Reporting Changes in Accounting Policies

Information needs of investors

OIC-Italian Accounting Standard Setter
CMAC - 27 February 2015

AP4

This project

- As part of the *Disclosure Initiative*, the IASB is now reviewing the requirements of IAS 8*
- The OIC is assisting with this review
  - ✓ launched a survey for investors in December 2014
  - ✓ report back to the IASB in Q2 2015
- In this meeting the OIC staff would like to:
  - ✓ discuss specific results of the investor survey with the CMAC members
  - ✓ ask the CMAC members about your information needs related to changes in accounting policies
  - ✓ discuss a possible solution

*IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

Quick recap:
change in accounting policy

Definition:
A change in accounting policy is a change in the specific principles, bases, conventions, rules and practices applied by a company in preparing and presenting financial statements.

This can result from:
- applying a new accounting requirement or Standard such as IFRS 9 *Financial Instruments*, or IFRS 15 *Revenue from Contracts with Customers* ; or
- a change in accounting due to options available today (eg capitalise or expense some expenditures for exploration assets).

Quick recap:

change in accounting estimate

Definition:
A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability that results from the assessment of the present status of an asset or a liability.

This can result from:
- new information (eg valuation assumptions); or
- new developments (eg new technology leads to shorter than originally expected useful life of assets).

These are ***not*** corrections of errors.

Reason for review (1/2)

- When a company changes an accounting policy, IAS 8 requires restatement of (or ‘retrospective application’ of the change to) comparative financial statements. This usually means:
  - ✓ two years of balance sheets
  - ✓ one year of income statement
  - ✓ a catch-up adjustment in the opening equity of the earliest comparative period

- Preparers have indicated that this can be costly and burdensome
  - ✓ as a result, sometimes do not restate comparatives due to impracticability

- In addition, when the IASB produces new guidance, it often modifies the transition requirements to ease the burden of application, eg **all comparatives remain unrestated**

Reason for review (2/2)

- When a company changes an accounting **estimate**, IAS 8 requires no restatement of comparatives (ie ‘prospective application’ of the change)

- As a result, the effect of the change is recognised :

  ✓ in the current period as a one-off adjustment; and
  ✓ future periods, if relevant.

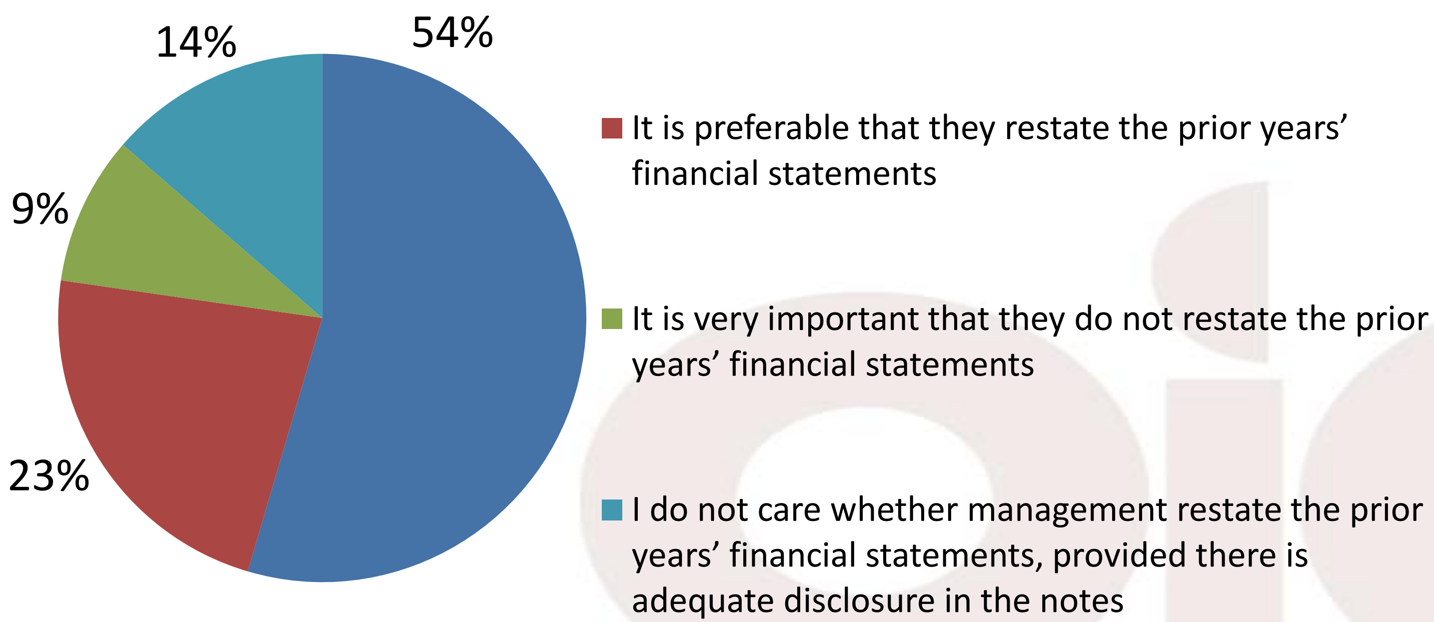
- There have been an increasing number of situations when it is difficult to distinguish whether the change relates to a **policy** or an **estimate**

  ✓ **in this case IFRS requires to treatment of the change as a change in estimate-ie all comparatives remain unrestated**

Change in accounting policy: information needs

Question for CMAC: How important is it for you to see a 'full restatement' of prior years' financial statements when management changes an accounting policy?

