

STAFF PAPER

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IASB Meeting

Project	Disclosure Initiative
Paper topic	IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i> —restatement of comparatives for mandatory changes in accounting policies
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This paper has been prepared for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in *IASB Update*.

Introduction

1. One of the outcomes of the Principles of Disclosure project will be the consolidation of the general presentation and disclosure requirements in IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* into one Standard. Within this context, we have undertaken research with the staff of the OIC (Organismo Italiano di Contabilità, the Italian standard-setter) investigating whether there are aspects of IAS 8 that should be changed.
2. This paper discusses whether the current requirement in IAS 8 to restate all comparative information should be retained as part of the retrospective application requirement for a changes in accounting policy upon initial application of an IFRS ('mandatory changes') and whether the IASB wants to consider this issue further.
3. Please note that this paper does not raise questions about the accounting for retrospective application, which is used to calculate the 'catch-up' adjustment and which is defined in IAS 8 as applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied. Instead the paper raises the question about how retrospective application is presented or disclosed in financial statements, ie with or without the restatement of comparative information.

4. The structure of the paper is:
 - (a) a summary of current guidance for changes in accounting policies (paragraphs 6–15);
 - (b) research on current practices and views, including surveys with users and preparers and outreach with the Capital Markets Advisory Committee (CMAC) and the Global Preparers Forum (GPF) (paragraphs 17–33);
 - (c) summary of findings from research and outreach (paragraphs 34–36); and
 - (d) discussion about whether the requirement to restate all comparative information should be retained as part of the retrospective application requirement in IAS 8 (paragraphs 37–47).
5. Agenda Paper 11E summarises application and transitional provisions of IFRS guidance issued after 2005 (including Standards, amendments, interpretations and annual improvements).

Current guidance of IAS 8

Conceptual Framework

6. Paragraph QC22 of the *Conceptual Framework* says that consistency helps to achieve the goal of comparability. Consistency refers to the use of the same methods for the same items, either from period to period within a reporting entity or in a single period across entities.
7. QC21 of the *Conceptual Framework* defines comparability as the qualitative characteristic that enables users to identify and understand similarities in, and differences among, items. Please note that Agenda Paper 11F for the June meeting is looking at comparability of information between entities.

IAS 8

8. The main driver in IAS 8 on how entities should present or disclose changes in accounting policies is the *comparability* of information in financial statements of

an entity. IAS 8 also acknowledges that a constraint in achieving comparability is *impracticability*.

9. Paragraph 15 of IAS 8 says that users of financial statements need to be able to compare the financial statements of an entity over time to identify trends in its financial position, financial performance and cash flows. Paragraph 7 of IAS 1 and paragraph 5 of IAS 8 define a requirement to be ‘impracticable’ when the entity cannot apply it after making every reasonable effort to do so. An accounting change is also considered impracticable if it requires the use of hindsight.

Voluntary changes

10. Paragraph 19(b) of IAS 8 states that entities must use retrospective application for voluntary changes in accounting policies, except to the extent that it is impracticable. In total, there are three methods of presenting voluntary changes in accounting policies in accordance with IAS 8 (the last two methods relate to the impracticability exemption):
- (a) required retrospective application, which means applying a new accounting policy to transactions and other events ‘as if that policy had always been applied’ (see paragraphs 5 and 19(b) of IAS 8); paragraph 22 of IAS 8 further requires that all the information in the financial statements that is affected by a change should be restated for all presented comparative periods. In accordance with paragraph 40A of IAS 1, this means restating one statement of profit and loss and other comprehensive income and two statements of financial position.
 - (b) when it is impracticable to determine the *period-specific effects*, an entity applies the new accounting policy to the assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable and makes a corresponding adjustment to the opening balance of equity for that period.¹
 - (c) when it is impracticable to determine the *cumulative effect*, the new policy is applied prospectively from the start of the earliest period

¹ See paragraph 24 of IAS 8.

practicable. The portion of the cumulative adjustment to assets, liabilities and equity arising before that date is therefore disregarded.²

11. Before IAS 8 was revised in 2003, it had allowed an alternative way to account for and present/disclose the retrospective application of a change in accounting policy. Under this alternative, any resulting adjustment from the retrospective application would be included in the determination of the profit or loss for the current period without restating comparative information. This alternative basically aligns the treatment of changes in accounting policies that relate to measurement with changes in estimates in the sense that all changes would be accounted for in the current period without restating comparative information.

