

## Snapshot: *Disclosure Initiative—Principles of Disclosure*

This Snapshot provides an overview of the Discussion Paper *Disclosure Initiative—Principles of Disclosure* published by the International Accounting Standards Board (the Board) as part of its work on Better Communication in Financial Reporting.

**Project objectives:** To identify disclosure issues and address them by developing new or clarifying existing principles of disclosure in IFRS Standards. The Board aims to:

- help entities apply better judgement and communicate information more effectively;
- improve the effectiveness of disclosures for the primary users of financial statements; and
- provide guidelines for improving disclosure requirements in Standards.

**Project stage:** The Discussion Paper seeks feedback on disclosure issues identified by the Board and on the Board's preliminary views on how to address them.

**Next steps:** The Board will consider comments on the Discussion Paper before deciding whether to develop an Exposure Draft of proposals to amend or replace parts of IAS 1 *Presentation of Financial Statements*.

The feedback received will also inform some of the Board's other projects, including the Primary Financial Statements project and the Standards-level Review of Disclosure project.

**Comment deadline:** 2 October 2017

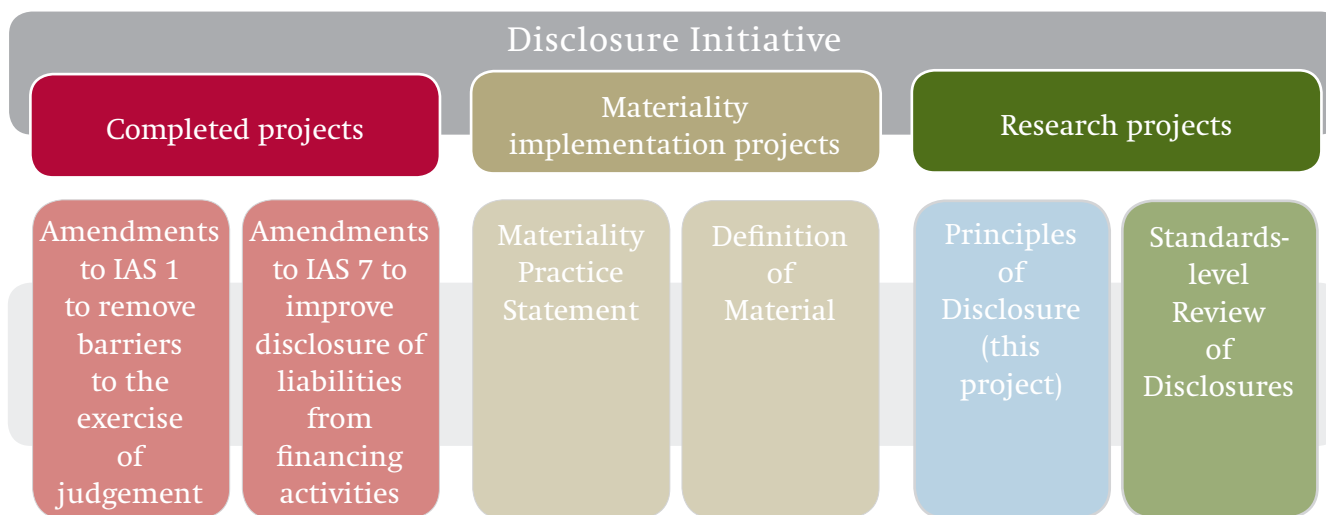
# Background to the Disclosure Initiative

## The Principles of Disclosure is a project in the Board's Disclosure Initiative.

The Board launched its Disclosure Initiative in 2013 to respond to feedback that there is a need to improve the effectiveness of disclosures in financial statements. The Board has already completed two projects as part of this Initiative (see diagram).

