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Accounting Standards Committee of Germany

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Berlin, 22. August 2017

DRAFT

Dear Hans,

**IASB Discussion Paper DP/2017/1 *Disclosure Initiative - Principles of Disclosure***

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on the IASB Discussion Paper DP/2017/1 (herein referred to as 'DP'). We appreciate the opportunity to comment on the DP and provide our response to the questions of the DP in the Appendix of this letter.

Notwithstanding our detailed responses to the DP questions, we would like to emphasize the following issues regarding the IASB's views expressed in the DP:

- We agree with the description of the disclosure problem as discussed in the initial section of the DP. Importantly, we think that not all of the highlighted factors contributing to the disclosure problem can be addressed by IASB alone. Other parties involved in the preparation and audit of IFRS financial statements as well as enforcement authorities also need to rethink their role and their efforts for setting the right incentives to overcome the shortfalls regarding effective and efficient communication of financial information.
- Regarding the proposed principles of effective communication in the DP, we believe that they can be helpful if they form part of mandatory guidance in a general disclosure standard. Nonetheless, we agree with those views highlighted in the DP that the way the IASB developed note disclosure guidance in the past contributed to the disclosure problem to a large degree. Hence, we do not believe that relying only on more prominent principles of effective communication in a general disclosure standard will address the main issues with current notes disclosure guidance. We think that the IASB must inevitably undertake a comprehensive standards-level review of existing guidance for note disclosures in a holistic manner. In this context, we think the proposals in the DP for developing a set of centralised disclosure objectives is a step in the right direction. Once those centralised disclosure objectives are defined, they should form the foundation for such a comprehensive and holistic standards-level review of existing disclosure requirements.
- Furthermore, and in the context of the proposed principles of effective communication, we think that the IASB should clarify that ensuring comparability of financial information *among*

*entities* should not be a preparer's responsibility of financial statements (but the responsibility of the standard-setter when developing disclosure guidance). Additionally, we believe that comparability of information *among entities* is of lower importance for note disclosures in comparison to the primary financial statements. In our view, notes disclosures mainly serve the purpose of making the summarised information in primary financial statements more understandable. Therefore, note disclosure requires a higher degree of flexibility to provide relevant information.

- With reference to the discussion about non-IFRS information in the DP, we share the IASB's preliminary view of not prohibiting such information in IFRS financial statements. However, we think that there is a limit in that the inclusion of non-IFRS information should make IFRS financial statements more useful to the user. In our view, non-IFRS information that is inconsistent with IFRS measurement or recognition guidance is, generally, not useful. In other words, non-IFRS information that is inconsistent with IFRS information should not be part of IFRS financial statements.

If you would like to discuss our comments further, please do not hesitate to contact Holger Obst or me.

Yours sincerely,

*Andreas Barckow*

President

**Appendix – Answers to the questions of the discussion paper**

## SECTION 1—OVERVIEW OF THE 'DISCLOSURE PROBLEM' AND THE OBJECTIVE OF THIS PROJECT

**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?

***Response to (a)***

We agree with the description of the disclosure problem for the reasons as set out in the DP.

***Response to (b)***

We think the development of disclosure principles – and a set of centralised disclosure objectives – in a general disclosure standard could only ever be a starting point for addressing the disclosure problem. In our view, the IASB must undertake a full standards-level review of existing disclosure requirements in all IFRSs based on a centralized set of disclosure objectives as discussed in Section 7 of the DP. Without such a comprehensive review the IASB will not be able to tackle the part that it is responsible for in addressing the disclosure problem. We also refer to our response to question 15.

**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?

In our view, the DP starts from the assumption that IFRS financial statements are paper-based or have the restriction of paper-based formatting. However, we believe that digitalisation of the communication process transforms the way users consume financial information. We understand that the IASB is of the view that digital reporting does not change the content of information, as content is driven by the objective for financial reporting and not by the way information is communicated. Nonetheless, we think that the discussion is missing to what extent digital reporting can have an impact on effective communication and whether some principles only apply in a paper-based communication world (e.g. presentation, formatting, and placement). Therefore, we think the IASB needs to reconsider its suggested disclosure principles and guidance, particularly those regarding cross-referencing, if applied in and to a digital reporting environment.

