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Accounting Policies and Accounting Estimates

Proposed amendments to IAS 8

Comments to be received by 15 January 2018

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(Proposed amendments to IAS 8)

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Exposure Draft ED/2017/5 *Accounting Policies and Accounting Estimates* (Proposed amendments to IAS 8) is published by the International Accounting Standards Board (Board) for comment only. The proposals may be modified in the light of the comments received before being issued in final form. Comments need to be received by **15 January 2018** and should be submitted in writing to the address below by email to commentletters@ifrs.org or electronically using our 'Open for comment' page at: go.ifrs.org/comment.

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Introduction

The IFRS Interpretations Committee informed the International Accounting Standards Board (Board) about diversity in the way entities distinguish accounting policies from accounting estimates. That distinction has consequences because IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* contains different requirements on how to account for changes in accounting policies and for changes in accounting estimates.

In this Exposure Draft, the Board proposes to amend IAS 8. The proposed amendments 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 accounting estimates are used 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.

Invitation to comment

The Board invites comments on the proposals in this Exposure Draft, particularly on the questions set out below. Comments are most helpful if they:

(a) comment on the questions as stated;

(b) indicate the specific paragraph or group of paragraphs to which they relate;

(c) contain a clear rationale;

(d) identify any wording in the proposals that is difficult to translate; and

(e) include any alternative the Board should consider.

The Board is not requesting comments on matters that are not addressed in this Exposure Draft.

Comments should be submitted in writing so as to be received no later than **15 January 2018**.

Questions for respondents

Question 1
The Board proposes clarifying the definition of accounting policies by removing the terms 'conventions' and 'rules' and replacing the term 'bases' with the term 'measurement bases' (see paragraph 5 and paragraphs BC5–BC8 of the Basis for Conclusions). Do you agree with this proposed amendment? Why or why not? If not, what do you propose and why?

Question 2
The Board proposes: (a) clarifying how accounting policies and accounting estimates relate to each other, by explaining that accounting estimates are used in applying accounting policies; and (b) adding a definition of accounting estimates and removing the definition of a change in accounting estimate (see paragraph 5 and paragraphs BC9–BC16 of the Basis for Conclusions). Do you agree with these proposed amendments? Why or why not? If not, what do you propose and why?

Question 3
The Board proposes clarifying 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 to use in applying an accounting policy for that item (see paragraph 32A and paragraph BC18 of the Basis for Conclusions). Do you agree with this proposed amendment? Why or why not? If not, what do you propose and why?

Question 4
The Board proposes clarifying 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 (see paragraph 32B and paragraphs BC19–BC20 of the Basis for Conclusions). Do you agree with this proposed amendment? Why or why not? If not, what do you propose and why?

Question 5
Do you have any other comments on the proposals?

[Draft] Amendments to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

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, measurement bases~~,~~ ~~conventions, rules~~ and practices applied by an entity in preparing and presenting financial statements.**

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.**

~~***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~~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, an entity may need to use accounting estimates in applying its accounting policies for some items. ~~Estimation involves judgements~~ Accounting estimates are 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.

32A 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 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.

Applying changes in accounting estimates

36 The effect of a change in an accounting estimate, other than a change to which paragraph 37 applies, shall be recognised prospectively by including it in profit or loss in:

(a) the period of change, if the change affects that period only; or

(b) the period of the change and future periods, if the change affects both.

37 To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, it shall be recognised by adjusting the carrying amount of the related asset, liability or equity item in the period of the change.

38 Prospective recognition of the effect of a change in an accounting estimate means that the change is applied to transactions, other events and conditions from the date of the change in estimate. A change in an accounting estimate may affect only the current period's profit or loss, or the profit or loss of both the current period and future periods. For example, a change in the estimate of the amount of bad debts affects only the current period's profit or loss and therefore is recognised in the current period. However, a change in the estimated useful life of, or the expected pattern of consumption of the future economic benefits embodied in, a depreciable asset affects depreciation expense for the current period and for each future period during the asset's remaining useful life. In both cases, the effect of the change relating to the current period

is recognised as income or expense in the current period. The effect, if any, on future periods is recognised as income or expense in those future periods.

Impracticability in respect of retrospective application and retrospective restatement

50 In some circumstances, it is impracticable to adjust comparative information for one or more prior periods to achieve comparability with the current period. For example, data may not have been collected in the prior period(s) in a way that allows either retrospective application of a new accounting policy (including, for the purpose of paragraphs 51–53, its prospective application to prior periods) or retrospective restatement to correct a prior period error, and it may be impracticable to recreate the information.

