meet the definition of accounting policies. In their view practical expedients, particularly those permitted or required by an IFRS Standard, are generally exceptions from principles and are by nature more rules than principles.

Deletion of the terms ‘conventions’ and ‘rules’ (Issue II-4)

53. Some respondents did not agree with the Board’s rationale for deleting the terms ‘conventions’ and ‘rules’ from the definition of accounting policies, ie that the meaning of the terms is not clear and the terms are not used elsewhere in IFRS Standards. These respondents said the remaining terms in the definition, ie principles, practices and measurement basis were also not defined and were open to differing interpretations. Some respondents said a preferred approach would be for the Board to define all terms used in the definition rather than delete the terms ‘conventions’ and ‘rules’.

54. One respondent said the term ‘rules’ was well understood in practice and should not be deleted. On the other hand, another respondent said it was appropriate to delete the term ‘rules’, not because the meaning of the term is not clear, but rather because, in that respondent’s view, rules are a subset of principles.

55. One respondent said a convention is generally defined as a way in which something is usually done. In the respondent’s view, it was appropriate to delete the term ‘conventions’, not because the meaning of the term is not clear but rather because it was not an appropriate basis on which to develop an accounting policy.

Staff Analysis

56. In proposing to amend the definition of accounting policies, the Board did not intend to narrow or broaden the scope of what constitutes accounting policies. Paragraphs BC6 and BC7 of the Exposure Draft state:

> BC6 In removing the terms ‘conventions’ and ‘rules’ from the definition of accounting policies, the Board does not intend to

> make the definition narrower or broader. Instead it wishes to provide more clarity.
>
> BC7 The Board proposes to keep the term 'practices'. This is because it thinks that referring to 'principles' only may be perceived as making the definition of accounting policies too narrow.

57. Considering the feedback, we think amending the definition of accounting policies could have unintended consequences—in particular, we think some stakeholders could see the changes as narrowing the scope of what constitutes accounting policies while others could see the changes as broadening the scope. The main purpose of the proposed amendments to IAS 8 was to clarify the relationship between accounting policies and accounting estimates (ie that an entity uses accounting estimates in applying accounting policies) and to provide a definition of accounting estimates. The proposed amendments to the definition of accounting policies were only incidental in nature and were intended to remove some ambiguity without narrowing or broadening the scope of what constitutes accounting policies.

58. Accordingly, we think the Board should not amend the definition of accounting policies. We also think that defining the remaining terms in the definition of accounting policies (ie principles, measurement bases and practices) is not necessary to meet the aims of this project. In addition, we think defining the remaining terms would be difficult, would broaden the scope of the project and could have unintended consequences.

Staff recommendation

59. We recommend that the Board not amend the definition of accounting policies (ie the Board retain the existing definition of accounting policies in IAS 8).

Proposed amendment regarding inventory cost formulas (Issue III)

Proposed amendment

60. The Exposure Draft proposed clarifying that, in applying IAS 2, selecting the FIFO cost formula or the weighted average cost formula for interchangeable inventories constitutes selecting an accounting policy (see proposed paragraph 32B of IAS 8 in

Appendix B to this paper). Paragraph BC19–BC20 of the Exposure Draft explain the Board's rationale for proposing this clarification. The Board concluded that selecting one of these two cost formulas does not involve the use of judgement or assumptions to determine the sequence in which those inventories are sold and accordingly, is not an attempt to estimate the actual flow of those inventories. Consequently, selecting one of these two cost formulas does not constitute selecting an accounting estimate.

Key matters raised

61. Several respondents agreed with the Board's conclusion that selecting the FIFO cost formula or the weighted average cost formula for interchangeable inventories constitutes selecting an accounting policy. However, several respondents did not agree with the Board's rationale and said the rationale did not align with the proposed definitions of accounting policy and accounting estimate. These respondents said:

(a) *selecting a cost formula requires the use of judgements and estimates and is an attempt to estimate the actual flow of inventories*

Some respondents said that even though IAS 2 allows entities a choice of selecting either the FIFO or the weighted-average cost formula, selecting an inventory cost formula is an attempt to estimate the actual flow of inventories. This is evidenced by paragraph BC10 of IAS 2 which explains the Board's rationale for eliminating the previously allowed alternative of using the last-in, first-out (LIFO) cost formula. This paragraph states that the LIFO cost formula 'is generally not a reliable representation of actual inventory flows'.

