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Australian Accounting Standards Board

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17 December 2021

Dear Andreas,

IASB Exposure Draft ED/2021/3 *Disclosure Requirements in IFRS Standards — A Pilot Approach*

The Australian Accounting Standards Board (AASB) is pleased to have the opportunity to provide comments on the *IASB ED/2021/3 Disclosure Requirements in IFRS Standards — A Pilot Approach* (the ED) issued on 25 March 2021.

In formulating these comments, the views of Australian stakeholders were sought and considered. This consultation included:

- consultation with the AASB's User Advisory Committee (UAC);
- consultation with the AASB's Disclosure Initiative (DI) Project Advisory Panel, which comprises subject matter experts across a range of stakeholder groups;
- two formal comment letters; and
- other targeted consultations on specific financial reporting issues involving a range of AASB stakeholders, including financial statement preparers, auditors, professional bodies, regulators, academics and users.

The AASB acknowledges the efforts of the International Accounting Standards Board (IASB) to address the disclosure problems identified by users of financial statements. However, the AASB does not support the proposed disclosure approach set out in ED/2021/3 (i.e. replacing the current disclosure requirements with those based on compliance with the disclosure objectives). The AASB is of the view that, due to the high level of subjectivity required, the proposals in the ED may be difficult to apply by preparers, assure by auditors and enforce by regulators. In addition, the proposals are unlikely to solve the disclosure problem as entities may not change their current disclosure behaviour.

In addition, as discussed in detail in the Appendix to this letter, we are concerned that the lack of clarity and specificity of the proposals in the ED would:

- not effectively eliminate immaterial disclosures;
- result in loss of detailed information required by users;

- reduce the comparability of financial statements;
- increase the compliance burden for preparers, particularly for the smaller entities with fewer resources; and
- increase users' costs to access and use the information contained in the financial statements.

We consider that some elements of the approach proposed in ED/2021/3 could help address the disclosure problem; for example, explaining the disclosure objectives could help preparers of financial statements better understand the rationale and intent behind the specific disclosure requirements. In addition, involving the users of the financial statements early in the standard-setting process to understand and articulate their information needs could result in more relevant disclosure requirements.

Therefore, the AASB suggests that the IASB considers using the proposals outlined in the ED as guidance when developing future Standards or reviewing detailed disclosure requirements of current Standards (e.g. as part of the post-implementation review) rather than replacing the current disclosure requirements.

The AASB also encourages the IASB to undertake further research into future forms of financial reporting (e.g. digital financial reporting) and machine reading technologies to understand better how information may be accessed in the future and how changing technology might affect users' information needs and hence, the identification of appropriate disclosure requirements and objectives.

The detailed recommendations and responses to the specific questions for respondents are provided in the Appendix to this letter. If you have any questions regarding this letter, don't hesitate to contact me or Helena Simkova, Deputy Technical Director (hsimkova@aasb.gov.au).

Yours sincerely,

Dr Keith Kendall
Chair
Australian Accounting Standards Board

Appendix

Question 1—Using overall disclosure objectives
Paragraphs DG5–DG7 of this Exposure Draft explain how the Board proposes to use overall disclosure objectives in future. (a) Do you agree that the Board should use overall disclosure objectives within IFRS Standards in future? Why or why not? (b) Do you agree that overall disclosure objectives would help entities, auditors and regulators determine whether information provided in the notes meets overall user information needs? Why or why not?

Question 2—Using specific disclosure objectives and the disclosure problem
Paragraphs DG8–DG10 of this Exposure Draft explain how the Board proposes to use specific disclosure objectives in future. (a) Do you agree that specific disclosure objectives, and the explanation of what the information is intended to help users do, would help entities apply judgements effectively when preparing their financial statements to: (i) provide relevant information; (ii) eliminate irrelevant information; and (iii) communicate information more effectively? Why or why not? If not, what alternative approach would you suggest and why? (b) Do you agree that specific disclosure objectives, and the explanation of what the information is intended to help users do, would provide a sufficient basis for auditors and regulators to determine whether an entity has applied judgements effectively when preparing their financial statements? Why or why not?

Question 3—Increased application of judgement
Paragraphs DG2–DG3 and DG8–DG13 of this Exposure Draft explain why, in future, the Board proposes to: (a) use prescriptive language to require an entity to comply with the disclosure objectives. (b) typically use less prescriptive language when referring to items of information to meet specific disclosure objectives. An entity, therefore, would need to apply judgement to determine the information to disclose in its circumstances. This approach is intended to shift the focus from applying disclosure requirements like a checklist to determining whether disclosure objectives have been satisfied in the entity's own circumstances. Paragraphs BC188–BC191 of the Basis for Conclusions describe the likely effects of this approach on the behaviour of entities, auditors and regulators towards disclosures in financial statements. Paragraphs BC192–BC212 of the Basis for Conclusions describe the likely effects of this approach on the quality of financial reporting, including the cost consequences of the approach.

