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# IASB publishes a discussion paper on Principles of Disclosures

Published on: May, 2017

Audit & Assurance

## Why the discussion paper has been issued

There has been consistent feedback from preparers and auditors that the disclosure requirements in IFRS are difficult to work with, and from investors that they aren't getting the right information. The IASB held a public forum in early 2013 and from that launched its Disclosure Initiative, a portfolio of implementation and research projects aimed at improving the effectiveness of financial statements disclosures. This DP is the output the Principles of Disclosures project.

The main objective of the Principles of Disclosures project is to identify disclosure issues and to develop new, or clarify existing, principles of disclosure in IFRS to address those issues. The principles proposed in the DP build on the existing requirements of IAS 1 and the concepts being developed in the Conceptual Framework project. The goal is to amend IAS 1, or to create a new disclosure standard that would incorporate and replace parts of IAS 1 (either outcome is referred to as the 'general disclosure standard' in the DP, and in the rest of this document).

## DP contents

The discussion paper has eight sections:

1. Overview of the 'disclosure problem' and the objective of this project
2. Principles of effective communication
3. Roles of the primary financial statements and the notes
4. Location of information
5. Use of performance measures in the financial statements
6. Disclosure of accounting policies
7. Centralised disclosure objectives
8. New Zealand Accounting Standards Board staff's approach to drafting disclosure requirements in IFRS Standards

## The overall disclosure problem and its causes

In a nutshell, the disclosure problem is the perception that financial statements:

- do not provide enough relevant information,
- include too much irrelevant information, and
- communicate the information ineffectively.

At the heart of this is judgement – deciding what to disclose and how to disclose it. Many of the problems are seen as being behavioural. The IASB says that treating the disclosure requirements as a checklist is perceived to save time on preparation and reduce the risks of auditors, regulators and users challenging management's judgement and assumptions.

In addition, some stakeholders say that preparers are discouraged from exercising judgement by the way in which the Standards are drafted because:

- the Standards lack clear disclosure objectives, making the purpose of some disclosure requirements unclear.
- the long lists of prescriptive disclosure requirements promote the use of a 'checklist' approach to disclosing information.

In the light of the above, the Board thinks that developing a set of disclosure principles could help improve the effectiveness of financial statements disclosures. Nevertheless, the Board observes that this will only be achieved if there is a corresponding change in the different stakeholders' attitude towards the use of judgement in disclosing information.

## The disclosure principles the Board considered

The Board considered and expressed preliminary views on the following matters in the DP:

1. Principles of effective communication
2. Principles on where to disclose information
   a. The role of the primary financial statements and of the notes
   b. Location of information
3. Principles to address specific disclosure concerns expressed by users of financial statements
   a. Use of performance measures
   b. Disclosure of accounting policies
4. Improving disclosure objectives and requirements – centralised disclosure objectives

## Changes being considered

This section sets out the specific disclosure problems identified by the Board and its preliminary views on how to resolve them.

### Effective communication

| The problem | Preliminary views |
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| The Board has identified the following examples of ineffective communication in financial statements:<br>• Using boilerplate descriptions that merely repeat the Standards' disclosure requirements;<br>• Omitting material information or including immaterial information that obscures material information;<br>• Using unclear descriptions, and providing no or poor cross-referencing between related information; and<br>• Using an inappropriate format when disclosing information (e.g. using tables, graphs, bullet points, or narrative descriptions inappropriately). | The Board is considering developing a set of principles of effective communication either in a general disclosure standard or in non-mandatory guidance.<br>These principles would require that information provided is:<br>• entity-specific and tailored to reflect the entity's specific facts and circumstances;<br>• described using simple and direct language;<br>• organised in a way that highlights important matters;<br>• properly cross-referenced to highlight relationships between different pieces of information and to facilitate navigation through the financial statements;<br>• not duplicated;<br>• disclosed in a way that optimises comparability among entities and across reporting periods; and<br>• provided in a format that is appropriate for that type of information.<br>Furthermore, the Board suggests developing non-mandatory guidance on the use of appropriate formats for different types of information to improve effective communication. |

Observation

The discussion on the use of appropriate formats is largely common sense. Thinking out-of-the-box, putting computer technologies to good use, and putting oneself in the users' shoes when preparing the disclosures would contribute to achieving effective communication.

