Disclosure of material accounting policies

Applying IFRS® Accounting Standards

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Disclosure of material accounting policies

What's the issue?

IAS 1 *Presentation of Financial Statements* has been amended[1] to require companies to **disclose 'material' rather than 'significant' accounting policies**.

Forming part of the International Accounting Standards Board (IASB)'s Disclosure Initiative project, the amendments aim to help companies provide more relevant, company-specific accounting policy disclosures.

Replacing 'significant' with 'material' means that a company's assessment will be based on a defined term in IFRS Accounting Standards. Further, companies can refer to the IASB's existing guidance when making materiality judgements.

What's the impact?

The impact for companies will depend on the existing accounting policy information they provide.

Companies will need to assess accounting policy information together with other information in the financial statements.

For some companies, the impact may be significant.

What's next?

Assess the potential impact now – the amendments are effective for annual periods beginning on or after 1 January 2023.

To help with this assessment, we share our three-step approach along with our insight and illustrative examples.

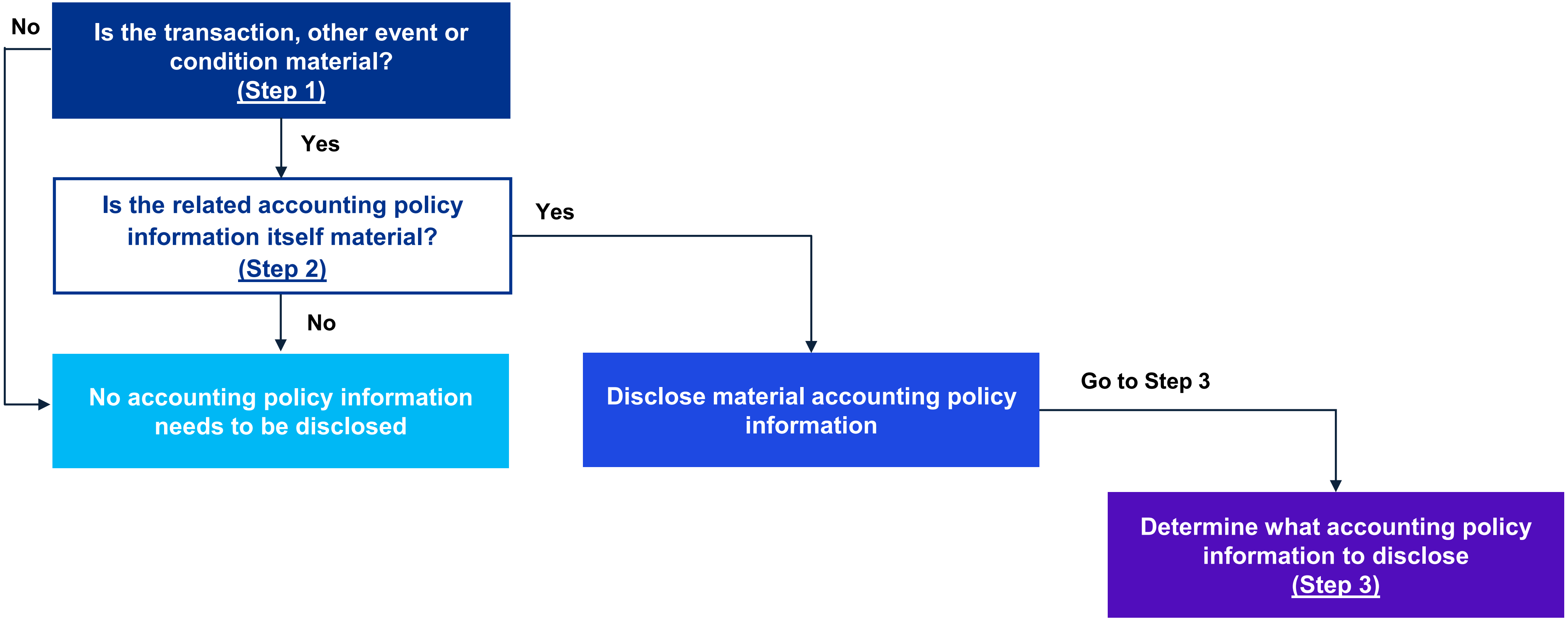
1 In February 2021, the IASB issued *Disclosure of Accounting Policies (Amendments to IAS 1)* and updated IFRS Practice Statement 2 *Making Materiality Judgements*.

Disclosure of material accounting policies

Our three-step guide sets out a logical approach for applying materiality judgements to accounting policy disclosures under IFRS Accounting Standards.

01 Three-step approach

When making materiality judgements about what accounting policy information to disclose, companies can follow a **three-step approach**.



