

## EFRAG SECRETARIAT PAPER FOR PUBLIC EFRAG BOARD MEETING

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### **Discussion Paper *Disclosure Initiative – Principles of Disclosure***

#### **Objective**

- 1 The objective of this session is to:
  - (a) provide a summary of the content of the Discussion Paper *Disclosure Initiative – Principles of Disclosure* ('the DP') and EFRAG TEG's preliminary views; and
  - (b) agree on the approval process for the draft comment letter.

#### **Background**

- 2 The IASB issued the DP on 30 March 2017, with comments requested by 2 October 2017.
- 3 The DP is likely to result either in amendments to parts of IAS 1 *Presentation of Financial Statements* or in the creation of a new general disclosure standard to replace relevant parts of IAS 1. The project might also result in the development of some non-mandatory guidance (such as educational material).
- 4 Overall, EFRAG TEG expressed some disappointment that the DP does not provide a clearer way forward to address concerns raised by constituents, including the need for more relevant information and a reduction in boilerplate and detailed disclosures that do not provide useful information to users.
- 5 The following sections discuss the main areas discussed in the DP and EFRAG TEG's preliminary views. They follow the order in the DP as:
  - (a) The objective of the DP;
  - (b) Principles of effective communication;
  - (c) Roles of the primary financial statements and the notes;
  - (d) Use of cross-references;
  - (e) Inclusion of non-IFRS information in the financial statements;
  - (f) Use of performance measures;
  - (g) Disclosure of accounting policies; and
  - (h) Approach for the IASB to draft disclosure requirements.

## **Objective of the discussion paper**

- 6 The DP:
- (a) defines what it refers to as the 'disclosure problems' as being both quantitative and qualitative: not enough relevant information too much irrelevant information; and ineffective communication of the information provided.
  - (b) considers that although there are many factors contributing to the problem (including behavioural ones), a set of disclosure principles could help address the disclosure problem by:
    - (i) helping entities apply better judgement about disclosures and communicate information more effectively;
    - (ii) improving the effectiveness of disclosures for the primary users of the financial statements; and
    - (iii) helping the IASB in improving disclosure requirements in standards.

### *EFRAG TEG's preliminary views*

- 7 EFRAG TEG reiterated the importance of the project, which was given the highest priority in EFRAG's response to the IASB's 2015 Agenda Consultation, and expressed concerns as to whether the proposed DP would achieve its initial ambitions to address the 'disclosure problem' and change behaviour.
- 8 In EFRAG TEG's view, the project should not limit its focus to the structure of the notes or the location of information but rather aim to develop principles to identify why, when and where information should be disclosed. Otherwise it could result in over-prescriptive guidance and could fail to achieve the objectives of the Disclosure Initiative to reduce clutter and improve disclosure effectiveness.
- 9 EFRAG TEG also expressed concerns about the lack of clarity in the overlap with other IASB projects, in particular the interactions with the Materiality and Primary Financial Statements projects.

## **Principles of communications**

- 10 The DP:
- (a) discusses the principles of effective communication that entities should apply in preparing financial statements. Of the 7 principles identified, 6 were initially included in the Conceptual Framework Discussion Paper;
  - (b) asks constituents whether the guidance should be mandatory or, for example, educational; and
  - (c) proposes the development of non-mandatory guidance on the use of formatting in the financial statements, such as the use of tables.

### *EFRAG TEG's preliminary views*

- 11 EFRAG TEG generally supported the principles of effective communication as enunciated. However, mixed views were expressed as to whether any resulting guidance should be mandatory or not.
- 12 EFRAG TEG recommended that a question to constituents about the form of the guidance should be included in EFRAG's draft comment letter; asking in particular whether non-mandatory guidance could be effective in changing behaviour.

### **The roles of the primary financial statements and the notes**

13 The DP:

- (a) specifies that the 'primary financial statements' are the statements of financial position, financial performance, changes in equity and cash flows; and
- (b) discusses the respective roles of the primary financial statements and of the notes and how those roles help to meet the objective of the financial statements.

