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European Financial
Reporting Advisory Group
(EFRAG)
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Ref: EFRAG's Draft Comment Letter on IASB's Exposure Draft *Disclosure of Accounting Policies*

Dear Mr Gauzès,

CHER JEAN-PAUL,

The European Securities and Markets Authority (ESMA) thanks you for the opportunity to contribute to EFRAG's due process regarding the draft comment letter on the IASB's Exposure Draft (ED) *Disclosure of Accounting Policies* which aims at proposing targeted changes to IAS 1 *Presentation of Financial Statements* and to IFRS Practice Statement 2 to improve the quality of disclosures on accounting policies applied by issuers in their IFRS financial statements. We are pleased to provide you with the following comments with the aim of improving the enforceability and consistent application of IFRSs.

Like EFRAG, ESMA welcomes the proposed amendments and, particularly, the replacement of the term 'significant' with 'material' in relation to the information that issuers shall disclose on the application of accounting policies. Nevertheless, unlike EFRAG, we would recommend that the IASB introduces a clear disclosure objective that enables reaching a proper balance between the focus on material information and the need to ensure that financial statements remain understandable, especially when more complex accounting standards are applied. In our view, unlike EFRAG, the disclosure of accounting policies should not be restricted only to those relating to material transactions or other conditions and for which an entity has exercised judgement, as this may not result in financial statements that are understandable for all users.

As indicated in ESMA's comment letter on the IASB's Discussion Paper *Principles of Disclosures*¹, in our view, disclosures of accounting policies can be improved by focusing on material and entity-specific information and avoiding the mere repetition of the text of IFRSs, while still ensuring that users are provided with the basis to get an understanding of how IFRS were applied.

¹ https://www.esma.europa.eu/sites/default/files/library/esma32-61-189_cl_to_iasb_on_pod.pdf



Finally, like EFRAG, we consider that the proposed examples of material information on the accounting policies provided in the ED are particularly useful and therefore we support their inclusion in the final amendments.

Our detailed comments on the ED are set out in the Appendix to this letter. In case you have any questions or comments please do not hesitate to contact me or Evert van Walsum, Head of the Investors and Issuers Department (Evert.vanWalsum@esma.europa.eu).

Yours sincerely,



Steven Maijor

Appendix – ESMA's detailed answers to the questions in the ED

Question 1

The Board 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?

1. ESMA supports the proposed amendment to paragraph 117 of IAS 1 to replace the term 'significant' with the term 'material' with regards to the disclosure of accounting policies. As ESMA indicated already in its comment letter to the IASB's Discussion Paper *Principles of Disclosure: 'disclosure of accounting policies can be improved to provide only material information without merely reproducing the text of IFRSs. ESMA notes that accounting policies disclosed in the financial statements provide relevant and useful information when they are entity-specific and provide users with the basis to get an understanding of how IFRS were applied especially when judgement was required'*².
2. However, we are concerned that, by relying in isolation on the reference to materiality, the proposed amendments may result in reducing the level of information provided to users, especially for what concerns the application of more complex standards. In fact, we believe that the proposed amendments should further consider the understandability of financial statements when defining which information on accounting policies should be disclosed.
3. To address this issue, we would propose that the IASB complements the reference to materiality in paragraph 117 of IAS 1 with a disclosure objective indicating that information about accounting policies shall enable users to get a general understanding of how an entity has applied the requirements in IFRS Standards to its own circumstances by providing entity-specific information. We note that the proposed new paragraph 117C could constitute already a suitable basis to set up such disclosure objective within paragraph 117.
4. Furthermore, we strongly support the reference in the new paragraph 117C to the importance of providing entity-specific information. However, in order to help enforceability of this aspect, we would recommend that the proposed text is amended to explicitly state that disclosure of accounting policies *shall* convey entity-specific information.
5. We also agree, as explained by the IASB in paragraph BC12 of the ED, that the notion of materiality in IAS 1 captures the fact that materiality '*depends on the nature or magnitude of information, or both*' and therefore '*it would be unnecessary to repeat such an explanation in the proposed amendments*'. On this basis, we would also encourage the IASB to reconsider whether other parts of the proposed amendments to paragraph 117 of IAS 1 are effectively needed as they reproduce the definition of 'material' that is already contained in IAS 1. Most notably, the ED proposal may seem redundant when it refers to the following aspects which are already part of the guidance on materiality in IAS 1:

² https://www.esma.europa.eu/sites/default/files/library/esma32-61-189_cl_to_iasb_on_pod.pdf

'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 that primary users of general purpose financial statements make on the basis of those financial statements'.

