EFRAG Secretariat: Hocine Kebli,
Ricardo Torres

Disclosure of Accounting Policies (Proposed Amendments to IAS 1 and IFRS Practice Statement 2)

Cover note and summary of responses

Objective

1 The objectives of this session are to:

(a) consider the comments received in response to EFRAG's draft comment letter ("DCL") on the IASB's Exposure Draft ED/2019/6 *Disclosure of Accounting Policies – Proposed amendments to IAS 1 and IFRS Practice Statement 2* (the 'ED'); and

(b) discuss and recommend to the EFRAG Board a final comment letter on the ED.

Background

2 The IASB published the ED in August 2019. Comments on the ED were requested by 29 November 2019.

3 The ED proposes to amend paragraphs 117–122 of IAS 1 *Presentation of Financial Statements* to require entities to disclose their "material" accounting policies rather than their "significant" accounting policies.

4 To support this amendment the IASB also developed guidance and examples to explain and demonstrate the application of the 'four-step materiality process' described in IFRS Practice Statement 2 *Making Materiality Judgements* to accounting policy disclosure and help entities:

(a) identify and disclose all accounting policies that provide material information to primary users of financial statements; and

(b) identify immaterial accounting policies and eliminate them from their financial statements.

EFRAG's Draft Comment Letter

5 EFRAG published its draft comment letter (DCL) on the ED on 4 October 2019 and requested comments by 22 November 2019. In the DCL, EFRAG's supported the proposal to replace the undefined reference to 'significance' with the defined concept of 'materiality'. This, with other Disclosure Initiative projects, may help entities to identify and disclose accounting policies that provide material information to users and the connection to the application of materiality to other information.

6 EFRAG considered 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.

7 However, EFRAG noted 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 policies choices and changes.

8 EFRAG also welcomed the provision of guidance and examples in IAS 1 Presentation of Financial Statements and in IFRS Practice Statement 2 Making Materiality Judgements to help entities determine when an accounting policy is material. However, EFRAG suggested that the IASB could consider providing additional examples.

9 Finally, EFRAG reiterated its regrets 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.

Comment letters received

10 EFRAG received ten comment letters in response to the EFRAG's DCL on the ED The ten comment letters from respondents representing national standard-setters (six), one regulator and three accounting organisations (see list of respondents and links to the comment letters in Appendix I).

11 In addition, two National Standard Setters provided input by email without submitted a formal letter.

Q1- Replacing the reference to 'significance' with the concept of 'materiality'.

12 Ten of the twelve respondents did address explicitly question 1. A majority of these respondents supported or did not object the IASB's proposal to replace the reference to 'significance' with the defined concept of 'materiality'.

13 Two respondents while agreeing with the objective to reduce immaterial disclosures, considered that only changing the terms would not achieve the desired objective:

(a) firstly, because in many languages the notions of 'material' and 'significant' translate into the same word; and

(b) also, because whilst concurring with the substance of that statement in paragraph 117, it was considered too generic and missing a clear link as to how this principle would apply to accounting policy disclosures.

14 One of these respondents suggested that disclosure requirements in IFRS Standards are already subject to the general application of materiality in paragraph 31 of IAS 1: i.e. a disclosure that would otherwise be required by an IFRS Standard need not be provided if the information resulting from that disclosure is not material. Therefore, instead of requiring entities to disclose their 'material' accounting policies, this respondent suggested a simple reference to the concept of materiality in the proposed paragraph 117 of IAS 1 as follows:

> *An entity shall disclose its ~~material~~ accounting policies**, subject to the general concept of materiality per paragraph 31 of this Standard**. Information about an accounting policy is material if, when considered together with other information included in an entity's financial statements, it can reasonably be expected to influence decisions.*

15 This respondent also considered the guidance should focus on pointing out more clearly the distinction between accounting policy disclosures that are relevant and, thus, shall be provided, and those disclosures that shall be omitted. This respondent suggested to clarify:

(a) the purpose of accounting policy disclosure requirements by providing a clear disclosure objective;

(b) which accounting policy disclosures would or would not provide relevant information to primary users of financial statements; and

(c) to what extent primary users of financial statements should be assumed to have the knowledge about specific requirements in IFRS Standards.

16 Another respondent considered that the proposed changes did focus too heavily on whether an accounting policy itself is material. The respondent considered that the relevant question is not whether an accounting policy itself is material but whether and what information about an accounting policy is material.

17 Lastly two respondents did not comment on this question. However, one of them considered that the proposals could reduce the number of duplicated requirements in IFRS Standards.

EFRAG Secretariat analysis

18 Based on the feedback received, the EFRAG Secretariat observes that a majority of respondents supports, like EFRAG's DCL, replacing the notion of 'significant' with 'materiality'. We therefore do not suggest major changes to the position expressed in the draft comment letter.

19 The EFRAG Secretariat considers that the suggestions made by two respondents reported in paragraphs 15 and 16, above, would go beyond the scope of the proposed amendments to IAS 1:

(a) The proposal to provide objectives for disclosure, to help assess materiality, is already being addressed as part of the IASB's other project on *Disclosure Initiative - Targeted Standard-Level Review project*.