Additionally, some respondents said that paragraph 25 of IAS 2 states that an entity uses the same inventory cost formula for all inventories having a similar nature and use to the entity. However, it also states (emphasis added): '…For inventories with a different nature or use, different cost formulas may be *justified*'. This implies that entities must justify and therefore, apply judgement when determining cost formulas in this situation.

(b) *the rationale for the proposed clarification does not align with the proposed definitions*

Paragraph 9 of IAS 2 requires an entity to measure inventories at the lower of cost and net realisable value. An entity applies the FIFO or weighted-average cost formula when measuring inventories at cost. Applying the proposed definitions of accounting policies and accounting estimates, some respondents said that cost is the measurement basis for inventory (ie the accounting policy) and the inventory cost formula an entity applies to determine the cost is the estimation technique or valuation techniques the entity uses to determine the cost. Accordingly, in applying the proposed definitions, selecting a cost formula appeared to constitute making an accounting estimate rather than selecting an accounting policy.

62. Some respondents suggested the Board include the proposed clarification within IAS 2 or as part of a separate section in IAS 8 together with other illustrative examples. These respondents said that including this as a separate paragraph within IAS 8 appears to create a rule which is not in line with the principles-based approach in IAS 8. Some respondents also said entities do not often change their cost formulas and questioned the need to provide this clarification particularly when the Board did not provide additional examples of accounting policies and accounting estimates. One respondent said paragraph 36(a) of IAS 2 already says that selecting a cost formula constitutes selecting an accounting policy—this paragraph requires an entity to disclose (emphasis added) ‘the accounting policies adopted in measuring inventories, *including* the cost formula used’.

Staff Analysis

63. The Board’s rationale for why selecting a cost formula constitutes selecting an accounting policy has raised broader questions about how the proposed definitions of accounting policy and accounting estimate apply in particular situations. The Board initially proposed this clarification because it is a matter that is frequently raised in discussions about improving the definitions of accounting policies and accounting estimates. However, we agree with respondents who say that entities do not often change the cost formula used to measure inventories—we are not aware of particular

problems in practice in this regard. We also agree with respondents who say that paragraph 36(a) of IAS 2 already states that selecting a cost formula constitutes selecting an accounting policy. Accordingly, we think the Board does not need to specifically address, as part of these amendments, whether selecting an inventory cost formula constitutes selecting an accounting policy.

Staff recommendation

64. We recommend the Board not address whether selecting an inventory cost formula constitutes the selection of an accounting policy.

The proposed deletion of IE3 and request for other examples (Issue IV)

Proposed amendment

65. The Exposure Draft proposed deleting Example 3 in the Guidance on Implementing IAS 8 (IE3). The rationale for the Board's decision was outlined in paragraphs BC25–BC28 of the Exposure Draft. The Board did not propose adding any additional illustrative examples.

Key matters raised

66. Several respondents suggested providing illustrative examples and supporting guidance to help entities distinguish accounting policies from accounting estimates. Some respondents said that although the proposed amendments provide some clarity, some uncertainties remain, and the proposed amendments may not deliver sufficient clarification unless supported by additional illustrative examples.

67. Some respondents commented on the deletion of IE3. These respondents suggested that the Board update, but not delete IE3. These respondents did not disagree with the Board's rationale for deleting the example, but nonetheless said replacing or updating the example would be helpful.

Staff Analysis

68. We continue to agree with the Board's rationale for deleting IE3. In developing the Exposure Draft, the Board considered a substantial rewrite of the example. However,

for reasons outlined in paragraph BC27 of the Exposure Draft, the Board decided against such an approach. Paragraph BC27 of the Exposure Draft states:

> …For the following reasons, the Board considers that such a rewrite would produce little or no benefit to readers of IAS 8:
>
> (a) the example relates too closely to a particular fact pattern to be of general use in distinguishing between accounting policies and accounting estimates; and
>
> (b) paragraphs 23-27 of IAS 8 set out the required approach for cases where retrospective application of a change in accounting policy is not practicable.

69. We considered whether the Board should provide illustrative examples to help entities distinguish between an accounting policy and an accounting estimate. To be useful, we think illustrative examples should be simple and have wide applicability across a range of different situations and different entity types. Based on our experience with this project, we think it is difficult to develop such illustrative examples. This is because assessing whether a change is a change in accounting policy, a change in accounting estimate or the correction of an error depends on facts and circumstances and we think it is not possible to consider all relevant facts and circumstances while at the same time keeping the example simple and ensuring it continues to be widely applicable.

