IFRS

STAFF PAPER

March 2019

IASB® meeting

Project	**Disclosure Initiative—Accounting Policies**		
Paper topic	Examples		
CONTACTS	Siobhan Hammond	shammond@ifrs.org	+44 (0) 20 7246 6937
	Kathryn Donkersley	kdonkersley@ifrs.org	+44 (0) 20 7246 6970

This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS® Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in IASB® *Update*.

Objective

1. The objective of this paper is to present staff analysis and recommendations about examples for inclusion in *IFRS Practice Statement 2: Making Materiality Judgements* (Materiality Practice Statement). The examples are intended to help entities determine which accounting policies to disclose.
2. This paper also addresses specific feedback on this topic raised by Board members at the October 2018 Board meeting.

Overview

3. This paper is structured as follows:
   (a) Staff recommendation (paragraph 4);
   (b) Background (paragraphs 5-8);
   (c) Approach to staff analysis (paragraphs 9-11)
   (d) Guidance for entities to use when applying the four-step materiality process to accounting policy disclosure (paragraphs 12-14);
   (e) Examples demonstrating the application of the four-step materiality process to accounting policy disclosure (paragraphs 15-23);
   (f) Next steps (paragraph 24);

(g) Staff recommendation and question for the Board;

(h) Appendix A—Draft guidance for *IFRS Practice Statement 2: Making Materiality Judgements*;

(i) Appendix B—Summary of feedback on the *Disclosure Initiative—Principles of Disclosure* Discussion Paper;

(j) Appendix C—Extracts from *IFRS Practice Statement 2: Making Materiality Judgements*;

(k) Appendix D—Mapping of Example 2 to requirements in IFRS Standards.

Staff recommendation

4. Staff recommend that the Board use two examples to demonstrate the practical application of guidance to help entities apply the four-step materiality process in the Materiality Practice Statement to accounting policy disclosure. Staff also recommend that those two examples:

(a) highlight the need to focus on information which is useful to users of financial statements; and

(b) demonstrate how the application of the four-step materiality process can address the issues of:

(i) boilerplate or generic information being disclosed in accounting policies that are material to the financial statements; and

(ii) accounting policy disclosures containing only information that repeats the requirements of IFRS Standards.

Background

5. In the Materiality Practice Statement, the Board introduced an approach to making materiality judgements. This approach, the four-step materiality process, explains how an entity might approach the assessment of materiality in the preparation of financial statements:

(a) Step 1—identify. Identify information that has the potential to be material;

(b) Step 2—assess. Assess whether information identified in step 1 is, in fact, material;

(c) Step 3—organise. Organise the information within the draft financial statements in a way that communicates the information clearly and concisely to primary users; and

(d) Step 4—review. Review the draft financial statements to determine whether all material information has been identified and materiality considered from a wide perspective and in aggregate, on the basis of the complete set of financial statements.

6. In its July 2018 meeting, the Board tentatively decided to develop additional guidance and examples for the Materiality Practice Statement. These would explain and demonstrate the application of the four-step materiality process to accounting policy disclosure (see ***July 2018 Agenda Paper 11E***).

7. In its October 2018 meeting, the Board discussed guidance and examples for the Materiality Practice Statement (see ***October 2018 Agenda Paper 11A***). At that meeting, the Board tentatively decided to:

(a) clarify that not all accounting policies relating to material transactions, other events or conditions are themselves material to the financial statements; and

(b) continue developing guidance and examples to help entities better exercise judgement about whether the accounting policies they apply to material transactions, other events or conditions are themselves material. The guidance and examples would be developed with the intention of helping entities to:

(i) identify accounting policies that have the potential to be material as they relate to material transactions, other events or conditions (step 1);

(ii) apply judgement about whether those accounting policies identified at step 1 are in fact material (step 2); and

(iii) effectively communicate accounting policies by disclosing accounting policy information that primary users find useful (step 3).

