Norsk RegnskapsStiftelse

15 January 2018

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UK

Cc: EFRAG

Dear Sir/Madam

Exposure Draft 2017/5: Accounting Policies and Accounting Estimates - Proposed Amendments to IAS 8

Norsk RegnskapsStiftelse (the Norwegian Accounting Standards Board – the NASB) is pleased to respond to your invitation to comment on the Exposure Draft proposing amendments to IAS 8 related to accounting policies and accounting estimates.

We support the IASB's work to make the definition of accounting policy clearer and more concise and to clarify how accounting policies relate to accounting estimates. However, in our opinion, the revised definition of accounting policy is still not sufficiently clear. Moreover, the Exposure Draft is silent on several issues that should be addressed in discussing the definition of accounting policies and how they relate to accounting estimates.

Our key comments are:

- Accounting policies should guide the operationalization of the fundamental qualitative characteristics in the Conceptual Framework. Therefore, the definition of accounting policy should include a clear link to relevance and faithful representation.
- Application of accounting policies might require the use of judgement and assumption. The proposed changes in the definition of accounting estimates seem to link accounting estimates to judgement and assumptions in relation to measurement. However, the Exposure Draft does not address the use of judgement and assumptions in applying accounting policies for recognition, derecognition, presentation and disclosures.
- In our view, selecting FIFO or weighted average cost formula does not constitute selecting an accounting policy.
- We believe that diversity in the way entities distinguish errors from changes in accounting estimates may be as pervasive as diversity in the way entities distinguish accounting policies from accounting estimates. Therefore, we suggest that this project also addresses the definition of error.

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The comments above are more fully explained in the appendix to this letter. You are welcome to contact us if you would like to discuss any specific issues addressed in our response further.

Yours faithfully,

Karina Vasstveit Hestås
Chair of the Technical Committee on IFRS of Norsk RegnskapsStiftelse

Appendix

Responses to specific questions

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 that the existing definition includes terms that are unclear. Removal of unclear terms may improve the definition. However, we are not convinced that the revised definition is sufficiently clear.

In our view, an accounting policy is an operationalization of the fundamental qualitative characteristics in the Conceptual Framework. Therefore, we believe that the definition of accounting policy should include a clear link to relevance and faithful representation. Further, when the IASB mandates, or the preparers of financial statements select, an accounting policy, the selection should be motivated by an assessment of relevance and faithful representation.

The proposed revision of the definition of accounting policy does not include any reference to relevance and faithful representation, and the terms that are included, are highly ambiguous. We agree to removing the terms *conventions* and *rules* from the definition, as these terms also were highly ambiguous, but we suggest that the remaining terms in the definition are reconsidered. In the following paragraphs, we will comment on each of the terms in the revised definition.

The term *principle* is an ambiguous term. In English dictionaries, we find several definitions of the term. One definition that seems relevant for the purpose of defining accounting policy is “A rule or belief governing one’s behaviour” (oxforddictionaries.com). However, this term is very wide and as part of the definition of *accounting policy* the term needs to be linked to relevance and faithful representation to fulfil its operationalization purpose. Moreover, the difference between *principle* and *measurement bases* and *practices* is also unclear, since the two latter also are *rules* and therefore are already captured by the term *principle*.

The term *measurement bases* provides some operationalisation into the definition. However, the definition is silent in relation to recognition, derecognition, presentation and disclosure. We had expected that accounting policies also should capture these dimensions of accounting.

The role of the term *practices* is also highly unclear. If the purpose of including the term is to capture accounting policies that are not described in any of the IASB’s standards or interpretations, but are developed by preparers in practice, we do not agree in including the term. An accounting policy is an accounting policy whether it is established through accounting standards or through practice. If the purpose is to include exceptions to a primary principle as part of the definition, we are more inclined to take the term into account. However, we still prefer to distinguish more clearly between the primary principles that are guided by relevance and faithful representation, and practical expedients.

For further discussion of this issue, we refer to the practical expedient in IFRS 15.63 as an example:

> *As a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less* (IFRS 15.63).

This practical expedient is an exception to IFRS 15's principle for significant financing components in the transaction price:

> *In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of [significant financing components]* (IFRS 15.60).

We presume that the adjustment for significant financing components, as stated in IFRS 15.60, is included as a principle because such an adjustment is considered necessary to make the measurement of transaction prices relevant and faithful representative. By applying the practical expedient in IFRS 15.63, the transaction price may be significantly different, and thereby the transaction price might be in conflict with the qualitative characteristics of relevance and/or faithful representation. We find it conceptually difficult to accept such conflicts as part of the definition of *accounting policy*. However, practical expedients may still be acceptable when considering cost-benefit. If the IASB permits such practical expedients and an entity applies them, the practical expedients are part of the specific principles applied by the entity. Hence, practical expedients should be considered as part of the entity's accounting policies. Nevertheless, it is crucial for both the preparers and the readers of financial reports as well as the standard setters to recognise when principles may result in information that does not meet the qualitative characteristics. Therefore, when a practical expedient is included as part of accounting policy, the definition of accounting policy (and the following accounting standards) should be explicit that it is a practical expedient.

In practice, entities may select practical approaches that do not fully comply with the principles that follow from the IFRSs, but the practical approaches are easier to apply and they do not cause the financial statements to be materially different from financial statements prepared in full compliance with the principles described in the standards. Such practical approaches are not the same as the practical expedients described above. Practical approaches without any material effect on the financial statements, are not considered to be deviations from the principles described in the standards. Practical expedients, however, may have a material effects on the financial statements, and are considered as deviations from the primary principles in the standards. While the application of practical approaches is under the preparers discretion, practical expedients cannot be applied unless it is approved by the IASB.

