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INVESTOR IN PEOPLE

International Accounting Standards Board
30 Cannon Street
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15 January 2018

Dear Board members,

Invitation to comment – Exposure Draft ED/2017/5– *Accounting Policies and Accounting Estimates - Proposed amendments to IAS 8*

Ernst & Young Global Limited, the central coordinating entity of the global EY organisation, welcomes the opportunity to offer its views on Exposure Draft ED/2017/5– *Accounting Policies and Accounting Estimates - Proposed amendments to IAS 8* (the Exposure Draft or ED) from the International Accounting Standards Board (IASB or Board).

We appreciate the objective of the Board in proposing certain amendments and additional guidance in IAS 8 *Accounting Policies and Accounting Estimates* to help entities distinguish accounting policies from accounting estimates. We believe that providing a definition of accounting estimates supports the achievement of this objective. Furthermore, we agree that in applying principles-based standards, such as IAS 8, judgement will always be required. Thus, defining accounting policies and accounting estimates cannot be done by way of bright-line rules.

However, we are not convinced that the proposed amendments will serve the intended purpose of facilitating more consistent accounting practices.

Our concerns are elaborated in following responses to the specific questions set out in the Appendix to the ED.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas at the above address or on +44 [0]20 7951 3152.

Yours faithfully

Ernst & Young Global Limited

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?

We agree with the proposal to remove the terms ‘conventions’ and ‘rules’, because they are not defined in IFRS and, therefore, are not helpful in clarifying the accounting policies.

The Board proposes to replace ‘bases’ with ‘measurement bases’ in the definition of accounting policies. The intention is to achieve consistency between the definition of accounting policies and paragraph 35. We note, however, that ‘bases’ is a wider concept than ‘measurement bases’. In particular, a ‘basis’ may refer to recognition, and by narrowing to ‘measurement basis’ it is unclear to us how recognition policies fit within the definition. Recognition policies might be principles or practices, but so may a measurement policy. Furthermore, the first sentence of paragraph 35 is rendered redundant if ‘bases’ is replaced by ‘measurement bases’ in the definition.

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?

We agree that defining accounting estimates is helpful in assisting entities in distinguishing between accounting policies and estimates. By adding a definition for estimates, it may promote a more consistent application of the requirements of IAS 8 because it clarifies the items (i.e., accounting estimates and accounting policies), rather than comparing the definition of an accounting policy to the change of an accounting estimate.

However, the amended definition retains the term ‘practices’, which is in contrast to principles and measurement bases. It is not clear what ‘practices’ refers to, in our view, as paragraph 12 refers to ‘accepted industry practices’, which may include both principles and measurement bases.

The outcome of judgements applied in estimation, for instance, a choice between an input and an output method in measuring progress when doing overtime recognition under

IFRS 15 *Revenue from Contracts with Customers*, might also be 'a practice', even though paragraph 43 of IFRS 15 declares a change in an entity's measure of progress as a change in accounting estimate.

In our view, 'a practice', in the context of accounting policies, is a policy that the entity arrived at for an area in which IFRS does not prescribe a particular policy, for instance, by allowing for a choice between two or more alternative policies. In contrast, where IFRS prescribes a particular policy, the policy applied would be in the nature of a principle.

Judgement is required in developing and applying accounting policies. However, the definition of a policy does not reflect the judgement involved, whereas the definition of accounting estimate does reflect the need to exercise judgement. We believe BC13 is helpful in clarifying the role of judgement. Therefore, we recommend that the Board considers including the guidance in that paragraph in the body of the standard.

Since a practice may be a policy and an element of an estimation, it appears to us that the definitions of policy and estimate overlap to some extent, and, as such, may not be particularly effective in distinguishing between policies and estimates.

Therefore, we suggest that the Board explores whether a better approach would be to define accounting policy as a default, i.e., if it is not an estimate and not an error, then it is a policy or, alternatively, if it is not a policy or an error, then it is an estimate. This may potentially take away some of the conceptual and practical challenges of defining accounting policies and estimates independently. As stated on in our response to Question 4 below, it appears that the Board has implicitly acknowledged this alternative approach.

The second sentence in paragraph 35 also includes some elements of the residual approach, by clarifying that if, in doubt, a change is to be treated as a change in estimate. However, we believe the relationship between the first and second sentence in paragraph 35 is unclear as to whether the second sentence is only to be applied in the context of measurement bases, or more generally. Although no amendment to paragraph 35 is proposed in the ED, we believe clarifying its intended purpose falls within the scope of the ED.

Furthermore, we believe the additional guidance provided in BC9 is potentially confusing. It is clarified that an accounting policy is 'the overall objective', while an estimate is an input 'in achieving that objective'. In particular, when referring to overall objective, it is unclear what 'overall' refers to. We would, for the sake of clarity, propose that the second sentence in BC9 is removed.

Although we agree that IAS 8 cannot provide a bright-line rule to establish the distinction between accounting policies and estimates, we believe that certain additional illustrative examples should be included to facilitate consistent application of the definitions. For instance, the Board should consider providing guidance on how to determine whether the following examples represent a change in accounting policy or estimate:

- Determining the discount rate for a defined benefit obligation in accordance with paragraph 83 of IAS 19 *Employee Benefits*: An entity changes from using government bonds to high quality corporate bonds because the market for corporate bonds has become deep.

- An entity changes the number of components identified for the purpose of depreciating property, plant or equipment (see our comments in Question 5 below).
- An entity in the extractive industry using the unit of production depreciation method changes the reserves base used (i.e., from proved developed reserves to proved and probable reserves).

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 with the proposed amendment, which clarifies that determining how to address uncertainty in measurement is a matter of estimation. However, please see our response to Question 4, as we believe paragraph 32B potentially conflicts with paragraph 32A.

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?

Paragraph 32B appears to be intended to illustrate paragraph 32A in that no judgement or assumptions are needed in choosing between the cost formulas. It is therefore assumed that applying a cost formula is not an estimate. However, selecting a cost formula does not represent a measurement basis since the measurement basis remains the same (i.e., historical cost). Arguably, the measurement basis for inventory is historical cost, whereas a choice between cost formulas is an estimation technique to determine historical cost, as per the last sentence of paragraph 32A.

Furthermore, the last sentence of paragraph 32B suggests that accounting policies are defined as anything that is not an estimate (or error). That is, it is concluded that since it is not an estimate, it is an accounting policy. See our comments above in response to Question 2. We do not rule out that such a residual approach may be helpful, but that is not how the ED proposes to define accounting policies.

For the reasons above, we believe that the basis for the conclusion in paragraph 32B requires further clarification, both in reference to the definition of accounting policies in paragraph 5 and in reference to paragraph 32A.

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

Example 3 in the Guidance on implementing IAS 8 is deleted. We agree that the example is not particularly helpful. In particular, we agree that including two simultaneous changes for property, plant and equipment reduces the illustrative effectiveness of the example. However, as our response to Question 2 indicates, we believe an example in which an entity changes the number of components identified for the purpose of depreciating a property, plant or equipment would be helpful in providing guidance in how to distinguish between accounting policies and estimates. The current example is potentially misleading in that it suggests that something that apparently represents an error correction is a change in policy. In our view, a change in the number of components identified for the purpose of depreciating a property, plant or equipment may, depending on the relevant circumstances, either be a change in estimate, i.e., the estimated useful lives of the different components have changed, or an error correction. In the event that it is an error correction, it would be because the entity has not applied the appropriate accounting policy in previous periods. We would suggest to amend Example 3 accordingly.