## Where information should be disclosed

### The roles of the primary financial statements and of the notes

| The problem | Preliminary views |
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| There is a perception that users, auditors and regulators seem to give greater weight to information included in the primary financial statements ('PFS') (i.e. the statements of financial position, financial performance, changes in equity and cash flows) than those included in the notes.<br>Preparers also find it difficult to judge what information should be included in the PFS versus the notes. The different terms used in the Standards to describe the PFS, as well as the use of 'to present' and 'to disclose' (which people tend to associate with the PFS and the notes respectively) aggravate this problem. | The Board thinks that a general disclosure standard should:<br>• specify that the 'primary financial statements' comprise the four statements stated alongside. This term would then be used consistently throughout all Standards when referring to the underlying four statements with the understanding that 'primary' is not intended to imply that the notes provide secondary or less important information than the PFS. Instead, they provide different information from the PFS and have a different role.<br>• define the roles of the PFS and the notes. The Board believes that this distinction would assist it in deciding what information is required or permitted to be included in the PFS or in the notes, and would assist preparers in making judgement about the appropriate level of disaggregation in the PFS and in the notes.<br>Moreover, the Board suggests not to make any formal association of the terms 'to present' and 'to disclose' with the PFS and the notes respectively; instead, when using these terms in the future, the Board would specify the intended location of the information as either in the PFS or in the notes. |

### Location of information

The problem here is two-fold: should the Board allow IFRS information to be disclosed outside the financial statements and non-IFRS information to be disclosed within the financial statements?

| The problem | Preliminary views |
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| **Disclosing IFRS information outside the financial statements**<br>Some Standards (e.g. IFRS 7 and IFRS 14) permit an entity to provide specific information outside the financial | **Disclosing IFRS information outside the financial statements**<br>The Board suggests that a general disclosure standard should allow information necessary to comply with the |

| The problem | Preliminary views |
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| statements, provided that the information is cross-referenced, and that the other statement is available to users on the same terms as the financial statements and at the same time.<br>There are diverse views on whether such cross-referencing should be limited to the specified disclosures, or whether they could be applied more generally to other Standards where cross-referencing is not specifically mentioned.<br>The diversity in views stems from how different stakeholders view the inclusion of IFRS information outside the financial statements enhancing (as it reduces duplication), or detracting from (as it could make the financial statements fragmented), the understandability of the financial statements as a whole. | Standards to be disclosed outside the financial statements if the information meets the following requirements:<br>a. it is disclosed within the entity's annual report;<br>b. its disclosure 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<br>c. it is clearly identified and incorporated in the financial statements by means of a cross-reference that is made in the financial statements.<br>The Board proposes to develop further criteria as to what constitutes 'clearly identified' information. |
| **Disclosing non-IFRS information within the financial statements**<br>Some entities include information described as 'non-IFRS' (or similar) in the financial statements, e.g. financial measures such as EBIT and EBITDA, number of units sold per employee, or management's expectations about future sales.<br>While some stakeholders believe that this information enhances the understandability of the financial statements, others are concerned it obscures the information required by IFRS, and its inclusion makes it difficult to identify which information forms part of the financial statements and which has been audited. | **Disclosing non-IFRS information within the financial statements**<br>The Board suggests that a general disclosure standard should not prohibit an entity from including non-IFRS information in the financial statements. Nevertheless, if information is labelled as such, then the entity should:<br>a. clearly identify that information as not being prepared in accordance with the Standards and, if applicable, as unaudited;<br>b. disclose in the financial statements a list of the information labelled as non-IFRS information, together with the unreserved statement of compliance required by IAS 1; and<br>c. explain why the information is useful and why it has been included in the financial statements. In other words, why is it relevant and represents faithfully the economic events that it purports to represent?<br>The Board did not discuss whether it should prohibit specific information from being included in the financial statements, especially if that information is inconsistent with the requirements of the Standards. The Board asks for feedback on this issue in the DP. |

### Observations

**Disclosing IFRS information outside the financial statements**

The term 'annual report' is not currently defined. The Board proposes to define it as 'a single reporting package issued by that entity, typically on an annual basis, that includes the financial statements', with boundaries similar to those described in the International Standard on Auditing (ISA) 720 (Revised).

This definition would apply by analogy to an interim report. The Board believes that limiting the disclosure of information required by the Standards to within the annual report would make the information sufficiently easy to find, and that the information would be available at the same time and for the same duration as the financial statements, thus allaying some of the stakeholders' concerns.

Once again, whether including IFRS information outside the financial statements would make the annual report as a whole 'more understandable' is a matter of judgement.

**Disclosing non-IFRS information within the financial statements**

During deliberation, the Board realised that it would not be operational to prohibit the disclosure of non-IFRS information within the financial statements. This is because the Board observed that there are differing views on what constitutes non-IFRS information. This ranges from 'anything that is not specifically required by the Standards' to 'information that is not necessary to comply with the Standards'.