Mandatory changes

12. Paragraph 19 of IAS 8 requires an entity to account for mandatory changes in accordance with the specific transitional provisions, if any, of new IFRS guidance. If the new guidance does not include specific transitional provisions, then an entity applies the change retrospectively with the restatement of all comparative information as described in paragraph 22 of IAS 8 (unless impracticable). This is the same treatment as for a voluntary change in accounting policy. In other words, the presumption in IAS 8 is that comparability is met by applying changes in policies retrospectively.

Specific transitional provisions in IFRSs

Voluntary changes

13. Current Standards do not provide many accounting options and therefore there is limited scope for voluntary changes in accounting policies by entities. A number of them relate to presentation (for example, balance sheet with decreasing or increasing liquidity);³ or classification (for example, dividends received can be classified as operating or investing cash flows).⁴

² See paragraph 25 of IAS 8.

³ See paragraph 63 of IAS 1.

⁴ See paragraph 33 of IAS 7.

Mandatory changes

14. Over the past 10 years (ie beginning in 2006) the IASB has issued a significant number of mandatory changes (ie requirements of new IFRS). They are listed in Agenda Paper 11E. Many of these Standards adopted specific transitional provisions that applied to the changes in accounting policies resulting from their initial application that differed from the default transition provisions in paragraph 19 of IAS 8.
15. These specific transitional provisions can be summarised as follows:
- (a) many (ie **nearly half**) of the mandatory changes do not require the restatement of *all* comparative information in financial statements as currently required by IAS 1 and IAS 8; this includes new Standards:
 - (i) IFRS 9 *Financial Instruments*;
 - (ii) IFRS 10 *Consolidated Financial Statements*; and
 - (iii) IFRS 15 *Revenue from Contracts with Customers*.
 - (b) most of the changes that do *not* require the restatement of all comparative information address the measurement of assets or liabilities; this is unlike changes that address recognition (for example, IFRIC 21 *Levies*), presentation (for example, amendments to IAS 1 about the presentation of items in other comprehensive income) or disclosures (for example, IFRS 8 *Operating Segments*) which require the restatement of all comparative information when an entity adopts a change.
 - (c) the reasons for transitional provisions *not* to require restatement of all comparative information for entities that adopt the change are:
 - (i) cost and effort for preparers; and
 - (ii) use of hindsight for assumptions and estimates (for example, IFRS 15); this reason has become increasingly relevant because various Standards require the use of estimates; or
 - (iii) a combination of both (i) and (ii).

- (d) different pieces of new IFRS guidance that include transitional provisions require/allow different transition methods:
- (i) some require/allow the restatement of information for one comparative period (for example, IFRS 10);
 - (ii) some do not require/allow the restatement of comparative information; instead, an entity would recognise a catch-up adjustment in opening equity (for example, IFRS 15); and
 - (iii) some require the prospective application (for example, IFRICs and annual improvements).

This variety of transition methods across new guidance adds complexity for users and preparers.

- (e) some new Standards allow options for how entities can adopt mandatory changes:
- (i) IFRS 9—contains two options;
 - (ii) IFRS 10—contains three options; and
 - (iii) IFRS 15—contains three options.

These options for transition methods reduce comparability of information across entities, especially when they are combined with the option to early adopt the new guidance.

Research and outreach

16. The staff research involved going through the transitional provisions of the new IFRS guidance identified in paragraph 5 and identifying reasons for them. It also involved surveys and outreach with users and preparers; their respective views on mandatory changes are discussed further on in the paper.

