Disclosure Initiative-Principles of Disclosure

Issues Paper - Towards a Draft Comment Letter

Objective

1 The objective of this issues paper is to discuss EFRAG TEG's views on the questions expected to be included in the forthcoming Discussion Paper *Disclosure Initiative - Principles of Disclosure* ('the DP').

Basis for the tentative views expressed in this paper

2 In preparing the tentative responses, the EFRAG Secretariat considered the tentative views expressed by EFRAG TEG, EFRAG CFSS and the EFRAG User Panel in previous meetings. The views expressed by EFRAG in the following publications were also considered:

(a) Discussion Paper *Towards a Disclosure Framework for the Notes* issued by EFRAG, the ANC and the FRC (' the EFRAG/ANC/FRC DP', see summary in Agenda Paper 05-03);

(b) EFRAG's comment letter in response to the IASB Exposure Draft *Conceptual Framework for Financial Reporting* (the 'CF ED');

(c) EFRAG's comment letter in response to the IASB/FASB Discussion Paper *Preliminary Views on Financial Statement Presentation*; and

(d) EFRAG's comment letter in response to the IASB Exposure Draft *Disclosure Initiative - Proposed amendments to IAS* 1.

3 This issues paper discusses the following topics expected to be included in the DP:

Summary of EFRAG's Secretariat's tentative views in response to the forthcoming DP

General comments on the DP

4 EFRAG welcomes the IASB's *Principles of Disclosure* project. The view that the Disclosure Initiative was one of the most important research projects that the IASB should undertake culminated in EFRAG's response to the *2015 IASB Agenda Consultation*.

5 EFRAG agrees with the description in the DP of the 'disclosure problem', which echoes assessments made in the EFRAG/ANC/FRC DP. However, EFRAG is concerned that while the IASB included proposals that address many different areas, the DP does not propose 'principles of disclosure' as its name suggests. EFRAG is also concerned about the significant overlap between the different IASB projects.

6 Finally, in EFRAG's opinion, the IASB should not wait until the proposals included in the DP have been completed to initiate its standard-level review of existing disclosures.

Detailed comments on the DP

7 EFRAG Secretariat's detailed comments and responses to the expected questions in the DP are set out in the next sections. A summary is provided in the paragraphs below.

Principles of effective communication

8 EFRAG welcomes the IASB's decision to develop guidance on effective communication in preparing the financial statements and broadly agrees with the principles identified by the IASB. EFRAG suggests that the IASB could include principles of effective communication in the form of illustrative examples or implementation guidance that will accompany, but will not form part of, the general disclosure standard. EFRAG also welcomes the IASB's decision to develop non-mandatory guidance on formatting and suggests that this guidance be included together with the guidance on principles of effective communication.

Roles of the primary financial statements and of the notes

9 EFRAG welcomes the overall objective of providing additional guidance on the roles of the primary financial statements and the notes. However, EFRAG has significant concerns in relation to the proposed definition of the role of the notes and, hence, recommends the IASB to consider, as an alternative, the proposed definition of the role of the notes contained in the EFRAG/ANC/FRC DP.

Location of information

<u>Disclosing IFRS information outside the financial statements</u>

10 EFRAG considers that, if used properly, cross-referencing can be an effective way to avoid repetition and reduce disclosure overload. Therefore, EFRAG welcomes the IASB objective to provide guidance in that area. However, EFRAG considers that the guidance should remain principles-based rather than refer to specific documents such as the annual report (where the content may vary across jurisdictions) and reiterates the view that cross-references should only be permitted to information that is available on the same terms and at the same time as the financial statements.

11 EFRAG disagrees with the requirement to allow cross-reference only 'if it makes the annual report as a whole more understandable' as it would not be practical to implement and to enforce.

Providing information identified as non-IFRS within the financial statements

12 EFRAG agrees that a general disclosure standard should not prohibit entities from including non-IFRS information as this may create conflicts with local regulations that may require the inclusion of such information, but considers that the boundaries of Categories B and C should be better explained and clarified. EFRAG broadly agrees with the qualitative requirements proposed in the DP.

Use of performance measures in the financial statements

13 EFRAG is concerned that the proposed piecemeal discussion on EBIT/EBITDA is unrelated to the main objective of the discussion paper to provide principles of disclosures and is of the view that the use of metrics such as EBIT or EBITDA would better be addressed more comprehensively as part of the *Primary Financial Statements* research project. EFRAG observes that there is guidance in IAS 1 to be used by entities to identify which subtotals they shall present when it is relevant to an understanding of an entity's financial position and performance.

14 EFRAG considers that providing guidance on disclosures when items are classified as unusual or infrequently occurring could be helpful. However, the IASB guidance should not be seen as an encouragement to separately present such items and the IASB should not try to provide definitions of such items.

Disclosure of accounting policies

15 EFRAG considers that guidance about disclosure of accounting policies is useful but should not be overly prescriptive as to the form and location of disclosures so as to allow necessary flexibility to determine the level of disclosure that most appropriately reflects users' needs. In addition, EFRAG considers that, as a matter of principle, the IASB should not provide guidance on information that is not required by IAS 1.

Centralised disclosure objectives

16 EFRAG supports the objective to further explore whether a more holistic and unified approach is achievable in developing disclosure objectives. However, EFRAG considers that a necessary preliminary step would be to clarify the boundaries of the notes.

17 EFRAG does not support grouping all disclosure requirements in a single standard, but acknowledges that, in some cases, it may be useful to cover disclosures on related topics in a single standard.

NZASB staff's approach to drafting disclosure requirements in IFRS Standards

18 EFRAG supports the NZASB staff's direction of the proposals on drafting disclosure requirements. However, EFRAG considers that the boundaries between the two categories of information should be further clarified.

Overview of the 'disclosure problem' and the objective of the project

Notes to EFRAG TEG

19 The IASB is expected to define the disclosure problem as consisting of three items:

(a) not enough relevant information;

(b) irrelevant information; and

(c) ineffective communication of the information provided.

20 The IASB is expected to consider that the main causes of the disclosure problem are:

(a) difficulties in applying judgement when deciding what information to disclose in financial statements and when deciding the most effective way to organise and communicate that information;

(b) difficulties arising from behavioural issues, observing that some entities, auditors and regulators appear to approach financial statements as compliance documents;

(c) lack of guidance on the content and structure of the financial statements;

(d) the absence of clear disclosure objectives in IFRS Standards; and

(e) long lists of prescriptive disclosure requirements.

21 The IASB is expected to consider that a set of disclosure principles could help address the disclosure problem by:

(a) helping entities apply better judgement about disclosures and communicate information more effectively;

(b) improving the effectiveness of disclosures for the primary users of the financial statements; and

(c) helping the IASB in improving disclosure requirements in standards.

22 The Principles of Disclosure project is likely to either result in amendments to IAS 1 *Presentation of Financial Statements*, or alternatively create a new general disclosure standard that would incorporate and build on those parts of IAS 1 that cover disclosures in the financial statements. Throughout the DP, the IASB expects to use the term 'general disclosure standard' to refer to either an amended IAS 1 or a new general disclosure standard.

Questions expected to be asked in the DP

23 Do you agree with this description of the disclosure problem and its causes? Why or why not? Do you think there are other factors contributing to the disclosure problem?

24 Do you agree that the development of disclosure principles in a general disclosure standard (i.e. either in amendments to IAS 1 or in a new general disclosure standard) would address the disclosure problem? Why or why not?

25 Are there any other disclosure issues that the IASB has not identified in the DP that you think should be addressed as part of the Principles of Disclosure project? What are they and why do you think they should be addressed?

EFRAG Secretariat's proposed response

26 **EFRAG agrees with the description in the DP of the 'disclosure problem', which echoes assessments made in the EFRAG/ANC/FRC DP. However, EFRAG is concerned that while the IASB included proposals that address many different areas, the DP does not propose 'principles of disclosure' as its name suggests. EFRAG is also concerned about the significant overlap between the different IASB projects. Finally, EFRAG has received feedback that the IASB should not wait until the proposals included in the DP have been completed to initiate its standard-level review of existing disclosures.**

27 EFRAG welcomes the IASB's initiative to develop guidance in order to address the disclosure issue.

28 EFRAG agrees with the description of the disclosure issue made by the IASB. In the EFRAG/ANC/FRC DP, EFRAG acknowledged that the relevance of the notes to the financial statements have become deteriorated for a number of reasons. In particular, EFRAG noted two main areas for improvement of the quality of disclosures:

(a) avoiding disclosure overload, which may be caused both by excessive requirements in the 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 to compare.

