May 2013

Discussion Forum—Financial Reporting Disclosure
Feedback Statement

IFRS®

Overview

During its first three-year Agenda Consultation, the IASB received feedback that it should review existing disclosure requirements in IFRS and develop a disclosure framework. There have also been increasing calls for the IASB to review the disclosure requirements in IFRS.

Conceptual Framework

In 2012 the IASB recommenced work on its revision of its *Conceptual Framework*. One of the topics being addressed is disclosure. The *Conceptual Framework* will likely set out principles relating to materiality, aggregation and the purpose of the notes. However, as helpful as these principles might be, the IASB has been told that it is the specific requirements in Standards, and how they are being applied, that is causing more immediate problems. Even with its ambitious timetable, the revised *Conceptual Framework* will not be completed until at least the second half of 2015.

In 2012 the IASB discussed with the IFRS Advisory Council the possibility of undertaking a short-term project to improve disclosure requirements. The strong message that the IASB received was that there were unlikely to be many 'quick wins'. Previous attempts by standard-setters to review or rationalise disclosure requirements had more often than not resulted in additional disclosure requirements.

It was against this backdrop that the IASB set up a public forum to discuss disclosure so that it could obtain a better understanding of the types of problems users, preparers, standard-setters, auditors and regulators think need to be addressed and to assess whether there are immediate steps that the IASB could take.

Discussion Forum

The Discussion Forum (the 'forum') was held in London in January 2013.

The IASB invited representatives from organisations that had already undertaken work in this area. The nature of that work varies, with some bodies focusing on narrower issues such as materiality or the notes to financial statements, whereas others have encouraged debate around more general frameworks for presentation and disclosure. Summaries of their work are presented on pages 23–30. As part of its preparation for the forum, the IASB also initiated its own survey on disclosure. A summary of the results was presented at the forum (see pages 31–40).

Feedback Statement

This Feedback Statement includes the following sections:

- The Discussion Forum (pages 3–12);
  - user and preparer prespectives (pages 6–11);
  - panel and open discussion (page 12).
- IASB response (pages 13–22);
- Work already undertaken (pages 23–30);
- Survey (pages 31–40).

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The Discussion Forum

The Discussion Forum: Financial Reporting Disclosure

The IASB hosted a public Discussion Forum on financial reporting disclosure to foster dialogue between users, preparers, standard-setters, auditors and regulators. The objective of this forum was for these and other interested parties to get a clearer picture of what the disclosure problem is, its causes and to identify:

- ways of making disclosure more effective that could be implemented in both the short-term and long-term; and
- solutions that could be implemented within existing disclosure requirements.

The forum was held on Monday 28 January 2013, starting at 8:30am (London time) and concluding at 3:10pm.

The forum was open to the public and was attended by around 120 people, mainly from the United Kingdom, but also some from elsewhere in Europe, the US and Asia-Oceania. The event was also audio-webcast live.

Attendees came from a range of backgrounds, including users, preparers, standard-setters, auditors and regulators. In addition, several IASB members and staff attended the event.

Recordings of the audio-webcast and the presentations are available on the Discussion Forum page of the IASB website.

Programme for the Discussion Forum

Welcome

Ian Mackintosh, Vice-Chairman IASB

Work already undertaken

Presentations by ICAS/NZICA, ESMA, EFRAG, FASB and IAASB

User and preparer perspectives

Paul Lee, Hermes—user perspective: how disclosure can better meet users' needs

- The problem identified from a user's perspective.
- Practical suggestions for improving the usefulness of financial reporting.

Russell Picot, HSBC—preparer perspective: how disclosure can be improved in practice

- The problem identified from a preparer's perspective.
- An example of a 'real life' response.

Panel discussion

The panel comprised parties involved in the financial reporting process, including users, preparers, standard-setters, auditors and securities regulators:

- Sue Harding — Harding Analysis (Chair—IASB Capital Markets Advisory Committee)
- Malcolm Cheetham — Novartis (Chair—IASB Global Preparers Forum)
- Patricia McConnell — IASB member (Standard-setter)
- Mark Vaessen — KPMG (Auditing and accounting professional)
- Patrick Parent — IOSCO/AMF (Securities regulator)

The panel was moderated by Kathryn Cearns, Herbert Smith Freehills.

Open forum discussion

The afternoon session of the Discussion Forum was two hours of open discussion. The panel was joined by Paul Lee and Russell Picot. The open discussion gave audience members and people participating via webcast the opportunity to ask questions of the panel and discuss their opinions of the 'disclosure problem'.

Summary

Alan Teixeira, IASB Senior Director of Technical Activities

Recent work already undertaken

A significant amount of work has already been undertaken in the area of disclosure in financial reporting. Some of the organisations that have undertaken that work were invited to present at the Discussion Forum, namely:

- The European Financial Reporting Advisory Group (EFRAG);
- European Securities Markets Authority (ESMA);
- US Financial Accounting Standards Board (FASB);
- International Auditing and Assurance Standards Board (IAASB); and
- The Institute of Chartered Accountants of Scotland (ICAS) and the New Zealand Institute of Chartered Accountants (NZICA).

Other organisations that have also undertaken work on disclosure include:

- The Autorité des Normes Comptables (ANC);
- Enhanced Disclosure Task Force (EDTF); and
- UK Financial Reporting Council (FRC), including the Financial Reporting Lab (the 'Lab').

Organisation	Projects include
ANC http://www.anc.gouv.fr	Towards a disclosure framework for the notes Proposal to simplify accounting obligations for 'small listed companies' in Europe
EDTF http://www.financialstabilityboard.org	Enhancing the risk disclosures of banks
EFRAG http://www.efrag.org	Towards a disclosure framework for the notes
ESMA http://www.esma.europa.eu	Considerations of materiality in financial reporting
FASB http://www.fasb.org	Disclosure Framework
FRC http://www.frc.org.uk	Towards a disclosure framework for the notes Thinking about disclosures in a broader context Cutting clutter
IAASB http://www.ifac.org/auditing-assurance	The Evolving Nature of Financial Reporting: Disclosure and its Audit Implications
ICAS/NZICA http://icas.org.uk http://www.nzica.com	Losing the excess baggage
The Lab http://frc.org.uk/Our-Work/Codes-Standards/Financial-Reporting-Lab	Various

They provided us with summaries of their work. These can be found on pages 23–30.

User and preparer perspectives

Paul Lee—a user's perspective

Paul Lee is a director at Hermes Equity Ownership Services. His work involves engaging with regulators, policy-makers and corporates with a special interest in long-term value for investors. Paul is also a member of The Auditing and Assurance Council of the UK FRC, the Quoted Companies Alliance, the Corporate Reporting Users' Forum (CRUF), the Financial Standards and Analysis Committee of the Chartered Financial Analyst (CFA) Society of the UK and the EDTF.

Communication not compliance

Paul began his session by emphasising that financial reports are about accountability. Management are entrusted with the assets of the company and therefore financial reports should show how effectively management have put those assets to use and the performance derived from those assets. Such accountability is embodied in the concept of stewardship.

Paul observed that the concept of stewardship is dealt with effectively in the IASB's *Conceptual Framework*. However the *Conceptual Framework* deals with the notion of a primary user less effectively. There is a confused view or too broad an understanding about who the primary user is. It should be clearer that management need to focus their financial reporting to the current shareholders.

Failure to communicate

Paul is firmly of the view that financial reports should communicate entity-specific information about how effectively management has put the assets of the entity to use.

Because entities try to fit into an inflexible financial reporting framework, disclosures fail to be entity-specific and do not communicate an entity's business model and strategies. Information about the business model of an entity, the strategy of that entity and performance against that strategy are key elements of financial reporting. These concepts should be the starting point for removing immaterial information and cutting back on the vast quantity of disclosures provided by entities that potentially obstruct more useful information. This would shift the focus of financial reporting away from compliance and instead shift the focus onto communication.

What is needed is better quality information

Paul asserts that there is a lack of professional judgment being applied when disclosing company information. More information is not necessarily better, just as less information is not necessarily better; instead better quality information is needed.

Investors have responded to the disclosure problem differently. The CFA Institute focused on communication rather than a tick-box/compliance approach, whereas the CRUF gave greater emphasis to concerns about gaps in disclosure and the need for more information. However these views are not necessarily contradictory. Both the IASB's survey on disclosure and the CFA's survey revealed that there is both missing disclosure and too much disclosure!

