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(EFRAG)
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Ref: EFRAG's comment letter on IASB's Discussion Paper *Disclosure Initiative – Principles of Disclosure*

Dear Mr Gauzès,

DEAR JEAN-PAUL,

The European Securities and Markets Authority (ESMA) thanks you for the opportunity to contribute to the IASB's due process regarding the Discussion Paper (DP) *Disclosure Initiative – Principles of Disclosure*. 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.

Improving disclosure requirements in IFRS is key to increase transparency in financial markets and enhance investor protection. Therefore, like EFRAG, ESMA is generally supportive of the IASB's efforts towards identifying problems with the existing disclosure requirements and addressing them in the context of its broader initiative on *Better Communication in Financial Reporting*, an initiative we very much support.

ESMA generally agrees with the IASB's view that there exists a multifaceted 'disclosure problem' which is linked to the application of judgement in selecting useful and relevant information to be disclosed and that a selection of mandatory principles of effective communication may, at least partially, address this problem. As mentioned in its 2015 Statement *Improving the quality of disclosures in the financial statements*, unlike EFRAG, ESMA believes that the disclosure problem is only partly caused by the way in which IFRS are written. The problem is also related to behavioural issues, including the way issuers apply the materiality judgements and the too limited focus on the relevance of the information provided which often results in disclosures that are boilerplate rather than entity-specific. This behaviour may lead to increasing the size of financial statements and to the perception of a 'disclosure overload' problem. However, unlike EFRAG, ESMA believes that in this case the disclosure overload would be the consequence, rather than the root cause, of the disclosure problem depicted by the IASB.

ESMA also generally supports the considerations expressed in the DP on the role of the primary financial statements and the notes and on the location of information. Particularly, ESMA believes that it is important that the IASB develops a general principle on the use of incorporation by reference in order to preserve the validity and consistency of financial statements as a self-standing document. However, like EFRAG, ESMA believes that these topics should be addressed taking into account the potential implications of technology developments, such as digital reporting, and the boundaries of financial statements in the wider corporate reporting environment. In ESMA's view, while technology facilitates investors' access and use of various forms of corporate financial and non-financial communication, it is increasingly important for the IASB to consider how the specific information that is conveyed in the financial statements contributes to this diverse information set and remains a relevant tool to support investment decisions.

In this context, ESMA believes that it is key to preserve the relevance of the information included in the financial statements by avoiding the inclusion of information that is not required by law, that is not necessary to comply with IFRS or that is inconsistent with it. Furthermore, ESMA highlights that financial statements should host performance measures only when they fulfil the principles of fair presentation proposed in the DP. ESMA recommends to the IASB to further align these principles with the ESMA's Guidelines on Alternative Performance Measures.

Like EFRAG, ESMA supports the IASB's efforts to improve the relevance of the accounting policies disclosure and the overall organisation of disclosures around centralised objectives. Particularly, ESMA notes that centralised disclosure objectives could help achieving a more coherent approach when both setting and applying the standard-specific disclosure requirements. However, as a necessary next step to increase consistency across IFRS disclosures, like EFRAG, ESMA urges the IASB to undertake a standard-level review of the existing requirements to then more accurately target the improvements needed.

Finally, like EFRAG, ESMA takes this opportunity to encourage the IASB to clarify how the different projects within the *Better Communication in Financial Reporting* initiative interplay and progress towards the objective of providing financial information that is useful to investors in making decisions. For example, ESMA found it confusing that the IASB is seeking feedback in this consultation on matters that specifically belong to the IASB's Primary Financial Statements project, such as the presentation of EBIT and EBITDA or the use of terms 'unusual' or 'infrequently occurring' for items presented in the statement of financial performance.

Our detailed comments on the DP are set out in Appendix I to this letter. Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely,



Steven Maijoor

Appendix I – ESMA’s detailed answers to the questions in the DP

Question 1

Paragraphs 1.5–1.8 describe the disclosure problem and provide an explanation of its causes.

(a) 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?

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

1. ESMA generally agrees with the IASB’s description of the disclosure problem and particularly with the fact that providing not enough relevant information or providing irrelevant information do not result in financial statements that provide a true and fair view and that comply with IFRS.
2. In its 2015 Statement *Improving the quality of disclosures in the financial statements*¹, ESMA recalled the importance of focusing on the quality of disclosures and expressed concerns with respect to the growth in size of annual reports, mainly due to excessive efforts on formal compliance rather than on the relevance of the information provided.
3. Enforcement experience in Europe has shown that when disclosures do not provide sufficient entity-specific information, but are limited to boilerplate text that merely reproduces the text of IFRS, the financial statements do not provide the primary users with information that is useful to make economic decisions. This is the case, for example, when IFRS 13 disclosures of significant unobservable input and the related sensitivity analyses are too generic². Similarly, entities may fail to provide additional information that is relevant to describe significant uncertainties that affect their judgements. For example, the underlying assumptions, subject to potential significant variability such as commodity prices used in impairment calculations are often not disclosed.
4. While ESMA generally agrees that the development of disclosure principles would help addressing the disclosure problem, ESMA also believes that the disclosure problem is a multifaceted one and, therefore, its solution requires more than just the development of disclosure principles.
5. Particularly, one of the main causes of the disclosure problem relates to the difficulties that entities face in applying materiality judgements. For example, while the DP attributes part of the disclosure problem to the existence of prescriptive lists of disclosures, in ESMA’s view the problem of how entities use prescriptive lists of disclosure requirements and corroborate those with disclosure objectives is a question of applying materiality judgments.