Voluntary changes

17. During the meeting of CMAC in February 2015, CMAC members said that entities should continue to use retrospective application with the restatement of comparative information for voluntary changes and that the impracticability

threshold for voluntary changes in accounting policies by entities should be very high.⁵

18. Decisions about voluntary changes in accounting policies are made by individual entities. According to the preparers' survey performed by the OIC staff, the majority of preparers participating in the survey said that voluntary changes in accounting policies were rare in practice.⁶

Mandatory changes

19. Our research showed that the specific transitional provisions for new or amended IFRS guidance ('mandatory changes') do not often require a full restatement of all comparative information by entities. This is opposite to the existing default retrospective application requirement in IAS 8 that requires a full restatement of all comparative information for mandatory changes in accounting policies.

Mandatory changes—users' views

20. According to the users' survey performed by the OIC staff in 2015, the majority of users participating in the survey said that comparative information should be restated for voluntary changes in accounting policies.⁷
21. However, when users were asked what they would think if changes in accounting policies related to measurement, half of the respondents saw merit in a proposal to present the effect of that change in the current year's financial statements akin to a change in estimates (ie without the restatement of comparative information). This response suggested that some users were open to considering options when it comes to restating comparatives.
22. Further discussion took place during the February 2015 CMAC meeting.⁸ CMAC members expressed an understanding for the reasons why the IASB needs to develop specific transitional provisions for some mandatory accounting changes.

⁵ <http://www.ifrs.org/About-us/IASB/Advisory-bodies/CMAC/past-meetings/Documents/CMAC-February-meeting-summary-April-2015.pdf>.

⁶ <http://www.ifrs.org/Meetings/MeetingDocs/Other%20Meeting/2015/March/AP6-IAS-8-GPF-March-2015.pdf>.

⁷ http://www.ifrs.org/Meetings/MeetingDocs/Other%20Meeting/2015/February/AP4%20Reporting%20Changes%20in%20Accounting%20Policies_Information%20needs%20of%20investors.pdf.

⁸ <http://www.ifrs.org/About-us/IASB/Advisory-bodies/CMAC/past-meetings/Documents/CMAC-February-meeting-summary-April-2015.pdf>.

These reasons included cost and effort for preparers and use of hindsight for certain changes. Nevertheless, they would prefer to have consistent financial information when an entity adopts a change in an accounting policy. This is because they need to have a point of comparison in their analysis of an entity's results.

23. Most CMAC members opposed the proposal to require the same transitional treatment for all measurement changes (ie accounting policies and estimates). In their view not requiring entities to restate comparative information for mandatory accounting changes would prevent entities from reporting useful information.
24. Most CMAC members said that information provided by the limited retrospective application transition method (ie the restatement of one comparative, for example, IFRS 10) and the catch-up adjustment transition method with enhanced disclosures (ie no restatement of comparative information but enhanced disclosures, for example, IFRS 15) should provide sufficient information in cases in which an entity finds it impracticable to restate all comparative information.
25. One CMAC member suggested that by giving entities more time for making mandatory accounting changes, the IASB could keep the requirement to restate comparative information. This would achieve greater consistency between periods.
26. Another CMAC member made a comment that it would be preferable—to the extent possible—to have the same transition methods for changes in accounting policies across Standards and entities. This would reduce complexity in using the information.

Mandatory changes—preparers' views

27. In 2011 the IASB issued a Request for Views about the effective dates of the upcoming standards (ie *Fair Value Measurement*, *Revenue from Contracts with Customers*, *Leases*, *Insurance Contracts* and *Financial Instruments*). One of the questions in the Request for Views asked about constituents' general views on transition methods in IFRS. Over 100 constituents, many of whom were preparers and accounting bodies, responded to this question.