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?

6. ESMA agrees with the proposed amendment introducing paragraph 117A. However, in line with our previous comments, we believe that materiality should be assessed having regard to the objective of providing entity-specific information that enables users of financial statements to gain an understanding of how an issuer has applied the relevant IFRS.
7. In this respect, we believe that when transactions, other events or conditions that are material to the financial statements require particularly complex accounting, the issuer should assess how it can provide material information on the application of its accounting policies so as to enable all users of financial statements to get an understanding of how IFRS have been applied.
8. ESMA acknowledges that striking the right balance between materiality and understandability in determining the information to be provided on accounting policies may require the exercise of judgement by issuers. However, we believe that combining these two factors is necessary to ensure that financial statements are accessible to all users.

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?

9. ESMA agrees that the examples provided in the new proposed paragraph 117B would give rise to material information that enables a user's understanding of how IFRS have been applied to the financial statements. In ESMA's view, the IASB should clarify that these are examples in which material information is expected, rather than merely likely, to arise.
10. We note that the examples proposed are in line with some of the cases highlighted in ESMA's 2015 public statement *Improving the quality of disclosures in the financial*

statements³, where it was highlighted that: “an investor should be able to identify significant accounting policies, that is, those that are important or unique to the business’ operations, where there is a choice of policy under IFRS or where significant judgement has been exercised in the selection and/or the application of the policy”.

11. Moreover, in line with the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, we suggest clarifying that the accounting policies relating to transactions or events that are not material in the current period but are expected to have a material effect in future periods should also be considered as material (e.g. new accounting policy) and therefore required to be disclosed.

Question 4

The Board proposes to add to IFRS Practice Statement 2 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?

12. ESMA agrees that the new examples added to IFRS Practice Statement 2 are useful to demonstrate the application of the concept of materiality.
13. However, regarding the proposed example S, while we agree with the conclusion provided therein, we consider that the analysis should clarify that the accounting policy regarding revenue recognition is material because it applies to a material transaction and it is relevant for users to understand if revenue is recognised at a point in time or over time. In addition, we consider that more weight should be given in the background description to the significant judgements made in allocating the transaction price and not only to the identification of performance obligations.
14. As opposed to proposed example S, we note that the proposed example T describes a situation in which the disclosure of entity-specific information needed to explain how an issuer has accounted for a specific transaction, other events or conditions may be required directly by the relevant Standard. In such circumstances, ESMA believes that it is important that the IASB sets a principle that aims at ensuring that the presentation of disclosures does not impair the ability of users to get a comprehensive view of the accounting policies applied by an issuer. Such principle should take into account the different features of paper-based and electronic reporting.
15. In addition, in line with our comments on the previous question, when contextual information would be considered necessary to enable users to better understand the entity-specific information, issuers should not be exempted from providing such information only because

³ https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-esma-1609_esma_public_statement_improving_disclosures.pdf

they have provided specific disclosures required by the standards applicable to the concerned transaction or event.

16. Finally, we would also suggest including examples addressing situations such as: (i) an accounting policy which has no material effect in the current period, but is expected to have a material effect in the future; and (ii) an accounting policy for items not recognised in the financial statements.

Question 5

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

17. We have not identified any specific wording or terminology issues.

Question 6

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

18. In line with the responses to questions 2 and 4 above, ESMA believes that the new proposed paragraph 117D should further clarify that providing the disclosures required by specific standards regarding the application of certain policies does not exempt issuers from assessing whether they have fulfilled the disclosure objective regarding the disclosure of accounting policies.
19. In addition, as part of the Disclosure Initiative, ESMA believes 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 use this understand the effects of applying these policies on an issuer's financial statements and the basis of their preparation.