

# Disclosure Initiative – Principles of Disclosure

JOINT INVESTOR OUTREACH EVENT IN MILAN

18 September 2017





# BACKGROUND

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# BRIEF HISTORY OF THE 'DISCLOSURE PROBLEM'

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2005

- Europe moves to IFRS Standard.
- Significant increase in disclosures and length of F/S for most European entities.

2005+

- Newer standards bring increased disclosures, e.g. IFRS 7, IFRS 13.
- Other trends also add to length of overall annual report.

2011+

- Several studies/initiatives target the 'disclosure problem'.
- EFRAG/ANC/FRC DP 'Towards a Disclosure Framework for the Notes' 2012.

2013

- IASB's Discussion Forum 'Disclosures in Financial Reporting'.
- IASB adds 'Disclosure Initiative' to its agenda.

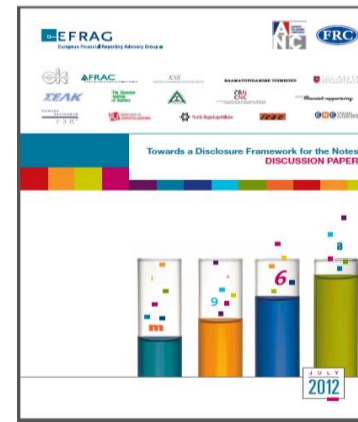
# SOME OF THE EUROPEAN INITIATIVES



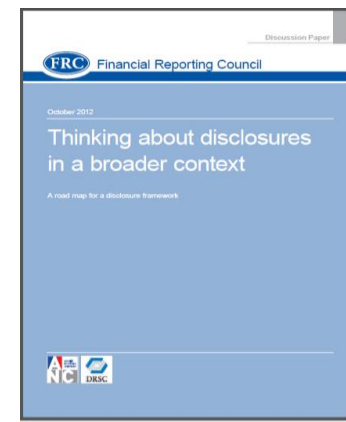
ESMA - 2011



ICAS & NZICA - 2011



EFRAG - 2012



FRC - 2012



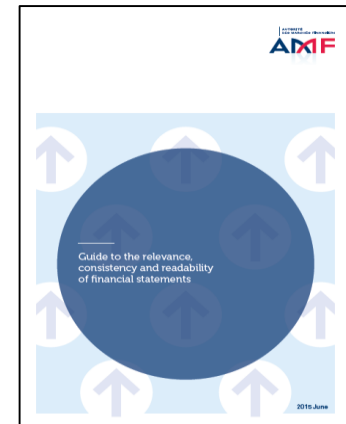
ICAEW - 2013



'Christmas letter' from the DBA - 2013



AFM - 2014



AMF - 2015

# KEY RECOMMENDATIONS FROM EFRAG'S 2012 DISCUSSION PAPER



## EFRAG/ANC/FRC 2012 RECOMMENDATIONS

- Define the purpose of the notes and their boundary.
- Disclosures should be **principle-based**, set consistently across standards, proportionate and achieve reasonable cost-benefit trade-off.
- Consider **how disclosure requirements are drafted** as this may influence behaviour.
- Strengthen the application of **materiality**
- Articulate key features of **effective communication** (communication not just compliance exercise).
- Preparers, auditors and regulators, each in their specific role, have a **shared interest** in fostering the improvement of disclosures.

# WHAT HAS THE IASB DONE TO DATE?

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| Completed standard-setting projects  |   | Materiality guidance   | Research projects   |
|--|---|--|---|
| <b>Amendments to IAS 1 (2014)</b><br><br>To remove barriers to the exercise of judgement | <b>Amendments to IAS 7 (2016)</b><br><br>To improve disclosure of liabilities from financing activities | <b>Practice Statement on application of materiality (September 2017)</b> | <b>Principles of Disclosure Discussion Paper (March 2017)</b> |