8. In its December 2018 meeting, the Board tentatively decided to amend paragraphs 117-124 of IAS 1 *Presentation of Financial Statements* to require entities to disclose their material accounting policies rather than their significant accounting policies (see ***December 2018 Agenda Paper 11A***).

Approach to staff analysis

9. In making the decisions described in paragraphs 6-8, some Board members provided feedback about the draft guidance and examples developed by the staff for inclusion in the Materiality Practice Statement (see paragraphs 14 and 17).

10. The staff think Board member feedback on the *guidance* for the Materiality Practice Statement is best addressed through the drafting process. Consequently, we are not asking the Board to make any further decisions about the guidance at this meeting. However, to facilitate the Board's discussion about the examples, Appendix A includes the indicative draft guidance from the October 2018 Board meeting.

11. We think that Board member feedback on the *examples* for inclusion in the Materiality Practice Statement was more fundamental. We think it would be helpful for the Board to discuss the examples further. Consequently, paragraphs 15-23 present a summary of feedback from the Board and further staff analysis and recommendations in light of this feedback.

Guidance for entities to use when applying the four-step materiality process to accounting policy disclosure

12. In its October 2018 meeting, the Board tentatively decided to develop guidance to help entities identify material accounting policies using the approach outlined in the 2017 *Disclosure Initiative—Principles of Disclosure* Discussion Paper (Discussion Paper). In doing so, the content from the Discussion Paper that respondents identified as useful would be reframed as a series of explanatory paragraphs (see ***October 2018 Agenda Paper 11A***).

13. The Board was also presented with an example of what that guidance might look like to assist the Board in their discussion about the accompanying examples. The draft guidance discussed in the October 2018 meeting has been included in Appendix A. This guidance is intended to be indicative only and is provided to help the Board members consider the examples that follow.

14. As noted in paragraph 10, Board member feedback about the guidance that we plan to address during the drafting process was that we should:

    (a) clarify that transactions, other events or conditions can be material by size, nature or both. In particular, entities may need to consider whether an accounting policy needs to be disclosed relating to a transaction, other event or condition that is material only by nature and not by size;

    (b) draft the guidance in a way that can be applied to both single transactions and aggregations of similar transactions. A single transaction (and consequently its accounting policy) is rarely material—it is often the aggregation of similar transactions that make them material;

    (c) clarify that IFRS Standards describe two different types of accounting policy choice and that both are an indicator that an accounting policy may be material—that is where IFRS Standards:

        (i) allow a free choice between alternative accounting policies; and

        (ii) contain alternative accounting policies, but require preparers to choose which accounting policy provides the most useful information;

    (d) clarify that entities may be required to provide other types of information about a transaction, other event or condition even if the related accounting policy is assessed as immaterial; and

    (e) consider whether any drafting adjustments are needed to clarify that existing guidance about prior-period information in paragraphs 66-71 of the Materiality Practice Statement also applies to the consideration of accounting policies.

Examples demonstrating the application of the four-step materiality process to accounting policy disclosure

15. Staff think the examples included in the Materiality Practice Statement should directly address the issues identified by users of financial statements and others with today's typical accounting policy disclosures (see Appendix B). In particular, we recommend that the examples should highlight the need to focus on information that is useful to users of financial statements, and address each of the scenarios listed below:
    (a) scenario 1—boilerplate or generic information being disclosed in accounting policies (paragraph 21); and
    (b) scenario 2—accounting policies which duplicate recognition and measurement requirements of IFRS Standards (paragraphs 22-23).

16. We think that the examples, together with the guidance, will provide entities with the tools they need to have confidence in judging whether to disclose an accounting policy.