The Board currently has four projects in the Disclosure Initiative, including the Principles of Disclosure project. The others are:

- The Materiality Practice Statement project. The Board is finalising a Practice Statement containing non-mandatory guidance to help entities make materiality judgements when preparing IFRS general purpose financial statements. This guidance aims to respond to concerns that financial statements do not contain enough relevant information and may include irrelevant information<sup>1</sup>.
- The Definition of Material project. The Board will issue an Exposure Draft of proposed amendments to IAS 1 (and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*) to refine the definition of material and clarify its application.
- The Standards-level Review of Disclosures project. This research project will consider how to improve disclosure requirements in Standards and will be partially informed by the feedback on the Discussion Paper *Disclosure Initiative—Principles of Disclosure*.



<sup>1</sup> Paragraph QC11 of the *Conceptual Framework 2010* states that '...materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report'.

# Better Communication in Financial Reporting

## The Disclosure Initiative is part of the Board's work on Better Communication in Financial Reporting.

In response to feedback received during its 2015 Agenda Consultation<sup>2</sup>, the Board plans to focus on projects that will improve communication in financial reporting. For this reason, the Board has made Better Communication in Financial Reporting a central theme of the Board's agenda for 2017–2021.

The Board's work on Better Communication in Financial Reporting consists of:

- projects in the Disclosure Initiative, which primarily look at improving disclosures in the notes to the financial statements;

- the Primary Financial Statements project, which is considering targeted improvements to the structure and content of the primary financial statements, focusing on the statement(s) of financial performance; and
- the IFRS Taxonomy, which enables structured electronic reporting of IFRS financial information.

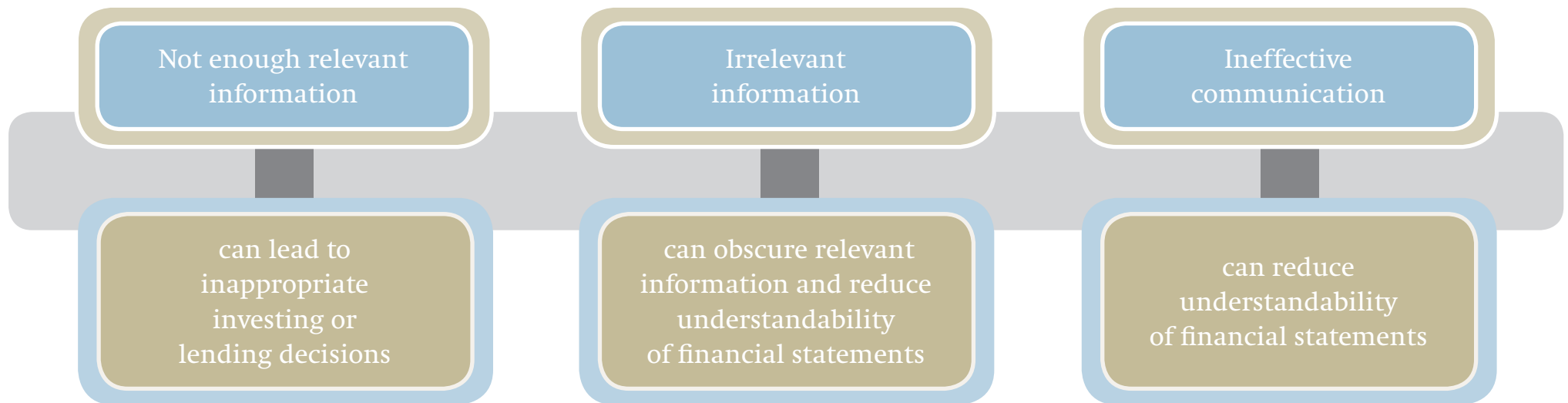
More information on the Board's work on Better Communication in Financial Reporting is available on its website here: <http://www.ifrs.org/Current-Projects/IASB-Projects/Pages/better-communication.aspx>



<sup>2</sup> The 2015 Agenda Consultation sought public input on the Board's strategic direction and work plan.

# The disclosure problem

**The Board has identified three main concerns about disclosures in the financial statements, collectively termed the 'disclosure problem'**



# Why develop principles of disclosure?

The Board has learned that entities have difficulty judging what information to disclose in financial statements and how best to disclose it, creating the disclosure problem.