¹ https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-esma-1609_esma_public_statement_improving_disclosures.pdf

² ESMA recently issued its report on the review of the application of IFRS 13 *Fair Value Measurement* requirements. The report is available here: <https://www.esma.europa.eu/file/22623/download?token=JQtnTJ05>

6. ESMA believes that no significant improvement in the way entities apply judgement when preparing disclosures can be achieved in the absence of a robust guidance on how entities shall apply the concept of materiality. In this respect, ESMA welcomes the IASB's work towards the finalisation of its *Practice Statement* on materiality which ESMA hopes will provide a useful anchor when entities undertake their materiality judgements.
7. In some cases, the disclosure problem is also linked to the way IFRS are written. For example, in the experience of enforcers, entities often seem to overlook the linkage that exists between standard-specific disclosure requirements and general disclosure requirement such as those in IAS 1 that require the disclosure of additional information when needed to provide relevant information or the disclosure of information on significant judgements and uncertainties. In addition, not all IFRSs contain an explicit requirement to disclose additional information when this is needed to meet the disclosure objective (e.g. amongst others, IFRS 12 *Disclosure of Interests in Other Entities* and IFRS 16 *Leases* include such requirement, while IFRS 7 *Financial Instruments: Disclosures* and IFRS 15 *Revenue from Contracts with Customers* do not include such requirement). These requirements are sometimes only optional and, in general, it is not clear what they add to the general provision in paragraph 31 of IAS 1 requiring entities to provide additional disclosures when "*compliance with the specific requirements in IFRS is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance*".
8. In ESMA's view, a general requirement to provide additional information contained in a general disclosure standard would be sufficient and would not need to be repeated in each standard. Alternatively, all standards should include such requirement in order not to introduce the risk of inconsistent application of disclosure requirements.
9. In other instances, disclosure objectives may be too far-reaching and lacking specificity. For example, the disclosure objective in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* requires an entity to "present and disclose information that enables users of the financial statements to evaluate the financial effects of discontinued operations and disposals of non-current assets (or disposal groups)".
10. Notwithstanding the improvements that can be made to the way IFRS are written, ESMA notes that compliance with the disclosure principles, objectives and requirements does not exempt issuers from providing information that is material, relevant and useful as financial statements are also a key tool to communicate with users. ESMA notes that complying with IFRS disclosure requirements and providing relevant information are not competing objectives and therefore an approach towards disclosures that builds on a dichotomy between these two aspects ultimately focuses too little on the relevance of the information provided and results in disclosures that are boilerplate rather than entity-specific.
11. ESMA points out that this behaviour may lead to increasing the size of financial statements and to the perception of a 'disclosure overload' problem. However, ESMA believes that in this case the disclosure overload would be the consequence, rather than the root cause, of the disclosure problem depicted by the IASB. For example, the enforcement experience shows that overreliance on the mere compliance with minimum disclosure requirements

in IFRS 7 or IFRS 12 does not necessarily ensure compliance with the disclosure objectives in these standards and often results in poor communication of information on an entity's financial position and performance, thus not achieving the objective of IFRS.

12. In addition, ESMA believes that the disclosure problem is also one of accessibility of information by users of financial statements. In this respect, ESMA would suggest that the new perspectives that are open by digital reporting should also be considered when assessing the issues identified in sections 2-7 of the DP. For example, the discussion on location of information needs to consider how new technologies are changing and will further change the way issuers process financial statements moving away from a traditional book-based approach to consuming financial statements information.
13. In light of the above, ESMA believes that addressing the issues that entities face in applying judgement will require the IASB to work, at the same time, on both (i) the general reorganisation and (ii) the standard-level review of disclosure requirements. In fact, both aspects are important in order to achieve better connectivity between standard-specific disclosures requirements and general disclosure requirements and to improve the overall consistency of IFRS. Also, the IASB should develop its considerations on disclosures improvement having in mind how these interact with the concept of materiality and its application. Finally, any future development on disclosure requirements needs to take into account also the digital dimension of reporting which is not addressed in the DP.

Question 2

Sections 2–7 discuss specific disclosure issues that have been identified by the Board and provide the Board's preliminary views on how to address these issues.

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

14. ESMA agrees with the issues identified in the DP. In addition, as mentioned in the answer to question 1 ESMA would like to highlight two issues : (i) the inconsistency across IFRS in the requirement to provide additional information; and (ii) the tendency to disregard the compliance with disclosure objectives.
15. We also note that paragraph 2.3 of the DP refers to the fact that when information in financial statements is communicated ineffectively, users might have difficulties in understanding it and therefore need to spend more time analysing it. This might suggest that poor communication and disclosure may be overcome by more time spent on analysing financial statements which would not often be the case.
16. ESMA also believes that some of the issues identified in section 5 of the DP relating to the use of performance measures in the financial statements specifically relating to *Performance measures that are line items or subtotals in the statement(s) of financial performance* would most effectively be addressed in the context of the project on primary

financial statements. Indeed, these concepts need further considerations and explanations to seek views of the market participants.