## SECTION 2—PRINCIPLES OF EFFECTIVE COMMUNICATION

**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.

***Response to (a)***

Generally, we agree with the IASB proposals regarding the set of principles of effective communication. IAS 1 already provides some guidance for effective communication; however, in our view, the proposed principles as drafted in the DP could make this guidance clearer for preparers and a more prominent reminder regarding the way information should be disclosed in financial statements. Nonetheless, we think that only adding those principles will not address the main disclosure issues raised by our constituents. These issues need to be addressed through a comprehensive review of the specific requirements and developing useful disclosure objectives in individual standards.

***Response to (b)***

We have concerns about the way the comparability principle is drafted in the DP. In paragraph 2.6(b) of the DP the IASB states that preparers should provide information "in a way that optimises comparability among entities and across reporting periods without compromising the usefulness of the information". We think that achieving a certain level of comparability among entities as regards information in financial statements is the prime task of the standard setter and not preparers. If comparability among entities had to be ensured by preparers, the standard setter would need to provide guidance on how such an objective could be achieved. For example, it is unclear as to how a preparer should select the peers for making information comparable. Further, the more emphasis is placed on comparability of information among entities, the higher the risk that preparers provide only general (and potentially boiler-plate) information that is not the most useful information that could have been provided.

***Response to (c)***

We agree with the IASB's view that the principles of effective communication should be prescribed in a general disclosure standard and not issued as non-mandatory guidance.

***Response to (d)***

We concur with the view that guidance on the use of formatting in the financial statements should not be part of mandatory guidance. We wish to highlight that IFRSs already use formatting guidance for specific disclosure requirements in individual standards, e.g. the use of tabular formats. Thus, the IASB should consider incorporating any guidance on the use of formatting into the Conceptual Framework for it to be used when developing disclosure requirements, including the way the information should be typically formatted by preparers.

## SECTION 3—ROLES OF THE PRIMARY FINANCIAL STATEMENTS AND THE NOTES

**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?

Generally, we agree with the proposals. In our view, the proposals reflect the common understanding and terminology already used in practice. However, it remains unclear to what extent the proposed definition of the role of the primary financial statements might impact standard setting for the primary financial statements. In particular, it remains unclear to us, whether the focus on comparability in the definition of the role of the primary financial statements will result in a more rigid structure of minimum line items for the primary financial statements.

Additionally, we think the IASB should clarify that comparability of information among entities disclosed in the notes has a lower priority compared to the summary information disclosed in the primary financial statements. This would be in line with the recent amendment to IAS 1 published in 2015, which clarified that prepares have a certain degree of flexibility when structuring note disclosures in order to make information more understandable and to 'tell their story'.

Despite our support on the IASB's preliminary views regarding Question 4, we are concerned that the distinction between primary financial statements vs. notes could result in a general misunderstanding of there being different quality levels for information that is disclosed in the primary financial statements vs. the notes. Therefore, we recommend the IASB make clear that the quality of information in the notes, especially the level of assurance, shall not to be deemed different compared to the quality of information that is disclosed as part of the primary financial statements.

Lastly, for the reasons described in the DP, we agree with the IASB's preliminary view not to prescribe the meanings of 'present' and 'disclose' and to specify the intended location as either 'in the primary financial statements' or 'in the notes'.

## SECTION 4—LOCATION OF INFORMATION

**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)?

***Response to (a)***

In our view, the developed cross-referencing principle can be useful and helps to clarify whether the exceptions in existing standards that already permit placement of information 'outside' financial statements for specific disclosure requirements (such as the risk disclosures required by IFRS 7) can be applied to other disclosure requirements, too.

When considering the proposed requirements in paragraphs 4.9(a)-(c), we believe that the guidance for scenarios to which criterion 4.9(b) is intended to apply could be improved and made clearer. We think that the link between the criterion and its description in paragraph 4.13(a)-(b) of the DP could be described more prominently as part of the principle.

[t.b.d. criterion of paragraph 4.9(a) in the DP to place information only in the annual report]

***Response to (b)***

[t.b.d.]

**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?

We only partially agree with the IASB's preliminary view. We share similar concerns as described in paragraph 4.31 of the DP regarding the use of non-IFRS information as part of financial statements that are prepared in accordance with IFRS. In our view, an entity has always a range of options to communicate non-IFRS information, e.g. reporting it separately but as part of the entity's annual report or in other parts of the investor relations communication package. Usually, non-IFRS information does not share the same quality, since in most cases the information is not audited and might not be available when comparing financial performance and position of an entity over time.