29 EFRAG agrees with the IASB that the 'disclosure problem' is not just about quantity (i.e. the disclosure overload) but also and primarily the quality and effectiveness of disclosures, in terms of meeting the needs of users.

30 EFRAG notes in particular that, although many factors contributed to the disclosure problem, one of the reasons for unsatisfactory disclosure requirements in standards is that these requirements have largely been developed on a standard-by-standard basis without an overall underlying basis. Therefore, EFRAG welcomes the objective to provide a set of disclosure principles to improve the effectiveness of disclosures.

Addressing the disclosure problem

31 As also referred to in the EFRAG/ANC/FRC DP, one of the main causes of the disclosure problem is that difficulties in applying judgement are often behavioural, rather than caused by the requirements in IFRS Standards. In particular, that preparers, as well as auditors and regulators, opt for 'safety' by using a 'checklist' approach. This factor has, in combination with others, has diminished the relevance of the information in the notes to the financial statements.

32 EFRAG therefore considers that the development of disclosure principles would be helpful in order to contribute to the effort in the wider financial reporting community to address the disclosure problem. The EFRAG/ANC/FRC DP provided a number of suggestions in moving towards developing a Disclosure Framework. EFRAG welcomes the fact that the IASB's proposals address all these suggestions.

33 However, EFRAG is concerned that the DP does not include a set of 'principles of disclosure'. Instead, the IASB has included proposals in the discussion paper addressing many different areas. In EFRAG's opinion, the proposals should be organised in a more logical sequence, such as the structure of the EFRAG/ANC/FRC DP:

(a) clarify the purpose of the notes;

(b) develop principles to identify what information to include in the notes;

(c) consider the form of disclosure requirements;

(d) strengthen the application of materiality so that the only information disclosed is what is necessary to understanding an entity's financial performance and position; and

(e) articulate the key features of effective communication that can be applied to the notes.

34 Consequently, it is sometimes difficult to understand how these proposals work together to address the disclosure problem described in this section.

35 Furthermore, EFRAG observes that there is significant overlap between the projects on the *Conceptual Framework*, *Primary Financial Statements* and *Principles of Disclosure*. We have the following comments in relation to this overlap:

(a) the definition and role of primary financial statements should be discussed in the project on the Conceptual Framework or Primary Financial Statements, instead of introducing the description in a discussion paper on principles of 'disclosure';

(b) the role of the notes was discussed in the project of the Conceptual Framework, which implies that one proposal would be subjected to two consultations and run the risk of contradictory feedback; and

(c) while we understand that the DP is expected to seek initial feedback on clarifications related to EBIT, EBITDA and on unusual or infrequently occurring items, to inform the Primary Financial Statements project, we do not support including a question for a different project in this consultation document as this may confuse stakeholders. In addition, in our opinion, any output from such consultations should only be considered as supplementary evidence, but should not drive the Primary Financial Statements project.

36 EFRAG notes that the overlap described above may create confusion to constituents on the boundaries of the projects and suggests that the IASB address these issues more comprehensively.

37 The EFRAG Secretariat proposes to include a question to constituents to ask whether they have identified any other disclosure issues that the IASB should address as part of the Principles of Disclosure project.

Principles of effective communication

Notes to EFRAG TEG

38 The IASB is expected to develop a set of principles of effective communication to help entities communicate information more effectively in the financial statements and indicate that the information provided should be:

(a) entity-specific, since information tailored to an entity's own circumstances is more useful than generic, 'boilerplate' language or information that is readily available outside the financial statements;

(b) described as simply and directly as possible without a loss of material information or unnecessarily increasing the length of the financial statements;

(c) organised in a way that highlights important matters, including providing note disclosures in an appropriate order and emphasising the important matters within them;

(d) linked when relevant to other information in the financial statements or to other parts of the annual report to highlight relationships between pieces of information and improve navigation through the financial statements;

(e) not duplicated unnecessarily in different parts of the financial statements or the annual report;

(f) provided in a way that optimises comparability among entities and across reporting periods without compromising the usefulness of the information; and

(g) provided in a format (e.g. lists, tables, narrative text, etc.) that is appropriate for that type of information.

39 The IASB is expected to observe that an entity might need to make a trade-off between some of these principles when preparing its financial statements. For example, while tailoring disclosures to an entity's own circumstances can help to ensure that information is relevant and easier for users of the financial statements to understand, it might reduce comparability and consistency between entities and periods. The IASB is expected to recommend that an entity use judgement when applying these principles in order to maximise the usefulness of the information for users of the financial statements.

40 The principles in paragraphs 38 (a)-(f) were included in the Conceptual Framework Discussion Paper. Many respondents to the Conceptual Framework Discussion Paper agreed with including these principles in the Conceptual Framework. However, some respondents suggested that some or all of them would be better placed in a Standard. The IASB observed that some of the principles focus more on the preparation of the financial statements than on underlying concepts.

41 Accordingly, in developing the CF ED the IASB proposed to include in the Conceptual Framework only those communication principles in paragraph 38 (a) and (e) that also describe the underlying concepts.

42 The IASB is not expected to form a preliminary view on whether the principles of effective communication should be included in non-mandatory guidance or prescribed in a general disclosure standard.

43 The IASB is expected to state that non-mandatory guidance could be:

(a) in the form of illustrative examples or implementation guidance that accompany, but do not form part of, the general disclosure standard;

(b) in the form of a Practice Statement that does not accompany a specific Standard; or

(c) provided as separate educational material, for example made available on the IFRS Foundation's website.

44 According to the IASB, non-mandatory guidance in (a) and (b) would be included in Part B of the IFRS Bound Volume and subject to full due process. Educational material in (c) would be subject to due process of a more limited nature.

45 The IASB is expected to suggest that it should develop non-mandatory guidance on the use of formatting in the financial statements, which would provide guidance on the types of formats, when a particular format might be more appropriate than another and some illustrative examples with some common formatting types.

Questions expected to be asked in the DP

46 Do you agree that the IASB should develop principles of effective communication that entities should apply when preparing the financial statements? Why or why not?

47 Do you agree with the proposed set of principles? Why or why not? If not, what alternative(s) do you suggest, and why?

48 Do you think that principles of effective communication that entities should apply when preparing the financial statements should be prescribed in a general disclosure standard or issued as non-mandatory guidance? If you support the issuance of non-mandatory guidance, please specify the form of non-mandatory guidance you suggest.

49 Do you think that non-mandatory guidance on the use of formatting in the financial statements should be developed? Why or why not? If you support the issuance of non-mandatory guidance, please specify the form of non-mandatory guidance you suggest.

EFRAG Secretariat's proposed response

50 **EFRAG welcomes the IASB's decision to develop guidance on effective communication in preparing the financial statements and broadly agrees with the principles identified by the IASB. EFRAG suggests that the IASB could include principles of effective communication in the form of illustrative examples or implementation guidance that will accompany, but will not form part of, the general disclosure standard.**

51 **EFRAG also welcomes the IASB's decision to develop non-mandatory guidance on formatting and suggests that this guidance be included together with the guidance on principles of effective communication.**

Principles of effective communication

52 EFRAG welcomes the IASB's decision to develop principles of effective communication, which can be used in preparing the financial statements. As stated in the EFRAG/ANC/FRC DP, poor communication hinders the quality of information, especially within lengthy reports and stressed the importance of the disclosures in financial statements in communicating information to users, rather than being seen as a compliance exercise.

53 EFRAG noted that communication principles in a Disclosure Framework could improve the quality of disclosures. However, as the notes form part of 'telling the entity's story', it would be difficult to establish anything other than high-level generic principles.

54 EFRAG generally agrees with the principles identified by the IASB, as these are broadly similar to those identified in EFRAG/ANC/FRC DP. However, in EFRAG's view, the link between communication principles and the qualitative characteristics of useful financial information in the Conceptual Framework (relevance, faithful representation, understandability and comparability) should be enhanced. For

example, EFRAG understands that the communication principle (a) relates to the relevance of information, communication principles (b), (c), (d), (e), (f) and (g) relate to the understandability of information, communication principle (b) also relates to the faithful representation and communication principle (f) relates to the comparability of information.