28. Many respondents acknowledged the theoretical merit of retrospective application with restated comparative information because it results in more consistent information in an entity's financial statements.
29. Nevertheless, many preparers who responded to the Request for Views supported the specific transitional provisions and the reliefs that were provided in various Standards.
30. With respect to the actual transition methods proposed in various new Standards, a significant number of respondents to the Request for Views—although they understood that the IASB considered each Standard individually—still believed that the variety of transition methods in various Standards 'adds to confusion' and expressed a wish for the IASB 'to promote a consistent set of principles when deciding the transition methods'.
31. According to the preparers' survey performed by the OIC staff in 2015, most preparers said that they supported the retrospective application with restated comparative information as the best way to represent changes in a measurement basis.⁹
32. However, when preparers were asked about what they would think if changes in accounting policies related to measurement that were presented in the current year's financial statements akin to changes in estimates (ie without restating comparative information), 60 per cent of the respondents saw merits of this proposal. Responses reflected practical concerns and included the following comments:
- (a) less complex to apply; and
 - (b) the challenges related to the restatement of comparative information for an accounting change outweigh the benefits of this restatement.
33. The remaining 40 per cent were content with the existing requirement to restate comparative information for all changes in accounting policies.

⁹ <http://www.ifrs.org/Meetings/MeetingDocs/Other%20Meeting/2015/March/AP6-IAS-8-GPF-March-2015.pdf>.

Summary of findings

34. The outreach described in paragraphs 16–33 of this paper showed that both users and preparers were willing to consider alternatives for how changes in accounting policies could be presented in financial statements. However, it also showed that the views within the groups about how these changes should be presented were sometimes mixed. Nevertheless, on balance, both groups were of the view that the retrospective application with restated comparative information would provide the most useful information for users of financial statements.
35. Despite general support for reflecting changes in accounting policies using retrospective application with restated comparative information, the IASB has often had to consider practical constraints when developing transitional provisions in new or amended IFRS, including:
- (a) changes that relate to measurement often involve estimations and assumptions. Restatement of comparative information may require preparers to use hindsight for estimations and assumptions for prior periods during the period of change. This is prohibited by IAS 8; and
 - (b) preparers' concerns about the cost and effort it takes to implement many accounting changes. These concerns can be perhaps explained—at least partly—with the amount and pace of mandatory changes over the past 10 years.
36. As a result of the above two factors, almost half of the recent mandatory changes in accounting policies did not require the restatement of all comparative information, particularly when the changes related to measurement.

Does the IASB want to consider the issue further?

37. Given that the requirement to restate all comparative information within the retrospective application requirement for a change in accounting policy has limited practical substance for mandatory changes in accounting policies and does not have unanimous support amongst constituents, the question arises whether this requirement needs to be retained in a replaced IAS 8. This paper does not provide

definitive answers to this question and raises a more general question for the IASB members about whether would like staff to consider this question further.

38. Based on the analysis performed, staff believe that mandatory changes that relate to measurement represent the main challenge for restatement of comparative information because these changes often involve the use of hindsight for the restatement of comparative information. The reasons for this are that:
- (a) a significant portion of IFRS guidance, including the changes, requires or permits measurements based on current value, which often require the use of estimates. In other words, a mandatory change can involve not only a change in accounting policy but also a change in estimate; and
 - (b) measurement also involves assumptions about management's intentions and conditions at the date of transactions.
40. The IASB members are not required to make decisions at this stage about whether the requirement to restate comparatives when retrospectively applying a mandatory change in accounting policy. Nevertheless, staff believed that it would be useful to summarise the arguments for and against retaining the requirement to restate comparatives. They are summarised below as follows:
- (a) not retaining the requirement (paragraphs 41–43); and
 - (b) retaining the requirement (paragraphs 44–46).

