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15 January 2018

Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London
United Kingdom
EC4M 6XH

Dear Mr Hoogervorst

Exposure draft 2017/5 – Accounting Policies and Accounting Estimates (Proposed amendments to IAS 8)

Deloitte Touche Tohmatsu Limited is pleased to respond to the International Accounting Standards Board's ('the Board's') exposure draft *Accounting Policies and Accounting Estimates (Proposed amendments to IAS 8)* ('the exposure draft').

The financial reporting requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* treat changes in accounting policies and errors differently from changes in estimates. Changes in an accounting policy and corrections of errors are applied retrospectively whereas changes in an estimates are accounted for prospectively and a third balance sheet is required to be presented for a change in an accounting policy. Additionally, the conditions for making an accounting policy change are more constrained than for changing an estimate. As long as these accounting differences remain in effect it will be important to provide clear guidance to help preparers distinguish, and users understand the difference, between a change in an accounting policy and a change in an estimate.

We agree with the Board that there is insufficient guidance in IAS 8 for those that apply IFRS to distinguish between changes in accounting policies and changes in accounting estimates

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consistently. We are regularly required to consider this distinction and many of our clients find it difficult to identify a clear principle in IAS 8. We support the goals of promoting greater consistency and improving the accounting and the information available to the primary users of the financial statements.

However, our assessment is that the proposed changes will not provide the clarity that stakeholders need to distinguish between a change in estimate and a change in accounting policy to the extent expected. In particular, we are concerned that the proposed amendment in relation to changes in an inventory cost formula suggests that some changes to how a measurement basis is calculated are changes in accounting policies without providing sufficient clarity to help users assess the principles applied in making this decision. Too much reliance is placed on one example to help resolve a broader, and clearly challenging, issue. We comment in the appendix on other areas where we believe better clarity is needed for these amendments to achieve the objective the Board set out to achieve.

Furthermore, we note that the Board plans to publish additional proposals to amend IAS 8 in relation to changes in accounting that result from agenda decisions issued by the IFRS Interpretations Committee. Rather than develop piece-meal amendments we think the Board should step back and look at the issue more comprehensively. Accordingly, on cost-benefit grounds we do not support the Board proceeding with the amendments in their current form.

We expand on these matters in the Appendix, which provides our more detailed responses to the questions in the invitation to comment.

If you have any questions concerning our comments, please do not hesitate to contact me in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader

Deloitte.

Appendix – detailed responses

Questions 1-4

The Board proposes clarifying the definition of accounting policies by removing the terms 'conventions' and 'rules' and replacing the term 'bases' with the term '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?

The Board proposes:

(a) clarifying how accounting policies and accounting estimates relate to each other, by explaining that accounting estimates are used in applying accounting policies; and

(b) adding a definition of accounting estimates and removing 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?

The Board proposes clarifying 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 for Conclusions).

The Board proposes clarifying that, in applying IAS 2 Inventories, selecting the first-in, first-out (FIFO) cost formula or the weighted average cost formula for interchangeable inventories constitutes 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?

Our response

The proposed amendment to the definition of an accounting policy needs to be considered in conjunction with the proposed revised definition of an accounting estimate, and the current definition of an error. Together, the three categories should cover all of the circumstances when an entity changes its accounting for a particular matter. The proposed new definitions are:

> ***Accounting policies* are the specific principles, measurement bases, and practices applied by an entity in preparing and presenting financial statements.**
>
> ***Accounting estimates* are judgements or assumptions used in applying an accounting policy when, because of estimation uncertainty, an item in financial statements cannot be measured with precision.**

Measurement Basis

The revised definition of an accounting policy would make it clear that a change in a measurement basis is a change in accounting policy. The proposed Conceptual Framework defines a measurement basis as "an identified feature of an item being measured (for example, historical cost, fair value or fulfilment value)." (ED CF 6.2) Accordingly, changing from a cost basis to fair value, for example, would be a change in accounting policy. Although this is not a change from the current requirements in IAS 8, we support the proposal to use terminology that is consistent with the forthcoming revised Conceptual Framework.

Changes within a measurement basis

What remains less clear is when a change in *how* a particular measurement basis is applied is a change in accounting policy and when it is a change in estimate. The proposed amendment in relation to an inventory cost formula suggests that the Board considers some changes within a measurement basis to be a change in accounting policy.

To make that assessment, the proposed amendments rely on distinguishing between a principle or practice (accounting policy) and a judgement or estimate (accounting estimate).

