STAFF PAPER

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IASB Meeting

Project	**Disclosure Initiative**		
Paper topic	Principles of Disclosure (POD)—Communication principles		
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Introduction

1. We have heard that poor communication is part of "the disclosure problem".[1] Although IAS 1 provides some guidance on communication by requiring financial statements to be fairly presented, the fact that poor communication is often raised as an issue suggests that this guidance may not be sufficient.

2. The purpose of this paper is to obtain the IASB's tentative views on:

   (a) whether additional guidance that promotes good communication is needed in IFRS; and if yes

   (b) what that additional guidance should be.

Staff recommendations

3. The staff recommend that:

   (a) there should be additional guidance to promote effective and efficient communication in IFRS.

   (b) additional guidance should be based on:

[1] IASB Discussion Forum—Financial Reporting Disclosure Feedback Statement, May 2013 pages 35-36

(i) the Qualitative Characteristics in the Conceptual Framework: understandability, comparability and faithful representation; and

(ii) the communication principles in the 2013 *Conceptual Framework* Discussion Paper.

Background

What we have heard

4. At the Discussion Forum—Financial Reporting Disclosure held in January 2013 (the Disclosure Forum) and from the related survey we heard that:

   (a) financial reports, including financial statements are a fundamental medium for communication;

   (b) the focus of financial reporting should be more on communication rather than on compliance; and

   (c) some financial reports are not effective in communicating financial information, because of one or more of the following:

      (i) poor organisation and structure;

      (ii) lack of linkage and signposting;

      (iii) internal inconsistencies;

      (iv) duplication.

5. Some respondents to the Disclosure Forum survey suggested that the IASB should provide more guidance in the form of communication principles. In their view, these principles would help entities to communicate the information contained in the financial statements more effectively. We have also heard that clear and concise disclosures enhance the confidence of users in financial statements and reports.

6. In its July 2013 Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* (the CF DP) the IASB proposed that effective communication reflects the fundamental qualitative characteristic of faithful representation and the enhancing qualitative characteristics of understandability and comparability. The IASB also proposed six communication principles that it should consider when setting

disclosure requirements. These principles are set out fully in Appendix A, but in summary proposed that the disclosure of information in financial statements should:

(a) be entity-specific;

(b) be clear, balanced and understandable;

(c) be organised in a way that highlights respective importance of different items of information;

(d) be linked and show relationships;

(e) not result in duplication; and

(f) optimise comparability without compromising usefulness.

7. Many respondents to the Discussion Paper commented on the proposal to include communication principles in the *Conceptual Framework*. Many of those who commented agreed with including communication principles either in the *Conceptual Framework* or in a Standard, such as IAS 1.

8. A few respondents suggested that the communication principles are not needed because the *Conceptual Framework* already discusses qualitative characteristics of financial information.

9. Some respondents suggested other communication principles that the IASB should include in the *Conceptual Framework*. For example, those respondents suggested that the IASB should:

(a) periodically review disclosure requirements and remove the requirements that are no longer relevant;

(b) explicitly state that disclosure of immaterial information is not required because such information reduces understandability;

(c) require entities to highlight particularly important entity-specific information at the beginning of the notes;

(d) require more disclosures about uncertainty in measurement.

10. In its June 2014 meeting the IASB tentatively decided to include in the *Conceptual Framework* those communication principles proposed in the Discussion Paper that are primarily directed at the IASB, namely that disclosure requirements should seek to:

(a) promote the disclosure of useful information that is entity-specific;

(b) result in disclosures that are clear, balanced and understandable;

(c) avoid duplication of the same information in different parts of the financial statements; and

(d) optimise comparability without compromising the usefulness of the information disclosed.

11. Those communication principles proposed in the CF DP which were primarily targeted at entities, were to be further explored in the Principles of Disclosure (POD) project.[2]

Current guidance on communication

12. Paragraph 15 of IAS 1 states that financial statements must present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the *faithful representation* of the effects of transactions, other events and conditions.

