# STAFF PAPER

**May 2020**

## IASB Meeting

| | | | |
|---|---|---|---|
| **Project** | **Disclosure Initiative: Accounting Policies** | | |
| Paper topic | Characteristics of primary users | | |
| CONTACT(S) | Siobhan Hammond | shammond@ifrs.org | +44 (0) 20 7246 6937 |
| | Rachel Knubley | rknubley@ifrs.org | +44 (0) 20 7246 6904 |



## Objective

1. Many respondents to the Exposure Draft *Disclosure of Accounting Policies* expressed concern that the Board is assuming that primary users have a greater knowledge of the requirements of IFRS Standards than is the case. Some of these respondents also sympathised with the Alternative View to the Exposure Draft (see Appendix A).

2. The objective of this paper is to present staff analysis and recommendations about how to address this feedback.

## Overview

3. This paper is structured as follows:

   (a) Summary of staff recommendation (paragraph 4);

   (b) Summary of feedback (paragraphs 5-10);

   (c) Staff analysis (paragraphs 11-30);

      (i) Developing guidance about the characteristics of primary users (paragraphs 15-19);

      (ii) Developing a disclosure objective for accounting policy disclosures (paragraphs 20-24);

(iii) Adding an example of a circumstance to proposed paragraph 117B of IAS 1 (paragraphs 25-29)

(iv) Staff recommendation and question for the Board (paragraph 30);

(d) Appendix A—Alternative View of Mr Martin Edelmann of the Exposure Draft *Disclosure of Accounting Policies*;

(e) Appendix B—Extract from the Exposure Draft: Proposed amendments to IAS 1 *Presentation of Financial Statements*;

(f) Appendix C—Extracts from existing guidance on the characteristics of primary users.

## Summary of staff recommendation

4. Staff recommend that the Board add a circumstance to proposed paragraph 117B of IAS 1 which would clarify that, when the accounting required by an IFRS Standard is complex or may not be generally understood by users of financial statements, material accounting policy information could include standardised descriptions or information that duplicates the requirements of IFRS Standards.

## Summary of feedback (see *February 2020 Agenda Paper 20*)

5. Most respondents agreed with the statement in paragraph 117A of the Exposure Draft that '*not all accounting policies relating to material transactions, other events or conditions are themselves material*' (see Appendix B). A few other respondents disagreed with this proposal because they thought accounting policies relating to material transactions, other events or conditions are inherently material.

6. However, many respondents were of the view that the proposals in the Exposure Draft place too much reliance on primary users understanding the requirements of IFRS Standards. Some of these respondents stated that, in their experience, users are not accounting experts and sympathised with the Alternative View in the Exposure Draft (see Appendix A). In particular, they believe that the understandability of financial statements could be affected by the proposals.

7. Some respondents also thought the Board should further consider the importance of the enhancing qualitative characteristic 'understandability'[1]. These respondents thought that including standardised descriptions, or duplicating the requirements of IFRS Standards, in an accounting policy can be useful when IFRS Standards are particularly complex. This is because describing such policies can help users understand how material transactions, other events or conditions are reflected in financial statements. These respondents suggested the Board consider:

    (a) including a disclosure objective indicating that information about accounting policies should enable users to get a general understanding of how an entity has applied the requirements in IFRS Standards to its own circumstances; or

    (b) stating that an entity should make accounting policy disclosures when they believe that such disclosure would provide useful information to their users. For example, in jurisdictions that have a local GAAP, disclosing standardised descriptions or duplicating the requirements of IFRS Standards might help users to understand how the IFRS Standards differ from their local GAAP.

8. Some respondents thought that the proposals imply that accounting policy information which contains standardised descriptions or duplicates the requirements of IFRS Standards should be assessed as immaterial and need not be disclosed. Many of these respondents thought that this could result in material information being omitted from the financial statements.

9. Some respondents also thought accounting policy information that is a standardised description or duplicates the requirements of IFRS Standards can provide context for other information in the financial statements. These respondents also thought that such accounting policy information could give even knowledgeable users a better understanding of assumptions applied by an entity in the financial statements.

