Financial Reporting and Accounting Guide

January 2024

Disclosure of Material Accounting Policies

This publication provides a high-level summary of the amendments made to AASB 101 Presentation of Financial Statements in relation to the disclosure of material accounting policies.

When do the new requirements apply?

The new requirements for the disclosure of material accounting policies apply to annual reporting periods beginning on or after 1 January 2023.

What's changed?

The amendments aim to help entities to provide accounting policy disclosures that are more useful by:

- Replacing the requirement for entities to disclose 'significant accounting policies' with a requirement to disclose 'material accounting policy information'; and
- Adding guidance on how entities apply the concept of materiality in determining accounting policy disclosures.

Accounting policy information 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 the primary users of general purpose financial statements make on the basis of those financial statements [AASB 101.117 and AASB 1060.95].

Amendments were made to AASB 101 *Presentation of Financial Statements* (AASB 101) to provide guidance and examples to help entities apply materiality judgements to accounting policy disclosures. Further, AASB Practice Statement 2 *Making Materiality Judgements* (PS2) was amended to support the amendments in AASB 101 by adding guidance and illustrative examples which explain and demonstrate the application of materiality to accounting policy disclosures.

These amendments were made through AASB 2021-2 *Amendments to Australian Accounting Standards – Disclosure of Accounting Policies and Definition of Accounting Estimates* and *AASB 2021-6 Amendments to Australian Accounting Standards – Disclosure of Accounting Policies: Tier 2 and Other Australian Accounting Standards.*

What is the expected impact?

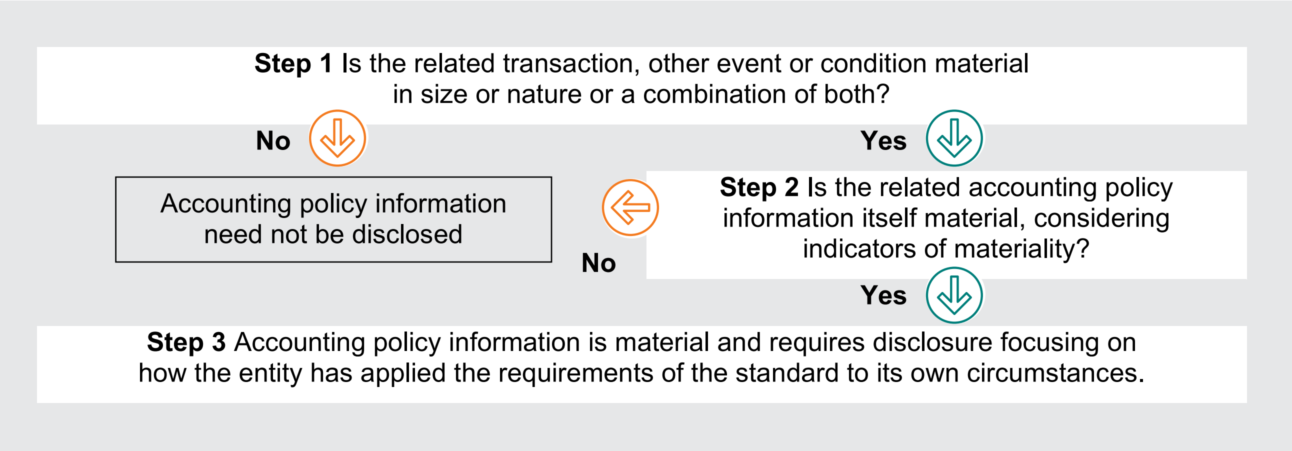
The replacement of 'significant accounting policies' with 'material accounting policy information' could impact the accounting policy disclosure of entities. Determining whether accounting policy information is material or not requires significant judgement. Therefore, entities will need to revisit their accounting policy disclosures to ensure compliance with the amended standard.

What was the need for the changes?

The International Accounting Standards Board (IASB) has made 'Better Communication in Financial Reporting' a central theme of its standard setting activities in recent years. These changes form part of the Disclosure Initiative, which was part of the IASB's Better Communication theme, which aims to address how disclosures in financial statements can be improved.

How to determine what is material accounting policy information

In order to assess whether accounting policy information is material to the financial statements the IASB included a diagram in PS2 to illustrate this. The flow chart below is based on Diagram 2 in PS2 [paragraph 88C]:



Step 1 – Is the related transaction, other event or condition material in size or nature or a combination of both?

When making this assessment it is important to consider both the current and comparative period. If it is concluded that the related transaction, other event or condition is not material, the accounting policy information is also not material and does not need to be disclosed.

Step 2 – Is the related accounting policy information itself material, considering indicators of materiality?

