

## STAFF PAPER

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## IASB Meeting

| Project     | Disclosure Initiative: Principles of Disclosure           |  |                      |
|-------------|---|--|----------------------|
| Paper topic | Comment letter feedback—disclosure of accounting policies |  |                      |
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**Objective**

1. This paper provides a detailed analysis of feedback received from comment letters on Section 6 of the *Disclosure Initiative—Principles of Disclosure* Discussion Paper. Feedback from users of financial statements is summarised separately in Agenda Paper 11B. Section 6 of the Discussion Paper discusses guidance to help entities provide more useful accounting policy disclosures.
2. This paper is structured as follows:
  - (a) Key messages (paragraphs 3-4);
  - (b) Background and questions in the Discussion Paper (paragraphs 5-6)
  - (c) Determining which accounting policies to disclose (paragraphs 7-19);
    - (i) Accounting policy categories (paragraphs 10-16);
    - (ii) Alternative suggestions (paragraphs 17-19);
  - (d) Location of accounting policy disclosures (paragraphs 20-27);
    - (i) Whether to develop any guidance (paragraphs 21-22);
    - (ii) Content of guidance (paragraph 23);
    - (iii) Form of guidance (paragraphs 24-27);

- (e) Appendix A—Extract from IAS 1 *Presentation of Financial Statements*—Paragraphs 117-124.

## Key Messages

3. Many respondents supported the Board developing guidance about which accounting policies to disclose. However, respondents expressed concerns about the approach to developing that guidance that was described in the Discussion Paper—in particular the use of categories. Respondents also expressed concerns about the risk of any requirements developed being overly prescriptive (paragraphs 7-19).
4. Respondents provided fewer comments about the location of accounting policies. They thought the Board should prioritise developing guidance about which accounting policies to disclose. Those that did provide comments on location had mixed views on whether the Board should develop any guidance, and on what that guidance should look like (paragraphs 20-27).

## Background and questions in the Discussion Paper

5. The Board observed that users of financial statements and other stakeholders often express concerns about how accounting policies are disclosed in the financial statements. In particular, the accounting policy section of an entity’s financial statements can be long and unhelpful due to the lack of clarity around how to effectively communicate accounting policy disclosures.
6. The Discussion Paper included the following questions on the disclosure of accounting policies:

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| <p><b>Question 10</b></p> <hr/> <p>The Board’s preliminary views are that:</p> <ul style="list-style-type: none"> <li>• a general disclosure standard should include requirements on determining which accounting policies to disclose as described in paragraph 6.16; and</li> </ul> |
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- the following guidance on the location of accounting policy disclosures should be included either in a general disclosure standard or in non-mandatory guidance (or in a combination of both):
    - the alternatives for locating accounting policy disclosures, as described in paragraphs 6.22-6.24; and
    - the presumption that entities disclose information about significant judgements and assumptions adjacent to disclosures about related accounting policies, unless another organisation is more appropriate.
- (a) Do you agree with the Board’s preliminary view that a general disclosure standard should include requirements on determining which accounting policies to disclose as described in paragraph 6.16? Why or why not? If you do not agree, what alternative proposal(s) do you suggest, and why?
- (b) Do you agree with the Board’s preliminary view on developing guidance on the location of accounting policy disclosures? Why or why not? Do you think this guidance should be included in a general disclosure standard or a non-mandatory guidance (or in a combination of both)? Why?

If you support the issuance of non-mandatory guidance in Question 10(b), please specify the form of non-mandatory guidance you suggest (listed in paragraphs 2.13(a)-(c)) and give your reasoning.

## Determining which accounting policies to disclose

7. Many respondents agreed with the Board’s preliminary view that a general disclosure standard should include requirements on determining which accounting policies to disclose. This was because respondents thought that requirements for determining which accounting policies to disclose would improve the effectiveness of disclosures for the users of financial statements.
8. However, some of these respondents also highlighted the importance of an entity being able to exercise judgement when determining which accounting policies to disclose. These respondents cautioned the Board against developing overly prescriptive requirements.
9. A few other respondents did not support requirements on determining which accounting policies to disclose. Most of these respondents expressed concerns about the risk of limiting an entity’s ability to apply judgement. In addition, some

of these respondents thought that the existing guidance in IAS 1 *Presentation of Financial Statements* is sufficient (see Appendix A).

### ***Accounting policy categories***

10. The Discussion Paper summarised three categories of accounting policies:
  - (a) Category 1—accounting policies that are always necessary for understanding information in the financial statements, and relate to material items, transactions or events:
    - (i) those that have changed during the reporting period because the entity either was required to or chose to change the policies;
    - (ii) those chosen from alternatives allowed in the IFRS Standards;
    - (iii) those developed in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in the absence of an IFRS Standard that specifically applies; and
    - (iv) those for which an entity is required to make significant judgements and/or assumptions as described in paragraphs 122 and 125 of IAS 1 in applying the accounting policy.
  - (b) Category 2—accounting policies that are not in Category 1, but also relate to items, transactions or events that are material to the financial statements, either because of the amounts involved or because of their nature; and
  - (c) Category 3—any other accounting policies used by the entity in preparing the financial statements not included in Categories 1 or 2.
11. The Board’s preliminary view is to require the disclosure of Category 1 and 2 accounting policies and exclude from disclosure Category 3 accounting policies.
12. Respondents generally expressed mixed views on both:
  - (a) whether the Board should categorise accounting policies at all; and
  - (b) the specific categories described in the Discussion Paper.