17. The Board discussed four examples in its October 2018 Board meeting, and provided the following feedback:
    (a) the use of the term 'useful' in the examples should align with the definition of 'useful' in the *Conceptual Framework for Financial Reporting*;
    (b) any example that addresses an entity making an accounting policy choice should specify which factors the entity considered in making that choice. In particular, examples should clearly explain why a specific component of an accounting policy is material and should be disclosed;
    (c) examples should clarify that, while an accounting policy may be judged to be immaterial, other information about the transaction, other event or condition may be material and may need to be disclosed; and
    (d) examples should be more explicit in demonstrating the application of judgement to excluding boilerplate or generic information, or information which only repeats the requirements of IFRS Standards, from accounting policies.

Examples for inclusion in the Materiality Practice Statement

18. Within the Materiality Practice Statement is a section that addresses specific topics detailing how an entity may choose to apply the concept of materiality in the context of:

    (a) prior-period information;

    (b) errors;

    (c) information about covenants; and

    (d) materiality judgements for interim reporting.

19. Each of the specific topics listed in paragraph 18 is accompanied by one or two examples to demonstrate the application of the four-step materiality process in these specific circumstances.

20. Staff recommend that the Board use two examples to accompany the guidance for inclusion in the Materiality Practice Statement. This is because including more than two examples for accounting policy disclosure may give undue weight to this topic in the Materiality Practice Statement.

Scenario 1

21. The following example addresses boilerplate or generic information being disclosed in accounting policies that are material to the financial statements (see paragraph 15). This example has been drafted to demonstrate that only information which will facilitate primary users' understanding of the financial statements as a whole should be disclosed as part of their accounting policy.

Example 1
Background An entity operates within the telecommunications industry. The entity has entered into a number of contracts to deliver both a mobile phone handset and data services. A typical contract is one in which the entity will provide a customer with a handset and data services over a 3-year term. The entity applies IFRS 15 *Revenue from Contracts with Customers* and recognises revenue when, or as, it satisfies its performance obligations in line with the terms of the contract. The entity has identified the following performance obligations:

(a) handset—the customer is expected to make monthly payments for the handset over 3 years; and

(b) data—the customer pays a fixed monthly charge to use a specified amount of data each month for a period of 3 years.

For the handset, the entity recognises revenue when it has satisfied the performance obligation (ie when the handset is provided to the customer). For the provision of data services over the 3-year life of the contract, the entity recognises revenue as it satisfies the performance obligation (ie as the entity provides data services to the customer).

The entity has identified that revenue generated from these contracts is material for the reporting period.

Application

The entity notes that there are two distinct accounting policies for revenue generated from this type of contract:

a) revenue recognised in relation to the sale of handsets; and
b) revenue recognised in relation to the provision of data services.

Having identified that revenue is material to the financial statements, the entity assesses whether its accounting policies for revenue are, in fact, material.

The entity evaluates the effect of disclosing the accounting policies by considering the presence of qualitative factors. The entity noted that its revenue recognition accounting policies:

a) have not changed during the reporting period;

b) were not chosen from alternatives allowed in IFRS Standards; and

c) were not developed in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in the absence of an IFRS Standard that specifically applies.

However, the entity's revenue recognition accounting policies relate to an area for which the entity:

a) has made significant judgements in applying its accounting policies, for example, in deciding how to allocate the transaction price to the performance obligations; and
b) has applied the requirements of the Standard in a way that reflects its own circumstances.

Consequently, the entity concluded that disclosing the accounting policies for revenue recognition are likely to be necessary for its primary users to understand information in the financial statements and could reasonably be expected to influence primary users' decisions. For example, understanding that some revenue is recognised at a point in time, rather than over time, is likely to help users understand how reported revenue streams and cash flows interact. Hence, the entity assessed information about the accounting policies for revenue recognition as material.

The entity then considered which information to include in the accounting policies. In doing so, the entity considered that those factors that led it to conclude that the accounting policies are material were helpful in identifying what information would be useful to its primary users. The entity therefore tailored the accounting policy information to reflect its own circumstances and disclosed information about the:

a) timing of revenue recognition for both revenue recognised in relation to the handset and to the provision of data services; and
b) methods, inputs and assumptions used to determine the transaction price and the amounts allocated to performance obligations.