# EFRAG'S COMMENT LETTER PROCESS

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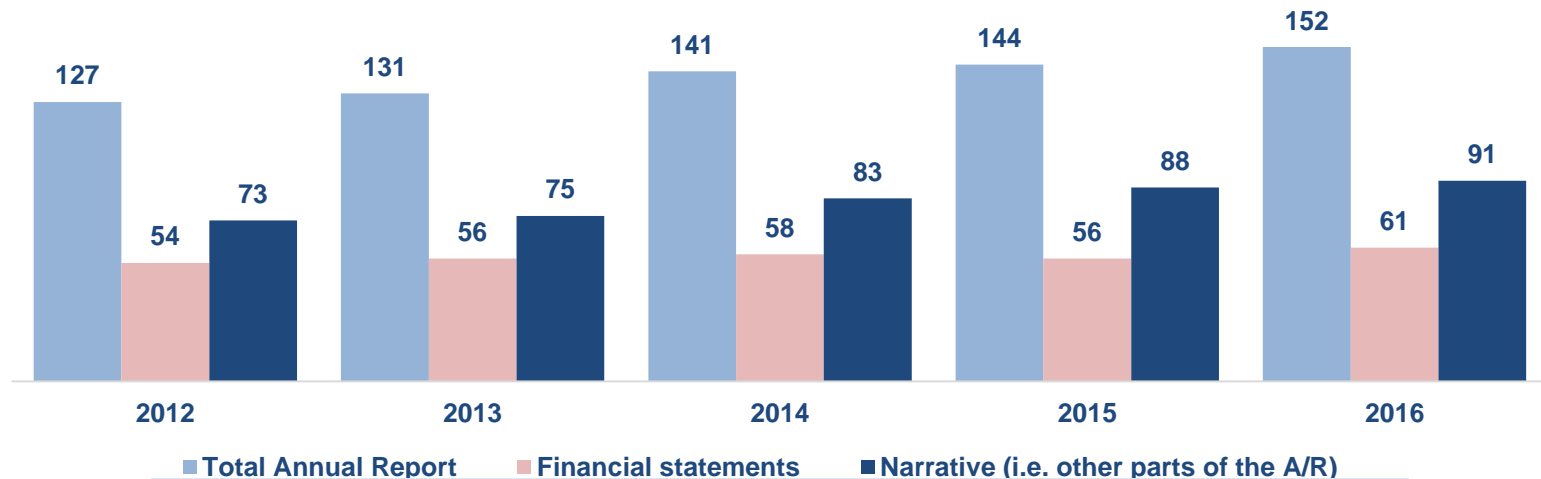


EFRAG's objective at the comment letter stage is the best possible outcome from a European perspective.

# TRENDS IN LENGTH OF ANNUAL REPORT (1)

... INCREASING ON AVERAGE

Changes in length of Annual Report and Financial Statements of UK listed entities 2012 - 2016



Source: Deloitte UK Annual Reporting Insights – Surveys 2014 to 2016  
Based on the Annual Reports of 100 listed UK companies surveyed for current practices

On average length of financial statements have increased by 13% (+7 pages) over the last 4 year.

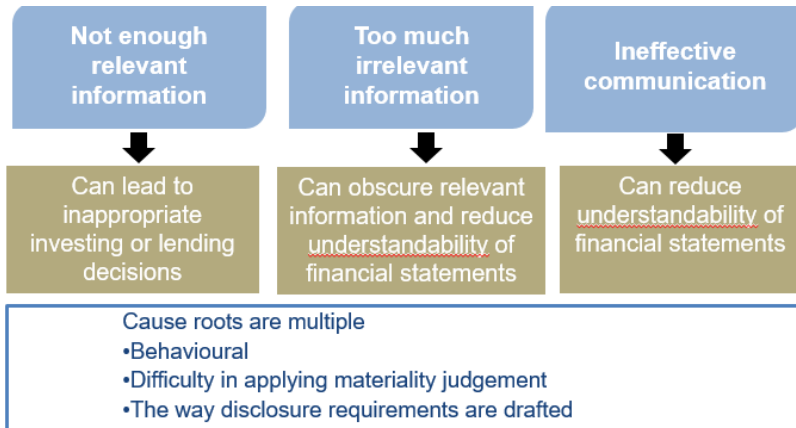




# EFRAG'S TENTATIVE VIEWS

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# DESCRIPTION OF THE 'DISCLOSURE PROBLEM'