02 Step 1 – Is the transaction, other event or condition material?

Materiality is a company-specific aspect of relevance

Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that **primary users** make on the basis of a company's financial information.

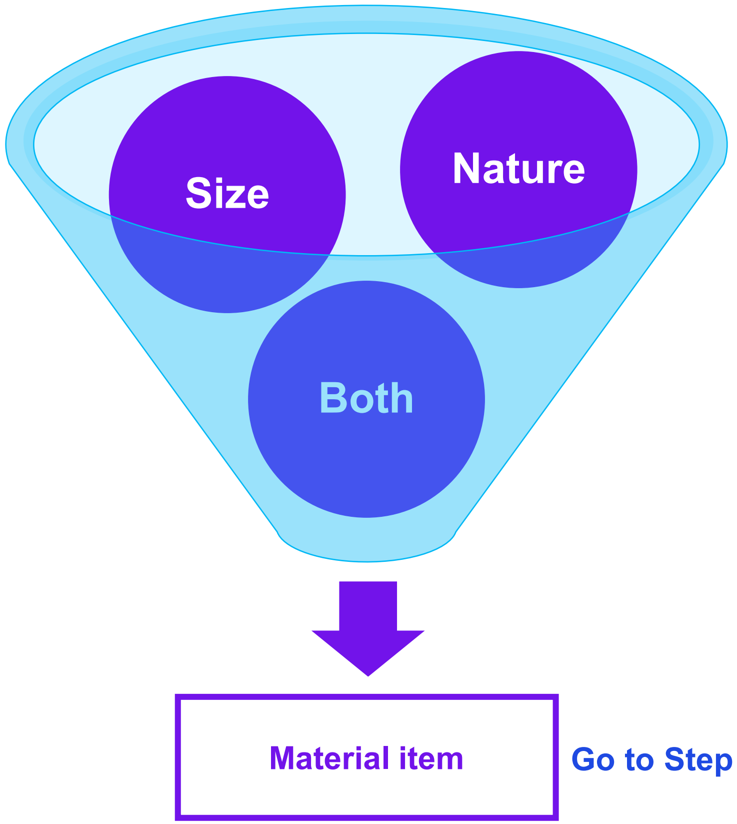
Either the **size or the nature of the item, or a combination of both**, could be the determining factor when assessing materiality of an item.

Items of immaterial size may be material due to their nature. For example, compensation of key management is material due to its nature, even if it is quantitatively immaterial to the company.

Other disclosure requirements in IFRS Accounting Standards and other events or conditions related to the transaction apply, regardless of whether management assesses accounting policy information to be immaterial.

For example, the disclosure requirements in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* apply even if management determines that the accounting policy information for provisions is immaterial to its financial statements.

Assessing materiality



Go to Step 2

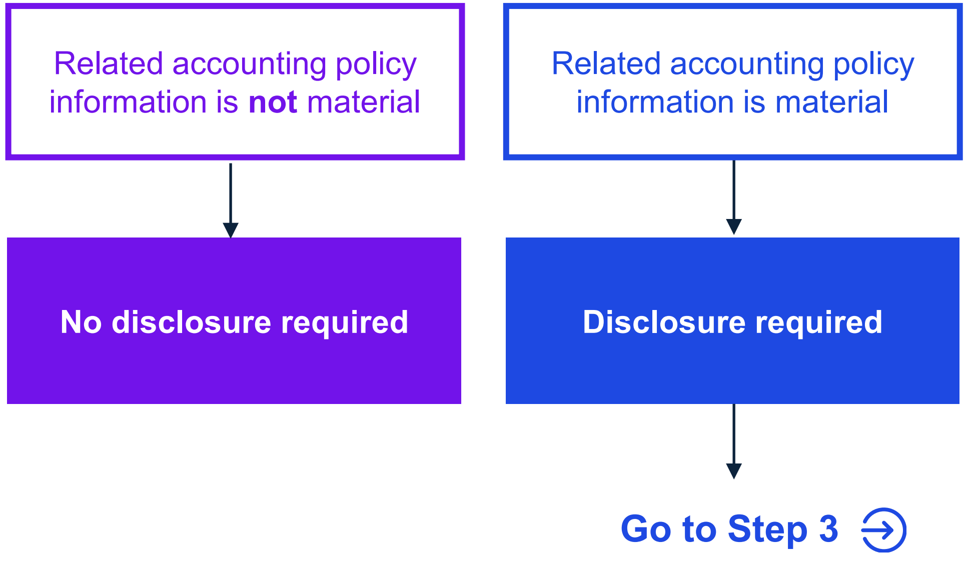
03 Step 2 – Is the related accounting policy information itself material?