Survey preliminary results



Change in accounting policy-information needs continued

Question for CMAC: What information about an accounting policy change would be most beneficial for you when a company finds it impracticable to restate all comparative information?

Potential ways to reflect the change:

- **limited retrospective application:** starting from the beginning of the earliest comparative period presented, ie only one comparative is restated
- **catch-up adjustment:** comparatives are not restated and a 'catch-up adjustment' is recognised in the opening retained earnings (ie equity) of the current period
- **prospective application:** comparatives are not restated and the effect of the change is recognised in current P&L
- **additional disclosures:** information for the current period financial statement line item that is affected - using both the old and the new accounting policies

Another Possible solution

Problems

- changes in measurement are often burdensome for preparers; they also often involve hindsight and estimates
- sometimes it is difficult to distinguish whether the change relates to an accounting policy or an accounting estimate

➢ as a result, companies do not restate prior years' financial statements

Possible solution

Distinguish accounting changes (both in policies and estimates) as:

- changes relating to measurement and
- other changes (ie relating to recognition, classification, presentation and disclosure)

And enhance disclosures

Another Possible solution: outcome

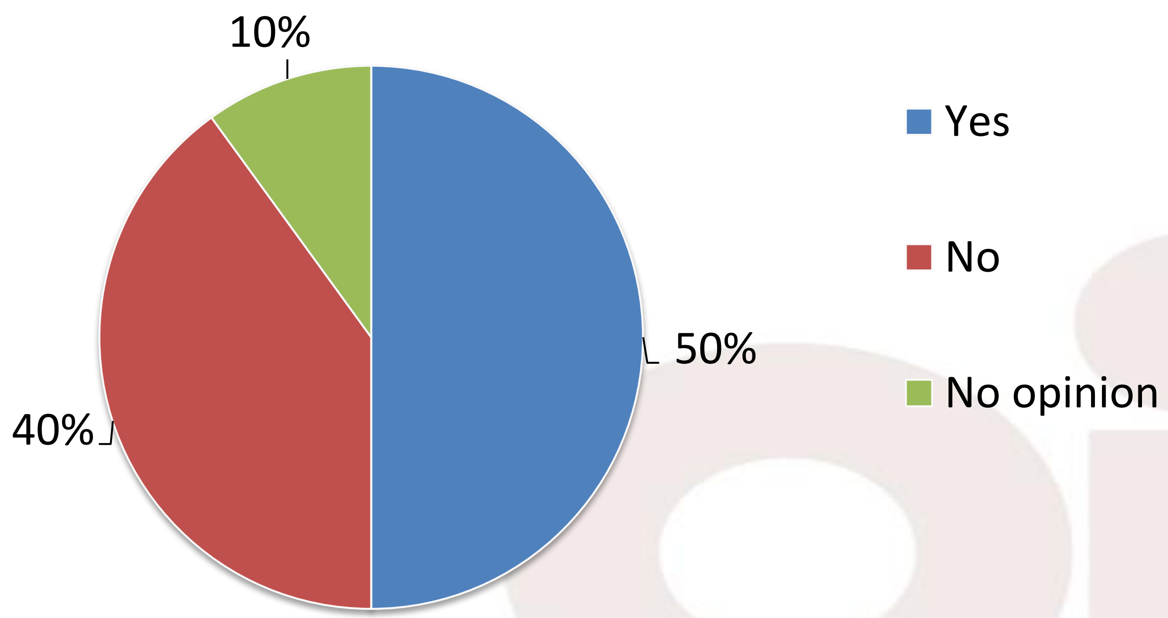
Outcome

- ✓ there will no longer be a need to distinguish between changes in accounting policies and estimates
- ✓ for changes in measurement – use prospective application (described on Slide 8)
- ✓ for all other changes – comparatives will be restated
- ✓ enhanced disclosures about the change

Possible solution: question

Question for CMAC: Do you agree with a solution that would distinguish between changes relating to measurement and other changes? Why or why not?

Survey preliminary results



Possible solution: comments received

Arguments in favor

- Broadly this seems a sensible approach
- It seems a simpler method
- All changes relating to measurement are treated similarly. Often a change in policy has elements of both a change in estimates and a change in policy, which can often mean that these two elements are combined in the disclosure of the change. Presenting all changes in measurement together will eliminate what is sometimes an artificial distinction

Arguments against

- Prefer the distinction between policies - that the preparer is not in control of - and estimates - that the preparer to a certain degree is in control of
- Estimations are fundamentally different to policy changes. A change in policy should be required when it is appropriate to do so (relevance and reliability) and management should also be responsible for making the changes retrospectively to the best of their ability
- It is just a mechanism for preparers to avoid using judgment

Questions /comments?

THANK YOU