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Disclosure Initiative – Principles of Disclosure Issues Paper

Objective

- 1 The objective of the session is to discuss and approve a full draft comment letter containing in response to the IASB's Discussion Paper DP/2017/1 *Disclosure Initiative - Principles of Disclosure* (the 'IASB DP').

Background

- 2 At its conference call on 3 May 2017, the EFRAG Board discussed the tentative responses to the questions raised in the IASB DP recommended by EFRAG TEG.
- 3 Some members expressed the view that the EFRAG document for public consultation issued on 5 May 2017 in response to the IASB DP (the 'preliminary consultation document') contained a number of 'strategic' issues that go beyond technical answers to the questions in the IASB DP and would need to be further deliberated by the EFRAG Board at its May meeting. The identified issues included:
 - (a) The nature of the 'disclosure problem' and whether the IASB's focus on disclosure effectiveness and communication (rather than the disclosure overload) was appropriate;
 - (b) Whether the form of proposed guidance in the IASB DP was likely to address the disclosure problem and whether the IASB was moving fast enough into standard setting;
 - (c) The consideration of the impact of technology on presentation and disclosure, whether the current focus is too limited to printed financial reports, and the relationship between general-purpose financial reporting and electronic filing;
 - (d) The scalability of disclosure requirements and the relevance of the proposals to the broad spectrum of listed companies; and
 - (e) The interactions and overlap with other IASB projects, in particular with the Materiality and Primary Financial Statements projects.
- 4 The following sections provide a summary of the issues, how they relate to the IASB DP and summarise the views expressed by EFRAG in previous publications (when applicable).

Disclosure overload or disclosure effectiveness: is the IASB targeting the right disclosure problems?

What is the issue?

- 5 The IASB DP was originally informed by the IASB's 2013 *Discussion Forum on Financial Reporting Disclosure* which was largely labelled at the time as a 'forum to discuss disclosure overload', creating some expectations that this would be the focus of the project. Feedback received by the IASB however outlined that users and preparers viewed the disclosure problem differently:

- (a) users viewed the main issues as poor communication and not enough relevant information; and
 - (b) preparers viewed the main issue as disclosure overload.
- 6 As a consequence, the focus of the IASB DP has shifted towards the notion of 'disclosure effectiveness' which places equal emphasis, in defining the 'disclosure problem', on the following:
- (a) too much irrelevant information being disclosed (i.e. disclosure overload);
 - (b) not enough relevant information being provided in all circumstances; and
 - (c) relevant information provided is not always effectively communicated.
- 7 At the May EFRAG Board conference call, some members expressed concerns that the IASB DP was not focusing enough on reducing disclosure overload as suggested in the Discussion Paper *Towards a Disclosure Framework for the Notes* published by EFRAG, the ANC and the FRC in 2012 (the 'EFRAG/ANC/FRC DP').
- 8 The EFRAG/ANC/FRC DP identified the two main areas of improvement for the quality of disclosures as:
- (a) avoiding disclosure overload, which may be caused by excessive requirements in IFRS Standards, and by ineffective application of materiality in the financial statements; and
 - (b) enhancing how disclosures are organised and communicated in the financial statements, to make them easier to understand and compare.
- 9 The EFRAG/ANC/FRC DP however noted that 'although reducing the length of the notes to financial statements is not the primary intent, a sharper focus on relevance will likely result in a reducing their volume, which is a legitimate expectation'.
- 10 Unlike the EFRAG DP which identified two main areas for improvement, the IASB DP:
- (a) proposes the development of guidance on the organisation and communication of information in the notes, which is the largest part of the IASB DP;
 - (b) does not include guidance on the application of materiality, which the IASB addresses as part of separate project (Practice Statement on materiality and targeted amendments to the definition of materiality); and
 - (c) does not address the question of whether 'excessive requirements exist in current standards'. However, the IASB is planning to conduct a comprehensive standards-level review of existing disclosure requirements using the principles developed in the *Principles of Disclosure* project. However, no time-table has been set for this review.

