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ED/2021/3 & ED 309 Disclosure Requirements in IFRS Standards – A Pilot Approach

I welcome this opportunity to make a submission and would like to comment both generally as well as on some of the specific questions.

General Comment

There are underlying assumptions in the exposure draft about 'users' of financial reports and that the product of the financial reporting process is the traditional financial report. It is assumed that for users a traditional financial report is the primary mechanism for accessing financial information, and this is accessed or utilized physically or as a 'virtual document'. While tags (e.g., xbrl) may be attached to items in the financial report, this is only to facilitate extraction of information electronically. As only information in the financial report can be tagged this use of financial report information is secondary.

Unfortunately, the implications of these assumptions are not addressed or considered in the exposure draft, and it has significant implications that are well identified in Rowbottom, Locke, and Troshani (2021). This identifies the conflicting requirements of financial reports where information is accessed and used traditionally and those where the information is accessed and used electronically. This may be by different users, or the same user at different times. Critically, the former allows standards to adopt the 'objective' approach to disclosure that is advocated in the exposure draft. It permits firm specific disclosures and requires financial report users (probably expert users) to understand the nature of disclosures that are not specifically prescribed by accounting standards and may vary across firms. The later quite simply requires consistency and comparability in data items that are appropriately identified or tagged. It also facilitates computer assisted use of financial reports by non expert users. These requirements are mutually exclusive. The problems of firm specific disclosures for electronic use of information in financial reports has already been unequivocally demonstrated in the United

States where flexibility was initially allowed in the tags applied to financial data (i.e., customized tags). The resultant diversity in disclosure and inconsistency in information and tags was an impediment the use of information in financial reports electronically. This was subsequently addressed and it triggered a major revolution in how information in financial reports is accessed and used. The absence of specific disclosures being prescribed in accounting standards might be addressed by including in the taxonomy tags that reflect 'Common Accounting Practice' but such an 'ad hoc' approach gives rise to a range of questions:

i. How and when is 'Common Accounting Practice identified?
ii. How are tags for 'Common Accounting Practices' attached to items not included in financial reports?
iii. Does 'Common Accounting Practices' become part of the accounting standards?
iv. If 'Common Accounting Practices' are part of the accounting standards then are there additional prescribed disclosures for these items (i.e., information overload)?
v. If 'Common Accounting Practice' is not part of the accounting standard is compliance mandatory or voluntary?

These are significant questions and in addressing them serious consideration needs to be given to how information in financial reports is accessed and used.

Insights into this are provided by a significant body of academic research considering the electronic accessing and use of financial information. The benefits of accessing and using the information in financial reports electronically include a lower cost of capital. For users they include a lower cost of gathering information and economically material abnormal stock returns from trading strategies.[1] For these reasons and others there is the demand for information in financial reports that can be accessed and used electronically. More importantly, there is also evidence that the accessing and using of information in financial reports electronically is increasing and now dominates. These studies focus on the United States where the SEC provides logs of data accesses made through EDGAR. Clear insights into utilization are apparent and consistent. For example Hollander and Litjens (2020) identify documents on EDGAR being accessed 2.3B times over the period 2010 – 2015. Admittedly this extends beyond 10K's but it is one of the major documents. Using a common process for distinguishing computers / robots accessing information they identify 2.1B or 89% of those accesses as being by robots, with this doubtless facilitating and being the precursor to the electronic use of financial information. This is equally apparent in Wang (2020), and this identifies accesses of 10K's specifically. In Figure 1, Panel B this clearly shows:

i. An escalation in electronic accessing of information since issues with flexible tags (identified above) were addressed; and,
ii. Over 90% of accesses of being by computer / robot.

Put simply, it can no longer be maintained that the primary output of the financial reporting process is a financial report that is accessed physically or as a virtual document. This outcome is not surprising as users (e.g., analysts) would be expected to increasing rely on computer screening to determine firms subject to additional, more expensive, evaluation.

[1] These are well accepted in the literature and in the interests of brevity they will not be included here.