Scenario 2

22. The following example addresses instances in which accounting policy disclosures contain *only* information that repeats the requirements of IFRS Standards (see paragraph 15). Feedback received from users of financial statements indicates that such accounting policies which duplicate the content of IFRS Standards do *not* provide useful information to users of financial statements (see Appendix B). Rather, accounting policy disclosures should reflect how an entity has applied the IFRS Standards in its own unique circumstances.

23. Staff acknowledge that in some circumstances an entity may be limited to duplicating the recognition and measurement requirements of individual IFRS Standards. However, the following example has been drafted to demonstrate the importance of considering whether the information disclosed in an accounting policy is useful to its primary users.

Example 2

Background

An entity has material amounts of intangible assets and property, plant and equipment. In 20X1 the entity disclosed the following accounting policy relating to impairment of non-current assets:

"The carrying amount of the group's intangible assets and property, plant and equipment are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. For goodwill, and intangibles without a finite life, the recoverable amount is estimated at least annually.

An impairment charge is recognised in the statement of profit or loss whenever the carrying amount of an asset or its cash-generating unit (CGU) exceeds its recoverable amount.

Impairment charges recognised in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to that CGU and then to reduce the carrying amount of the other assets in the unit on a pro rata basis.

The recoverable amount of assets is the greater of their fair value less costs to sell and their value in use. In assessing value in use, estimated future cash flows are discounted to present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the CGU to which the asset belongs.

An impairment charge in respect of goodwill is not subsequently reversed. For other assets, an impairment charge is reversed if there has been a change in the estimates used to determine the recoverable amount, but only to the extent that the new carrying amount does not exceed the carrying amount that would have been determined, net of depreciation and amortisation, if no impairment charge had been recognised."

Application

Having identified that assets that are subject to impairment are material to the financial statements, the entity assesses whether its accounting policy for impairment is, in fact, material.

The entity's impairment accounting policy relates to an area for which the entity is required to make significant judgements or assumptions as described in paragraphs 122 and 125 of IAS 1.

However, the entity noted that it would also be making disclosures about its impairment assessments in meeting the disclosure requirements of IAS 36 *Impairment of Assets* and paragraphs 122 and 125 of IAS 1.

The entity concluded that disclosing a separate accounting policy for impairment is unlikely to be useful to its primary users in understanding information in the financial statements and is therefore not material. This is because the accounting policy does not contain entity-specific information and as a result repeats the requirements of IFRS Standards (see Appendix D). However, the entity would still be required to comply with the specific disclosure requirements of IAS 36 and paragraphs 122 and 125 of IAS 1, and provide information about how the entity has applied IAS 36 during the period, if that information is material.

Next steps

24. If the Board agrees with the staff recommendation in this paper, our next step will be to ask the Board for permission to begin the balloting process for an Exposure Draft of amendments to IAS 1 and the Materiality Practice Statement.

Staff recommendation and question for the Board

Question 1
Does the Board agree with the staff recommendation that the Board should: a) use two examples to accompany the guidance for entities to use when applying the four-step materiality process to accounting policy disclosure; and b) that those two examples should highlight the need to focus on information that is useful to users of financial statements and demonstrate how the application of the four-step materiality process can address the issues of: i) boilerplate or generic information being disclosed in accounting policies that are material to the financial statements; and ii) instances in which accounting policy disclosures contain only information that repeats the requirements of IFRS Standards?

Appendix A—Draft guidance for *IFRS Practice Statement 2: Making Materiality Judgements*

A1. This draft guidance was presented to the Board in its October 2018 meeting (see ***October 2018 Agenda Paper 11A***). It will be updated to reflect the feedback from Board members (see paragraph 14).

Accounting policies

(a) Accounting policies that relate to immaterial transactions, other events or conditions are themselves immaterial and need not be disclosed.