EFRAG Secretariat recommendation

- 11 In its preliminary consultation document, EFRAG broadly agreed with the description of the disclosure problem made in the IASB DP. However, EFRAG considered that the IASB DP, related to the disclosure problem, were focused on the structure of the notes or the location of information rather than developing principles to identify why, when and where information should be disclosed.
- 12 In addition to the above, EFRAG Secretariat recommends that the draft comment letter should:
- (a) emphasise the importance of the standards-level review of disclosure requirements in identifying whether excessive requirements exist in current standards and call for a prompt starting of that activity;

- (b) acknowledge that although reducing the length of the notes to financial statements is not necessarily the primary intent, a sharper focus on relevance will likely result in a reduction in some areas; and
- (c) propose that the IASB better explain how the guidance in the IASB DP relates to other projects conducted by the IASB (in particular, the Materiality project) and explain how these projects will be effective in tackling the 'disclosure problem' as identified.

If the proposed guidance likely to address the disclosure problem and is the IASB moving fast enough into Standard Setting?

What is the issue?

- 13 In its response to the IASB's 2015 Agenda Consultation, EFRAG stressed the importance of having a clear, effective, coherent and comprehensive but concise package of disclosure requirements and regretted that 'so far only small amendments to standards have been made whereas the main project has not yet reached standards-level stage'. EFRAG and other regional and national accounting standards bodies have undertaken substantial work related to the disclosure problem: leveraging on this work would allow the IASB to move more quickly into standard setting. EFRAG also noted that the FASB, who cooperated with EFRAG and its partners in 2011, is now working on the disclosure framework at standards-level whereas the IASB is still at the research project stage.
- 14 The IASB DP is meant to result either in amendments to, or a replacement of, IAS 1 *Presentation of Financial Statements*. Therefore, most of the guidance proposed is designed to be mandatory. There are a limited number of instances where the IASB DP discusses whether to develop non-mandatory guidance:
- (a) Principles of effective communication – the IASB DP is seeking views on whether those principles should be mandatory or not. The IASB has not yet formed a preliminary view;
 - (b) Formatting – the IASB is proposing non-mandatory guidance; and
 - (c) Location of disclosures about accounting policies (i.e. in a single note, in the same note as the information to which it relates, or a combination) – the IASB is seeking views on whether the guidance should be mandatory. It has not yet formed a preliminary view.
- 15 The EFRAG/ANC/FRC DP did not include explicit views as to whether a Disclosure Framework should be part of mandatory or non-mandatory guidance (such as the Conceptual Framework).

EFRAG Secretariat recommendation

- 16 In its preliminary consultation document, EFRAG:
- (a) encouraged the IASB to leverage the work conducted by other organisations in order to move faster into standard setting;
 - (b) stated that the principles of effective communication could be included as non-mandatory guidance, accompanying but not forming part of a general disclosure standard;
 - (c) considered that the guidance on the location of accounting policy disclosures could be mandatory, as similar guidance is already included in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*; and
 - (d) proposed that the IASB should not be over-prescriptive about the location of disclosures of accounting policies and significant judgements and assumptions.

- 17 Questions were however raised to constituents as to whether non-mandatory guidance would be less effective in changing behaviour. EFRAG Secretariat proposes that these views should be reiterated in EFRAG's draft comment letter.

Differential disclosure regime

What is the issue?