Finally, we do also suggest the IASB to reconsider the last part of the proposed definition. The last part refers to "preparing and presenting financial statements". This phrase is too wide; it captures elements of the closing process and the communication process that is far beyond what we expect from the definition of an accounting policy.

In summary, we recommend the IASB to develop further the definition of accounting policy to capture that the assessment of accounting policy is related to an assessment of the relevance and faithful representation of the policies. Moreover, the definition should be better linked to recognition, measurement, presentation and disclosure. We provide a first attempt for a revised definition that captures our concerns above. However, this attempt should be further developed:

> *Accounting policies are the specific principles applied by an entity in recognising, measuring, presenting and disclosing transactions and other events in the entity's financial statements to provide users with financial information that is relevant and faithfully represent what it purports to represent. The accounting policies do also include practical expedients that are approved by the IASB and applied by the entity.*

We also refer to our answer to question 4 for further considerations of the practical application of the definition of accounting policies and as an illustration of the underlying need for improving the definition of accounting policy.

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 in defining *accounting estimate* rather than *a change in accounting estimate*, and we agree in the need to clarify how accounting policies and accounting estimates relate to each other. We do also agree in linking accounting estimates to measurement.

However, neither the Exposure Draft nor the existing IAS 8 address the use of judgement and assumptions in applying accounting policies for recognition, derecognition, presentation and disclosures and how changes in these judgements and assumptions should be reflected in the financial statements. These changes may influence the narratives as well as the numbers that are included in the financial statements. Here are some examples of recognition-issues that require judgement, which might affect the amounts recognised in the financial statements:

- the definition of control (e.g. IFRS 10)
- probability-thresholds (e.g. IAS 37.10)
- reliability-thresholds (e.g. IAS 37.10)
- definition of unavoidable costs (e.g. IAS 37.68)

We suggest that the IASB's revision of IAS 8 also addresses the use of judgement and assumptions in applying accounting policies for recognition, derecognition, presentation and disclosures.

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

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?

We support examples that can illustrate how to apply the definitions of accounting policies and accounting estimates on specific cases. However, we do not support including a separate paragraph in IAS 8 dealing with cost formulas in IAS 2. IAS 8 should deal with general factors that can be applied to distinguish between accounting policies and accounting estimates in most circumstances. Specific examples should be included in Basis for Conclusions, in Illustrative Examples or in the standard dealing with the topic.

We are not convinced that the selection of FIFO or weighted average cost formula is a matter of accounting policy rather than a matter of accounting estimate. According to IAS 2.23 specific identification appears to be the primary principle for identification. IAS 2.25 requires that cost of inventories of items that are ordinarily interchangeable shall be assigned by using the FIFO or weighted average cost formula. If these two cost formulas were *permitted* as practical approximation methods, the main principle would remain the same and a choice between the cost formulas would be a choice between estimation methods. However, IAS 2.25 does not allow specific identification but *requires* one of the two cost formulas and, as such, the choice between the two alternatives may seem as a choice between two policies. Nevertheless, we are still not convinced that this choice is a matter of accounting policies.

In our view, a choice between accounting policies should be motivated by the qualitative characteristics relevance and faithful representation regardless of whether the choice is made by the standard setter or by the preparer of financial statements. To be a choice between accounting policies, the choice between FIFO and weighted average should be based on an assessment of which method is most relevant and faithful representative. Otherwise, it would seem to be a choice between estimation methods. If the IASB gives prepares free choice between alternatives without requiring an assessment of relevance and faithful representation (such as the choice between two cost formulas in IAS 2 or the choice between the cost model and the revaluation model in IAS 16), such a free choice should be dealt with in the same way as practical expedients discussed in our answer to Question 1. Such an override of the basic principle of choosing the most relevant and faithful representative policy, should not affect the definition in relation to the fundamental understanding of what an accounting policy is.

The IASB argues that the main principle of "specific identification of costs is inappropriate when there are large numbers of items of inventory that are ordinarily interchangeable. In such circumstances, the method of selecting those items that remain in inventories could be used to obtain predetermined effects on profit or loss" (IAS 2.24). In our opinion, such an aim of preventing manipulative actions is not the primary objective of accounting policies. Still, specific identification might be rejected if other identification will be more relevant and contribute to more faithful representation. If so, it can be argued that the Board's choice between specific and non-specific identification is the choice of accounting principles and the choice between cost formulas is a choice of estimation method within the principle of non-specific identification. In our opinion, this line of thinking is in line with the Board's own argument that "the accounting policy is the overall objective and the accounting estimates are inputs used in achieving that objective" (ED, BC9) – we cannot see that it is appropriate to consider FIFO or weighted average as an overall objective, but we can see arguments for considering specific or non-specific identification as an overall objective.

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

We appreciate the IASB's effort to clarify the definitions of accounting policy and accounting estimate to make it easier to distinguish between changes in accounting policies and changes in accounting estimates. However, we believe that diversity in the way entities distinguish errors from accounting estimates may be as pervasive as diversity in the way entities distinguish accounting policies from accounting estimates. Therefore, we suggest that this project also address the definition of error.

Moreover, the IASB has announced an exposure draft on accounting policy changes and we suggest the IASB to issue all proposed changes in IAS 8 at the same time.