(b) Providing guidance on what information to provide about accounting policies is addressed in each IFRS Standards.

Q2- Clarifying that that not all accounting policies relating to material transactions, other events or conditions are themselves material to an entity's financial statements.

20 Ten of the twelve respondents provided input on this proposal. Two respondents did not explicitly address the question.

21 The vast majority of respondents supported the proposals and EFRAG's assessment.

22 One respondent disagreed with excluding information accounting policies for material transactions that only repeats IFRS Standards as such transactions would merit providing at least some basic information (possibly with further references to respective IFRS) on their accounting treatment.

23 Two respondents raised concerns about the possible effects of the amendments on the understandability of the financial statements, in particular for the most complex standards (in both responses to Questions 1 and 2). These respondents considered that the amendments should further consider the understandability of the financial statements when defining which information on accounting policies should be disclosed and the importance of providing entity – specific information.

24 Three respondents noted that, although the proposed amendments are clear that disclosure of immaterial accounting policies are not required but are not prohibited either, it should be made clearer that it is up to the reporting entity to assess what additional information, apart from material accounting policies, need to be disclosed

in order for the users to read and understand the financial statements; if relevant to an entity's circumstances.

25 Conversely, one respondent recommended that the IASB strengthens the language in the ED to explicitly discourage immaterial disclosures, irrespective of whether the accounting policy relates to line items in the financial statements that are material. This respondent suggested to add examples illustrating situations where entities disclose accounting policies for transactions, other events or conditions that are not applicable to them; and highlights this as an example of inappropriate disclosure.

26 This respondent also suggested that one way forward and important safeguard against unnecessary disclosures could be a clear understanding of the assumed knowledge of users of financial statements with respect to the IFRS Standards. This would be helpful when the IASB could address that in the standards or in related due process documents.

EFRAG Secretariat analysis

27 Based on the feedback received, the EFRAG Secretariat observes that the vast majority of respondents support the assessment made in the draft comment letter.

28 We however note the suggestion made that an entity may also consider additional disclosures needed to make the financial statements understandable as a whole has already been addressed in the response to the first question.

29 We therefore suggest revising EFRAG's Comment Letter to emphasise that materiality for disclosures about accounting policies should be assessed having also regard to the <u>overall understandability</u> of the financial statements as to how IFRS Standards have been applied. This change is located in response to Question 2 as this is more appropriate (although some of the comments made by respondents were also included in response to Question 1 as well).

30 The revised response states that EFRAG however suggests that the IASB further clarifies that, in applying the principle of materiality, an entity needs also consider the accounting policies that are relevant to an understanding of its financial statements taken as a whole. We understand that the amendment aims at preventing entities to include "boilerplate" information repeating the text of IFRSs in their financial statements. However, in some cases, information about immaterial accounting policies or information reproducing the requirements in IFRS Standards may be helpful, particularly the case when some accounting requirements in IFRS Standard may be particularly complex as not all primary users of financial statements are accounting experts. Entities should avoid the mere repetition of the text of IFRSs but at the same time they should still ensure that users are provided with the basis to get an understanding of how IFRSs are applied.

31 In addition, we note the suggestion made in paragraph 15 that the guidance should focus on pointing out more clearly the distinction between accounting policy disclosures that are relevant and, thus, shall be provided, and those disclosures that shall be omitted. This change is located in response to Question 2 as this is more appropriate (although the comment was included in response to Question 1).

32 Therefore, the revised response states that EFRAG considered that the application of materiality to accounting policy disclosure requirements would be made easier if and when:

(a) Clear objectives are assigned to each IFRS Standards, allowing preparers to exercise their judgement. We observe that this is the objective of the 'Disclosure Initiative-Targeted Standards-level Review of Disclosures'.

(b) The ED further clarifies which kind of accounting policy disclosures is considered as immaterial or 'boilerplate' (in order to demonstrate which disclosure the IASB would not think to provide relevant information to primary users of financial statements) and which accounting policy disclosures be provided, by including positive examples of entity specific accounting policy disclosures (See question 4); and

(c) To what extent primary users of financial statements should be assumed to have the knowledge about specific requirements in IFRS Standards.

Q3 – *Proposed examples of circumstances in which an entity is likely to consider an accounting policy to be material to its financial statements.*

33 Nine respondents addressed this question. Three respondents did not specifically comment on this matter.

34 The vast majority of respondents who addressed the question agreed with EFRAG's assessment in response to question 3 regarding the examples of circumstances which an entity is likely to consider an accounting policy to be material to its financial statements.

35 While agreeing with the proposed examples:

(a) One respondent suggested that the IASB might consider the situation where information is assessed to be material last year but not in the current year. This respondent suggested that the IASB clarify that the materiality assessment is made in relation to the financial statements, i.e. including the (minimum) comparative information presented in accordance with paragraph 38 of IAS 1.

(b) One respondent expressed doubt to whether the examples (while accurate) would be of much help for preparers as they appeared as rather obvious.

