

**ED/2017/5 Accounting Policies and Accounting Estimates (Proposed amendments to IAS 8)**

# **Feedback to constituents – EFRAG Final Comment Letter**

**January 2018**

## Introduction

### Objective of this feedback statement

EFRAG published its final comment letter on ED /2017/5 *Accounting Policies and Accounting Estimates (Proposed amendments to IAS 8)* (‘the ED’) on 8 January 2018. This feedback statement summarises the main comments received by EFRAG on its draft comment letter and explains how those comments were considered by EFRAG during its technical discussions leading to the publication of EFRAG’s final comment letter.

### Background to the ED

In September 2014, the IFRS Interpretations Committee informed the IASB about divergent practices regarding the assessment of whether a change represents a change in an accounting policy, or in an accounting estimate, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

In September 2017, the IASB published the ED which proposes to:

- clarify the definitions of accounting policies and provide a definition of accounting estimates with the objective of making them more concise and distinctive;
- clarify how accounting policies and estimates relate to each other;
- clarify that changes in valuation techniques and changes in estimation techniques are changes in accounting estimates; and

- clarify that, in applying IAS 2 *Inventories*, a change in the formula used in determining the cost of interchangeable inventories is a change in accounting policy.

Further details are available on the EFRAG [website](#).

### EFRAG’s draft comment letter

EFRAG published a [draft comment letter](#) on the proposals on 29 September 2017. In the letter, EFRAG:

- Supported the IASB’s initiative to clarify the definition of accounting policies and to provide a definition of accounting estimates but considered that the proposals may not deliver sufficient clarification unless supported by additional illustrative examples.
- Agreed with the proposed clarification that, when an item in the financial statements cannot be measured with precision, selecting an estimation technique or valuation technique constitutes making an accounting estimate.
- Acknowledge the need to address the diversity in practice in the application of IAS 2 and, on that basis, supported the IASB’s proposed guidance. However, EFRAG regretted that the proposed changes to the principles in IAS 8 were not considered sufficient to address the issue without recourse to a specific rule.
- Lastly, EFRAG recommended, that the proposed Amendments are delayed and then grouped with other amendments to IAS 8 tentatively approved by the IASB on accounting policy changes; to avoid repeated changes to the Standard in a very short period of time.

### **Comments received from constituents**

EFRAG received nine comment letters from constituents. These comment letters are available on the EFRAG [website](#).

The comment letters received came from national standard setters, regulator, accounting and professional organisations.

A majority of respondents:

- Supported, like EFRAG, the IASB’s objective of clarifying the criteria for distinguishing between accounting policy and accounting estimate, to encourage more consistent application of the requirements of IAS 8.
- Supported providing a direct definition of ‘accounting estimates’ and changing the definition of accounting policies while concurring with EFRAG that the proposed changes may not deliver sufficient clarification and further clarifications and illustrative examples could help to reduce confusion.
- Supported the IASB’s objective of providing further guidance regarding changes in an estimation technique or valuation technique.
- Concurred with EFRAG, that the revised principles and definitions in IAS 8 should be clear enough to enable entities to make the determination without recourse to specific rules such as the proposed guidance in relation to ordinarily interchangeable inventories.

A majority of respondents, while agreeing with the proposed guidance on a change to the inventory cost formula when applying IAS 2, suggested that this guidance is placed in IAS 2 to avoid application by analogy to other circumstances (in its draft comment letter, EFRAG suggested that it is placed in both IAS 8 and IAS 2).

Some respondents also suggested that:

- EFRAG clarifies the objectives of its recommendation to include additional examples and its effects on the IASB’s due process; and
- IASB provides further guidance on the distinction between revising an estimate and correcting an error.

### **EFRAG’s final comment letter**

Considering the feedback received, EFRAG retained the main views expressed in its draft comment letter with limited drafting changes to reflect the following:

- (a) The proposed guidance on a change to the inventory cost formula is placed in IAS 2 as its inclusion in IAS 8 could lead to inappropriate analogies being drawn in other circumstances;
- (b) EFRAG’s recommendation to include examples does not aim at providing guidance on specific cases but rather at illustrating how the proposed revisions in the ED would help to clarify the distinction between accounting policies and estimates;
- (c) Highlight that any such additional illustrative examples should be subject to the appropriate due process; and
- (d) Reinforce the statement in paragraph 18 regarding the link between changes in accounting estimates and corrections of errors and suggest that this is considered in the context of the next amendments to IAS 8.