The only reference in IAS 8 to "practice" relates to industry practices, in the IAS 8 hierarchy. However, there is no discussion that provides guidance on how to distinguish, in particular, between a change in practice and a change in judgement. We believe better articulation is needed for users to be able to apply this principle consistently.

Selecting an estimation or valuation technique

The proposed new paragraph 32A states:

> When an item cannot be measured with precision, selecting an estimation technique or valuation technique to measure that item involves the use of judgement or assumptions in applying the accounting policy for that item. For this reason, selecting that estimation technique or valuation technique constitutes making an accounting estimate.

The proposed amendments also provide an example of how the Board thinks the principles should be applied by characterising a change in cost formula in IAS 2 as a change in accounting policy.

When the Board was developing this proposal it considered seven examples from five Standards—IAS 2, IAS 16, IAS 19, IAS 39 and IFRS 13 (see Agenda Paper 11A, discussed at the May 2015 IASB meeting). In those examples three different measurement bases were identified: present value, fair value, and cost-based measures (such as depreciated cost and amortised cost). In all of the other cases the paper concluded that when the measurement basis does not change (cost, PV or fair value) any change in how that base is measured is a change in estimate. This includes a change in depreciation method which IAS 16 states is a change in estimate.

In the Basis for Conclusions to the proposed amendments the Board states that "the accounting policy is the overall objective and the accounting estimates are inputs used in achieving that objective." (BC9) IAS 2 describes FIFO and Weighted Average as Cost Formulas, which can easily be thought of as inputs used in achieving the objective of measuring cost—ie a method for measuring the cost of inventory on hand. The Board reached a different conclusion, stating that "selecting one of these two cost formulas is not an attempt to estimate the actual flow of those inventories. Consequently, this selection does not constitute making an accounting estimate." (BC19)

In our own discussions, we identified differences between the inventory and property, plant and equipment cases that might justify characterising the change in the inventory cost formula as a change in policy and a change in depreciation method as a change in estimate. However, the explanation the Board has given in BC19 does not provide sufficient guidance for understanding why a change in depreciation is treated differently. We cannot assess whether the factors we identified are the same as those identified by the Board.

Whatever the merits of characterising a change in inventory cost formula as a change in accounting policy, it is the broader implications of how that characterisation affects the assessment of other changes in accounting, for which specific guidance is not provided, that are more important. The proposed treatment for changes in the inventory cost formula does not demonstrate the application of a clear principle.

Changes in technique - fair value

We looked back to IFRS 13 *Fair Value Measurement* to review why the Board decided that revisions "resulting from a change in the valuation technique or its application shall be accounted for as a change in accounting estimate in accordance with IAS 8." (IFRS 13.66)

Our first observation is that IFRS 13 does not state that a change in valuation technique is a change in accounting estimate, only that such a change be accounted for as such. When the Standard was being developed, the Board proposed requiring an entity "to disclose the effect of a change in valuation technique on a fair value measurement (similar to the disclosures required by IAS 8 for a change in valuation technique)." Although IAS 8 does not use the term valuation technique, the implication is that the Board thought a change in valuation technique was different from a change in inputs.

IFRS 13.BC147 states that respondents "thought it would be difficult to determine whether a change in fair value was attributable to a change in the valuation technique used or attributable to changes in other factors (such as changes in the observability of the inputs used in the measurement)." The Board agreed and decided that "revisions resulting from a change in the valuation technique or its application should be accounted for as a change in accounting estimate in accordance with IAS 8."

The discussion in the Basis for Conclusions to IFRS 13 can be read as suggesting that if it had been easier to distinguish between a change in technique and a change in inputs, the Board would have characterised the change in technique as a change in accounting policy. As it stands, the specific guidance in IFRS 13 means that changing from Black-Scholes to a Binomial Model or a Monte Carlo Simulation for measuring options, for example, is accounted for as a change in estimate. However, the IFRS 13 conclusion and the characterisation by the Board of a change in inventory formula as a change in accounting policy make it difficult to assess how some other changes should be accounted for. The proposed guidance does not provide clarification in respect of changes in valuation technique. Similarly, it does not provide clarity of how to apply the guidance to other difficult areas. For example, it remains unclear how a change in the approach to measuring the "best estimate of the expenditure required to settle

the present obligation" (IAS 37) should be characterised and whether the Board views a change from the most likely outcome to a probability weighted outcome differently to a change in the methodology used to measure the estimate. Similar uncertainty remains about how changes in how the deficit or surplus of a defined benefit plan (IAS 19) is measured should be characterised.