13. Paragraph 17(b) of IAS 1 further states:

> In virtually all circumstances, an entity achieves a fair presentation by compliance with applicable IFRSs. A fair presentation also requires an entity:
>
> (a) …
>
> (b) to present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.
>
> (c) …

Staff analysis

14. The staff analysis is as follows:

(a) Do we need communication principles?

[2] June 2014 IASB Meeting Agenda Paper 10F.

(b) What is good communication? (paragraphs 18-23)

(c) Communication principles (paragraphs 24-32).

(d) Specific guidance (paragraphs 33-34).

(e) Applying the communication principles (paragraph 35).

Do we need communication principles?

15. Before we proceed any further, we questioned whether we should add communication principles to an IAS 1 replacement. At a very basic level, telling people to write clearly and to organise their information carefully would seem to some to be patronising. On the other hand, many accounting and professional organisations have had initiatives aimed at improving communication. The SEC has had several initiatives, including ‘plain English’ initiatives that have included guidance on improving the readability of documents.

16. We concluded that we should recommend that we provide communication principles, because we can explain how general communication principles can be applied to financial reporting.

17. We have one caveat. We are concerned that there has been too much focus on page counts in financial reports. The experience internationally is that plain English initiatives and the application of good design principles tend to increase the number of pages. This is because there is more white space, and plain English explanations are inherently longer than short-hand jargon.

What is good communication?

18. Because we have heard that poor communication is part of the disclosure problem, we think it is important to understand what we mean by communication and what makes it good or poor.

19. Communication is a process that involves:

(a) the message (the ‘what’);

(b) the means of communication (the ‘how’); and

(c) the receipt of the message by someone who understands it.

20. The purpose of this paper is to consider financial statements in the context of communication. Within that context, the message the statements contain is useful financial information. The entity communicates this financial information using text, numbers and data relationships, which, as a group, constitute the financial statements. Communication can also include the format in which the information is delivered; for example, paper, pdf, on a screen or as structured data.

21. Understandability is a key feature of communication. Good communication means that information is easily understood ie it is both effective and efficient at getting the message across. For example long textual descriptions of aspects of an entity's financial performance and financial position might be understandable. However, the information is probably more easily (effectively) and more quickly (efficiently) understood by users if the entity's financial position and performance is described using tables. This is because the information in the table is likely to be more concise or clearer.

22. The cost of disclosure and the medium of communication can act as a constraints.[3] Disclosing information more concisely may also have positive consequences from a cost/benefit perspective. Unnecessarily voluminous disclosures may be inefficient for preparers producing financial statements as large amounts of data in financial statements files may require more resources to be produced. The choice of a specific communication medium may also have different cost implications. For example, we have heard that using XBRL filings or structured online reports are beneficial to some users of financial statements, however entities could incur additional costs when selecting these media.

23. We recognise however, that the way preparers communicate with the users of its financial statements is not just limited to the delivery of its financial statements. There are a range of ways preparers communicate with their users, including press releases, earnings presentations and direct dialogue. In addition, users also communicate to the preparers by providing feedback. Feedback from users helps

[3] QC35-QC39 of the *Conceptual Framework.*

entities determine the content of its financial statements, but may also provide suggestions for how information may be better communicated.

Communication principles

24. We think that a Disclosure Standard (replacement of IAS 1) should contain communication principles. We think the obvious starting point would be:

    (a) the qualitative characteristics of understandability, faithful representation (specifically neutrality) and comparability; and

    (b) the six communication principles set out in the CF DP.

Understandability

25. As discussed in paragraphs 18- 22 above, we think understandability is the fundamental characteristic of good communication.

26. Paragraph QC30 of the *Conceptual Framework* states that "classifying, characterising and presenting information clearly and concisely makes it *understandable*". We think the elements of this definition relate to communication as follows:

    (a) Classifying information means arranging a group of things in classes or categories according to their shared qualities. Classifying information may determine what information is disclosed eg categorising income by its nature, geographical region, type of customer. It may also relate to how it that information is communicated, for example grouping notes that present closely related information.