36 Lastly, one respondent considered that examples should not focus on identifying which accounting policy is material but rather on what <u>information about an accounting policy</u> is material and therefore to be disclosed.

EFRAG Secretariat analysis

37 Based on the feedback received, the EFRAG Secretariat does not suggest substantive changes to the drafting of the comment letter. We however suggest including the suggestion made in paragraph 35(a) regarding the materiality assessment is made in relation to the financial statements as a whole, i.e. including the (minimum) comparative information presented in accordance with paragraph 38 of IAS 1.

Q4 – Proposed Examples in IFRS Practice Statement 2 two examples illustrating how the concept of materiality can be applied in making decisions about accounting policy disclosures.

38 Nine of the twelve respondents addressed this question. Three respondents did not comment specifically.

39 The vast majority of respondents who addressed this question overall agreed with the proposed examples.

40 One respondent reiterated the view (made in response to questions 1 and 2) that it was important that the IASB sets a principle that aims to ensuring that the presentation of disclosures does not impair the ability to users to get a comprehensive view and understanding of the accounting policies applied by an entity.

41 Another respondent suggested providing positive example (i.e. examples of disclosure to include rather than only disclosures to exclude) demonstrating how to make materiality judgment on how to provide entity-specific disclosures.

42 Three respondents while overall agreeing with EFRAG's response, also suggested additional examples to illustrate situations where the information on accounting policy is judged to be immaterial, although the accounting policies relates to material transaction.

43 Another respondent suggested to better align the description of the Flowchart Diagram presented in Paragraph 88C of the ED (which refers to *material in size or nature or a combination of both*) with paragraph 41 of Materiality PS describing Step 2 of the 4-step approach materiality assessment (which refers to *the item's nature or size or a combination of both*).

EFRAG Secretariat analysis

44 Based the feedback received, the EFRAG Secretariat does not suggest significant changes to the initial drafting other than the suggested language alignment in Paragraph 43 above.

Q5 – Terminology

45 Eight respondents addressed this question. Four respondents did not comment specifically.

46 The vast majority of respondents who addressed the question agreed with EFRAG's DCL not having identified wording or terminology difficulties in the proposed amendments.

47 Two respondents indicated that the notions of 'material' and 'significant' are translated and used into the same way in many languages (e.g. German or Danish).

EFRAG Secretariat analysis

48 Based the feedback received, the EFRAG Secretariat does not suggest changes to the initial drafting other than reporting the fact that in some jurisdictions the terms significance and materiality are translated into similar or close terms.

Q6- Other comments (if any)

49 Two respondents agreed with EFRAG's comment that the IASB has not further considered the effect of the use of technology on the presentation of financial statements. One of these respondents encouraged EFRAG to elaborate on the role of technology mentioned in paragraphs 36 and 37 of EFRAG's DCL, by addressing how the proposed amendment would change if the impact of technology was taken into account.

50 This respondent also considered that, for consistency, the requirements currently included in other IFRS Standards to disclose accounting policies should also be removed or revisited to incorporate the same principles of these amendments when the IASB implements its proposed amendments.

51 One respondent considered that the IASB should further consider how to improve the way in which disclosures of accounting policies are presented to ensure that users can more easily understand the effects of applying accounting policies on an entity's financial statement and the basis of their preparation.

EFRAG Secretariat analysis

52 Based the feedback received, the EFRAG Secretariat does not suggest changes to the initial drafting other than reporting the fact that the IASB could for instance reconsider whether its proposal, contained in the *Principles of Disclosure Discussion Paper* to allow disclosure on immaterial accounting policies to be incorporated by way of cross reference could be a possible way forward.

Question to EFRAG TEG

53 Does EFRAG TEG have comment on the above analyses of responses received to the DCL consultation?

54 Does EFRAG TEG agree to recommend the final comment letter contained in agenda paper 05-02, to the EFRAG Board?

Agenda papers

55 In addition to this cover note, agenda paper 05-02 *Proposed Final Comment letter on the IASB ED 2019.6 Disclosure of Accounting Policies (marked-up version)* has been provided for this session.

Appendix I: List of respondents

1 The comment letters were received from the following organisations (links to the letters are provided with the respondents' names):

Respondent	Type	Country
UK Financial Reporting Council (FRC)	National Standard Setter	UK
Swedish Enterprise Accounting Group (SEAG)	Accounting Organisation	Sweden
Comissão de Normalização Contabilística (CNC)	National Standard Setter	Portugal
Dutch Accounting Standard Board (DASB)	National Standard Setter	Netherlands
European Securities and Markets Authority (ESMA)	Regulator	United Kingdom
Accounting Standards Committee of Germany (ASCG)	National Standard Setter	Germany
The Italian Standard Setter (OIC)	National Standard Setter	Italy
The Institute of Chartered Accountants in England and Wales (ICAEW)	Accounting Organisation	United Kingdom
Spanish Standard Setter (ICAC)	National Standard Setter	Spain
The Association for Financial Markets in Europe (AFME)	Accounting Organisation	United Kingdom