EFRAG's Letter to the European Commission Regarding Endorsement of Definition of Accounting Estimates (Amendments to IAS 8)

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European Commission
1049 Brussels

8 July 2021

Dear Mr John Berrigan

Endorsement of Disclosure of Accounting Policies and Definition of Accounting Estimates

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards, EFRAG is pleased to provide its opinion on *Definition of Accounting Estimates* (Amendments to IAS 8) (the Amendments), which were issued by the IASB on 12 February 2021. An Exposure Draft of the Amendments was issued on 12 September 2017. EFRAG provided its comment letter on that Exposure Draft on 8 January 2018.

The objective of the Amendments is to help entities distinguish accounting policies from accounting estimates introducing a definition of accounting estimates and provide other clarifications to help entities distinguish accounting policies from accounting estimates.

The Amendments shall be applied for annual reporting periods beginning on or after 1 January 2023 with earlier application permitted. An entity shall apply the amendments to changes in accounting estimates and policies that occur on or after the beginning of the first annual reporting period in which it applies the Amendments.

A description is included in Appendix 1 to this letter.

In order to provide our endorsement advice as you have requested, we have first assessed whether the Amendments would meet the technical criteria for endorsement, in other words whether the Amendments would provide relevant, reliable, comparable and understandable information required to support economic decisions and the assessment of stewardship, lead to prudent accounting and are not contrary to the true and fair view principle. We have then assessed whether the Amendments would be conducive to the European public good. We provide our conclusions below.

EFRAG has carried out an evaluation of the Amendments. As part of that process, EFRAG issued its initial assessment for public comment and, when finalising its advice and the content of this letter, took the comments received in response into account. EFRAG's evaluation is based on input from standard setters, market participants and other interested parties, and its discussions of technical matters are open to the public.

Do the Amendments meet the IAS Regulation technical endorsement criteria?

Based on the above reasoning, EFRAG has concluded that the Amendments meet the qualitative characteristics of relevance, reliability, comparability and understandability required to support economic decisions and the assessment of stewardship, and raise no issues regarding prudent accounting. EFRAG has also assessed that the Amendments do not create any distortion in their interaction with other IFRS Standards and that all necessary disclosures are required. Therefore, EFRAG has concluded that the Amendments are not contrary to the true and fair view principle. EFRAG's reasoning is explained in Appendix 2 to this letter.

Are the Amendments conducive to the European public good?

EFRAG has assessed that the Amendments would improve financial reporting and would reach an acceptable cost-benefit trade-off. EFRAG has not identified that the Amendments could have any adverse effect on the European economy, including financial stability and economic growth. Accordingly, EFRAG assesses that endorsing the Amendments is conducive to the European public good. EFRAG's reasoning is explained in Appendix 3 to this letter.

In EFRAG's assessment of whether the Amendments would be conducive to the European public good, EFRAG has assessed whether the Amendments would improve financial reporting, would reach an acceptable cost-benefit trade-off, and whether the Amendments could affect economic growth.

Our advice to the European Commission

As explained above, we have concluded that the Amendments meet the qualitative characteristics of relevance, reliability, comparability and understandability required to support economic decisions and the assessment of stewardship, raise no issues regarding prudent accounting; and that they are not contrary to the true and fair view principle. We have also concluded that the Amendments are conducive to the European public good. Therefore, we recommend the Amendments for endorsement without further delay.

On behalf of EFRAG, I would be happy to discuss our advice with you, other officials of the European Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

Appendix 1: Understanding the changes brought about by the Amendments

Background of the Amendments

1 In September 2014, the IFRS Interpretations Committee informed the IASB about entities facing difficulties 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*.

The issue and how it has been addressed

2 On 12 February 2021, the IASB published the Amendments which aim at helping entities distinguish accounting policies from accounting estimates.

3 Before the Amendments, IAS 8 contained a definition for 'accounting policies' and a definition for 'change in accounting estimates' but no definition of 'accounting estimates'.