Deliver on the concept of materiality

Paul then focused on materiality. He believes that the concept of materiality and the lack of its appropriate application is a key contributor to the excessive disclosures in financial reports. If the concept of materiality was applied successfully then immaterial information that clouds more relevant information would be removed. This means that the performance and the position of the entity would be more visible.

The concept of materiality needs to be clearly understood so that it can be applied appropriately. In order to do this, the purpose of financial reporting needs to be known and we need to be clear who the primary users of those financial reports are.

Effective application of the concept of materiality requires professional judgement. Currently, there is a lack of professional judgment being applied when deciding what information to disclose. A number of parties within the financial reporting process, including preparers, auditors and investors, are not exercising professional judgment when preparing, auditing or using financial reports.

The miasma of data, too often provided by management in an entity's financial reports, does not reflect clarity of thought. In fact, it does the entity a disservice—it gives a bad image of the entity. Investors gain a lot of insight into the quality of management from seeing how directors have exercised professional judgment in determining what is important information and how to disclose it. This insight can sometimes be more useful than the disclosed information.

Many financial reports provide evidence of auditors not being willing to exercise professional judgment. It suggests that auditing seems to have become more focused on compliance. Investors pay auditors for their professional judgment and therefore something needs to change.

Investors also need to use professional judgment when asking an entity for information. Instead of asking for more information, they need to ask for better, more relevant, more specific, material information. It would be beneficial if preparers and investors worked together more often to achieve these goals.

It is recognised that some investors are nervous about the idea of removing disclosure requirements from accounting standards because some of that information is wanted by investors. Instead, professional judgment should be applied to identify those disclosures that are more important.

Regulators and standard-setters should set standards that do not read as rules or checklists. Instead they should provide principle-based guidance that helps people to do their job better rather than forcing them into a certain pattern of disclosure. Addressing performance reporting is an important aspect of this goal. It is noted that this was a strong message in the feedback received on the IASB's *Agenda Consultation 2011*.

The regulators, investigators and enforcers, in the context of both corporate reporting and auditing, also have a crucial role to play in addressing the lack of professional judgement being applied in the context of disclosures. They need to be seen to be encouraging the use of judgment rather than 'ticking the tickers' and therefore encouraging a lack of judgment.

Paul concluded by observing that using professional judgment will mean that sometimes things can go wrong—sometimes, the right things may not be disclosed; however this would be better than what we have now, where disclosures are wrong all the time.

User and preparer perspectives continued

Russell Picot—a preparer's perspective

Russell Picot is responsible for group external financial reporting at HSBC and is a director of HSBC's main UK pension fund trustee and chairs its Asset and Liability Committee. Russell is Co-Chair of the EDTF and is a member of the International Integrated Reporting Council (IIRC) and the British Bankers' Association Financial Reporting Advisory Panel. He was Chairman of the IASB's Advisory Committee on IFRS 7 *Financial Instruments: Disclosures*.

Disclosures are very important

Russell opened his talk by emphasising that disclosures are important to HSBC. HSBC publishes its annual report and Pillar III report at the same time as they release their financial results to the market. This means that the annual report and accounts is a fundamental medium of communication with the market. This approach is unusual, but HSBC has a philosophy that all information, whether it is financial or risk, should be available to the market at the same time.

Radically improving and strengthening disclosures is not straight-forward

The cost of failure

Russell noted that there is an 'accounting risk' that probably did not exist ten years ago, because correspondence with regulators is now made public. When such correspondence takes place it sets an inappropriate tone and causes investors to be concerned about whether they can trust the probity and integrity of management. As a result, there is a risk that companies take an overly cautious approach to disclosure to reduce that risk and annual reports have become a compliance exercise. The cost of failure is not something that can be underestimated.

Disclosure requirements come from many sources

The banking sector is regulated and there are many layers of regulation. Russell observed that HSBC is regulated by the Financial Stability Board, the Basel Committee, the European Banking Authority and the UK Financial Services Authority. Unsurprisingly, the pressure from the regulators is always to add more disclosure rather than to remove disclosure and they have particular views on what should be disclosed. Some believe that sometimes making a nil statement is useful and they think that templates have an important role in assisting comparability and understanding internationally, nationally and regionally.

Management uses other communication channels to tell the story

Russell then discussed claims that the audited financial statements are becoming less useful in their own right. HSBC's experience is that the unaudited front section of the annual report, including the management commentary, is where the analysts tend to focus. Perhaps this is because the notes to the accounts stand by themselves with no explanation.

HSBC also uses other communication channels to tell their story, particularly investor relations presentations. But he cautioned that we need to be wary of what this could lead to, for example, the proliferation of non-GAAP measures. HSBC is very disciplined about this and tends to provide their investors with a list of items that they should be aware of as being important in the current year's results, but no non-GAAP adjustment is made to those items.

The disclosure problem

Aspects of the disclosure problem

Russell identified some of the factors that contribute to too much irrelevant disclosure:

- poor organisation and structure of reports;
- duplication of disclosures;
- poorly targeted disclosure requirements that elicits boilerplate disclosures; and
- disclosures that are not focused on the key issues and the emerging issues and what has changed.

Annual reports have been used as a bit of a dumping ground

Russell believes that the disclosure problem is not just confined to the audited financials; but also to the annual report as a whole. Annual reports have lengthened over time and interim and other reports have also had more requirements added. The UK FRC's Cutting clutter project (see page 27) has resonated with HSBC.

The annual report has been used as a bit of a dumping ground. The annual report is not just used by investors, there are many stakeholders. For example, the discussion in Europe about making country-by-country reporting part of the annual reporting process is probably because there is not another place for this to be conveniently disclosed.

What are some of the causes?

Preparers and users are somewhat trapped on the treadmill of quarterly reporting

Russell emphasised that it is quite demanding taking a fresh look at your annual report—there isn't much time available in the corporate reporting calendar for the level of senior management engagement that is required for such a review. Taking a very fresh look at your financial statements and annual report is not a bottom-up process—it is very much a top-down process.

Undoubtedly, the requirements themselves could be improved. Preparer, auditor and regulator behaviour is also a cause of the disclosure problem. In addition, it is difficult for the corporate world to engage with the investor world in a meaningful dialogue about what should be done to improve their annual reports.

User and preparer perspectives continued

Distinguishing the generic from the specific

The accounting policies and basis of preparation part of HSBC's annual report is 22 pages long and this contains accurately produced text from the IFRS, because that is what is required. Yet explicit accounting options in IFRS are limited. There is very little policy choice that affects the financial statements.

It is also difficult to distinguish the generic from the specific accounting policies. Disclosures should convey the particular flavour or slant that a company actually made in complying with accounting standards. Useful information is often drowned in a lengthy sea of technical disclosure. For example, HSBC's accounting policies on accounting for loans should draw out the way that HSBC has applied the IAS 39 *Financial Instruments: Recognition and Measurement* requirements about loan impairment and forebearance. Making this disclosure without it being dominated by technical detail is challenging.

Work should focus on finding a place to put the body of standing data where it is still accessible. It is valid to ask whether standing data needs to be in the annual report.

Steps HSBC has taken

Structure, format and presentation

In each year since 2007 HSBC has reviewed the structure, format and presentation of its annual report. As a result of these annual reviews, there has been quite a lot of work done to improve the look and feel of the document. For example, greater use of both tables and colour to improve accessibility. Russell emphasised that these annual reviews are a major undertaking involving an extensive process of engagement throughout HSBC, the results of which then come to one individual who is responsible for expressing these results in a single voice in the annual report.

Improved disclosure in the risk section

Russell said that a broader concern HSBC had was that some of the messages to investors were being lost, especially in the risk section. This led HSBC to put into the public domain more information about how it manages risk. The new disclosures coincided with changes to HSBC's internal risk management to focus more on top and emerging risks.

Russell said that reading many companies' accounts gave the impression that market and other events were a surprise to them. HSBC decided to provide a pattern of narrative that describes what had happened in the market and what had changed. It was important to let investors know what management did about those risks and how that manifested itself in the income statement and balance sheet.

HSBC also decided to restructure its risk section by moving the standing data to the back. The front of the annual report now has the disclosures that are the most vibrant and relevant to the current year's financial statements. The materiality of some disclosures was also reviewed and, as a result, some disclosures were removed.

These actions improved HSBC's annual report significantly. However, Russell noted that the amount of time and senior management effort required should not be under-estimated.

What else can be done?

Russell encouraged efforts to enable greater use of a company's website as a place to provide some disclosures. HSBC has been able to use its website to publish information about its share plans, which has meant that it can remove related disclosures from its annual report. However, such changes need to work both from a technical and legislative perspective.

