Huawei Industrial Base
Bantian Longgang
518129 Shenzhen
People's Republic of China

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

12 January 2018

ED/2017/5 – *Accounting Policies and Accounting Estimates (Proposed amendments to IAS 8)*

Dear Mr Hoogervorst,

We write in response to the Exposure Draft ED/2017/5 *Accounting Policies and Accounting Estimates* (the ED).

About Huawei Technologies ("Huawei")

Huawei is a worldwide leader of ICT solutions. Our telecoms network equipment, smart devices, and IT products and solutions are used in over 170 countries supported by a company workforce of 180,000 employees. Our annual sales revenue in 2016 was CNY 522 billion (US$ 75.1 billion). The Group does not have listed shares, but uses IFRS Standards in its consolidated financial statements and in its subsidiaries' financial reporting, wherever permitted by local laws and regulations.

Our main comments on the International Accounting Standards Board's (the Board's) proposals are set out below and our detailed comments to the questions in the Exposure Draft are set out in Appendix A.

Main comments

- We propose an alternative approach to the issue identified. We propose that the Board removes the requirement to distinguish between a change in accounting policy and a change in accounting estimate and instead requires that all changes are applied prospectively.

- We provide details of our alternative approach in Appendix A, but in summary we propose:

1. An entity should change an accounting policy or how an accounting estimate is made only if it results in a faithful representation of information that is more relevant.
2. All such changes should be applied prospectively, from the start of the current annual reporting period.
3. An entity should explain in the financial statements what has changed in both qualitative and quantitative terms, and why the change provides more relevant information. An entity would apply normal materiality considerations, as explained in the IFRS Practice Statement 2 *Making Materiality Judgements*, in identifying which changes need to be explained.
4. The Board would continue to be able to specify retrospective application in transition requirements for a new or amended IFRS Standard when prospective application is considered inadequate.

- We agree that distinguishing between changes in accounting policy and changes in accounting estimates can be difficult, and there are differences of view on how to draw the distinction. Consequently, the existing guidance in paragraph 35 of IAS 8, to treat a change as a change in estimate when it is difficult to determine the nature of the change, is useful guidance.

- The proposals in the ED improve the current guidance but greater clarity is needed. We question whether the proposed improvements are sufficient to justify the costs involved in amending the Standard, given the guidance already included in paragraph 35.

- If the Board wishes to make changes along the lines of those proposed in the ED, we offer some specific suggestions in Appendix A to this letter to improve the amendments further.

We trust that you find these comments useful. If you wish to discuss them in more detail, please contact Jerry Cheng (chengzhongping@huawei.com) or Michael Stewart (michael.stewart@huawei.com).

We would also be happy to meet with IASB staff to provide context for our letter should you require it.

Yours sincerely,

Wanzhou Meng
Ms. Wanzhou Meng
Huawei Technologies Co. Ltd.
Chief Financial Officer

Fan Chang Chen
Mr. Fan Chang Chen
Huawei Technologies Co. Ltd.
Vice President, Accounting

Our alternative proposal

We recognise that the difficulties in distinguishing between a change in accounting policy and a change in accounting estimate are long-standing. We think that the Board should go further in addressing these concerns than the proposals in the ED. We have therefore developed an alternative proposal to address the concerns that avoids the need to make the distinction.

The premise of our proposal is that it is not necessary to distinguish between a change in accounting policy and a change in accounting estimate if both are accounted for in the same way, with the same disclosure requirements. In summary we propose:

1. An entity should change an accounting policy or how an accounting estimate is made only if it results in a faithful representation of information that is more relevant.
2. All such changes should be applied prospectively, from the start of the current annual reporting period.
3. An entity should explain in the financial statements what has changed in both qualitative and quantitative terms, and why the change provides more relevant information.
4. The Board would continue to be able to specify retrospective application in transition requirements for a new or amended IFRS Standard when prospective application is considered inadequate.

We propose in (1) above that a change is made only if it meets the same threshold as that described in paragraph 14(b) of IAS 8. That paragraph requires an entity to change an accounting policy only if it results in financial statements that provide reliable[1] and more relevant information.