4 To make the distinction clearer, the Amendments replace the definition of a change in accounting estimates with a definition of accounting estimates and introduce other changes to the requirements in IAS 8.

What has changed?

5 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.

6 Accounting estimates are defined "monetary amounts in financial statements that are subject to measurement uncertainty".

7 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.

When do the Amendments become effective?

8 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.

Appendix 2: EFRAG's technical assessment on the Amendments against the endorsement criteria

Does the accounting that results from the application of the Amendments meet the technical criteria for endorsement in the European Union?

9 EFRAG has considered whether the Amendments meet the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002 (The IAS Regulation), in other words that the Amendments:

(a) are not contrary to the principle set out in Article 4 (3) of Council Directive 2013/34/EU (The Accounting Directive); and

(b) meet the criteria of understandability, relevance, reliability, and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

10 Article 4(3) of the Accounting Directive provides that:

The annual financial statements shall give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss. Where the application of this Directive would not be sufficient to give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss, such additional information as is necessary to comply with that requirement shall be given in the notes to the financial statements.

11 The IAS Regulation further clarifies that *'to adopt an international accounting standard for application in the Community, it is necessary firstly that it meets the basic requirement of the aforementioned Council Directives, that is to say that its application results in a true and fair view of the financial position and performance of an enterprise - this principle being considered in the light of the said Council Directives without implying a strict conformity with each and every provision of this Directive'* (Recital 9 of the IAS Regulation).

12 EFRAG's assessment as to whether the Amendments would not be contrary to the true and fair view principle has been performed against the European legal background summarised above.

13 In its assessment, EFRAG has considered the Amendments from the perspectives of both usefulness for decision-making and assessing the stewardship of management. EFRAG has concluded that the information resulting from the application of the Amendments is appropriate both for making decisions and assessing the stewardship of management.

14 EFRAG's assessment on whether the Amendments are not contrary to the true and fair view principle set out in Article 4(3) of Council Directive 2013/34/EU is based on the assessment of whether it meets all other technical criteria and whether they lead to prudent accounting. EFRAG's assessment also includes assessing whether the Amendments do not interact negatively with other IFRS Standards and whether all necessary disclosures are required. Detailed assessments are included in this appendix in the following paragraphs:

(a) relevance: paragraphs 15 to 21;

(b) reliability: paragraphs 22 to 27;

(c) comparability: paragraphs 28 to 32

(d) understandability: paragraphs 33 to 37;

(e) whether overall they lead to prudent accounting: paragraphs 38 to 39; and

(f) whether they would not be contrary to the true and fair view principle: paragraphs 40 to 44.

Relevance

15 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations. Information is also relevant when it assists in evaluating the stewardship of management.

16 EFRAG considered whether the Amendments would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.

17 EFRAG first observes that the distinction between accounting estimates and accounting policies affects the relevance of the information at it determines the way the changes are accounted and whether restatements are made; and the nature of the disclosures to be provided.

18 Entities sometimes find it difficult to distinguish between a change in accounting policy and a change in accounting estimate, especially when it relates to a change in a measurement method. EFRAG assesses that the Amendments will enhance the relevance of the information by clarifying that the effects of a change in an input or a measurement technique used to develop an accounting estimate are changes in accounting estimates unless if they result from the correction of prior period errors.

19 EFRAG considers that clarifying the distinction would result in the provision of information that will help users confirm or correct their current and past evaluations.

20 As regards accounting policies, EFRAG observes that the Amendments do not introduce changes to the definition or accounting requirements which have been previously assessed to result in relevant information.

21 EFRAG's overall assessment is that the Amendments would not result in the omission of relevant information and, therefore, satisfy the relevance criterion.

Reliability

22 EFRAG also considered the reliability of the information that will be provided by applying the Amendments. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent, or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

23 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.

24 EFRAG considers that introducing a definition of accounting estimates, together with the existing definition of accounting policies, will better ensure that changes are faithfully characterised and represented as either accounting policies or estimates, and therefore accounted for in accordance with their nature.