70. Nonetheless, we considered whether we could develop an illustrative example that would demonstrate how an entity would consider the requirements in IAS 8 when assessing whether a change is a change in accounting policy or a change in estimate. We presented such an example at the April 2018 ASAF meeting and asked for ASAF members' views on that illustrative example. Appendix C to this paper reproduces that example and summarises feedback received from ASAF members on that example. Although ASAF members considered the example somewhat helpful, they were of the view that it would not enhance the amendments proposed in the Exposure Draft.

71. In addition, when we presented a summary of the feedback on this Exposure Draft at the Board's March 2018 meeting, some Board members informally suggested keeping the amendments at a high-level and not providing additional illustrative examples.

Staff recommendation

72. Based on our analysis and considering feedback from ASAF members, we recommend that the Board:

    (a) confirm deletion of IE3; and

    (b) not develop additional illustrative examples.

Question 1 for the Committee
Do Committee members have any questions or comments on the analysis and recommendations set out in paragraphs 10–72 and Appendix A of this paper?

Consideration of whether finalising the amendments would lead to benefits that outweigh the cost

73. As outlined in paragraph 3 of this paper, some respondents asked whether finalising the proposed amendments would lead to benefits that outweigh the cost.

74. We agree with some respondents who say that finalising the amendments would not address all problems in practice in this regard. Nonetheless, we think finalising the proposed amendments (modified by our recommendations as summarised in paragraph 9(b)–9(e) of this paper) would lead to benefits that outweigh the cost. This is because:

    (a) the proposed amendments help clarify the distinction between accounting policies and accounting estimates by specifying how accounting policies relate to accounting estimates. The proposed amendments state that an entity uses accounting estimates in applying accounting policies. The Basis for Conclusions to the Exposure Draft states that an accounting policy is the overall objective and an entity develops an accounting estimate to achieve that objective.

    (b) feedback on the Exposure Draft was generally positive with several respondents stating that the proposed amendments provided additional clarity and would help distinguish accounting policies from accounting estimates. Although several respondents asked the Board to provide illustrative examples and additional supporting guidance, they generally agreed with the direction of the proposed amendments.

(c) At the April 2018 ASAF meeting, we asked ASAF members for their views on whether finalising the proposed amendments (as proposed in the Exposure Draft) would lead to benefits that outweigh the costs of doing so. ASAF members recommended that the Board proceed with the proposed amendments. ASAF members advice included the following:

(i) the EFRAG member stated that the proposed amendments would improve IAS 8, even though the principles-based guidance proposed in the Exposure Draft probably left some 'grey areas'. He also asked the Board to consider further defining or explaining the term 'practices' which is currently used in the definition of accounting policies and was proposed in the Exposure Draft to be retained;

(ii) the FASB member said that the proposed amendments would be useful. He recommended that the Board should be cautious about extending the scope of the project.

Staff recommendation

75. On the basis of our analysis, we think finalising the proposed amendments (modified by our recommendations as summarised in paragraphs 9(b)–9(e) of this paper) would lead to benefits that outweigh the cost. Accordingly, we recommend that the Board proceed with finalising the amendments (modified by our recommendations as summarised in paragraphs 9(b)–9(e) of this paper).

Question 2 for the Committee

What advice do Committee members have for the Board on how to proceed with this project? In particular, do Committee members think that:

(a) finalising the proposed amendments could have unintended consequences?

(b) finalising the amendments (modified by the staff recommendations summarised in paragraphs 9(b)–9(e) of this paper) would lead to benefits that outweigh the cost? Why or why not? If not, what would Committee members recommend and why?

Appendix A—Analysis of other matters

A1. The following table summarises other matters raised by respondents together with our analysis and recommendation on those matters.

Issue	Staff analysis and recommendation
Proposed definition of accounting estimates	
Some respondents made the following suggestions to improve 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 currently in the Basis for Conclusions). (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 40 of this paper, the definition would no longer use the term ‘precision’. We also think that 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 proposed definition 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).
Estimation techniques and valuation techniques	
(a) Some respondents said IFRS 13 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 similar requirements be introduced in IAS 8 for changes in estimation techniques and valuation techniques.	*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 recommendation
	measurement basis. We continue to think the Board should not introduce this requirement.
(b) One respondent said paragraph 66 of IFRS 13 *Fair Value Measurement* 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 that paragraph 147 of Basis for Conclusion of 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 recommendation in paragraph 41 of this paper, we recommend that the Board clarify that 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 changes result from new information or new developments. As part of this clarification, we 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 recommendation in paragraph 40 of this paper, the proposed definition of an accounting estimate 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 changes in estimation techniques and valuation techniques as examples of changes in an accounting estimates.

