Draft Comment Letter

You can submit your comments on EFRAG's draft comment letter by using the 'Express your views' page on EFRAG's website, then open the relevant news item and click on the 'Comment publication' link at the end of the news item.

Comments should be submitted by [date].

International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

XX September 2019

Dear Mr Hoogervorst,

Re: ED/2019/6 *Disclosure of Accounting Policies (Proposed amendments to IAS 1 and IFRS Practice Statement 2)*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the ED/2019/6 *Disclosure of Accounting Policies (Proposed amendments to IAS 1 and IFRS Practice Statement 2)*, issued by the IASB on 1 August 2019 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS Standards in the European Union and European Economic Area.

EFRAG supports the proposal to replace the reference to the concept of 'significance' (which is not defined in IFRS Standards) with the defined concept of 'materiality'. This has the potential to better relate the assessment about information on accounting policies with the application of materiality to the other information and thus help entities apply judgement in order to identify and disclose accounting policies that provide material information to users.

EFRAG considers that information about accounting policies is most useful when it both relates to material transactions, other events or conditions and also provides insight into how an entity has exercised judgement in selecting and applying accounting policies in its specific circumstances.

EFRAG also notes draws the IASB's attention to the possible interactions inconsistencies of the proposed guidance with the existing disclosure requirements in IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors regarding accounting policy elections and changes.

EFRAG also welcomes the provision of guidance and examples in IAS 1 and Materiality Practice Statement 2 *Making Materiality Judgements* to help entities determine when an accounting policy is material. However, EFRAG has some concerns with proposed illustrative example T which are further described below.

Finally, EFRAG reiterates the regrets it has expressed in its comment letter in response to the IASB's Discussion Paper *Principles of Disclosure* that the IASB has not further considered the effect of the use of technology on the presentation of financial statements, and in particular for standing information such as disclosure about accounting policies.

EFRAG's detailed comments and responses to the questions in the ED are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Hocine Kebli, Ricardo Torres or me.

Yours sincerely,

Jean-Paul Gauzès

President of the EFRAG Board

Appendix - EFRAG's responses to the questions raised in the ED

Question 1

The IASB proposes to amend paragraph 117 of IAS 1 to require entities to disclose their 'material' accounting policies instead of their 'significant' accounting policies. Do you agree with this proposed amendment? If not, what changes do you suggest and why?

Notes to constituents

1 *IAS 1 requires entities to disclose their 'significant' accounting policies. The ED proposes to replace that requirement with a requirement to disclose 'material' accounting policies. The ED also aims at providing guidance to help entities apply the concept of materiality in making decision and help entities identify and disclose all accounting policies that provide material information to primary users of financial statements*

2 *The ED provides that an accounting policy is material if, 'when considered together with other information included in an entity's financial statement, it can reasonably be expected to influence decisions that users make on the basis of those financial statements'.*

3 *In addition, the ED proposes removing the existing description of what an accounting policy comprises from paragraph 117 of IAS 1 to better enable preparers to apply judgement and only disclose material accounting policy information. This is because paragraph 117(a) of IAS 1 refers to the measurement basis used in preparing the financial statements and might be interpreted to mean that an entity should always disclose this information.*

EFRAG's response

EFRAG supports the proposal to replace the reference to the concept of 'significance' (which is not defined in IFRS Standards) with the concept of 'materiality'. This has the potential to better relate the assessment about information on accounting policies with the application of materiality to the other information and, thus help entities apply judgment, to identify and disclose accounting policies that provide material information to users.

4 EFRAG supports referring to the concept of materiality, rather than significance.

5 In its response to the IASB's *Principles of Disclosures* Discussion Paper, EFRAG considered that, in determining which accounting policies to disclose, '*materiality should always be considered*' and suggested that the focus for the IASB should be to clarify '*whether disclosure of accounting policies that relate to material items, transactions or events but are not entity specific should always be provided'*. EFRAG, therefore, welcomes the publication of the ED addressing the above suggestions.

6 EFRAG observes that the term 'significant', is not defined in IFRS Standards and has been translated in a varieties of ways[1] in Europe. Significant is used throughout IFRS Standards to denote the degree of importance or relevance, e.g. 'significant

[1] For instance, the European Union translation of IAS 1 refers to "**principal** accounting policies', in French , whereas the German version refers to "**relevant** accounting policies' (der "maßgeblichen" Rechnungslegungsmethoden).

costs' (IAS 16 *Property, Plant and Equipment*), 'significant increase in turnover rates' (IAS 19 *Employee Benefits*), 'significant period of time' (IFRS 2 *Share-based payment*). Conversely, the term material is well defined understood and already applies to the other information in the financial statements.

7 EFRAG acknowledges that there is an inherent difficulty in applying the concept of materiality to disclosure about accounting policies. This is because an accounting policy, considered in isolation, would rarely directly affect the decisions of users of financial statement. Therefore, as proposed in the ED, the materiality of an accounting policy can only be assessed in combination with other information identified as material.

