ACAG
AUSTRALASIAN COUNCIL
OF AUDITORS GENERAL

28 October 2019

Ms Kris Peach
Chair
Australian Accounting Standards Board
PO Box 204
Collins St West Victoria 8007
AUSTRALIA

Dear Ms Peach

ED 296 *Disclosure of Accounting Policies – Proposed amendments to AASB 101 and AASB Practice Statement 2*

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on Exposure Draft 296 *Disclosure of Accounting Policies – Proposed amendments to AASB 101 and AASB Practice Statement 2* (the ED). The views expressed in this submission represent those of all Australian members of ACAG.

ACAG agrees with the ED's objective to help entities provide accounting policy disclosures that are more useful to primary users of financial statements. To this extent, ACAG supports the proposal to require entities to disclose their 'material' accounting policies instead of their 'significant accounting policies'. Materiality is a commonly accepted and understood concept and we believe this change will help financial statement preparers streamline and focus their accounting policy disclosures.

However, ACAG has some concerns around the application of materiality and the introduction of the concept of 'immaterial' accounting policies that relate to material transactions, other events or conditions. We believe the proposals may create confusion between users, likely pose interpretive challenges for financial statement preparers and auditors, and result in unintended consequences. These concerns are detailed in the attachment to this letter.

Additionally, ACAG notes that the ED focuses primarily on the selection of accounting policies to be disclosed rather than addressing the underlying issue of ensuring that entities disclose accounting policies that are relevant to their specific facts and circumstances. ACAG believes that the proposals as currently drafted are not sufficient to "help entities provide accounting policy disclosures that are more useful to primary users of financial statements". Rather, ACAG believes the proposals should focus on requiring entities to provide customised accounting policies, with additional guidance on what should be disclosed, not just on selecting accounting policies that need to be disclosed.

The attachment to this letter addresses the AASB's specific matters for comment outlined in the ED. Also attached is ACAG's response to the International Accounting Standards Board (IASB) Exposure Draft *ED/2019/6 Disclosure of Accounting Policies—Proposed amendments to IAS 1 and IFRS Practice Statement 2*.

ACAG appreciates the opportunity to comment and trusts the attached comments are useful.

Yours sincerely

Rod Whitehead
Chairman
ACAG Financial Reporting and Accounting Committee

Attachment

AASB Specific Matters for comment

1. **Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:**

   (a) not-for-profit entities; and
   (b) public sector entities, including GAAP/GFS implications.

   ACAG is not aware of any regulatory or other issues arising in the Australian environment that may affect the implementation of the proposals by not-for-profit (NFP) entities and public sector entities, including GAAP/GFS implications.

2. **Whether, overall, the proposals would result in financial statements that would be useful to users.**

   ACAG agrees with the intention to improve accounting policy disclosures, however whether the proposals will result in financial statements that are useful for users will depend upon:

   1. The entity's application of the materiality concept and whether an entity discloses all the accounting policies their primary users will need to understand the material transactions, other events or conditions in the financial statements. This may not be straightforward as primary users will have varying knowledge of Australian Accounting Standards (AAS).

      Paragraph 2.36 of the *Conceptual Framework for Financial Reporting 2018* (the Framework) states that primary users are expected to have a "reasonable knowledge of business and economic activities". A reasonable knowledge of business and economic activities is not the same as having a knowledge of AAS. While we acknowledge that there will be primary users who are conversant with AAS (such as institutional investors of listed companies), there will be many who will not be knowledgeable of AAS (potentially those in the unlisted private sector, NFP private sector or those in the public sector). For these instances, the disclosure of accounting policies for material transactions, other events or conditions in the financial statements will be useful and beneficial to those users.

   2. Whether the accounting policies an entity discloses provide users with relevant entity specific information rather than boilerplate disclosures or disclosures that merely duplicate the requirements in AAS.

      As currently drafted, ACAG believes the inclusion or exclusion of an accounting policy will be driven by the application and determination of materiality – that is, where preparers believe that an accounting policy relating to material transactions is 'immaterial', then the policy is excluded but where it is determined to be 'material', then the policy is included.