Issue	Staff analysis and recommendation
Proposed definition of accounting policy	
Some respondents said the definition of accounting policies focuses on presentation and appears to exclude other elements such as recognition, and measurement.	*We recommend no change.* The definition of accounting policies refers to 'preparing and presenting financial statements' and does not only refer to 'presenting individual elements in the financial statements'. We think the definition includes accounting policies relating to recognition, measurement, presentation and disclosures.
Transition requirements	
One respondent said the Board constantly undermines the principle of retrospective application by providing transition relief. Some respondents said the proposed wording of the transition requirements in paragraph 54(f) of IAS 8 is not clear and suggested it be amended.	*We recommend no change.* The Board proposed that entities apply the amendments to changes in accounting policies and changes in accounting estimates that occur on or after the start of the first annual period in which the entity first applies the amendments. The Board proposed this requirement because it thought the benefits of applying the amendments to changes that occurred before that date would be minimal. We continue to think the proposed transition requirements are appropriate. We will consider wording suggestions when drafting the final amendments.
Other suggestions	
(a) Some respondents suggested the Board consider enhancing disclosure requirements, particularly for changes in accounting estimates.	*We recommend no change.* We are not aware of particular problems with the existing disclosure requirements for changes in accounting estimates and we think providing additional disclosure requirements in this respect is beyond the scope of this project.

Issue	Staff analysis and recommendation
(b) Some respondents suggested the Board consider whether the first sentence of paragraph 35 of IAS 8[3] is required, particularly because the proposed definition of accounting policies in the Exposure Draft clarifies that measurement basis are accounting policies.	*We recommend no change* Based on our analysis, we recommend that the Board not change the definition of accounting policies (see paragraph 59 of this paper). Accordingly, we think the Board should not delete the first sentence of paragraph 35 of IAS 8.
(c) Some respondents suggested the Board consider alternative approaches to addressing this matter. Some of the alternative approaches suggested by respondents include the following: (i) revisit the requirements in IAS 8 for retrospective application by considering whether and when retrospective application provides useful information; (ii) define either an accounting policy or an accounting estimate and use a residual approach for all other changes; (iii) remove the requirement for retrospective application of changes [ie entities would apply all changes prospectively], and permit changes only if they provide more relevant information. The respondent said the Board could also strengthen disclosure requirements for all changes. (iv) specify that an accounting policy is an objective reality and an accounting estimate is a subjective reality.	*We recommend no change.* We think considering these alternative approaches is beyond the scope of these narrow-scope amendments.
(d) Some respondents requested the Board clarify other aspects of IAS 8 such as: (i) how entities account for changes in classification and presentation; (ii) interaction of the requirements in IAS 8 with the disclosure requirements in paragraphs 122–130 of IAS 1;	*We recommend no change.* We think clarifying other aspects of IAS 8 is beyond the scope of the narrow-scope amendments.

[3] Paragraph 35 of IAS 8 states: ‘A change in the measurement basis applied is a change in an accounting policy, and is not a change in an accounting estimate…’

Issue	Staff analysis and recommendation
(iii) the meaning of 'new information' in the definition of a change in accounting estimate; and (iv) whether the second sentence of paragraph 35 of IAS 8[4] applies only in the context of measurement bases or more generally.	
(e) Some respondents suggested that when the Board develops new or amended requirements in future projects, it should specify whether a change is a change in accounting policy or a change in accounting estimate.	*We agree* We will inform the Board of this suggestion and will recommend they consider this when developing new or amended requirements.
(f) Some respondents suggested the Board align the timing of finalising these proposed amendments with other proposed changes to IAS 8, particularly those related to the project on Accounting Policy Changes.	*We agree* We will inform the Board of this suggestion and will suggest the Board finalise all amendments to IAS 8 at the same time.
(g) Some respondents provided some wording suggestions to improve the clarity of the proposed amendments. For example, some respondents suggested that (i) the wording in paragraph 32 of IAS 8 be amended to confirm with the amendments; (ii) the wording in paragraph BC9 of the Exposure Draft could be improved; and (iii) the title of the Standard and other headings be amended to confirm with the proposed amendments.	We will consider wording suggestions when drafting the final amendments.

[4] Paragraph 35 of IAS 8 states 'A change in the measurement basis applied is a change in an accounting policy, and 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.'

Appendix B—Extract from the Exposure Draft: Proposed amendments to IAS 8

Paragraphs 5, 32, 34 and 51–53 are amended and paragraphs 32A, 32B and 54F are added. Deleted text is struck through and new text is underlined. Paragraphs 33, 35–38 and 50 have been included for ease of reference, but are not proposed for amendment.