It would also be really helpful to get greater alignment and discussion between the various bodies responsible for disclosure and the regulators.

Conclusion

Russell concluded his session by discussing examples of initiatives that he thinks should be encouraged. He thought the work of the EDTF, of which he was a Co-Chair, is a good example of what can be done. It is one of the first examples of a forum that got 30 people in a room (preparers, auditors, regulators and investors) with a common objective of improving risk disclosure. EDTF made a really important breakthrough, not just in specific recommendations but by vocally changing the mind-set of the banks. It is a model that he thinks should be applied more widely.

Russell also thinks we need forums where it is safe for companies and their shareholders, and potentially auditors, to discuss disclosure-related issues—he is a supporter of the FRC's Lab (see page 28).

Lastly, Russell mentioned the work of the IIRC, an initiative that also holds promise for quite significant change. One of the criticisms that can be levelled at annual reports is that they do not deal with one of the most important questions of this century: 'Do you as management believe that your business model is sustainable for the long-term and if so, why?'. This is an important question for institutional investors investing for the long-term. In financial services, reputation is probably the driver for long-term sustainability, but it is quite difficult to see a mature, responsible discussion of questions like that in annual reports. The IIRC will provide a useful impetus to see how this can be done.

Panel and open discussion —what we heard

The Discussion Forum and the IASB survey demonstrated that there is no clear agreement on defining the disclosure problem. On the one hand, we hear a general concern that financial reports are getting bigger and bigger, which is costly for preparers. On the other hand, investors say that the reports are not giving them the information that they need. What seems clear is that preparers and investors agree that financial reports are an important communication tool. Preparers want to tell their story and investors want to hear that story.

The discussions at the forum highlighted that there are several impediments to this dialogue.

As a standard-setter, the IASB has the important role of developing financial reporting standards that ensure that financial reports contain high quality, transparent and comparable information. Auditors add credibility to financial reports through their independent audit and review of the financial information. Securities regulators are able to enhance consistency through their independent oversight. Although no one questioned the importance of the IASB, preparers, auditors or regulators, there is a perception that some of the actions of these parties are impediments to good reporting.

The reporting chain of events starts with IFRS. The IASB needs to ensure that it provides the right tools for preparers, auditors and securities regulators to work with. Some participants gave examples of Standards that they perceive to compel disclosures rather than guiding preparers to identify which information is likely to be important in their particular circumstances. There is also a perception that the IASB is quick to add new disclosure requirements, but rarely remove such requirements. As a consequence, there is a tendency for disclosure requirements to accumulate over time.

Some of the preparers speaking at the forum thought that they have to take some responsibility themselves. Some preparers treat financial statements as compliance rather than communication documents. The result is an excessive use of boilerplate text. In their own defence, some preparers said that the cost of failing to disclose what later proved to be relevant information was high. The incentives faced by preparers skew them towards taking the line of least resistance by disclosing more rather than less information.

Other participants gave examples of experiences where they consider that their auditors and securities regulators had focused on compliance at the expense of communication, leading to a 'tick the box' approach to disclosure. Some auditors, it was claimed, used disclosure checklists to ensure that 'all' disclosures had been made. We also heard claims that regulatory enforcement using a 'comply or explain approach', whereby preparers are called to explain why a particular disclosure is not material, leads to a 'better safe than sorry' attitude. Preparers, and auditors, claim that this leads them to err on the side of caution so preparers include disclosures even if they do not consider the information to be material.

Some participants from the investor and analyst communities also thought that they did not help matters by tending to ask for more information rather than helping to identify better ways for entities to communicate information.

Summary

The forum highlighted a sense of shared responsibility among participants. Users, preparers, standard-setters (including the IASB), auditors and regulators all accept that they contribute in some way to 'the disclosure problem' and that there is no single step or solution to fixing the problem. Having said that, there seemed to be agreement that progress could be made if one body took a lead in addressing these issues—and that that body should be the IASB. The IASB is well placed as an international body to bring the parties together. Just as importantly, the IASB could be a catalyst for change by making small yet meaningful amendments to IFRS disclosure requirements.

IASB response

IASB response

Background

Users, preparers, standard-setters, auditors and regulators are all important parties in the financial reporting supply chain. The messages we heard in the Discussion Forum made it clear that each of these parties contributes to one or more of the perceived problems about disclosure. This also means that each party can contribute to improvements in disclosure.

Despite this shared responsibility, it was also clear that the forum participants thought that the body best placed to take a lead in improving disclosure is the IASB. As a standard-setter, the IASB is responsible for shaping the financial reporting disclosure requirements. The other parties take their lead from those Standards. By taking some clear yet simple steps, the IASB has an opportunity to be a catalyst for improving disclosure.

In this section of the Feedback Statement we set out some of the steps that the IASB will be asked to consider taking in the near and medium term. They relate to:

- **materiality**;
- **perceptions** that existing Standards prevent judgement; and
- **a more general review** of disclosure requirements—including reconsideration of the *Financial Statement Presentation* project and a Standard-by-Standard review.

The IASB has not yet considered the merits of these steps, each of which will need to be analysed and then discussed by the IASB in public meetings before deciding whether to seek public comment on any possible changes to our Standards.

Short Term	Medium Term
Narrow scope amendments to IAS 1 *Presentation of Financial Statements* will be considered by the IASB in the second half of 2013	In 2013 the IASB will start a research project reviewing IAS 1, IAS 7 *Statement of Cash Flows* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The goal will be to replace those Standards, in essence creating a disclosure framework. The research will be undertaken in parallel with the work on the *Conceptual Framework*, with the goal of developing a full Standards-level proposal in time for the next Agenda Consultation.
The IASB will start a project in the second half of 2013 to consider developing education material or guidance on materiality, working with securities regulators, auditors, preparers and users.	The requirements in all Standards will be reviewed systematically, in the light of the revised *Conceptual Framework* and any work undertaken on IAS 1, IAS 7 and IAS 8.
The disclosure requirements in new Exposure Drafts will be drafted using less prescriptive language.	

IASB response

Materiality

When the IASB revised the *Conceptual Framework* it included the following paragraph:

> **Materiality**
>
> QC11 Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. In other words, 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. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

The concept of materiality is an important aspect of relevance. In practical terms, materiality can be thought of as a two-way filter. On the one hand, it should ensure that relevant information is not omitted or mis-stated. On the other hand, it should help filter out details that obscure information and are not helpful to users of the financial statements.

The *Conceptual Framework* describes materiality as an application of relevance by a particular entity. When an entity is assessing materiality it is assessing whether the information is relevant to the readers of its own financial statements. Information relevant for one entity might not be as relevant for another entity, perhaps because of the nature of its activities.

IAS 1 states, in paragraph 31, that an entity "need not provide a specific disclosure required by an IFRS if the information is not material".

On the other hand, to capture relevant information for which there is no specific IFRS disclosure specified, paragraph 15 of IAS 1 states "[t]he application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation". In other words, material information must be disclosed irrespective of whether there is an explicit disclosure requirement.

The feedback we received at the Discussion Forum confirmed what we have heard from many sources:

(a) although preparers, auditors and regulators understand the concept of materiality, they are less certain about how it should be applied—the result is that they tend to be too cautious. Preparers are reluctant to filter out information that is not relevant to the readers of their financial statements, and auditors and regulators are reluctant to accept such omissions at face value—they challenge preparers who omit disclosures 'required' by Standards.

(b) the way in which some Standards are drafted suggests to some readers that the specific requirements of those Standards override the general statement in paragraph 31 of IAS 1 that an entity need not provide information that is not material.

IASB response continued

Application of materiality

The concept of materiality is introduced in the *Conceptual Framework*. The IASB is currently revising that framework, but has no plans to revise the description of materiality in paragraph QC11 (see page 15) or to include any additional discussion about the topic as part of that project. If any additional guidance is developed it would be at the Standards-level.

The IASB plans to start a project on materiality with a view to creating either general application guidance or education material. Such a project will look at how materiality is applied in practice and whether we need to add more guidance to IAS 1.

Although the IASB should lead this project, the IASB plans to work closely with auditors and securities regulators. It is important that users, preparers, the IASB, auditors and regulators have a shared view of materiality.

The review would also consider whether to develop any application guidance specific to one or more particular Standards. IFRS already has some specific guidance—the related party disclosure requirements are the consequence of context-specific application (ie special relationships) of materiality. Although we think that it is unlikely that we will find many cases where we should add special materiality guidance to an individual Standard, this should not be dismissed as a possibility.