17. Finally, ESMA also highlights the importance of addressing the role of financial statements in the broader context of corporate reporting in order to have a more focused discussion on the role of the notes and the primary financial statements.

Question 3

The Board's preliminary view is that a set of principles of effective communication that entities should apply when preparing the financial statements as described in paragraph 2.6 should be developed. The Board has not reached a view on whether the principles of effective communication should be prescribed in a general disclosure standard or described in non-mandatory guidance.

The Board is also of the preliminary view that it should develop non-mandatory guidance on the use of formatting in the financial statements that builds on the guidance outlined in paragraphs 2.20–2.22.

- (a) Do you agree that the Board should develop principles of effective communication that entities should apply when preparing the financial statements? Why or why not?*
- (b) Do you agree with the principles listed in paragraph 2.6? Why or why not? If not, what alternative(s) do you suggest, and why?*
- (c) 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?*
- (d) 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 in Question 3(c) and/or (d), please specify the form of non-mandatory guidance you suggest (see paragraph 2.13(a)–(c)) and give your reasoning.

18. ESMA praises the IASB's efforts in translating what are commonly understood areas of disclosure improvement into clear principles. ESMA notes that the principles mentioned in paragraph 2.6 of the DP are broadly aligned with those indicated in ESMA's 2015 Statement *Improving the quality of disclosures in the financial statements* and thus we agree with them.

19. ESMA agrees that providing principles of effective communication would help addressing the disclosure problem. In ESMA's view, identifying some principles in a general disclosure standard together with guidance on how to make materiality assessments and detailed illustrative examples would have the potential to help issuers applying judgement in a more structured way when preparing disclosures. Education and outreach initiatives could also be implemented to address issues relating to behavioural aspects. For example, ESMA would suggest that the IASB considers reaching out to issuers to understand whether the

amount of time devoted to the preparation of disclosures may partly explain why, in some cases, there is a tendency towards overly relying on disclosure checklists due to time constraints.

20. ESMA highlights that the IASB should ensure that these principles are consistent with those in paragraph 10 of IAS 8 *Accounting Policies, Changes in Accounting Estimate and Errors* relating to the application of accounting policies that results in relevant and reliable information and with the principles included in the *Conceptual Framework*. For this purpose, ESMA suggests that these principles are clearly framed as means to ensure that information that is disclosed is relevant and provides a faithful representation of the phenomena it purports to represent.
21. ESMA generally agrees with the principles provided in paragraph 2.6 of the DP. However, due to their high-level nature, ESMA would suggest that the IASB considers making a distinction between two categories: (i) principles that improve the *contents* of disclosures; and (ii) principles that improve the *delivery* of the content. In this respect, ESMA suggests that the principle requiring disclosure of entity-specific information falls into the first category and the other principles fall into the second category. In addition, ESMA would suggest introducing an ordering amongst those principles, for example, the IASB could consider treating the principle that information needs to be entity-specific as the *key* principle and the other principles could be seen as ways to *enhance* the communication of entity-specific information.
22. Finally, regarding formatting, ESMA believes that the combination of mandatory principles of effective communication – including principles of clear disclosure and connection with other relevant information – combined with non-mandatory guidance on how to format information could help achieving significant improvements in the way issuers present and disclose information. The non-authoritative guidance on formatting could take the form of examples and application guidance to explain how to implement the principles. This may assist issuers when deciding the best way to meet the disclosure requirements but, at the same time, it may assist the IASB when setting disclosures in order to decide whether to recommend some disclosures to be provided in a specific format.

Question 4

The Board's preliminary views are that a general disclosure standard should:

- *specify that the 'primary financial statements' are the statements of financial position, financial performance, changes in equity and cash flows;*
- *describe the role of primary financial statements and the implications of that role as set out in paragraphs 3.22 and 3.24;*
- *describe the role of the notes as set out in paragraph 3.28, as well as provide examples of further explanatory and supplementary information, as referred to in paragraphs 3.26–3.27; and*

- *include the guidance on the content of the notes proposed in paragraphs 7.3–7.7 of the Conceptual Framework Exposure Draft, as described in paragraph 3.7.*

In addition, the Board's preliminary views are that:

- *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*
- *if it uses the terms 'present' and 'disclose' when describing where to provide information in the financial statements when subsequently drafting IFRS Standards, it should also specify the intended location as either 'in the primary financial statements' or 'in the notes'.*

Do you agree with the Board's preliminary views? Why or why not? If you do not agree, what do you suggest instead, and why?