55 EFRAG agrees with the IASB that entities need to use judgment when applying these communication principles, including the trade-off between these principles. For example, if there is more emphasis on making disclosures entity-specific and thereby providing more relevant information for users, then inevitably there has to be some ground given up on achieving comparability and vice-versa.

56 Lastly, EFRAG notes that the principle of comparability among entities may be difficult to apply in practice and that the IASB should explain the meaning of the term comparability 'among entities', as this could be interpreted in many ways (e.g. entities in the same industry, in the same jurisdiction, etc.).

Form of the guidance on principles of effective communication

57 Although EFRAG appreciates the importance of principles of effective communication in addressing the disclosure problem, we consider that principles of effective communication should not be prescribed in a general disclosure standard, as they would be difficult to enforce and audit. EFRAG therefore recommends that the IASB publish the principles of effective communication as non-mandatory guidance.

58 Regarding the specific forms of non-mandatory guidance discussed by the IASB, EFRAG would welcome a document that will be part of the IFRS Bound Volume and will be subject to full due process. Such a document will have more authority than educational material, will remain accessible over time and will be updated when necessary.

59 EFRAG suggests that the IASB could include principles of effective communication in the form of illustrative examples or implementation guidance that will accompany, but will not form part of, the general disclosure standard. We consider that guidance which accompanies a standard is preferable because it is subject to due process and is given more visibility than education material or a practice statement.

60 EFRAG considers that developing guidance on the appropriate use of formats may improve the effectiveness of the communication of information in the financial statements. Therefore, EFRAG welcomes the IASB's decision to develop non-mandatory guidance material on formatting, which would cover the types of formats available, when a particular format might be appropriate and some illustrative examples. However, the IASB should also consider the interactions with its taxonomy project.

61 EFRAG considers that such guidance should be included together with the principles of effective communication, so that constituents can access them within the same document. Having said that, we consider that guidance on formatting should also be included in the form of illustrative examples or implementation guidance that will accompany, but will not form part of, the general disclosure standard.

Roles of the primary financial statements and of the notes

Notes to EFRAG TEG

62 The IASB is expected to:

(a) specify that the statements of financial position, financial performance, changes in equity and cash flows collectively form the 'primary financial statements' and consider the implications; and

(b) describe the role of the primary financial statements as being to provide a structured and comparable summary of an entity's recognised assets, liabilities, equity, income and expenses, which is useful for:

(i) obtaining an overview of the entity's assets, liabilities, equity, income and expenses;

(ii) making comparisons between entities and reporting periods; and

(iii) identifying items or areas within the financial statements about which users of the financial statements will seek additional information in the notes.

63 The IASB is also expected to:

(a) describe the role of the notes as being to:

(i) provide further information necessary to disaggregate, reconcile and explain the items recognised in the primary financial statements; and

(ii) supplement the primary financial statements with other information that is necessary to meet the objective of financial statements.

(b) propose to include in the future general disclosure standard some of the following examples of further explanatory information:

(i) disaggregation and reconciliations of line items in the primary financial statements;

(ii) descriptions of the nature of the items included in the primary financial statements; and

(iii) information about the methods, assumptions and judgements used in recognising and measuring the items included in the primary financial statements.

(c) propose to include in the future general disclosure standard some of the following examples of supplementary information:

(i) information about the nature and extent of an entity's unrecognised elements; and

(ii) information about an entity's exposure to various types of risks, such as market risk or credit risk, arising from both recognised and unrecognised elements.

64 Finally, the IASB is expected to suggest continuing to use the words 'present or 'disclose' as before, but be more 'disciplined' by always specifying the intended location (e.g. 'presented in the primary financial statements' or 'presented in the notes').

Questions expected to be asked in the DP

65 Do you agree with the IASB's preliminary view that a general disclosure standard should:

(a) specify that the 'primary financial statements' are the statements of financial position, financial performance, changes in equity and cash flows;

(b) describe the role of primary financial statements and the implications of that role;

(c) describe the role of the notes as proposed, as well as provide examples of further explanation and supplementary information; and

(d) include the proposed guidance on the content of the notes?

66 In addition, do you agree with the IASB's preliminary view that:

(a) it should not prescribe the meaning of 'present' as presented in the primary financial statements and the meaning of 'disclose' as disclosed in the notes; and

(b) if it uses the terms 'present' and 'disclose' when describing where to provide information in the financial statements when subsequently drafting an IFRS Standard, it should also specify the intended location as either 'in the primary financial statements' or 'in the notes'?

EFRAG Secretariat's proposed response

67 **EFRAG welcomes the overall objective of providing additional guidance on the roles of the primary financial statements and the notes. However, EFRAG considers that:**

(a) **the proposed definition of the role of the notes does not set the boundaries of the notes; and**

(b) **the proposed definition of the role of primary financial statements does not refer to cash flows although the statement of cash flows is part of these statements.**

The IASB could consider, as an alternative the proposed definition of the role of the notes contained in the EFRAG/ANC/FRC DP.

68 **EFRAG supports the IASB's proposal to be more disciplined in the use of the terms 'present' and 'disclose' in standards by specifying the intended location as a practical solution.**

69 EFRAG welcomes the overall objective of providing additional guidance on the role of the primary financial statements and of the notes.

70 EFRAG considers that defining the roles can help define the respective boundaries of the notes and of the primary financial statements. EFRAG considers that this is a necessary step prior to developing any forms of principles of disclosures.

71 EFRAG considers that the term 'primary financial statements' is generally well understood and has not heard major concerns raised by constituents.

72 We refer to our comments on the interaction with other projects of the IASB in paragraph 35.

Role of the primary financial statements

73 EFRAG observes that the proposed description of the role of the primary financial statements refers to assets, liabilities, income and expense, but it does not refer to cash flows. This seems contradictory to the fact that the statement of cash flows is one of the primary financial statements.

74 Furthermore, as stated previously in its comment letter in response to the CF ED, EFRAG understands that many users of financial statements also consider that the statement of cash flows provides useful information about an entity's performance.

75 In EFRAG's opinion, it is therefore unclear why the statement of cash flows is not considered in the description of the role of the primary financial statements.

Role of the notes

76 EFRAG considers that the proposed description of the role of the notes, as drafted, does not define the boundaries of the notes, in particular in the generic reference to 'all other information that is necessary to meet the objective of financial statements'.

77 An alternative definition of the role of the notes is proposed in the EFRAG/ANC/FRC DP that could be considered for the sake of the discussion: 'the purpose of the notes is to provide a relevant description of the items presented in the primary financial statements and of unrecognised arrangements, claims against and rights of the entity that exist at the reporting date'.

78 Such a definition would better define the boundaries of the notes by stating that:

(a) the disclosures in the notes should provide information which amplifies and explains the primary financial statements; and

(b) the notes should focus on past transactions and other events existing at the reporting date; information about the future that is unrelated to those past transactions and other events, is not provided in the notes.

Using the terms 'present' or 'disclose'

79 In EFRAG's comment letter in response to the CF ED, EFRAG stated that the IASB should consider how to distinguish between presentation and disclosure and provide principles for when disclosures should be provided. EFRAG observes that, as the DP proposes a definition of the term 'primary financial statements', this would be a logical next step. EFRAG observes that the words are sometimes used interchangeably in current IFRS Standards although 'present' is more often used to describe including information in the primary financial statements whereas the term 'disclosure' is often used to describe including information in the notes.

80 However, EFRAG considers that trying to clarify the respective meanings of the words may not necessarily be helpful as the two words have a common meaning in the English language and nuances would not necessarily translate well in other languages. Furthermore, EFRAG does not consider the distinction between 'present' and 'disclose' to be a major issue in financial reporting.

81 EFRAG therefore supports the IASB's proposal to be more disciplined in the use of the term in standards by specifying the intended location (e.g. 'disclosed in the notes'…) as a practical solution.