Possible amendments to IAS 1

The IASB does not normally refer to materiality in individual Standards. Instead, the IASB relies on the more general statement in paragraph 31 of IAS 1 (see page 15).

Many commentators have said that they do not have the confidence to apply this more general requirement against what appear to be more specific, and therefore overriding, disclosure requirements in other Standards. Some commentators have suggested that references to materiality should be made clearer in individual Standards.

Context

IAS 1 warns about the risks of aggregating dissimilar items—a preparer should not omit material information by aggregating it with other items. However, there is no corresponding explanation to give the context, or reason, for the statement in paragraph 31 of IAS 1 about why immaterial disclosures need not be included in the main financial statements or notes.

More recent Standards have included a statement explaining that too much detail can obscure useful information—ie an explanation about why materiality should filter out entity-specific information that is not relevant to the users of the financial statements of a particular entity.

The IASB will be asked to consider adding a similar explanation to IAS 1. Although this will not change the meaning of, or interpret, materiality, it should bring a stronger focus on the existing words by explaining why they are important.

Primary financial statements versus notes

The IASB has been told that some people think that the statement about not needing to disclose information if it is not material means that an entity does not need to disclose an item in the primary financial statements (statement of comprehensive income, statement of financial position, etc), but instead must disclose it in the notes.

The IASB will be asked to consider clarifying that materiality applies to the whole financial statements. If information is not material it need not be presented in the primary financial statements and it need not be disclosed in the notes.

Materiality within a Standard

The IASB is aware that some people think that the statement in paragraph 31 of IAS 1 about not needing to disclose information if it is not material relates to assessing whether something in the statement of financial position or statement of profit or loss and other comprehensive income is material. If it is a material amount, those people believe that this triggers a requirement to disclose everything about that item that is set out in the related Standard—IFRS 2 *Share-based Payment* is the most quoted example.

Others think that paragraph 31 of IAS 1 means that, within a Standard, there could be some specified disclosures that, for a particular entity, are simply not important enough to justify separate disclosure.

The IASB will be asked to consider clarifying that the latter view is the appropriate application of paragraph 31.

Drafting Standards

Many participants in the forum said that the way the disclosure requirements in some Standards are drafted implies that the items must be presented in all circumstances.

Most Standards use the words 'an entity shall present (or disclose) ...'. Even more recent Standards, which have clear disclosure objectives, tend to follow that objective with the statement 'in meeting that objective an entity shall disclose ...' with a list of the requirements. In the forum the IASB heard that many preparers and auditors see that list as the minimum requirements. Others stated that the specific disclosure requirements appear to take precedence over the more general materiality overlay in IAS 1.

The IASB will be asked to consider less prescriptive wording in some forthcoming proposals. The IASB will work with auditors to ensure that any changes it makes do not affect the auditability of the Standards. Comments made at the forum suggest that having clear disclosure objectives is critical to this process. The IASB has made considerable progress in this regard in its recent Standards.

IASB response continued

Perceptions that some existing Standards prevent judgement

The IASB heard from preparers, at the forum and in follow-up meetings with smaller listed entities, that some of the words in IAS 1 make it difficult for preparers to exercise their judgement in presenting their financial reports.

The IASB will be asked to consider proposing narrow-scope amendments to IAS 1 to address some of these concerns. Although each of the issues being considered is relatively small their cumulative effect could be greater, acting as a catalyst for improved reporting.

Presentation order

Investor respondents to the IASB survey and participants at the Discussion Forum told the IASB that they want to be able to see how disclosures are related. They consider the financial statements to be disjointed, making it difficult to connect relevant information together.

Paragraph 113 of IAS 1 says that an entity must present its notes to the financial statements in a systematic manner. In paragraph 114 it goes on to state that the 'normal' order of presentation is the accounting policies followed by explanatory notes that follow the same order as the items presented in the primary financial statements.

Some preparers told the IASB that this perception of 'normal' makes it difficult for an entity to present the explanatory notes in order of importance or to present related information together in cohesive sections. Examples of entities that have broken this mould were identified at the forum. One presented accounting policies with the relevant explanatory notes, combining explanatory information for the same topic from the statement of comprehensive income and the statement of financial position. Another presented the explanatory information sorted from most to least important, as viewed by the entity.

We are told that both sets of financial statements were well received by the market. But these are exceptions.

The IASB will be asked to consider amending IAS 1 to remove this perception of what is a normal order of presentation, making it easier for entities to provide more contextual and holistic information.

Accounting policies

Investors also said that the accounting policy section of financial statements is long and unhelpful. It does not distinguish between the important policies and those that are simple descriptions of IFRS (and for which the entity has no choice but to apply the requirements set out in the Standard).

IAS 1 only requires significant accounting policies to be disclosed. However, IAS 1 also includes words that make it difficult to argue that an accounting policy is insignificant. For example, it states that if an entity is taxed it should disclose its income tax accounting policy even though IAS 12 *Income Taxes* does not provide any choice to entities. Some preparers interpret this as requiring an entity to disclose the accounting policy for *any* activities it undertakes.

Many preparers said that they would like to be able to either delete boilerplate accounting policy disclosures or relegate them to a website or to the back of the financial statements.

The IASB will be asked to consider amending IAS 1 so that it is seen to be less restrictive about how accounting policies should be presented, making it easier for more important accounting policies to be given greater prominence in financial reports.

Minimum disclosure requirements

IAS 1 has some very specific disclosure items that some preparers seem reluctant to adapt, or are discouraged from adapting to the specific circumstances of their entity. They are simple things such as requirements to disclose intangible assets (including goodwill), trade and other receivables, and trade and other payables.

The consensus among preparers and users is that an entity should be able to present, on the face of the primary financial statements, goodwill as a separate item and then other intangible assets, or trade receivables as separate items. Many preparers think that IAS 1 prevents them from doing so or that they must use the specific terms used in IAS 1.

The IASB will be asked to consider adding some additional explanations with examples of how the IAS 1 requirements are designed to shape financial statements instead of specifying precise terms that must be used.

Among the potential issues are whether subtotals of IFRS numbers such as EBIT (earnings before interest and tax) and EBITDA (earnings before interest, tax, depreciation and amortisation) should be acknowledged in IAS 1.

Some preparers have told the IASB that they would like to be able to include these subtotals on the face of the income statement, but their auditors discourage them from doing so.

Net debt

Over the last five years investors have consistently asked the IASB to introduce a requirement that entities must disclose and explain their net debt reconciliation. This is an example where users think that adding a requirement might reduce clutter by specifying about how debt information should be disclosed.

Currently, the debt-related disclosure requirements are perceived as being scattered through the financial statements and not connected. The IASB will consider proposing to add such a requirement to IAS 1.

General review of disclosure requirements

The IASB has heard, from many sources, concerns about the cumulative effect of the disclosure requirements that have been introduced in new or revised Standards over the last ten years. Many of those commentators have suggested that the IASB should conduct a general review of disclosure requirements.

The IASB is currently considering disclosure principles as part of the *Conceptual Framework* project. Ideally, the IASB would prefer to complete its work on those principles before it begins any Standards-level work. However, waiting until the *Conceptual Framework* is completed would mean delaying any such review until at least 2016.

Recognising that there is strong and broad support for improving disclosure, the IASB will consider whether there are ways that it can accelerate Standards-level work.

IASB response continued

Conceptual Framework

The *Conceptual Framework* is likely to include high-level principles—such as the type of information that should be disclosed in explanatory notes.

The principles are also likely to explain the importance of setting clear disclosure objectives in a Standard.

These principles will be designed to help the IASB in developing specific disclosure requirements. It is not intended that preparers will apply these principles directly. Accordingly, the *Conceptual Framework* will not have a direct effect on current disclosure requirements. A change to specific disclosure requirements needs Standards-level action.

IAS 1, IAS 7 and IAS 8

The two main Standards that provide the general disclosure requirements, by shaping the primary financial statements and identifying the items that 'must' be disclosed on the face of those statements, are IAS 1 and IAS 7. They also specify the subtotals that should be reported.

IAS 8 provides additional guidance on the notions of consistency and comparability discussed in IAS 1 and IAS 7.

IAS 1 and IAS 7 were the focus of a major project on financial statement presentation. The project was suspended in June 2010.

The IASB will be asked to consider beginning exploratory work on whether the work previously done on the Financial Statement Presentation project could form the basis of a research project. The IASB and the FASB received a great deal of feedback on the original project. As a first step, the staff would review that feedback in the light of the work on the *Conceptual Framework* and what we have learned from our disclosure activities. That review will help us to set the scope of a revised project.