10. A few respondents thought it would be useful if the Board clarified what the assumed knowledge of users is with respect to IFRS Standards.

[1] See paragraphs 2.34-2.36 of the *Conceptual Framework for Financial Reporting*

## Staff analysis

### *Overview*

11. The Basis for Conclusions on the Exposure Draft explained that the Board has received feedback that:

    (a) accounting policy disclosures are useful to users of financial statements only when they:

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

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

    (b) users of financial statements do not find accounting policy disclosures useful when they:

        (i) contain standardised descriptions, sometimes referred to as 'boilerplate'; and

        (ii) only duplicate or summarise the requirements of IFRS Standards.

12. To address the feedback in paragraph 11 and help entities focus on disclosing information about their accounting policies which is material, the Board clarified that not all accounting policies relating to material transactions, other events or conditions are themselves material.

13. We do not think it was the Board's intention in developing the proposals to prohibit entities from including standardised descriptions or duplicating the requirements of IFRS Standards in their accounting policies. Instead, the Board is seeking to help entities provide accounting policy disclosures that are more useful to users of financial statements by focusing on entity-specific information.

14. Staff agree with those respondents that thought that, without providing guidance in addition to the proposals in the Exposure Draft, there is a risk that entities could omit material accounting policy information from their financial statements (see paragraphs 5-10). Consequently, staff have analysed the following options:

(a) developing guidance about what the characteristics of primary users are—for example, the Board could clarify what the assumed knowledge of primary users is with respect to IFRS Standards (see paragraphs 15-19);

(b) developing a disclosure objective for accounting policy disclosures—the disclosure objective could remind preparers to consider whether they have made all material accounting policy disclosures and if those disclosures are understandable (paragraphs 20-24); and

(c) adding an example to proposed paragraph 117B of IAS 1 to clarify that accounting policy information that includes standardised descriptions or duplicates the requirements of IFRS Standards may be material in some circumstances—for example, if the entity believes that such information is required for their users to understand material transactions, other events or conditions in their financial statements (paragraphs 25-29).

### *Developing guidance about the characteristics of primary users*

15. A few respondents to the Exposure Draft thought it would be useful if the Board clarified what the assumed knowledge of users is with respect to IFRS Standards as this would help them identify accounting policy information that is likely to be material.

16. Staff note that there is already guidance in the *Conceptual Framework for Financial Reporting*, IFRS Standards and other IFRS publications to help entities (see Appendix C):

    (a) identify their primary users;

    (b) determine the characteristics of those primary users; and

    (c) identify the common information needs of those primary users.

17. The guidance being proposed in paragraph 117B of IAS 1 focuses on helping an entity identify when information about its accounting policies could meet the common information needs of their primary users.

18. We think that further guidance on the characteristics of primary users, such as their assumed level of knowledge about IFRS Standards, is probably unnecessary and is beyond the scope of this project.

19. Consequently, staff recommend that the Board does not develop additional guidance about the characteristics of primary users, including their level of assumed knowledge, as part of this project.

### *Developing a disclosure objective for accounting policy disclosures*

20. Some respondents suggested the Board develop a disclosure objective for accounting policies based on the enhancing qualitative characteristic 'understandability'. The objective would explain that accounting policy information should enable users to understand how an entity has applied the requirements in IFRS Standards to its own circumstances (see paragraph 7(a)).

21. Proposed paragraph 117B of IAS 1 includes a reference to 'understandability':

> 117B An accounting policy is material if information about that accounting policy is needed to understand other material information in the financial statements…

22. Proposed paragraph 117C of IAS 1 goes further to provide guidance on the type of information that is most useful to users of financial statements:

> 117C Information about accounting policies that focuses on how an entity has applied the requirements in IFRS Standards to its own circumstances provides entity-specific information that is more useful to users of financial statements than standardised descriptions or information that only duplicates the recognition or measurement requirements of IFRS Standards.

23. Staff think that, in line with proposed paragraphs 117B and 117C of IAS 1, the objective of disclosing accounting policy information is to make the financial statements more understandable to users, thereby enhancing their usefulness.