ACAG questions whether the intent of the ED is to focus on the determination of whether accounting policies are disclosed rather than addressing the underlying issue of the relevance and usefulness of the content of those accounting policies as we do not believe that the proposals provide sufficient guidance to "help entities provide accounting policy disclosures that are more useful to primary users of financial statements".

We believe that entities are more likely to disclose accounting policies relevant to their specific facts and circumstances if the proposals:

- require entities to provide entity specific information
- provide more guidance on what should be disclosed in the accounting policies, and not just on selecting the accounting policies that need to be disclosed.

3. Whether the proposals are in the best interests of the Australian economy.

ACAG is not able to comment on whether these proposals are in the best interests of the Australian economy.

4. Unless already provided in response to specific matters for comment 1 – 3 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

ACAG is not able to comment on the costs and benefits of the proposals relative to the current requirements.

ACAG
AUSTRALASIAN COUNCIL
OF AUDITORS GENERAL

28 October 2019

IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

By email: commentlettters@ifrs.org

ED/2019/6 *Disclosure of Accounting Policies – Proposed amendments to IAS 1 and IFRS Practice Statement 2*

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on the Exposure Draft *Disclosure of Accounting Policies – Proposed amendments to IAS 1 and IFRS Practice Statement 2* (the ED). The views expressed in this submission represent those of all Australian members of ACAG.

ACAG agrees with the ED's objective to help entities provide accounting policy disclosures that are more useful to primary users of financial statements. To this extent, ACAG supports the proposal to require entities to disclose their 'material' accounting policies instead of their 'significant accounting policies'. Materiality is a commonly accepted and understood concept and we believe this change will help financial statement preparers streamline and focus their accounting policy disclosures.

However, ACAG has some concerns around the application of materiality and the introduction of the concept of 'immaterial' accounting policies that relate to material transactions, other events or conditions. We believe the proposals may create confusion between users, likely pose interpretive challenges for financial statement preparers and auditors, and result in unintended consequences. These concerns are detailed in the attachment to this letter.

Additionally, ACAG notes that the ED focuses primarily on the selection of accounting policies to be disclosed rather than addressing the underlying issue of ensuring that entities disclose accounting policies that are relevant to their specific facts and circumstances. ACAG believes that the proposals as currently drafted are not sufficient to "help entities provide accounting policy disclosures that are more useful to primary users of financial statements". Rather, ACAG believes the proposals should require entities to provide customised accounting policies, with additional guidance on what should be disclosed in the accounting policies, and not just on selecting the accounting policies that need to be disclosed.

The attachment to this letter addresses the Board's matters for comment within the ED. ACAG appreciates the opportunity to comment and trusts the attached comments are useful.

Yours sincerely

Rod Whitehead
Chairman
ACAG Financial Reporting and Accounting Committee

Matters for comment

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?

ACAG agrees with the proposal to require entities to disclose their 'material' accounting policies instead of their 'significant accounting policies' as:

- materiality is a commonly known and understood concept used to determine whether or not to disclose information in financial statements
- it is an appropriate basis for determining inclusion of accounting policies, given it is premised on user needs
- it will better assist preparers to continue streamlining and decluttering their financial statements by removing immaterial accounting policy information, thus ensuring more focused and relevant disclosures are included in the financial statements.

Whilst ACAG agrees that the focus should be on 'material' accounting policies, ACAG believes there may be merit in the inclusion of immaterial accounting policies, so long as they enhance the primary users' ability to understand the financial statements and do not detract from the material information presented.

Notwithstanding ACAG's agreement to remove 'significant', we do not believe it is necessary in each instance to replace this with 'material' as a preface to 'accounting policies'. We are of the view that including such a preface is contrary to recent drafting[1] by the Board where materiality is applied to particular disclosures, without including a specific reference to materiality. If 'materiality' is removed from paragraph 117, similar adjustments should also be made to paragraphs 10, 114 and 122 of IAS 1.