Not retaining the requirement to restate comparatives

41. Removing the requirement to restate all comparative information within the retrospective application requirement for a mandatory change in accounting policy (as described in paragraph 12) has the advantage of:
- (a) reducing cost and effort for preparers because they need to prepare and present restated information for comparative periods;
 - (b) reducing the need to consider hindsight for changes that relate to measurement; more consistency in transition methods if there is a new—more 'workable'—default method for transitional provisions; and

(c) more prominent presentation of the change for users of financial statements if the adjustment is presented on the face of the statement of profit and loss and other comprehensive income as opposed to the restated comparative information for prior periods.

42. Please note that at this stage staff is not considering what would be the best way to represent the catch-up adjustment (ie in the opening equity or in the current periods' results). This is something that will need to be considered separately if the IASB decides not to retain the requirement to restate comparatives as a default requirement for mandatory changes in accounting policies.

43. The disadvantage with this approach is that it results in a lack of historic trend information for users of financial statements.

Retaining the requirement to restate comparatives

44. Retaining the requirement to restate all comparative information within the retrospective application requirement for a mandatory change in accounting policy has the advantage that it provides trend information for users of financial statements.

45. Retaining the requirement also has the following disadvantages, because it leads to:

(a) more cost and efforts for preparers because they do not need to prepare and present restated information for comparative periods;

(b) greater potential need to consider hindsight for changes that relate to measurement, as demonstrated in the Example above;

(c) a variety of transition methods because the existing default method for transitional provisions (ie retrospective application with restatement of all comparative information) can often be overwritten; and

(d) less prominent presentation of the change for users of financial statements if the effect is not presented on the face of the statement of profit and loss and other comprehensive income.

46. In this case, based on the feedback received during the research, the staff plan to develop and propose how transitional provisions could be more consistent across

new guidance in the future. This is likely to be done as part of work on internal drafting guidelines for the IASB and its staff. It will be important to ensure that constituents will have a chance to comment on the proposals on the internal drafting guidelines because they are going to affect them. However, at this stage, the exact process has not been developed fully.

Potential further considerations

47. As mentioned earlier, we are not recommending a specific change to how the IASB should require a change to an IFRS to be accounted for. However, our research and analysis has highlighted that changes to the measurement basis in IFRS are almost never required to be applied retrospectively. In that sense, the exception is the norm. The IASB could acknowledge this and specify how changes in the measurement basis should be applied.
48. Additionally, the IASB has tended to develop limited exceptions to full retrospective application that target specific requirements in a Standard. Unfortunately, this means that there are many different combinations and permutations of these exceptions which must make it difficult for preparers and users. We think it might be possible to develop a much narrower range of “exceptions”. This could enhance comparability and simplify transition arrangements.
49. Potential ways of dealing with the challenge that arises from mandatory changes that relate to measurement because of the use of hindsight—whilst still providing comparative information— include development of transitional methods, such as:
 - (a) the ‘catch-up’ adjustment with enhanced disclosures which has been used in IFRS 15 *Revenue from Contracts with Customers*. Although this method does not provide restated comparative information, the enhanced disclosures provide information for the current period’s results using both the ‘old’ and the ‘new’ accounting policies. Therefore, the users are still able to compare like with like (ie amounts determined using the old accounting policy) for prior and current periods; or

- (b) giving entities more time for implementing a change and gathering the necessary information for comparative periods at an earlier stage, including information which if it were gathered during the subsequent period would require the use of hindsight.
50. We think this might be best developed as internal guidelines that the IASB could use when it develops transitional provisions for changes that relate to measurement. This will enable the IASB to limit the range of transitional provisions. These internal guidelines should respond to the challenges associated with restating information relating to the measurement of assets, liabilities and equity.
51. The cost and effort constraint requires judgement and it will continue to be dealt with on a standard-by-standard basis.

Question – Whether staff should consider the issue further

Does the IASB want staff to consider ways to change how the IASB sets transition requirements for changes to an IFRS, with a view to improving the comparability of financial statements?

Note: In terms of the process, any proposals would be brought back to the IASB for its consideration. Any decisions will be included in the forthcoming Discussion Paper on Principles of Disclosure.