24. Including a disclosure objective in IAS 1 that is based on the enhancing qualitative characteristic of 'understandability' might prompt entities to apply judgement about

what accounting policy information is material to the users of their financial statements. However, we do not recommend adding such an objective, because:

(a) adding a disclosure objective to the proposals would not address the concern raised which was that entities could omit material accounting policy information from their financial statements if that information were a standardised description or duplicated the requirements of IFRS Standards; and

(b) such an objective, if added, would duplicate the guidance already proposed in paragraphs 117B and 117C of IAS 1.

### *Adding an example of a circumstance to proposed paragraph 117B of IAS 1*

25. As explained in paragraph 11, the Board has received feedback that accounting policy disclosures are useful when they include entity-specific information.

26. However, some respondents to the Exposure Draft thought that in some situations, such as when the requirements of an IFRS Standard are particularly complex, useful accounting policy information can also include information that contains standardised descriptions or duplicates the requirements of IFRS Standards. These respondents thought in these circumstances such information is so fundamental to users' understanding of the financial statements that it would be material. They thought there was a risk that the proposals, as drafted, could lead to entities omitting material information from the financial statements (see paragraphs 5-10).

27. To address this concern, a few respondents suggested that the Board consider adding an example to proposed paragraph 117B of IAS 1 (see Appendix B) that would describe a circumstance in which an entity is likely to consider accounting policy information that is a standardised description or that duplicates the requirements of IFRS Standards to be material.

28. For example, a circumstance could be added to the list in proposed paragraph 117B of IAS 1 which reads:

> An accounting policy is material if information about that accounting policy is needed to understand other material information in the financial statements. For example, an entity is likely to consider an accounting policy to be material to its financial statements if that accounting policy relates to material transactions, other events or conditions and:
>
> …
>
> (x) the accounting required by an IFRS Standard is complex or may not be generally understood by users of the entity's financial statements.

29. We think this suggestion has merit because it would:

    (a) prompt entities to consider whether primary users have sufficient information about the entity's accounting policies to understand its material transactions, other events or conditions;

    (b) address the feedback that in particular situations useful accounting policy information can include standardised descriptions or information that duplicates the requirements of IFRS Standards; and

    (c) address the concern raised that the proposals, as drafted, may result in material information being omitted from the financial statements.

### *Staff recommendation and question for the Board*

30. Staff recommend that the Board add an example of a circumstance to proposed paragraph 117B of IAS 1 which would clarify that, when the accounting required by an IFRS Standard is complex or may not be generally understood by users of financial statements, material accounting policy information could include standardised descriptions or information that duplicates the requirements of IFRS Standards.

| **Question 1** |
| --- |
| Does the Board agree with the staff recommendation in paragraph 30? |

## Appendix A—Alternate View of Mr Martin Edelmann of the Exposure Draft *Disclosure of Accounting Policies*

AV1 Mr Edelmann voted against the publication of the Exposure Draft *Disclosure of Accounting Policies* which proposes to amend IAS 1 *Presentation of Financial Statements* and IFRS Practice Statement 2 *Making Materiality Judgements*.

AV2 In Mr Edelmann's view, accounting policies should be disclosed if management believes the disclosure would assist users of financial statements in understanding how transactions, other events and conditions are reflected in the reported financial performance and financial position. Not all primary users of financial statements are accounting experts (see paragraph 2.36 of the *Conceptual Framework of Financial Reporting*). Hence, the disclosure of accounting policies could help them to better understand an entity's reported financial performance and financial position even if such accounting policies are not important enough to be assessed as material because they would not be expected to influence the investment decisions of users.

AV3 Mr Edelmann suggests that, in some cases, accounting policies available from sources, such as IFRS Standards, should be disclosed because they may help users to better understand financial performance and position. Such disclosure may be useful when the accounting required by an IFRS Standard is particularly complex.

