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IFRS Developments

Disclosure Initiative – Principles of Disclosure

What you need to know

- The IASB's *Disclosure Initiative* consists of research and implementation projects that address how the effectiveness of disclosures in IFRS financial statements can be improved.
- The IASB issued the DP to gather feedback on "the disclosure problem" and its preliminary views on how to address it.
- The DP sets out disclosure principles in several areas.
- Comments on the proposals are due by 2 October 2017.

Highlights

On 31 March 2017, the International Accounting Standards Board (IASB or Board) issued the discussion paper, *Disclosure Initiative—Principles of Disclosure* (DP). The *Principles of Disclosure* project is one of four that make up the *Disclosure Initiative*. The DP seeks feedback on disclosure issues identified by the Board and on its preliminary views on how to address them.

The Disclosure Initiative

In an attempt to seek ways to enhance communication in financial reporting, the IASB has made *Better Communication in Financial Reporting* a central theme of its agenda for 2017 to 2021. The *Disclosure Initiative* aims to address how the effectiveness of disclosures in IFRS financial statements can be improved. In addition to the *Principles of Disclosure* project, the other three projects are, as follows:

- *Materiality* – The IASB is developing clarifications on the definition and application of materiality.
- *Materiality Practice Statement* – In 2015, the IASB published an exposure draft of a Practice Statement on materiality. The final Statement is expected within the next few months and will look at the general characteristics of materiality and provide guidance on making judgements about materiality when presenting and disclosing information in financial statements.
- *Standards-level review of disclosures* - This project is to develop a drafting guide for the Board's use when setting disclosure requirements in new and amended standards. Disclosure requirements in existing standards may be reconsidered to improve disclosure effectiveness.

The following two projects have already been completed as part of the initiative:

- Narrow-scope amendments to IAS 1 *Presentation of Financial Statements* – In 2014 the IASB made certain amendments to help entities apply judgement when preparing their financial statements.

Building a better working world

- Amendments to IAS 7 *Statement of Cash Flows* – The amendments issued in January 2016 require disclosure of changes in liabilities arising from financing activities.

In addition to the *Disclosure Initiative*, the IASB is examining possible changes to the structure and content of primary financial statements in its *Primary Financial Statements* project. The Board is also revising the *Conceptual Framework for Financial Reporting (the Conceptual Framework)* in a separate project in order to improve financial reporting by providing a more complete, clear and updated set of concepts.

The "disclosure problem"

Based on its research activities and a *Discussion Forum on Disclosures in Finanical Reporting* in January 2013, the IASB observed three main concerns about disclosures in the financial statements ("the disclosure problem"):

- Not enough relevent information is being provided in all circumstances – this can lead to inappropriate investing or lending decisions
- Irrelevant information is being disclosed – which can obscure relevant information, reduce understandability and add unnecessary costs to the preparation of financial statements
- Relevant information that is provided is not always effectively communicated – this can reduce understandability of financial statements

The IASB considers difficulty in applying judgement about which information to disclose in financial statements and determining the most effective way to organise and communicate the information to be the main causes of the disclosure problem. These difficulties are often behavioral. Some entities, auditors and regulators seem to approach the finanical statements primarly as compliance documents, rather than as a tool to facilitate communication with users. The disclosure requirements in IFRS are sometimes applied mechanically, and some entities tend to use the requirements as a checklist without applying judgement to determine what is relevant to users.

The Discussion Paper

The DP seeks to identify and better understand the disclosure issues and develop a set of new, or clarify existing, disclosure principles. It focuses on the general disclosure requirements in IAS 1 and concepts being developed in the project to revise the existing *Conceptual Framework*. As such, the DP is relevant to both users and preparers of finanical statements.