(a) Do you agree with this approach? Why or why not? If not, what alternative approach do you suggest and why?

(a) Do you agree that this approach would be effective in discouraging the use of disclosure requirements in IFRS Standards like a checklist? Why or why not?

(b) Do you agree that this approach would be effective in helping to address the disclosure problem? For example, would the approach help entities provide decision-useful information in financial statements? Why or why not?

(c) Do you agree that this approach would be operational and enforceable in practice? Why or why not?

(d) Do you have any comments on the cost of this approach, both in the first year of application and in subsequent years? Please explain the nature of any expected incremental costs, for example, changes to the systems that entities use to produce disclosures in financial statements, additional resources needed to support the increased application of judgement, additional audit costs, costs for users in analysing information, or changes for electronic reporting.

Responses to Question 1 – Question 3

The comments to Questions 1–3 of the ED are interrelated and are provided in a combined response below. The responses to Questions 1–3 should be read in light of our overall comments in the cover letter.

The AASB appreciates the IASB's initiative to address the disclosure problems via promoting judgements in disclosure decisions. However, the AASB does not support the proposed disclosure approach set out in the ED for the same reasons stated by those IASB members expressing alternative views, which are noted in paragraphs AV1– AV14 of the Basis for Conclusions (BC) of the ED. The AASB is concerned that the proposed disclosure approach may not result in the desired outcome, mainly due to the significant level of judgement required from the preparers. In particular, the AASB is concerned that:

- increased reliance on materiality judgements and requiring preparers to determine whether they meet user information needs would not effectively solve the problem. The AASB considers the key driver of the disclosure problem is whether entities can appropriately apply materiality judgements when deciding on disclosures. The disclosure problem can be adequately addressed only through the proposed objective-based disclosure approach if preparers apply the materiality concept appropriately. Some entities, particularly the smaller ones with fewer resources, might be challenged by the level of complex judgement required, and instead use the proposed items of information in the ED as a new form of 'checklist', which would not result in the provision of less irrelevant information. In other cases, preparers may tend to disclose all available information because they would be unsure of users' needs, resulting in lengthy financial statements.
- the level of judgement involved would make it difficult for auditors to provide assurance and also for regulators to enforce. Without more specific disclosure requirements, it could be difficult for auditors and regulators to determine whether preparers have

appropriately and adequately assessed their primary users' information needs and whether the specific information disclosed is sufficient or needed to meet the disclosure objectives.

- the proposals in the ED could reduce the comparability of information in financial statements. There might be a diversity in the extent and quality of disclosures among entities as different preparers may provide various types of information to meet the disclosure objectives. The AASB acknowledges the IASB's view that uniform information and comparable information are not the same thing (as outlined in para. BC198). However, the information content reflected from other disclosures is only comparable in all material respects if each entity applied its judgement appropriately. Further, audit firms could become the key driver for comparability and financial statements audited by the same audit firm would likely be more comparable than those audited by other audit firms.
- more entity-specific narrative information that is less standardised may increase the information cost for users. Users would be required to perform additional steps to convert the information into a form that is comparable between entities.

Further, the AASB noted that the recent IASB ED/2021/7 *Subsidiaries without public accountability: Disclosures* does not include disclosure objectives. The AASB recommends that the IASB consider whether the different disclosure approaches could potentially confuse some stakeholders and potentially impair comparability of financial statements. For example, a parent entity complies with the disclosures required by IFRS 13 *Fair Value Measurement* under the proposals in ED/2021/3 whereas a subsidiary complies with the disclosure requirements of IFRS 13 as proposed in ED/2021/7.

Question 4—Describing items of information to promote the use of judgement
The Board proposes to use the following less prescriptive language when identifying items of information: 'While not mandatory, the following information may enable an entity to meet the disclosure objective'. Paragraphs BC19–BC26 of the Basis for Conclusions describe the Board's reasons for this language and alternative options that the Board considered. Do you agree that the proposed language is worded in a way that makes it clear that entities need to apply judgement to determine how to meet the specific disclosure objective? If not, what alternative language would you suggest and why?

Responses to Question 4

Our response to Question 4 should be read in light of our overall disagreement with the proposed disclosure approach in the ED.

As discussed earlier in our response to Questions 1–3 above, the AASB is concerned that the proposals in the ED would be unlikely to achieve their desired outcome due to the high level of subjectivity involved. The subjectivity is partly attributed to the less prescriptive language used to identify the items of information.

The AASB agrees that the proposed language is worded to clarify that entities need to apply judgement to determine how to meet specific disclosure objectives. However, the AASB is concerned that some entities might misinterpret the "while not mandatory…may enable…" as a voluntary disclosure requirement. Stakeholder feedback indicated that entities tend not to disclose information prescribed by non-mandatory requirements. Some entities might purposely use this term as an opportunity to avoid disclosing relevant and material information that they do not want to share with users.