A company then considers:

- if the **users of its financial statements need the accounting policy information to understand other information** in the financial statements; and
- whether the accounting policy information can **reasonably be expected to influence decisions** that the users make on the basis of the financial statements.

IAS 1 provides a **non-exhaustive list of examples** of when accounting policy information is likely to be material, as follows.

- Change in policy during the period.
- Policy chosen from one or more options permitted – e.g. fair value vs cost.
- Policy developed in absence of directly applicable guidance in IFRS Accounting Standards.
- Significant judgement or assumptions required in applying the policy.
- Accounting treatment is complex.



04 Step 3 – Determine what accounting policy information to disclose

Generally, it is more useful to users when a company provides accounting policy information that:

- focuses on how it has applied IFRS Accounting Standards to its **own specific facts and circumstances**;
- includes **judgements** it has made; and
- avoids boilerplate information.

In some cases, a company may include information that is standardised, or that duplicates or summarises the requirements of the Accounting Standards – e.g. when:

- the accounting treatment is complex – e.g. a company applies more than one accounting standard to the item; or
- local GAAP differs from IFRS Accounting Standards.

If a company decides to disclose **immaterial** accounting policy information, then this information **must not obscure** other material accounting policy information.

Illustrative example – Consolidation of subsidiaries

Enhancing an existing accounting policy

1 Is the transaction, other event or condition material?

Yes. The Company controls a number of subsidiaries that are material to the Group.

2 Is the related accounting policy information itself material?

Yes. Management has determined that it has 'de facto' control over Subsidiary X despite owning less than half of X and having less than half of the voting power. Because management considers this an area of significant judgement, it determines that accounting policy information about consolidation of subsidiaries is itself material to the financial statements.

3 Determine what accounting policy information to disclose

Management notes the following.

- The 'control' definition provided in Part A is standardised information derived from IFRS 10 *Consolidated Financial Statements*. This information might be useful for users because local GAAP requirements differ from IFRS Accounting Standards.
- The consolidation procedures provided in Part B replicate the requirements in IFRS 10. These might not be useful for users because they are not company-specific and result in boilerplate accounting policy information. Further, management assesses that its users are familiar with how consolidated financial statements are prepared.

Existing accounting policy extract

"

A. Subsidiaries

Subsidiaries are entities controlled by the Group. The Group 'controls' an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The Group has 'de facto' control over Subsidiary X despite owning 22% of the ordinary shares (see Note G for further details).

B. Consolidation procedures

The Group's consolidated financial statements:

- combine like items of assets, liabilities, equity, income, expenses and cash flows of the Company with those of the subsidiaries;
- offset (eliminate) the carrying amount of the Company's investment in each subsidiary and the Company's portion of equity of each subsidiary; and
- eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the Group (profits or losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full). "

See enhanced accounting policy

Illustrative example – Consolidation of subsidiaries (cont.)

Enhancing an existing accounting policy (cont.)

3 Determine what accounting policy information to disclose (cont.)

Management revises its accounting policy information by:

- removing the standard consolidation procedures; and
- retaining the standardised information about the ‘control’ definition.

Enhanced accounting policy extract

“Subsidiaries are entities controlled by the Group. The Group ‘controls’ an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The Group has ‘de facto’ control over Subsidiary X despite owning 22% of the ordinary shares (see Note G for further details).”

Illustrative example – Financial assets: Business model assessment

Enhancing an existing accounting policy

1 Is the transaction, other event or condition material?

Yes. Financial assets are material to the Group.

2 Is the related accounting policy information itself material?

Yes. Management assesses that accounting policy information about the business model assessment is itself material to the financial statements because:

- users may consider financial asset accounting complex; and
- the business model objective affects classification and subsequent measurement of certain financial assets directly.

3 Determine what accounting policy information to disclose

Management notes the following.

- Some of the information provided is standardised information – e.g. it replicates the requirements in IFRS 9 *Financial Instruments*.
- Standardised information might be useful for users because accounting for financial assets and how the business model affects classification and measurement can be complex.
- Local GAAP requirements differ from IFRS Accounting Standards.
- The information provided here and elsewhere in the financial statements fails to explain the business model for specific financial assets.

Existing accounting policy extract

"The Group makes an assessment of the objective of the business model in which a financial asset is held at a portfolio level, because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. These include whether management's strategy focuses on earning contractual interest income, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of any related liabilities or expected cash outflows or realising cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to the Group's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- how managers of the business are compensated – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales of financial assets in prior periods, the reasons for such sales and expectations about future sales activity."

See enhanced accounting policy

Illustrative example – Financial assets: Business model assessment (cont.)

Enhancing an existing accounting policy (cont.)