23. ESMA agrees with the proposed definitions of the roles of the primary financial statements and the notes respectively. However, ESMA highlights that defining the boundaries between primary financial statements and the notes requires considering how digital reporting may impact the way users consume the financial information contained in the financial statements and, more generally, what the role of financial statements is in the broader context of corporate reporting. Therefore, ESMA would encourage the IASB to take into account these aspects when re-deliberating on the roles of the primary financial statements and the notes. Furthermore, as mentioned in response to question 5, we recall the importance of discussing the role of the primary statements and the notes as part of a broader discussion on the role of financial statements in wider corporate reporting.
24. The proposed definitions of the roles identified for the primary financial statements and the notes are based on the definition of the objective of financial statements that was proposed in the 2015 Exposure Draft *Conceptual Framework for Financial Reporting* (and confirmed by the IASB during its re-deliberations). ESMA supports the approach to make the definitions of the primary financial statements and the notes flow directly from the objective of the financial statements. However, ESMA notes that the DP could more clearly describe how differently the primary financial statements and the notes respectively contribute to providing information that is useful to users of financial statements in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's resources.
25. Finally, ESMA is of the view that the IASB should address the long-standing issue relating to the use of the terms 'present' and 'disclose'. In its comment letter in response to the 2015 ED on Conceptual Framework³, ESMA already called for providing a clear distinction between these two terms. ESMA believes that the general review of its disclosures requirements and the planned standard-level review, are unique opportunities for the IASB to revisit the use of these terms and ensure that 'present' and 'disclose' point to primary statements and the notes respectively, in line with their commonly understood meaning in the accounting domain.

³ https://www.esma.europa.eu/sites/default/files/library/2015-1733_esma_cl_ed_conceptual_framework_and_update_of_references.pdf

Question 5

The Board's preliminary view is 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 requirements in paragraphs 4.9(a)–(c).

- (a) *Do you agree with the Board's preliminary view? Why or why not? If you do not agree, what alternative(s) do you suggest, and why?*
- (b) *Can you provide any examples of specific scenarios, other than those currently included in IFRS Standards (see paragraphs 4.3–4.4), 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 criteria in paragraphs 4.9(a)–(c)?*
26. The issue relating to location of information and the use of incorporation by reference is of paramount importance as recent developments in digital reporting have challenged the role of financial statements and their status as self-standing document that provides a complete picture about an entity's financial position and performance.
27. ESMA highlights the risk that by referring to various sources, users are ultimately provided with a *dispersed* set of information which makes it more difficult for them to gain a holistic picture of an entity's financial position and performance. Therefore, ESMA strongly believes that it is still key to set boundaries for the information that are cross-referenced as being part of the financial statements, but are placed elsewhere.
28. At the same time, ESMA concurs with the IASB's recollection that there is an overlap between information required by IFRS standards and the information required by legislation or regulatory authorities. For example, financial institutions tend to incorporate disclosures regarding capital management according to paragraphs 134-136 of IAS 1 *Presentation of Financial Statements* into the financial statements by means of references although IAS 1 does not explicitly provide this possibility.
29. Therefore, ESMA agrees that a general principle on the use of incorporation by reference should be provided by the IASB in order to preserve the validity and consistency of financial statements. ESMA also agrees with the principles stated in paragraph 4.9 (a) and (c) and with the second part or sub-paragraph (b). However, ESMA is concerned that the principle proposed in the DP that information can be incorporated into the financial statements by means of cross-references if the information makes "*the annual report as a whole more understandable*" may place challenges to the enforcement and audit activities.
30. While the concept of "understandability" is already used in IFRS in the context of information provided in the financial statements, the same concept may pose practical challenges when applied to the broader context of an entity's annual report as it may give rise to different interpretations and to diversity in practice. Particularly, applying the notion of understandability of the entire annual report by comparing the situation *with and without*

cross-references may result in divergent interpretations due to the extensive judgement that needs to be exercised.

31. Therefore, ESMA would suggest that the IASB investigates either how the concept of understandability can be made more practical to the annual report by means of examples and application guidance or whether a different concept or combination of indicators can be identified. For example, referencing may be allowed if an entity uses it as a means to meet demonstrable users' needs and to avoid unnecessary repetitions and increase the overall understandability of its annual report without detracting from the overall understandability of financial statements.
32. ESMA also believes that the principle that financial statements need to remain understandable even if part of the information required by IFRS are incorporated by means of references may need to be clarified with examples that may suggest how the IASB believes that cross-referencing could be used without impairing the understandability of financial statements. In ESMA's view, it is also important that the cross-references are very specific to avoid any confusion as to what is the scope of a cross-reference within an extensive document.
33. ESMA also notes that in its recent Exposure Draft *Improvements to IFRS 8 Operating Segments* the IASB has proposed a definition for the 'annual reporting package'. While disagreeing with providing such definition in the context of an amendment to IFRS 8 and suggesting to refer to the definition given in IFRS 15, ESMA proposed that the concept of 'annual reporting package' be addressed in the Principles of Disclosure project. ESMA believes that a general disclosure standard should carefully address this issue to ensure that any notion of 'annual report' or 'annual reporting package' that does not conflict with existing legal definitions provided for in the jurisdictions where IFRS are applied. If any such conflicts emerge, ESMA would suggest that IASB considers investigating a different approach that would allow cross-referencing to other documents provided that these are made available at the same time and on the same terms as the financial statements.
34. Finally, as information incorporated by cross-reference forms part of the audited financial statements, ESMA believes that the IASB should more closely liaise with the audit profession to investigate any areas in which general guidance of cross-referencing could potentially place challenges on the audit of financial information.