51 It is frequently necessary to make accounting estimates in applying an accounting policy to elements of financial statements recognised or disclosed in respect of transactions, other events or conditions. Estimation is inherently subjective, and accounting estimates may be developed after the reporting period. Developing accounting estimates is potentially more difficult when retrospectively applying an accounting policy or making a retrospective restatement to correct a prior period error, because of the longer period of time that might have passed since the affected transaction, other event or condition occurred. However, the objective of accounting estimates related to prior periods remains the same as for accounting estimates made in the current period, namely, for the accounting estimate to reflect the circumstances that existed when the transaction, other event or condition occurred.

52 Therefore, retrospectively applying a new accounting policy or correcting a prior period error requires distinguishing information that

(a) provides evidence of circumstances that existed on the date(s) as at which the transaction, other event or condition occurred, and

(b) would have been available when the financial statements for that prior period were authorised for issue

from other information. For some types of accounting estimates (eg a fair value measurement that uses significant unobservable inputs), it is impracticable to distinguish these types of information. When retrospective application or retrospective restatement would require making a significant accounting estimate for which it is impossible to distinguish these two types of information, it is impracticable to apply the new accounting policy or correct the prior period error retrospectively.

53 Hindsight should not be used when applying a new accounting policy to, or correcting amounts for, a prior period, either in making assumptions about what management's intentions would have been in a prior period or estimating the amounts recognised, measured or disclosed in a prior period. For example, when an entity corrects a prior period error in calculating its liability for employees' accumulated sick leave in accordance with IAS 19 *Employee Benefits*, it disregards information about an unusually severe influenza season during the next period that became available after the financial statements for the prior

period were authorised for issue. The fact that significant accounting estimates are frequently required when amending comparative information presented for prior periods does not prevent reliable adjustment or correction of the comparative information.

Effective date

...

54F [Draft] *Amendments to IAS 8*, issued in [date to be decided after exposure], amended paragraphs 5, 32, 34, 51–53 and added paragraphs 32A and 32B. An entity shall apply those amendments only:

(a) from the start of the first annual period beginning on or after [date to be decided after exposure], or from the start of an earlier annual period selected by the entity; and

(b) to all changes in accounting policies and all changes in accounting estimates that occur on or after the date determined in (a). The entity shall apply the rest of this Standard to these changes in accounting policies and changes in accounting estimates. For example, for changes in accounting policies, the entity shall apply paragraphs 14–31.

[Draft] Amendments to Guidance on implementing IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

Example 3 in the Guidance on implementing IAS 8 is deleted. Deleted text is struck through and new text is underlined.

Example 3 – Prospective application of a change in accounting policy when retrospective application is not practicable

[Deleted]

~~3.1~~ ~~During 20X2, Delta Co changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a components approach, whilst at the same time adopting the revaluation model.~~

~~3.2~~ ~~In years before 20X2, Delta's asset records were not sufficiently detailed to apply a components approach fully. At the end of 20X1, management commissioned an engineering survey, which provided information on the components held and their fair values, useful lives, estimated residual values and depreciable amounts at the beginning of 20X2. However, the survey did not provide a sufficient basis for reliably estimating the cost of those components that had not previously been accounted for separately, and the existing records before the survey did not permit this information to be reconstructed.~~

~~3.3~~ ~~Delta's management considered how to account for each of the two aspects of the accounting change. They determined that it was not practicable to account for the change to a fuller components approach retrospectively, or to account for that change prospectively from any earlier date than the start of 20X2. Also, the change from a cost model to a revaluation model is required to be accounted for prospectively. Therefore, management concluded that it should apply Delta's new policy prospectively from the start of 20X2.~~

~~3.4~~ ~~Additional information:~~

~~Delta's tax rate is 30 per cent.~~

	~~CU~~
~~Property, plant and equipment at the end of 20X1:~~	
~~Cost~~	~~25,000~~
~~Depreciation~~	~~(14,000)~~
~~Net book value~~	~~11,000~~
~~Prospective depreciation expense for 20X2 (old basis)~~	~~1,500~~

~~*continued...*~~

~~*...continued*~~

~~Some results of the engineering survey:~~

~~Valuation~~	~~17,000~~
~~Estimated residual value~~	~~3,000~~
~~Average remaining asset life (years)~~	~~7~~
~~Depreciation expense on existing property, plant and equipment for 20X2 (new basis)~~	~~2,000~~

~~Extract from the notes~~

~~1~~ ~~From the start of 20X2, Delta changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a components approach, whilst at the same time adopting the revaluation model. Management takes the view that this policy provides reliable and more relevant information because it deals more accurately with the components of property, plant and equipment and is based on up-to-date values. The policy has been applied prospectively from the start of 20X2 because it was not practicable to estimate the effects of applying the policy either retrospectively, or prospectively, from any earlier date. Accordingly, the adoption of the new policy has no effect on prior years. The effect on the current year is to increase the carrying amount of property, plant and equipment at the start of the year by CU6,000; increase the opening deferred tax provision by CU1,800; create a revaluation surplus at the start of the year of CU4,200; increase depreciation expense by CU500; and reduce tax expense by CU150.~~

Approval by the Board of Exposure Draft *Accounting Policies and Accounting Estimates* (Proposed amendments to IAS 8) published in September 2017

The Exposure Draft *Accounting Policies and Accounting Estimates* (Proposed amendments to IAS 8) was approved for publication by 12 of 13 members of the International Accounting Standards Board. Françoise Flores abstained in view of her recent appointment to the Board.