*Whether to categorise accounting policies at all*

13. Some respondents agreed that a general disclosure standard should describe categories of accounting policies because this would be helpful to stakeholders applying the requirements.
14. Some other respondents thought that the Board should not categorise accounting policies in a general disclosure standard. This was because:
  - (a) many of these respondents thought that the categories would make accounting policy disclosures more confusing and more complex; and
  - (b) some of these respondents expressed concerns that entities might be unable to appropriately distinguish between the categories. For example, respondents were concerned that entities might disclose Category 3 policies only because they would not be able to distinguish them from Categories 1 and 2.

*Specific categories described in the Discussion Paper*

15. Many respondents thought that the Board needed to provide more clarification about how to classify accounting policies between the three categories. In particular, many thought that entities might find it difficult to distinguish between Category 1 and 2 accounting policies. These respondents also commented that it may be unnecessary to distinguish between these two categories of accounting policy if entities are required to disclose both. Consequently, respondents suggested these two categories should be combined.
16. Respondents expressed the following views on Category 3 accounting policies as described in the Discussion Paper:
  - (a) most agreed that the Board should not require entities to disclose Category 3 accounting policies. Furthermore, many of these respondents thought the Board should not provide guidance on Category 3 accounting policies at all. This was because Category 3 accounting policies are, by definition, not material to the financial statements;
  - (b) some suggested that, if the Board does develop requirements about Category 3 accounting policies, these requirements should allow

entities to exercise judgement about what to disclose. These respondents cautioned the Board against developing any overly prescriptive requirements;

- (c) some expressed concerns about prohibiting disclosure of Category 3 accounting policies from the financial statements. These respondents also thought that, if Category 3 accounting policies are prohibited from being disclosed the financial statements:
  - (i) companies would need to include an explicit statement in their financial statements to inform users of this; and
  - (ii) they should be made available elsewhere (for example, on company websites); and
- (d) a few respondents thought that *all* accounting policies used in the preparation of the financial statements should be disclosed regardless of their relevance, usefulness and/or materiality. Consequently, these respondents disagreed with the preliminary views in the Discussion Paper about Category 3 accounting policies.

### ***Alternative suggestions***

- 17. Many respondents suggested alternative approaches to developing guidance on which accounting policies to disclose. Most of these respondents thought the Board should develop guidance based on the relevance, usefulness and/or materiality of accounting policies. These respondents thought that, instead of categorising accounting policies, the Board should develop guidance on how an entity should determine when an accounting policy is material and needs to be disclosed.
- 18. Some respondents also thought that the Board should develop guidance to help companies determine when an accounting policy does not need to be disclosed.
- 19. Many respondents said that, in their view, preparer education would result in improved accounting policy disclosures. These respondents generally were not specific about how best to achieve such education.

## Location of accounting policy disclosures

20. Respondents provided feedback on:
- (a) whether the Board should develop guidance on the location of accounting policy disclosures at all;
  - (b) the content of any such guidance; and
  - (c) what form any guidance should take (ie mandatory vs non-mandatory).

## *Whether to develop guidance*

21. Many respondents thought the development of guidance on the location of accounting policies would be helpful.
22. Some other respondents expressed concerns about developing guidance on the location of accounting policies:
- (a) some respondents expressed the view that problems with the location of accounting policy disclosures are a direct consequence of problems with the content of these disclosures. For example, some think that because accounting policies often, in their view, contain unnecessary or unhelpful information, guidance on location is needed to avoid obscuring (or “cluttering”) more relevant information. These respondents generally thought that if problems with content of accounting policy disclosures can be resolved, then guidance on location would be unnecessary. In other words, these respondents thought the Board should prioritise developing guidance on which accounting policies to disclose rather than focusing on location;
  - (b) a few respondents stated that the development of such guidance would be a move away from a principle-based disclosure guidance;
  - (c) a few respondents thought that development of such guidance might restrict innovation by companies determining how to most effectively communicate with their users;

- (d) a few respondents also thought that sufficient guidance already exists and that educating preparers could solve many of the accounting policy disclosure issues discussed in the Discussion Paper; and
- (e) a few respondents were concerned about how the location of accounting policies could be audited if the Board develops any mandatory requirements.