What constitutes information that is not necessary to comply with the Standards is also subject to interpretation: e.g. where one party believes that a piece of information provides additional information that is relevant to an understanding of the financial statements (which is a required disclosure in terms of IAS 1), another party might consider it redundant as a matter of judgement. Accordingly, as an alternative, the Board suggests requiring specific disclosures if an entity identifies information as non-IFRS information.

## Principles to address specific disclosure concerns expressed by users of financial statements

### Use of performance measures in the financial statements

The Board has a separate research project on Primary Financial Statements. In that project the Board is considering whether changes are necessary to the structure and content of the PFS, including the use of performance measures (referred to as 'alternative performance measures' or 'APMs' in this paper). Accordingly, the Board has limited its discussion on this topic to two issues:

1. whether including EBIT and EBITDA in the statement of financial performance can achieve fair presentation; and
2. whether to provide guidance on the presentation of unusual and infrequently occurring items.

| The problem | Preliminary views |
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| Entities often present APMs in their financial statements (e.g. operating profit, EBITDA, normalised earnings), and label expenses as 'infrequent' or 'non-recurring'. While most users acknowledge that entities should be given the flexibility to present APMs as long as they are not misleading, and are a faithful representation of the entity's performance, others question their usefulness for the following reasons:<br>• The financial statements often do not explain how the subtotals are calculated;<br>• The method of calculation is not always consistent across periods and/or entities;<br>• The performance measures sometimes present a favourable picture of the entity, and are sometimes presented more prominently than the measures required by the Standards, which may mislead users;<br>• Transactions identified as 'infrequent' or 'non-recurring' occur all too often to justify the terms used;<br>• Expenses are classified as 'infrequent' but income is rarely classified as such, thus presenting a biased view of the entity's performance. | The Board suggests that a general disclosure standard should not prohibit the presentation of APMs.<br>Nevertheless, if an entity presents APMs, then they should meet the following criteria in order to achieve fair presentation. The APMs should be:<br>• displayed with equal or less prominence than the totals/subtotals required by the Standards;<br>• reconciled to the most directly comparable measures specified in the Standards;<br>• neutral, free from error and clearly labelled so they are not misleading;<br>• classified, measured and presented consistently over time;<br>• identified as to whether they form part of the financial statements and whether they have been audited; and<br>• accompanied by certain explanations and comparative information.<br>The Board is also considering:<br>• clarifying that the presentation of EBIT and EBITDA could achieve fair presentation in the following circumstances:<br>– an entity could present EBITDA only if it classifies expenses by nature; and<br>– an entity could present EBIT regardless of whether it classifies expenses by nature or by function.<br>• developing requirements for the presentation of unusual or infrequently occurring items in the statement of financial performance |

**Observation**

Since EBITDA excludes expenses by *nature* (e.g. depreciation and amortisation), the Board believes that its presentation would be inconsistent with an analysis of expenses by *function*.

'Unusual' or 'infrequently occurring' items have been a conundrum for standard setters for a long time. The use of the term 'extraordinary' items was prohibited by the Board in 2002. At the time, extraordinary items were defined as 'transactions that… are not expected to recur frequently or regularly'. The Board acknowledges that users need information that helps them analyse performance, and that separating items that mask underlying performance can be helpful. However, this is an issue the IASB struggled with in its abandoned project on financial statement presentation. The Board's thinking on this subject will also have to fit into its PFS project.

## Disclosure of accounting policies

### The problem

Users find it difficult to identify which accounting policies are important to the financial statements. Symptoms of the problem include:

- The accounting policy section of the financial statements is often very long and mainly includes generic wording copied verbatim from the Standards that are not tailored to show how they apply to the entity's specific circumstances.
- The financial statements do not distinguish between accounting policies that require significant judgements or that allow entities a choice (e.g. measuring investment properties at cost or at fair value) and those that offer no/ little discretion to an entity when applying the requirements.

Entities often present APMs in their financial statements (e.g. operating profit, EBITDA, normalised earnings), and label expenses as 'infrequent' or 'non-recurring'.

While most users acknowledge that entities should be given the flexibility to present APMs as long as they are not misleading, and are a faithful representation of the entity's performance, others question their usefulness for the following reasons:

- The financial statements often do not explain how the subtotals are calculated;
- The method of calculation is not always consistent across periods and/or entities;
- The performance measures sometimes present a favourable picture of the entity, and are sometimes presented more prominently than the measures required by the Standards, which may mislead users;
- Transactions identified as 'infrequent' or 'non-recurring' occur all too often to justify the terms used;

Expenses are classified as 'infrequent' but income is rarely classified as such, thus presenting a biased view of the entity's performance.