#### *EFRAG TEG's preliminary views*

14 EFRAG TEG generally agreed that the IASB should define the purpose of the notes and the primary financial statements. However, members considered that:

- (a) the proposed definition of the role of the primary financial statements focused too much on the elements (assets, liabilities, income, expense) and not enough on the overall objective of providing summarised information about financial performance and financial position); and
- (b) the proposed definition of the role of the notes focused too much on disaggregation and reconciliation.

### **Use of cross-references**

15 The DP considers whether the financial statements could include a reference to certain information that is disclosed outside the financial statements rather than requiring the same information to be included within the financial statements. The DP proposes:

- (a) to permit the use of cross-references; and
- (b) guidance to ensure discipline in the use of cross-references.

16 It sets out the principle that information necessary to comply with IFRS Standards can be provided outside the financial statements only if such information meets all of the following requirements:

- (a) it is provided within the entity's annual report;
- (b) its location outside the financial statements makes the annual report as a whole more understandable, the financial statements remain understandable and the information is faithfully represented; and
- (c) it is clearly identified and incorporated in the financial statements by means of a cross-reference that is made in the financial statements.

#### *EFRAG TEG's preliminary views*

17 While acknowledging that the use of cross references is already explicitly permitted in a few specific areas of IFRS, and applied more widely in practice in some jurisdictions, EFRAG TEG expressed mixed views as to whether the IASB should explicitly allow the generalised use of cross-references:

- (a) some supported the proposals and stressed that the absence of guidance in IFRS Standards on cross-referencing had led to inconsistent positions from regulators or auditors;
- (b) some doubted the benefits of cross-references and considered that they could make the financial statements less understandable and less comparable for users; and

- (c) some considered that the legal and audit implications would need consideration in each jurisdiction.

#### **Inclusion of non-IFRS information in the financial statements**

- 18 Non-IFRS information refers to information that is not prescribed by IFRS Standards, either directly or by virtue of a requirement such as that in IAS 1 to disclose information that is relevant to an understanding of the entity's financial performance. This part of the DP does not address "performance measures", as these are considered in another Section (see below).
- 19 The DP:
  - (a) does not propose to prohibit the inclusion of such information in IFRS financial statements; but
  - (b) proposes to require an entity to identify such information as not being prepared in accordance with IFRS Standards and explain why the information is useful and has been included in the financial statements.

#### *EFRAG TEG's preliminary views*

- 20 EFRAG TEG was generally supportive of providing guidance on the use of non-IFRS information and observed that including such information in financial statements was a common practice.
- 21 However, EFRAG TEG members considered that the IASB should target more narrowly the categories of non-IFRS information to which the guidance should apply. Otherwise the proposal could add complexity and result in disclosures that are not useful.

#### **Use of performance measures**

- 22 The DP discusses whether an IFRS Standard should include requirements regarding fair presentation of 'performance measures' (defined in the DP as 'any summary financial measure of an entity's financial performance, financial position or cash flows') in the financial statements.
- 23 The IASB's preliminary view is that a performance measure:
  - (a) should be displayed with equal or less prominence than the line items, subtotals and totals in the primary financial statements required by IFRS Standards;
  - (b) should be reconciled to the most directly comparable measure specified in IFRS Standards; and
  - (c) should be accompanied by an explanation of how the performance measure provide relevant information, and why the adjustments to the most directly comparable measure specified in IFRS Standards have been made.
- 24 The IASB is also taking the opportunity of public consultation through the DP to seek early feedback on two specific issues relating to its primary financial statements research project. In particular, it seeks constituents' views on whether:
  - (a) the subtotals of EBIT and/or EBITDA can be considered a fair presentation in accordance with IFRS Standards; and
  - (b) the IASB should develop definitions of, and requirements for, the presentation of unusual or infrequently-occurring income and expenses.

*EFRAG TEG's preliminary views*

- 25 As noted above, EFRAG TEG expressed concerns about the overlap of the Principles of Disclosure project with other projects and, in particular, the Primary Financial Statements project.
- 26 EFRAG will need to consider whether it should respond separately to the questions on performance measures in the DP or have a single response after assessing the expected outcomes of the forthcoming Primary Financial Statements project.

