AcSB
Accounting
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Submitted electronically via www.ifrs.org

International Accounting Standards Board
30 Cannon Street, 1st Floor
London EC4M 6XH
United Kingdom

Dear Sirs:

Re: Accounting Policies and Accounting Estimates (ED/2017/5)

This letter is the response of the Canadian Accounting Standards Board (AcSB) to the International Accounting Standards Board's (IASB) Exposure Draft, "Accounting Policies and Accounting Estimates (Proposed amendments to IAS 8)", issued in September 2017.

Our process

As part of our due process for these proposals, we consulted with our IFRS® Discussion Group and took into account the results of this discussion when developing this letter.

Our views

We commend the IASB's work to clarify the distinction between accounting policies and accounting estimates to reduce the debates that preparers, auditors and regulators have in this area.

While we agree with some parts of the proposals, we are concerned with the way the relationship between accounting estimates and accounting policies is described. We recommend that the IASB focus on defining what accounting estimates are as opposed to how they are used in applying accounting policies, and explore defining accounting estimates independently from accounting policies to reduce unintended circularity.

To improve application in practice, we strongly encourage the IASB to develop illustrative examples to assist stakeholders in distinguishing between the two concepts. The illustrative examples should cover a spectrum of complex situations in which there is a change in an accounting policy, a change in an accounting estimate, and a change in both. Such examples would help stakeholders in determining the appropriate accounting treatment and reduce potential diversity in practice going forward.

Our responses to your questions

The Appendix to this letter responds to the questions posed in the Exposure Draft and expands on the points raised above.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me or, alternatively, Rebecca Villmann, Director, Accounting Standards (+1 416 204-3464 or email rvillmann@acsbcanada.ca) or Davina Tam, Principal, Accounting Standards (+1 416 204-3514 or email dtam@acsbcanada.ca).

Yours truly,

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About the Canadian Accounting Standards Board

We are an independent body with the legal authority to establish accounting standards for use by all Canadian publicly accountable enterprises, private enterprises, not-for-profit organizations and pension plans in the private sector. We are comprised of a full-time Chair and volunteer members from a variety of backgrounds, including financial statement users, preparers, auditors and academics; a full-time staff complement supports our work.

Our standards

We have adopted IFRS® Standards as issued by the IASB for publicly accountable enterprises. Canadian securities legislation permits the use of U.S. GAAP in place of IFRS Standards in certain circumstances. We support a shared goal among global standard setters of high-quality accounting standards that result in comparable financial reporting outcomes regardless of the GAAP framework applied.

We developed separate sets of accounting standards for private enterprises, not-for-profit organizations and pension plans. Pension plans are required to use the applicable set of standards. Private enterprises and not-for-profit organizations can elect to apply either the set of standards developed for them, or IFRS Standards as applied by publicly accountable enterprises.

Our role vis-à-vis IFRS Standards

Our responsibility to establish Canadian GAAP necessitates an endorsement process for IFRS Standards. We evaluate and rely on the integrity of the IASB's due process as a whole, and monitor its application in practice. In addition, we perform our own due process activities for each new or amended IFRS Standard to ensure that the standard is appropriate for application in Canada. We reach out to Canadians on the IASB's proposals to understand and consider their views before deciding whether to endorse a final IFRS Standard. A final standard is available for use in Canada only after we have endorsed it as Canadian GAAP.

APPENDIX

Question 1
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?

1. We agree with removing the terms "conventions" and "rules", and retaining the term "practices" for the reasons provided in paragraphs BC5–BC7 of the Basis for Conclusions. However, we think that the term "measurement bases" should be removed such that the definition of accounting policies only refers to principles and practices. For a financial statement item, the principles specified by an IFRS Standard, or the practice applied in the absence of a specific IFRS Standard, include the measurement basis for that item along with the requirements for recognition, presentation and disclosures. Specifying measurement bases in the definition of accounting policies could increase the risk of the definition being narrowly interpreted.

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?

2. For question 2(a), we are concerned with the way the relationship between accounting estimates and accounting policies is described because of the focus on one aspect of an accounting estimate (i.e., an accounting estimate is used in applying an accounting policy when a financial statement item cannot be measured with precision). This focus is further reinforced in paragraph BC9 of the Basis for Conclusions, which states "the accounting policy is the overall objective and the accounting estimates are **inputs** used in achieving that objective." (emphasis added)

3. We think that accounting estimates are broader than what is defined in the Exposure Draft. In our view, accounting estimates are judgments and assumptions that management makes based on information derived from current period circumstances to address existence and measurement uncertainty in a financial statement item. As contemplated in the Conceptual Framework project:

- existence uncertainty is whether an asset or liability exists, possibility due to the probability of inflow or outflow of economic benefits; and
- measurement uncertainty is when a measure for an asset or liability cannot be observed directly and must be estimated instead.[1]

Then, following from the guidance in paragraph 34 of IAS 8, a change in an accounting estimate is when there is a change in the circumstances on which the accounting estimate was based or as a result of new information or more experience.

4. The proposed definition focuses only on when an item cannot be measured with precision and does not contemplate that management also applies judgments or assumptions to determine if an asset or liability exists for recognition purposes. For example, to recognize an intangible asset, management makes an assessment of whether it is probable that the expected future economic benefits attributable to the asset will flow to the entity in order to satisfy part of the recognition criteria.

