EFRAG
European Financial Reporting Advisory Group

Proposed Amendments to IAS 8 - Draft Comment Letter

Comments should be submitted by 7 December 2017 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 recommend the development of some more illustrative examples in order to further clarify the distinction between an accounting policy and an accounting estimate.

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 may not deliver sufficient clarification unless supported by additional illustrative examples.

4 EFRAG supports the proposed clarification of the definition of accounting policies.

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 However, EFRAG considers that the proposals may not deliver sufficient clarification unless supported by additional guidance. We recommend that, in addition to changing the definitions, more guidance and examples are added to IAS 8 in order to address the diversity that has been identified in this area effectively. We expand on this in paragraph 10 below.

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 EFRAG recognises that, in distinguishing between a change in accounting policy or a change in accounting estimate in particular circumstances, certain 'grey areas' may remain and that professional judgement will continue to be required. However, in EFRAG's opinion, the distinction between an accounting policy and an accounting estimate can nonetheless be improved by eliminating what is perceived to be an overlap between the existing definitions and by adding supporting guidance and illustrative examples. Illustrative examples would also help to ensure that the

proposed amendments are not perceived as narrowing the definition of 'accounting policies' to a greater extent than intended.

12 EFRAG also notes that some of the examples currently provided in IAS 8 paragraph 32 may not be fully up-to-date in view of changes in other IFRS Standards. EFRAG recommends that for instance "bad debts" be updated with the terminology used in IFRS 9 *Financial Instruments*.

Classification when selecting an estimation technique or valuation technique

Notes to constituents

13 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.

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

15 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

16 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.

17 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, supports the IASB's proposal. However, EFRAG regrets that the proposed changes to the principles in IAS 8 are not considered sufficient to address the issue without recourse to a specific rule.

18 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 may be a need for specific guidance in this case to resolve diversity in practice in applying a Standard that has not been substantively revised for many years.

19 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.

20 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.

21 EFRAG regrets that an issue that was raised repeatedly during the discussions is not considered to be addressed by clarifying the principle-based definitions in IAS 8 and requires the addition of a specific rule. EFRAG does however acknowledge that some 'grey areas' may persist despite the proposed clarifications to the relevant definitions and accepts the case for addressing this particular grey area in an unambiguous manner.

22 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

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

24 EFRAG recommends that the proposed changes are delayed and then grouped with the second forthcoming amendments to IAS 8 (*Accounting policy changes*). This will prevent two amendments to IAS 8 in a very short period of time.

25 EFRAG proposes that IAS 8 should reflect that when an accounting estimate is changed it can, in some cases, be the result of correcting an error and should be treated as such. Although estimates are based on judgement, there are cases where, for example, a material calculation error has been made and the change in accounting estimate is the correction of an error. IAS 8 should contain guidance to assist entities in making this distinction.