STAFF PAPER

February 2018

IASB Meeting

Project	**Disclosure Initiative: Principles of Disclosure**		
Paper topic	Comment letter feedback—the disclosure problem		
CONTACTS	Kathryn Donkersley	kdonkersley@ifrs.org	+44 (0) 20 7246 6970
	Aishat Akinwale	aakinwale@ifrs.org	+44 (0) 20 7246 6910

Objective

1. This paper provides a detailed analysis of feedback received from comment letters on Section 1 of the *Disclosure Initiative—Principles of Disclosure* Discussion Paper. Feedback from users of financial statements is summarised separately in Agenda Paper 11B. Section 1 of the Discussion Paper discusses the disclosure problem and the need for principles of disclosure.

2. This paper is structured as follows:
   - (a) Key messages (paragraphs 3-5);
   - (b) Background and questions in the Discussion Paper (paragraphs 6-8);
   - (c) The disclosure problem (paragraphs 9-16);
     - (i) preparers (paragraphs 11-12);
     - (ii) other stakeholders (paragraphs 13-16);
   - (d) The way the Board drafts IFRS Standards (paragraphs 17-21);
   - (e) Development of disclosure principles (paragraphs 22-34);
     - (i) disclosure principles in a general disclosure standard (paragraphs 23-26);
     - (ii) standards-level review (paragraphs 27-31);
     - (iii) disclosure “framework” for the Board (paragraphs 32-34).

Key messages

3. Most respondents broadly agreed with the disclosure problem as described in the Discussion Paper. Preparers think the main underlying cause of the disclosure problem is 'disclosure overload'. Other stakeholders generally identified behavioural issues—particularly around the application of materiality judgements—as a primary factor (paragraphs 9-16). Note that users of financial statements expressed a different view to preparers—they were more concerned about a lack of relevant disclosure than about disclosure overload (see Agenda Paper 11B).

4. However, almost all stakeholders agreed that the way the Board drafts IFRS Standards contributes to the problem (paragraphs 17-21).

5. Respondents expressed mixed views as to whether the development of disclosure principles in a general disclosure standard would resolve the problem. The most prevalent view was that this would help, but would not be enough alone. Many respondents recommended that the Board should undertake a standards-level review of disclosure requirements (paragraphs 22-34).

Background and questions in the Discussion Paper

6. In Section 1 of the Discussion Paper, the Board observed that there are three main concerns about information disclosed in general purpose financial statements:

    (a) not enough relevant information;

    (b) irrelevant information; and

    (c) ineffective communication of the information provided.

7. The Board also observed that developing a set of disclosure principles could help to address the disclosure problem by:

    (a) helping entities apply better judgement about disclosures and communicate information more effectively;

    (b) improving the effectiveness of disclosure for the primary users of the financial statements; and

(c) helping the Board improve disclosure requirements in IFRS Standards.

8. The feedback described in this paper includes the responses provided by stakeholders to the following two questions in the Discussion Paper.

Question 1

Paragraphs 1.5-1.8 describe the disclosure problem and provide an explanation of its causes.

(a) Do you agree with this description of the disclosure problem and its causes? Why or why not? Do you think there are other factors contributing to the disclosure problem?

(b) Do you agree that the development of disclosure principles in a general disclosure standard (ie either in amendments to IAS 1 or in a new general disclosure standard) would address the disclosure problem? Why or why not?

Question 15

Some stakeholders say that the way that disclosures are drafted in IFRS Standards might contribute to the ‘disclosure problem’, as described in Section 1. Some cite in particular the absence of clear disclosure objectives and the presence of long lists of prescriptively written disclosure requirements in Standards (see paragraph 8.4).

Nevertheless, other stakeholders observe that specific disclosure requirements might be simpler to use than applying judgement when determining how to meet disclosure objectives.

Do you think the way the Board currently drafts IFRS Standards contributes to the disclosure problem? Please give your reasoning. If you think the current drafting contributes to the disclosure problem, please provide examples of where drafting in Standards could be improved and why.

The disclosure problem

9. Most respondents broadly agreed with the disclosure problem as described in the Discussion Paper. Some of these respondents described their position as ‘do not disagree’ rather than ‘agree’. However, different respondents attributed more or less weight to different elements of the problem. Additionally, some respondents identified additional causes of the problem.

10. Preparers generally described the causes of the disclosure problem differently to other stakeholder groups. This section summarises the views of preparers and the views of other stakeholder groups separately.

