ICAEW
REPRESENTATION 120/19

DISCLOSURE OF ACCOUNTING POLICIES: PROPOSED AMENDMENTS TO IAS 1 AND IFRS PRACTICE STATEMENT 2

Issued 22 November 2019

ICAEW welcomes the opportunity to comment on the *Disclosure of Accounting Policies: Proposed amendments to IAS 1 and IFRS Practice Statement 2* published by IASB in August 2019, a copy of which is available from this link.

ICAEW supports IASB efforts to address user concerns about the disclosure of accounting policies in the financial statements. While we support the overall progress made by the IASB on this project, we have some concerns with the proposal to replace the requirement to disclose 'significant' accounting policies with the requirement to disclose 'material' accounting policies. We believe the proposed changes focus too heavily on whether an accounting policy itself is material rather on what information about an accounting policy is material.

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KEY POINTS

SUPPORT FOR PROJECT

1. ICAEW supports IASB efforts to address user concerns about the disclosure of accounting policies in the financial statements. In our response to the IASB's 2017 Discussion Paper *Disclosure Initiative - Principles of Disclosure*, we supported the development of guidance to help preparers determine whether an accounting policy might be relevant, and on the location of those disclosures. At the time we welcomed the progress made by the IASB in developing factors to consider when determining whether an accounting policy is relevant but felt that further work was required.
2. We were also not entirely convinced by the proposal to identify three different categories of accounting policies which, in our view, would result in an overly prescriptive approach and might lead to confusion. We welcome IASB's move away from the previous suggested approach and the further work carried out on this project.

FOCUS ON INFORMATION ABOUT AN ACCOUNTING POLICY

3. While we support the overall progress made by the IASB, we have some concerns with the proposal to replace the requirement to disclose 'significant' accounting policies with the requirement to disclose 'material' accounting policies. We believe the proposed changes focus too heavily on whether an accounting policy itself is material. However, in our view, the relevant question is not whether an *accounting policy* itself is material but whether and what *information about an accounting policy* is material.
4. We believe the focus of any new requirements should be on helping preparers decide what information *about* an accounting policy is material to the financial statements. If approached this way we believe further guidance would be most helpful on: emphasising the provision of entity specific information for accounting policy disclosures; and encouraging entities to apply judgement on the extent to which their disclosures simply describe the requirements of IFRS Standards, taking into account the needs of their user base. Regarding this second point, we believe there either needs to be some flexibility on the inclusion or exclusion of 'generic' descriptive information on the requirements of IFRS Standards or the IASB needs to rule on whether it is required or not.

ANSWERS TO SPECIFIC QUESTIONS

Question 1

The Board proposes to amend paragraph 117 of IAS 1 to require entities to disclose their 'material' accounting policies instead of their 'significant' accounting policies. Do you agree with this proposed amendment? If not, what changes do you suggest and why?

5. We understand that the proposed amendments have been developed in response to stakeholder feedback suggesting that ineffective disclosure of significant accounting policies is primarily due to difficulties in applying the concept of materiality. While we agree that materiality is important when determining what information to disclose in the financial statements, we believe the proposed changes focus too heavily on whether an accounting policy itself is material. For example, proposed paragraph 117 requires an entity to 'disclose its material accounting policies' and proposed paragraph 117(b) goes on to state that 'An accounting policy *is* material if information about that accounting policy is needed to understand other material information in the financial statements.'
6. In our view, the relevant question is not whether an *accounting policy* itself is material but whether and what *information about an accounting policy* is material. From this starting point,

the focus of any new requirements should then be on helping preparers decide what information *about* an accounting policy is material to the financial statements. If approached this way we believe there a several key areas where further guidance would be most helpful:

- Emphasising the provision of entity-specific information – at the heart of any accounting policy note should be an entity-specific description of how the entity has accounted for its material transactions, in particular the judgements made by the entity in applying the accounting policies ie, in accordance with IAS 1.122 and any related requirements such as IFRS 12.7-9. Similarly, some accounting standards provide a choice of accounting policy, for example the choice under IA6 16 Property, Plant and Equipment to account for PPE either at cost or revaluation. Information about what choice the entity has made is likely to be material, provided it makes a material difference to the numbers in the financial statements.
- Encouraging entities to apply judgement on the extent to which their disclosures describe the requirements of IFRS Standards (insofar as those requirement are relevant to the financial statements). This judgement should be based on the entity's understanding of the needs of their user base. The importance of taking into account the audience for the financial statements was highlighted in the Financial Reporting Council's Financial Reporting Lab 2014 Report *Accounting Policies and Integration of Related Financial Information* which encouraged companies to find a balance that 'respects knowledgeable readers while being understandable to non-specialists'.

7. With regards to the second point above, we believe there either needs to be some flexibility on the inclusion or exclusion of 'generic' descriptive information on the requirements of IFRS Standards or the IASB needs to rule on whether it is required or not. This is an example of an area where the application of the normal materiality judgment falls short as while information about IFRS is necessary to understand other information in the financial statements, this information is also available elsewhere.

