Accounting policy or estimate?

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Global IFRS Institute

Highlights

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What's the issue?

Distinguishing between accounting policies and accounting estimates is important because changes in accounting policies are generally applied retrospectively, while changes in accounting estimates are applied prospectively. The approach taken can therefore affect both the reported results and trends between periods.

The International Accounting Standards Board (the Board) has noted diversity in practice in making this distinction because the term accounting estimates was not defined and the previous definition of a change in accounting estimate was unclear.

The Board has now issued amendments to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to clarify how companies should distinguish changes in accounting policies

from changes in accounting estimates, with a primary focus on the definition of and clarifications on accounting estimates.

> The focus of the amendments is solely on the clarifications regarding accounting estimates rather than accounting policies. The addition of a definition of accounting estimates plugs a gap and along with further clarifications could help reduce the diversity in practice.
>
> Gabriela Kegalj
> KPMG global IFRS presentation leader

A focus on accounting estimates

The amendments introduce a new definition for accounting estimates: clarifying that they are monetary amounts in the financial statements that are subject to measurement uncertainty[1].

The amendments also clarify the relationship between accounting policies and accounting estimates by specifying that a company develops an accounting estimate to achieve the objective set out by an accounting policy.

Developing an accounting estimate includes both:

- selecting a measurement technique (estimation or valuation technique) – e.g. an estimation technique used to measure a loss allowance for expected credit losses when applying IFRS 9 *Financial Instruments*; and
- choosing the inputs to be used when applying the chosen measurement technique – e.g. the expected cash outflows for determining a provision for warranty obligations when applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

The effects of changes in such inputs or measurement techniques are changes in accounting estimates.

The definition of accounting policies remains unchanged.

The amendments also provide two examples as illustrated below on the application of the new definition.

	Fair value of an investment property	Fair value of a cash-settled share-based payment liability
"Monetary amount subject to measurement uncertainty[1]?"	✓	✓
"Output of a measurement technique used in applying the accounting policy?"	✓	✓
"Requires use of judgements and assumptions?"	✓	✓
	Accounting estimate	
Examples of changes in accounting estimates	Change in *valuation technique* from income approach to market approach	Change in *input* – i.e. expected volatility of share price
Change in accounting policy?	✗ Measure investment property at fair value	✗ Measure liability at fair value

Effective date and transition

The amendments are effective for periods beginning on or after 1 January 2023, with earlier application permitted, and will apply prospectively to changes in accounting estimates and changes in accounting policies occurring on or after the beginning of the first annual reporting period in which the company applies the amendments.

To find out more about the amendments, speak to your KPMG contact.

[1] Measurement uncertainty is defined in the Appendix to the *2018 Conceptual Framework* as the 'uncertainty that arises when monetary amounts in financial reports cannot be observed directly and must instead be estimated'.

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