Hans Hoogervorst	Chairman
Suzanne Lloyd	Vice-Chair
Stephen Cooper	
Martin Edelmann	
Françoise Flores	
Amaro Luiz De Oliveira Gomes	
Gary Kabureck	
Takatsugu Ochi	
Darrel Scott	
Thomas Scott	
Chungwoo Suh	
Mary Tokar	
Wei-Guo Zhang	

Basis for Conclusions on the proposed amendments to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

This Basis for Conclusions accompanies, but is not part of, the proposed amendments. It summarises the considerations of the International Accounting Standards Board (Board) when developing the proposed amendments. Individual Board members gave greater weight to some factors than to others.

Background

BC1 The IFRS Interpretations Committee informed the Board of diversity in the way entities distinguish accounting policies from accounting estimates. The Board understands that the diversity arises because the definitions in IAS 8 of accounting policies and of a change in accounting estimate are not sufficiently clear. The two definitions also appear to overlap.

BC2 Distinguishing accounting policies from accounting estimates has consequences because IAS 8 contains different requirements on how to account for changes in accounting policies and for changes in accounting estimates.

Proposed amendments to IAS 8

BC3 The proposed amendments focus on the definitions of accounting policies and of accounting estimates in IAS 8. The Board proposes clarifying how accounting policies relate to accounting estimates. More specifically, the Board proposes clarifying that accounting estimates are used in applying accounting policies.

BC4 The proposed amendments would also clarify some other aspects of the distinction between accounting policies and accounting estimates, as discussed below.

Definition of accounting policies (paragraph 5)

BC5 The existing definition of accounting policies in IAS 8 includes five terms—'principles', 'bases', 'conventions', 'rules' and 'practices'. To make the definition clearer and more concise, the Board proposes removing from the definition the terms 'conventions' and 'rules' because their meanings are not clear and because these terms are not used elsewhere in IFRS Standards.

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.

BC8 Paragraph 35 of IAS 8 currently states that a change in the measurement basis applied is a change in an accounting policy. The Board proposes to refer to 'measurement bases' instead of 'bases' in the definition of accounting policies in order to align paragraph 35 and the definition of accounting policies in IAS 8.

Definition of accounting estimates (paragraph 5)

BC9 The central clarification the Board proposes is to state explicitly that accounting estimates are used in applying an accounting policy. In other words, the accounting policy is the overall objective and the accounting estimates are inputs used in achieving that objective.

BC10 In addition, some practical issues arise from the existing definitions because IAS 8 defines accounting policies and a *change* in accounting estimate but does not define accounting estimates. The combination of a definition of one item (accounting policies) with a definition of changes in another item (changes in accounting estimates) obscures the distinction between accounting policies and accounting estimates. To make that distinction clearer, the Board proposes removing the definition of a *change* in accounting estimate and, instead, providing a definition of accounting estimates.

BC11 The Board proposes including in the definition of accounting estimates a reference to the inability to measure items in financial statements with precision. This notion already exists in paragraph 32 of IAS 8, which states that many items in financial statements cannot be measured with precision but can only be estimated. The Board notes that the level of precision associated with accounting estimates will vary; in some cases an accounting estimate may have a relatively high level of precision.

BC12 The Board proposes using both ‘judgements’ and ‘assumptions’ in the definition of accounting estimates because both terms appear in IFRS Standards. For example, IAS 1 *Presentation of Financial Statements* uses the term ‘judgements’ and IAS 19 *Employee Benefits* uses the term ‘assumptions’.

BC13 The use of judgement might be necessary in developing an accounting policy (as acknowledged in paragraph 10 of IAS 8) or in applying an accounting policy. Using the proposed definition, judgements made in applying an accounting policy are accounting estimates if they are made when, because of estimation uncertainty, an item cannot be measured with precision.

Changes in accounting estimates (paragraphs 34–38)

BC14 Paragraphs 36–38 of IAS 8 currently specify how an entity accounts for a change in accounting estimate. The Board proposes not to amend those paragraphs.

BC15 The existing definition of a change in accounting estimate refers to changes in the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset. Those references are not needed in a definition of an accounting estimate. They are also included in paragraphs 32(d) and 38 of IAS 8 and the Board has concluded it is sufficient to retain them only there.