These difficulties are often behavioural; for example, entities sometimes apply disclosure requirements mechanically without considering why particular disclosures are useful to the users of financial statements.

The Board has also been told that the lack of guidance coupled with lists of prescriptive disclosure requirements in IFRS Standards sometimes discourage entities from using their own judgement.

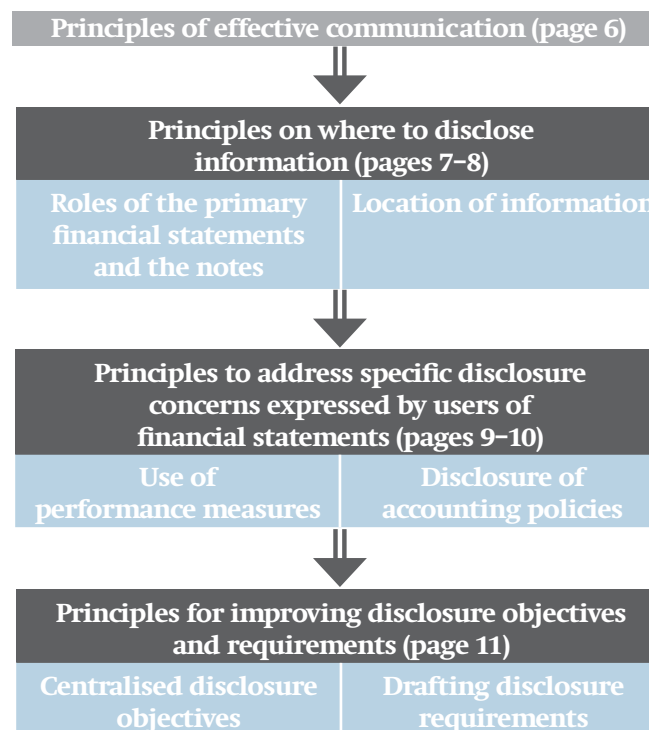
The Board believes that disclosure principles could:

- encourage entities to apply better judgement and communicate information more effectively to users of the financial statements; and
- help the Board improve disclosure requirements in Standards.

However, entities, auditors and regulators will need to work together with the Board to ensure these principles are effective in improving disclosures in financial statements.

The Discussion Paper considers the development of principles in the areas shown in the diagram.