Location of information

Disclosing IFRS information outside the financial statements

Notes to EFRAG TEG

82 IFRS Standards already allow entities to provide specified information outside the financial statements in a limited number of cases, for example:

(a) paragraph 21B of IFRS 7 *Financial Instruments: Disclosures* permits that disclosures on hedge accounting (required by paragraphs 21A-24F of that Standard) be incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time;

(b) paragraph 31 of IFRS 14 *Regulatory Deferral Accounts* (not endorsed in the EU) permits the description of the nature of, and the risks associated with, an entity's rate-regulated activities (required by paragraph 30 of that Standard) to be provided by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time;

(c) paragraph 32b of IFRS 1 *First-time Adoption of International Financial Reporting Standards* allows a first time adopter to incorporate specified information in its first interim financial report in accordance with IAS 34 *Interim Financial Reporting* by cross-reference to another published document that includes this information; and

(d) paragraphs 150 of IAS 19 *Employee Benefits* allows entities to incorporate specified information about defined benefit plans that share risks between entities under common control, by cross-reference to disclosures in another group entity's financial statements, if that group entity's financial statements are available to users of the financial statements on the same terms and at the same time, or earlier than the financial statements of the entity.

83 The IASB is expected to propose that a general disclosure standard should include a principle that information necessary to comply with IFRS Standard can be provided outside the financial statements if such information meets 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.

84 The IASB is expected to describe 'annual report' as 'a single reporting package issued by an entity that includes the financial statements' and has boundaries similar to those described in International Standard on Auditing (ISA) 720 (Revised) *The Auditor's Responsibilities Relating to Other Information*[1]. The IASB is expected to observe that an interim report could also be described as a single reporting package

[1] A document, or combination of documents, prepared typically on an annual basis by management or those charged with governance in accordance with law, regulation or custom, the purpose of which is to provide owners (or similar stakeholders) with information on the entity's operations and the entity's financial results and financial position as set out in the financial statements. An annual report contains or accompanies the financial statements and the auditor's report thereon and usually includes information about the entity's developments, its future outlook and risks and uncertainties, a statement by the entity's governing body, and reports covering governance matters. (Ref: Para. 12(a) [of ISA 720(Revised)]).

issued by an entity and that the principle in paragraph 83 could similarly be applied to an interim report.

85 The IASB has decided to limit the cross-reference of IFRS information in the boundaries of the annual report to avoid the risk of making it difficult to find or access the cross-referenced information, as may happen if it were to be placed outside of a single reporting package-for example, if the cross-referenced material is on the entity's public website or in a stand-alone report.

86 It has to be noted that, in the forthcoming Exposure Draft *Improvements to IFRS 8 Operating Segments:* proposed amendments to IFRS 8 and IAS 34 , the IASB is expected to propose including the following paragraph in IFRS 8 which describes an entity's annual reporting package. 'An entity's annual reporting package is a set of one or more documents that:

(a) is published at approximately the same time as the entity's annual financial statements;

(b) communicates the entity's annual results to users of its financial statements; and

(c) is publicly available, for example, on the entity's website or in its regulatory filings'.

87 In addition to the annual financial statements, the annual reporting package may include a management commentary, press releases, preliminary announcements, investor presentations and information for regulatory filing purposes.

88 The IASB observes that the description of an 'annual reporting package' is broader than its description of an 'annual report'. The IASB might incorporate the broader term 'annual reporting package' proposed in the Exposure Draft of proposed amendments to IFRS 8 and IAS 34 depending on the feedback it receives on that document.

89 The IASB is expected to suggest the following ways that entities could identify clearly the information necessary to comply with IFRS Standards that has been provided outside the financial statements. That is, entities could:

(a) provide in the financial statements a list of any information that forms part of the financial statements and is incorporated in them by cross-reference, together with its unreserved statement of compliance with IFRS Standards;

(b) clearly identify the cross-referenced information as information necessary to comply with IFRS Standards and that forms part of the financial statements;

(c) ensure the cross-reference in the financial statements clearly identifies and describes the information that it relates to; and

(d) ensure the cross-referenced information remains available over time as part of the annual report.

90 The IASB is expected to observe that these principles might not address all stakeholders' concerns about duplication, some of which have arisen from the existence of similar, but not identical, requirements in IFRS Standards and regulatory requirements. For example, a regulator might require an entity to disclose one piece of information that is similar to, but not the same as, a piece of information required by IFRS Standards. The entity would still have to comply with both requirements, but would not be able to use cross-referencing to avoid duplication in this case. Furthermore, there might be local requirements in a jurisdiction that restrict an entity from providing the information necessary to comply with IFRS Standards outside the financial statements.

Questions expected to be asked in the DP

91 Do you agree with the IASB's preliminary view that a general disclosure standard should include a principle that an entity can provide information that is necessary to comply with IFRS Standards outside financial statements if the information meets the proposed requirements? Why or why not? If you do not agree, what alternative(s) do you suggest, and why?

92 Can you provide any examples of specific scenarios, other than those currently included in IFRS Standards, for which you think an entity should or should not be able to provide information necessary to comply with IFRS Standards outside the financial statements? Why? Would those scenarios meet the proposed requirements?

EFRAG Secretariat's proposed response

93 **EFRAG considers that, if used properly, cross-referencing can be an effective way to avoid repetition and reduce disclosure overload. Therefore, EFRAG welcomes the IASB objective to provide guidance in that area. However, EFRAG considers that the guidance should remain principles-based rather than refer to specific documents such as the annual report (where the content may vary across jurisdictions) and reiterates the view that cross-references should only be permitted to information that is available on the same terms and at the same time as the financial statements.**

94 **EFRAG disagrees with the requirement to allow cross-reference only 'if it makes the annual report as a whole more understandable' as it would not be practical to implement and to enforce.**

Should a general disclosure standard allow cross-reference?

95 EFRAG acknowledges that, in some limited cases, IFRS Standards already allow entities to provide specified information outside the financial statements. In EFRAG's view, if used properly, cross-referencing could be an effective way to reduce repetition and direct the reader to a section that contains additional relevant information on a topic.

96 Therefore, EFRAG agrees that a general disclosure standard should include a general principle that an entity can disclose information necessary to comply with IFRS Standards outside of financial statements if some requirements are met.

Guidance on cross-reference

97 EFRAG agrees with the requirement that the information should be clearly identified and should be incorporated in the financial statements by including a cross-reference in the financial statements to that information. This would ensure there is clarity regarding the information that is and is not subject to IFRS Standards and to audit.

98 EFRAG observes that reporting requirements and practices vary across jurisdictions and across industries and may change over time. Thus, rather than prescribing that cross-references should be limited within an entity's annual report, we suggest that the IASB should highlight the underlying principle, which is that cross-references should be allowed to information outside of the financial statements, if the information is available to users of the financial statements on the same terms as the financial statements and at the same time.

99 This principle will aim to reach an adequate and controlled way of cross-referencing, avoiding impairment of understandability, among other concerns, thereby ensuring the same quality of the information. It would allow entities to include information in the financial statements by cross-reference (not necessarily included in the 'single

reporting package issued by an entity' as described), such as a separate risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time.

100 Regarding the requirement to allow incorporation by reference only when it 'makes the annual report as a whole more understandable', EFRAG considers that it may not be practical to implement and enforce, as it may be very difficult for entities to justify that an annual report as a whole is made more understandable. Including cross-references, for instance to avoid duplication of information, does not necessarily and mechanically result in more understandable information as a whole.

101 Moreover, EFRAG notes that the annual report includes sections that are not in the scope of IFRS requirements. EFRAG considers that the IASB should clarify the reasons for addressing the understandability of the annual report as a whole. We suggest that the requirement refers only to the understandability of the financial statements.

Examples of specific situations where cross-references are used

102 EFRAG has heard that it is not uncommon in some jurisdictions to use cross-references for items such as information on risks or management remuneration as the local regulations require detailed statements on these topics. Disclosure requirements in these jurisdictions may be more extensive and may overlap with the IFRS Standards. The management remuneration disclosures may be required in the management commentary section of the annual report or in a separate remuneration report.

103 The EFRAG Secretariat proposes to gather input from constituents in its draft comment letter by including specific questions to constituents:

(a) whether cross-references are used in the jurisdiction and for what types of information; and

(b) whether the guidance proposed by the IASB to allow cross-references within the annual report could conflict with local regulations.

Providing information identified as non-IFRS within the financial statements

Notes to EFRAG TEG

104 The IASB is expected to refer to three categories of information in financial statements:

(a) Category A: information specifically required by IFRS Standards;

(b) Category B: additional information necessary to comply with IFRS Standards (paragraphs 17(c), 55, 85 and 112(c) of IAS 1); and

(c) Category C: additional information that is not within Categories A and B. This includes information that is inconsistent with IFRS Standards and some non-financial information.