Although a related transaction, other event or condition may be material it does not automatically follow that the corresponding accounting policy information is also material to the entity's financial statements. To assist entities with the assessment of materiality, paragraph 117B of AASB 101 includes example indicators of when an entity is likely to consider the accounting policy information to be material to its financial statements. These indicators are outlined in the following table, together with illustrative examples of their application:

Indicators of materiality	Illustrative examples
The accounting policy was selected from one or more options permitted by Australian Accounting Standards.	Choosing either the cost model or the revaluation model for the subsequent measurement of property, plant and equipment.
The accounting policy was developed in the absence of an Australian Accounting Standard that specifically applies to the transaction, other event or condition.	Accounting for business combinations of entities or businesses under common control (excluded from the scope of AASB 3 *Business Combinations*).
The accounting policy was changed during the period and this change resulted in a material change to the information in the financial statements.	Changing the basis of measurement of investment property from the cost model to the fair value model.
The accounting policy relates to an area for which the entity is required to make significant judgements or assumptions in applying an accounting policy.	Identification of separate performance obligations in contracts with customers and measuring progress towards the satisfaction of performance obligations for revenue recognised over time.
The accounting required for the material transaction, other event or condition is complex and users of the financial statements would otherwise not understand those transactions, other events or conditions.	Accounting for compound financial instruments, hybrid financial liabilities, embedded derivatives and hedging arrangements.

Step 3 – Disclosure of material accounting policy information

Once an entity has concluded that accounting policy information is material, the entity must then determine what accounting policy information to disclose. In this regard, paragraph 117C of AASB 101 states that accounting policy information that focuses on how an entity has applied the requirements of Australian Accounting Standards to its own circumstances provides entity-specific information that is more useful to users of the financial statements than standardised information (i.e., boilerplate information), or information that only duplicates or summarises the requirements of Australian Accounting Standards.

If the entity chooses to disclose immaterial accounting policy information (which still seems acceptable under paragraph 117D of AASB 101), they need to make sure it does not obscure material information. This may mean not giving immaterial accounting policy information more prominence or not presenting immaterial information together with material information, so it is unable to be distinguished.

Illustrative example of enhancing an existing accounting policy – Income tax

Based on the accounting policy description obtained below, obtained from a set of financial statements prior to the amendment on accounting policies, we have reviewed this income tax accounting policy to determine whether this accounting policy information is material and what should be disclosed if it is material.

Accounting policy extract

(n) Income tax

Income tax expense is the tax payable on the current period's taxable income based on the applicable income tax rate adjusted by changes in deferred tax assets and liabilities. It is recognised in profit or loss except to the extent that it relates to a business combination, or items recognised in other comprehensive income or directly in equity.

Deferred tax assets and liabilities are recognised for temporary differences at the applicable tax rates when the assets are expected to be recovered or liabilities are settled. Deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill. Deferred income tax is also not recognised if it arises from the initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss.

Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

Current and deferred tax balances attributable to amounts recognised directly in equity are also recognised directly in equity.

Significant accounting estimates and judgement extract

The **key assumptions** about the future, and other major sources of estimation uncertainty at the reporting date, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year are outlined below:

(a) Recoverability of unused tax losses

A deferred tax asset is recognised for carry forward (unused) tax losses to the extent that it is probable that future taxable profit will be available against which the unused tax losses can be utilised.

The **recoverability of unused tax losses** of $xxx,xxx (2023: $xxx,xxx) has been assessed as probable, based on management's current profit forecasts for the next three-year period. On the basis of this assessment, unused tax losses have been recognised as a deferred tax asset.

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

This depends on the facts and circumstances relevant to the entity. Consider the amount of tax expense as a percentage of profit, as well as the nature and amount of deferred tax balances (such as the amount of temporary differences and unused tax losses). For example, if the effective tax rate was 24% it would be considered that this transaction was material to the entity.

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

This depends on the facts and circumstances relevant to the entity. Considering the indicators of materiality, the only relevant consideration may be in the areas of complexity or whether the accounting policy relates to an area for which the entity is required to make significant judgements or assumptions in applying an accounting policy. Income tax of itself is generally not a complex area in terms of the accounting treatment. However, there could be significant judgements or assumptions applied in assessing the accounting for tax losses. Therefore, some context around this significant judgement may be relevant to include in the accounting policies, to the extent it is not already included in the information associated with significant judgements disclosure.

Step 3 – What accounting policy information should be disclosed?

The information that is standardised (i.e., boilerplate) and not complex regarding income tax could be removed. However, the information regarding the accounting treatment of income tax losses is specific to the entity and should remain to provide the appropriate context for the disclosure in the significant judgements note. Alternatively, all this information could be combined and disclosed in the income tax note, therefore providing the material accounting policy information, significant judgements and the detailed tax disclosures all in the one note for completeness. This is illustrated below:

Amended disclosure

Income tax expense

Income tax expense is the tax payable on the current period's taxable income based on the applicable income tax rate adjusted by changes in deferred tax assets and liabilities.

Recoverability of unused tax losses

Deferred tax assets are recognised for deductible temporary differences and unused tax losses to the extent it is probable that future taxable profit will be available against which the deductible temporary differences and unused tax losses can be utilised.

The assessment of the recoverability of unused tax losses requires the application of significant judgement. The recoverability of unused tax losses of $xxx,xxx (2023: $xxx,xxx) has been assessed as probable, based on management's current profit forecasts for the next three-year period. On the basis of this assessment, unused tax losses have been recognised as a deferred tax asset.

Further information and assistance

Contact Pitcher Partners for further information and assistance on the amendments to AASB 101 in relation to the disclosure of material accounting policy information.

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