

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

IASB ED/2017/X Amendments to IAS 8: Changes in Accounting Policies and Accounting Estimates

Issues Paper: Towards a Draft Comment Letter

Objective

- 1 The objective of this session is to discuss the amendments that are expected to be included in the forthcoming IASB Exposure Draft *Accounting Policies and Accounting Estimates (Proposed amendments to IAS 8)* (the 'ED') and to obtain EFRAG TEG's views on them.

Background

- 2 The expected issues to be covered in the ED are as follows:
 - (a) Shortening the definition of accounting policies;
 - (b) Deleting the definition 'change in accounting estimates' and replacing it with a definition for 'accounting estimates';
 - (c) Clarifying the relationship between accounting policies and accounting estimates;
 - (d) Clarifying that, where an item cannot be measured precisely, selecting an estimation technique is selecting an accounting estimate; and
 - (e) Selecting a cost formula for IAS 2 *Inventories* is selecting an accounting policy.
- 3 The EFRAG Secretariat has prepared tentative responses to the questions that are expected to be included in the ED. The EFRAG Secretariat will use the views expressed at this meeting as the basis for preparing a draft comment letter.

Previous discussions

- 4 In June 2016 EFRAG CFSS and EFRAG TEG discussed draft proposed amendments to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, aimed at clarifying the distinction between changes in accounting policies and changes in accounting estimates. Members generally acknowledged that there was a need to clarify this aspect of IAS 8, but felt that the draft proposed amendments could be improved and did not address issues such as the distinction between a change estimate and an error, or the disclosure requirements relating to changes in accounting estimates. In July 2016, EFRAG User Panel members underlined the importance of maintaining comparability and expressed concerns with lowering the threshold for prospective application. Since that meeting, the IASB has significantly changed the expected proposals.

Issues to be addressed in the Exposure Draft

Issue 1: Shortening the definition of accounting policies

Notes for EFRAG TEG

- 5 The IASB is expected to amend the definition of accounting policies to: *Accounting policies* are the specific principles, ~~bases, conventions, rules~~ and practices applied by an entity in preparing and presenting financial statements.
- 6 The IASB is expected to provide the following reasons for the proposed amendments to the definition:
 - (a) the terms 'conventions' and 'rules' were removed because their meanings are not clear and because these terms are not used elsewhere in IFRS Standards; and
 - (b) the term 'bases' was removed because although the *Conceptual Framework for Financial Reporting* and some IFRS Standards, including IAS 8 use the term 'measurement basis', the term 'bases' is not defined.
- 7 The IASB is expected to state that it proposes to retain the term 'practices' because the IASB was concerned that the amendments would otherwise be perceived as narrowing the definition of accounting policies.

EFRAG Secretariat's proposed response

EFRAG supports the IASB's initiative to simplify the definition of accounting policies but is concerned that the deletion of 'bases', 'conventions' and 'rules' has the potential to narrow the scope.

In EFRAG's view, the IASB should clarify further the reasoning behind the proposed changes.

- 8 EFRAG supports the proposed simplification of the definition of accounting policies. However, EFRAG is concerned that the deletion of the terms 'bases', '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.
- 9 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.

Question for EFRAG TEG

- 10 Does EFRAG TEG agree with the proposed approach to preparing a draft answer to issue 1?

Issue 2: Deleting the definition 'change in accounting estimates', replacing it with the definition for 'accounting estimates' and clarifying the relationship between accounting policies and accounting estimates

Notes for EFRAG TEG

- 11 The IASB is expected 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.

- 12 The IASB is also expected to clarify 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 Secretariat's proposed 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.

- 13 IFRS Standards usually define items rather than changes in those items. As a result, EFRAG agrees with the proposed change in definitions.
- 14 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 bonds (HQCB): 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)
- 15 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.

Question for EFRAG TEG

- 16 Does EFRAG TEG agree with the proposed approach to preparing a draft answer to issue 2?

Issue 3: Clarifying that, where an item cannot be measured precisely, selecting an estimation technique is selecting an accounting estimate

Notes for EFRAG TEG

- 17 The IASB is expected to add a paragraph which clarifies 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 Secretariat's proposed response

EFRAG supports the proposed amendments in the ED.

- 18 EFRAG welcomes the IASB's proposal to provide further guidance about changes in estimation or valuation techniques.
- 19 EFRAG 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. EFRAG therefore supports the proposed amendments in the ED.

Question for EFRAG TEG

- 20 Does EFRAG TEG agree with the proposed approach to preparing a draft answer to issue 3?

Issue 4: Selecting a cost formula for IAS 2 *Inventories* is selecting an accounting policy

Notes for EFRAG TEG

- 21 The IASB is expected to propose 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.
- 22 The IASB is expected to conclude 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 actual flow of such inventories. For interchangeable items, the sequence in which items are sold has no economic significance.

EFRAG Secretariat's proposed response

EFRAG agrees with the proposed amendment. However, EFRAG is concerned that the proposed change to IAS 8 was not sufficient to address the issue.

- 23 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 welcomes practical guidance in this case because it clarifies a requirement of a Standard that has not been substantively revised for many years.
- 24 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.
- 25 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 therefore agrees with the IASB's view that selecting a cost formulas 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.
- 26 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 was required to insert a specific rule into IAS 2 in order to ensure consistent application. In EFRAG's opinion, the IASB should ensure that the rule is not applied by analogy but solely applied in relation to the specified paragraphs in IAS 2.

Questions for EFRAG TEG

- 27 Does EFRAG TEG agree with the proposed approach to preparing a draft answer to issue 4?
- 28 Do EFRAG TEG members have any other comments?