Therefore, we think that non-IFRS information as defined in the DP should be more clearly limited for inclusion in IFRS financial statements. That being said, we would not go as far as to prohibit such non-IFRS information; however, it needs to be evident that including non-IFRS information makes the IFRS financial statements more useful to users. Especially, non-IFRS information should not be used by preparers to present an alternative view regarding the financial position and the financial performance of an entity. Thus, non-IFRS information that is inconsistent with IFRS recognition and measurement guidance should not be considered useful for users of IFRS financial statements and be prohibited. Further, IAS 1 guidance already includes tools an entity may use if it considers that the application of IFRS recognition and measurement guidance would not result in a fair presentation. Thus, we believe that disclosure guidance regarding the inclusion of non-IFRS information should be defined in a more restrictive manner compared to the DP proposals. We also refer to our response to question 7 below.

In case non-IFRS information are included in IFRS financial statements, we agree with the proposed requirements in paragraphs 4.38(a) and (c). However, we do not agree with the requirement in paragraph 4.38(b) to provide a list of such information, together with the statement of compliance with IFRS Standards. In our view, such a list is redundant because paragraph 4.38(a) already requires to identify non-IFRS information clearly as not being prepared in accordance with IFRS Standards and, if applicable, as unaudited.

**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?

Generally, all information included in IFRS financial statements must be useful to users of financial statements, i.e. information must be relevant and represented fairly. In our view, it is highly questionable to what extent information can be useful if it is inconsistent with IFRS Standards, specifically with applicable IFRS recognition and measurement guidance. Therefore, such information should not be included in IFRS financial statements. As explained above, the entity has suitable alternatives to report such information outside of IFRS financial statements.

We also considered the scenario described in paragraph 4.39(a) in which an entity would be *legally* required to report information that is inconsistent with recognition and measurement guidance of applicable IFRS Standards. While this scenario is undesirable, we think the requirements in paragraphs 4.38(a) and (c) should also apply to such information. Hence, the entity would explain that it is *legally* obliged to report that information inside the IFRS financial statements.

SECTION 5—USE OF PERFORMANCE MEASURES IN THE FINANCIAL STATEMENTS

**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:
    - o the presentation of an EBITDA subtotal if an entity uses the nature of expense method; and
    - o 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.

***Response to (a)***

We agree with the IASB's preliminary views. We think that users of financial statements would benefit from greater comparability of information among entities if more standardisation was available as regards the presentation of unusual or infrequently occurring items. The current lack of IFRS guidance – and the explicit prohibition of labelling items as 'extraordinary' – results in a variety of different approaches for reporting and depicting unusual or infrequently occurring transactions or events in IFRS financial statements. Ideally, the proposal would push back the reporting of non-IFRS 'adjusted' or 'underlying' alternative performance measures.

In our view, classification of whether an item is 'unusual' or 'occurring infrequently' will inevitably remain judgmental to a certain degree. Thus, we expect the IASB to set limits to what extent an item is not deemed unusual or occurring infrequently. Furthermore, concerns about the misuse by an entity should be addressed with a sufficient level of disaggregation and narrative requirements of those amounts presented as unusual or infrequently occurring. In other words, the presentation requirements must ensure that a user of financial statements can readjust the financial effects that he – in contrast to the reporting entity – does not consider unusual or occurring infrequently.

Regarding the presentation of EBITDA and EBIT, we agree with the IASB's preliminary views for the reasons set out in the DP. Nonetheless, we expect that the IASB would also address, in its project on Primary Financial Statements, the cross-cutting implications of presenting EBITDA or EBIT as regards the classification of cash flows in the statement of cash flows and other potential cross-cutting issues within the primary financial statements.

***Response to (b)***

We think that guidance about unusual and infrequently occurring items should limit the terminology to be used by preparers for depicting those items in the primary financial statements. The variety of terms currently used in practice could be considered as reflecting the absence of guidance in IFRSs and the specific prohibition to label items as 'extraordinary' in accordance with IAS 1.

***Response to (c)***

We suggest the IASB also consider how the other primary financial statements, particularly the statement of financial position and the statement of cash flows, would be affected regarding the depiction of unusual or infrequently occurring transactions and events. In our view, presentation guidance should not only refer to items of the statement of financial performance.

**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?

We agree with the IASB's preliminary view. However, we think the IASB should not develop two sets of requirements regarding the fair presentation of performance measures and presentation of non-IFRS information as discussed in Section 4 of the DP. We think that the requirements as listed in paragraph 5.34 follow from the requirements listed in paragraph 4.38 of the DP.