Question 6

The Board's preliminary view is 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 as described in paragraphs 4.38(a)–(c).*

Do you agree with the Board's preliminary view? Why or why not? If you do not agree, what alternative(s) do you suggest, and why?

Question 7

The Board did not discuss whether any specific information—for example, information that is inconsistent with IFRS Standards—should be required to be identified as described in paragraphs 4.38(a)–(c) or should be prohibited from being included in the financial statements.

Do you think the Board should prohibit the inclusion of any specific types of additional information in the financial statements? If so, which additional information, and why?

35. ESMA notes that non-IFRS information is a rather broad category that includes information needed to comply with local laws and regulations as well as information that is neither required by IFRS nor by laws and regulations.
36. ESMA believes that this second category also includes information that relates to performance measures which could be included in the financial statements, subject to the considerations expressed in our response to questions 8 and 9.
37. For other types of non-IFRS information, ESMA believes that non-mandatory information (i.e. information that is not required to be included in the financial statements by laws and regulations) should be prohibited from being included in the financial statements, when it is inconsistent with IFRS requirements.
38. This is because ESMA believes that if information is useful and in compliance with IFRS principles, then it will most likely need to be disclosed anyway as several requirements in IAS 1 indicate (i.e. paragraphs 31, 55, 58 and 112(c)).
39. ESMA also suggests that the IASB provides examples of non-IFRS information that is therefore prohibited, so to increase the degree of consistency in the interpretation of what non-IFRS information is (i.e. an entity's turnover including the equity-consolidated entities, etc.).
40. In sum, ESMA believes that information that falls outside one or more of the following categories should be prohibited from being included in the financial statements (either directly or by means of cross-references):
 - Information that is necessary to comply with IFRS, including information that is not inconsistent with IFRS and is provided when compliance with specific IFRS requirements is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance (as required by paragraph 31 of IAS 1);
 - Information required by law or regulation to be included in the IFRS financial statements; and

- Information that relates to performance measures that meet the definition and comply with the principles described in the section 5 of the DP and subject to our comments provided.

41. Nevertheless, ESMA encourages the IASB to keep further exploring what type of non-IFRS information that falls outside any of the above categories (i.e. non-financial information such as physical measures), might be permitted to be included in the financial statements as they would provide relevant information. ESMA believes that if any such information would be allowed to be presented in the financial statements, it should be subject to the principles in paragraph 4.38 (a) and (b) of the DP.

Question 8

The Board's preliminary views are 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:*
 - *the presentation of an EBITDA subtotal if an entity uses the nature of expense method; and*
 - *the presentation of an EBIT subtotal under both a nature of expense method and a function of expense method.*
 - *develop definitions of, and requirements for, the presentation of unusual or infrequently occurring items in the statement(s) of financial performance, as described in paragraphs 5.26–5.28.*
- (a) *Do you agree with the Board's preliminary views? Why or why not? If you do not agree, what alternative action do you suggest, and why?*
- (b) *Should the Board prohibit the use of other terms to describe unusual and infrequently occurring items, for example, those discussed in paragraph 5.27?*
- (c) *Are there any other issues or requirements that the Board should consider in addition to those stated in paragraph 5.28 when developing requirements for the presentation of unusual or infrequently occurring items in the statement(s) of financial performance?*

The feedback on Question 8 will be considered as part of the Board's Primary Financial Statements project.

42. ESMA believes that the discussion on specific performance measures, such as EBIT and EBITDA, or specific items to be identified in the statement(s) of financial performance, such as *unusual or infrequently occurring items* would benefit from a comprehensive discussion on the content of the primary financial statements within the dedicated project on *Primary Financial Statements* rather than being subject to two different consultations. ESMA also takes the opportunity to encourage the IASB to clarify how the different projects within *Better Communication in Financial Reporting* initiative interplay with each other.

43. In its 2016 European Common Enforcement Priorities⁴, ESMA reminded issuers that any additional line items, headings and subtotals presented in the statement of financial position and in the statement(s) of profit or loss and other comprehensive income shall be relevant to the understanding of the entity's financial position or the entity's financial performance.
44. Therefore, ESMA agrees with the IASB's initiative to clarify how the presentation and relevance of subtotals, such as EBIT and EBITDA, can be improved. Particularly, ESMA agrees that consistency between the type of cost analysis used in the statement of profit or loss and the subtotals adopted therein is important to fairly depict an issuer's performance. Specifically, ESMA notes that the enforcement experience shows that such consistency is not always achieved as some issuers still tend to present the EBITDA subtotal in conjunction with an analysis of costs by function.
45. Regarding the use of terminology to indicate that certain items presented in the statement of financial performance are unusual and/or infrequently occurring, ESMA notes the following:
- On the one hand, paragraph 87 of IAS 1 prohibits the presentation of extraordinary items and it is not clear how terms such as infrequent or unusual are different compared to extraordinary; and
 - On the other hand, paragraph 86 of IAS 1 indicates that subtotals providing information on the frequency of occurrence of certain items in the statement(s) of financial performance may assist users in understanding the financial performance achieved and in making projections of future financial performance.
46. While ESMA believes that the IASB should retain the prohibition to label items as 'extraordinary', the IASB should further clarify how the frequency of occurrence of certain items of financial performance can be depicted using subtotals or additional line items. ESMA also suggests that when exploring the notion of 'non-recurring' items, the IASB also clarifies how this differs from the notion of 'extraordinary' items.
47. ESMA notes that in its Guidelines on Alternative Performance Measures (APMs)⁵, reference is made to the principle of fair labelling of APMs and to the requirement not to convey misleading messages to users. In this context, paragraph 25 of the Guidelines makes explicit reference to the fact that issuers shall not mislabel items as non-recurring, infrequent or unusual.
48. ESMA highlights that a similar principle is included in paragraph 15 of IAS 1 which refers to the *fair presentation* of financial position, performance and cash flows, however ESMA believes that the IASB should further highlight this principle and more explicitly link it to