25 EFRAG notes that by its nature a change in an accounting estimate may result from new information or new developments and does not relate to prior periods and clarifying that in the definition and accompanying requirements will ensure that changes in estimates are accounted for in a way that faithfully depict that nature.

26 As regards accounting policies, EFRAG observes that the Amendments do not introduce changes to the definition or accounting requirements which have been previously assessed to result in reliable information.

27 EFRAG's overall assessment is that the Amendments results in reliable information.

Comparability

28 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

29 EFRAG has considered whether the Amendments result in transactions that are:

(a) economically similar being accounted for differently; or

(b) transactions that are economically different being accounted for as if they are similar.

30 EFRAG first observes that the Amendments affect comparability insofar as, as mentioned in the section assessing Relevance, the distinction between accounting estimates and accounting policies determines the way the changes are accounted for and the nature of the disclosures to be provided.

31 Clarifying the distinction between accounting estimates and accounting policies by providing a formal definition to the former is likely to bring more consistency in the characterisation and accounting of the changes, and therefore will increase comparability between entities and enhance users' analysis.

32 Therefore, EFRAG's overall assessment is that the Amendments satisfy the comparability criterion.

Understandability

33 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting, and the willingness to study the information with reasonable diligence.

34 Although there are a number of aspects related to the notion of 'understandability', EFRAG believes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.

35 As a result, EFRAG believes that the main additional issue it needs to consider, in assessing whether the information resulting from the application of the Amendments is understandable, is whether that information will be unduly complex.

36 In EFRAG's view, the Amendments do not introduce complexity that may impair understandability. EFRAG considers that, on the contrary, the current combination of a definition of one item (accounting policies) with a definition of only changes in the other item (changes in accounting estimates) creates complexity, possible overlaps and obscures the distinction between the two items. Therefore, the Amendments are expected to reduce complexity by having both items defined.

37 Therefore, EFRAG's overall assessment is that the Amendments satisfy the understandability criterion in all material respects.

Prudence

38 For the purpose of this endorsement advice, prudence is defined as caution in conditions of uncertainty. In some circumstances, prudence requires asymmetry in recognition such that assets or income are not overstated and liabilities or expenses are not understated.

39 The Amendments do not affect recognition and measurement. EFRAG has therefore concluded that they raise no issues in relation to prudence as defined above.

True and Fair View Principle

40 A Standard will not impede information from meeting the true and fair view principle when, on a stand-alone basis and in conjunction with other IFRS Standards, it:

(a) does not lead to unavoidable distortions or significant omissions in the representation of that entity's assets, liabilities, financial position and profit or loss; and

(b) includes all disclosures that are necessary to provide a complete and reliable depiction of an entity's assets, liabilities, financial position and profit or loss.

41 EFRAG has assessed that the Amendments do not create any negative interactions with other IFRS Standards. EFRAG notes that the definition of accounting estimates is anchored to the existing notion of 'measurement uncertainty' in IFRS Standards and the reference to '*monetary amounts in financial statements that are subject to measurement uncertainty'* is consistent with the way 'measurement uncertainty' is being defined in particular in the Appendix to the 2018 Conceptual Framework as the '*uncertainty that arises when monetary amounts in financial reports cannot be observed directly*'.

42 Accordingly, EFRAG has assessed that the Amendments do not lead to unavoidable distortions or significant omissions and therefore do not impede financial statements from providing a true and fair view.

43 EFRAG has concluded that the appropriate disclosures that are necessary to provide a complete and reliable depiction of an entity's assets, liabilities, financial position and profit or loss are required.

44 As a result, EFRAG concludes that the application of the Amendments would not lead to information that would be contrary to the true and fair view principle.

Conclusion

45 Accordingly, for the reasons set out above, EFRAG's assessment is that the Amendments meet the technical requirements for EU endorsement as set out in the IAS Regulation.

