

## STAFF PAPER

October 2016

## IASB Meeting

| Project     | Disclosure Initiative: Materiality |                   |                     |
|-------------|------------------------------------|-------------------|---------------------|
| Paper topic | Accounting policy disclosures      |                   |                     |
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**Purpose of this paper**

1. This paper considers the comments received on the Exposure Draft and should be read together with Agenda Paper 11A *Materiality - Cover paper*. It asks the Board whether further guidance on the application of materiality to the disclosure of accounting policies should be included in the final *Practice Statement*; and if yes, what that further guidance should be.

**Guidance proposed in the Exposure Draft**

2. The Exposure Draft did not contain a specific section on the application of materiality to the disclosure of accounting policies. It used the disclosure of accounting policies as an example of how considering quantitative aspects may not be helpful when making assessments about materiality ('Qualitative and quantitative assessment' section, paragraph 27 of the Exposure Draft).
3. In paragraph 27(a) the Exposure Draft stated:

in deciding whether a particular accounting policy should be disclosed, management considers whether its disclosure is *necessary to understand the financial statements*. A description of an accounting policy would be material by its nature if the primary users would be unable to understand the financial statements sufficiently

for their decision-making purposes if it were not disclosed or if it were inadequately disclosed. An example of an *inadequate* and *potentially immaterial* disclosure would be when an entity simply quotes the requirements within IFRS without tailoring the description of its accounting policy to explain how it has been applied by the entity [emphasis added].

## Summary of the feedback

4. Respondents generally welcomed the reference to the disclosure of accounting policies in the Exposure Draft, but they suggested further expanding the guidance provided. One such view was expressed by KPMG in their comment letter (CL69<sup>1</sup>) noting that ‘the guidance provided in paragraph 27(a) is too broad and generic’. They encouraged the Board to ‘clarify principles and provide examples when disclosure of accounting policy is considered necessary’ (CL69).

5. Similarly the Institute of Chartered Accountants in England and Wales (ICAEW) said:

The specific example at paragraph 27(a) does not seem to relate well to the point at issue, which is whether disclosure of a particular accounting policy would be necessary to understand the financial statements (CL16).

6. Respondents also highlighted a number of practical issues on the disclosure of accounting policies:

- (a) whether to disclose accounting policies for items that appear as a comparative but not for the current year, or that do not appear in the financial statements either for the current year or as a comparative:

... do I have to disclose the accounting policy for transactions that affected the comparative figures but not

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<sup>1</sup> The reference CLxx refers to the ID number assigned to the comment letter. The comment letters can be found at <http://www.ifrs.org/Current-Projects/IASB-Projects/Disclosure-Initiative/Materiality/Exposure-Draft-October-2015/Pages/Comment-letter.aspx>

the current period? If the answer is conditional, what are the conditions? (Bill Heritage CL32).

... it would be useful to add guidance emphasising that it is pointless to disclose accounting policies for items that do not appear in the financial statements either for the current year or as comparatives (ICAEW CL16).

- (b) whether an accounting policy related to an item sufficiently material to warrant separate presentation in the financial statements should always be considered material:

If an item is sufficiently material to warrant separate presentation in the financial statements, it is not obvious from the proposed guidance whether the disclosure of the related accounting policy is necessarily material (Asian-Oceania Standard-Setters Group (AOSSG) CL90 and Singapore Accounting Standards Council (Singapore ASC) CL93).

- (c) whether accounting policies that are applied in a straightforward way could be considered not material regardless of the materiality of the items they relate to:

The [Australian Accounting Standards Board (AASB)] is concerned that the wording of the example in the paragraph could be read as suggesting that disclosure of accounting policies that are straightforward (for example, that property, plant and equipment is depreciated over its useful life) and which may consequently appear “boilerplate” could be immaterial for disclosure (AASB CL89).

We had read IAS 1 as requiring an accounting policy in respect of a material accounting area to be disclosed even if there was no choice in IFRS as to that policy (Shell International Limited CL87).

We suggest inclusion of another example illustrating circumstances (if any) where the IASB considers that a non entity-specific accounting policy (ie one where the

requirements must simply be applied without any choice in application) would be material and therefore require disclosure (Australia and New Zealand Banking Group Limited (ANZ) CL47).