Additionally, we note that the DP uses a narrower scope to define the term 'performance measure' compared to the description of performance measure used in the IFRS Practice Statement Management Commentary and the general use of this term in practice. In our view, performance measures can also contain quantitative information about the financial position and financial performance of the entity that is not reconcilable to amounts recognised in the primary financial statements. Thus, we think it is important to reconsider the scope for the definition of the term 'performance measure' and to emphasize the fact that a reconciliation to IFRS measures may not always be possible, depending on the nature of the reported performance measure.

SECTION 6—DISCLOSURE OF ACCOUNTING POLICIES

**Question 10**

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?

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.

***Response to (a)***

We share the IASB's preliminary views regarding the requirements on determining which accounting policies to disclose in IFRS financial statements and to include that guidance as part of a general disclosure standard. However, it is not clear to us whether the requirements only apply to 'significant' accounting policies as required by IAS 1 or would also apply to disclosure of accounting policies specifically required by some IFRSs. Therefore, more clarification is necessary regarding the link between the general requirement of significant accounting policies in IAS 1 and specific disclosure requirements about accounting policies in other IFRSs.

***Response to (b)***

We agree with the IASB's preliminary view and think that such guidance should be mandatory and, therefore, be included in a general disclosure standard.

## SECTION 7—CENTRALISED DISCLOSURE OBJECTIVES

**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?

Generally, we agree with the IASB's preliminary views. Understanding the disclosure objectives helps preparers to make better judgement regarding the materiality of information. We think that all other – more granular – disclosure objectives and derived disclosure requirements in specific IFRSs should be linked clearly to those centralised disclosure objectives.

Furthermore, we think that centralised disclosure objectives will play a key role for the IASB regarding the development and review of disclosure requirements and form an essential part of a disclosure framework. Therefore, those centralized disclosure objectives should not only be part of mandatory IFRS guidance for preparers, but should also have their prominent place within the Conceptual Framework.

**Kommentar [FG1]:** Ist das nicht ein Widerspruch zur Antwort zu Q1(b)? Dort sagen wir das diese in einem Disclosure Standard enthalten sein sollen.

**HO:** Das sehe ich nicht unbedingt als Widerspruch, da sowohl für den IASB, als auch für den Ersteller die Zielsetzung(en) für geforderte Anhangangaben wichtig sind. Das ist m.E. auch die aktuelle Argumentationslinie vom IASB, warum man die Zielsetzungen im Rahmenkonzept nicht braucht (weil sie ja dann schon im Standard stehen würden). Ich halte diese Argumentation aber für zu schwach, weil es für fast alle Bereiche des Rahmenkonzepts zutrifft. Zudem sollte ein Rahmenkonzept für sich allein stehen und nicht die Existenz von Standards zugrunde legen.

In this way, it is also evident that the IASB should have a clear view what those centralized disclosure objectives are before undertaking the standards-level review of disclosure requirements in specific IFRSs.

**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.

Methods A and B are in the early stages of development and have not been discussed in detail by the Board. We will consider the feedback received on this Discussion Paper about how centralised disclosure objectives might best be developed before developing them further.

We agree with the description regarding the benefits and potential disadvantages of either method in the DP.

In our view, Method B might be more in line with the way many entities already communicate other financial information to (potential) investors. Method B would also be very similar to the way additional financial information is communicated in the entity's group management report in our jurisdiction. Thus, Method B may provide a better ground for 'telling the story' in financial statements compared to Method A, which appears to be a more compliance-focused approach.

Additionally, Method B would require the IASB to move away from the past process of developing disclosures in isolation. In other words, Method B may help the IASB to reconsider already existing disclosure requirements and, therefore, avoid the silo thinking with just adding new disclosure requirements in new or revised standards that we've often seen in the past. In other words, a holistic approach for disclosure requirements and their objectives appears to be more in line with Method B, because it does not focus on individual items or transactions.

However, Method B would be a less convincing approach if it was only applied to note disclosure and not to the primary financial statements. For example, disclosing information about the entity's operating assets and the entity's operating result in the notes would not be intuitive to users if the information was not also depicted as line items in the primary financial statements.

**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?

Generally, we think that the question regarding the location of disclosure objectives and the requirements derived from them is not of high importance.