5. In addition, the proposed definition also implies that an accounting estimate is used to achieve an end goal, meaning that it cannot be the end goal itself or the end result. This one-sided relationship creates confusion because in some circumstances, management develops an accounting estimate that is reflected in the financial statements. That said, we agree that an accounting estimate can also be used in applying an accounting policy as contemplated in the Exposure Draft. To illustrate what we mean, below are two examples for consideration.

   a) **An accounting estimate is used in applying an accounting policy** – An entity's accounting policy is to carry property, plant and equipment at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis. Management makes a judgment or assumption about the useful life of the depreciable asset based on the expected consumption of the asset. In this situation, the useful life (i.e., an accounting estimate) is used in applying the accounting policy because it is an input for calculating depreciation expense.

   b) **An accounting estimate is a result of applying an accounting policy** – An entity has an accounting policy for share-based payments. For cash-settled share-based payment plans, the compensation expense is determined based on the fair value of the liability incurred at each reporting date until the award is settled. The fair value of the liability is measured using the Black-Scholes model. In this situation, the model produces a fair value estimate of the liability that is reflected in the financial statements.

[1] We think that the term "estimation uncertainty" is meant to be the same as "measurement uncertainty" and, therefore, suggest using consistent terminology between the forthcoming Conceptual Framework and individual IFRS Standards.

6. We think that these two examples illustrate why it is difficult to solely explain that accounting estimates are used in applying an accounting policy. Instead of trying to describe how accounting policies and accounting estimates relate to each other, we recommend the IASB explore whether these two terms can be clarified independently of each other in order to distinguish between the two concepts. In particular, we suggest not using accounting policy in the definition of an accounting estimate to reduce unintended circularity.

7. To help stakeholders understand how to account for a change in an accounting policy, a change in an accounting estimate, or a change in both, we strongly encourage the IASB to provide illustrative examples. A change in both could be when a change in an accounting policy leads to a change in an accounting estimate. The illustrative examples should address complex situations in which debates have occurred in practice. For example, at its December 2015 meeting, our IFRS Discussion Group discussed whether changing from a single weighted average or traditional discount rate approach to an alternative accepted approach for measuring a defined benefit obligation is a change in accounting policy or a change in accounting estimate.

8. Furthermore, we encourage the IASB to provide more clarity in the Basis for Conclusions to help stakeholders apply the definition of accounting estimates. For example, paragraph BC13 of the Basis for Conclusions appears to repeat the accounting estimates definition as opposed to explaining why the definition also applies when an entity develops an accounting policy.

9. For question 2(b), we agree that the IASB should remove the definition of a change in accounting estimate to achieve consistency in defining what is an accounting policy, and what is an accounting estimate in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The title of the standard should also be updated to align with this change (i.e., IAS 8 *Accounting Policies, Accounting Estimates and Errors*).

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?

10. We agree that selecting an estimation technique or valuation technique constitutes making an accounting estimate because this is consistent with the requirements in paragraphs 65 and 66 of IFRS 13 *Fair Value Measurement*.

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?

11. We are concerned that this proposed amendment weakens the distinction between an accounting policy and an accounting estimate. As per this Exposure Draft, accounting policies are specific principles and practices (which include measurement bases) applied by an entity in preparing and presenting financial statements. Measurement bases, as defined in the forthcoming Conceptual Framework, are historical cost and current value. The requirements relating to interchangeable inventories in IAS 2 address selecting a cost formula. The measurement basis of historical cost does not change as a result of management selecting either FIFO or the weighted average cost formula. In fact, paragraph 27 of IAS 2 indicates that the FIFO formula assumes a pattern of sale and the weighted average formula assumes a pattern of purchase or production. Both assumptions are aimed at addressing the unobservable movement or flow of interchangeable inventory, which is a measurement uncertainty issue. As a result, this clarification seems to contradict the definition of an accounting policy because selecting either FIFO or the weighted average cost formula involves management making judgments and assumptions to address measurement uncertainty (i.e., making an accounting estimate as per paragraph 3 of this response letter).

12. Paragraph 36(a) of IAS 2 also requires disclosing the accounting policies adopted in measuring inventories, including the cost formula used. Following the same reasoning as paragraph 12 of this response letter, we suggest changing this disclosure requirement so that the selection of a cost formula is distinguished from the accounting policy to measure inventories at lower of cost and net realizable value.

Question 5
Do you have any other comments on the proposals?

13. We note that paragraph 122 of IAS 1 requires an entity to disclose judgments, apart from those involving estimations, that management has made in the process of applying the entity’s accounting policies. Depending on the use of the word “judgment” in the amended text of IAS 8, we encourage the IASB to consider the requirements in IAS 1 on disclosures of accounting policies and sources of estimation uncertainty to ensure these are still clear and aligned with the final definitions of accounting estimates and accounting policies.

14. In addition, the proposals in this project should be considered in conjunction with the forthcoming proposals on accounting policy changes. Grouping together all amendments to IAS 8 will make it easier for stakeholders to digest the changes in a succinct and efficient manner.