THE STANDARD STANCE

Disclosure of material accounting policies

Volume 4
November 2023

BDO

DISCLOSURE OF MATERIAL ACCOUNTING POLICIES

On 31 March 2023, the Ministry of Corporate Affairs notified Companies (Indian Accounting Standards) Amendment Rules, 2023 amending the Companies (Indian Accounting Standards) Rules, 2015. The amendments come into force with effect from 1 April 2023, i.e., Financial Year 2023-24. One of the major changes is in Ind AS 1 ‘Preparation of Financial Statements’, which requires companies to disclose in their financial statements ‘material accounting policies’ as against the erstwhile requirement to disclose ‘significant accounting policies’. The word ‘significant’ is substituted by ‘material’.

The above change is in line with amendments made to IAS 1 ‘Preparation of Financial Statements’, which is applicable for accounting periods commencing from 1 January 2023. The amendments to IAS 1 arose from the Disclosure Initiative Project being carried out by the International Accounting Standards Board (IASB).

IASB also issued amendments to the IFRS Practice Statement 2 ‘Making Materiality Judgements’ (PS) to support the amendments in IAS 1 by adding guidance and illustrative examples that explain and demonstrate the application of the said amendments. From an Indian reporting perspective, it may be noted that the PS is not a part of Ind AS; however, this document does provide useful information on how the amendments to IAS 1/Ind AS 1 should be applied in practice.

Before the above amendment, some entities interpreted the requirement to disclose ‘significant accounting policies’ broadly to mean virtually all accounting policies that an entity applies in preparing financial statements in accordance with Ind AS. The rationale for introducing the amendments is to encourage entities to provide entity-specific accounting policies and not disclose standardised information, or information that only duplicates or summarises the requirements of the IFRSs/ Ind ASs.

The amendments provide that 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 based on those financial statements. It further clarifies that accounting policy information is expected to be material if users of an entity’s financial statements would need it to understand other material information in the financial statements.

The immaterial accounting policy information need not be disclosed. However, if it is disclosed, it should not obscure material accounting policy information. For example, an entity could obscure material accounting policy information by giving the immaterial accounting policy information more prominence or presenting immaterial information with material information such that the reader is unable to distinguish between the two.

It may be noted that an entity’s conclusion that accounting policy information is immaterial does not affect the related disclosure requirements set out in other Ind ASs. For example, an entity may conclude that it has no material accounting policy information to disclose relating to property, plant, and equipment; however, if material, the entity must still disclose the information required by Ind AS 16 ‘Property, Plant and Equipment’. Therefore, it is necessary to adhere to the disclosure requirements of the relevant Ind ASs regardless of the analysis conducted about the materiality involved in reporting accounting policies under Ind AS 1.

The following flow chart, which is based on Diagram 2 in the PS will assist an entity in assessing whether accounting policy information is material and therefore should be disclosed:

Is the transaction, other event, or condition material on account of:
- Size?
- Nature? Or Both?

Yes

Is the accounting policy information that relates to a material transaction, other event, or condition itself material to financial statements?

Factors to consider for this evaluation are:
- Is an accounting policy choice available as per the existing Ind AS?
- Is a new accounting policy required to be developed as per Ind AS 8 ‘Accounting Policies, Changes in Accounting Estimates and Errors’?
- Is there a change in accounting policy?
- Is the accounting complex?
- Are significant judgements or assumptions involved?

No

Immaterial Accounting policy information need not be disclosed. (Ind AS 1.117A, 117D)

Yes

Material Accounting policy information is required to be disclosed.

(Ind AS 1.117.C)

The following illustrative examples will assist management in assessing whether the accounting policy information is material to the financial statements.

Example 1: Revenue recognition

Background:

Company A provides (i) internet services and (ii) sells modems/ routers to its customers. In a typical contract, Company A provides the customer with modems/ routers and sells internet services for a period of 2 to 3 years. However, the buyer company is not required to purchase the modems/ routers and can avail of the internet services using their own equipment.