Source: IASB

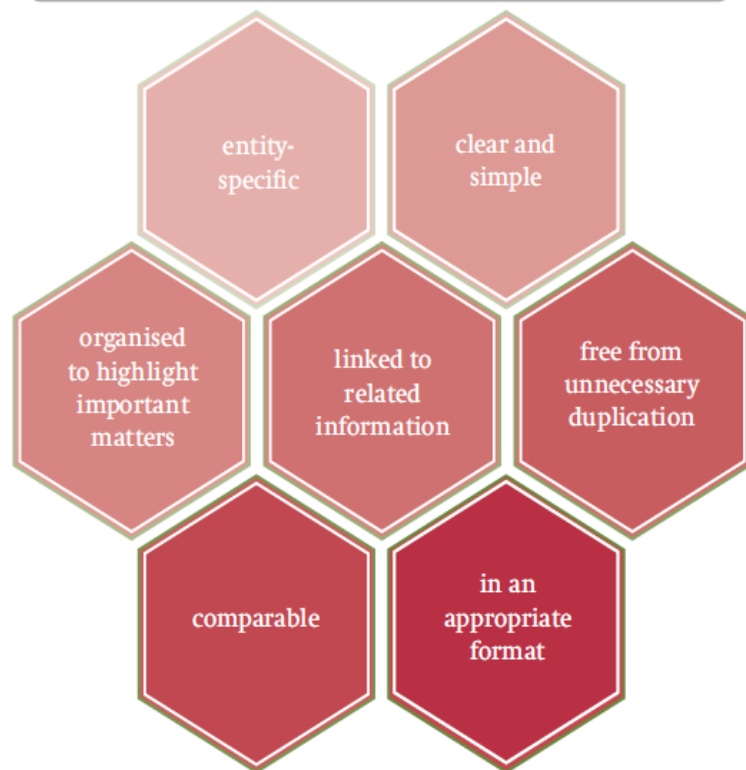
EFRAG wants more focus on tackling 'overload'

## EFRAG'S TENTATIVE VIEWS

- Acknowledge that the problem is complex and multifaceted.
- But stakeholders have already made extensive efforts on better application of materiality and improved communication.
- In this context IASB's description lacks sufficient emphasis or focus. The main priority should now be a comprehensive review of disclosure requirements aimed at:
  - Developing a coherent and comprehensive but concise package of disclosure requirements; and
  - Removing requirements that are disproportionate/redundant.

# PRINCIPLES OF EFFECTIVE COMMUNICATION

Information in financial statements should be



Source: IASB

## EFRAG'S TENTATIVE VIEWS

- EFRAG takes no issue with the particular principles proposed in the IASB DP.
- But EFRAG is not convinced that additional non-mandatory guidance of this type brings substantial new insights.
- Further work needed to determine whether some of these principles could be developed into requirements to be included in a general disclosure standard.
- Similar concerns on the effectiveness development of non-mandatory guidance on formatting.

# ROLES OF THE PRIMARY FINANCIAL STATEMENTS AND OF THE NOTES

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| Component of financial statements  | Role  |
|--|---|
| <b>Primary financial statements</b> are statements of: <ul style="list-style-type: none"><li>• financial position</li><li>• financial performance</li><li>• changes in equity</li><li>• cash flows</li></ul> | To provide a structured and comparable summary of an entity's recognised assets, liabilities, equity, income and expenses |
| <b>Notes</b>   | To explain and supplement the primary financial statements  |

Source: IASB

## EFRAG'S TENTATIVE VIEWS

- EFRAG would have preferred a broader discussion about the relevance of the distinction between the primary financial statements and the notes.
- The proposed role of the primary financial statements focuses too much on assets, liabilities etc and too little on the objective of providing summarised financial information.
- The proposed role of the Primary Financial Statements and of the Notes does not clarify their respective boundaries.

# LOCATION OF INFORMATION

## Principles for the location of information

Information necessary to comply with IFRS Standards can be placed outside financial statements but within the annual report, providing the following are met

- annual report more understandable;
- financial statements understandable; and
- information faithfully represented, clearly identified and cross-referenced.



Information labelled as 'non-IFRS' can be placed inside the financial statements if it is

- listed, together with a statement of compliance with IFRS Standards;
- identified as not in accordance with IFRS Standards and, if applicable, as unaudited; and
- accompanied by explanation of why it is useful.

Source: IASB

## EFRAG'S TENTATIVE VIEWS

### Cross referencing

- EFRAG welcomes guidance on cross-referencing, but:
  - The IASB should first identify the issues associated with the use of cross-references; and
  - Further work needed with audit authorities and regulators to assess the audit, legal and regulatory implications of the proposed guidance across a range of jurisdictions
- Guidance should remain principles-based rather than referring to specific documents:
  - source documents should be available on the same terms, at the same time and for the same duration as the financial statements
- Question the practicality of the proposed test that cross-referencing is allowed only if 'it makes the annual report as a whole more understandable'.

# LOCATION OF INFORMATION (continued)

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Source: IASB

## EFRAG'S TENTATIVE VIEWS (CONTINUED)

### Non-IFRS information:

- EFRAG is concerned that the proposed guidance on identifying non-IFRS information will lead to clutter unless targeted better.
- The primary focus should be on financial information that supplements IFRS information or provides an alternative depiction of some type. For this type of information EFRAG supports the approach proposed in the IASB DP.
- Non-IFRS information should be prohibited if it is so inconsistent or in conflict with IFRS Standards that it misleads or detracts from understandability.