105 The IASB is expected to refer to 'non-IFRS information' as being limited to Category C above. However, the IASB acknowledges that other stakeholders may think that Category B and Category C are both non-IFRS information, because information disclosed under these categories is not specifically required by IFRS Standards. Accordingly, they suggest that the term 'non-IFRS information' should be used with care.

106 The IASB is expected to acknowledge that, because Category B can be interpreted so broadly, it could be difficult to determine whether some information falls within Category B or within Category C. The IASB is also expected to observe that it has previously concluded that prohibiting entities from disclosing immaterial information, which would fall under Category C, is not operational.

107 When non-IFRS information is included in the financial statements, a general disclosure standard should require an entity:

(a) to identify clearly such information as not being prepared in accordance with IFRS Standards and, if applicable, as unaudited;

(b) to provide a list of such information, together with the statement of compliance with IFRS Standards required by paragraph 16 of IAS 1; and

(c) to explain why the information is useful and has been included in the financial statements. For information to be 'useful' it must comply with the qualitative characteristics of financial information, i.e. it must be relevant and faithfully representative.

108 The IASB is expected to propose that additional information provided in accordance with the requirements of IAS 1 (i.e. Category B information) should not be identified by an entity as 'non-IFRS information' in this way.

109 The IASB is not expected to discuss whether to prohibit any specific Category C information from being included in the financial statements, or place any further restrictions on its inclusion. The IASB observes that it might want to consider additional restrictions applicable to information that is inconsistent with IFRS Standards, for example because it is measured on a different basis. The IASB is expected to seek feedback on whether to prohibit or restrict the inclusion in the financial statements of any specific types of information.

110 The IASB is also expected to include general requirements for fair presentation in the financial statements of performance measures. The definition of performance measures as well as these general requirements are discussed in the next section. If information identified as 'non-IFRS information' also fits the description of a performance measure, then the discussion in section 'Use of performance measures in the financial statements' will also apply.

Questions expected to be asked in the DP

111 Do you agree with the IASB's preliminary view that a general disclosure standard should not prohibit an entity from including information in its financial statements that it has identified as 'non-IFRS information', or by a similar labelling, to distinguish it from information necessary to comply with IFRS Standards, but should include requirements about how an entity provides such information? Why or why not? If you do not agree, what alternative(s) do you suggest, and why?

112 Do you think the IASB should prohibit the inclusion of any specific types of additional information in the financial statements (for example information that is inconsistent with IFRS Standards)? If so, which additional information, and why?

EFRAG Secretariat's proposed response

113 **EFRAG agrees that a general disclosure standard should not prohibit entities from including non-IFRS information (classified as Category C) as this may create conflicts with local regulations that may require the inclusion of such information. EFRAG broadly agrees with the qualitative requirements proposed in the DP.**

114 **EFRAG also considers that the boundaries of Categories B and C should be better explained and clarified.**

115 EFRAG agrees with the IASB's preliminary view that a general disclosure standard should not prohibit an entity from including information that an entity has identified as non-IFRS information in its financial statements. In EFRAG's view, prohibiting entities from disclosing non-IFRS information may conflict with existing regulatory requirements, and thus would not be operational.

116 EFRAG considers that financial information prepared and presented in accordance with IFRS Standards is of primary relevance. Therefore, we welcome the IASB's proposed requirement to clearly identify non-IFRS information and disclose a list of them in the financial statements. However, we consider that the requirement to always explain why the non-IFRS information is useful and has been included in the financial statements could result in boilerplate disclosures.

117 EFRAG observes that the distinction between Categories B and C is not always clear considering the broad principle contained in paragraph 112(c) of IAS 1 that the notes shall present '*information that is not presented elsewhere in the financial statements but is relevant to an understanding of any of them*'.

118 EFRAG also considers that the IASB should better explain the relationship between non-IFRS information (analysed in this section) and the discussion on 'performance measures' (discussed in the following section) in case information identified as 'non-IFRS' information, also meets the description of a performance measure.

119 The IASB could consider restructuring the sections of the DP, so that non-IFRS information and performance measures are addressed together as discussion the topics separately may create confusion.

Use of performance measures in the financial statements

Notes to EFRAG TEG

120 This section of the DP is expected to focus on general requirements for fair presentation of performance measures in financial statements.

121 The IASB has a separate research project, which will consider the structure and content of the primary financial statements, including the use of performance measures. The IASB is taking the opportunity of this public consultation to seek feedback on two specific issues considered by the IASB during its discussions about performance measures for the purposes of informing its Primary Financial Statements project and supplementing its research in that project. At this stage, the IASB is not seeking feedback on the structure and content of the primary financial statements, except as specified in the questions included in this DP.

122 The IASB is expected to limit its discussion in this DP to the following two issues:

(a) when presentation of EBIT and/or EBITDA in the statement(s) of financial performance can be considered a fair presentation in accordance with IFRS Standards; and

(b) whether to provide guidance on the presentation of unusual and infrequently occurring items.

123 This DP addresses these issues because:

(a) they relate to concerns about the fair presentation of commonly used performance measures that might be disclosed in the notes as well as presented in the primary financial statements;

(b) they were specifically discussed by the IASB as part of its discussion of disclosure of performance measures in the Principles of Disclosure project, whereas other common measures, such as presentation of operating profit, were not; and

(c) comments on this DP would provide early feedback on these issues to inform the Primary Financial Statements project.

Presentation of EBIT and EBITDA and depiction of unusual or infrequently occurring items in the statement(s) of financial performance

Notes to EFRAG TEG

124 Though commonly reported by entities, neither EBITDA nor EBIT are required or defined by IFRS Standards.

125 The IASB is expected to clarify the following points if an entity reports EBITDA and/or EBIT:

(a) presenting EBITDA as a subtotal in the statement(s) of financial performance can provide a fair presentation if an entity presents an analysis of expenses on the basis of their nature (referred to as the 'nature of expense' method-paragraph 102 of IAS 1) and if the subtotals are presented in accordance with the requirements in paragraphs 85–85B of IAS 1 for using subtotals. However, presenting EBITDA as a subtotal in the statement(s) of financial performance is unlikely to achieve a fair presentation if an entity presents an analysis of expenses on the basis of their function (referred to as the 'function of expense' method-paragraph 103 of IAS 1). EBITDA excludes expenses of specified natures (for example, amortisation), so presenting EBITDA when the function of expense method is used results in a mixture of the nature of expense and function of expense methods that would disrupt the analysis of expenses and might cause confusion. Nevertheless, an entity using a function of expense method might still disclose EBITDA, for example in the notes; and

(b) EBIT is usually a subtotal that fits within both the nature of expense and the function of expense method.

126 The IASB is expected to discuss that they will allow entities to present separately unusual or infrequently occurring items. The IASB is also of the preliminary view that a general disclosure standard should explain when and how items can be presented in the statement(s) of financial performance as unusual and/or infrequently occurring. The starting point for these requirements could be the IASB/FASB staff draft[2] developed in 2010 in the IASB's previous Financial Statement Presentation project. However, the IASB should develop these further by considering the feedback it receives on the questions in this DP and the following issues suggested by stakeholders:

(a) whether entities can use the term 'infrequently occurring' to describe an item or transaction that has occurred more than once within a stated period-for example, within the previous five years-or that is likely to occur in the foreseeable future;

(b) whether describing an item as unusual or infrequently occurring should only depend on the particular circumstances of the entity, for example, losses from hurricanes and earthquakes might be relatively common in general, but the chances of them having a material effect on a particular entity might be remote;

(c) the size of an item, in addition to its nature and frequency, should be considered when deciding whether to classify it as unusual or infrequently occurring. By way of illustration, while it may be fairly common for an entity to make small payments to settle legal claims, if it needs to make a significant one-off payment to settle a legal claim, should the entity separately disclose the unusually large item as unusual or infrequently occurring? Or should the IASB consider a third category, for example re-occurring items that are unusually large?

(d) other characteristics besides the frequency or the unusual nature of an item would make separate disclosure of items of income or expense relevant for users of financial statements. For example, some respondents say the following characteristics similarly warrant separate disclosure:

(i) the variability of the item; and

(ii) whether current-period amounts represent a remeasurement of prior-period estimates; and

(e) an entity should be permitted to isolate the impact of an event that affects several line items, for example as a consequence of a hurricane or a major economic event.