A similar disclosure to that described in (3) above is required by paragraph 29 of IAS 8, although the existing requirement applies only to changes in accounting policy and so does not capture significant changes in accounting estimates. In addition, the disclosure required by paragraph 29 is written in a prescriptive, rules-based manner. We recommend that the Board drafts any new or revised disclosure requirement in the form of a disclosure objective, as discussed in its recent *Principles of Disclosure* discussion paper.

We explain the basis for our proposals as follows:

We agree that there is a need to address the difficulty of distinguishing a change in accounting policy from a change in accounting estimate. We have observed frequently differences of view between experienced IFRS professionals in discussions about whether to classify a change in how an item is recognised or measured as a change in accounting policy or a change in accounting estimate.

The distinction between a change in accounting policy and a change in accounting estimate is important at present in IFRS Standards because a change in accounting policy results in an

[1] Elsewhere in this letter we use the term 'faithful representation' instead of 'reliable' when referring to the qualitative characteristics of information included in the financial statements.

application of the change retrospectively and an adjustment of comparative information whereas a change in accounting estimate is applied prospectively from the date of the change.

Furthermore, IFRS Standards set a threshold that must be met in order to change an accounting policy but set no such threshold for a change in accounting estimate. Similarly, there is a requirement to explain a change in accounting policy but no such requirement to explain a change in accounting estimate.

We note that the retrospective application of a change in accounting policy helps users compare the current period financial information with that of the prior period. However the Board has waived the requirement for full retrospective application in some new or revised IFRS Standards (for example IFRS 13 *Fair Value Measurement*, IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases*) through transition provisions. Few entities restate comparatives voluntarily.

We also note the Board's observation in the Exposure Draft of the *Conceptual Framework for Financial Reporting* that 'a temporary reduction in comparability as a result of prospectively applying a new financial reporting standard may be worthwhile to improve relevance or faithful representation in the longer term. Appropriate disclosures may partially compensate for non-comparability'.

We argue that a change that arises from a voluntary change in accounting policy could be less significant than the change that could arise from a change in an IFRS Standard for which the Board permitted prospective application. Consequently we contend that the prospective application of a voluntary change in accounting policy, supplemented by appropriate disclosure, should be less harmful to the comparability of information than the change that arises from applying some of the more recent new or amended IFRS Standards.

There are three consequences of the current difficulty in distinguishing between a change in accounting policy and a change in accounting estimate. These are (i) the possibility for arbitrage between the two treatments, (ii) the lack of a threshold that needs to be met to justify a change in accounting estimate, and (iii) the absence of a need to disclose and explain significant changes in accounting estimates. Concerns about these consequences are especially acute when the change is a change in the model used to recognise or measure an item.

Our proposed alternative approach addresses these concerns. It imposes the same accounting consequences on the changes, removing the need to classify that change as one type or the other. It places the same threshold requirement on a change, that is, a change must result in a faithful representation of information that is more relevant. It also places the same disclosure requirements on a change; this includes the need to explain why the change improves the information in the financial statements.

Some stakeholders might be concerned that the requirement to explain the way in which an item is recognised or measured has changed will lead to an onerous and voluminous disclosure obligation. We disagree. Proper application of materiality will ensure that only the information that could reasonably be expected to influence the decisions of the primary users of the financial statements would need to be disclosed.

We suggest that our proposed approach, which combines a single approach with the use of an improvement threshold and a disclosure requirement will be appropriate for the range of changes that are permissible within the confines of IFRS Standards. In the case of changes introduced by a new or amended Standard we recognise that the change might be more significant. We suggest that in the case of changes introduced by a new or improved Standard, that the Board continues its current approach of determining transition requirements on a case-by-case basis.

We offer below our comments on the detailed questions in the ED on the Board's proposals, in case the Board is not persuaded by our alternative approach described above.

Responses to detailed questions in the ED
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?

We disagree with the Board's proposals because we think that the Board should go further in addressing the concerns raised about distinguishing between a change in accounting policy and a change in accounting estimate.

