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Mr Hans Hoogervorst
International Accounting Standards Board
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Our ref RD/288

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Dear Mr Hoogervorst

Comment Letter on Exposure Draft ED/2017/5 *Accounting Policies and Accounting Estimates (Proposed amendments to IAS 8)*

We appreciate the opportunity to comment on the International Accounting Standards Board's (the Board) Exposure Draft *Accounting Policies and Accounting Estimates - Proposed amendments to IAS 8* (ED). We have consulted with, and this letter represents the views of, the KPMG network.

We support the Board's objective of helping companies to distinguish accounting policies from accounting estimates, in order to reduce diversity in practice. We believe that the proposed definition of accounting estimates provides more clarity compared to the current standard and is a step in the right direction.

However, we are concerned that the proposed amendments do not go far enough with respect to the definition of accounting policies. While the amendments focus primarily on the definition of accounting estimates (which is the default anyway under paragraph 35 of IAS 8), the proposed definition of accounting policies continues to use terms that contribute to existing diversity because they are ambiguous and open to differing interpretation. As such, the proposed amendments may not be effective in enabling preparers to consistently distinguish between accounting policies and accounting estimates.

The Appendix to this letter contains our detailed responses to the questions on the proposals.



Please contact Reinhard Dotzlaw or David Littleford at +44 (0)20 7694 8871 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

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Appendix

This appendix contains our detailed responses to the proposals.

Question 1
<p>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).</p> <p>Do you agree with this proposed amendment? Why or why not? If not, what do you propose and why?</p>

Overall, we do not believe that the proposed amendments make the definition of accounting policies clearer, because they are themselves defined using terms – notably, “principles, practices and measurement bases” – that are ambiguous and open to differing interpretations; in particular, the term “practices” may be open to a wide interpretation.

We agree that replacing “bases” with “measurement bases” ties in with paragraph 35 of IAS 8 and that the term is generally better understood than simply “bases”. While currently there is no clear definition in IFRS of what constitutes a “measurement basis”¹ and individual IFRSs do not necessarily identify the measurement basis that they prescribe (e.g. IAS 19, IAS 37), the future revised Conceptual Framework for Financial Reporting may provide more clarity on its meaning.

However, even if the revised Conceptual Framework is to provide more clarity around the meaning of “measurement bases”, the other terms that are part of the definition of accounting policies – i.e. “principles” and “practices” – are not clearly defined and may be confused with “estimation / valuation technique” that is used to measure an item in the financial statements (see proposed paragraph 32A).

We are concerned that in the absence of clarity on the meaning of those terms, it may be difficult to consistently distinguish between an accounting policy and an accounting estimate. As such, the proposals may not reduce the possible divergence in practice.

For example, it may not be clear whether the following constitutes an accounting policy (because it is a principle, a measurement basis or a practice), or rather an accounting estimate (because it is an estimation / a valuation technique):

¹ Although it is sporadically used in several IFRSs and described in the Conceptual Framework.

- an approach used to determine the discount rate under the projected unit credit method (e.g. using a single / split discount rate method);
- selecting a cost formula for measuring interchangeable inventories (notwithstanding the proposed paragraph 32B);
- selecting the method of depreciation of an item of PP&E (notwithstanding paragraph 61 of IAS 16).

In light of the above, we believe that accounting policies should be more robustly defined. This is true especially as the definition of an accounting estimate also relies on what an accounting policy is - i.e. the definitions are inter-related.

A clearer distinction can be achieved, for example, by defining the terms used in the proposal and further explaining and illustrating the relationship between them, possibly through a set of examples in the Guidance on implementing IAS 8. We encourage the Board to consider the developments under the Conceptual Framework project, and potentially other standard-setters' definitions (for example, FRS 18² under UK GAAP), as a possible starting point.

Question 2

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?

While we agree with the proposed definition of an accounting estimate and consider it an improvement as compared to the current standard, we have the following comments.