**Disclosure of accounting policies**

- 27 The DP proposes guidance to identify:
  - (a) what makes an accounting policy significant;
  - (b) which information about a significant accounting policy should be disclosed; and
  - (c) where accounting policy disclosures should be located in the financial statements.
- 28 The core principle is that the objective of disclosing accounting policies in the financial statements is to provide an entity-specific description of accounting policies that (i) have been applied by the entity in preparing its financial statements; and (ii) are necessary for an understanding of the financial statements.
- 29 The proposed guidance on the location of accounting policy disclosures could be included either in a general disclosure standard or in non-mandatory guidance (or in a combination of both).

*EFRAG TEG's preliminary views*

- 30 EFRAG TEG generally agreed that the objective of disclosing accounting policies is to provide an entity-specific description of the accounting policies that have been applied and that are necessary for an understanding of the financial statements.
- 31 However, EFRAG TEG generally considered the categorisation of accounting policies, as proposed in the DP, needed further clarifications and that materiality should always be considered.
- 32 EFRAG TEG did not express strong views, at this stage, about the location of accounting policy disclosures.

**Approach for the IASB to draft disclosure requirements**

- 33 The last two chapters of the DP seek views as to actions that the IASB should take as a standard setter. Chapter 7 discusses:
  - (a) whether the IASB should continue developing objectives for disclosure requirements on a standard-by-standard basis as at present or, rather, try to develop a 'central set of disclosure objectives' to provide a basis for more unified disclosure objectives and requirements across IFRS Standards; and
  - (b) whether the IASB should consider having a single Standard (or a set of Standards) that covers all disclosures in the financial statements.
- 34 To develop a central set of disclosure objectives, the IASB could consider two alternatives:
  - (a) focusing on the different types of information disclosed about an entity's assets, liabilities, equity, income and expenses (method A); or
  - (b) focusing on information about an entity's activities to better reflect the way users of financial statements assess prospects for future cash inflows and the performance of management (method B); or

(c) a combination of both.

- 35 Chapter 8 of the DP provides an illustration of developing such centralised disclosure objectives based on method A.

*EFRAG TEG's preliminary views*

- 36 EFRAG TEG expressed support for objective-based disclosure requirements but expressed concerns that disclosure objectives, if expressed too generically, would not be helpful.
- 37 Some members observed that the approach in Method B (paragraph 34(b) above) whereby centralised disclosure objectives would be developed by the IASB on the basis of an entity's main activities could provide more useful information, as it is based on the way financial information is often used by users. However, the proposed categories of activities (relying on the distinction between operating, investing and financing activities) may not be suitable for all industries.
- 38 EFRAG TEG discussed the proposed Method A 'drafting guide' for disclosure requirements in Chapter 8 at its meetings in October 2015 and March 2016 (jointly with EFRAG CFSS). Overall, members expressed support for the direction of the proposals but expressed concerns as to the need to set clearer and less generic objectives for disclosures.

**EFRAG's proposed Work plan for the Draft Comment Letter**

*Draft Comment Letter*

- 39 EFRAG TEG expects to have a more in-depth discussion on the content of the Discussion Paper in its conference call on 26 April and submit its advice to the EFRAG Board (in the form of a draft comment letter) shortly after that meeting.
- 40 Subject to the agreement of the EFRAG Board, the draft comment letter will be sent to the EFRAG Board for approval by written procedure.
- 41 Alternatively, EFRAG TEG will approve the draft comment letter at the meeting in early May and the EFRAG Board will consider the advice from EFRAG TEG at the meeting of the EFRAG Board on 31 May.
- 42 In the context of the consultation on its draft comment letter, EFRAG will set up outreach events over the consultation period (May to September). The EFRAG Secretariat is in the process of developing an outreach plan. EFRAG is more particularly considering:
- (a) consulting with its advisory forums (EFRAG CFSS and User Panel);
  - (b) organising outreach events with users during the consultation period on specific topics contained in the DP; and
  - (c) setting up outreach events in collaboration with interested National Standard Setters.

**Questions for the EFRAG Board**

- 43 Does the EFRAG Board have any comments on the proposals in the DP at this stage?
- 44 Does the EFRAG Board agree that the draft comment letter on the DP is approved by written procedure?