The Board proposes to retain the term 'practices' as a component of the definition of accounting policy but the proposals do not explain what is meant by a practice. We suggest that the Board explains the term 'practice' and how it differs from a 'model'. We note that IFRS 13 states that a change in a model (specifically a change in a valuation model) is a change in accounting estimate, whereas we understand that the Board's proposals would require a change in 'practice' to be treated as a change in accounting policy. The amendments will therefore be clearer if they explain how a 'practice' and a 'model' differ.

We note that the Basis for Conclusions of the ED describes an accounting policy as the 'overall objective'. We agree with this description and suggest that the Board uses this as the principle for the definition of an accounting policy. This principle could be supported by an explanation of the role of 'principles' and 'measurement bases' in the context of an accounting policy. This explanation could also include the role of 'practices', subject to the Board's conclusions on the point we raise in the preceding paragraph. In other words we think the amendment would be clearer if the Board includes in the definition of an accounting policy the statement that it is 'the overall financial reporting objective' for the applicable item in the financial statements.

Questions 2 and 3

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).

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 these proposed amendments? Why or why not? If not, what do you propose and why?

We agree with the Board's objective of explaining how accounting policies and accounting estimates relate to each other. We also agree with the Board's objective of introducing a definition of an accounting estimate in place of the definition of a change in accounting estimate.

Moreover, we agree with the description in the Basis for Conclusions that accounting estimates are inputs used in achieving the objective of the accounting policy. We therefore recommend that the Board includes in the definition of accounting estimates the notion that accounting estimates are 'inputs used to achieve the accounting policy'. This will help distinguish accounting policies from accounting estimates.

We observe that some inputs used to achieve an accounting policy will be subject to estimation uncertainty but this will not be the case for all inputs. For example the quantity of inventories held might be capable of being counted and the individual cost of those items might be known if the inventory comprises items that are not ordinarily interchangeable. We therefore observe that accounting estimates are a sub-set of the inputs used to achieve an accounting policy. We suggest that the Board acknowledges this in the amendments.

We agree with the statement that selecting an estimation technique or valuation technique involves the use of judgement or assumptions in applying the accounting policy for that item. However, the Board does not explain in the proposed amendments why judgement or assumptions are required in selecting such an estimation technique or valuation technique. We understand that judgement is required in order to assess whether the information provided by the estimation technique or valuation technique gives a faithful representation. If our understanding is consistent with the Board's reasoning, we suggest that the Board makes this explicit in the amendments.

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?

The question of whether a change between the FIFO cost formula and the weighted average cost formula is a change in accounting policy or a change in accounting estimate has long been subject to differences of view among IFRS professionals. This question is therefore a good test of the clarity of the Board's proposals. We found that views about such a change in cost formulas remain divided among IFRS professionals in our organisation in the light of the Board's proposals. This suggests to us that further improvement to the Standard is needed.

The Board has concluded that selecting one of the two cost formulas permitted by IAS 2 is the selection of an accounting policy and not the making of an accounting estimate. The Board explains that the selection does not involve the use of judgement or assumptions to determine the sequence in which the inventories are sold. We agree that the sequence, or flow, of inventories is a question of fact, however the question of which of the two cost formulas most faithfully represents the flow of a specific item of inventory would, in our opinion, require judgement.

We acknowledge that IAS 2 itself does not specify the need to select a cost formula on the basis of faithful representation. However, we note that paragraph BC19 of IAS 2 explains that the possibility to select the LIFO cost formula was removed from IAS 2 because of its lack of representational faithfulness of inventory flows. Consequently we imply from BC19 that representational faithfulness is important in selecting a cost formula. We also read the requirements in paragraph 25 of IAS 2 to imply that an entity needs to apply judgement in selecting a cost formula. Paragraph 25 of IAS 2 explains that the same cost formula is used for all inventories having a similar nature or use, but that an entity might be 'justified' for using a different cost formula for inventories with a different nature or use. We do not think that it is possible to justify different cost formulas unless judgement is made in making that justification.

Consequently we conclude that IAS 2 requires judgement to be applied in selecting the cost formula used for goods that are ordinarily interchangeable. This suggests to us that selecting one of the two cost formulas permitted by IAS 2 is the making of an accounting estimate if we follow the Board's reasoning described in the proposed amendments.

Question 5

Do you have any other comments on the proposals?

We do not have any further comments on the proposals.