⁴ ESMA's 2016 European Common Enforcement Priorities are available here:

https://www.esma.europa.eu/system/files_force/library/esma-2016-1528_european_common_enforcement_priorities_for_2016.pdf?download=1

⁵ ESMA's Guidelines on APMs are available here:

<https://www.esma.europa.eu/sites/default/files/library/2015/10/2015-esma-1415en.pdf>

paragraphs addressing presentation of subtotals and additional such as paragraph 85A and 86.

49. ESMA generally agrees with the examples proposed by the IASB in paragraph 5.28 of the DP and believes that these should be more clearly stated as principles to guide an issuer's judgement when deciding to present certain items of performance as not repeatable in the future. ESMA would also recommend to accompany these principles with illustrative examples.
50. For example, regarding the notion of recurring/non recurring item and synonyms, ESMA considers that:
- a. in assessing frequency an issuer shall consider how often an event has occurred in the past, but also the magnitude of the event, so to identify items that, although re-occurring, present a significantly higher or lower amount in particular years compared to the past.
 - b. The IASB should investigate what unit of account shall be considered in assessing the unusual or infrequent nature of certain items. For example, for one subsidiary within a group an impairment may be an unusual item, whilst at group level it may be a recurring item. As the consolidated financial statements are meant to present the activities of the parent and its subsidiaries as of a single economic entity, ESMA believes that the assessment on the frequency of occurrence should be performed at group level and therefore the labelling of any subtotals and line items should reflect the non-recurring nature of impairments at group level.
 - c. Frequency should be assessed with reference to the reasonable future expectation for an event to re-occur. ESMA would also like to highlight that the industry which an issuer belongs to and the geographical location are also factors that may influence an issuer's assessment on frequency.
 - d. The IASB should investigate how the notion of 'unusual and infrequently occurring' interacts with the circumstances that would give rise to separate disclosure stated in paragraph 98 of IAS 1.
 - e. It is important that the assessment regarding the frequency of an item should be symmetrical and free from bias in a way that ensures that gains and losses are labelled consistently when they arise from the same or comparable circumstances (e.g. if an impairment loss is deemed not recurring, a reversal of an impairment with the same characteristics should also be considered non recurring).

Question 9

The Board's preliminary view is that a general disclosure standard should describe how performance measures can be fairly presented in financial statements, as described in paragraph 5.34.

Do you agree with the Board's preliminary view? Why or why not? If you do not agree, what alternative action do you suggest, and why?

51. Firstly, ESMA notes that the scope of the performance measures addressed by the proposed guidance in the DP is not entirely clear. The IASB identifies in paragraph 5.14 of the DP the possibility that all three categories of information from section 4 of the DP (i.e. Category A, B and C) could be a source of performance measures in financial statements.
52. Particularly, paragraph 5.14(a) mentions performance measures 'specified' in IFRS standards (i.e. Category A performance measures) and it is not clear whether performance measures mentioned, for example in the Basis for Conclusions or in Examples or other guidance, can be understood as 'specified'.
53. ESMA believes that the IASB should better articulate the interaction between the non-IFRS information addressed in Section 4 of the DP and the performance measures discussed in Section 5. Particularly, as mentioned in our response to question 6, ESMA believes that performance measures, other than subtotals or measures required by IFRS, should be treated as a special category of non-IFRS information.
54. In this respect, ESMA generally fully agrees with the principles to ensure fair presentation of performance measures in paragraph 5.34 of the DP, however it would recommend the IASB to consider further aligning those with the principles for the presentation of APMs included in the ESMA's Guidelines on Alternative Performance Measures. Specifically, ESMA would recommend to consider including as part of the principles for fair presentation the requirement to use meaningful labels that do not convey misleading messages to users and the basis for calculation as well as the definition of the APM.
55. ESMA also notes that the DP describes the concept of prominence with reference to line items, total or subtotals in the primary financial statements required by IFRS. However, it is not clear how this principle should be interpreted, for example, when a performance measure in the form of a subtotal (compliant with paragraph 85A of IAS 1) is presented along with other required totals in the statement of profit or loss. ESMA suggests the IASB to further explore the concept of prominence and, in doing so, it recommends considering the specific Q&A published by ESMA on the application of this and other concepts relating to APMs⁶.
56. Finally, ESMA notes that the principle in paragraph 5.34(g) seems to imply that financial statements should host performance measures which are unaudited. While ESMA understands that the scope of audits of financial statements falls outside of the IASB's remit, nevertheless ESMA believes that the IASB should not implicitly encourage entities from including unaudited information in the financial statements. As financial statements are audited any voluntary information included therein is generally intended to be audited.