(b) An accounting policy relating to a material transaction, other event or condition should be disclosed if the accounting policy is material to the financial statements. In making this assessment, an entity considers the factors described in paragraphs 46 to 55 (see Appendix C).

(c) Accounting policies are likely to be material if they are necessary to understand the information in the financial statements. For example, an entity may consider an accounting policy to be material to the financial statements if it:

  (i) has changed during a reporting period because the entity was required to or chose to change its policy and this change has resulted in a material change to the amounts included in the financial statements;

  (ii) was chosen from alternatives allowed in IFRS Standards, for example, the option to measure investment property at either cost or fair value;

  (iii) was developed in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in the absence of an IFRS Standard that specifically applies;

  (iv) relates to an area for which an entity is required to make significant judgements or assumptions in applying an accounting policy as described in paragraphs 122 and 125 of IAS 1; or

  (v) relates to an area for which an entity has applied the requirements of an IFRS Standard in a way that reflects its own unique circumstances.

(d) Accounting policies that describe how an entity has applied the requirements in IFRS Standards to its own circumstances (ie entity-specific accounting policies) are likely to be most useful to users and enhances their understanding of financial statements.

Appendix B—Summary of feedback on the *Disclosure Initiative—Principles of Disclosure* Discussion Paper

B1. While respondents supported the Board in developing guidance about which accounting policies to disclose, they did not support the Board's proposed categorisation of accounting policies. They were concerned that requirements based on such categories of accounting policy would be confusing and overly prescriptive (see ***February 2018 Agenda Paper 11J***).

B2. Few respondents provided alternative approaches to the proposal in the Discussion Paper for the Board to consider. However, most respondents thought that any guidance developed by the Board on this topic should be based on the relevance, usefulness and/or materiality of accounting policies (see ***February 2018 Agenda Paper 11J***).

Feedback from users of financial statements

B3. Most users of financial statements who provided feedback on the Discussion Paper thought that accounting policy disclosures are often not useful today and could be improved (see ***February 2018 Agenda Paper 11B***).

B4. Most users said they do not find accounting policies that reproduce or summarise IFRS requirements useful. They thought that accounting policy disclosures are useful only when they:

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

(b) provide insight into how an entity has exercised judgement in selecting and applying accounting policies.

B5. This feedback was reiterated by some participants at the March 2018 meeting of the Board's Capital Markets Advisory Committee. In particular, one user described accounting policy disclosures as "probably the most visible reason why this project started in the first place. [Accounting policy disclosures] are so meaningless and eat up so much space [in the financial statements]".

B6. Unlike some other areas of the Discussion Paper, there was clear support from users for the Board developing guidance to help preparers decide which accounting policies to disclose. Further, users said that the application of materiality is key to deciding which accounting policies to disclose and thought that materiality should be the basis of any requirements developed by the Board. These users thought it would be useful if the Board develop more guidance on how to determine if an accounting policy is material.

Appendix C—Extracts from *IFRS Practice Statement 2: Making Materiality Judgements*

Qualitative factors

46 For the purposes of this Practice Statement, qualitative factors are characteristics of an entity's transactions, other events or conditions, or of their context, that, if present, make information more likely to influence the decisions of the primary users of the entity's financial statements. The mere presence of a qualitative factor will not necessarily make the information material, but is likely to increase primary users' interest in that information.

47 In making materiality judgements, an entity considers both entity-specific and external qualitative factors. These factors are described separately in the following paragraphs. However, in practice, the entity may need to consider them together.

48 An entity-specific qualitative factor is a characteristic of the entity's transaction, other event or condition. Examples of such factors include, but are not limited to:

(a) involvement of a related party of the entity;

(b) uncommon, or non-standard, features of a transaction or other event or condition; or

(c) unexpected variation or unexpected changes in trends. In some circumstances, the entity might consider a quantitatively immaterial amount as material because of the unexpected variation compared to the prior-period amount provided in its financial statements.

