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

12 December 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 'significance' (which is not defined in IFRS Standards) with the defined concept of 'materiality'. This, together with the other Disclosure Initiative projects to clarify the definition and application of materiality 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 suggests that the IASB further clarifies that, in applying the principle of materiality, an entity also needs to consider the accounting policies that are relevant to an understanding of its financial statements taken as a whole, consistently with Step 4 of the Materiality assessment process developed by the IASB[1]. EFRAG considers that the assessment of materiality for accounting policies inherently involves a more qualitative assessment considering in particular features such as the level of judgement implied by the accounting policy or the existence of accounting options.

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 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. EFRAG suggests some examples of situations where this might be the case in its detailed response hereafter.

[1] IFRS Practice Statement 2: Making Materiality Judgements.

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.

EFRAG also draws the IASB's attention to 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 elections and changes.

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

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: the development of taxonomy and the digitalisation of information.

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?

EFRAG's response

EFRAG supports the proposal to replace the reference to 'significance' (which is not defined in IFRS Standards) with the concept of 'materiality'. This, together with the other Disclosure Initiative projects to clarify the definition and application of materiality, 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, to identify and disclose accounting policies that provide material information to users.

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

2 This, together with the other Disclosure Initiative projects to clarify the definition and application of materiality has the potential to better relate the assessment about information on accounting and thus help entities apply judgement in order to identify and disclose accounting policies that provide material information to users.

3 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.

4 EFRAG observes that the term 'significant' is not defined in IFRS Standards and has been translated in a variety of ways[23] in Europe. Significant is used throughout IFRS Standards to denote the degree of importance or relevance, e.g. 'significant 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.

5 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.

[3] 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).

6 As indicated in paragraph BC7 of the Basis for Conclusions, 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'. EFRAG considers that this usefully clarifies the purposes of the Amendments and suggests including this in the body of the Amendments.

7 Further, this addition to IAS 1 has the potential to assist entities to better apply judgement to the assessment about information on accounting policies with the application of materiality to the other information 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?

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.

EFRAG 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 consistently with Step 4 of the Materiality assessment process developed by the IASB. EFRAG considers that the assessment of materiality for accounting policies inherently involves a more qualitative assessment considering in particular features such as the level of judgement implied by the accounting policy or the existence of accounting options.

EFRAG suggests some examples of situations where this might be the case in its detailed response.

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 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.

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

9 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.

10 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.

11 Therefore, EFRAG agrees that information on accounting policies 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.

12 The Amendments propose that immaterial accounting policies need not be disclosed, but do not prohibit entities from doing so*.* However, the recent introduction of the term 'obscuring' in the definition of materiality has the potential to limit the disclosure of immaterial information.

13 EFRAG 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 consistently with Step 4 of the Materiality assessment process developed by the IASB. EFRAG considers that the assessment of materiality for accounting policies inherently involves a more qualitative assessment considering in particular features such as the level of judgement implied by the accounting policy or the existence of accounting options.

14 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 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.

15 For example, an entity may have entered into acquisition agreements which may not amount to material balances as of the end of the period but involve elements of complexity and such transactions are expected to occur gain in the future. It may also have already applied accounting policies to such transactions, or similar ones in past periods. In such instances, a proper disclosure of the accounting policies for such transactions may be beneficial to enhance users' understanding of the financial statements. Similarly, an entity may have entered, or considers entering into reverse factoring transactions to finance supply its supply chain. The amount of outstanding transactions as of the balance sheet date may not be material but, because of the specificity and complexity of such transactions, and their re-occurrence over time, the entity may want to further explain the accounting policies applicable to these transactions.

16 EFRAG also considered that the application of materiality to accounting policy disclosure requirements would be made easier if and when clear objectives are assigned to each IFRS Standards, allowing preparers to exercise their judgement. We observe that this is the objective of the project on '*Disclosure Initiative-Targeted Standards-level Review of Disclosures*'.

17 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, has 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 (for example 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?

EFRAG's response

EFRAG considers that providing guidance to help entities determine when an accounting policy is material is useful. However, EFRAG has some comments on the list of circumstances, identified in the ED, in which information about accounting policies is likely to be material.

In particular, EFRAG agrees that information on accounting policies is mostly useful when it provides insight into how an entity has applied accounting requirements in its own circumstances. However, EFRAG observes that item in paragraph 117B(e) ('applying accounting policies in a way that reflects the entity's specific circumstances') may not be helpful in identifying accounting policies that are material as this criteria is more akin to a communication principle as entities are always expected to apply IFRS Standards 'in a way that reflects their specific circumstances'. Therefore, EFRAG proposes that criteria (d) and (e) are combined.

Finally, EFRAG 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 policies elections and changes.

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

19 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.

20 Regarding the examples of circumstances in which an accounting policy is likely to be considered as material, as provided in paragraph 117B of the ED, EFRAG has the following comments:

(a) Criterion (e) (i.e. applying requirements in IFRS Standards in a way that reflects the entity's specific circumstances) may not be helpful, as a standalone criterion in identifying accounting policies that are material. This is because entities are expected to apply IFRS Standards in a way that reflects their specific circumstances. EFRAG considers that this is more align to a principle of communication.

(b) Criterion (d) refers to significant judgements or assumptions. EFRAG suggests that a cross-reference to the relevant paragraphs in IAS 1 discussing significant judgements and assumption is added. EFRAG also suggests clarifying that the level of judgements and assumptions must be assessed in the context of the entity's specific circumstances, events and transactions, thus effectively combining criteria (d) and (e).

21 EFRAG 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 policies 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)**.

22 If a change in an accounting policy relates to transactions or events that are not material to the current period but are expected to have a 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 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?

EFRAG's response

EFRAG welcomes the provision of further guidance to illustrate how entities apply judgement to determine if an accounting policy is material and linking the application of materiality to accounting policies disclosures with the four-step materiality process applied to other information described in paragraph 33 of IFRS Practice Statement 2. EFRAG also suggests that IASB could consider providing additional illustrative examples.

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

24 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.

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

26 EFRAG also observes that some of the proposed guidance is duplicated in similar terms in IAS 1 and in the IFRS Practice Statement 2. For instance, proposed

paragraph 88D of the revised IFRS Practice Statement 2 reproduced in full proposed paragraph 117B of revised IAS 1. The IASB could reconsider whether this is the most useful and practical way to provide the guidance.

27 Regarding Example S, EFRAG agrees with the conclusion that the accounting policy described is material. However, we believe that, in reaching the conclusion, more emphasis should be put on the different revenue recognition patterns rather than the level of judgements involved.

28 Finally, EFRAG considers that it could be helpful to consider additional examples to illustrate situations where assessment about the materiality of accounting policies are less straightforward. For instance, when:

(a) A new accounting policy has no material effect in the current period but is expected to have material effects in the future (see comments in paragraphs 21 and 22 about the possible inconsistencies with the requirements in IAS);

(b) An accounting policy related to an item that is not recognised in the financial statements (for instance unconsolidated SPVs); and

(c) An entity' selection of an accounting option or used allowed practical expedients in applying an accounting policy.

29 Lastly, EFRAG suggests to better align the description in 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 the Materiality Practice Statement describing Step 2 of the 4-step approach materiality assessment and refers to the 'item's nature or size or a combination of both'.

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.

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

31 As mentioned in paragraph 4 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.

32 EFRAG has received feedback that, in some jurisdictions, the words 'significant' and 'material' are translated the same or very similarly, the understanding in both cases being that entities should disclose 'important' policies that are necessary for primary users to understand the financials.

Question 6

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

EFRAG's response

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: the development of taxonomy and the digitalisation of information.