The IASB could then consider whether, or how, it can develop the Financial Statement Presentation project in parallel with the work on the *Conceptual Framework* with a view to replacing IAS 1, IAS 7 and IAS 8. The outcome of such a project could, in essence, be a disclosure framework for IFRSs.

Other Standards

Assessing the cumulative effect of the disclosure requirements in IFRS will be challenging. Our expectation is that improving the understanding and application of materiality would go a long way towards addressing the cumulative effect of many Standards, because preparers will be better able to assess which Standards, and disclosures, are material to their entity.

Specific disclosure requirements are normally developed with the related recognition and measurement requirements. Disclosure requirements need to be considered in the context in which the recognition and measurement requirements were developed.

This does not mean that the IASB should not review the disclosure requirements in individual Standards.

The IASB will begin a research project to review disclosure more holistically in order to identify and assess conflicts, duplication and overlaps between Standards. The purpose of such a review would be to document these conflicts. This information will place the IASB in a better position to assess whether additional action is required.

As part of that review of disclosure requirements we will look at each individual Standard. We expect to undertake that review over the next two years, although some Standards will be reviewed sooner, as part of our Post-implementation Review process.

The IASB is considering disclosure requirements as part of its review of IFRS 8 *Operating Segments*. The next review is of IFRS 3 *Business Combinations*. Some have mentioned that this Standard's disclosure requirements are too prescriptive. The IASB has started that review.

Process

In many projects disclosure requirements are discussed towards the end, creating a perception that the IASB considers disclosure as an afterthought. The reality is that the IASB wants to consider disclosure as a package, which is why it is generally considered once the recognition and measurement requirements have been determined. Forum participants supported considering disclosures as a package.

Not all projects are developed this way. Joint arrangements and consolidation both began with an overview of how information about investments of this nature should be presented and what information about them would be helpful to the readers of financial statements.

It is not clear that changing the timing of disclosure discussions would affect the decisions that the IASB makes. Nevertheless, if it helps to address perceptions that the IASB does not consider the disclosure requirements carefully enough, there could be some benefit from conducting such a review.

Additional consultation and outreach

We plan to use this Feedback Statement as the basis for developing additional outreach events. The purpose of these events will be to get the different parties in the financial reporting supply chain together in different countries, to keep momentum in this project and to identify other ways in which we can help improve disclosure quality.

Broader issues

Technology

Some participants at the forum thought that technology could help make disclosure more meaningful. Many of those participants cited XBRL-tagged documents as providing users with easy access to a lot of data. On the other hand, there is a tension between the data-oriented-XBRL documents and the demands for financial statements to 'tell a story'.

The IASB has recently undertaken a fundamental review of its XBRL initiative and, as a result, has begun integrating the development of its IFRS Taxonomy into the standard-setting function. The IFRS Advisory Council has plans to discuss the relationship between general-purpose reporting and electronic filing of financial information later in 2013.

Mid-cap entities

Feedback received from the IASB's review of the *IFRS for SMEs*, the Disussion Forum and discussions with bodies such as the Quoted Companies Alliance highlight a concern held by some smaller listed entities that disclosure requirements are more burdensome for them than for larger corporates. They argue that the IASB should consider creating a differential disclosure regime, relieving smaller listed entities from having to disclose the same level of information as other entities applying IFRS.

The IASB does not have any plans to consider developing a disclosure tier between *IFRS for SMEs* and full IFRS. However, the IASB does recognise that any actions that reduce the disclosure burden are likely to benefit smaller listed entities proportionately more than the larger entities.

Country-by-country reporting

The IASB has also been asked to consider adding 'country-by-country' reporting requirements to its agenda. Feedback from the *2011 Agenda Consultation* strongly and consistently highlighted that this should not be a priority for the IASB. In the light of this feedback the IASB has decided not to undertake proactive work in this area for the next two years. The IASB will review its priorities again in 2015.

Integrated reporting

Integrated reporting takes a broader view of business reporting, emphasising the need for entities to provide information to help investors assess the sustainability of their business model. The IASB is a member of the International Integrated Reporting Council (IIRC) and has staff on IIRC working groups. The IASB will continue to monitor this initiative.

Recent work already undertaken

Recent work already undertaken

As indicated earlier in the Feedback Statement (see page 5), below are summaries provided by a number of organisations about some of the recent work they have undertaken on disclosures.

ANC

Proposal to simplify accounting obligations for 'small listed companies' in Europe

The proposal is the ANC's response to the concerns that have been expressed by small listed companies that IFRS is not meeting their needs because of complexity in IFRS.

The ANC, after consulting with users, companies, auditors and regulators in and outside of France, has concluded that full IFRS should be retained, but that disclosure requirements should be alleviated for these smaller entities. They believe that these proposals would reduce disclosures by a third.

This 'proportionality' principle reflects the fact that companies with, for example, ten employees do not have the same complex issues, or the means to address them, as a company with hundreds of thousands of employees. This principle is gaining interest and consideration globally, given the existing challenges currently faced by small listed companies. The ANC's proposal is not a substitute for the parallel proposals to revise the disclosure requirements for all companies, but rather complements these.

EDTF

Enhancing the Risk Disclosures of Banks

The EDTF was established by the Financial Stability Board in May 2012. It has three Co-Chairs and approximately thirty members, including banks, institutional investors, major investing houses, the 'Big 4' accountancy firms and ratings companies.

The EDTF met four times over a period of five months and undertook significant outreach around the world. It identified several investor concerns, including difficulty in understanding a company's business model, risk disclosures, liquidity disclosures and the lack of detailed disclosures on credit exposures.

The EDTF published its report, *Enhancing the Risk Disclosures of Banks*, in October 2012. The report set out seven fundamental principles for disclosures and thirty-two recommendations. About a third of those recommendations focused on improving the reporting of capital adequacy and risk-weighted assets.

EFRAG, ANC and FRC

Towards a Disclosure Framework for the Notes

EFRAG believes that there is consensus that disclosures in the notes to the financial statements have become unwieldy. It thinks that the debate needs to move on from a discussion about whether more or less disclosures would improve the quality of information. Instead, a more comprehensive re-think is needed.

EFRAG, together with the ANC and the FRC, undertook this project with the objective of ensuring that all relevant, and only relevant, information is included in the notes. They published a Discussion Paper *Towards a Disclosure Framework for the Notes* in July 2012, with the aim to discuss and obtain feedback on:

- clarifying the purpose of the notes;
- developing principles to identify what information to include in the notes;
- improving the way requirements are set out in Standards;
- strengthening the application of materiality; and
- articulating the main features of effective communication.

The Discussion Paper sets out 14 principles designed to improve standard-setting practices as well as the application of the Standards. Responses indicated that action is needed and that developing a disclosure framework is the appropriate way to address the issue. The notes need to be considered in the broader context of financial reporting and the purpose of the notes should be clear. The responses also assert that there is a tension between an emphasis on explaining transactions up to the reporting date and a focus on providing information that is useful to predict the entity's prospects for future cash flows.

Respondents held different views on how disclosure requirements should be set out in Standards, with:

- some supporting having disclosure objectives with illustrative material;
- some supporting a 'tiered' approach (a core set plus an expanded set that is to be assessed by each entity); and
- some supporting having requirements in Standards, possibly at a less detailed level.

The responses note that materiality is important and there was strong support for developing related application guidance. The responses also state that a change in behaviour is also needed with a switch from compliance to communication. Respondents encouraged investigating further the role of technology (including XBRL).

EFRAG, the ANC and the FRC welcome the IASB's decision to work actively on the project. They urge the IASB to take steps, in addition to the development of a disclosure framework, to trigger rapid improvement in disclosure practice.

ESMA

Materiality in Financial Reporting

In the context of contributing to the consistent application of IFRS in the European Union, ESMA issued a Consultation Paper entitled *Considerations of Materiality in Financial Reporting* in November 2011. ESMA published a *Summary of Responses* in August 2012, which provided an overview of the views expressed by respondents to the Consultation Paper and organised a public round-table discussion on 1 October 2012 about some of the issues raised. ESMA published a Feedback Statement *Considerations of Materiality in Financial Reporting* in February 2013 that summarises the responses received as part of the consultation process.

Respondents believe that the concept of materiality in financial reporting is generally well understood. However, there seems to be diversity in application due to challenges in the correct application of the concept, particularly in the areas of disclosures, the qualitative aspect of materiality and management's exercise of judgement.