127 The IASB discussed, but did not form any preliminary views on, whether to prohibit the use of particular terms used to describe unusual and infrequently occurring items because some terms, such as 'non-recurring' or 'special', are less helpful for users of financial statements if an entity does not also explain why items are classified that way (i.e. the term itself is unclear as to whether the items are unusual, or infrequent, or both). Furthermore, these terms might be interpreted in a similar way to the term 'extraordinary items', whose use is prohibited by paragraph 87 of IAS 1. In addition, terms like 'one-off' suggest that the items can never recur, which is difficult to substantiate.

[2] http://www.ifrs.org/Current-Projects/IASB-Projects/Financial-Statement-Presentation/Phase-B/Documents/FSPStandard.pdf

Questions expected to be asked in the DP to provide for input into the IASB's Primary Financial Statements project

128 Do you agree with the IASB's preliminary view that it should clarify that the following subtotals in the statement(s) of financial performance comply with IFRS Standards if such subtotals are presented in accordance with paragraphs 85–85B of IAS 1:

(a) the presentation of an EBITDA subtotal if an entity uses the nature of expense method; and

(b) the presentation of an EBIT subtotal under both a nature of expense method and a function of expense method.

If you do not agree, what alternative action do you suggest, and why?

129 Do you agree with the IASB's preliminary view that it should develop definitions of, and requirements for, the presentation of unusual or infrequently occurring items in the statement(s) of financial performance? Why or why not? If you do not agree, what alternative action do you suggest, and why?

130 Should the IASB prohibit the use of other terms to describe unusual and infrequently occurring items?

131 Are there any other issues or requirements that the IASB should consider in addition to those proposed when developing requirements for the presentation of unusual or infrequently occurring items in the statement(s) of financial performance?

EFRAG Secretariat's proposed response

132 **EFRAG is concerned that the proposed piecemeal discussion on EBIT/EBITDA is unrelated to the main objective of the discussion paper to provide principles of disclosure. EFRAG is of the view that the use of metrics such as EBIT or EBITDA would better be addressed more comprehensively as part of the Primary Financial Statements research project. EFRAG observes that there is guidance in IAS 1 to be used by entities to identify which subtotals they shall present when it is relevant to an understanding of an entity's financial position and performance.**

133 **EFRAG considers that providing guidance on disclosures when items are classified as unusual or infrequently occurring could be helpful. However, the IASB guidance should not be seen as an encouragement to separately present such items and the IASB should not try to provide definitions of such items.**

Presentation of EBIT and EBITDA

134 EFRAG understands that the IASB expects to use the DP as an opportunity to obtain early feedback on some aspects of its Primary Financial Statements research project. As mentioned in our response to questions in section 'Overview of the disclosure problem and the objective of the project', EFRAG questions whether this piecemeal approach on performance reporting is the most efficient way to collect input from constituents.

135 In EFRAG's view, the principle in paragraphs 55A and 85A of IAS 1 that 'the subtotals shall be comprised of line items made up of amounts recognised and measured in accordance with IFRS Standards' can be used by entities to identify which subtotals they shall present when it is relevant to an understanding of an entity's financial position and performance. Therefore, EFRAG does not see the reason why the IASB should clarify in which cases the presentation of EBIT and EBITDA in the statement(s) of financial performance comply with IFRS Standards.

Depiction of unusual or infrequently occurring items in the statement(s) of financial performance

136 EFRAG has received feedback from users that they would like to have information about events and transactions that are genuinely unusual or infrequent, because it enables them to identify the recurring/sustainable numbers and use those to make assessments about the future. In EFRAG's opinion, if possible, this reasonable request should be satisfied.

137 EFRAG generally considers that the IASB should not try to provide definitions of unusual or infrequently occurring items, as there are many factors involved and the way each company defines them depends heavily on the facts and circumstances. However, considering their widespread use, some guidance or principles of how they should be presented and disclosed would be useful. The IASB should ensure that the guidance around the use of unusual or infrequently occurring items should not be seen by constituents as an encouragement to separate such items.

Note to EFRAG TEG

138 In its comment letter in response to the Discussion Paper *Preliminary Views on Financial Statement Presentation*, EFRAG was divided on whether it would be preferable to develop definitions of unusual and infrequent items and require the information to be provided in the financial statements or to recommend appropriate disclosures in the management commentary.

139 The FASB requires separate presentation of items that are unusual or infrequent:

140 'A material event or transaction that an entity considers to be of an unusual nature or of a type that indicates infrequency of occurrence or both shall be reported as a separate component of income from continuing operations. The nature and financial effects of each event or transaction shall be presented as a separate component of income from continuing operations or, alternatively, disclosed in notes to financial statements.

141 *Gains or losses of a similar nature that are not individually material shall be aggregated. Such items shall not be reported on the face of the income statement net of income taxes. Similarly, the EPS effects of those items shall not be presented on the face of the income statement'.*

General requirements for all performance measures in the financial statements

Notes to EFRAG TEG

142 For the purposes of the DP, the IASB is expected to refer to the term 'performance measure' as 'any summary financial measure of an entity's financial performance, financial position or cash flows'.

143 The IASB is expected to provide guidance when performance measures are used. The guidance applies to all performance measures in the financial statements, whether presented in, or disclosed adjacent to, the primary financial statements or disclosed in the notes. The IASB also thinks it should develop those requirements further as set out below.

144 The IASB's preliminary view is expected to be that these requirements should require a performance measure to be:

(a) displayed with equal or less prominence than the line items, subtotals and totals in the primary financial statements required by IFRS Standards;

(b) reconciled to the most directly comparable measures specified in IFRS Standards to enable users of financial statements to see how the performance measure has been calculated;

(c) accompanied by an explanation in the notes to the financial statements of:

   (i) how the performance measure provides relevant information about an entity's financial position, financial performance or cash flows;

   (ii) why the adjustments to the most directly comparable measure specified in IFRS Standards (see paragraph (b)) have been made;

   (iii) if the reconciliation in (b) is not possible, why not; and

   (iv) any other information necessary to aid understanding of the measure (such an explanation would mean that entities would have to provide their rationale for making adjustments as well as a list of all adjustments).

(d) neutral, free from error and clearly labelled so it is not misleading;

(e) accompanied by comparative information for all periods presented in the financial statements;

(f) classified, measured and presented consistently to enable comparisons to be made over time, except when IFRS Standards require a change in presentation, as stated in paragraph 45 of IAS 1; and

(g) presented in a way that makes it clear whether the performance measure forms part of the financial statements and whether it is has been audited.

Questions expected to be asked in the DP

145 Do you agree with the IASB's preliminary view that a general disclosure standard should describe how performance measures can be fairly presented in financial statements? Why or why not? If you do not agree, what alternative action do you suggest, and why?

EFRAG Secretariat's proposed response

146 **EFRAG first reiterates its concerns that some aspects of performance measures are discussed in a Principles of Disclosures DP whereas the main discussion on performance reporting will be part of the Primary Financial Statements project.**

147 **Overall EFRAG agrees that a general disclosure standard should provide guidance as to how performance measures can be fairly presented in financial statements and agrees with the qualitative requirements identified in the DP. However, EFRAG is concerned that the definition of performance measures may be broader than intended.**

148 EFRAG acknowledges that IFRS Standards define few measures and that performance measures, other than defined IFRS measures, are widely used. Concerns have been raised by users about the consistency and comparability of such information and adequacy of disclosures.

149 EFRAG agrees that, when performance measures, other than measures defined in IFRS Standards, are presented in the primary financial statements or in the notes, they should be clearly defined and explained by preparers, presented consistently over time and reconciled to measures defined in IFRS Standards to improve the understanding of the entity's performance by users of financial statements. EFRAG considers that it is important that users of financial information can understand all the measures used, the reason for their use and their calculation or determination.

150 EFRAG agrees with the requirements identified by the IASB, which aim to reduce the risk of investors being misled by performance measures reporting. EFRAG notes that the IASB guidelines are similar in the areas of focus (transparency, comparability, consistency and no undue prominence) to existing guidelines from

major securities regulatory organisations, such as the US Securities Exchanges Regulation (US SEC), the European Securities Markets Authority (ESMA) and the International Organization of Securities Commission (IOSCO). We note that the guidance of ESMA and IOSCO was intended for performance measures disclosed outside the financial statements.

