Financial Reporting Council

Mr Hans Hoogervorst
Chairman of the IASB
IFRS Foundation
30 Cannon Street
London
EC4M 6XH

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Dear Hans

This letter sets out the comments of the UK Financial Reporting Council (FRC) on the Exposure Draft (ED) ED/2018/1 '*Accounting Policy Changes (Proposed amendments to IAS 8)*'. Our main comments on the ED are summarised below with our detailed responses to the consultation questions included in the appendix to this letter.

While we support the objective of encouraging companies to improve their accounting policies, we do not support the proposal to apply different requirements to voluntary changes in accounting policies that result from agenda decisions issued by the IFRS Interpretations Committee (IFRS IC) and other voluntary changes in accounting policies.

The proposal to differentiate between voluntary changes in accounting policy that result from agenda decisions and other voluntary changes in accounting policy raises broader questions about the status and objectives of the explanatory information published in agenda decisions. The proposed amendments may be interpreted as elevating the status of agenda decisions above that of the "other accounting literature" referred to in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (IAS 8) and exacerbate the existing difficulties that arise in distinguishing a voluntary change in accounting policy from the correction of an error. Irrespective of the amendments proposed in the ED, in our view the IASB should clarify the criteria for making this determination.

In our view, it is not clear on what basis a company should determine whether a voluntary change "results from an agenda decision" because in many cases the company's accounting policies and particular facts and circumstances may be similar but not identical to those described in the agenda decision. The distinction between such changes and other voluntary changes in accounting policy seems somewhat arbitrary and will be difficult for companies to apply consistently because it may not be clear whether the proposed relief is available in a specific situation.

In any case, retrospective application is equally likely to be a hindrance to implementing voluntary changes in accounting policy regardless of whether those changes result from an agenda decision. Voluntary changes in accounting policy permitted by paragraph 14(b) of IAS 8 must improve the relevance of the information in the financial statements and should be encouraged. We suggest that the IASB provides the proposed relief from retrospective application for all voluntary changes in accounting policy, to facilitate companies in making such improvements. This would be more consistent with how the IASB sets requirements for retrospective application of changes in accounting policy required as a result of new IFRSs or amendments to existing IFRSs; transition provisions often provide relief from retrospective application when this is justified on cost/benefit grounds. The impracticability threshold for voluntary changes in accounting policy seems unduly burdensome in comparison. We believe that it would be reasonable to limit the retrospective application of any voluntary change in accounting policy to those cases where the benefits to the primary users exceed the costs to preparers.

We also suggest that the description in paragraphs A6-A10 of the ED of factors to consider when performing the cost/benefit analysis is supplemented with practical guidance that illustrates the steps of the process that companies should apply to determine the extent of retrospective application required. Step-by-step guidance could be structured similarly to the guidance for making materiality judgements in *IFRS Practice Statement 2* (*Making Materiality Judgements)* and include illustrative examples to demonstrate how the process should be applied. This would assist companies in making a robust analysis in a systematic and consistent manner.

If you would like to discuss these comments, please contact me or Rosalind Szentpéteri on 020 7492 2474.

Yours sincerely

Paul George
Executive Director Corporate Governance and Reporting
Financial Reporting Council
DDI: 020 7492 2340
Email: p.george@frc.org.uk

Appendix 1

Question 1

The Board proposes to amend IAS 8 to introduce a new threshold for voluntary changes in accounting policy that result from an agenda decision published by the IFRS Interpretations Committee. The proposed threshold would include consideration of the expected benefits to users of financial statements from applying the new accounting policy retrospectively and the cost to the entity of determining the effects of retrospective application.

Do you agree with the proposed amendments? Why or why not? If not, is there any particular aspect of the proposed amendments you do or do not agree with? Please also explain any alternatives you would propose, and why.

The status of agenda decisions and distinguishing voluntary changes in accounting policies from errors

There are several other types of non-authoritative literature published by the IASB and IFRS IC, including implementation guidance, illustrative examples and educational material. We are concerned that the proposed amendments may be interpreted as elevating the status of agenda decisions above other types of non-authoritative literature. Despite agenda decisions being non-authoritative, enforcers and auditors in many jurisdictions expect companies to apply accounting policies that are consistent with the explanatory material in agenda decisions. The line between compulsory and voluntary changes in accounting policy therefore, in practice, is blurred to some extent and the proposals in the ED may heighten this ambiguity.

