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

### **Cover Note and Summary of Feedback**

#### **Objective**

- 1 The objectives of the session are to:
  - (a) consider the feedback received in response to EFRAG's draft comment letter on ED/2017/5 *Accounting Policies and Accounting Estimates (Proposed amendments to IAS 8)* (the 'ED');
  - (b) discuss and recommend to the EFRAG Board a final comment letter on the ED; and
  - (c) discuss and approve a feedback statement.

#### **Background**

- 2 The IASB published the ED on 12 September 2017. Comments are requested by 15 January 2018.
- 3 The changes proposed in the ED are focused on four areas:
  - (a) 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*'.
  - (b) Clarify how accounting policies and accounting estimates relate to each other, and add a definition of 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*'.
  - (c) 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.
  - (d) Clarify that, for ordinarily interchangeable inventories, selecting a cost formula (i.e. FIFO or Weighted Average Cost) in applying IAS 2 *Inventories* is selecting an accounting policy. 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.
- 4 The ED does not contain a proposed effective date which the IASB intends to decide on after the exposure. However, the IASB has already concluded 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.

#### **EFRAG's Draft Comment Letter**

- 5 EFRAG published its draft comment letter on 29 September 2017. In the letter EFRAG:
  - (a) Supported the IASB's initiative to clarify the definition of accounting policies but considered that the proposals may not deliver sufficient clarification unless supported by additional illustrative examples.
  - (b) Supported adding a definition of 'accounting estimates' (and removing the definition of a 'change in an accounting estimate') but considered that the IASB should further clarify the interaction between an accounting estimate and policy by providing illustrative examples.
  - (c) 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.
  - (d) Agreed with the need to address the diversity in practice in the application of IAS 2 *Inventories* 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.
- 6 EFRAG did not provide specific comments on the proposed transition requirements (i.e. prospective application) but recommended, to avoid multiple changes to IAS 8 in a very short period of time, that the proposed Amendments are delayed and then grouped with other amendments to IAS 8 tentatively approved by the IASB on accounting policy changes. 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. The proposed threshold would include a consideration of the costs and benefits of applying such changes retrospectively. The IASB plans to issue an exposure draft in the first quarter of 2018.

#### **Comment letters received**

- 7 EFRAG received comment letters from five respondents representing national standard-setters and one professional organisation. Letters from constituents are available on the [EFRAG project page](#).
- 8 A majority of respondents:
  - (a) 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.
  - (b) 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.
  - (c) Supported the IASB's objective of providing further guidance regarding changes in an estimation technique or valuation technique.
  - (d) 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 the treatment of cost formulas applied to ordinarily interchangeable inventories.

- 9 Two respondents supported EFRAG's draft comment letter as a whole without further comments. One of these respondents however considered that the ED was not considered a high priority issue.
- 10 While agreeing with the EFRAG's overall assessment, one respondent did not support EFRAG's suggestion that the IASB should include additional guidance and examples. This respondent considered that IAS 8 worked best if kept as a principles-based standard. This respondent also considered that it was unnecessary, and potentially confusing, to introduce in the definition of 'accounting estimates a form of subordination to accounting policy' by stating that accounting policies are the overall objective and accounting estimates are inputs used to achieve that objective.
- 11 One respondent considered that the ED should be finalised as proposed.

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

- 12 Most comments provided by constituents regarded the ED's proposed clarification on selecting a cost formula or ordinarily interchangeable inventories in applying IAS 2 *Inventories*:
  - (a) 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 to be used 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.
  - (b) This respondent stated that if the IASB did retain its proposed guidance it should be included only in IAS 2 because its inclusion in IAS 8 could lead to inappropriate analogies being drawn in other circumstances.
  - (c) One respondent while agreeing with the clarification, also suggested that it should be placed in IAS 2 as IAS 8 should remain a principles-based standard. The respondent considered that introducing a specific rule may have unintended consequences if made in IAS 8, whereas in IAS 2 it would deal with the specific problem which the IASB has identified.

#### *Other comments*

- 13 Respondents generally agreed with EFRAG's preliminary view that:
  - (a) the proposed changes are delayed and then grouped with the second forthcoming amendments to IAS 8; and
  - (b) further guidance is needed to assist entities in assessing when a change in accounting estimate is the correction of an error material calculation error has been made.
- 14 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 that paragraph 39 is amended to require the disclosure of the financial statement line items that are affected. This respondent also suggested to draft paragraph 54F more concisely by stating simply that the requirements are to be applied prospectively from the effective date, with early application permitted

**EFRAG Secretariat proposed responses/recommendation**

- 15 Considering the input received from constituents, the EFRAG Secretariat is proposing to retain the preliminary views expressed by EFRAG with the following limited drafting improvements to:
- (a) Suggest that the proposed guidance on changes to cost formula of inventories is placed in IAS 2 (in its draft comment letter, EFRAG suggested that it is placed in both IAS 8 and IAS 2);
  - (b) Suggest that paragraph 54F on transition requirements be drafted more concisely by stating simply that the requirements are to be applied prospectively from the effective date, with early application permitted.

**Questions for EFRAG TEG**

- 16 Does EFRAG TEG agreed to recommend the final comment letter, contained in Agenda paper 08-02, to the EFRAG Board?

**Agenda Papers**

- 17 In addition to this cover note, agenda papers for this session are:
- (a) Agenda paper 08-02 – Proposed Final Comment Letter; and
  - (b) Agenda paper 08-03 – Feedback Statement.