7. Furthermore, respondents expressed different views regarding accounting policies that simply quote the requirements of IFRS Standards:
- (a) some respondents said they should be considered as inadequate ('we support the suggested clarification in paragraph 27(a), that just quoting the requirements within IFRS [Standards] without tailoring its description in the accounting policy note is inadequate' Ernst & Young (EY) CL70; 'we agree that it will usually be inadequate' Basel Committee on Banking Supervision (BCBS) CL82);
  - (b) one respondent expressed the opposite view: 'a material transaction or balance in the primary financial statements may be adequately described by quoting from the relevant IFRS if the related accounting treatment is straightforward' (BDO CL94).

The Canadian Accounting Standards Board (AcSB) observed 'the key issue here is the level of knowledge of IFRS [Standards] that an entity can assume the primary users of its financial statements have' (CL44).

8. Finally, some respondents were concerned about the current wording in paragraph 27(a) of the Exposure Draft. They expressed the view that having both 'inadequate' and 'immaterial' in the same sentence might be confusing since it 'is unclear how a disclosure can be both inadequate and immaterial' (AcSB CL44). Moreover 'if an accounting policy disclosure is considered inadequate then the accounting policy must be material in the first place, not immaterial' (KPMG CL69). Singapore ASC also noted that 'it is debatable whether a disclosure of accounting policy that is otherwise material could be rendered immaterial by the manner of its disclosure' (CL93).

## Staff analysis

9. The Board preliminarily discussed the disclosure of accounting policies as part of its Materiality project in September 2014<sup>2</sup> (research stage) and concluded the discussion on accounting policy disclosure should be included in its Principles of Disclosure (POD) project.
10. We have worked closely with the staff assigned to the POD project in considering how to address the concerns raised by respondents to the Exposure Draft.
11. The Discussion Paper on Principles of Disclosure will include a section on the disclosure of accounting policies. That section will discuss whether further guidance should be developed, either in a general disclosure standard or educational material, to help preparers to improve their accounting policy disclosures.
12. In particular, one of the objectives of the POD project is to describe when accounting policies are *significant* for the purpose of paragraph 117 of IAS 1 ('an entity shall disclose its *significant* accounting policies' [emphasis added]), ie which accounting policies should be disclosed in an entity's financial statements.
13. In our view there are two possible approaches in which the Board could address the concerns on accounting policy disclosures raised by respondents to the Exposure Draft. These depend on how the Board views the application of materiality to the disclosure of accounting policies. The Board could:
  - (a) not provide guidance in the final *Practice Statement* on the application of materiality to the disclosure of accounting policies, but develop the requested guidance only within the POD project (Alternative A); or
  - (b) acknowledge the discussion in the POD project but explain that information about an accounting policy can be material information and provide guidance on what makes an accounting policy *material* in the final *Practice Statement* (Alternative B).

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<sup>2</sup> See Agenda Paper ref 11A(c) *Materiality—accounting policy disclosures* presented at the September's Board meeting in 2014.

