European Securities and
Markets Authority

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The IASB's Exposure Draft Amendments to IAS 1 - *Presentation of Financial Statements* under the Disclosure Initiative

Dear Ms Flores,

The European Securities and Markets Authority (ESMA) thanks you for this opportunity to contribute to EFRAG's due process regarding the Exposure Draft ('ED') *Amendments to IAS 1 Presentation of Financial Statements* under the Disclosure Initiative. We are pleased to provide you with the following comments with the aim of improving the enforceability of IFRSs and the transparency and decision usefulness of financial statements.

ESMA is broadly supportive of the IASB's proposals included in the ED to clarify some of the presentation and disclosure requirements included in IAS 1 in order to address perceived impediments to issuers exercising judgement in presenting their financial statements. We believe that they will contribute to greater awareness of the identified challenges and will enhance the quality of financial statements in the short-term.

However, ESMA believes there is a need for change in behaviour and is thus looking forward to the IASB's deliverables of the long-term projects of the Disclosure Initiative, in particular the research projects on IAS 1, IAS 7 – *Statement of Cash Flows* and IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors*. ESMA believes it is important that these research projects propose more fundamental changes which might be necessary to improve the quality of the presentation of financial statements.

Regarding materiality, while ESMA supports the proposed amendments included in the ED, we strongly believe that a separate project within the Disclosure Initiative will result in more authoritative guidance on the application of materiality in financial statements. In this respect we would like to refer to the ESMA Feedback Statement on materiality[1] where the application of materiality is assessed as divergent.

In the ED it is proposed to amend paragraph 31 of IAS 1 to state that entities 'need not' provide a disclosure if the information resulting from it is not material. ESMA is grateful that EFRAG suggested to constituents to have the opportunity to share their position on the question whether this 'need not' should be changed to 'shall not'. In this respect, we would like to draw the attention to a very important point of view from an enforcement perspective which is developed in the appendix I to this letter.

Our detailed comments on the ED are set out in the appendix I to this letter. Please do not hesitate to contact us should you wish to discuss all or any of the issues we have raised.

Yours sincerely,

Steven Maijoor

Chair

European Securities and Markets Authority

[1] http://www.esma.europa.eu/system/files/2013-218.pdf

Appendix I – ESMA's detailed answers to the questions in the Amendments to IAS 1 *Presentation of Financial Statements* under the Disclosure Initiative

Question 1 – Do you agree with each of the amendments? Do you have any concerns about, or alternative suggestions for, any of the proposed amendments?

Topic 1: Materiality and aggregation (paragraphs 29–31 and BC1–8 of the ED)

1. ESMA supports the proposed amendments to IAS 1 which address concerns relating to the proper application of the concept of materiality as we believe they are useful in terms of clarification and enforceability and contribute in solving the so-called disclosure problem. However, ESMA believes it is important that more fundamental changes will be proposed by the IASB and thus ESMA is looking forward to the IASB's deliverables of the long-term projects of the Disclosure Initiative, in particular the research projects on IAS 1, IAS 7 and IAS 8.

2. As already pointed out in the ESMA Feedback Statement on materiality where the application of materiality is assessed as divergent, ESMA strongly believes that a separate project on materiality within the Disclosure Initiative will result in more authoritative guidance on the application of materiality in financial statements.

3. The ED proposes to include more guidance on the application of the 'materiality' concept to disclosures, by amending paragraph 31 of IAS 1. As indicated in paragraph BC5 of the ED, the IASB did consider specifically stating in paragraph 31 that entities need not to provide a specific item if not material either individually or collectively. However the IASB decided not to do so, because it believes the definition of what is 'material' already incorporates the notions of individual and collective assessment of materiality and therefore, reference to material is sufficient. ESMA understands the decision of the IASB to clarify that materiality applies also to the notes but suggests that, in order to better reflect the intention of the IASB and align to the definition of materiality, paragraph 31 is slightly amended by referring to all disclosures instead of specific disclosure: "An entity need not provide ~~a specific~~ disclosures required by IFRS in the financial statements, including in the notes, if the information is not material".

4. ESMA believes the IASB strikes the right balance in paragraph 31 of IAS 1 which states that entities 'need not' to provide a disclosure if the information resulting from it is not material. ESMA is aware that some market participants suggested replacing 'need not' with 'shall not' in order to change behaviour. We are not sure this is the right way forward as this could create enforceability issues in case of detected infringements, as materiality is mostly a judgment call. As a result, it would be difficult, if not impossible, to enforce such a ban and to prevent an issuer from including a specific disclosure. Auditors could also encounter similar issues.

5. We also believe that great care should be taken before preventing entities from disclosing information which they believe is relevant. From the feedback we have received from users, we understand that they are more concerned about the incompleteness and/or incorrectness of the disclosures provided, rather than the overload of information. However, it could be reminded that entities will not include immaterial information in a manner that obscures other relevant and useful information.

6. ESMA welcomes the IASB's intention to undertake a broader review of the IFRSs with the view to address and align specific disclosure requirements which do contain the reference to 'as a minimum', as reflected in BC4. However, ESMA believes effect of this review should not harm the consistent application and enforcement of IFRS.

Topic 2: Statement of financial position and statement of profit or loss and other comprehensive income (paragraphs 54, 55A, 82, 85A and 85B and BC9–BC15 of the ED)

7. ESMA supports the proposed amendments to IAS 1 to clarify the criteria to be met for disaggregation and presentation of additional lines than those specifically required by IFRS, and believes that address the concerns ESMA raised in its comment letter to the IFRS Interpretations Committee (IFRS IC) [2].