Question 10

⁶ The Q&A on ESMA Guidelines on Alternative Performance Measures are available here: https://www.esma.europa.eu/file/21236/download?token=-jY_oH39

The Board's preliminary views are that:

- a general disclosure standard should include requirements on determining which accounting policies to disclose as described in paragraph 6.16; and
 - 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):
 - the alternatives for locating accounting policy disclosures, as described in paragraphs 6.22–6.24; and
 - the presumption that entities disclose information about significant judgements and assumptions adjacent to disclosures about related accounting policies, unless another organisation is more appropriate.
- (a) Do you agree with the Board's preliminary view that a general disclosure standard should include requirements on determining which accounting policies to disclose as described in paragraph 6.16? Why or why not? If you do not agree, what alternative proposal(s) do you suggest, and why?
- (b) Do you agree with the Board's preliminary view on developing guidance on the location of accounting policy disclosures? Why or why not? Do you think this guidance should be included in a general disclosure standard or non-mandatory guidance (or in a combination of both)? Why?
- (c) Are there any other issues or requirements that the Board should consider in addition to those stated in paragraph 5.28 when developing requirements for the presentation of unusual or infrequently occurring items in the statement(s) of financial performance?

If you support the issuance of non-mandatory guidance in Question 10(b), please specify the form of non-mandatory guidance you suggest (listed in paragraphs 2.13(a)–(c)) and give your reasoning.

57. ESMA believes that the disclosure of accounting policies can be improved to provide only material information without merely reproducing the text of IFRSs. ESMA notes that accounting policies disclosed in the financial statements provide relevant and useful information when they are entity-specific and provide users with the basis to get an understanding of how IFRS were applied especially when judgment was required. This is consistent with the principle stated in paragraph 6.16(a) of the DP. ESMA agrees with the IASB that it would be redundant to provide further guidance on the need for entities to make accounting policies entity-specific, especially if a specific principle of effective communication is in place. However, ESMA believes that examples such as those provided in paragraph 6.18(b) of the DP would be useful if included in the future revised standard.
58. Therefore, ESMA agrees with the IASB's preliminary view to provide guidance on which accounting policies should be disclosed and particularly, ESMA agrees that the focus should be on accounting policies belonging to categories 1 and 2.

59. In addition, ESMA believes that the IASB should further reconsider the existing requirement in paragraph 122 of IAS 1 that entities should disclose the judgments that have the most significant effect on the amounts recognised in the financial statements. ESMA believes that once entities identify the accounting policies that belong to categories 1 and 2, it should then disclose all the judgements that are material to the application of that specific accounting policy and not only the most significant ones.
60. ESMA also notes that the interrelation with the materiality project is critical to this area of the DP as the application of the concept of materiality will guide which policies are disclosed. Therefore, ESMA encourages the IASB to ensure that future developments in the field of the application of materiality are taken into consideration when further developing proposals on the disclosure of accounting policies.
61. ESMA disagrees with providing category 3 accounting policies as these by definition do not meet the materiality threshold and result in information that is boilerplate and that may cause material information to be overlooked.
62. Finally, regarding the location of accounting policies, ESMA believes that the IASB should seek to further refine the existing requirements in paragraphs 113 and 114 of IAS 1 regarding the systematic ordering of the notes to specifically refer in the core principle to accounting policies which should be located in a way that maximises the understandability of financial statements. ESMA believes that, rather than providing mandatory guidance on location of accounting policies, the IASB could complement the existing requirements with reference to systematic ordering of the notes with examples of how location can maximise understandability of financial statements.

Question 11

The Board's preliminary view is 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.

Centralised disclosure objectives could be used by the Board as a basis for developing disclosure objectives and requirements in Standards that are more unified and better linked to the overall objective of financial statements.

Do you agree that the Board should develop centralised disclosure objectives? Why or why not? If you do not agree, what alternative do you suggest, and why?

63. In principle, ESMA believes that centralised disclosure objectives would help giving overall consistency to standard-specific disclosure requirements. This is particularly true if the goal of the centralised objectives is mainly to assist the IASB in setting disclosure requirements.
64. However, ESMA would also like to highlight the practical challenges posed by the fact that setting centralised disclosure objectives with the aim to further detail them at standard-level may result in boilerplate or generic disclosure objectives. Nevertheless, ESMA believes that some disclosure objectives in existing IFRS, such as IFRS 7 and IFRS 12, are

examples of high-level but not-boilerplate objectives which may be a useful starting point for a comprehensive review in this area.

65. For this reason, while being in favour of the general proposal to achieve more consistency across IFRS with respect to disclosures requirements, ESMA would suggest the IASB to further investigate how in practice this might result in useful general objectives that support standard-specific objectives. In this respect, ESMA believes that such exercise could effectively be undertaken only starting from a standard-by-standard review of disclosure requirements.

