

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.

Definition of Accounting Estimates (Amendments to IAS 8)

Cover Note

Objective

- 1 The objective of this session is to discuss and agree to recommend to the EFRAG Board, a draft endorsement advice and invitation to comment on Definition of Accounting Estimates (Amendments to IAS 8) (the 'Amendments').
- 2 A link to the IASB publication, on EFRAG's website, is provided under permission of the IASB and is only valid until the publication of the Amendments/Standard in the official journal. ([here](#)).

Background

- 3 In September 2014, the IFRS Interpretations Committee informed the IASB about difficulties faced by entities in assessing whether a change constitutes a change in an accounting policy, or a change in an accounting estimate, in applying IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.
- 4 In response, the IASB issue and exposure draft in September 2017, aiming to help entities distinguish accounting policies from accounting estimates. The distinction is relevant because changes in accounting estimates are applied prospectively, while changes in accounting policies need to be applied retrospectively and comparative figures need to be restated.
- 5 The ED proposed:
 - (a) Introducing a definition of accounting estimates and removing the definition of a change in accounting estimate.
 - (b) Clarifying the existing definition of accounting policies by removing the reference to the terms 'conventions' and 'rules' because their meanings were not clear and these terms are not used elsewhere in IFRS Standards¹.
 - (c) clarifying how accounting policies and accounting estimates relate to each other by explaining that an entity uses accounting estimates in applying accounting policies. The Exposure Draft also proposed clarifying that when an item in the financial statements cannot be determined with precision, selecting an estimation technique or valuation technique constitutes making an accounting estimate.
- 6 A specific application issue of the distinction between accounting estimates and accounting policy concern the choice of a cost formula for inventories under IAS 2 allows to use both FIFO and weighted average cost, but there are seemingly different

¹ Under the proposals accounting policies were defined as 'specific principles, measurement bases, ~~conventions, rules~~ and practices applied by an entity in preparing and presenting financial statements'.

- views about whether changing the formula used is a change in estimates or in policy. The ED proposed to clarify that selecting a cost formula constitutes selecting an accounting policy.
- 7 Several respondents, including EFRAG, agreed that it was helpful to provide a definition of accounting estimates and clarify that an entity uses accounting estimates in applying accounting policies. Several respondents also considered that accounting estimates would be defined more helpfully not as judgements or assumptions themselves (as proposed in the ED), but rather as the output of measurement techniques.
 - 8 EFRAG also encourage the IASB to develop of some more illustrative examples in order to further clarify the distinction between an accounting policy and an accounting estimate.
 - 9 Regarding the proposed changes to the definition of 'accounting policies', the IASB received mixed views. Some respondents (including EFRAG) considered that it was helpful to remove terms such as 'conventions' and 'rules' that were not defined by IFRS Standards and not clear. However, some questioned whether the proposed changes would improve the definition. This is because the remaining terms in the definition were also not defined and are open to differing interpretations and some respondents suggested the IASB to define terms such as define 'measurement bases'.
 - 10 Some respondents (including EFRAG) agreed with the IASB characterisation of a selection a cost formula for inventories as an accounting policy. Some however noted that paragraph 36(a) of IAS 2 already implicitly states that selecting a cost formula constitutes selecting an accounting policy as this this paragraph requires an entity to disclose (emphasis added) 'the accounting policies adopted in measuring inventories, including the cost formula used'. However, others did not agree and noted that the IASB's conclusion did not clearly align with the new proposed definitions of accounting policy and accounting estimate.
 - 11 Based on the feedback received, the IASB decided to proceed with the Amendments with the following changes:
 - (a) revise the proposed definition of accounting estimates to specify that accounting estimates are 'monetary amounts' (rather than 'judgements and assumptions'). This is to highlight that the estimates are not judgements or assumptions themselves, but rather the output of a measurement technique, such as a valuation technique or an estimation technique, that requires an entity to use judgements and assumptions;
 - (b) clarify that the effects of a change in an input and/or measurement technique used to develop an accounting estimate are part of the change in accounting estimate and not the correction of an error if that change results from new information or new developments; and
 - (c) specify that estimation techniques and valuation techniques are examples of measurement techniques an entity uses to develop accounting estimates.
 - 12 Considering the mixed feedback received, the IASB staff assessed that amending the definition of accounting policies could have unintended consequences; in particular, stakeholders could see the changes as narrowing the scope of what constitutes accounting policies while others could see the changes as broadening the scope whereas the main purpose of the proposed amendments to IAS 8 was to clarify, and not change, the definition. Accordingly, the IASB decided to not amend the definition of accounting policies. Other issues
 - 13 The IASB also decided to not add a discussion of whether selecting an inventory cost formula constitutes selecting an accounting policy; and not develop additional illustrative examples (as it was considered difficult to develop useful example that would not confuse further stakeholder).