8. In addition, ESMA suggests that the IASB clarifies the meaning of requiring subtotals to be made up of items recognised and measured in accordance with IFRS, as proposed in paragraphs 55A (a) and 85A (a) of IAS 1. Based on enforcement experience ESMA is wondering if the IASB could also clarify in paragraphs 55A or 85A of IAS 1 how to insert subtotals that do not add up when presenting financial statements; for example ESMA believes that the proposed guidance does not clarify whether presentation of Earnings before Interests Tax Depreciation and Amortisation (EBITDA) in profit or loss statement for which the costs are presented by function is allowed. Finally ESMA believes that further clarification on the notion of 'with more prominence' would be helpful in the view of consistent application.

9. Another suggestion would be that the IASB clarifies under which conditions the practice of adding extra column(s) is accepted, if any. It is our view that adding an extra-column always does not always meet the criteria of paragraph 55A and 85A in particular if only a part of a line item is included in the extra column, such as in the case where operating income would include all revenues but only a small part of expenses.

10. Moreover, we would welcome additional guidance and requirements in the standard to address the concern raised in by ESMA to the IFRS IC regarding what could be considered as 'operating result'. In

[2] http://www.esma.europa.eu/system/files/2013-1555_esma_comment_letter_to_the_ifrs_ic_on_application_of_ias_1.pdf

its submission to the IFRS IC, ESMA pointed out that the lack of definition for 'operating result' or 'financial results' and lack of implementation guidance or examples in IAS 1 lead to diversity in practice and impairs the understandability and comparability of the financial statements. ESMA would thus welcome strengthening the principle currently included in BC 56 of IAS 1 that 'it would be misleading and impair the comparability of financial statements if items of an operating nature were excluded from the results of operating activities'. ESMA suggests adding the principles of BC 56 in the standard.

11. In light of the multiple submissions to the IFRS IC regarding the presentation of statement of cash flows, ESMA would also suggest that the IASB considers a similar short term solution for statement of cash flows by proposing a narrow scope amendment for IAS 7.

12. In this respect we would like to refer to the ESMA comment letter[3] suggesting to the IASB to align the guidance for interim financial statements more closely with the principles for including additional line items or notes in the financial statements in IAS 1.

Topic 3: Notes structure (paragraphs 112–117 and BC16–BC19 of the ED)

13. ESMA welcomes the proposed amendments to paragraphs 113 and 114 and the inclusion of the paragraph 113A to IAS 1 as from the enforcement experience we have noticed that the current text of the standard is interpreted as requiring a specific order for the notes. The proposed new paragraph 113A allows issuers to give more prominence to disclosures which are more relevant rather than following the order from the primary statements.

14. We welcome the proposed references to 'grouping' of related topics and the requirement in the amendments to paragraph 115 of setting cross-references between statements and related information in the notes as an improvement in terms of understandability. We suggest strengthening the provision that notes can be given in a different order than the one used in the primary financial statements provided they increase the understandability to users.

15. Nevertheless, we believe that a balance should be struck between understandability and comparability. If varying the order of the notes will increase understandability it might at the same time imply that comparability between issuers' financial reports will be reduced. Moreover, ESMA would like to also suggest a change in paragraph 113 of IAS 1 as the proposed characteristics of "understandability and comparability" would be advantageously supplemented by "relevance and faithful representation" as generic principles at the beginning of paragraph 112 of IAS 1.

[3] ESMA letter ESMA/2014/603 to the IFRS Interpretations Committee's tentative agenda decision on IAS 34 - Interim Financial Reporting: condensed statement of cash flows, dated 4 June 2014

16. ESMA notes the amended wording in paragraph 114 (in particular the word 'alternatively') could create the impression that there is a preference for ordering the notes in a way that gives prominence to disclosures that are viewed more relevant by the entity. We would like to suggest the IASB to clarify if there is a preference or not.

17. ESMA suggests the IASB to clarify in IAS 1 that the notes should be considered as a single separate part of the financial statements and presented after the primary financial statements.

Topic 4: Disclosure of accounting policies (paragraphs 120 and BC20–BC22 of the ED)

18. Regarding the proposals in the ED, ESMA agrees with the removal of potentially unhelpful examples but suggests to retain the first sentence of paragraph 120 which appears to be useful guidance.

19. ESMA understands that the IASB will undertake further work in the research phase to define clearly what a significant accounting policy principle for an entity is when developing additional guidance on materiality as part of the Disclosure Initiative.

Question 2 – Presentation of items of other comprehensive income arising from equity-accounted investments

Do you agree with the IASB's proposal to amend IAS 1 for the presentation of items of other comprehensive income arising from equity-accounted investments amendments (paragraphs 82A, BC1–BC6 and the Guidance on implementing IAS 1)? If not, why and what alternative do you propose?

20. ESMA agrees with the proposal to clarify that an entity's share of OCI of equity-accounted associates and joint-ventures should be presented in disaggregated line items based on whether or not it will subsequently be reclassified to the Statement of profit or loss.

Question 3 – Transition provisions and effective date

Do you agree with the proposed transition provisions for the amendments to IAS 1 as described in this Exposure Draft (see paragraphs 139N and BC23–BC25)? If not, why and what alternative do you propose?

21. ESMA agrees with the absence of transitional provisions as these amendments are intended to clarify existing requirements in IAS 1 and should not result in the reassessment of the judgements about presentation and disclosure previously made. Paragraph 38 of IAS 1 already provides relief from having to disclose comparative information that is not considered relevant in the current period and

requires comparative information for new amounts presented or disclosed in the current period. If an entity alters the order of the notes or the information disclosed compared to the previous year, it also adjusts the presentation and disclosure of comparative information to align with the current period presentation and disclosure. We thus believe no additional relief is needed for these amendments to IAS 1.