Question 12

The Board has identified, but not formed any preliminary views about, 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:

- *focusing on the different types of information disclosed about an entity's assets, liabilities, equity, income and expenses (Method A); or*
- *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).*

(a) Which of these methods do you support, and why?

(b) 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.

66. Although methods A and B are in the early stages of development and have not been discussed in detail by the Board, ESMA acknowledges the significant change to the current approach to setting disclosure requirements which would be introduced by embracing method B. ESMA also notes that in some cases, for example when the assessment of an issuer's business model is critical to account for a specific event or transaction, method B may complement method A.
67. However, ESMA is not in the position to assess how this method, although theoretically appealing, could ultimately provide concrete benefits to the users of financial statements. For example, it is not clear whether there will be consistency between the way users look at the business activities around which under Method B the disclosure requirements should be designed or grouped and the users' understanding of these activities.
68. Therefore, considering the current information available and the preliminary status of development of Method B, ESMA would be more in favour of continuing pursuing a refinement of disclosure requirements under Method A. Nevertheless, ESMA encourages the IASB to further explore method B based on the feedback received especially by the users' community.

Question 13

Do you think that the Board 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?

69. ESMA believes that a single disclosure standard could contribute to achieving more coherence across when setting disclosure requirements, even though there might be practical challenges that this might pose in terms of volume and frequency of the maintenance required.
70. ESMA also sees merits in keeping dedicated disclosure requirements at standard-level so to maintain a closer link between the other standard-specific requirements for example relating to recognition, classification and measurement.
71. ESMA believes that a disclosure standard could be in place as a single source of general guidance on disclosure requirements that is then complemented by standard-specific objectives and requirements. In addition, ESMA suggests that the IASB prioritises a standard-level review of disclosure requirements and makes the necessary amendments to achieve consistency across disclosures across different IFRS. Once this exercise completed, ESMA encourages the IASB to develop a specific protocol that it shall apply when it revises or introduces standard-specific disclosure requirements in order to maintain the overall consistency.
72. While ESMA understands that overall consistency considerations are already part of the standard setting process, nevertheless ESMA would suggest to make these considerations part of a structured process. This will avoid perpetuating the current situation in which differences across disclosure requirements amongst IFRS are the result of a stratification of different generations of disclosure requirements being developed at different stages without necessarily taking into account the need to maintain overall consistency across IFRS.

Question 14

This section describes an approach that has been suggested by the NZASB staff for drafting disclosure objectives and requirements in IFRS Standards.

- (a) *Do you have any comments on the NZASB staff's approach to drafting disclosure objectives and requirements in IFRS Standards described in this section (the main features of the approach are summarised in paragraph 8.2 of this section)?*
- (b) *Do you think that the development of such an approach would encourage more effective disclosures?*
- (c) *Do you think the Board should consider the NZASB staff's approach (or aspects of the approach) in its Standards-level Review of Disclosures project? Why or why not?*

Note that the Board is seeking feedback on the NZASB staff's overall approach, rather than feedback on the detailed drafting of the paragraphs on the use of judgement in the NZASB staff's example 1 or the detailed drafting of the specific disclosure requirements and objectives included in the NZASB

staff's examples 2 and 3. In addition, the Board is not seeking feedback on where specific disclosure objectives and requirements should be located in IFRS Standards (except as specifically requested in Question 13).

73. ESMA believes that the NZASB staff's approach provides an interesting basis as to how improvements could be made to the structure of disclosure requirements to encourage issuers to provide more entity-specific disclosures.
74. However, looking at the examples provided in the DP to illustrate this approach, if IFRS were to include only examples of disclosures and no specific requirements, ESMA is concerned by the risk that disclosures would no longer be comparable across issuers due to the lack of a minimum set of disclosures required by the IASB.
75. ESMA believes that the existing approach adopted in some IFRS to indicate specific disclosure requirements accompanied by a clause to provide additional information if necessary to comply with the disclosure objective and subject to a general materiality threshold, ensures that a certain balance between comparability and flexibility is achieved. In ESMA's view, compared to the existing approach in IFRS, the NZASB's staff approach seems more inclined towards improving the flexibility aspect.
76. While ESMA believes that the combination of a summary and an 'additional information' section is a useful starting point to improve the way disclosure requirements are currently incorporated into IFRS, ESMA would suggest the IASB that, in considering any new approach to disclosures, it further explores how to balance the needs for comparability and flexibility. Moreover, ESMA is concerned that applying the NZ staff's approach in all IFRS standards will be time consuming.

Question 15

Some stakeholders say that the way that disclosures are drafted in IFRS Standards might contribute to the 'disclosure problem', as described in Section 1. Some cite in particular the absence of clear disclosure objectives and the presence of long lists of prescriptively written disclosure requirements in Standards (see paragraph 8.4).

Nevertheless, other stakeholders observe that specific disclosure requirements might be simpler to use than applying judgement when determining how to meet disclosure objectives.

Do you think the way the Board currently drafts IFRS Standards contributes to the disclosure problem? Please give your reasoning. If you think the current drafting contributes to the disclosure problem, please provide examples of where drafting in Standards could be improved and why.

77. ESMA's feedback on this topic is included in our response to Question 1.