## Detailed analysis of issues, comments received, and changes made to EFRAG’s final comment letter

### EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

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### EFRAG’s response to constituents’ comments

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#### Changes to the definition of accounting policies

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##### *Proposals in the ED*

The ED proposes to change the definition of accounting policies to “accounting policies are the specific principles, measurement bases, ~~conventions, rules~~ and practices applied by an entity in preparing and presenting financial statements”.

##### *EFRAG’s tentative position*

EFRAG supported the IASB’s initiative to clarify the definition of accounting policies and agreed with removing the references to ‘convention’ and ‘rules’ while keeping the term ‘practices’ in the definition as it clarifies that accounting policies also cover those that are developed in the absence of specific guidance, as set out in IAS 8. However, EFRAG considered that the proposals may not deliver sufficient clarification unless supported by additional guidance and recommended that more guidance and examples are added to IAS 8 in order to address the diversity that has been identified in this area effectively.

##### *Constituents’ comments*

A majority of respondents supported the IASB’s initiative to clarify the definition of accounting policies but concurred with EFRAG suggestion to include additional illustrative examples.

Two respondents suggested to either clarify or remove the term ‘practice’ from the definition of accounting policies as the terms is not defined.

Two respondents considered that the amendment should be finalised as proposed.

##### *EFRAG final position*

Considering the feedback received, EFRAG essentially retained its initial views. EFRAG also clarified that its recommendation to include additional examples was not aimed at providing guidance on specific cases but rather at illustrating how the proposed revisions in the ED would help to clarify the distinction between accounting policies and estimates (see response to Question 2, below).

## EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

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### Clarifying the relationship between accounting policies and accounting estimates

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#### *Proposals in the ED*

The ED proposes to remove the definition of changes in accounting estimates and to define accounting estimates as ‘*judgements or assumptions used in applying an accounting policy when, because of estimation uncertainty, an item in financial statements cannot be measured with precision*’.

The ED also clarifies that an accounting estimate is used in applying an accounting policy. In other words, the accounting policies are the overall objective and the accounting estimates are inputs used as a means of achieving that objective.

#### *EFRAG’s tentative position*

EFRAG supported adding a definition of ‘accounting estimates’ to IAS 8 and removing the definition of ‘change in an accounting estimate’.

EFRAG however considered that the IASB should further clarify the interaction between an accounting estimate and an accounting policy by providing illustrative examples. EFRAG recognised that, in distinguishing between a change in accounting policy or a change in accounting estimate in particular circumstances, certain ‘grey areas’ may remain and that professional judgement will continue to be required. In EFRAG’s view, the distinction between an accounting policy and an accounting estimate can nonetheless be improved by eliminating what is perceived to be an overlap between the existing definitions and by adding supporting guidance and illustrative examples.

## EFRAG’s response to constituents’ comments

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#### *EFRAG final position*

Considering the feedback received, EFRAG retained its initial views.

EFRAG also reiterated its concerns that the IASB should further clarify the interaction between an accounting estimate and an accounting policy and how the amended definition should be applied in practice by providing illustrative examples. However, the letter was clarified to state that:

- The examples should not aim at providing guidance on specific cases and fact patterns but rather at illustrating how the proposed revisions in the ED would help in clarifying the distinction between accounting policies and estimates; and
- Any such additional illustrative examples should be subject to an appropriate due process.

**EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments**

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*Constituents’ comments*

A majority of respondents agreed with EFRAG’s initial assessment supporting the proposed definition of ‘accounting estimates’ and calling for further clarifications on the interaction between an accounting estimate and an accounting policy by providing illustrative examples.

Some respondents expressed concerns about EFRAG’s suggestion that the IASB should include additional guidance and examples. These respondents considered that IAS 8 worked best if kept as a principles-based standard.

One respondent suggested to further clarify that the proposed definition of an accounting estimate is amended slightly to clarify that accounting estimates are the outputs that result from judgements and assumptions being used to apply an accounting policy.

Two respondents considered that the amendment should be finalised as proposed.

**EFRAG’s response to constituents’ comments**

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**EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments**

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**Classification when selecting an estimation technique or valuation technique**

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*Proposals in the ED*

The ED proposes to add paragraph 32A to state that when an item in the financial statements cannot be measured with precision, selecting an estimation technique or valuation technique, is selecting an accounting estimate.

*EFRAG’s tentative position*

EFRAG welcomed the IASB’s proposal to provide further guidance about changes in estimation techniques or valuation techniques. EFRAG further observes that the proposed change to IAS 8 is similar to the existing guidance in paragraphs 65 and 66 of IFRS 13 *Fair Value Measurement* concerning changes in valuation techniques.