Recent work already undertaken continued

While respondents believe that the correct application of the concept of materiality could help to address the disclosure overload problem, ESMA believes that a key element that must be considered is that relevant entity-specific disclosures should be provided in IFRS financial statements in order to be useful for investors and other users. There was consensus that it should be the IASB that provides guidance on materiality, if such additional guidance is deemed necessary.

On the basis of the consultation process, ESMA sees demand for additional guidance on materiality in the following areas:

- the application of the materiality concept to disclosure requirements;
- the assessment of qualitative aspects of materiality; and
- the application of the materiality concept in interim financial reporting.

FASB

Disclosure Framework Project

The objective and primary focus of this project is to improve the effectiveness of disclosures in the notes to financial statements by requiring entities to clearly communicate the information that is most important to users of each entity's financial statements. While not the primary focus, it is believed that clearer communications could reduce the volume of disclosures.

Improving effectiveness will require the development of a framework that promotes more consistent decision-making about disclosure requirements by the FASB and the appropriate exercise of discretion by reporting entities.

The FASB issued the Invitation to Comment, *Disclosure Framework* on 12 July 2012. The FASB received 84 comment letters, a summary of which was presented at its 13 February 2013 meeting.

The FASB held two forums related to this project, in conjunction with the Center for Audit Quality. The forums were designed to encourage dialogue between a wide range of financial reporting stakeholders on improving the effectiveness of disclosures in the notes to financial statements and other parts of the financial reporting package. The forums were held at Columbia University's Center for Excellence in Accounting and Security Analysis, New York, on 4 October 2012 and at the Stanford University Graduate School of Business in Stanford, California, on 8 October 2012.

FRC

Activities relating to disclosures

The FRC believes that improved disclosures can make a significant contribution to improving financial reporting. Two of its recent initiatives in this area relate to thinking about disclosures in a broader context and cutting clutter. It also established the Lab in late 2011 as a means to improve the effectiveness of corporate reporting. The Lab provides a collaborative environment for listed companies and the investment community to explore innovative reporting solutions that better meet their needs.

Thinking about disclosures in a broader context

In October 2012 the FRC published a Discussion Paper *Thinking about disclosures in a broader context* (the 'Discussion Paper'). The FRC notes that a disclosure framework should consider disclosures in a financial report as a whole. It recognises that improving disclosure is a "shared responsibility" between standard-setters, regulators, preparers, auditors and users.

The Discussion Paper set out a road map for a disclosure framework based on four key areas:

- users' needs;
- placement of disclosures;
- proportionality and materiality; and
- communication.

The Discussion Paper introduced placement criteria with a view to organising disclosures in a way that is more informative to users. The criteria stemmed from three components of a financial report: management commentary; corporate governance; and financial statements.

The Discussion Paper also introduced a number of important topics for debate, including the need to identify who the users of financial statements are, determining the boundaries of financial reporting and distinguishing between presentation and disclosure in the IASB's *Conceptual Framework*.

Responses to the Discussion Paper indicate broad support for the proposals, including its scope. The FRC intends to publish a Feedback Statement on the Discussion Paper by mid-2013.

The ANC and the Accounting Standards Committee of Germany supported this Discussion Paper.

Cutting clutter

Cutting clutter: Combatting clutter in annual reports was published in April 2011 and highlights that clutter in financial reports is a problem because it obscures relevant information.

Common sources of clutter in financial reports are:

- immaterial disclosures;
- explanatory information that remains unchanged year to year ('standing data');
- behavioural influences that can be barriers; and
- accounting policies.

Cutting clutter recommended that there is a need for:

- debate around what 'material' means from a disclosure perspective; and
- a consideration of the presentation of 'standing data' outside the printed financial report.

Recent work already undertaken continued

The Lab

The Lab's work focuses on how to improve the content and presentation of information that is disclosed in reports. Its three reports on debt and cash flow disclosures emphasise several disclosures that, while not all specified by IFRS, are considered by the investment community to be critical in at least some circumstances. For example, the reports provide practical illustrations of how some companies communicate the cash and non-cash changes in what they manage as net debt, how much debt principal is due and when it is due, and the relationship between operating profits and operating cash flows. This work highlights key characteristics of disclosure, including the importance of linking information to related items in the primary financial statements, using language that is clear and consistent and using tables to succinctly convey important relationships between items reported or developments in an item over the period.

The Lab has also undertaken work on market-risk disclosure, including a presentation format that separates, in an appendix, the more static disclosure on policies and procedures, allowing the main disclosures to focus on developments in the current period. Building on this, the Lab is currently developing a project on the content and presentation of accounting policy disclosure and is inviting companies to identify information that they perceive to be clutter, so that views can be taken from the investment community to help determine when information is material and to help companies reduce repetition. The Lab is also developing a project on technology-enabled reporting.

IAASB

Auditing Financial Statement Disclosures

In the light of the trends in financial statement disclosures, the IAASB commenced activities in this area in 2010. In January 2011, the IAASB released a Discussion Paper *The Evolving Nature of Financial Reporting: Disclosure and its Audit Implications* that set forth various issues and concerns that it had heard from auditors, regulators and others about the auditing of disclosures. In January 2012, the IAASB issued a Feedback Statement *The Evolving Nature of Financial Reporting: Disclosure and its Audit Implications* to share what it had learned from the responses to the Discussion Paper, because the responses from a wide range of stakeholders were informative, thoughtful and likely to stimulate debate on this important topic.

Following these efforts, the IAASB approved a project in September 2012 to explore whether revisions to the International Standards on Auditing in the form of new or revised requirements or additional application material are required and, if so, to develop such revisions. The IAASB will also further explore whether non-authoritative guidance, such as an International Auditing Practice Note, would be helpful and, if so, it will develop the content.

The main issues for the IAASB relating to this project are the application of the concept of materiality to disclosures, the treatment of mis-statements in disclosures, and the judgements related to the sufficiency and appropriateness of audit evidence for both quantitative and qualitative disclosures. Collaboration and co-ordination with the IASB and other organisations that are pursuing related initiatives will be critical to this project.

ICAS and NZICA

Losing the Excess Baggage

In October 2010 the IASB asked ICAS and NZICA to review the disclosure requirements in IFRS and to recommend changes to those requirements. They delivered their report in July 2011.

The project was intended to be a short-term review of existing disclosure requirements so that ways to rationalise and reduce disclosure requirements could be identified, complementing the broader, more conceptual work being undertaken by others.

ICAS and NZICA noted that the main objective of financial reporting note disclosures should be to allow users of financial statements to focus on what is important and to filter out information that is not material. Their report recommended that each Standard should include a disclosure objective emphasising the need for management to exercise judgement when determining what is 'material'. This could lead to each Standard having less prescriptive disclosure requirements. Their report also concluded that more emphasis should be given to the correct application of the materiality concept. The report proposed that this could be achieved by:

- including more references in IFRS to materiality; and
- separating the consideration of the materiality of financial statement line items from the consideration of the materiality of each piece of information disclosed relating to those financial statement line items.

The report also recommended that the IASB should:

- remove 'encouraged' disclosures;
- remove detailed reconciliations (keeping the material reconciling items only); and
- incorporate accounting policies by reference (except those that have changed).

ICAS and NZICA anticipated that if the IASB implemented their recommendations for disclosures in the notes, the length of financial statements could be reduced by around 30 per cent.

Survey

Survey

Survey background

In conjunction with the Discussion Forum, the staff of the IASB launched a survey on financial reporting disclosure in December 2012.

The survey was aimed at preparers and primary users (for example, investors, analysts, etc) and assisted the IASB in gaining a clearer picture on the perceived 'disclosure problem' in advance of the Discussion Forum.