49 The relevance of information to the primary users of an entity's financial statements can also be affected by the context in which the entity operates. An external qualitative factor is a characteristic of the context in which the entity's transaction, other event or condition occur that, if present, makes information more likely to influence the primary users' decisions. Characteristics of the entity's context that might represent external qualitative factors include, but are not limited to, the entity's geographical location, its industry sector, or the state of the economy or economies in which the entity operates.

50 Due to the nature of external qualitative factors, entities operating in the same context might share a number of external qualitative factors. Moreover, external qualitative factors could remain constant over time or could vary.

51 In some circumstances, if an entity is not exposed to a risk to which other entities in its industry are exposed, that fact could reasonably be expected to influence its primary users' decisions; that is, information about the lack of exposure to that particular risk could be material information.

Interaction of qualitative and quantitative factors

52 An entity could identify an item of information as material on the basis of one or more materiality factors. In general, the more factors that apply to a particular item, or the more significant those factors are, the more likely it is that the item is material.

53 Although there is no hierarchy among materiality factors, assessing an item of information from a quantitative perspective first could be an efficient approach to assessing materiality. If an entity identifies an item of information as material

solely on the basis of the size of the impact of the transaction, other event or condition, the entity does not need to assess that item of information further against other materiality factors. In these circumstances, a quantitative threshold—a specified level, rate or amount of one of the measures used in assessing size—can be a helpful tool in making a materiality judgement. However, a quantitative assessment alone is not always sufficient to conclude that an item of information is not material. The entity should further assess the presence of qualitative factors.

54 The presence of a qualitative factor lowers the thresholds for the quantitative assessment. The more significant the qualitative factors, the lower those quantitative thresholds will be. However, in some cases an entity might decide that, despite the presence of qualitative factors, an item of information is not material because its effect on the financial statements is so small that it could not reasonably be expected to influence primary users' decisions.

55 In some other circumstances, an item of information could reasonably be expected to influence primary users' decisions regardless of its size—a quantitative threshold could even reduce to zero. This might happen when information about a transaction, other event or condition is highly scrutinised by the primary users of an entity's financial statements. Moreover, a quantitative assessment is not always possible: non-numeric information might only be assessed from a qualitative perspective.

Appendix D—Mapping of Example 2 to requirements in IFRS Standards

D1. The table below demonstrates how the accounting policy disclosure in the Background to Example 2 links to requirements in IAS 36 *Impairment of Assets*. Note that this example was based on several sets of published financial statements.

Extract from Example 2	IAS 36 requirement
The carrying amount of the group's intangible assets and property, plant and equipment are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated.	Paragraph 9
For goodwill, and intangibles without a finite life, the recoverable amount is estimated at least annually.	Paragraph 10(a)
An impairment charge is recognised in the income statement whenever the carrying amount of an asset or its cash-generating unit (CGU) exceeds its recoverable amount.	Paragraphs 59-60
Impairment charges recognised in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to that CGU and then to reduce the carrying amount of the other assets in the unit on a pro rata basis.	Paragraph 104
The recoverable amount of assets is the greater of their fair value less costs to sell and their value in use.	Paragraph 74
In assessing value in use, estimated future cash flows are discounted to present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.	Paragraph 55
For an asset that does not generate largely independent cash inflows, recoverable amount is determined for the CGU to which the asset belongs.	Paragraph 22
An impairment charge in respect of goodwill is not subsequently reversed. For other assets, an impairment charge is reversed if there has been a change in the estimates used to determine the recoverable amount,	Paragraph 114
but only to the extent that the new carrying amount does not exceed the carrying amount that would have been determined, net of depreciation and amortisation, if no impairment charge had been recognised.	Paragraph 117

The International Accounting Standards Board is the independent standard-setting body of the IFRS Foundation, a not-for-profit corporation promoting the adoption of IFRS Standards. For more information visit www.ifrs.org.