3 Determine what accounting policy information to disclose (cont.)

Management revises its accounting policy information to include:

- certain standardised information about the business model assessment; and
- more company-specific information about the business model for the Group's specific financial assets.

Enhanced accounting policy extract

"The Group assesses the objective of the business model in which a financial asset is held at a portfolio level, because this best reflects the way the business is managed and information is provided to management.

Transfers of financial assets to third parties in transactions that do not qualify for derecognition are not considered sales for this purpose, consistent with the Group's continuing recognition of the assets.

The business models of the Group are as follows.

Held to collect

There are two main portfolios of financial assets that have a held-to-collect business model.

The Group holds financial assets which arise from its paper manufacturing business and investment property. The objective of the business model for these financial instruments is to collect the amounts due from the Group's receivables and to earn contractual interest income on the amounts collected.

The Group also holds a portfolio of corporate debt securities for the purposes of earning fixed coupons throughout the life of the instrument, as well as maintaining a largely fixed interest rate profile to manage its interest rate risk exposure (see Notes X and Y for further details).

Held to collect and sell

The Group holds a portfolio of corporate debt securities for liquidity management purposes (see Notes X and Y for further details).

Held for trading

The Group holds a portfolio of listed equity securities and sovereign debt securities for the purposes of trading (see Note X for further details)."

Illustrative example – Revenue: New type of contract

Updating an existing accounting policy

During the current period, the Group introduced a new type of contract that allows some customers to return products in certain instances and exchange them for new items.

1 Is the transaction, other event or condition material?

Yes. Revenue from this type of contract is material to the Group.

2 Is the related accounting policy information itself material?

Yes. The new contract permits the customer to return products in certain instances, requiring management to estimate expected returns when accounting for revenue. Because management considers this estimation uncertainty significant, it assesses that accounting policy information about the revenue from this contract is itself material to the financial statements.

3 Determine what accounting policy information to disclose

The new contract allows product returns but neither the existing accounting policy nor other disclosures in the financial statements include this information.

A new refund liability and a right to recover returned goods asset are also recognised in the financial statements.

Management determines that users need specific information about:

- the new contract terms;
- the impact on the accounting for revenue, including new balances recognised; and
- significant estimates made by management.

Existing accounting policy extract

"The Group is in the business of selling XYZ products.

Customers obtain control of standard XYZ products when the goods are delivered to and have been accepted at their premises. Invoices are generated at that point in time. Invoices are usually payable within 30 days. No discounts are provided for standard XYZ products.

Revenue is recognised when the goods are delivered and have been accepted by customers at their premises."

See updated accounting policy

Illustrative example – Revenue: New type of contract (cont.)

Updating an existing accounting policy (cont.)

3 Determine what accounting policy information to disclose (cont.)

Management revises its accounting policy information to include information about:

- the new contract terms and the impact on the accounting for revenue;
- the new refund liability and right to recover returned goods asset recognised; and
- the assumptions management made on future returns.

Updated accounting policy extract

"The Group is in the business of selling XYZ products.

Customers obtain control of standard XYZ products when the goods are delivered to and have been accepted at their premises. Invoices are generated at that point in time. Invoices are usually payable within 30 days. No discounts are provided for standard XYZ products.

Some contracts permit the customer to return an item. Returned goods are exchanged only for new goods – i.e. no cash refunds are offered.

Revenue is recognised when the goods are delivered and have been accepted by customers at their premises.

For contracts that permit the customer to return an item, revenue is recognised to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur.

Therefore, the amount of revenue recognised is adjusted for expected returns, which are estimated based on the historical data for specific types of paper, size, finish etc. In these circumstances, a refund liability and a right to recover returned goods asset are recognised.

The right to recover returned goods asset is measured at the former carrying amount of the inventory less any expected costs to recover goods. The refund liability is included in other payables (see Note G) and the right to recover returned goods asset is included in inventory (see Note H). The Group reviews its estimate of expected returns at each reporting date and updates the amounts of the asset and liability accordingly."

New text denoted in *italics*

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Appendix: Disclosure Initiative timeline

September 2017

The IASB **issues** non-mandatory guidance, IFRS Practice Statement 2 *Making Materiality Judgements* (PS2)

October 2018

The IASB **refines** its definition of 'material' to make it easier to understand and apply

As part of the **Disclosure Initiative project**, the IASB has issued various amendments and non-mandatory guidance to help companies make materiality judgements

February 2021

Disclosure of Accounting Policies (Amendments to IAS 1 and PS2) **issued** by the IASB

January 2023

Disclosure of Accounting Policies (Amendments to IAS 1 and PS2) **effective** for periods beginning on or after 1 January 2023 kpmg.com/be/ifrs

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