151 EFRAG is concerned that the definition of performance measures is overly broad and may significantly increase the scope of the requirements and hence the volume of disclosures. For example, the proposed definition would cover a much broader range of common and well-understood measures such as:

(a) measures defined in IFRS Standards; and

(b) line items (including totals and sub-totals) presented on the face of the statement of financial position, statement(s) of financial performance, statement of changes in equity or statement of cash flows that are not specifically defined by IFRS Standards.

Disclosure of accounting policies

Notes to EFRAG TEG

Determining which accounting policies should be disclosed

152 The IASB is expected to suggest that the objective of accounting policy disclosures is to provide an entity-specific description of accounting policies that:

(a) have been applied by the entity in preparing financial statements; and

(b) are necessary for an understanding of the financial statements.

153 In addition, the IASB is expected to describe three categories of accounting policies:

(a) accounting policies that are always necessary for understanding information in the financial statements (such as those that have changed, that provide different alternatives, that were developed by the entity or that require significant judgement and/or assumptions);

(b) accounting policies that are not part of the previous category, but for which disclosure would be necessary for users to understand the information in the financial statements (that is, those that relate to items, transactions or events that are material to the financial statements); and

(c) any other accounting policies used by an entity in preparing financial statements and that are not part of the other categories.

154 In relation to these categories, the IASB is expected to:

(a) clarify that only accounting policies necessary for an understanding of the financial statements need to be disclosed (categories (a) and (b)); and

(b) explain that an entity is not required to disclose any other accounting policies (category (c)).

155 The IASB is expected to state that it is unnecessary to provide further guidance about the need for entities to make accounting policy disclosures entity-specific, in addition to the objective stated above and the principles for effective communication (see paragraphs 38 and following.

Location of disclosures on accounting policies

156 The IASB is expected to specify that if an entity chooses to disclose accounting policies of category (c), it could consider the following ways to distinguish them from its significant accounting policies:

(a) present the additional accounting policies in a separate note or disclose them together at the end of the accounting policies note; or

(b) present additional accounting policies outside the financial statements and provide a cross-reference to their location, for example in an appendix to the financial statements, in another part of the annual report, or on the entity's website.

157 The IASB is also expected to clarify that accounting policy disclosures can be presented all in a single note, separately in the same note as the information to which it relates; or a combination of both. Whichever alternative an entity selects, the IASB is expected to clarify that an entity should clearly identify the location of its category (a) accounting policies, for example by describing where they are disclosed in the index of notes of on the content page of the financial statements.

Location of significant accounting judgements, estimates and assumptions

158 The IASB is expected to clarify that, to make an entity's accounting policy disclosures more useful for users of financial statements, disclosures about significant judgements and assumptions used in applying an accounting policy

should be made adjacent to the disclosure of that accounting policy, unless the entity judges that another location would improve the understandability of the financial statements.

Questions expected to be asked in the DP

159 Do you agree with the IASB's preliminary views that:

(a) a general disclosure standard should include requirements on determining which accounting policies to disclose; and

(b) the following guidance on the location of accounting policy disclosures should be included either in a general disclosure standard or in non-mandatory guidance (or in a combination of both):

(i) the alternatives for locating accounting policy disclosures; and

(ii) the presumption that entities disclose information about significant judgements and assumptions adjacent to disclosures about related accounting policies, unless another organisation is more appropriate?

Why or why not? If you do not agree, what alternative proposal(s) do you suggest, and why?

160 Do you think the guidance on the location of accounting policy disclosures should be included in a general disclosure standard or non-mandatory guidance (or in a combination of both)? Why? If you support the issuance of non-mandatory guidance, please specify the form of non-mandatory guidance you suggest and give your reasoning.

EFRAG Secretariat's proposed response

161 **EFRAG considers that guidance about disclosure of accounting policies is useful but should not be overly prescriptive as to the form and location of disclosures so as to allow necessary flexibility to determine the level of disclosure that most appropriately reflects users' needs.**

162 **EFRAG considers that, as a matter of principle, the IASB should not provide guidance on information that is not required by IAS 1, which is information referred to as category C, which is not necessary for an understanding of the financial statements.**

Determining which accounting policies should be disclosed

163 In its response to the IASB's Exposure Draft ED/2014/1 *Disclosure Initiative (Proposed amendments to IAS 1)*, EFRAG assessed that disclosure of accounting policies as a mere summary of a standard is generally not useful. EFRAG observed that useful disclosure provides insights into how the entity has exercised judgement in selecting and applying accounting policies.

164 EFRAG acknowledges that some believe that it should be possible to read financial statements as a self-contained document, i.e. including all applied accounting policies, regardless of whether they imply judgement or options. However, in EFRAG's opinion, when an entity merely reproduces parts of the existing standards, this sometimes has little or no information value.

Location of accounting policy disclosures

165 EFRAG considers that the IASB should not be over-prescriptive about the location of the disclosures on accounting policies, so as to ensure that a preparer has the necessary flexibility to determine the level of disclosure that most appropriately reflect the needs of its users.

166 In that regard, EFRAG observes that the proposals in the DP are consistent with the existing guidance in paragraphs 113-114 of IAS 1, as revised in 2014, which require entities to consider a 'systematic ordering or grouping of the notes' and clarifies that entities are allowed to group accounting policies together with the other disclosures that relate to them. EFRAG recommends the IASB to clarify how the proposals differ from the existing guidance.

167 Finally, in EFRAG's view, the IASB should not discuss the disclosure of information that is not required by IAS 1 (that is information classified as category C, which is information that is not necessary for an understanding of the financial statements). We also observe that the considered alternative to allow, for such information, cross-reference to information that is presented on the entity's public website seems inconsistent with the proposal in the chapter *location of information* to restrict cross-references to information disclosed in the entity's annual report.

Centralised disclosure objectives

Development of centralised disclosure objectives

Notes to EFRAG TEG

168 This part of the guidance is aimed at the IASB as standard setter.

169 The IASB is expected to discuss whether disclosure objectives should be developed 'centrally' rather than at standard-level and to consider how centralised disclosure objectives could be used as a basis for developing and organising disclosure objectives and requirements in IFRS Standards that are better linked to the objective of financial statements and the role of the notes.

Questions expected to be asked in the DP

170 Do you agree with the IASB's preliminary view that it should develop a central set of disclosure objectives (centralised disclosure objectives) that consider the objective of financial statements and the role of the notes? Why or why not? If you do not agree, what alternative do you suggest, and why?

EFRAG Secretariat's proposed response

171 **EFRAG supports the objective to further explore whether a more holistic and unified approach is achievable in developing disclosure objectives. However, EFRAG considers that a necessary preliminary step would be to clarify the boundaries of the notes.**

172 EFRAG supports the objective of exploring whether a more holistic and unified approach is achievable in developing disclosure objectives.

173 As mentioned in the section '*Overview of the 'disclosure problem' and the objective of the project*', EFRAG considers that one of the reasons for unsatisfactory disclosure requirements is that these requirements have largely been developed on a standard-by-standard basis without an overall underlying basis; implying the lack of a unified and consistent approach.

174 EFRAG observes that more recent IFRS Standards (from IFRS 2 *Share-based Payments* onward) have included a general objective of the disclosure requirements. However, these objectives have been developed in isolation, as part of the discussions on each standard, and the relationships between the disclosure requirements in different standards (including the links between IAS 1 and other IFRS Standards) have not always been considered.

175 Developing disclosure objectives more holistically could be done, as proposed by the IASB, by using as a basis a single central set of disclosure objectives (to be contained in a general standard on disclosures), supplemented by more specific objectives developed at the level of each standard.

176 However, as explained in EFRAG's response to an earlier question, in order to develop centralised disclosure objectives for the notes, the IASB should first take a step back and articulate more clearly the boundaries of the notes.

Methods for developing centralised disclosure objectives

Notes to EFRAG TEG

177 The IASB is expected to consider two possible approaches for developing centralised disclosure objectives.

178 Under Method A, the first step is to identify what types of information would be useful to the primary users of financial statements about an entity's assets, liabilities, equity, income and expenses. Information could be grouped into types in many

different ways. Without forming any preliminary views, the ED is expected to specify the following types of information that could be used as the basis for developing centralised disclosure objectives:

(a) information about the reporting entity;

(b) information about the methods, assumptions and judgements;

(c) information about items included in the primary financial statements;

(d) information about unrecognised items;

(e) information about the risks and other uncertainties (including measurement uncertainty);

(f) information related to management's stewardship; and

(g) information about events after the reporting period.