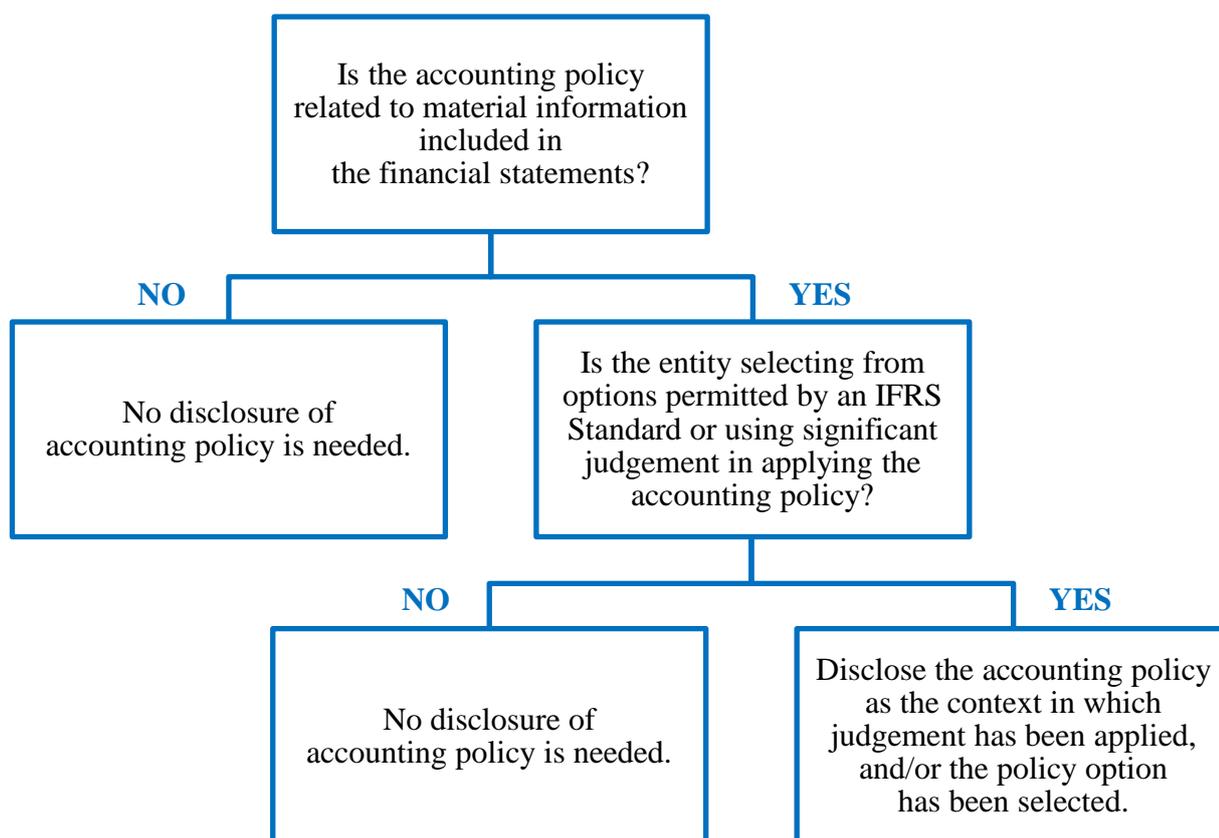
**Alternative A: Do not provide guidance on application of materiality to disclosure of accounting policies**

14. Some argue that accounting policies *only* provide the ‘context’ for a proper understanding of information included in the financial statements. That is, information about accounting policies is not capable of influencing primary users’ decisions. Consequently, the concept of materiality does not apply to accounting policies.
15. Those holding that view argue that, in assessing whether to disclose an accounting policy, an entity would consider whether it is ‘significant’ to an understanding of the financial statements rather than whether it is ‘material’.
16. The POD Discussion Paper suggests that *significant* accounting policies should be disclosed and that significant accounting policies are those that are necessary for an understanding of the financial statements. Moreover, the POD Discussion Paper suggests that accounting policies related to immaterial items, events or transactions (as well as accounting policies that are not used by an entity in preparing the financial statements) are not necessary to understand the information in the financial statements and, therefore, need not be disclosed. The POD Discussion Paper also provides guidance on *what* information should be disclosed about significant accounting policies and *where* accounting policy disclosures should be located in the financial statements.
17. If the Board followed Alternative A, it would describe in the POD project what makes an accounting policy *significant*, suggesting that only significant accounting policies need to be disclosed in the financial statements. This would appear to be consistent with the requirement in paragraph 117 of IAS 1: ‘an entity shall disclose its *significant* accounting policies’ [emphasis added].
18. If Alternative A were followed, there would be no need to provide specific guidance on accounting policy disclosures in the final *Practice Statement*; it would be sufficient that the final *Practice Statement* acknowledges that the disclosure of accounting policies is a matter of significance, as dealt within the POD project, rather than materiality, ie depends on whether the information is necessary for an understanding of the financial statements.