## Content of the Discussion Paper



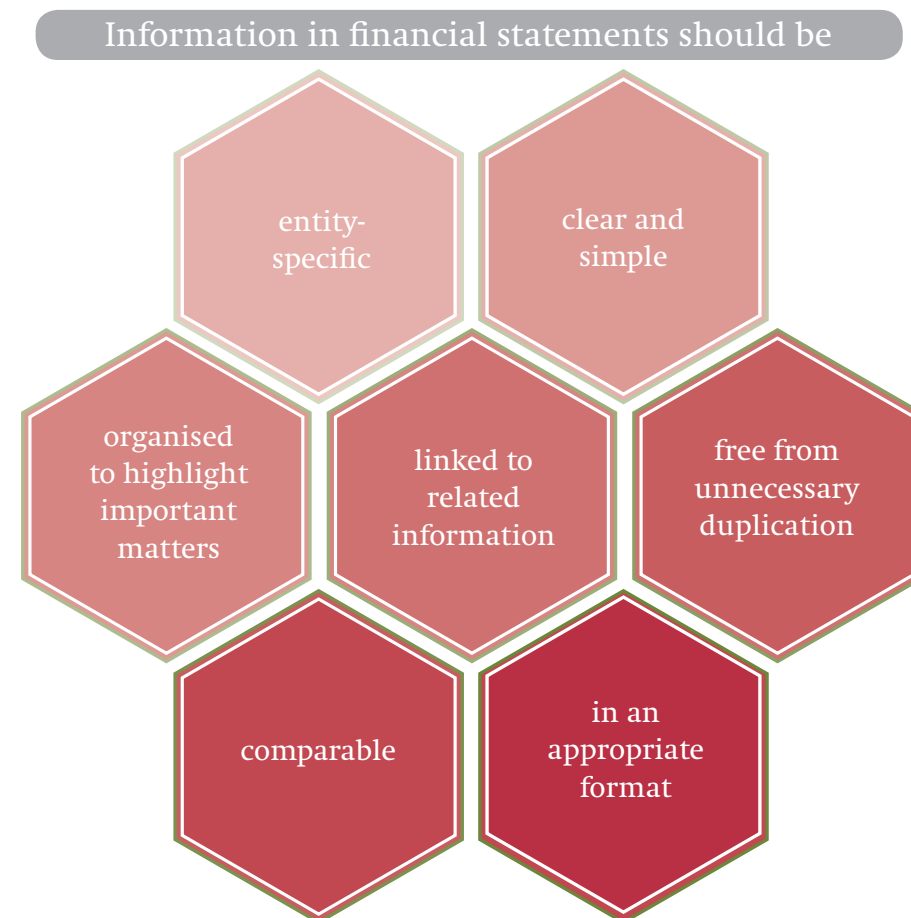
# Principles of effective communication

When information is communicated ineffectively, users have difficulty understanding it and need to spend more time analysing it.

The Discussion Paper identifies seven principles (shown in the diagram) to help entities communicate information more effectively in the financial statements.

Entities may need to make a trade-off between some of these principles to maximise the usefulness of information for users of the financial statements.

For example, making information entity specific might mean it is relevant and easier to understand, but could reduce comparability between entities and between accounting periods.



# Roles of primary financial statements and notes

Entities sometimes have difficulties exercising judgement about what information to present in the primary financial statements and what information to disclose in the notes.

Evidence suggests that users of financial statements pay more attention to the primary financial statements than to the notes. This implies that the role of the primary financial statements differs from the role of the notes in meeting the objective of financial statements.

The Discussion Paper identifies what constitutes the primary financial statements and considers their role and the implications of that role.

The Discussion Paper also explores the role and the content of the notes with a view to helping the Board and entities decide where to include information within the financial statements.

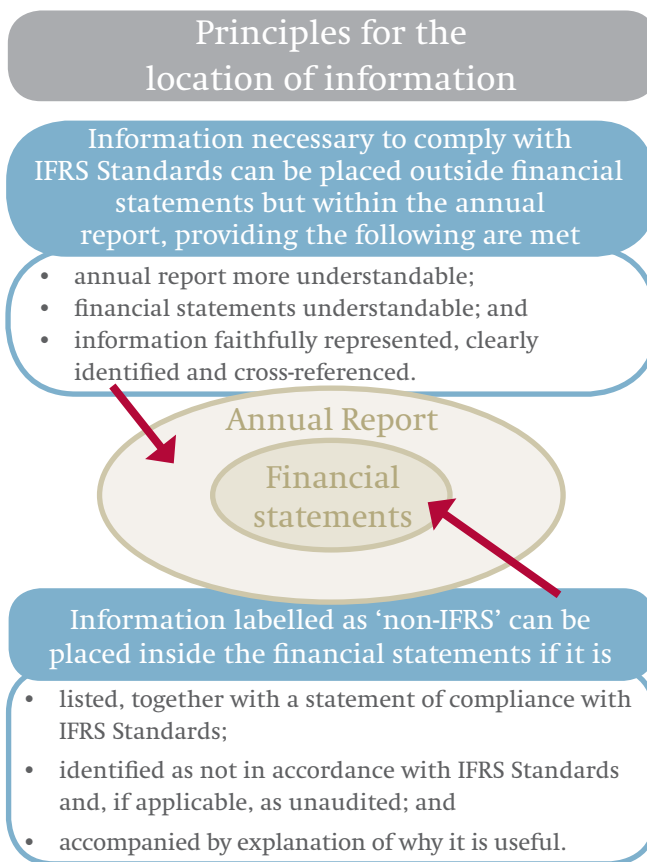
Component of Financial Statements	Role
Primary financial statements are statements of: <ul style="list-style-type: none"><li>• financial position;</li><li>• financial performance;</li><li>• changes in equity; and</li><li>• cash flows.</li></ul>	To provide a structured and comparable summary of an entity's recognised assets, liabilities, equity, income and expenses.
Notes	To explain and supplement the primary financial statements.