Question 5—Other comments on the proposed Guidance
Paragraphs BC27–BC56 of the Basis for Conclusions describe other aspects of how the Board proposes to develop disclosure requirements in IFRS Standards in future applying the proposed Guidance. Paragraphs BC188–BC212 of the Basis for Conclusions explain the expected effects of any disclosure requirements developed using the proposed Guidance. Do you have any other comments on these aspects? Please indicate the specific paragraphs or group of paragraphs to which your comments relate (if applicable).

Responses to Question 5

Comments relating to 'whether and how the Board can develop specific disclosure objectives' (paragraphs BC27-BC47)

As suggested in the cover letter, despite not supporting the proposed objective-based disclosure approach, the AASB considers that some elements of the approach proposed in ED/2021/3 could be useful to address the disclosure problem and enable standard setters to develop requirements that produce more relevant disclosure because:

- disclosure objectives could help preparers of financial statements better understand the rationale and intent behind the specific disclosure requirements; and
- developing disclosure objectives early in the standard-setting process would help better articulate users' needs, and in turn, would provide a better basis for standard setters to determine what disclosure is necessary.

The AASB, therefore, encourages the IASB to consider alternative uses of the disclosure objectives, such as using the proposed Guidance as a guide when developing future Standards and reviewing detailed disclosure requirements (e.g. as part of the post-implementation reviews). This approach would retain the advantages noted above but bypass many practical challenges identified in our response to Questions 1–4. The benefits of the current disclosure approach (i.e. mandatory disclosure requirements) would continue under this approach, and preparers would not be burdened by the extra layer of complex judgements. Comparability issues and enforcement challenges would be avoided. Entities' opportunistic disclosure behaviour would also be avoided.

As part of this approach, it is also suggested that the IASB includes the disclosure objectives in the Basis for Conclusions section of each standard. This would allow preparers, auditors, and regulators to better understand users' needs and, ultimately, lead to more relevant disclosures and more effective communication of the information presented.

Comments relating to 'working with the IFRS taxonomy team' (paragraphs BC48–BC49) and digital financial reporting

The AASB acknowledges that the IASB technical team works with the IFRS taxonomy team when new disclosure requirements are developed. However, the AASB is concerned that objective-based disclosures could result in inconsistent tagging, which could impede the electronic use of the information in financial reports. This concern is based on findings from academic research.[1] For example, objective-based disclosures could encourage custom tagging and result in a situation where a company tags a whole paragraph of text as 'company-specific' disclosure. The tag itself would not provide meaningful information to users and require users to read through the disclosure to classify the information.

Academic research has observed an increasing trend in using machine reading technologies to access information in financial reports.[2] Digital reporting has become the dominant form of financial reporting in some jurisdictions, for example, the US. When financial information is accessed via machine reading/learning technology, comprehensive prescriptive disclosure requirements are preferred over principles-based requirements, as they enable standardised comparability.[3] Users who access and analyse financial statements electronically require consistency and comparability of appropriately identified or tagged data. Digital financial reporting enables users to access financial reporting disclosure in a way customised to users' needs and capacity, as opposed to 'one size fits all' financial statements.

Digital reporting may develop further through, for example, multiple-layered reporting. While not directly addressed in the ED, future developments may mean that the issue of disclosing too much irrelevant information identified by the IASB in the ED may become irrelevant. Application of material judgements may not be required as extensively if the information is accessed and used electronically.

With the expectation that digital reporting will be the primary form for financial reporting in the future and machine reading will be widely used, the AASB encourages the IASB to:

- undertake further research into future forms of financial reporting beyond the existing taxonomy (e.g. digital financial reporting and use of machine reading technology to access financial statements) to better understand the potential effects on financial reporting and how disclosure requirements might be expressed; and
- consider developing disclosure requirements that embrace future forms of financial reporting and the use of machine reading/learning technology to access information in the financial statements.

Questions 6 – Question 18

We have no comments on Questions 6–18. Australian stakeholder feedback to the proposed amendments to IFRS 13 was primarily related to the implementation challenges for the proposed new disclosure approach in the ED, similar to our comments to Questions 1–5 above. We have no specific comments for the proposed amendments to IAS 19 *Employee Benefits*. The proposed amendments are not expected to significantly impact Australian stakeholders as defined benefit plans are not frequently used in the private sector in Australia.

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1 For example Rowbottom, N., Locke, J. & Troshani, I. (2021). When the tail wags the dog? Digitalisation and corporate reporting. *Accounting, Organizations and Society*, 101226.

2 For example, Hollander, S. & Litjens, R. (2020). Localized Information Acquisition: What Do Two Billion EDGAR Queries Say About Who Acquires Information from SEC Filings and When? https://ssrn.com/abstract=3691111; Wang, P. (2020). Demand for information and stock returns: Evidence from EDGAR. University of Rochester, https://finance.business.uconn.edu/wp-content/uploads/sites/723/2020/01/Wang_Rochester_JMP.pdf.

3 See footnote 1.