In a composite contract, where Company A provides modems/ routers and internet services, it has identified two performance obligations (a) internet services – where revenue is recognised over time and (b) sale of modems/ routers where revenue is recognised upfront. Company A allocates the transaction price to each performance obligation and recognises revenue, separately, as it satisfies each performance obligation.

In coming to the above conclusion, Company A determines that it has made judgements about:

- Determining transaction pricing
- Allocation of the transaction price to the performance obligation
- Timing of revenue recognition

Company A has also concluded that revenues from the sale of modems/ routers and internet services are material to its financial statements. Their previous accounting policy relating to revenue recognition included: A reference to the five-step model of Ind AS 115.

- Summary of guidance given in Ind AS 115 to identify a contract.
- Summary of guidance given in Ind AS 115 to identify performance obligations.
- Summary of guidance given in Ind AS 115 to determine the transaction price.
- Summary of guidance given in Ind AS 115 to allocate the transaction price to performance obligations.
- Summary of guidance given in Ind AS 115 to recognise revenue.
- Other points like – principal vs agent, licensing guidance, contract cost, etc.

Analysis

Company A evaluates the effect of disclosing accounting policy information including evaluating factors specified in Ind AS 1.117B and it notes that:

- Under Ind AS, no accounting policy choice is available with respect to the accounting for the above transaction.
- Ind AS 115 provides guidance on how to account for the above transaction – there is no need to develop an accounting policy as per Ind AS 8.
- There is no change in accounting policy.
- The accounting policy is not very complex.
- Significant judgements are involved in (a) determining transaction price – including accounting for significant financing component, variable consideration, etc., (b)

allocating transaction price to individual performance obligation, and (c) timing of revenue recognition for the two performance obligations.

Considering the above, the management of Company A is likely to conclude that primary users of Company A's financial statements might need information on how the accounting policies for revenue recognition have been applied. Their accounting policies should be entity-specific and should focus on aspects relevant to the areas requiring significant judgment. In other words, the accounting policies should include information on how the entity determines the transaction prices, allocates transaction prices amongst performance obligations, the timing of revenue recognition and any other information that management of Company A believes is expected to influence the decision of the primary users of the financial statements.

Example 2: Consolidation

Background:

Company Z is a large, diversified group with many subsidiaries spread across various jurisdictions (Company Z together with its subsidiaries referred to as 'Group'). The subsidiaries are material to the Group.

For most entities, the evaluation of whether control exists is relatively simple. In these entities, Company Z has more than 51% ownership and the right to appoint most of the directors on the Board with no other factors that could indicate that Company Z does not control these entities. However, for certain entities which are material to the Group, evaluation of control involves significant judgment due to factors like 'de facto' control. The shareholder agreements include clauses which either demonstrate that control exists (e.g. right to appoint a majority in the Board in spite of less than 51% ownership) or indicate that control may not exist (e.g. substantive rights held by the other shareholders). In its previous accounting policies, Company Z disclosed the definition of control and the detailed consolidation procedures followed by Company Z while consolidating its subsidiaries.

Analysis

Company Z evaluates the effect of disclosing accounting policy information including evaluating the factors specified in Ind AS 1.117B and it notes that:

- Under Ind AS, no accounting policy choice is available with respect to the accounting for the above transaction.
- Ind AS 110 'Consolidated Financial Statements' provides guidance on how to account for the above transaction – there is no need to develop an accounting policy as per Ind AS 8.
- There is no change in accounting policy.
- The accounting policy is not very complex.
- Significant judgements are involved in evaluating whether Company Z controls certain material subsidiaries due to the concept of 'de facto' control, certain clauses included in shareholder agreements which either demonstrate control or indicate that control may not exist.