In our view, and as highlighted in the DP, Method B would probably work best if related disclosures are bundled in a single Standard, or set of Standards. However, reconsidering the location of disclosure guidance would trigger a bigger question about the overall structure of other IFRS guidance, e.g. recognition and measurement guidance. It would require discussion about a kind of codification project.

## SECTION 8—NEW ZEALAND ACCOUNTING STANDARDS BOARD STAFF'S APPROACH TO DRAFTING DISCLOSURE REQUIREMENTS IN IFRS STANDARDS

**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).

Generally, we agree with the aim of making disclosure objectives more specific such that they would help prepares in applying materiality judgement. However, it is unclear to us how a two-tier (or even multiple-tier) disclosure approach, as proposed by the NZASB staff, should work in practice. We understand the underlying idea of defining a minimum set of notes disclosure as a core set of information and a second set of information resulting from specific requirements for additional information. However, such an approach, where the dividing line between the two tiers of disclosure requirements is the "relative importance of information", would imply that the requirements in different disclosure tiers also imply a different degree of materiality. So far, the IASB has not developed different degrees of materiality regarding financial information in its materiality project and we foresee difficulties in doing so, especially taking into account the significant differences between entities and industries.

Furthermore, such an approach could also encourage two-dimensional disclosure thinking by preparers. If the item or transaction was considered to be of relative importance to the reporting entity, the entity would provide information for all requirements (tier 1 and tier 2); conversely, if an item or a transaction was not considered to be of relative importance to the reporting entity, it would only provide information for tier 1 requirements.

In conclusion, we are not completely convinced by the NZASB staff's approach as described in the DP, including the redraft examples.

An alternative to the NZASB staff approach could be (a) to define only a core set of note disclosure requirements in light of achieving comparability of IFRS financial statements among entities and (b) additional, but more principle-based guidance regarding additional information that is relevant to an understanding of the primary financial statements (similar to current guidance in paragraph 122(c) of IAS 1). On the other hand, such an approach may give rise to concerns that not all relevant information will be reported by the entity in the absence of specific requirements.

**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.

In our view, the way the IASB currently develops and drafts IFRS Standards contributes to the disclosure problem. Beside the issues described in paragraph 8.4 of the DP, we also think that the issues described in paragraph 7.7 of the DP, i.e. cross-cutting issues such as inconsistency of wording and lack of consideration for the relationships between the disclosure requirements in different Standards, contribute to the problem. Since disclosure requirements are developed in isolation and not on a holistic basis, it appears that disclosure requirements from specific IFRSs are also considered in isolation by prepares as a consequence. For example, some accounting policy disclosures are disclosed in accordance with the general requirements of IAS 1 to report significant accounting policies, yet the same information is more or less repeated in other places of the notes to address the specific disclosure requirements as promulgated by specific IFRSs. We think the development and review process regarding disclosures should be considered in a more holistic manner.

It goes without saying that drafting disclosure requirements is not the only cause of the disclosure problem. In our view, a fresh start is equally overdue as regards the way preparers, enforcement bodies, and regulators address the application of materiality judgement in context of note disclosure. We concur with the description provided in paragraph 1.7 that preparers often consider that it is easier to use a checklist approach than to apply materiality judgement because of time pressures, and because following a mechanical approach means that their judgement is less likely to be challenged by auditors, regulators and users of their financial statements. To achieve such a mind-shift, a critical assessment is needed as to what extent (economic) incentives currently in place are inappropriate and how those incentives could be changed. This would not be within the scope of IASB's work efforts.

**Appendix – Answers to the EFRAG questions**

## SECTION 1—OVERVIEW OF THE 'DISCLOSURE PROBLEM' AND THE OBJECTIVE OF THIS PROJECT

a) Do you agree with EFRAG's concern that the description of the disclosure problem in the IASB DP does not give sufficient emphasis to the problem of disclosure overload?

b) Do you have any other concerns related to the description of the disclosure problem beyond those identified by EFRAG?

c) Do you consider that the proposals in the IASB DP (including EFRAG's suggestions, where applicable) will help in addressing the disclosure problem? Why or why not? Please explain.

***Response to (a) and (b)***

We think the DP adequately documents the factors that contribute to the disclosure problem and we do not share EFRAG's view that the DP does not give sufficient emphasis to the problem of disclosure overload.

***Response to (c)***

We think the proposals in the DP will help to address parts of the disclosure problem. Nonetheless, we highlight in our response to questions 1, 2, and 15 of the DP that the IASB must undertake a comprehensive standards-level review as we share concerns regarding the way the IASB developed and drafted note disclosures in the past.