179 Under Method B, centralised disclosure objectives would be developed by the IASB on the basis of an entity's main activities with the aim of providing information that helps users of financial statements assess both prospects for future net cash inflows and management's stewardship.

180 The following activities of an entity are expected to be identified:

(a) operating and investing activities, including information about operating capacity, operating segments and business combinations;

(b) financing activities, including information about liquidity and solvency, capital structure and capital management;

(c) discontinued operations; and

(d) taxation.

Questions expected to be asked in the DP

181 Which of the following two methods, that could be used for developing centralised disclosure objectives and therefore used as the basis for developing and organising disclosure objectives and requirements in standards, do you support and why:

(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 how users commonly assess the prospects for future net cash inflows to an entity and management's stewardship of that entity's resources (Method B)?

182 Can you think of any other methods that could be used? If you support a different method, please describe your method and explain why you think it might be preferable to the methods described in this section.

EFRAG Secretariat's proposed response

183 **EFRAG considers that exploring both approaches have merits but Method B may be more challenging to implement and more research would be needed to determine whether the identified 'activities' would meet users' needs.**

184 **EFRAG is concerned that this could further delay the standard-level review of existing disclosures that many have called for to start promptly.**

185 EFRAG welcomes the IASB's initiative to improve the process of developing disclosure objectives in standards. EFRAG agrees that formalising an approach will make the process more transparent and will provide a common basis for developing

disclosure objectives and requirements, leading to greater consistency between standards.

186 EFRAG observes that Method A will be easier to implement. In EFRAG's opinion, the approach will also be better aligned with the proposed description of the role of the notes, which is to 'explain and expand' the information as contained in the P-primary financial statements. EFRAG observes that, with the exception of the statement of cash flows, the primary financial statements are not based on a distinction between operating, financing and investing activities.

187 Regarding Method B, EFRAG is concerned that the approach could increase complexity for the following reasons:

(a) it is based on the underlying assumption that there is a 'common way' for users, across all industries, to 'assess the prospects for future net cash inflows and management's stewardship' that is based on the distinction between operating, financing and investing activities. EFRAG is not persuaded that this always holds true and the discussion around the usefulness of the information of statement of cash flows in the financial industry has provided specific evidence to the contrary;

(b) it assumes that there is a common understanding of what operating, financing and investing activities mean for all information disclosed (including for balance sheet and statement of income items and other disclosures); and

(c) the feasibility and relevance of Method B could be reconsidered after the research on Primary Financial Statements currently undertaken by the IASB is completed.

188 Furthermore, EFRAG observes that selecting the approach is only the first step. An important objective of the disclosure initiative is to improve the wording of the current disclosure requirements, in particular in the older standards. EFRAG considers that this standards-level review of disclosures should not be delayed significantly due to the development of a new approach. Instead, we consider that the IASB should ensure that the standards-level review of disclosures can commence shortly.

Considering a single standard for disclosures in the notes

Questions expected to be asked in the DP

189 Do you think that the IASB should consider locating all disclosure objectives and requirements in IFRS Standards within a single standard, or set of standards, for disclosures? Why or why not?

EFRAG Secretariat's proposed response

190 **EFRAG does not support grouping all disclosure requirements in a single standard, but acknowledges that, in some cases, it may be useful to cover disclosures <u>on related topics</u> in a single standard.**

191 Although having a single standard for disclosures may have some advantages (for instance by enabling disclosure requirements to be arranged by topic rather than by standard, avoid duplications and highlight relationships between disclosure requirements), EFRAG considers that the following drawbacks will outweigh such advantages:

(a) it may make it difficult for preparers to see how the disclosure requirements relate to the recognition and measurement requirements;

(b) it would represent for preparers a fundamental change to existing standards which might have unintended consequences; and

(c) it could lead to overlooking the specific nature of some transactions when developing disclosure requirements and consequently omit useful information that particular to the type of transaction.

192 EFRAG is therefore not in favour of grouping all disclosure requirements in a single standard. However, EFRAG acknowledges that in some cases, it may be useful to cover disclosures on related topics in a single standard. An example of this is provided by IFRS 12 *Disclosure of Interests in Other Entities* which contains comprehensive disclosure requirements for all forms of interests in other entities, including subsidiaries, joint arrangements, associates and unconsolidated structured entities.

NZASB staff's approach to drafting disclosure requirements in IFRS Standards

Notes to EFRAG TEG

193 The DP is expected to describe an approach that has been developed by the staff of the New Zealand Accounting Standards Board (NZASB) of how disclosure objectives and requirements in standards might be developed based on centralised disclosure objectives using Method A.

194 The DP is expected to state that, if feedback on the NZASB staff's approach is positive, the IASB might consider this approach in its Standards-level Review of Disclosures project.

195 The NZASB's staff used Method A, as a basis for their approach in developing centralised disclosure objectives and then derive standard-level disclosure objectives and requirements.

196 The main features of the proposed approach on which feedback will be sought in the Discussion Paper are:

(a) the inclusion of disclosure objectives, comprising an overall disclosure objective for each standard and more specific ones for each type of information required to meet that overall disclosure objective;

(b) the division of disclosure requirements into two tiers:

(i) a level of summary information, that all entities would be required to provide subject only to materiality, to provide an overall picture of the effect of the item or transaction; and

(ii) a level of additional information, which an entity would consider disclosing if that information is necessary to meet the overall disclosure objective in the standard.

197 The effects are illustrated based on the disclosure requirements IAS 16 *Property, Plant and Equipment* and IFRS 3 *Business Combinations*.

198 The IASB is not expected to seek feedback on the detailed redrafting of the disclosure requirements and objectives included in the NZASB staff's two examples, but rather on the applicability of the proposed approach. The feedback is also expected to inform the IASB's *Standards-level Review of Disclosures Project*.

Note to EFRAG TEG

199 The approach prepared by the NZASB, including the illustrative examples, has been presented in the October 2015 EFRAG TEG meeting and in the March 2016 EFRAG CFSS meeting.

Questions expected to be asked in the DP

200 Do you have any comments on the NZASB staff's approach to developing the disclosure objectives and requirements in IFRS Standards? Do you think that the development of such an approach would encourage the provision of enhanced disclosures by entities?

201 Do you think the IASB should consider the NZASB staff's approach (or aspects of the approach) in its Standards-level Review of Disclosures Project? Why or why not?

EFRAG Secretariat's proposed response

202 **EFRAG supports the NZASB staff's direction of the proposals on drafting disclosure requirements. EFRAG considers in particular that the proposed two-tiered approach can strike a balance between comparability and entity-specific relevance. However, EFRAG considers that the boundaries between these two categories should be further clarified.**

203 **EFRAG does not provide specific feedback on the illustrative redrafting of the disclosure requirements in IAS 16 and IFRS 3 included.**

204 As a preliminary comment, EFRAG does not provide specific feedback on the detailed redrafting of the disclosure requirements included in the two examples, but rather focuses on the applicability of the proposed approach.

205 EFRAG supports the direction of the proposals on drafting disclosure requirements.

206 In the EFRAG/ANC/FRC DP, some general principles were provided that standard setters should always apply when drafting disclosure requirements. EFRAG observes that the NZASB staff's approach achieves many of these principles.

207 EFRAG considers in particular that the proposed two-tiered approach can strike a balance between comparability (with the summary information required in all instances subject only to materiality) and entity-specific relevance (with the 'additional information').

208 However, EFRAG observes that the objectives set for the disclosures, in the illustrative examples, are drafted in very generic and similar terms in the two illustrative examples provided. EFRAG considers that, to be useful, clearer objectives must be set at the standard's level.

209 In addition, EFRAG observes that different levels of disclosure requirements are already applied in IFRS Standards depending on whether the entity has (or is in the process of issuing) debt or equity instruments that are traded in a public market, more specifically in IFRS 8 *Operating Segments* and IAS 33 *Earnings per Share*. EFRAG recommends the IASB to consider whether this practice in standard setting should be applied in a more principles-based way or whether the IASB should describe the specific conditions in which such a practice is allowed.