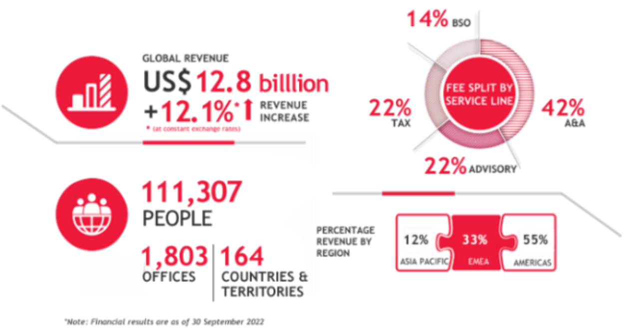
Considering the above, the management of Company Z is likely to conclude that in addition to disclosures relating to significant judgements as required by Ind AS 112.7-10 'Disclosure of Interest in Other Entities', primary users of their financial statements might need information on how Company Z has evaluated that has control over its subsidiaries as per the specific requirements of Ind AS 110. Their accounting policies should be entity-specific and should focus on aspects relevant to the areas requiring significant judgment (i.e., how control is demonstrated concerning fact patterns relevant to Company Z). Accounting policy relating to consolidation procedures may not be provided as they are boilerplate accounting policies that replicate the requirements of Ind AS 110 and are not entity specific.

CONCLUDING REMARKS:

As seen from the analysis above, determining whether accounting policy information is material or not will require significant use of judgment and could result in additional efforts, in the year of adopting the amendments. Managements of impacted companies should commence the process of drafting their material accounting early, including having discussions with their audit committees, auditors, etc.

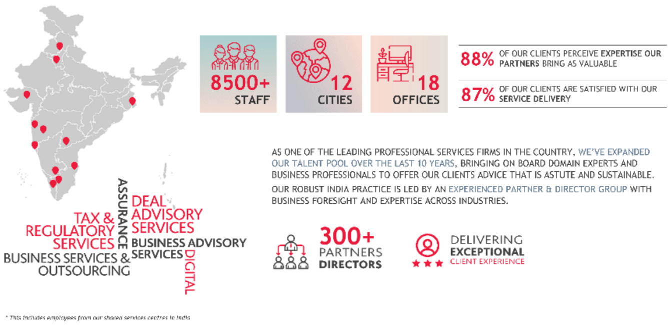
ABOUT BDO GLOBAL

BDO is a leading professional services organisation and are global leaders of the mid-tier, with a presence in 160+ countries and over 111,300 people working out of more than 1,800 offices. We endeavor to deliver an exceptional client experience through a tailored solutions approach, while partnering with our employees and clients globally.



ABOUT BDO IN INDIA

BDO in India offers Assurance, Tax, Advisory, Business Services & Outsourcing and Digital Services for both domestic and international clients across industries. The team at BDO in India consists of over 8,500 professionals led by more than 300 partners and directors operating out of 18 offices, across 12 key cities.



OUR SERVICES

ASSURANCE

- Accounting Advisory Services
- Financial Statement Audit and Attestation Services

ADVISORY

- Forensics
- Government Advisory
- IT Risk Advisory & Assurance
- Management Consulting
- Risk Advisory Services
- Sustainability & ESG
- Business Restructuring
- Corporate Finance and Investment Banking
- Deal Value Creation
- Financial Due Diligence
- M&A Tax and Regulatory
- Strategy & Commercial Due Diligence
- Valuations

BUSINESS SERVICES & OUTSOURCING

- Global Outsourcing
- Finance and Accounting Outsourcing
- Human Resource Outsourcing
- Payroll Management and Compliance Services
- Secretarial Services and Compliance Management
- Shared Services Centre

BDO DIGITAL

- Digital Services
- Technology Products and Solutions

TAX

- Corporate Tax Services
- Financial Services Tax
- Global Employer Services
- International Tax Services
- Private Client Services
- Tax Outsourcing
- Transfer Pricing
- Customs & International Trade
- Goods & Services Tax (GST)
- Indirect Tax Assessment & Litigation Assistance
- Incentives & ESG
- Tax Technology

CONTACT US

For any content related queries, you may write in to accountingadvisory@bdo.in

For any other queries or feedback, kindly write to us at marketing@bdo.in

Ahmedabad | Bengaluru | Chandigarh | Chennai | Coimbatore | Delhi | Goa | Hyderabad | Kochi | Kolkata | Mumbai | Pune