### ***Content of guidance***

23. Respondents that commented on the content of any guidance or requirements on location of accounting policies had mixed views:
- (a) some respondents thought that any guidance should not be too prescriptive and should allow entities to exercise judgement. These respondents thought it important for companies to have flexibility to decide how best to communicate most effectively with their users;
  - (b) conversely, some other respondents thought that allowing entities to choose the location and format of accounting policy disclosures would negatively affect comparability across different companies. These respondents supported guidance that would encourage consistent and comparable disclosures;
  - (c) some respondents supported disclosures of accounting policies and significant judgements and estimates being located in a single place within the financial statements; and
  - (d) some other respondents supported disclosure of accounting policies and significant judgements and estimates being located with the relevant note to the financial statements.

### ***Form of guidance***

24. Respondents expressed mixed views on the best form for any guidance on location of accounting policies. Some preferred mandatory requirements, others preferred non-mandatory guidance, and some preferred a mix of the two.

25. Those that supported mandatory guidance expressed the following views:
- (a) a few respondents thought that mandatory requirements would improve the consistency and comparability of accounting policy disclosures more than non-mandatory guidance. These respondents also thought such an approach might reduce costs through the standardisation of information;
  - (b) a few respondents thought that mandatory guidance would assist in addressing the behavioural issues described in the Discussion Paper;
  - (c) a few respondents stated that non-mandatory guidance would potentially be subject to regional regulation that would, in effect, make it mandatory for some jurisdictions. These respondents thought it would be less confusing if the Board provide mandatory guidance in the first place; and
  - (d) a few respondents thought that non-mandatory guidance might be more confusing than helpful. These respondents thought that mandatory guidance would provide a clearer message about what the Board is trying to achieve.
26. Those that supported non-mandatory guidance expressed the following views:
- (a) some thought that the most effective way to communicate accounting policies is likely to be entity-specific. These respondents thought that companies should have the flexibility to apply judgement as to how to communicate most effectively with the users of their financial statements;
  - (b) a few thought that sufficient mandatory guidance on the disclosure of accounting policies already exists in IAS 1 (refer paragraphs 117 to 124); and
  - (c) those that generally did not support any activity by the Board relating to the location of accounting policies said that, if the Board must do something, they would prefer that it be non-mandatory.
27. Some of those that supported the development of non-mandatory guidance specified that this should take the form of an Illustrative Example.

**Appendix A—Extract from IAS 1 *Presentation of Financial Statements*—  
Paragraphs 117-124**

***Disclosure of accounting policies***

- 117 **An entity shall disclose its significant accounting policies comprising:**
- (a) **the measurement basis (or bases) used in preparing the financial statements; and**
  - (b) **the other accounting policies used that are relevant to an understanding of the financial statements.**
- 118 It is important for an entity to inform users of the measurement basis or bases used in the financial statements (for example, historical cost, current cost, net realisable value, fair value or recoverable amount) because the basis on which an entity prepares the financial statements significantly affects users' analysis. When an entity uses more than one measurement basis in the financial statements, for example when particular classes of assets are revalued, it is sufficient to provide an indication of the categories of assets and liabilities to which each measurement basis is applied.
- 119 In deciding whether a particular accounting policy should be disclosed, management considers whether disclosure would assist users in understanding how transactions, other events and conditions are reflected in reported financial performance and financial position. Each entity considers the nature of its operations and the policies that the users of its financial statements would expect to be disclosed for that type of entity. Disclosure of particular accounting policies is especially useful to users when those policies are selected from alternatives allowed in IFRSs. An example is disclosure of whether an entity applies the fair value or cost model to its investment property (see IAS 40 *Investment Property*). Some IFRSs specifically require disclosure of particular accounting policies, including choices made by management between different policies they allow. For example, IAS 16 requires disclosure of the measurement bases used for classes of property, plant and equipment.
- 120 [Deleted]
- 121 An accounting policy may be significant because of the nature of the entity's operations even if amounts for current and prior periods are not material. It is also appropriate to disclose each significant accounting policy that is not specifically required by IFRSs but the entity selects and applies in accordance with IAS 8.
- 122 **An entity shall disclose, along with its significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph 125), that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.**
- 123 In the process of applying the entity's accounting policies, management makes various judgements, apart from those involving estimations, that can

significantly affect the amounts it recognises in the financial statements. For example, management makes judgements in determining:

- (a) [deleted]
- (b) when substantially all the significant risks and rewards of ownership of financial assets and, for lessors, assets subject to leases are transferred to other entities;
- (c) whether, in substance, particular sales of goods are financing arrangements and therefore do not give rise to revenue; and
- (d) whether the contractual terms of a financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

124 Some of the disclosures made in accordance with paragraph 122 are required by other IFRSs. For example, IFRS 12 *Disclosure of Interests in Other Entities* requires an entity to disclose the judgments it has made in determining whether it controls another entity. IAS 40 *Investment Property* requires disclosure of the criteria developed by the entity to distinguish investment property from owner-occupied property and from property held for sale in the ordinary course of business, when classification of the property is difficult.