An agenda decision may lead to a voluntary change in accounting policy but, in other circumstances, it may highlight that the company has not been applying IFRS appropriately and result in the identification of an error that must be corrected. Specific requirements applicable only to voluntary changes in accounting policy that result from agenda decisions will exacerbate the tension in distinguishing between these two scenarios. In our view, irrespective of the proposals in the ED, the IASB should clarify the circumstances in which a change in accounting policy constitutes a voluntary improvement or the mandatory correction of an error.

We note that, if certain requirements in IFRS are deemed to be unclear this should be addressed by through the IASB's standard-setting procedures, and any resulting proposals subjected to the IASB's full due process. In contrast, issues addressed by an IFRS IC agenda decision in general should consist of confirmation of the correct application of existing requirements. Therefore, we expect that the majority of changes in accounting policy resulting from agenda decisions should constitute the mandatory correction of an error rather than a voluntary change in accounting policy. As a result, the circumstances in which the relief proposed in the ED would be applicable seem to be rather limited, and unlikely to have the

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intended impact in terms of facilitating more widespread changes of accounting policy that would improve reporting.

Relief from retrospective application

We do not support the proposal to lower the impracticability threshold for relief from retrospective application only for those voluntary changes in accounting policy resulting from IFRS IC agenda decisions. In our view it would be difficult for companies to distinguish between such changes and other voluntary changes in accounting policy in a consistent manner because it may not be clear whether a change "results from an agenda decision". For example, often the company's accounting policies and particular facts and circumstances may be similar but not identical to those described in the agenda decision, leading to diversity in application and confusion regarding whether the proposed relief is available in a specific situation.

That said, we support the objective of encouraging companies to improve their accounting policies when this provides reliable and more relevant information in the financial statements, in accordance with paragraph 14(b) of IAS 8. In our view, retrospective application is equally likely to be a hindrance to implementing voluntary changes in accounting policy regardless of whether those changes result from an agenda decision. As a result, we suggest that the IASB makes the proposed relief from retrospective application available for all voluntary changes in accounting policy permitted by paragraph 14(b) of IAS 8, removing the need to distinguish between voluntary changes that result from agenda decisions and other voluntary changes. Limiting the retrospective application of any voluntary change in accounting policy to those cases where the benefits to the primary users exceed the costs to preparers appears reasonable to us.

The IASB sets requirements for retrospective application of new IFRSs or amendments to existing IFRSs that require a change in accounting policy in accordance with paragraph 14(a) of IAS 8 on a cost/benefit basis. For example, the IASB may determine that a new IFRS or amendments to an existing IFRS should be applied prospectively, or make transition provisions for modified retrospective application, on cost/benefit grounds. The impracticability threshold for voluntary changes in accounting policy, with no consideration of the costs involved, seems unduly burdensome in comparison.

Our suggestion to make the relief proposed in the ED available for all voluntary changes in accounting policy would more closely align the requirements for all accounting policy changes, both voluntary and required. When a change is required by IFRS, the IASB is in a position to perform a cost/benefit analysis on behalf of constituents to determine an appropriate level of relief (if any) from retrospective application, whereas for a voluntary change applied by an individual company in accordance with paragraph 14(b) of IAS 8, the company would need to perform a cost/benefit analysis specific to the situation. However, the underlying principles applied to determine the appropriate extent of the relief should be consistent. This is not the case with the current requirements in IAS 8.

We believe that cost/benefit-based relief from retrospective application for all voluntary changes in accounting policy would facilitate improvements to reporting that reflect current

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best practice, promoting greater consistency in the application of IFRS and improving the quality and comparability of the information available to investors. Paragraph BC8 of the ED suggests that lowering the threshold for all voluntary changes in accounting policy might "result in a loss of comparability between entities and a loss of information to users" but we believe that, subject to the restrictions already set out in paragraph 14(b) of IAS 8, it would be likely to have the opposite effect.

Analysis of costs versus benefits

In our view, it is essential that the IASB provides clear guidance on how to perform the cost/benefit analysis required by paragraph 23(b) of the ED because the analysis is inherently judgemental. In the absence of this, the requirements may be applied inappropriately, and companies may not provide sufficient retrospective information to meet investors' needs. The analysis may be particularly difficult to perform for smaller companies with fewer resources, without sufficient guidance.

