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15 January 2018

Dear Sir

ED/2017/5 Accounting Policies and Accounting Estimates

We are pleased to comment on the above Exposure Draft (the ED). Following consultation with the BDO network[1], this letter summarises views of member firms that provided comments on the ED.

We agree with the Board's decision to clarify the definition of accounting policies and the interrelation of accounting policies and accounting estimates. We also agree that the definition of changes in accounting estimates should be replaced by the definition of accounting estimates.

However, we disagree with the addition of 'measurement bases' to the definition of accounting policies. A change in measurement basis is an example of a change in accounting policy. The proposed definition could therefore inappropriately result in certain changes in presentation failing to be accounted for as changes in accounting policy.

We also disagree with the identification of the choice of cost formulas as an example of an accounting policy. In our view, the application of FIFO or weighted average cost represents an accounting estimate, in the application of the accounting policy that is required by IAS 2 which is to measure inventory at the lower of cost and net realisable value.

Our responses to the questions in the ED are set out in the attached Appendix.

We hope that you will find our comments and observations helpful. If you would like to discuss any of them, please contact me at +44 (0)20 7893 3300 or by email at abuchanan@bdoifra.com.

Yours faithfully,

Andrew Buchanan

Andrew Buchanan

Global Head of IFRS

[1] Service provision within the international BDO network of independent member firms ('the BDO network') in connection with IFRS (comprising International Financial Reporting Standards, International Accounting Standards, and Interpretations developed by the IFRS Interpretations Committee and the former Standing Interpretations Committee), and other documents, as issued by the International Accounting Standards Board is provided by BDO IFR Advisory Limited, a UK registered company limited by guarantee. Service provision within the BDO network is coordinated by Brussels Worldwide Services BVBA, a limited liability company incorporated in Belgium. Each of BDO International Limited (the governing entity of the BDO network), Brussels Worldwide Services BVBA, BDO IFR Advisory Limited and the member firms is a separate legal entity and has no liability for another such entity's acts or omissions. Nothing in the arrangements or rules of the BDO network shall constitute or imply an agency relationship or a partnership between BDO International Limited, Brussels Worldwide Services BVBA, BDO IFR Advisory Limited and/or the member firms of the BDO network.

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 do not agree with the addition of 'measurement bases'; however, we agree with the clarifications of removing the terms 'conventions' and 'rules'.

We disagree with the addition of 'measurement bases' to the definition of an accounting policy because we believe it is unnecessary. While we agree that a change in measurement basis (for example, from depreciated cost to fair value) is a change in accounting policy, the measurement basis applied by an entity represents the principle and practice that the entity follows. Consequently, a change in measurement basis is an example of a change in accounting policy, in the same way as (for example) a change in the way income and/or expenses are presented in an entity's primary financial statements is a change in policy.

We agree with the removal of 'conventions' and 'rules' from the definition of accounting policies. However, we do not agree with the reasoning in paragraph BC5 of the Basis for Conclusion for their removal, which is because their meanings are not clear and because these terms are not used elsewhere in IFRS Standards. We agree it is preferable if terms are used elsewhere in IFRS Standards, as this assists in maintaining consistency. However, the meanings of 'conventions' and 'rules' are clearly defined in the English language and so we disagree with the assertion that the meanings of these terms and not clear.

Our agreement with the proposal to remove 'conventions' and 'rules' is for other reasons.

- Conventions are defined as a way in which something is usually done. We believe an accounting policy should not be developed or applied on the basis of a particular approach being the way in which something is usually done, because this might not be the most appropriate approach for a particular entity. Consequently, we agree with the removal of this term.

- Rules are defined as one of a set of explicit or understood regulations or principles governing conduct or procedure within a particular area of activity. Since rules are a subset of principles it is appropriate to retain only 'principles' in the definition of accounting policies.

We believe the retention of 'principles' and 'practices' is appropriate based on their definitions. A principles is defined as a fundamental truth or proposition that serves as the foundation for a system of belief or behaviour for a chain of reasoning, and a practice is defined as the actual application or use of an idea, belief, or method, as opposed to theories relating to it. Therefore, the inclusion of only principles and practices covers the development of the foundation of an accounting policy as well as the application of that accounting policy.

Consequently, we believe that the definition of an accounting policy should be:

> *Accounting policies* are the specific principles and practices applied by an entity in preparing and presenting financial statements.

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?

(a) We agree with clarifying how accounting policies and accounting estimates relate to each other by including in the definition of an accounting estimates that accounting estimates are used in applying accounting policies.

(b) We agree with adding a definition of accounting estimates and removing the definition of a change in accounting estimates.

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 clarification that, when an item in the financial statements cannot be measured with precision, an accounting estimate is used in applying the accounting policy for that item.

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 do not agree, and consider that the proposed amendment is inconsistent with IAS 2.

We disagree with the Board's conclusion in BC19 that the selection of one of the two cost formulae in IAS 2 is not an attempt to estimate the actual flow of those inventories. We note that IAS 2.9 requires that inventories:

> '...shall be measured at the lower of cost and net realisable value.'

This links to the requirement in IAS 2.23 that:

> 'The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects shall be assigned by using specific identification of their individual costs.'

For other inventories, IAS 2.25 requires that their cost:

> '...shall be assigned by using the first-in, first-out (FIFO) or weighted average cost formula...'

We do not believe that this represents a free choice, nor that the application of FIFO or an average cost formula represents an accounting policy choice. Instead, we consider that an entity does not have an accounting policy choice for inventory, with inventory being required to be measured at the lower of cost and net realisable value (IAS 2.9 - see above).

For inventories covered by IAS 2.25, it follows that the approach selected (FIFO or an average cost formula) will be the approach which is estimated most closely results in the entity complying with the requirement in IAS 2.9, and therefore most closely results in amounts recorded in the financial statements reflecting the actual flow of inventories.

We also note the Board's amendment, in 2003, of IAS 2 to eliminate the LIFO method. IAS 2.BC10 notes that:

> 'The LIFO method treats the newest items of inventory as being sold first, and consequently the items remaining in inventory are recognised as if they were the oldest. This is generally not a reliable representation of actual inventory flows.'

It follows that the FIFO and average cost formula methods were retained because they are both capable of providing a reliable representation of actual inventory flows. We note that this is referred to in paragraph BC20 of the ED, but we disagree with the Board's assertion that:

> '....FIFO and weighted average cost both reflect equally realistic cost flow assumptions for ordinarily interchangeable items.'

In contrast, and as noted above, in our view an entity will apply either FIFO or weighted average cost, selecting the approach that it estimates will best result in it complying with the requirement to measure inventory at the lower of cost and net realisable value.

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

We do not have any other comments on the proposals.