### Preliminary views

The Board is considering developing guidance to clarify:

- what makes an accounting policy significant;
- what information should be disclosed about a significant accounting policy; and
- where should the accounting policies be located in the financial statements?

**What makes an accounting policy significant?**

The Board suggests that a general disclosure standard should:

- explain the objective of providing accounting policy disclosures, which is to provide an entity-specific description of those accounting policies that:
  a. have been applied by the entity in preparing and presenting its financial statements (i.e. those that were not used should not be disclosed); and
  b. are necessary for an understanding of the financial statements.

  The Board has preliminarily identified two categories of accounting policies that are necessary for an understanding of the financial statements as follows:

  Category 1 – accounting policies that are always necessary for understanding information in the financial statements and relate to material items, transactions or events. These include:

  c. those that have changed during a reporting period because the entity either was required to change the policies or chose to do so;
  d. those selected from alternatives allowed in the Standards;
  e. those developed in accordance with IAS 8 in the absence of a Standard that specifically applies; and
  f. those for which an entity is required to make significant judgements or assumptions.

  Category 2 – accounting policies that are not in category 1, but which relate to items, transactions or

| The problem | Preliminary views |
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| | events that are material to the financial statements.<br>• explain that an entity is not required to disclose any other accounting policies used that do not fall within categories 1 or 2 above (i.e. category 3). However, these accounting policies may still be disclosed to the extent that they do not obscure material information or make the financial statements more difficult to understand.<br>**What information should be disclosed about a significant accounting policy?**<br>This requires an assessment of what information is material and thus should be disclosed. The Board will shortly publish a Materiality Practice Statement that contains non-mandatory guidance aimed at helping entities judge whether information is material.<br>Furthermore, the Board reiterates the need for an entity to show how it has applied a significant accounting policy to *its own circumstances*, e.g. instead of merely stating 'revenue is recognised when the risks and rewards pass to the buyer', the entity should describe the actual event(s) that signifies when risks and rewards pass to the buyer.<br>**Where should the accounting policies be located in the financial statements?**<br>The Board suggests providing the following guidance either in a general disclosure standard or in non-mandatory guidance (or a combination of both):<br>• the alternatives for locating accounting policy disclosures (e.g. all in a single accounting policy note; to be shown together with the related detailed disclosures; or a combination of both), clearly distinguishing between category 1, 2 and 3 accounting policies; and<br>• an explanation that entities should disclose significant judgements and assumptions adjacent to the related accounting policies, unless another organisation is more appropriate. |

### Centralised disclosure objectives

| The problem | Preliminary views |
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| The lack of clear disclosure objectives in the Standards makes is difficult for preparers to understand the purpose of the disclosure requirements, which in turn hinders their ability to decide what information should be disclosed. | The Board is considering developing centralised disclosure objectives in a general disclosure standard. The Board believes that having centralised objectives, as opposed to developing them in isolation for each Standard, could help them develop more unified disclosure objectives and requirements for all the Standards.<br>Although the Board refers to 'centralised' disclosure objectives, it is still considering whether they should be included in a single disclosure standard, or to group them into several disclosure standards, each covering a group of related topics, e.g. an approach similar to IFRS 12, which covers the disclosure requirements of IFRS 10, IFRS 11 and IAS 28. |

### Redrafting disclosure requirements

The IASB has been assessing different ways it could draft disclosure requirements. The DP includes examples of how revised objectives, sub-objectives and specific requirements might be expressed. The work has been undertaken for the IASB by the staff of the New Zealand Accounting Standards Board.

Currently, most Standards lack clear disclosure objectives, making it difficult to work out what purpose the disclosures are trying to meet. And many have long lists of disclosure requirements. The approach being developed is designed to provide clearer objectives and requirements that are more consistent across Standards. The DP includes two examples of how current Standards could be rewritten using this approach – IAS 16 *Property, Plant and Equipment* and IFRS 3 *Business Combinations*. The IASB is not proposing amendments to these Standards. They selected Standards that people would be familiar with so that the focus of the discussion would be on how the disclosure requirements are written.

Of particular interest is a two tier approach to disclosure requirements, with the amount of information an investor should expect to see about a particular subject linked to the relative importance of an item or transaction to the reporting entity and the extent of judgement required in accounting for the item or transaction.

### Next steps

Comments to the DP are due by 2 October 2017. The Board will consider the comments received before deciding whether to develop an exposure draft proposing to amend or replace parts of IAS 1. The Board will also take this feedback into account when considering the other Disclosure Initiative projects and related projects.

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