There are also many examples of initial cost measurement for which an entity will need to exercise judgement. The initial cost of self-constructed property, plant and equipment can include decisions about which costs are "directly attributable costs", and what threshold determines when an asset is capable of operating in the manner intended by management. Does the Board consider that changes to those cost inputs are changes in practice or changes in estimates (or assumptions)? Similarly, an entity might determine that it has a more reliable means of assessing when an asset is operating as intended. If that is a better indicator, is that a change in technique for determining when cost-capitalisation stops or a change in policy?

Summary

IAS 8 should set out clearly the principles for distinguishing between an accounting policy and an accounting estimate. The specific examples in individual Standards should be consistent with those principles or, if appropriate, when they depart from those principles that decision should be deliberate and clearly explained.

Without clear principles it is unlikely that the proposed amendments as a whole will provide guidance that will lead to the consistent accounting for other, similar, changes and the proposed amendment in relation to inventory would likely be perceived as a rule. There is too much reliance on one example to help resolve a broader, and clearly challenging, issue.

We think it would be helpful for the Board to consider what accounting the proposed revised IAS 8 would require for the additional examples we have mentioned—IAS 37, IAS 19 and initial cost determination.

It would also be helpful if IAS 8 had criteria that the Board could use to assess when prospective or retrospective accounting provides better information for a particular change, and why. Factors such as the risk of hindsight bias in implementing a change, or enhanced comparability in future periods could help determine whether the change should be characterised as a change in policy or a change in estimate.

Question 5

Do you have any other comments on the proposals?

Topic-specific guidance

As a principle, we think that any guidance on how to account for a particular change in how a Standard is applied should be in that Standard. In developing the specific financial reporting requirements the Board should have in mind which aspects of the requirements they consider require the use of estimates and which relate to the selection and application of an accounting

policy. We support the way the Board has provided clarity around how to account for changes when applying IAS 38, IAS 16, IFRS 13, and IFRS 9, within those Standards.

The fair value example demonstrates that this has been a difficult area for some time. In the case of IFRS 13 we think the Board reached the appropriate conclusion that changes in technique or inputs must be accounted for as changes in accounting estimate. This approach is consistent with IAS 8.35 which states that when "it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate." That the Board made this decision as part of the development of IFRS 13 is instructive. We think that the analysis of how to account for changes in accounting requirements is more likely to lead to better accounting outcomes when it is undertaken as part of the development of the Standard in which the requirement is contained.

We encourage the Board to add guidance to other Standards to clarify how particular changes should be accounted for, if there is evidence of diversity in practice. For example, we would support adding guidance to IAS 19 *Employee Benefits* in relation to changes to the basket of high quality corporate bonds used to determine the discount rate for a defined benefit obligation.

If the Board does wish to clarify how to account for changes in the cost formula for inventory, it should do so by amending IAS 2. Having said that, we rarely observe entities changing their cost formula and, accordingly, are not aware of any diversity in practice that would justify amending IAS 2.

Practical expedients

The Board has included several practical expedients in recent Standards, some of which do not require the entity to assess whether adopting the expedient will have a material effect on the financial statements. Entities are able to elect to apply those expedients, or stop using them. It is clear that the current version of IAS 8 requires that any such change be accounted for as a change in accounting policy, with retrospective application. That assessment would not be affected by the proposed amendments to IAS 8.

When an expedient does not have to be justified on grounds of materiality, entities applying them are unlikely to be capturing the information necessary to account for the change retrospectively if they decide to no longer use the expedient. This would seem to create an onerous requirement when the nature of the expedients is to provide relief to an entity. Similarly, if an entity elects to change its policy to apply an expedient, it is not clear that adjusting the financial statements to apply the expedient retrospectively provides the users of the financial statements with helpful information.

The practical expedients are an example of the type of issue that we would like the Board to consider as part of a broader review of IAS 8, particularly if the Board plans to use expedients more frequently. We think there is merit in considering whether such changes should be accounted for prospectively, for cost-benefit reasons. That might depend on the nature of the

expedient, which is why we would expect to see consideration of a particular expedient take place within the context of the Standard in which it sits.

Reliable and more relevant information

IAS 8 has a requirement that a change in accounting policy can only be made if it results in the financial statements providing reliable and more relevant information than the policy that it replaced.

We would support an equivalent constraint being developed for changes in the technique or inputs used to make an accounting estimate, such as a requirement that a change in the method of estimating the information should be cost-beneficial to the primary users. This would allow for changes in estimation techniques if the entity can demonstrate that there are net benefits to investors from making the change. One such case would be when an entity is able to show that changing to a less costly technique, or inputs, produces estimates that are not materially different from the estimates using their current, and more expensive, technique or inputs.