Paragraphs A6-A10 of the ED set out factors that may impact the benefits to the users of the financial statements of retrospective application and the magnitude of the associated costs to the company. We suggest that this description is supplemented with guidance that describes the steps of the process that companies should apply when performing the analysis, illustrating how costs and benefits should be weighed against each other in a systematic way. It may be relatively straightforward to determine the costs, but the benefits are more judgemental and difficult to quantify.

The guidance could be structured similarly to the step-by-step approach for making materiality judgements set out in *IFRS Practice Statement 2* (*Making Materiality Judgements)*. Such practical guidance would assist companies in making a robust analysis, which is likely to increase consistency in application of the requirements and reduce the risk of bias impacting the analysis. We believe that illustrative examples would also be helpful, to demonstrate how the process can be applied to various scenarios. Such guidance on how to perform the cost/benefit analysis would be relevant for all voluntary changes in accounting policy if the IASB accepts our suggestion to lower the threshold for retrospective application for all voluntary changes and a company wished to make use of this relief.

We recognise that in certain cases, when retrospective application is straightforward, the cost of performing the cost/benefit analysis may exceed the cost of retrospective application. Although not explicitly stated in the ED, we assume that in such circumstances the company could apply full retrospective application without the need to perform a detailed cost/benefit analysis (i.e. that the proposed relief is optional).

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Question 2

The Board decided not to amend IAS 8 to address the timing of applying a change in accounting policy that results from an agenda decision published by the IFRS Interpretations Committee. Paragraphs BC18-BC22 of the Basis for Conclusions on the proposed amendments set out the Board's considerations in this respect.

Do you think the explanation provided in paragraphs BC18-BC22 will help an entity apply a change in accounting policy that results from an agenda decision? Why or why not? If not, what do you propose, and why? Would you propose either of the alternatives considered by the Board as outlined in paragraph BC20? Why or why not?

<u>Effective date for a voluntary change in accounting policy resulting from an agenda decision</u>

We agree with the IASB's decision not to mandate an effective date for voluntary changes in accounting policy that result from agenda decisions. As noted in paragraph BC22 of the ED, it would generally be unreasonable to expect an entity to apply a change in accounting policy that results from an agenda decision immediately upon publication of that agenda decision. Companies will need to determine the implementation time required on a case by case basis because such changes will vary in nature and complexity. We agree with the IASB that neither of the alternatives described in paragraph BC20 of the ED would work in practice.

The difficulties arising from the ambiguity regarding the status of agenda decisions are also relevant to the discussion of effective dates. If a change in accounting policy that results from an agenda decision is deemed to be a voluntary change in accounting policy, then it follows that the IASB cannot mandate an effective date for implementing that change because the company is under no obligation to implement the change at all. Mandating an effective date in the context of a change in accounting policy that results from an agenda decision would indicate that the change is required in order to comply with IFRS. It would therefore constitute the correction of an error that was identified upon publication of the agenda decision, rather than a voluntary change within the scope of this ED.

Promoting greater awareness of agenda decisions through a variety of communication channels could be an effective way to improve the timeliness of the implementation of voluntary changes in accounting policy arising from agenda decisions. We encourage the IASB to explore this further.

<u>Transition provisions for the proposals in the ED</u>

Paragraph BC14 of the ED explains that the Board intends to set an effective date for the amendments proposed in the ED and states that "there is no reason to either allow or require an entity to change its accounting for changes in accounting policy made before that date." As noted above, we do not believe that the Board can require voluntary changes in accounting policy. However, we see no reason why the Board would not make the relief from retrospective application for voluntary changes in accounting policy available to companies immediately upon publication of the amendments to IAS 8, to encourage earlier implementation of voluntary

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changes that would improve the relevance of the information in companies' financial statements. We suggest that paragraph 54G of the ED is redrafted to give the amendments immediate effect upon publication.

Procedural matter

We recommend that, if the IASB proceeds with the proposals in the ED, the amendments are published at the same time as any amendments arising from the recent Exposure Draft ED/2017/5 '*Accounting Policies and Accounting Estimates (Proposed amendments to IAS 8)*, to avoid amending IAS 8 twice within a short period.

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