Appendix 3: Assessing whether the Amendments are conducive to the European public good

Introduction

46 EFRAG considered whether it would be conducive to the European public good to endorse the Amendments. In addition to its assessment included in Appendix 2, EFRAG has considered a number of issues in order to identify any potential negative effects for the European economy on the application of the Amendments. In doing this, EFRAG considered:

(a) Whether the Amendments improve financial reporting. This requires a comparison of the Amendments with the existing requirements and how it/they fit into IFRS Standards as a whole;

(b) The costs and benefits associated with the Amendments; and

(c) Whether the Amendments could have an adverse effect to the European economy, including financial stability and economic growth.

47 These assessments allow EFRAG to draw a conclusion as to whether the Amendments are likely to be conducive to the European public good. If the assessment concludes there is a net benefit, the Amendments will be conducive to the objectives of the IAS Regulation.

EFRAG's evaluation of whether the Amendments are likely to improve the quality of financial reporting

48 The Amendments are designed to clarify the requirements in IAS 8 to help entities distinguish changes in accounting policies from changes in accounting estimates.

49 EFRAG considers that introducing a definition of accounting estimates, together with the existing definition of accounting policies, will improve the quality of the financial reporting by better ensuring that changes are faithfully characterised and represented as either accounting policies or estimates, and therefore accounted for in accordance with their nature.

50 The Amendments will also enhance the relevance of the information by clarifying that the effects of a change in an input or a measurement technique used to develop an accounting estimate are changes in accounting estimates unless if they result from the correction of prior period errors.

51 EFRAG has therefore concluded that the Amendments are likely to improve the quality of financial reporting.

EFRAG's initial- analysis of the costs and benefits of the Amendments

52 EFRAG first considered the extent of the work. For some Standards or Interpretations, it might be necessary to carry out some extensive work, in order to understand fully the cost and benefit implications of the Standard or Interpretation being assessed. However, in the case of the Amendments, EFRAG's view is that the cost and benefit implications can be assessed by carrying out a more modest amount of work.

53 Therefore, as explained more fully in the main sections of this appendix, the approach that EFRAG has adopted has been to carry out detailed initial assessments of the likely costs and benefits of implementing the Amendments in the EU, to consult on the results of those initial assessments, and to finalise those assessments in light of the comments received.

Cost for preparers

54 EFRAG has carried out an assessment of the cost implications for preparers resulting from the Amendments.

55 The Amendments are designed to clarify rather than change the requirements in IAS 8 and are applied prospectively for changes on or after January 2023; thus, avoiding the administrative burden to apply the requirements retrospectively.

56 Therefore, preparers are not expected to incur additional costs other than getting familiar with the revised requirements.

57 Overall, EFRAG's assessment is that the Amendments are likely to result in insignificant initial and ongoing costs for preparers of complying with the Amendments.

Costs for users

58 EFRAG has carried out an assessment of the cost implications for users resulting from the Amendments.

59 Users are not expected to incur implementation cost insofar as the Amendments are applied prospectively and users will not be required to update their data for past periods and re-establish comparable information about trends.

60 Overall, EFRAG's assessment is that the implementation of the Amendments will not result in increased costs to users; that is, it is likely to be cost neutral.

Benefits for preparers and users

61 EFRAG has carried out an assessment of the benefits for users and preparers resulting from the Amendments.

62 Overall, EFRAG's assessment is that:

(a) Preparers are likely to benefit from the added guidance helping them to better distinguish accounting policies from accounting estimates and determine the appropriate accounting.

(b) Users are likely to benefit from greater comparability in accounting for such changes; thus, reducing inconsistencies and enhancing their analysis.

Conclusion on the costs and benefits of the Amendments

63 EFRAG's overall assessment is that the overall benefits of enhanced consistency of application and increased comparability are likely to outweigh costs associated with complying with the Amendments.

Conclusion

64 EFRAG believes that the Amendments will generally bring improved financial reporting when compared to current 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.

65 EFRAG has not identified that the Amendments could have any adverse effect to the European economy, including financial stability and economic growth.

66 Furthermore, EFRAG has not identified any other factors that would mean endorsement is not conducive to the public good.

67 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.