- 18 The IASB DP does not discuss differential disclosure regimes, i.e. whether relieving smaller (listed) entities from having to disclose the same level of information as other entities applying IFRS Standards could help solve the disclosure problem. The IASB indicated that it did not have any plans to consider developing a 'disclosure tier' between IFRS for SMEs and full IFRS Standards but considered that relying on the principles of disclosure and materiality would help ensure proportionality in disclosures.
- 19 The concept of differential disclosure regimes is not unprecedented in IFRS:
- (a) Chapter 1 of the Conceptual Framework acknowledges that 'cost constraints and differences in activities among entities may sometimes lead the IASB to permit or require differences in reporting for different types of entities'; and
 - (b) IFRS 8 *Operating Segments* and IAS 33 *Earnings per Share* are examples of differential disclosure regimes since they only apply to listed companies.
- 20 Some consider that disclosure exceptions similar to those in IFRS 8 or IAS 33 should also be considered for other IFRS disclosure requirements. The 2012 EFRAG/ANC/FRC DP explored the conditions for the application of such a differential accounting regime.
- 21 Further, some consider that the improved application of the materiality concept cannot be expected to fully address the concerns about disclosure and that a differential disclosure regime is necessary to achieve a significant reduction in disclosure overload.
- 22 The EFRAG/ANC/FRC DP considered two ways of applying differential disclosures requirements either:
- (a) based on the type of financial statements being prepared (individual versus consolidated financial statements or interim and year-end financial statements), the size of the reporting entity, the industry of the entity or the public accountability of the applicable entity (e.g. listed versus non-listed); or
 - (b) by setting different levels of requirements within each standard that is defined by a minimum set of requirements (assuming the item was material to the entity) to which each entity would add more layers of information based on the relative importance of the item in the context of its financial statements.
- 23 Section 8 of the IASB DP contains an approach for drafting disclosure requirements (suggested by the staff of the New Zealand Accounting Board – 'NZASB') that, similar to paragraph 22(b), includes a division of disclosure requirements into two tiers, with the amount of information to be disclosed depending on the relative importance of an item or transaction to the reporting entity and the extent of judgement required in accounting for the item or transaction.
- 24 However, this is only meant to illustrate a possible approach to developing centralised disclosure requirements and IASB has not yet formed any views about the NZASB staff's proposals.

EFRAG Secretariat recommendation

- 25 The preliminary consultation document did not include a detailed discussion on differential disclosure regimes.

- 26 EFRAG Secretariat recommends proposing that the IASB should consider the issue of a differential disclosure regime more comprehensively. In doing so, it could consider the work done by other standard setters, including:
- (a) the Australian Accounting Standards Board, which permits entities applying IFRS Standards that are not publicly accountable to apply a reduced disclosure regime;
 - (b) the UK FRC, which implemented a reduced disclosure framework that provides exemptions from certain disclosure requirements in IFRS Standards for qualifying subsidiaries and parent entities as well as introducing a differential disclosure regime for financial institutions; and
 - (c) the ANC, which has proposed a reduced disclosure regime for 'small listed companies', and suggested the elimination of a series of disclosure requirements considered superfluous for small entities.

The impact of technology on the presentation of financial statements and on disclosures

What is the issue?

- 27 The IASB DP does not contain a comprehensive discussion on the effect of technology on the presentation of financial statements or on disclosures.
- 28 The EFRAG/ANC/FRC DP commented on the influence of technology in development of financial reporting. EFRAG noted that, for example, the organisation of disclosures might be less important as users dip in and out of the 'digital annual report' to find information that they need, rather than by reading it from front to back. EFRAG and its partners also observed that developments in technology might influence how much information is included in printed financial statements. In electronic format, there may be less need for disaggregated disclosures, if disaggregation could be achieved by drilling down on the numbers in primary financial statements in a digital format. This view was generally supported by constituents in the feedback statement of the EFRAG/ANC/FRC DP.
- 29 Digital reporting could impact the following sections in the IASB DP:
- (a) guidance on formatting;
 - (b) the role of the notes and of the primary financial statements; and
 - (c) the use of cross-referencing.
- 30 In its comment letter, in response to the consultation on *The IFRS Trustees' Review of Structure and Effectiveness*, EFRAG noted the following: 'The IASB's Standards are developed on the basis that entities are required to prepare a general purpose financial report whether that report is printed or in electronic format, ranging from a PDF version to one that is 'tagged' (in a computer-readable code that identifies specific items) using a structured data format. EFRAG appreciates that one of the reasons the IASB produces the IFRS Taxonomy is to assist with the accurate digital representation of IFRS in a structured format and to facilitate electronic filing.'

EFRAG Secretariat recommendation

- 31 In its preliminary consultation document, EFRAG noted its concern that the IASB DP does not include a broader discussion about the relevance of the proposed guidance in the context of the increasing use of digital reporting.
- 32 EFRAG Secretariat recommends that this concern should be repeated in the draft comment letter, and that the IASB should be encouraged to:
- (a) consider the impact of technology on the presentation of financial statements, rather than to focus only on approaches and formats that are appropriate for

printed financial reports, and the relationship between general-purpose financial reporting and electronic filing; and

- (b) contemplate how technology might affect the way financial information is delivered and accessed more generally.

