EFRAG SECRETARIAT PAPER FOR PUBLIC EFRAG TEG MEETING

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Proposed Amendments to IAS 8 - Draft Comment Letter

Comments should be submitted by [date] by using the 'Express your views' page on EFRAG website or by clicking here

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

[Date]

Dear Mr Hoogervorst,

Re: Exposure Draft ED/2017/5 *Accounting Policies and Accounting Estimates (Proposed Amendments to IAS 8)*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure Draft ED/2017/5 *Accounting Policies and Accounting Estimates (Proposed Amendments to IAS 8),* issued by the IASB on 12 September 2017 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS in the European Union and European Economic Area.

Overall, EFRAG agrees with the IASB's objective to clarify the criteria to distinguish between a change in an accounting policy and a change in an accounting estimate, in relation to the application of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, we are of the view that the proposed changes would not have a significant impact on the diversity that currently exists.

EFRAG also recommends the development of some illustrative examples on the application of a change in accounting estimate and an accounting policy as it would further clarify the interaction of an accounting estimate and accounting policy.

EFRAG's detailed comments and responses to the questions in the ED are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Albert Steyn or me.

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

Appendix - EFRAG's responses to the questions raised in the ED

Change in definition of accounting policies

Notes to constituents

1 *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".*

2 *The ED provides the following reasons for the proposed amendment:*

(a) *the terms 'conventions' and 'rules' were removed because their meanings are not clear and these terms are not used elsewhere in IFRS Standards; and*

(b) *the term 'bases' was amended to align the definition of accounting policies with paragraph 35 of IAS 8 that states that a change in the measurement basis applied is a change in an accounting policy.*

3 *The IASB decided to retain the term 'practices' because of concerns that the amendments would otherwise be perceived as narrowing the definition of accounting policies. The purpose of the amendment was not to make it narrower or broader but rather to provide more clarity.*

Question 1

The IASB proposes to change the definition of accounting policies by removing the terms 'conventions', 'rules' and amending bases to '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?

EFRAG's response

EFRAG supports the IASB's initiative to clarify the definition of accounting policies but we consider that the proposals are not sufficient to address the diversity in practice in a manner that would improve financial reporting.

4 EFRAG supports the proposed clarification of the definition of accounting policies. However, EFRAG is concerned that the deletion of the terms 'conventions' and 'rules' from the definition of accounting policies may cause unintended consequences. For example, if an entity had adopted a presentation convention that is commonly used in its industry, the implications of the removal of the term 'convention' are unclear.

5 EFRAG agrees with keeping the term 'practices' in the definition of accounting policies as it clarifies that accounting policies also cover those that are developed in the absence of specific guidance, as set out in paragraphs 10-12 of IAS 8 . EFRAG welcomes the amendment of 'bases' to 'measurement bases' to align it with paragraph 35 of IAS 8 as it would ensure consistency in IAS 8.

6 Overall EFRAG is concerned that the proposed changes will not achieve the objective of providing more clarity. For example, entities could regard the proposed definition as narrower than the existing definition and that more changes will be classified as changes in accounting estimates than changes in accounting policies. We consider, in addition to the change in definition, that more guidance and examples are needed in IAS 8 to address the existing diversity in practice in a manner that would improve financial reporting.

Clarifying the relationship between accounting policies and accounting estimates

Notes to constituents

7 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".

8 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.

Question 2

The IASB proposes to:

(a) clarify how accounting policies and accounting estimates relate to each other, by explaining that accounting estimates are used in applying accounting policies; and

(b) add a definition of accounting estimates and remove 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?

EFRAG's response

EFRAG supports adding a definition of 'accounting estimates' to IAS 8 and removing the definition of a change in an accounting estimate.

EFRAG considers that the IASB should further clarify the interaction between an accounting estimate and an accounting policy by providing illustrative examples.

9 IFRS Standards usually define items rather than changes in those items. As a result, EFRAG agrees with the proposed change in the definition.

10 However, EFRAG considers 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. We observe that ESMA's submission identified a number of issues, some of which would still be relevant after the issue of an amendment to IAS 8 arising from the ED, namely:

(a) *change in the own credit risk calculation*: a change in the assessment of own credit risk for measurement of financial liabilities at fair value (e.g. from using a credit default swap curve to using the spread of the most recent debt issuance);

(b) *change in the definition of high quality corporate bond*: a change in the basket of high quality corporate bonds used to determine the discount rate for a defined benefit obligation (e.g. from AA-rated bonds to A-rated bonds); and

(c) *change in the method of credit value adjustment (CVA)* calculation to determine the probability of default (e.g. from historical approach to market based approach).

11 In EFRAG's opinion, the issues entities face when trying to distinguish between an accounting policy and an accounting estimate will only be resolved if the IASB includes illustrative examples that clarify how the proposed definitions should be

applied in practice. Illustrative examples would also help to ensure that the proposed amendments are not perceived as lowering the threshold for prospective application.

Classification when selecting an estimation technique or valuation technique

Notes to constituents

12 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.

Question 3

The IASB proposes to clarify 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 of Conclusions).

Do you agree with the proposed amendment? Why or why not? If not, what do you propose and why?

EFRAG's response

EFRAG supports the proposed amendment.

13 EFRAG welcomes the IASB's proposal to provide further guidance about changes in estimation techniques or valuation techniques.

14 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.

Selection of cost formula in IAS 2

Notes to constituents

15 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 Inventories is selecting an accounting policy.

16 The IASB concluded that selecting one of these two cost formulas is not an accounting estimate because the selection is not based on an attempt to estimate the physical flow of such inventories. For interchangeable items, the sequence in which items are sold has no economic significance.

Question 4

The IASB proposes to clarify that, in applying IAS 2 *Inventories*, selecting a cost formula for interchangeable inventories, is 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?

EFRAG's response

EFRAG agrees with the need to address the diversity in practice in the application of IAS 2 *Inventories,* and on that basis, accepts the IASB's proposal in this respect. However, EFRAG is concerned that the proposed change to IAS 8 was not sufficient to address the issue.

17 EFRAG generally supports principle-based standards and notes that the proposed amendment to IAS 2 is more of a rule than a principle. However, EFRAG agrees that there is a need for practical guidance in this case to resolve diversity in practice in applying a Standard that has not been substantively revised for many years.

18 EFRAG understands that during the discussions that resulted in the ED, many stakeholders raised the issue of whether a change in the cost formulas that are used, is a change in an accounting policy or a change in an accounting estimate.

19 FIFO or weighted average cost are permitted when the order in which the items flow through a cycle of transactions has no economic consequences. EFRAG understands the IASB's view that selecting a cost formula for interchangeable inventories is not an accounting estimate because the selection is not based on an attempt to estimate the actual flow of such inventories. Instead, the selected cost formula is generally a practical expedient to avoid the cost of specifically identifying items.

20 However, EFRAG is concerned that an issue that was raised repeatedly during the discussions could not be resolved by applying the proposed changes to IAS 8 on accounting policies and accounting estimates. Instead, the IASB decided that the solution required was to insert a specific rule into IAS 8 in order to ensure consistent application of IAS 2.

21 EFRAG recommends that the requirement, if proceeded with, be included in IAS 2 as well as IAS 8 to ensure that it is easy to find when entities are determining their accounting policies.

Other issues

Question 5

Do you have any other comments on the proposals?

EFRAG's response

22 EFRAG recommends that the name of IAS 8 is updated to reflect the amendments proposed in the ED.