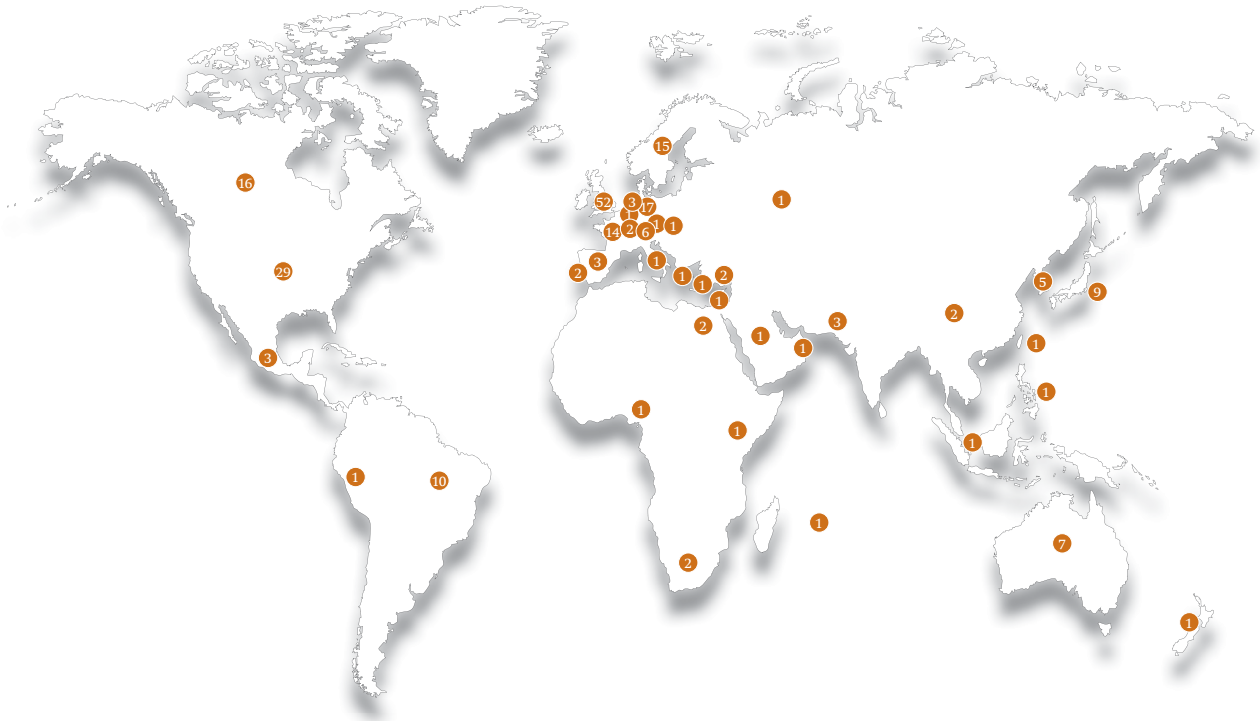
The survey asked several questions, including whether there is a disclosure problem and where in the annual report it is located. It focused on three potential areas of the disclosure problem:

- not enough relevant information;
- too much irrelevant information; and
- poor communication of disclosures.

The survey asked respondents how strongly they agreed or disagreed with these areas being sources of the disclosure problem.

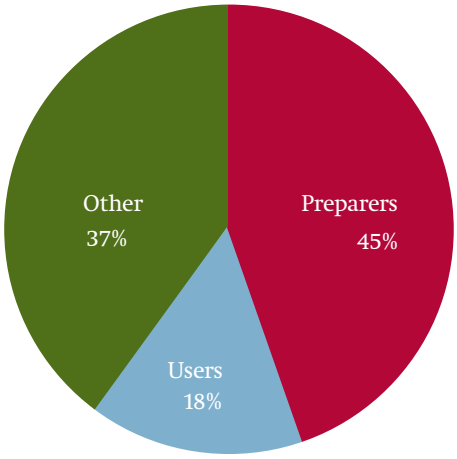
We received 233 responses to the survey.

Who responded*



* In addition, the IASB received responses from respondents who represent global interests or those of a particular region. Global: 5, Europe: 3

Respondents to the survey



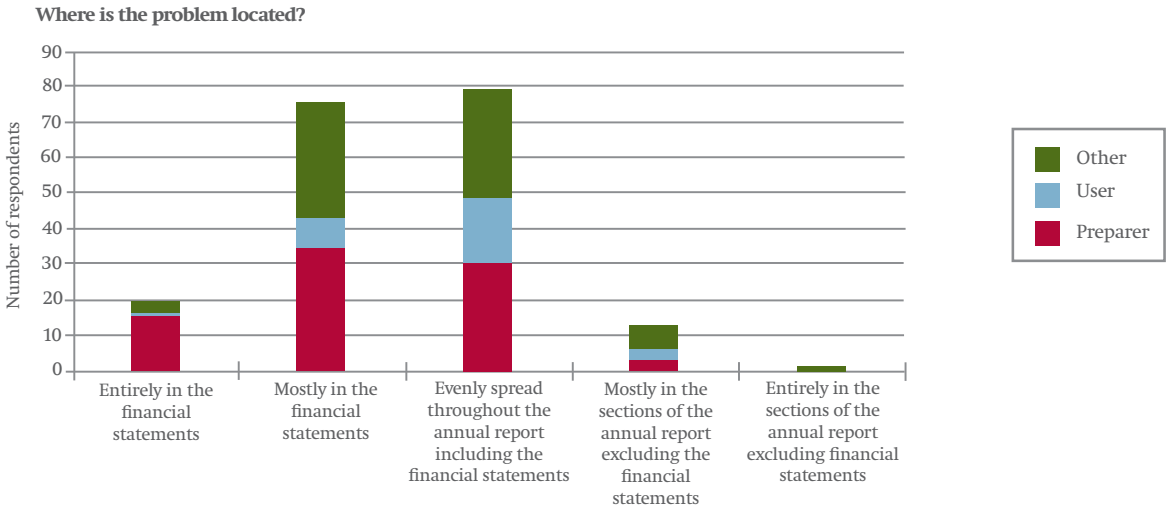
> "We need a change of mindset on this issue. But there must be consensus here, otherwise companies will not change. Nobody is willing to change if the others do not."
>
> **—a preparer**

Survey continued

Is there a disclosure problem?

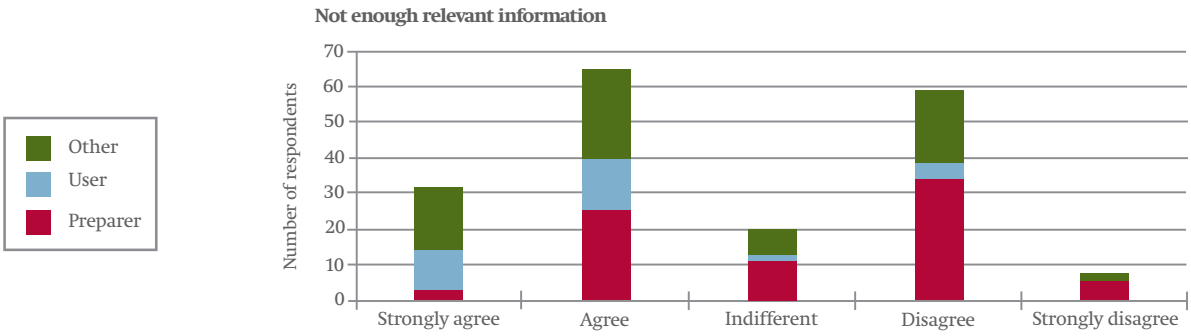
Over 80 per cent of all respondents to the survey, across all three categories (preparer, user and 'other'—for example, auditors, regulators, standard-setters), were of the view that there is a disclosure problem.

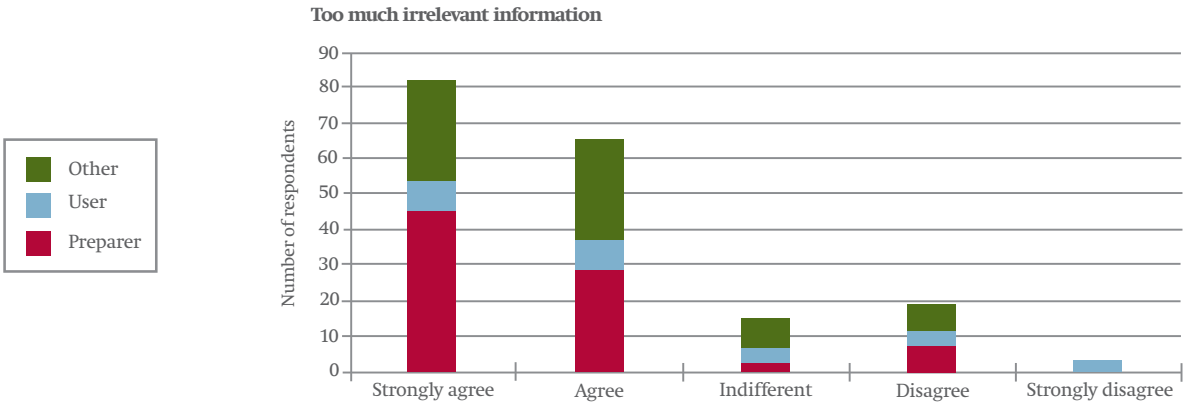
Where in the annual report is the problem located?