Question 2

The proposed new paragraph 117A of IAS 1 states that not all accounting policies relating to material transactions, other events or conditions are themselves material to an entity's financial statements. Do you agree with this proposed statement? If not, what changes do you suggest and why?

8. Notwithstanding our comments above in response to question 1, we agree that any new requirements/guidance should support the underlying idea that an entity need not disclose information about an accounting policy solely because the transactions or events to which that policy applies are themselves material.

Question 3

The proposed new paragraph 117B of IAS 1 lists examples of circumstances in which an entity is likely to consider an accounting policy to be material to its financial statements. Do the proposed examples accurately and helpfully describe such circumstances? If not, what changes do you suggest and why?

9. We agree that it will be helpful to include examples within any new requirements/guidance on the disclosure of accounting policies. However, following on from our earlier comments, these examples should be designed to help preparers decide whether and what *information about an accounting policy* is material.

Question 4

The Board proposes to add to IFRS Practice Statement 2 two examples that illustrate how the concept of materiality can be applied in making decisions about accounting policy disclosures? If not, what changes do you suggest and why?

10. Assuming the IASB proceeds with the proposal to replace the term 'significant' with 'material' when referring to the disclosure of accounting policies in IAS 1, we agree that further guidance in Practice Statement 2 would be helpful. We have outlined below a number of comments on the various proposed changes.

Scope for further guidance

11. Proposed paragraph 88C in Practice Statement 2 states that 'an entity assesses whether information about accounting policies is material to its financial statements by considering whether that information together with other information in the financial statements, could reasonably be expected to influence decisions that primary users make on the basis of those financial statements'. We agree with this statement but believe that the Practice Statement could go further here, for example, by explaining that accounting polices provide context for the transactions, other events or conditions being reported.

Flowchart diagram

12. We support the inclusion of a flowchart in Practice Statement 2 and agree with the overall logic illustrated by the diagram (within the context of the proposed amendments). However, we believe improvements could be made in the following places:

    - First box: the phrasing used is not consistent with Step 2 of the 4-step materiality process. It refers to 'material in size or nature or a combination of both'. However, Practice Statement 2 states that information is either material or it isn't, but the reason for assessing information about an item as material could be because of 'the item's nature or size or a combination of both' (paragraph 41). This may be a nuanced point but it is important. As drafted, it could give the impression of different types of materiality when in fact there is only one definition of material.

    - Box on second row, right hand side: this box explains that the entity should assess whether the information about the accounting policy is material. However, it provides no guidance on how to assess whether that information is material. We suggest it would be helpful to provide more guidance to help entities make this assessment.

Examples

13. The final paragraph of proposed Example S explains how the entity assesses what information about the revenue recognition policy is material and then only discloses that information ie, it does not disclose all possible information about the revenue recognition policy. We believe that this is an important point that should be drawn out further within Practice Statement 2. We note that this point is outlined in BC11 and believe it should be included in the main body of Practice Statement 2, perhaps preceding proposed Example S.

14. More generally, we believe that the examples might be better placed within IAS 1 rather than in the Practice Statement. In our view, this would ensure that they are more accessible and helpful to preparers when considering what information to include in the financial statements. It might also be helpful to include examples of accounting policies which are commonly considered to be problematic and where less information might result in a more meaningful disclosure, for example, foreign currency transactions.

Style and drafting

15. We have also identified several style-related points, as set out below:

- The amendments include references to the Standards in the body of the text whereas elsewhere in the Practice Statement, such references are made only by footnote.

- Proposed paragraph 88D includes a quote from the Standard, whereas the Practice Statement should explain the application of the Standard.

- The examples outlined in proposed paragraph 117B (which are directly quoted in the Practice Statement 2 –see above) appear to be specific ‘materiality factors’ for accounting policies. Practice Statement 2 refers to ‘materiality factors’ throughout, but not when referring to these proposed amendments. For consistency, we believe the amendments to the Practice Statement should, where relevant, also use this term.

Question 5

Would any wording or terminology introduced in the proposed amendments be difficult to understand or to translate?

16. We have no further comments, over and above those outlined elsewhere, on the drafting of the proposed amendments.

Question 6

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

17. It is not clear why consequential amendments are needed for IFRS 7 *Financial Instruments: Disclosures*. The IASB appears to be changing the meaning of ‘material’ for IFRS 7, which undermines the notion that materiality has a single meaning and is consistent throughout IFRS and is judged in the context of the financial statements as a whole.
18. Also, as a general point, the IASB does not appear to have considered the subject of technology when developing the proposed amendments. For example, it might be possible for certain descriptive information on the requirements of IFRS Standards to be included on an external website with cross-references included in the financial statements. As the IASB continues to develop proposals as part of its Better Communication project, we believe it is important to consider further the likely impact of current and new technologies, which may bring risks as well as opportunities in terms of the future use and relevance of financial reporting.