    (b) Characterising information means describing the distinctive nature or features of that information. To disclose information tailored to the entity's transactions or operations is a way to characterise this information. For example by relating an entity's accounting policies explicitly to its underlying activities.

    (c) Clear information is easy to perceive or interpret. Being clear, makes information effective. This may mean using simple, non-technical language and formats as much as possible. We also think that saying that information should be clear relates to the accessibility of the information.

Information that is difficult to find (obscured or in a different location) is not clear. Thus, decisions about placement of information should take into consideration how easy the information is to access and to read as a part of the financial statements as a whole.

(d) Concise relates to describing things accurately using the least amount of descriptive resources eg words/text, pages etc possible whilst still making sure the information is understood. For example tables generally result in the disclosure of the same amount of information in less words. Information that is presented concisely is a more efficient use of resources. In addition, presenting information concisely often means that the important aspects of what is written are clearer and therefore more understandable.

Comparability

27. “Comparability is the qualitative characteristic that enables users to identify and understand similarities in, and differences among, items” (QC 21).

28. One of the most important reasons that financial reporting standards are needed is to increase the comparability of reported financial information (BC 3.33 of the *Conceptual Framework*). It follows that applying IFRS will result in financial statements that have some degree of comparability between entities and across periods.

29. Comparing information between entities and periods ultimately enhances its understandability. For example, comparing an entity’s profit in the current period against the losses reported in previous periods, gives the current periods profit additional context in which to assess and understand it.

30. Consistent disclosure format and content between periods and between entities can make comparability easier. However, striving to make comparability easier by using consistent formats may, in some cases, obscure differences between entities and periods. This could make financial statements less understandable. For example, using an industry format of presentation may not be appropriate where that presentation obscures a relevant aspect of a particular transaction.

Neutrality

31. "A neutral depiction is without bias in the selection or presentation of financial information. A neutral depiction is not slanted, weighted, emphasised, de-emphasised or otherwise manipulated to increase the probability that financial information will be received favourably or unfavourably by users" (QC 33).

32. We think neutrality plays a role in trying to ensure that useful information is not misleading, both in what is disclosed and how it is disclosed. Thus, we think neutrality acts as a constraint on how information is communicated. For example, undue prominence given to an adjusted profit number may be seen as causing a misleading depiction.

Specific guidance

33. We think the communication principles in the CF DP sought to describe, in a practical way, how the qualitative characteristics (discussed in paragraphs 25-32) relate to good communication.

34. By combining our analysis and the CF DP communication principles, we think good communication principles in a Disclosure Standard could be described as follows:

    (a) Information in financial statements should be presented or disclosed in such a way that makes it easy to understand. That is, information should be as clear and concise as possible. More specifically, entities should make disclosures that:

        (i) are entity-specific. That is information should be characterised with entity's features that focus the reader on how that information is related or applied to the entity and its activities;

        (ii) use simple and direct language as much as possible. For example minimise the use of technical terms, jargon, long sentences;

        (iii) use appropriate formats for the type of information being disclosed for example tables lend themselves to the disclosure of quantitative information, lists can be used to break-up long narrative text;

(iv) are organised in a way that highlights what is important for a user to know. This could be done by the use of summaries or indexes, ordering notes, use of different fonts such as underlining, bold, colour etc to make clear key messages or differences;

(v) are linked. Disclosures should highlight the relationships between information within the financial statements and other parts of the financial report. For example, relationships can be highlighted by use of cross-referencing, grouping of disclosures and by hyperlinks. Relationships can also be highlighted through consistent use of terminology in different sections of the financial report.

(vi) are easy to access and able to be read in the context of the financial statements as a whole.

(vii) do not obscure useful information. For example, information can be obscured through the inappropriate use of ordering eg moving items to the back, or placing information in superfluous text.

(viii) does not unnecessarily duplicate information located elsewhere in the financial statements or in the financial report. Cross-referencing or grouping disclosures may be used in some circumstances to alleviate duplication.