*Constituents’ comments*

All respondents agreed, like EFRAG, with the proposed clarification.

**EFRAG’s response to constituents’ comments**

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*EFRAG final position*

Considering the feedback received, EFRAG retained its initial views.

## EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

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### Selection of cost formula in IAS 2 *Inventories*

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#### *Proposals in the ED*

The ED proposes to clarify that, for ordinarily interchangeable inventories, selecting a cost formula (i.e. first-in, first-out (FIFO) or weighted average cost) in applying IAS 2 is selecting an accounting policy.

#### *EFRAG’s tentative position*

EFRAG agreed with the need to address the diversity in practice in the application of IAS 2 and, on that basis, supported the IASB’s proposal. However, EFRAG regretted that the principles in IAS 8 had not been clarified enough to address the issue without recourse to a specific rule.

#### *Constituents’ comments*

Most respondents agreed with EFRAG’s initial assessment that guidance was needed to address the diversity in practice.

Two respondents considered that the amendment should be finalised as proposed.

One respondent disagreed with the IASB’s assessment as it considered that the measurement base (i.e. that inventory accounted for at the lower of cost and net realisable value) is the accounting policy and the cost formula is an accounting estimate selected in applying that policy. This respondent noted that Paragraph 32B appeared to conflict with paragraph 35 insofar as paragraph 35 seemed to imply that a change in cost formula should always be treated as a change in accounting estimate.

Two respondents recommended that the requirement, if proceeded with, be included in IAS 2 and not in IAS 8 to avoid inappropriate analogies.

## EFRAG’s response to constituents’ comments

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#### *EFRAG final position*

Considering the input received from constituents, EFRAG retained its preliminary views.

However, EFRAG finally recommends including the guidance in IAS 2 because its inclusion in IAS 8 could lead to inappropriate analogies being drawn in other circumstances.

## EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

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### Other Issues

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#### *Proposals in the ED*

Not applicable.

#### *EFRAG’s tentative position*

EFRAG recommended that:

- The name of IAS 8 is updated to reflect the amendments proposed in the ED (i.e. remove the reference to ‘changes’ in accounting policies or estimates).
- The proposed changes are delayed and then grouped with other amendments on accounting policy change tentatively approved by the IASB (these amendments are aimed at lowering the ‘impracticability threshold’ regarding retrospective application of voluntary changes in accounting policies that result from the IFRS Interpretations Committee’s agenda decisions).
- IAS 8 should reflect that when an accounting estimate is changed it can, in some cases, be the result of correcting an error and should be treated as such. Although estimates are based on judgement, there are cases where, for example, a material calculation error has been made and the change in accounting estimate is the correction of an error. IAS 8 should contain guidance to assist entities in making this distinction.

## EFRAG’s response to constituents’ comments

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#### *EFRAG final position*

Considering the feedback received, EFRAG retained its initial views.

In addition, EFRAG reinforced the statement in paragraph 18 of its letter regarding the link between changes in accounting estimates and corrections of errors and suggest that this is considered in the context of the next amendments to IAS 8.

**EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments**

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**EFRAG’s response to constituents’ comments**

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*Constituents’ comments*

Most respondents agreed with EFRAG’s recommendations.

One respondent, while agreeing with the above, also suggested that the IASB takes the opportunity while amending IAS 8, to improve the requirements for reporting the effect of changes in estimates and, in particular to require the disclosure of the financial statement line items that are affected.

Some respondents noted that replacement of IAS 8’s current definition of ‘a change in accounting estimate’ with the proposed definition of ‘accounting estimates’ would remove some guidance that aims to clarify the distinction between a change in an accounting estimate and the correction of an error. They encouraged the IASB to consider whether some additional clarification of this distinction would be useful in finalising these amendments.

One respondent considered that the amendments should be finalised as proposed with no further changes.

## Appendix 1: List of respondents

**Table 1: List of respondents**

<b>Name of constituent</b>	<b>Country</b>	<b>Type / Category</b>
UK Financial Reporting Council (UK FRC)	United Kingdom	Standard Setter
Dutch Accounting Standard Board (DASB)	The Netherlands	Standard Setter
Danish Accounting Standards Committee (DASC)	Denmark	Standard Setter
Insurance Europe	Europe	Professional Organisation
Organismo Italiano di Contabilità – OIC	Italy	Standard Setter
The European Securities and Markets Authority (ESMA)	Europe	Regulator
Swedish Enterprise Accounting Group (SEAG)	Sweden	Professional Organisation
The Institute of Chartered Accountants in England and Wales (ICAEW)	UK	Accounting organisation
ACTEO	France	Professional Organisation