# Location of information

## Information duplication and fragmentation can make financial statements and annual reports difficult to analyse.

The Discussion Paper suggests introducing a principle for situations when information necessary to comply with IFRS Standards can be disclosed outside financial statements (as shown in the diagram).

The Discussion Paper suggests that an entity should not be prohibited from disclosing information in its financial statements that it has identified as 'non-IFRS information'. However, entities should seek to minimise such information and it should be clearly identified and explained.



The Discussion Paper also seeks feedback on whether any specific types of information should be excluded from the financial statements, such as information inconsistent with IFRS Standards.

For example, an entity might decide or be required to provide additional information about its pension plans that is not measured in accordance with IAS 19 *Employee Benefits*. Should such information be permitted inside the financial statements?



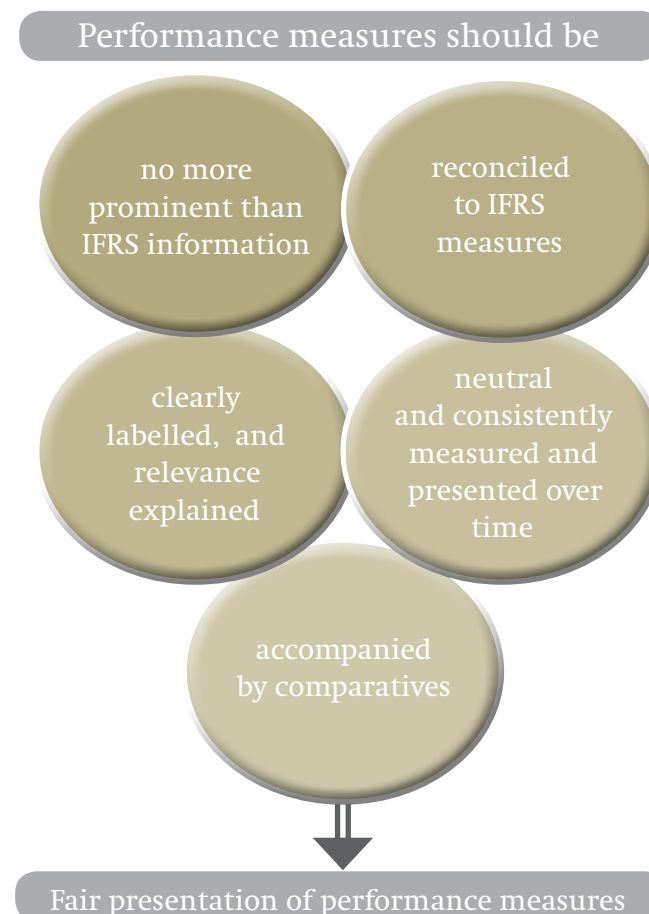
# Use of performance measures

The Board has received feedback that some performance measures in the financial statements provide misleading information.

Entities often use a variety of performance measures<sup>3</sup> in their financial statements and other communications. Many of these performance measures are not specified in IFRS Standards, such as EBITDA<sup>4</sup> or adjusted EBITDA. Performance measures of this type are sometimes referred to as non-IFRS, non-GAAP, alternative or adjusted performance measures. Regulators and users of financial statements are increasingly scrutinising whether these measures provide helpful or misleading information.

Most users have said that performance measures provide useful information if they are fairly presented. The Discussion Paper suggests general requirements for fair presentation of performance measures in the financial statements. These general requirements are illustrated in the diagram.

The Discussion Paper does not include a comprehensive discussion about performance measures presented in the primary financial statements because the Board has a separate Primary Financial Statements research project that will consider these. However, the Board is taking the opportunity of this public consultation to seek feedback on two issues: the presentation of unusual or infrequently occurring items and the use of EBIT and EBITDA ratios in the statement(s) of financial performance. The feedback will supplement the Board's research in its Primary Financial Statements project.