BC16 The proposed definition of an accounting estimate does not reproduce the following two components of the current definition in IAS 8 of a change in accounting estimate:

(a) that changes in accounting estimates arise from new information or new developments; and

(b) that changes in accounting estimates are not corrections of errors.

Those two components are also currently contained in paragraph 34 of IAS 8. The Board has concluded that it is sufficient to retain them only there.

Amendments to examples of accounting estimates (paragraph 32)

BC17 Paragraph 32 of IAS 8 provides examples of estimates. The Board proposes deleting the term 'financial' from paragraph 32(c), because it has no reason to restrict the example about fair value to financial assets and financial liabilities.

Other clarifications (paragraphs 32A and 32B)

BC18 The Board proposes clarifying that selecting an estimation technique or valuation technique when an item in the financial statements cannot be measured with precision, constitutes selecting an accounting estimate (paragraph 32A). The Board proposes using both terms, 'estimation techniques' and 'valuation techniques', because both terms appear in IFRS Standards. For example, IFRS 9 *Financial Instruments* uses the term 'estimation techniques' and IFRS 13 *Fair Value Measurement* uses the term 'valuation techniques'.

BC19 The Board also proposes clarifying that, for ordinarily interchangeable inventories, selecting a cost formula (ie first-in, first-out (FIFO) or weighted average cost) in applying IAS 2 *Inventories* constitutes selecting an accounting policy (paragraph 32B). Paragraph 24 of IAS 2 states that specific identification of costs is inappropriate when there are large numbers of items of inventory that are ordinarily interchangeable. If specific identification of costs were to be permitted for such items, the method of selecting items that remain in inventories could be used to obtain predetermined effects on profit or loss. Because specific identification of costs is inappropriate for ordinarily interchangeable inventories and because specific identification for such items would involve determining their actual flow, the Board concluded in developing this Exposure Draft that selecting one of these two cost formulas is not an attempt to estimate the actual flow of those inventories. Consequently, this selection does not constitute making an accounting estimate.

BC20 In 2003, the Board eliminated the last-in, first-out (LIFO) cost formula. Paragraphs BC9–BC21 of the Basis for Conclusions on IAS 2 explain that the Board eliminated LIFO because it imposes an unrealistic cost flow assumption for interchangeable items. In contrast, the Board noted in developing this Exposure Draft that FIFO and weighted average cost both reflect equally realistic cost flow assumptions for ordinarily interchangeable items.

Transition (paragraph 54F)

BC21 The Board proposes that an entity should apply the amendments only 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 applies the amendments.

BC22 The Board proposes this transition because the benefits of applying the amendments to reclassify changes that occurred before the date mentioned in paragraph BC21 (ie in a prior period) would be minimal. The only information that such retrospective reclassifications would provide is the fact that a change in an accounting policy in a prior period would now have been reclassified as a change in an accounting estimate, or vice versa, and the effect of the difference between those two treatments. In the Board's view, this information would have neither predictive value nor confirmatory value. In addition, retrospective reclassification would impose on users of financial statements cost and effort to review and understand the resulting adjustments. It would also require entities to incur cost and expend effort in searching for past changes that the entities would have to reclassify on applying the new definitions and guidance.

BC23 The Board proposes to permit early application. In the Board's opinion, early application would enable entities to adopt more promptly a clearer and more consistent distinction between accounting policies and accounting estimates without:

(a) depriving users of financial statements of useful information; or

(b) impairing comparability between entities that adopt the amendment early and entities that wait until the effective date.

BC24 The Board does not propose creating a requirement for an entity to disclose the fact that it has applied those amendments for an earlier period. The Board concluded that this information is unlikely to be material. Moreover, paragraph 28 of IAS 8 requires an entity to disclose the effect, if any, of initial application of a Standard.

Deletion of IG Example 3

BC25 The Board proposes deleting IG Example 3 from the Guidance on Implementing IAS 8. The example deals with two simultaneous changes for property, plant and equipment:

(a) adopting the revaluation model; and

(b) applying a components approach more fully for depreciation purposes.

BC26 The change mentioned in paragraph BC25(b) relates to matters such as how to identify components, and ultimately, how to determine the useful lives of components. IG Example 3 states that applying a components approach more fully for depreciation purposes is a change in accounting policy. The Board believes that this statement raises several questions, for example:

(a) was the failure to apply the components approach 'more fully' in prior years an accounting error?

(b) did the entity conclude appropriately in prior years that the effect of not applying the components approach 'more fully' was not material?

BC27 Because IG Example 3 does not address these questions, it risks causing confusion about the distinction between accounting policies and accounting estimates, and possibly about how to identify accounting errors and about materiality. Moreover, the Board believes that to address these and other questions would require a substantial rewrite of the example. 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.

BC28 The Board therefore proposes to delete IG Example 3.

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