Definitions

5 The following terms are used in this Standard with the meanings specified:

***Accounting policies* are the specific principles, <u>measurement</u> bases~~, conventions, rules~~ and practices applied by an entity in preparing and presenting financial statements.**

<u>*Accounting estimates* are judgements or assumptions used in applying an accounting policy when, because of estimation uncertainty, an item in financial statements cannot be measured with precision.</u>

~~*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 result from new information or new developments and, accordingly, are not corrections of errors.~~

…

~~Changes in a~~<u>A</u>ccounting 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, an entity may need to use accounting estimates in applying its accounting policies for some items.</u> ~~Estimation involves judgements~~<u> Accounting estimates are</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;

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

(e) warranty obligations.

<u>32A</u> <u>When an item cannot be measured with precision, selecting an estimation technique or valuation technique to measure that item involves the use of judgement or assumptions</u>

in applying the accounting policy for that item. For this reason, selecting that estimation technique or valuation technique constitutes making an accounting estimate.

32B Selecting one of the two cost formulas prescribed by paragraphs 25–27 of IAS 2 *Inventories* for ordinarily interchangeable inventories does not involve the use of judgement or assumptions to determine the sequence in which those inventories are sold. For this reason, selecting that cost formula does not constitute making an accounting estimate, it constitutes selecting an accounting policy.

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

Changes in accounting estimates

34 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 more experience. By its nature, a ~~revision of~~ change in an accounting estimate does not relate to prior periods and is not the correction of an error.

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.

…

Appendix C— Extract from Agenda Paper 4 of the April 2018 Accounting Standards Advisory Forum (ASAF) meeting and summary of feedback

Illustrative example

C1. The extract below reproduces the illustrative example presented at the April 2018 ASAF meeting.

> **Example**
>
> Entity A has the following accounting policy for its inventories:
>
> *Inventories are stated at the lower of cost and net realisable value.*
>
> *Net realisable value is the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale.*
>
> *Note: the example deals only with inventories that are not interchangeable. It does not discuss the selection of a cost flow formula for inventories that are interchangeable.*
>
> **Accounting estimates used in applying the accounting policy**
>
> In applying this accounting policy for its inventories Entity A uses accounting estimates for the following inputs because they cannot be measured with precision and involve the use of judgements or assumptions.
>
> Paragraph 10 of IAS 2 states that the cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.
>
> In converting materials into finished goods, Entity A incurs some fixed production overheads, such as depreciation and maintenance of factory buildings and equipment used in the production process, and the cost of factory management and administration. As part of its accounting policy in accordance with paragraphs 10 and 12 of IAS 2, in determining the costs of conversion of inventories, Entity A includes fixed production overheads in the cost of its inventories.
>
> In doing so, Entity A determines the basis for allocating fixed production overheads. Production overheads are usually incurred centrally and they cannot be allocated with precision to individual items of inventories unlike, for example, costs of purchasing items that are not interchangeable. Paragraph 14 of IAS 2 says that when the costs of conversion of each project are not separately identifiable, they are allocated between the products on a rational and consistent basis, for example based on the relative sales value of each product.

Consequently, Entity A needs to select the basis (ie the type of costs and the allocation method) for allocating overheads to determine the cost of inventories. Selecting the basis for allocating overheads involves the use of judgement or assumptions to estimate the amounts of overheads attributable to items of inventory. Thus, selecting that basis constitutes making an accounting estimate.

In assessing net realisable value, Entity A might also need to estimate:

- the selling price for inventories; and
- costs of completion and costs necessary to make the sale.

Feedback[5]

C2. ASAF members' views were sought on whether to include illustrative examples, as requested by some respondents to the Exposure Draft. ASAF members expressed the following views:

a. illustrative examples for specific fact patterns can be helpful (AOSSG, EFRAG and AASB/NZASB), but they are difficult to draft because answers often depend on very specific facts and circumstances (DRSC and CASC);

b. the ANC and OIC members were not supportive of specific illustrative examples in principle-based guidance; and

c. the AcSB member empathised with the Board's dilemma about providing and drafting illustrative examples.

C3. ASAF members' views regarding the example provided in the Agenda Paper 4 for this meeting were requested; the example aims to demonstrate the thought process on how to distinguish accounting policies from accounting estimates. Although ASAF members considered the example somewhat helpful, they were of the view that it would not enhance the amendments proposed in the Exposure Draft.

[5] Extract of summary note of ASAF meeting held on 16 April and 17 April 2018 which can be accessed here.