<sup>3</sup> The Discussion Paper uses the term 'performance measure' to refer to any summary financial measure of an entity's financial performance, financial position or cash flows.

<sup>4</sup> EBITDA—earnings before interest, taxation, depreciation and amortisation.

# Disclosure of accounting policies

Users of financial statements say that entities sometimes provide irrelevant information in accounting policy disclosures or depict the information in a confusing way.

The Discussion Paper considers guidance to help entities provide users with more informative accounting policy disclosures.

The Discussion Paper outlines three categories of accounting policies and suggests that only accounting policies necessary to understand financial statements need be disclosed (see Categories 1 and 2 in the diagram).

However, an entity would not be prohibited from disclosing Category 3 accounting policies provided that relevant information is not obscured.

The Discussion Paper also discusses how accounting policies and significant assumptions and judgements used in those policies might be located and disclosed more effectively.

## Three categories of accounting policies

### Category 1—always necessary to understand the financial statements

The accounting policy relates to material items, transactions or events and:

- is selected from alternatives in IFRS Standards;
- reflects a change from a previous period;
- is developed by the entity in the absence of specific requirements; and/or
- requires use of significant judgements or assumptions.

### Category 2—not in Category 1 but necessary to understand the financial statements

The accounting policy is not in Category 1 but relates to material items, transactions and events.

### Category 3—not in Categories 1 and 2 but is used in preparing the financial statements

This category includes all other accounting policies used in preparing the financial statements.

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# Improving disclosure objectives and requirements

Feedback suggests that the absence of clear disclosure objectives in IFRS Standards, coupled with lists of prescriptive disclosure requirements, may be contributing to the disclosure problem.

The Board has heard that the lack of clear disclosure objectives can make it difficult for entities to:

- understand the purpose of some disclosure requirements; and
- apply judgement in deciding what information to disclose to meet the objective of financial statements.

The Discussion Paper considers whether the Board should develop a central set of disclosure objectives (centralised disclosure objectives). They could be used by the Board as a basis

(or ‘framework’) for developing more unified and consistent disclosure objectives and requirements that are better linked to the objective of financial statements.

The Discussion Paper explores possible methods for developing centralised disclosure objectives. It also discusses the possibility of placing all disclosure objectives and requirements in IFRS Standards in a single Standard that sets out all disclosures in the financial statements.

The Discussion Paper also seeks feedback on an approach that has been developed by the staff of the New Zealand Accounting Standards Board (NZASB staff) for drafting disclosure objectives and requirements in IFRS Standards.

The main features of the NZASB staff’s approach are:

- an overall disclosure objective for each Standard, and more specific disclosure subobjectives to support that overall objective;

- the division of disclosure requirements into two tiers:
  - summary information disclosed by all entities, subject to a materiality assessment; and
  - additional information to meet subobjectives.
- emphasis on the need for entities to apply judgement when deciding how and what to disclose to meet the disclosure objectives; and
- use of less prescriptive wording in disclosure requirements.

Depending on the feedback on the Discussion Paper, the Board may consider the NZASB staff’s approach in its Standards-level Review of Disclosures project (described on page 2).

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# Further information

The Discussion Paper includes questions on the topics it presents. Respondents are invited to respond to any or all of these questions and to comment on any other disclosure issues that the Board should consider when deciding whether to develop an Exposure Draft proposing to amend or replace parts of IAS 1. The Board's discussions will take place in public meetings. To access information about these public meetings, to view the Discussion Paper and to submit your comments, please visit [www.ifrs.org](http://www.ifrs.org).

The deadline for comments on the Discussion Paper is 2 October 2017.

## **Stay informed**

To stay up to date with the latest developments and to sign up for email alerts about the Disclosure Initiative, please visit the project homepage at [www.ifrs.org](http://www.ifrs.org).

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