## Appendix B—Extract from the Exposure Draft: Proposed amendments to IAS 1 *Presentation of Financial Statements*

**Disclosure of accounting policies**

**117 An entity shall disclose its ~~significant~~ material accounting policies. Information about an accounting policy is material if, when considered together with other information included in an entity's financial statements, it can reasonably be expected to influence decisions that primary users of general purpose financial statements make on the basis of those financial statements. ~~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.~~**

117A Accounting policies that relate to immaterial transactions, other events or conditions are themselves immaterial and need not be disclosed. Furthermore, not all accounting policies relating to material transactions, other events or conditions are themselves material.

117B An accounting policy is material if information about that accounting policy is needed to understand other material information in the financial statements. For example, an entity is likely to consider an accounting policy to be material to its financial statements if that accounting policy relates to material transactions, other events or conditions and:

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

(b) was chosen from one or more alternatives in an IFRS Standard, for example, the option to measure investment property at either historical cost or fair value;

(c) was developed in accordance with IAS 8 in the absence of an IFRS Standard that specifically applies;

(d) relates to an area for which an entity is required to make significant judgements or assumptions in applying an accounting policy and discloses those judgements or assumptions in accordance with paragraphs 122 and 125 of IAS 1; or

(e) applies the requirements of an IFRS Standard in a way that reflects the entity's specific circumstances, for example, by explaining how the requirements of a Standard are applied to the facts and circumstances of a material class of transactions, other events or conditions.

117C Information about accounting policies that focuses on how an entity has applied the requirements in IFRS Standards to its own circumstances provides entity-specific information that is more useful to users of financial statements than standardised descriptions or information that only duplicates the recognition or measurement requirements of IFRS Standards.

117D If an entity concludes that an accounting policy is not material, the entity shall nevertheless disclose other information required by IFRS Standards if that information is material.

118 [Deleted]~~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 [Deleted]~~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 [Deleted]~~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~~ material 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.**

## Appendix C—Extracts from existing guidance on the characteristics of primary users

### *Extract from the* Conceptual Framework of Financial Reporting

…

1.5 Many existing and potential investors, lenders and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial reports for much of the financial information they need. Consequently, they are the primary users to whom general purpose financial reports are directed.

1.6 However, general purpose financial reports do not and cannot provide all of the information that existing and potential investors, lenders and other creditors need. Those users need to consider pertinent information from other sources, for example, general economic conditions and expectations, political events and political climate, and industry and company outlooks.

1.7 General purpose financial reports are not designed to show the value of a reporting entity; but they provide information to help existing and potential investors, lenders and other creditors to estimate the value of the reporting entity.

1.8 Individual primary users have different, and possibly conflicting, information needs and desires. The Board, in developing Standards, will seek to provide the information set that will meet the needs of the maximum number of primary users. However, focusing on common information needs does not prevent the reporting entity from including additional information that is most useful to a particular subset of primary users.

…

2.36 Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena.

…

### *Extract from IAS 1*

7 …

Assessing whether information could reasonably be expected to influence decisions made by the primary users of a specific reporting entity's general purpose financial statements requires an entity to consider the characteristics of those users while also considering the entity's own circumstances.

…

***Extract from IFRS Practice Statement 2***

…

**Meeting primary users' information needs**

21 The objective of financial statements is to provide primary users with financial information that is useful to them in making decisions about providing resources to an entity. However, general purpose financial statements do not, and cannot, provide all the information that primary users need. Therefore, the entity aims to meet the common information needs of its primary users. It does not aim to address specialised information needs—information needs that are unique to particular users.

…

22 To meet the common information needs of its primary users, an entity first separately identifies the information needs that are shared by users within one of the three categories of primary users defined in the Conceptual Framework—for example investors (existing and potential)—then repeats the assessment for the two remaining categories—namely lenders (existing and potential) and other creditors (existing and potential). The total of the information needs identified is the set of common information needs the entity aims to meet.

23 In other words, the assessment of common information needs does not require identifying information needs shared across all existing and potential investors, lenders and other creditors. Some of the identified information needs will be common to all three categories, but others may be specific to only one or two of those categories. If an entity were to focus only on those information needs that are common to all categories of primary users, it might exclude information that meets the needs of only one category.

…