Interactions with other IASB projects: guidance on performance measures

What is the issue?

- 33 Some EFRAG Board members identified the proposed guidance on performance measures as potentially problematic, especially the reference to unusual and infrequently occurring items.
- 34 The context of this topic is that the IASB is taking this opportunity to seek preliminary feedback on issues that are not related to the *Principle of Disclosures* project but, rather, to performance measures:
 - (a) the presentation of unusual or infrequently occurring items in the statement of financial performance; and
 - (b) the presentation of EBIT and EBITDA ratios in the statement of financial performance.
- 35 The IASB DP does not include a comprehensive discussion about performance measures because the IASB has a separate *Primary Financial Statements* research project that will consider these. The feedback is designed to supplement the IASB's research in this project. As a result, the IASB is seeking views on:
 - (a) whether it should develop guidance on unusual or infrequently occurring items and if so what factors should be considered in identifying such items; and
 - (b) whether it should clarify the criteria in which an EBIT or EBITDA subtotal can be considered to be fairly presented in accordance with IAS 1.

EFRAG Secretariat recommendation

- 36 In its preliminary consultation document, EFRAG was generally supportive of the objective of providing guidance on the issues identified in paragraph 34. The preliminary consultation document noted that the IASB has not yet developed detailed guidance and that EFRAG would have the opportunity to express a view when considering the proposals in the IASB's *Primary Financial Statements* project.
- 37 EFRAG Secretariat proposes to reiterate that view in EFRAG's draft comment letter.
- 38 EFRAG Secretariat also proposes that EFRAG should respond to the piecemeal questions on performance measures contained in the IASB DP at a very high level while reserving its right to revise and expand its preliminary views when the IASB has addressed performance measures more comprehensively, as part of its *Primary Financial Statements* project.

Matters addressed in the IASB DP that step outside the boundaries of the IASB's mandate

What is the issue?

- 39 The IASB DP includes two references to information contained in the Annual Report:
 - (a) one of the proposed principles for effective communication states that information should not be 'duplicated unnecessarily in different parts of the financial statements or the annual report'; and
 - (b) the use of cross-references is conditional on whether they 'make the annual report as a whole more understandable and the financial statements remain understandable'.

- 40 Concerns have been raised that the IASB was proposing guidance that would potentially step outside its mandate.
- 41 Similar concerns were expressed in EFRAG's draft comment letter in response to the IASB ED/2017/2 *Improvements to IFRS 8 Operating Segments – Proposed amendments to IFRS 8 and IAS 34*. EFRAG expressed 'preliminary reservations' over the proposal to require an entity to explain why the segments identified in an entity's financial statements are different to the segments reported outside the financial statements (in other parts of an entity's annual reporting package).
- 42 EFRAG noted in particular that paragraph 14 of IAS 1 states that reports and statements outside financial statements are outside the scope of IFRS Standards and that such reports are primarily the responsibility of other regulatory authorities resulting in requirements varying from one jurisdiction to another. In EFRAG's preliminary view, the proposal risked creating a broader precedent that future amendments to IFRS Standards might require entities to explain other differences between information reported inside and outside the financial statements.
- 43 In its preliminary consultation document, EFRAG agreed that a general disclosure standard should include principles guiding the use of cross-referencing. However, EFRAG was concerned that the proposed condition that the use of cross-referencing should make the annual report as a whole more understandable would not be practical to implement and raises questions about the IASB's mandate.
- 44 Some EFRAG Board members suggested having a discussion on whether such issues should be addressed separately by EFRAG in the context of each relevant consultation, or whether EFRAG should have a more coordinated approach and engage with the IASB on the matter. EFRAG Secretariat recommends that the position finally developed in this project should be reiterated whenever relevant to any future project.

Questions for the EFRAG Board

- 45 Does the EFRAG Board agree with the EFRAG Secretariat recommendations on the identified issues?
- 46 Does the EFRAG Board approve the draft comment letter, as contained in agenda paper 07-02, for publication?