8 Under the proposed amendments an accounting policy would be material if its disclosure is needed for a user to understand information provided about a material transaction, other event or condition in the financial statements.

9 This has the potential to better relate the assessment about information on accounting policies with the application of materiality to the other information and, thus, help entities apply judgment, to identify and disclose accounting policies that provide material information to users.

Question 2

The proposed new paragraph 117A of IAS 1 states that not all accounting policies relating to material transactions, other events or conditions are themselves material to an entity's financial statements. Do you agree with this proposed statement? If not, what changes do you suggest and why?

Notes to constituents

10 Proposed paragraph 117A states that accounting policies that relate to immaterial transactions, other events or conditions are themselves immaterial and need not be disclosed. Furthermore, not all accounting policies relating to material transactions, other events or conditions are themselves material.

11 For example, accounting policies that only duplicate the requirements of an IFRS Standard, even though the transaction may be material, and those that describe situations which do not require the exercise of judgement, are unlikely to influence the decisions that primary users of financial statements.

12 The ED further provides examples of circumstances in which an entity is likely to consider an accounting policy to be material to its financial statements (see next question on Paragraph 117B of the ED).

EFRAG's response

EFRAG agrees that not all accounting policies relating to material transactions, other events or conditions are necessarily themselves material to an entity's financial statements.

EFRAG considers that information about an accounting policy is mostly useful when it both relates to material transactions, other events or conditions and also provides insight into how an entity has exercised judgement in selecting and applying accounting policies in its specific circumstances.

13 EFRAG agrees that not all accounting policies relating to material transactions, other events or conditions are themselves material to an entity's financial statements.

14 In its response to the 2014 IASB's Exposure Draft (ED/2014/1) *Disclosure Initiative - Proposed amendments to IAS 1,* EFRAG assessed that disclosure of accounting policies as a mere summary of an IFRS Standard is generally not useful and observed that useful disclosure provides insights into how the entity has exercised judgement in selecting and applying accounting policies.

15 EFRAG acknowledged that some are of the view that it should be possible to read financial statements as a self-contained document, i.e. including all applied accounting policies, regardless of whether they involve significant judgement or result from an accounting policy choice. However, in EFRAG's opinion, merely reproducing parts of IFRS Standards had generally little or no information value.

16 Therefore EFRAG agrees that information on accounting policy is mostly useful to users of financial statements when it both:

(a) relates to material transactions, other events or conditions; and

(b) provides insight into how an entity has exercised judgement in selecting and applying accounting policies in its specific circumstances.

17 The proposed amendments provide that immaterial accounting policies 'need not be disclosed', but do not prohibit entities from doing so. Therefore one of the stated objectives of the ED to '*identify and eliminate immaterial accounting policies from the financial Statements*' may not be fulfilled. However the recent introduction of the term 'obscuring' in the definition of materiality has the potential to limit the disclosure of immaterial information.

18 Finally, EFRAG regrets again that the impact of technology on the presentation of financial statements, and in particular for standing information such as disclosure about accounting policies, have not been considered as part of the Disclosure Initiative project so far. Some of the issues addressed by this ED may become less important in a digital reporting era (use of cross-references…)

Question 3

The proposed new paragraph 117B of IAS 1 lists examples of circumstances in which an entity is likely to consider an accounting policy to be material to its financial statements. Do the proposed examples accurately and helpfully describe such circumstances? If not, what changes do you suggest and why?

Notes to constituents

19 Paragraph 117B states that an accounting policy is material if information about that accounting policy is needed to understand other material information in the financial statements. The ED further provides that an entity is likely to consider an accounting policy to be material if that accounting policy relates to material transactions, other events or conditions and:

(a) *was changed during the reporting period;*

(b) *was chosen from one or more alternatives in an IFRS Standard;*

(c) *was developed in accordance with IAS 8 in the absence of an IFRS Standard;*

(d) *relates to an area which an entity is required to make significant judgement or assumption; or*

(e) *applies the requirements of an IFRS Standard in a way that reflects the entity's specific circumstances.*

EFRAG's response

EFRAG considers that providing guidance to help entities determine when an accounting policy is material is useful.

Regarding the list of exampled of circumstances provided in the ED, EFRAG considers that items (e) (applying accounting policies in a way that reflects the entity's specific circumstances) should be identified as a core principle rather than the last 'example of circumstanced') and be given more prominence. This is because EFRAG considers that information on accounting policy is mostly useful when it provides insight into how an entity has exercised judgement in selecting and applying accounting policies in its specific circumstances.

EFRAG also notes the possible inconsistencies of the proposed guidance with the existing disclosure requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* regarding accounting policy elections and changes.

20 EFRAG welcomes the provision of guidance to help entities make materiality judgement to determine whether an accounting policy should be disclosed.

21 In its 2012 Discussion Paper *Towards a Disclosure Framework For the Notes,* EFRAG suggested that a Disclosure Framework should include indicators that assist entities to assess when disclosures are needed. The indicators suggested by EFRAG at the time are generally consistent with the ones proposed in the ED.