This exposure draft pre-empts the proper consideration of

i. How the accessing and use of financial information is occurring now?
ii. Whether information should be presented in both a traditional format and electronically?
iii. What should be the relation between information presented in traditional financial reports and electronically (i.e., the same?)

Addressing this last question may not only be relevant to the current exposure draft but also the Disclosure Initiative and the presentation of information in financial reports generally and Extended External Reporting. For example, materiality might be an issue in traditional financial reports where excess information may be a distraction, but this is unlikely to be the case if information is accessed and used electronically. Hence, it would also help to address concerns with the application of materiality. Put simply a determination needs to be made on whether traditional financial reports and electronic reports substitutes or compliments.

These issues would probably be more appropriately addressed in the Conceptual Framework and would require a substantial re-consideration of the users of financial reports and how they use financial information in the 21st century. It would also likely issue a potential pathway to address the potentially divergent requirements of users for information in Extended External Reporting.

Specific Comments

1. Using overall disclosure objectives. In addition to the comments above I would caution against the use of overall disclosure objectives. While it is relatively easy to appreciate the rationale for overall disclosure objectives being incorporated in the Conceptual Framework, translating this to specific accounting standards, even IAS 1, is more difficult. Ostensibly this would encourage preparers to determine additional disclosures with the risk that these disclosures become excessive and complicated. As an example of excessive and complex disclosures consider Remuneration Reports in the financial reports of Australian firms. There is also the likelihood that 'boilerplates' will be developed ostensibly claiming to meet these objectives. This would be similar to the model financial reports that are published presently. Such a change is occurring against a background of trying to simplify financial reports and enhance understandability. These are mutually inconsistent. A more fundamental question is whether any additional disclosures that may he highly technical can / should occur outside the financial report and this already occurs for many firms where the determination of items in the financial report are complex (e.g., iSelect Ltd provides considerable information about the estimation of future cash flows used to determine current period revenues outside its financial report with investor presentations). If the disclosures are necessary there will be sufficient economic incentives for them to be made without creating the risk of increasing financial report complexity and opacity.

2. Using specific disclosures objectives and the disclosure problem. The concerns expressed above also manifest here. Furthermore, to the extent that specific disclosure objectives form the basis for determining what is relevant, or more problematically irrelevant, this is challenging if it results in inconsistent, and potentially complex disclosures. Again an assumption underpinning the development of specific disclosure outcomes is that financial reports are the only relevant disclosure mechanism for the firm. This is limiting and creating objectives for financial reports that simply can't be achieved.
3. Increased application of judgement. There are likely two responses to an objectives based determination of disclosures. One would be a diversity of disclosures across time and firms that likely undermines comparability and understandability. This may also be used as a means to argue certain information is irrelevant which could be an adverse outcome. The second is a set of boilerplate disclosures developed by accounting firms that are 'defensible' in arguments that the objectives are satisfied. Neither outcome is considered favourably. The alternative for firms is to risk criticism when challenged in the event of a failure. Rather, the standards should dictate specific and consistent disclosures that capture how recognition and measurement has occurred.
4. Describing items of information to promote the use of judgement. Irrespective of how this is written, the language will inevitably create a presumption that the identified disclosures satisfy the disclosure objective. This will create what for most firms will simply be a 'defacto' checklist and little improvement on the current situation.
5. Other comments on the proposed guidelines. The development of disclosure objectives that address the needs of diverse users is unlikely to be straightforward. Insights into magnitude of this problem might be obtained by considering the history of conceptual framework projects (Joyce, Libby, & Sunder, 1982) and there is significant risk the disclosure objectives developed will be either vague and ineffective to cater for diverse user needs, or focused on the needs of particular users to the exclusion of others.

If I could make two concluding comments, they are that careful consideration needs to be given to the users of financial information, and how that information is accessed and used. There are limits about what can be achieved or included in (traditional) financial reports. Doubtless there would be scope for future development of traditional financial reports if there were alternative electronic disclosures of financial information. However this requires determination of the roles both traditional and electronic financial reports and this is more appropriately addressed in the context of the conceptual framework.

Yours faithfully

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