(b) Information in financial statements should be presented or disclosed in a neutral manner. Therefore disclosures should be unbiased and not misleading.

(c) Disclosures should also help make it easier to compare financial reports, without compromising useful information. Entities can enhance comparability between entities and across periods by:

(i) using consistent labelling, terms and presentations where possible. When moving away from enhancing industry comparability the reasons to do so would be relevant and should be provided.

(ii) Giving due prominence and explanations to major changes to the reporting structure or to other changes that would impair comparability.

Applying the communication principles

35. The POD project will develop further topics that will build on these disclosure principles. These topics which we plan to discuss with the IASB in future meetings include: :

(a) Format of information.

(b) Grouping/cohesiveness.

(c) Cross-referencing.

(d) Order of the notes.

(e) Summary of significant accounting policies.

(f) Consistency in notes disclosures.

Questions for the IASB
1. Do you agree with the Staff view that a Disclosure Standard (replacement of IAS 1) should contain communication principles (see paragraphs 33-34)?
2. If yes, do you agree with the principles described in paragraph 34 above?

Appendix A—Communication principles in the 2013 *Conceptual Framework* Discussion Paper

Communication principles

7.49 The objective of financial reporting is to provide useful information to users of financial statements. To achieve this, disclosure guidance in Standards should seek to promote disclosure (including presentation) in the financial statements as a form of communication guided by Standards, as opposed to a mechanism whose sole purpose is compliance with specific requirements of Standards.

7.50 Consequently, in developing disclosure guidance in IFRSs, the IASB not only needs to consider what information would be useful in the circumstances of a wide range of entities (ie a faithful representation of relevant information), but should also develop guidance that promotes effective communication of that information. Effective communication reflects the fundamental qualitative characteristic of faithful representation and the enhancing qualitative characteristics of understandability and comparability. As a result, this Discussion Paper proposes that the IASB should consider the following communication principles when it sets disclosure requirements:

(a) disclosure guidance should seek to promote the disclosure of useful information that is entity-specific. In other words, disclosure guidance should be aimed at emphasising the aspects of transactions, events or circumstances, and the way they have been accounted for, in order to enhance a user's understanding of that entity. Disclosure guidance should therefore discourage the use of 'boilerplate' or generally available information that is not specific to the entity as this can impair the understandability of useful information.

(b) disclosure guidance should result in disclosures that are clear, balanced and understandable. Guidance should therefore give entities the flexibility to write disclosures as simply and directly as possible without:

(i) a loss of useful information; and

(ii) unnecessarily increasing the length of the financial statements.

(c) disclosure guidance should enable an entity to organise disclosures in a manner that highlights to a user of financial statements what is important. Consequently, where possible, disclosure guidance should enable an entity to determine the order of disclosures or the emphasis given within a single disclosure.

(d) disclosures should be linked. Disclosure guidance in IFRS should therefore result in disclosures that help users of financial statements to understand the relationships between the items in the primary financial statements and the information disclosed in the notes. Where appropriate, disclosure guidance should require or permit entities to show the relationship between the information disclosed in different notes and also, where possible, with other published information, such as disclosures in management commentary, if there is one. IFRSs should therefore permit the use of cross-referencing where possible and appropriate.

(e) disclosure guidance should not result in the duplication of the same information in different parts of the financial statements. The IASB should therefore review existing IFRSs when developing new disclosure guidance to minimise any duplication. Links between disclosures (for example, cross-referencing) may be appropriate in some circumstances (see 7.50(d)).

(f) disclosure guidance should seek to optimise comparability without compromising the usefulness of the information disclosed. When developing disclosure guidance, the IASB needs to weigh up the need for the information to be comparable among entities and across reporting periods against the need to give entities the flexibility to determine what and how information is disclosed in the most understandable manner. This assessment will determine whether the IASB permits or requires disclosures and whether Standards stipulate the form of disclosure, for example, in tables rather than descriptions.