**Alternative B: Provide guidance on assessing what makes an accounting policy material**

19. The basis of Alternative B is that information about accounting policies is capable of influencing the primary users' decisions. Therefore, the concept of materiality should be applied to that information. Consequently the decision about which accounting policies to disclose depends on the materiality of the accounting policy (ie what makes an accounting policy *material*), rather than on its significance. Alternative B therefore seeks to provide guidance on when an accounting policy is material.
20. Under Alternative B, accounting policies would not be material if they relate to information that is not material. Alternative B (in line with Alternative A) would therefore allow entities to exclude from the financial statements accounting policies related to immaterial information.
21. Assessing whether an accounting policy relating to material information is itself material involves assessing whether that accounting policy is a 'straightforward' accounting policy. This aspect of Alternative B, which is not shared by Alternative A, relies on primary users having a *level of knowledge about IFRS Standards* sufficient to understand an entity's financial statements without having to disclose a *straightforward* accounting policy.
22. For the purpose of Alternative B, we based the expectation of primary users' *level of knowledge of IFRS* on paragraph QC32 of the Conceptual Framework for Financial Reporting (*Conceptual Framework*): primary users are not expected to be financial reporting experts, however they are expected to 'have a reasonable knowledge of business and economic activities and [they] review and analyse the information diligently'.
23. For the purpose of Alternative B, an accounting policy is *straightforward* if it is applied without having to use significant judgement (either in applying the policy itself or in developing the policy in accordance with the IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in the absence of specific guidance in IFRS Standards) or having to make a choice in accordance with an option permitted by an IFRS Standard.

24. Therefore, under Alternative B, if material information is accounted for by applying the applicable accounting policy in a straightforward way, there is no need to disclose the accounting policy.
25. We have prepared a decision tree outlining the process proposed in Alternative B.



26. Alternative B would lead to a different outcome compared to the guidance provided in the POD Discussion Paper. According to the reasoning in the POD Discussion Paper, accounting policies that are applied in a straightforward way would still need to be disclosed for primary users to understand the information in the financial statements if they relate to material items. Moreover, the POD Discussion Paper considers as significant (ie requires the disclosure of) all accounting policies that have changed during the period. The POD Discussion Paper and Alternative B diverge in the perception of primary users' knowledge of IFRS Standards.
27. If Alternative B were followed the Board should include in the final *Practice Statement* the decision tree as presented above. Additionally, the final *Practice Statement*

*Statement* could acknowledge that guidance on the significance of an accounting policy will be developed by the POD project, as well as *what* information about the policy should be disclosed and *where*—the location in the financial statements.

### **Basis for the Board decision**

28. The following question might be useful to the Board in deciding between Alternatives A and B: does the Board believe that information about accounting policies is capable of influencing the primary users' decisions and that the expected primary users' knowledge of IFRS Standards would allow them to understand an entity's financial statements without having to disclose a straightforward accounting policy? If yes, the Board should consider selecting Alternative B. If no, the Board should consider choosing Alternative A.

### **Staff recommendation**

29. In our view information about an accounting policy is a piece of information capable of influencing primary users' decisions when:
- (a) the accounting policy is related to material information; and
  - (b) an entity makes an accounting policy choice, or uses significant judgement to either apply or develop the accounting policy.
30. We also believe, on the basis of our interpretation of the guidance provided in the *Conceptual Framework*<sup>3</sup>, primary users of an entity's financial statements should be expected to understand those financial statements without having to disclose straightforward accounting policies.
31. We recommend that the Board includes in the final *Practice Statement* a specific section on accounting policy disclosure based on the guidance outlined in Alternative B. Respondents asked for specific guidance on the application of materiality to the accounting policy disclosures. The guidance outlined in Alternative B is consistent with both the definition of materiality and the guidance

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<sup>3</sup> See paragraph QC32 of the *Conceptual Framework*.

in IAS 1 that information need not be included in the financial statements if it is not material.

## Question for the Board

### **Question 1—guidance on accounting policy disclosure in the final *Practice Statement***

- (a) Do you agree that information about an accounting policy is capable of influencing primary users' decisions when: (i) it relates to material information in the financial statements and (ii) the entity has made an accounting policy choice or has used significant judgement to either apply or develop the accounting policy?
- (b) Do you agree that primary users of an entity's financial statements should be expected to understand those financial statements without having to disclose straightforward accounting policies?
- (c) If yes, do you agree that the final *Practice Statement* should include guidance reflecting these decisions (Alternative B)?