Previous discussion by EFRAG CFSS and EFRAG TEG

- 14 The above IASB decisions were discussed with EFRAG TEG and EFRAG CFSS at their September 2018 joint meeting.
- 15 Some members supported the revised proposals while others expressed concerns about the reduced ambition of the final amendments compared to the initial proposals contained in the exposure draft. Some regretted that the IASB did not follow EFRAG's suggestion to include further illustrative examples.
- 16 Some members supported the reference to monetary amounts in the proposed definition of accounting estimates. It was noted that the reference was consistent with the concept of 'Measurement uncertainty' as defined in the Appendix to the 2018 Conceptual Framework as the '*uncertainty that arises when monetary amounts in financial reports cannot be observed directly*'. Entities may use non-monetary amounts as inputs to estimate monetary amounts in the financial statements: for example the useful life of an asset (a non-monetary amount) may be used as an input in estimating the depreciation expense for that asset (a monetary amount).

Amendments issued

- 17 The IASB issued the Amendments on 12 February 2021. No members dissented with the publication.
- 18 As mentioned above, the Amendments replace the definition of a change in accounting estimates with a definition of accounting estimates, and provide other clarifications to help entities distinguish accounting policies from accounting estimates. Accounting estimates are defined "monetary amounts in financial statements that are subject to measurement uncertainty".
- 19 The Amendments also clarify that:
 - (a) a change in accounting estimate that results from new information or new developments is not the correction of an error.
 - (b) the effects of a change in an input or a measurement technique used to develop an accounting estimate are changes in accounting estimates if they do not result from the correction of prior period errors.
- 20 The Amendments are effective for annual periods beginning on or after 1 January 2023 to changes in accounting policies and changes in accounting estimates that occur on or after the start of that period. Earlier application is permitted.
- 21 The European Commission issued a letter requesting advice on the endorsement of the Amendments on 17 February 2021 (uploaded as paper 13-04). The letter does not identify specific additional issues to investigate.

Draft endorsement advice

- 22 The proposed draft Endorsement Advice submitted to EFRAG TEG review suggests the following conclusions:
 - (a) EFRAG considers that the Amendments will bring improved financial reporting when compared to previous guidance. As such, their endorsement is conducive to the European public good in that improved financial reporting improves transparency and assists in the assessment of management stewardship.
 - (b) EFRAG has not identified that the Amendments could have any adverse effect to the European economy, including financial stability and economic growth.
 - (c) Furthermore, EFRAG has not identified any other factors that would mean endorsement of the Amendments is not conducive to the European public good.

- (d) Having considered all relevant aspects, including the trade-off between the costs and benefits of implementing the Amendments, EFRAG assesses that endorsing the Amendments is conducive to the European public good.

Questions for EFRAG TEG

- 23 Do EFRAG TEG members have comments on the above project information contained in paragraphs 4 to 22?
- 24 Do EFRAG TEG members agree to recommend the draft endorsement advice (contained in paper 12-02) and the invitation to comment (contained in paper 12-03) for consideration by the EFRAG Board?
- 25 Do EFRAG TEG members agree with a consultation period of three months for the Draft Endorsement Advice?

Agenda Papers

- 26 In addition to this cover note, agenda papers for this session are:
- (a) Agenda paper 12-02 – EFRAG’s draft letter to the European Commission regarding endorsement of *Definition of Accounting Estimates (Amendments to IAS 8)*;
- (b) Agenda paper 12-03 – Invitation to comment on EFRAG assessment; and
- (c) Agenda paper 12-04 – Letter from the European Commission requesting endorsement advice– for background only.