In addition to this, ACAG has noted subtle differences between the wording used in the definition of material in IAS 1 which states "An accounting policy is material if information about that accounting policy is needed to understand other material information in its financial statements" and the wording used in the definition of material in:

- the second sentence in the proposed paragraph 88A of IFRS Practice Statement 2 which states "Accounting policies relating to material transactions, other events or conditions are disclosed if material information provided by the accounting policies is material to the financial statements"
- paragraph 2.11 of the *Conceptual Framework for Financial Reporting 2018* (the Framework) which states "Information is material if omitting it or misstating it could influence decisions that the primary users of general purpose financial reports make on the basis of those reports, which provide financial information about a specific reporting entity".

The subtle differences in the wording used in the definition of 'material' above has the potential to result in different interpretations of the materiality concept by the financial statement preparers. ACAG suggests the Board determine and adopt the one definition of 'material'.

[1] For example, IAS 1 paragraphs 30A and 31 introduced by the Board's Disclosure Initiative clarifying that a 'shall' requirement is applied in the context of materiality, and disclosure objectives included in IFRS 15 and IFRS 16.

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?

Although the majority of ACAG Offices see merit in the argument that not all accounting policies relating to material transactions, other events or conditions are themselves material, we believe the proposals may create confusion between users, likely pose interpretive challenges for financial statement preparers and auditors, and result in unintended consequences. The unintended consequence ACAG notes is that financial statement preparers may inadvertently remove disclosures primary users would consider useful to their understanding of the financial statements.

Firstly, determining the accounting policies primary users will need to understand material transactions, other events or conditions in the financial statements may not be straightforward as primary users will have varying knowledge of IFRS requirements. Paragraph 2.36 of the Framework states that primary users are expected to have a "reasonable knowledge of business and economic activities". A reasonable knowledge of business and economic activities is not the same as having a knowledge of IFRS requirements. While we acknowledge that there will be primary users who will be conversant with IFRS (such as institutional investors of listed companies), there will be many who will not be as knowledgeable (potentially those in the unlisted private sector, and not-for-profit private and public sectors). For these instances, the disclosure of accounting policies for material transactions, other events or conditions in the financial statements will be useful and beneficial to those users.

Secondly, the introduction of a new concept of 'immaterial' accounting policies that relate to material transactions, other events or conditions will likely pose interpretative challenges between preparers and auditors, and may lead to disagreements that may have the potential to result in a modification to the independent auditor's report. ACAG is concerned that the premise of the proposal is that the decision on whether the accounting policy relating to material transactions, other events or conditions is material or immaterial is binary. ACAG does not believe this is the case, as the decision requires judgement to determine how, and to what extent, the entity specific facts and circumstances would affect the application of IFRS requirements.

As an alternative to the Board's proposal, ACAG believes the Board should require accounting policy disclosures be included for material transactions, other events or conditions, but with a focus on how the entity applies the IFRS requirement to their specific facts and circumstances. This will also address the feedback as outlined in BC 10 of the ED which states that feedback from primary users indicates that accounting policies which simply restate IFRS requirements in financial statements are unlikely to influence their decisions. To illustrate the difference, ACAG suggests including an example of a 'boilerplate' policy disclosure which merely restates IFRS requirements and a contrasting example where the entity customises the disclosure to reflect how they applied IFRS requirements to their specific facts and circumstances. ACAG believes this change will provide better and more relevant information to primary users of the financial statements.

The ACAG suggestions above, should be read as relating to both the proposed content and diagram to be included in IFRS Practice Statement 2.

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?

Following on from our arguments above, ACAG have concerns with the drafting of the list of example circumstances within paragraph 117B of IAS 1. ACAG suggests the Board reframe the example circumstances as guidance for financial statement preparers to consider when applying IFRS requirements to their specific facts and circumstances. If this approach is adopted, ACAG suggests the Board remove the qualifier 'and' in paragraph 117B to link material accounting policies and the consider points (a) to (e).

If the Board decides to retain the examples of circumstances in its current format, ACAG provides the following feedback:

1. The drafting should have a stronger focus on applying to groups of transactions as it is often the aggregation of similar transactions that result in the transactions being 'material'.