Importantly, we also believe that not all factors identified as contributing to the disclosure problem can be addressed by the IASB's alone. We think that other stakeholders have an important role to play in addressing the disclosure problem. Especially, we think a mind-shift is necessary regarding the way preparers, enforcement bodies and regulators consider note disclosure in financial statements and the importance of materiality judgement.

## SECTION 2—PRINCIPLES OF EFFECTIVE COMMUNICATION

a) Do you agree with EFRAG's initial assessment that additional non-mandatory guidance on effective communication will not bring substantial further insights or benefits? Why or why not?

b) Do you agree with EFRAG's initial assessment that further work is needed from the IASB to determine whether some of these principles could be developed into requirements to be included in a general disclosure standard or carried forward in illustrative examples or implementation guidance accompanying but not forming part of a standard?

We concur with the IASB's view that the proposed principles regarding effective communication should be part of mandatory guidance. In our view, the principles of effective communication are a helpful reminder how preparers can maximize the qualitative characteristics (comparability, verifiability, timeliness, and understandability) that enhance the usefulness of financial information that is relevant and faithfully represented. Similar to the Conceptual Framework guidance regarding the enhancing qualitative characteristics of financial information, the DP discussion highlights that there is a trade-off between some of these principles when preparing its financial statements. Therefore, we think it would be difficult to transform those principles into more specific requirements in a general disclosure standard. Nonetheless, we think that the IASB would need to develop specific requirements in IFRSs if there are clear views as to how specific information should be communicated in the most effective manner to users of financial statements. For example, for specific note disclosures, the IASB would still need to consider whether the information would be reported better together with other information in a single place or in tabular format.

We also agree with the IASB's view that guidance about formatting financial information should not be part of mandatory guidance for preparers. We think that guidance on formatting should be contained in the Conceptual Framework to help the IASB in developing specific disclosure requirements.

## SECTION 4—LOCATION OF INFORMATION

a) Do you agree with EFRAG assessment that more work is needed to assess the issues associated with the use of cross-references? In what circumstances do you think cross-references should be used?

b) Is the use of cross-referencing, i.e. including IFRS information in the financial statements by cross-reference, common in your jurisdiction? If yes, for what types of information? Please explain.

c) Do you consider that cross-referencing should be allowed in a broader set of circumstances than in current IFRS Standards? Please explain what would in your view be the appropriate conditions.

***Response to (a)***

We do not think that further work is necessary to explore the principle of cross-referencing. The principle for making cross-references is clearly described and based on the objective to maximise the overall understandability of financial reporting. As explained in the DP, there are mainly two circumstances when cross-referencing could improve the understandability of communicating financial information:

(1) making financial reporting more concise by avoiding duplication of information; and

(2) combining related information in a single place

As with all principle-based guidance, judgement is necessary regarding the application of the proposed cross-referencing principle. In our view, the proposed cross-referencing principle would be considered if the improvements to understandability were substantial.

***Response to (b)***

The use of cross-referencing is not unusual in our jurisdiction. For example, an entity is eligible to cross-reference specific (group) management report disclosures if these are already part of note disclosures in the (consolidated) financial statements. However, different from the principle of cross-referencing proposed in the DP, cross-referencing in our jurisdiction is only used in order to avoid duplication of information (and not for combining related information together in one place).

***Response to (c)***

[t.b.d.]

## SECTION 5—USE OF PERFORMANCE MEASURES IN THE FINANCIAL STATEMENTS

Do you agree with EFRAG's tentative view that providing guidance on unusual or infrequently occurring items may be helpful, but the IASB should consider more broadly what adjustments are made to performance reporting? If yes, what other issues or requirements the IASB should consider? Please explain.

We agree with the IASB's preliminary view to provide guidance regarding unusual or infrequently occurring transactions or events within the statement of financial performance. However, we think such guidance is also necessary regarding the related depiction of those events or transactions in the statement of cash flows, the statement of financial performance, and corresponding note disclosures.

At this stage, we do not see other aspects regarding changes to the way an entity reports performance in the primary financial statements. This discussion is subject to the other ongoing IASB project on Primary Financial Statements.

## SECTION 6—DISCLOSURE OF ACCOUNTING POLICIES

Do you have any particular views on the extent to which entities should be required to disclose accounting policies referred to as Category 2 in paragraph 96(b) above? Please explain your views.

[t.b.d.]