22 However, EFRAG considers that example (e) (i.e. how an entity has applied the requirements in IFRS Standards in a way that reflects its own circumstances) should be identified as a core principle (rather than a mere 'example of circumstance') and should be given more prominence. This is because, as mentioned in paragraph 16, above, EFRAG considers that information on an accounting policy is most useful when it provides insight into how an entity has exercised judgement in selecting and applying accounting policies in its specific circumstances.

23 Finally, EFRAG also notes the possible inconsistency between the proposals in the ED and the existing requirements in IAS 8. The ED proposes to consider an accounting policy to be material if that accounting policy both relates to material transactions, other events or conditions and was changed during the reporting period. In contrast, IAS 8 requires specific disclosure on accounting policy elections and changes when they 'have an effect on the current period or any prior periods **or might have an effect on future periods' (emphasis added)**.

24 If a change in accounting policy relates to transactions or events that are not material to the current period but are expected to have material effect in future periods, it is unclear whether the accounting policy would be considered as 'immaterial' for the current period, under the proposals in the ED. EFRAG suggests that the IASB clarifies that the disclosure would still be required under that circumstance.

Question 4

The IASB proposes to add to IFRS Practice Statement 2 *Making Materiality Judgements* two examples that illustrate how the concept of materiality can be applied in making decisions about accounting policy disclosures. Are these examples useful and do they demonstrate effectively how the concept of materiality can be applied in making decisions about accounting policy disclosures? If not, what changes do you suggest and why?

Notes to constituents

25 *The ED proposes amending IFRS Practice Statement 2, adding guidance and examples to help entities applying judgment to determine if an accounting policy is material to its financial statements and how the four-step materiality process can be applied to accounting policy disclosures.*

26 *Proposed amendments include*

(a) *A diagram (decision tree) to help entities determine whether an accounting policy is material; and*

(b) *Two illustrative examples:*

(i) *Example S to illustrating the provision of entity specific information while avoiding standardised ('boilerplate') accounting policy disclosures; and*

(ii) *Example T illustrating a situation whereby an entity's accounting policies only duplicate requirements in IFRS Standards.*

EFRAG's response

EFRAG welcomes the provision of further guidance to illustrate how entities apply judgment to determine if an accounting policy is material and linking the application of materiality to accounting policy disclosures with the four-step materiality process applied to other information described in paragraph 33 of IFRS Practice Statement 2.

27 EFRAG welcomes the provision of examples to illustrate how the concept of materiality can be applied in making decisions about accounting policy disclosures.

28 In particular, EFRAG considers that the clarifications and diagram in proposed paragraph 88C of IFRS Practice Statement 2 are very helpful:

(a) highlighting the need to focus on useful information for users of financial statements; and

(b) clarifying that an accounting policy may be material by nature, even if related amounts in the financial statements are not material by size.

29 However EFRAG considers that the ED could better explain how the application of materiality to accounting policy disclosures is linked with the four-step process applied to other information described in paragraph 33 of IFRS Practice Statement 2

30 EFRAG has also reservations on the usefulness of example T which illustrates a case of impairment policy of tangible and intangible assets. In this example it is suggested that even if the entity's impairment policy is assessed to be material (as it applies to material assets and involves significant judgement and estimates) it need not be disclosed because the entity is applying the provisions of IAS 36 *Impairment of Assets* and IAS 1 already requires specific disclosures on judgements and estimates. That is, there is no benefit in providing additional disclosure about its accounting policy.

31 However, EFRAG notes that:

(a) The disclosures on judgements and sources of estimation uncertainty required by IAS 1, paragraphs 122 and 125, are high level and are limited to the most difficult, subjective and complex judgements (IAS 1, paragraph 127).

(b) Disclosure requirements in IAS 1 about sources of estimation uncertainty only apply to a defined and limited set of matters as they relate to assumptions and estimates at the end of the current reporting period that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

32 EFRAG considers that Example T, if interpreted too broadly, in a loss of information about how an entity has applied IAS 36 to its specific circumstances (including the material estimates made over the period).

33 Lastly, EFRAG also considers that it could be helpful to develop an example whereby an new accounting policy has no material effect in the current period but is expected to have material effects in the future.

Question 5

Would any wording or terminology introduced in the proposed amendments be difficult to understand or to translate?

EFRAG's response

EFRAG has not identified wording or terminology difficulties in the proposed amendments.

34 The terminology used in the proposed amendments does not introduce new concepts and relies on existing and well understood concept of materiality.

35 As mentioned in paragraph 6 above, the term significant is undefined and had been translated in a variety of ways. The proposed amendments could eliminate some of the potential inconsistencies associated with the use of that term.

Question 6

Do you have any other comments about the proposals in this Exposure Draft?

EFRAG's response

EFRAG reiterates its encouragement to the IASB to consider the implication of developments in technology on disclosures such as accounting policies.

36 In its response to the IASB Discussion Paper *Principles of Disclosure*, EFRAG encouraged the IASB to consider the implication of developments in technology on the standing information, such as accounting policies.

37 Developments in technology may influence how much information is included in the printed financial statements.