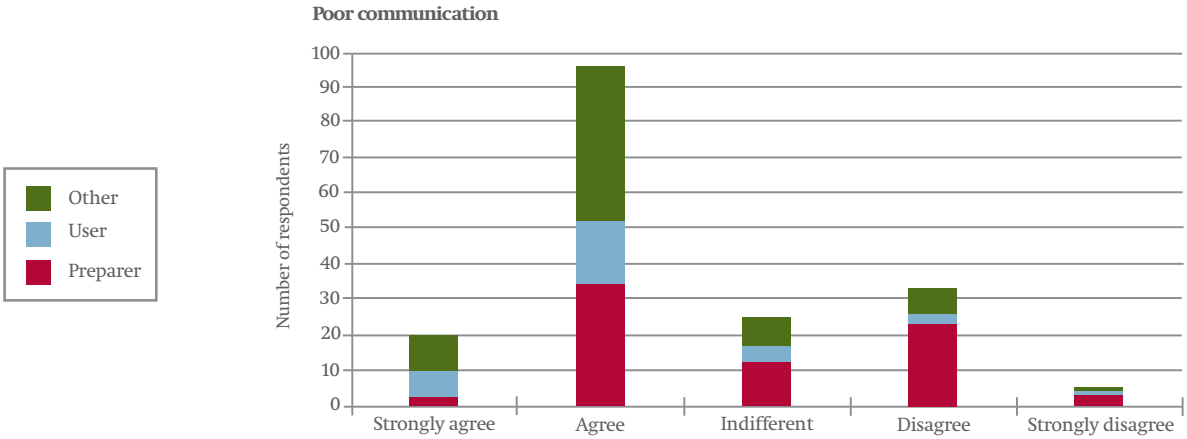


What is the problem?

Our survey asked respondents what they perceived to be the disclosure problem: not enough relevant information; too much irrelevant information (disclosure overload); or poor communication. The graphs below summarise the responses received:*



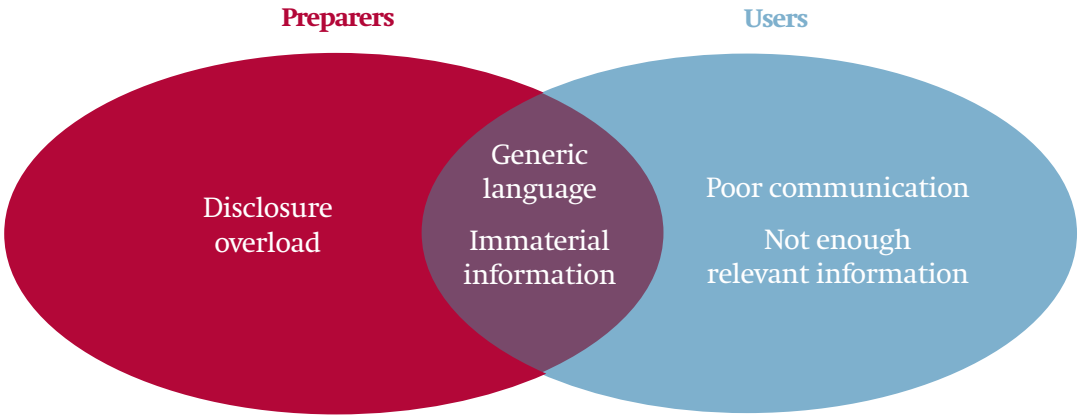




* 'Number of respondents' does not include those who responded 'Dont know' or those who did not respond.

Survey continued

Those preparers who responded to the survey viewed the disclosure problem as primarily one of disclosure overload. Many users who responded saw disclosure overload as an annoyance rather than as a barrier to understanding the financial statements. Overall, users who responded focused on poor communication and a lack of relevant information to describe the disclosure problem. 'Other' respondents were broader in their view of the problem, with most agreeing that all aspects cited in the survey contribute to the disclosure problem.



"The volume of information dilutes the report's meaning and makes it difficult to tell the story."

—a preparer

"[We] believe incomplete or missing disclosures are a much greater threat to the usefulness of financial reporting than too much irrelevant information ('disclosure overload')."

—a user

What is the cause of the problem?

The concept of materiality and its application was a pervasive theme in the survey. It was cited as contributing to all aspects of the disclosure problem.

Preparers and 'other' respondents cited a checklist approach as a particular example of how the concept of materiality was not being appropriately applied. This approach, which treats disclosure guidance in IFRS and other legal or regulatory regimes as a list of requirements, ie a checklist, results in a lack of appropriate judgement to determine whether information is material or not. For example:

- the way Standards are written means that they are interpreted as prescriptive requirements, which invites a checklist approach.

- the time and resources available in a reporting cycle mean that many preparers are not capable or willing to make a materiality judgement. Complying with a checklist is easier. Diverging from a checklist may result in opposition and scrutiny from auditors and regulators, with further implications for time and resources and potential reputation or legal implications if the judgement is proved to be incorrect.

- auditors' review processes were identified as being heavily reliant on checklists. Many preparers indicated that extensive documentation would be required to move an auditor away from a checklist.

- regulators were seen by many as being unwilling to apply a principle-based view, and were often quick to raise a query when a disclosure had been removed or not included.

"Consolidation processes in large multinationals with hundreds of subsidiaries are set up as efficient[ly] as possible with mainly fixed reporting requirements or transfer of accounting information. That, naturally, gives a tendency to 'roll-forward' disclosures without too much consideration for materiality."
—a preparer

"There is also a pronounced problem with auditors and enforcers. As long as these bodies use checklists preparers are clearly discouraged from omitting irrelevant information. However, there could also be disagreement between preparer, auditor and/or enforcer [about] what constitutes a material transaction."
—an enforcer

"If less relevant disclosures relating to less material items were omitted, then there would be greater focus and clarity around what was really relevant. Disclosure overload can obscure the true picture."
—an auditor

Many users who responded to the survey emphasised that preparers and auditors should recognise that there is no need to provide information about immaterial items and, in particular, that boilerplate (non-entity-specific) information should be discouraged. For example, many respondents said that accounting policy disclosures repeated information that was contained in IFRS and was not entity-specific. Many users were clear that they did not want unnecessary repetition of the same (or even worse—almost the same) information throughout the annual report. Repetition not only creates clutter but also creates additional work to identify any differences and to determine whether those differences are meaningful.

Users also cited the concept of materiality and its embodiment in the checklist approach as a cause for not enough relevant information. In their view, the checklist approach means that preparers are less willing to disclose information that, although useful, is not a requirement of IFRS. For example. accounting rules were seen as a reason for companies putting useful information into presentations (for example, earnings releases) rather than in the financial statements. The implication of this is that the information outside of financial statements cannot be policed and reinforces the perception that financial statements are a compliance document.

In terms of poor communication, many respondents cited internal inconsistency and lack of links and signposting throughout the entire annual report as key problems. For example, segment disclosures are not always consistent with information provided elsewhere.

> "Focus on the content rather than the volume of disclosures—it should be possible to both increase content and reduce volume"
>
> **—a user**

Survey continued

Possible solutions

Respondents suggested different ways of addressing the disclosure problem, including:

- IFRS should provide more guidance or education material on the following:
    - the concept of materiality, particularly how it applies to disclosure; and
    - communication principles that would help entities to communicate efficiently the information contained in the financial statements (for example, using illustrative examples).
- to address the problem of poor communication, IFRS should clearly define the overall objective of disclosure requirements. On the basis of principles (commonly shared by preparers, auditors and users) the IASB could then develop consistent disclosure objectives for each Standard. Following on from this, disclosure guidance in each Standard should change from a set of requirements to a set of examples bound by an overall objective.
- it would be helpful to have a better sense of users' interests and requirements. Thus, consideration should be given to regular dialogue with a broad and representative group of users and analysts to come up with balanced, useful disclosures on an ongoing basis. For example, many users raised the issue of non-GAAP data and would like amounts reported in financial statements and 'headline earnings' to be reconciled.
- in the medium-term, technology may help to balance the needs of the more sophisticated users, who tend to demand more and more disclosure, with the needs of those who would prefer more narrative reporting.
- all parties in the financial reporting process (users, preparers, standard-setters, auditors and regulators) should work together to enhance and improve disclosure. In particular, there was a call for improved co-operation between the IASB and regulators.

> "I recommend a statement from [the] IASB where it is clearly stated that preparers can reduce the extent of disclosures even under the existing Standards, with reference to materiality and relevance."
>
> **—a preparer**

Notes

Notes

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International Accounting Standards Board® (IASB®)
The IASB is the independent standard-setting body of the IFRS Foundation

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