The DP considers the development of principles in the following areas:

Principles of effective communication

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Principles on where to disclose information	
Role of the primary financial statements and of the notes	Location of information

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Principles to address specific disclosure concerns expressed by users of financial statements	
Use of performance measure	Disclosure of accounting policies

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Principles to improve disclosure objectives and requirements	
Centralised disclosure objectives	Drafting disclosure requirements

We discuss each of these areas in more detail below:

Principles of effective communication

The DP identifies seven principles to help entities communicate information effectively in the financial statements. The information provided should be:

Entity-specific	Information tailored to an entity's business and specific circumstances rather than generic "boilerplate" language
Clear and simple	No loss of material information and without unnecessarly increasing the length of the financial statements
Organised to highlight important matters	Providing disclosures in an appropriate order and emphasising the important matters
Linked to related information	Highlighting relationships between pieces of information and improving navigation
Free from unnecessary duplication	In different parts of the financial statements or the annual report
Comparable	Easing comparability among entities and across reporting periods without compromising the usefulness of the information
In an appropriate format	Using lists, tables, graphs and charts to increase understandability where appropriate

Principles on where to disclose information

The DP suggests introducing a principle that information necessary to comply with the disclosure requirements of IFRS can be provided outside the financial statements (e.g., in the management report) using cross-references if certain criteria are met. It also seeks feedback on whether entities should be prohibited or restricted from disclosing "non-IFRS information" in its IFRS financial statements. The Board proposes that if non-IFRS financial information is disclosed within the financial statements, entities must clearly identify and explain it.

Principles to address specific disclosure concerns

Performance measures

Entities increasingly use performance measures in their financial statements and other communication with users of the financial statements (e.g., press releases, shareholder presentations, etc.) that are not defined or specified in IFRS, such as earnings before interest, tax, depreciation and amortisation (EBITDA) or adjusted EBITDA (e.g., excluding unusual or infrequently ocurring transactions). While some users support the presentation of performance measures because they can provide helpful insights into how the business is managed, others are concerned that such performance measures may be misleading by presenting a biased view of an entity's financial position and/or performance.

In the DP, the IASB responded to concerns raised by users and proposed that performance measures, if disclosed in the financial statements, should be:

- Displayed with no more prominence than IFRS information
- Reconciled to the most directly comparable IFRS measures
- Clearly labelled and explained (i.e., relevance and purpose of the measure) so it is not misleading
- Neutral, free from error, and consistently measured and presented to enable comparisons to be made over time
- Accompanied by comparative information

Accounting policies

Currently, the predominant practice is to disclose accounting policies in a lengthy note at the beginning of the notes section that does not distinguish between different types of policies. The DP describes three categories of accounting policies:

- Category 1 – the accounting policy relates to material items, transactions or events

  And

  - Has changed from previous period because the entity was required to or did it on a voluntary basis
  - Is selected from alternatives in IFRS
  - Is developed by the entity in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in the absence of an applicable IFRS standard
  - Requires use of significant judgements or assumptions
- Category 2 – relates to material items, transactions or events but is not in Category 1
- Category 3 – includes all other accounting policies used in preparing the financial statements that are not included in Categories 1 or 2

The DP suggests that an entity is only required to disclose accounting policies in Categories 1 and 2. However, it would not prohibit entities from disclosing Category 3 policies provided that relevant information is not obscured. Furthermore, the DP outlines where disclosures of accounting policies and significant judgements and assumptions may be located.

Principles to improve disclosure objectives and requirements

The IASB acknowledges that some standards do not provide clear disclosure objectives, which makes it difficult for entities to identify the purpose of disclosure requirements and decide which information is relevant to disclose. The DP discusses two alternative approaches that may faciliate more tailored disclosures:

1) The development of centralised disclosure objectives

2) The development of a single standard, or set of standards, that cover all disclosures

These two approaches are not conflicting and both may be adopted.

On the first approach, the DP suggests different methods, one that focuses on the types of information, to a great extent similar to the current standards, and one that focuses on an entity's activities. The latter approach would significantly change the way the IASB sets disclosure requirements, and would lead to major changes in how entities apply the requirements.

Next steps

The comment period for the DP ends on 2 October 2017.

How we see it

We encourage stakeholders to provide feedback to the IASB in the form of comment letters, to contribute to a well-grounded and robust discussion of the Principles of Disclosure. Given the importance of the topic, the DP deserves the attention of all relevant parties - preparers, users, auditors and regulators.

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