# USE OF PERFORMANCE MEASURES

## EFRAG'S TENTATIVE VIEWS

- EFRAG is concerned about the significant overlap between the Disclosure Initiative and the Materiality and Primary Financial Statements projects.
- EFRAG would have preferred a more holistic and comprehensive discussion:
  - on the use of metrics such as EBIT/EBITDA, and
  - on unusual or infrequently occurring items in the context of the Primary Financial Statements project, which would look at all aspects of the issue, potentially including other adjustments made to performance figures which would be better addressed in the Primary Financial Statements project.



Source: IASB

# DISCLOSURE OF ACCOUNTING POLICIES

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## Three categories of accounting policies

### Category 1—always necessary to understand the financial statements

The accounting policy relates to material items, transactions or events and:

- is selected from alternatives in IFRS Standards;
- reflects a change from a previous period;
- is developed by the entity in the absence of specific requirements; and/or
- requires use of significant judgements or assumptions.

### Category 2—not in Category 1 but necessary to understand the financial statements

The accounting policy is not in Category 1 but relates to material items, transactions and events.

### Category 3—not in Categories 1 and 2 but is used in preparing the financial statements

This category includes all other accounting policies used in preparing the financial statements.

## EFRAG'S TENTATIVE VIEWS

- EFRAG does not support prescriptive requirements as entities should have some flexibility on how best to meet users' needs.
- Focus should be on disclosure of those accounting policies that relate to items, transactions or events that are material to the financial statements without always being necessary (Category 2), where judgement is most needed.
- The IASB should not provide guidance on information that is not required by IFRS Standards (Category 3).

Source: IASB



# DRAFTING DISCLOSURE REQUIREMENTS

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|                                      | Method A  | Method B   |
|--------------------------------------|---|--|
| Basis for developing                 | Type of information focus   | Entity's activity focus                                      |
| Standards-level objectives           | Developing disclosure objectives for individual standards                     | Not developing disclosure objectives in individual standards |
| Disclosure requirements in Standards | Developed on the basis of the disclosure objectives of an individual standard | Developed on the basis of centralised disclosure objectives  |

## EFRAG'S TENTATIVE VIEWS

- Support exploring how to achieve a more holistic and unified approach in developing disclosure objectives/requirements.
- Support further analysis of how disclosure requirements could be focused on the entity's activities and business model (Method B in the IASB DP) as this has the potential to provide improved information for users but we are not yet to assess its practicality and outcomes.
- Location of the disclosure requirements is not the primary issue.



# QUESTIONS FOR DEBATE

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# QUESTIONS

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Can principles make communication more effective?

What do investors think are useful examples of disclosures in the financial statements?

Does it make a difference presenting information separately in the primary financial statements rather than presenting it aggregated with other information in the primary financial statements and disclosing it solely in the notes?

What is the impact of cross-referencing IFRS information outside the financial statements for investors?

## QUESTIONS (continued)

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Should 'non-IFRS information' be permitted within the financial statements? Alternative (non-IFRS) performance measures in the financial statements: misleading or useful?

Should EBITDA be permitted or required in the financial statements?

Should unusual and infrequent items be separately presented and if so how?

# HOW IMPORTANT ARE JUDGEMENTS ON MATERIALITY?

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- **Materiality is critical to effective communication:** acts as a filter when deciding what and how to disclose information.
- **Proposed changes to the Definition of Materiality**
  - Now a separate project form the Principles of Disclosure Project (ED in September 2017).
  - New definition: *information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of a specific reporting entity's general purpose financial statements make on the basis of those financial statements.*
- **Proposed Practice Statement on Materiality**
- Provides non-mandatory guidance on the application of Materiality to Financial Statements (Publication in September 2017).

## Questions

How important is the application of materiality when deciding what and how to disclose information?

# DISCLOSURES ON FAIR VALUE MEASUREMENT

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- IFRS 13 provides the guidance on assessing fair value measurements within three levels of the fair value hierarchy:
  - Level 1: Unadjusted quoted prices in active markets;
  - Level 2: Other observable inputs not included within Level 1; and
  - Level 3: Unobservable inputs for the asset or liability
- Concerns have been raised **about disclosures on Level 3 measurements**:
  - generic information rather than entity-specific information failing to reflect entities' business management; and
  - aggregation of disclosures for dissimilar underlying assets or liabilities so that the disclosures are not sufficiently granular.

## Question

Do you think the principles in the Discussion Paper will help address concerns raised about disclosures on Fair Value Measurement?



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# Thank you for your attention



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