- The proposal defines an accounting estimate as the inputs (assumptions and judgements), rather than as the monetary outcome. We recommend that the Board consider whether this is consistent with other IFRSs (some standards, such as

² FRS 18 *Accounting Policies*.

IAS 37, may imply that the estimate is the monetary outcome rather than the inputs used to arrive at the outcome).

We also note that the recently exposed ISA 540³ proposes to define accounting estimates as the monetary outcome. We believe it would be useful if the IASB and the IAASB took a consistent approach in defining key terms in both projects to avoid a potential confusion between preparers' and auditors' perspective.

- IFRS 13 contains a threshold to changing a valuation technique used to estimate fair value. It also contains a requirement to disclose a description of the valuation technique used, any change thereto and the reason for that change.⁴

No similar explicit requirements exist in IAS 8 for changes in accounting estimates, although entities may disclose the chosen estimation or valuation technique and any changes thereto under the existing requirements of paragraph 39 of IAS 8.

As such, we would encourage the Board to consider whether there are sufficiently cohesive disclosure requirements in IAS 8 concerning the chosen estimation or valuation technique, regardless of whether they involve fair value measurements. We believe that such disclosure would provide users with relevant information that would enable them to better assess the quality of earnings.

- The change in the definition of an accounting estimate may require conforming amendments to paragraphs 125-133 of IAS 1, dealing with the sources of estimation uncertainty.

For example, the disclosure requirement in paragraph 125 currently refers only to *assumptions* (and other sources of estimation uncertainty), although the proposed definition suggests that *judgements* and assumptions are equally important.

Furthermore, paragraph 125 currently refers to changes in estimates that may result in adjustments to the carrying amounts of assets and liabilities. It does not cover other changes in estimates that do not result in such adjustments (e.g. share-based payments expense in the statement of comprehensive income and related disclosure, or other estimates disclosed in the notes). Similarly, the current definition of changes in accounting estimates in IAS 8 also seems to ignore changes that do not result in adjustments to items that are not assets or liabilities. However, considering that the proposed definition of an accounting estimate does not limit accounting estimates only to those that affect assets and liabilities, we question whether similar amendments should be made to the requirement in paragraph 125.

³ Proposed International Standard on Auditing 540 (Revised) *Auditing Accounting Estimates and Related Disclosures*.

⁴ See paragraphs 65 and 93(d) of IFRS 13.

Question 3

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).

Do you agree with this proposed amendment? Why or why not? If not, what do you propose and why?

We agree that selecting an estimation or valuation technique constitutes making an accounting estimate.

However, as noted in our response to question 1 above, we are concerned that estimation / valuation techniques are not well distinguished from the terms used in the definition of an accounting policy (i.e. principles, measurement bases, and practices). This may result in confusion and potential divergence in practice.

Question 4

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?

Although we agree that selecting a cost formula for interchangeable inventories constitutes an accounting policy, we note that the proposed paragraph 32B does not actually explain why selecting a cost formula meets the definition of an accounting policy; instead, the reasoning provided focuses on why it does not meet the definition of an accounting estimate. We believe that it would be more appropriate to provide a rationale that reconciles with the definition of an accounting policy. This exercise may help the Board to further clarify the definition of an accounting policy (as we suggest in response to question 1).

Question 5

Do you have any other comments on the proposals?
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While we agree that the amendments should apply prospectively (as suggested by paragraph BC22 in the ED), we are concerned that the current drafting of the transition requirements may not be sufficiently clear. We suggest to redraft the requirements in the following manner:

“An entity shall apply the amendments:

- (a) For annual periods beginning on or after [*insert date*]. Early application is permitted; and
- (b) Prospectively to changes in accounting policies or changes in accounting estimates occurring after the beginning of the annual period in which the entity first applies the amendments.”

Finally, we suggest replacing the proposed heading “Applying changes in accounting estimates” with “Recognising changes in accounting estimates”.