2. The ED provides five example circumstances where an entity will be required to conclude that an accounting policy is material to its financial statements. ACAG recommends the Board clarify whether these examples are intended to be exhaustive or whether an entity can still conclude an accounting policy is material if it does not meet one or more of the examples listed.

3. ACAG believes that paragraph 117B(e) should not be included as an example circumstance of a material accounting policy but rather included within paragraph 117C, further articulating the importance of the entity providing specific, customised disclosures rather than boilerplate disclosures, that are useful and relevant to the primary users of the financial statements.

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.

Are these examples useful and do they demonstrate effectively how the concept of materiality can be applied in making decisions about accounting policy disclosures? If not, what changes do you suggest and why?

Following on from our arguments above, ACAG does not agree with the focus of the examples and suggest that the Board include an example of a 'boilerplate' disclosure which merely restates IFRS requirements and one where the entity customises the disclosure to reflect how they applied IFRS requirements to their specific facts and circumstances. ACAG believes this change will provide better and more relevant information to primary users of the financial statements.

Notwithstanding this, if the Board decides to retain the examples, ACAG does not believe that the examples as currently drafted are useful in demonstrating how materiality can be applied in making decisions about accounting policy disclosures. ACAG believes the examples would be more useful by:

- including an example to demonstrate a situation where no accounting policy is required to be disclosed
- including a boilerplate or generic version of the accounting policy to demonstrate the difference between how an accounting policy should and should not be disclosed
- providing additional guidance on what information is relevant to disclose in an accounting policy, and not just on the selection of the accounting policies that are material for disclosure. For example, including within Example S, the entity specific information that should be disclosed in the accounting policy, similar to that included in Scenario 1 of the March 2019 staff paper[2]
- in proposed Example S, including a different example where significant judgement is required, as ACAG does not believe the allocation of a transaction price will necessarily require significant judgement
- redrafting or removing the proposed Example T in IFRS Practice Statement 2 which illustrates a situation where it is established that 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 – that is, it fits the circumstances described in the proposed paragraph 117B(d) as likely to be a material accounting policy. However, Example T concludes that the impairment accounting policy is not material as the entity already discloses material information on its impairment assessments and its significant judgements and assumptions under IAS 36 and IAS 1 paragraphs 122 and 125, respectively. Whilst the conclusion in Example T is reasonable, ACAG is unclear of the reason for its inclusion as it does not demonstrate the proposed intent of the ED.

Question 5

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

ACAG has highlighted the identified issues in our answers to the above questions.

Question 6

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

ACAG has the following comments on the proposals in the ED.

1. ACAG is unclear why the reference to measurement basis has been deleted from paragraph 117 of IAS 1. In our view the measurement bases used, especially for material balances is not immaterial. Primary users may require the disclosure of the measurement basis in an accounting policy to understand the impact of the material transaction, balance, event or condition. While primary users that are conversant with IFRS requirements may not require the disclosure of measurement bases where the IFRS standard requires entities to use it, there will be many who will not be as knowledgeable who may need this information.

[2] The Staff Paper for the Disclosure Initiative – Accounting Policies was included in the papers for the IASB's March 2019 Board meeting.

ACAG believes that the information previously contained in paragraphs 117(a) and 118 on measurement bases should be addressed through an example. To demonstrate when the disclosure of the measurement basis is necessary, ACAG suggests the Board consider including Example 1A of the Staff Paper for the Disclosure Initiative – Accounting Policies included in the papers for the IASB's October 2018 Board meeting.

2. ACAG suggests the Board consider the definition of 'material'/materiality in the light of auditing standards and considering the views of the International Auditing and Assurance Standards Board.

3. In the diagram in paragraph 88C of IFRS Practice Statement 2, ACAG does not agree with the last box stating "an entity still considers whether it has met other disclosure requirements that apply" especially when the transaction, other event or condition is not considered to be material. This is because in such cases, paragraph 117D will be Not Applicable. In that case, we believe the conclusion box should be 'Not required to disclose'.