Preparers

11. Most preparers identified disclosure overload as the primary cause of the disclosure problem. Preparers thought that disclosure overload is a direct consequence of the disclosure requirements in IFRS Standards. They described the disclosure overload problem as follows:

    (a) prescriptive language in IFRS Standard disclosure requirements, together with the compliance approach of auditors and regulators, is perceived in practice as overriding materiality. It is generally less costly to provide disclosure in response to each prescriptive requirement than to justify why a particular disclosure requirement is not material. Many refer to this as the “checklist approach”;

    (b) the volume of prescriptive disclosure requirements in IFRS Standards limits the resources available to apply judgement. In other words, preparers say that they spend so much time complying with prescriptive requirements that there is no time to apply judgement;

    (c) in addition to the use of prescriptive language, many preparers were also concerned about the content of disclosure requirements. These preparers take the view that IFRS Standards currently contain excessive disclosure requirements that:

        (i) are redundant—ie were developed to address a particular information need in the past that preparers no longer think is relevant;

        (ii) do not reflect the underlying commercial transactions;

        (iii) provide information only to a small group of specialised users of financial statements;

        (iv) are more costly to prepare than is justified by the benefits to users of financial statements; and

(v) the Board developed to address perceived flaws in accounting requirements rather than in response to an identified information need of users of financial statements.

12. Consequently, some preparers think the three contributors to the disclosure problem that are identified in the Discussion Paper are all linked to disclosure overload. These preparers say that if disclosure overload could be resolved—by reducing the burden of prescriptive disclosure requirements—this would:

(a) reduce the use of the checklist approach and, consequently, reduce the disclosure of irrelevant information; and

(b) mean preparers could instead allocate resources to:

(i) applying judgement in identifying relevant information; and

(ii) deciding how to most effectively communicate that relevant information.

Other stakeholders

13. Similar to preparers, many other stakeholders also identified the use of a checklist approach as a primary cause of the disclosure problem. However, other stakeholders tended to articulate the checklist issue differently to preparers. They described the underlying problem as one of behaviour, particularly in relation to the application of judgement around materiality.

14. For example, in contrast to preparers, some other stakeholders described disclosure overload as a consequence of the disclosure problem rather than the root cause. These stakeholders thought that if behavioural issues could be resolved—for example by encouraging proper application of materiality rather than a checklist approach—then disclosure overload would reduce.

15. Respondents identified the following underlying reasons for the behaviours that they think cause a checklist approach:

(a) strong emphasis on compliance: respondents said that, in their view, preparers see financial statements as a compliance exercise, rather than an opportunity to convey useful information to users. Some added that this approach is understandable given the regulatory and audit regimes that preparers are subject to. These stakeholders said that a behavioural change is needed by several stakeholder groups if the disclosure problem is to be resolved;

(b) application of materiality: respondents said that, in their view, preparers are not properly applying materiality judgements to disclosure requirements. This is because preparers often think providing all disclosures required by IFRS Standards, regardless of materiality or relevance, is the safest course of action. In other words, preparers see the application of judgement as a compliance risk; and

(c) the way IFRS Standards are drafted: respondents identified a lack of clear disclosure objectives, long lists of prescriptive disclosure requirements and inconsistencies in the way that individual Standards are drafted as reasons why preparers and other stakeholders adopt a checklist approach (see paragraphs 17-21).

16. A few national standard-setters noted that over the last few years, particular local jurisdictions have seen improvements in the communication effectiveness of financial statements. This included some European jurisdictions and New Zealand. The national standard-setters making these comments said that achieving improvement has required efforts and initiatives from multiple stakeholder groups to address behavioural issues. In particular, these national standard-setters identified the following examples of how communication effectiveness has improved:

(a) improvements in the application of materiality to disclosure requirements, including the removal of irrelevant or immaterial disclosures from financial statements; and

(b) improvements in communication effectiveness, including more entity-specific disclosures, avoiding boilerplate language and re-ordering disclosures.

The way the Board drafts IFRS Standards

17. The Discussion Paper asked a specific question about whether respondents think the way the Board currently drafts IFRS Standards contributes to the disclosure

problem. Almost all of the respondents that answered this question said that, in their view, the way the Board drafts IFRS Standards does contribute to the disclosure problem. This included all preparers, regulators, standard-setters and accounting firms that answered the question. Note that users of financial statements provided few comments about drafting, although some users mentioned that they particularly supported clear disclosure objectives (see Agenda Paper 11B).

18. Stakeholders gave reasons for this view that reflected their feedback on the reasons for the disclosure problem. In summary, stakeholders think that the way the Board drafts IFRS Standards contributes to the disclosure problem in four main ways:

    (a) prescriptive language such as "shall disclose" or "as a minimum". The feedback received was consistent with that described in paragraph 11(a);

    (b) volume of disclosure requirements. The feedback received was consistent with that described in paragraph 11(b);

    (c) lack of specific disclosure objectives (see paragraph 20 below); and

    (d) inconsistent/piecemeal drafting (see paragraph 21 below).

19. As described in paragraphs 9-16, different stakeholder types described the disclosure problem differently. In particular, they attributed more or less weight to different contributing factors. Nevertheless, in responding to the question on drafting, all stakeholder types identified all four issues listed in paragraph 18.

Lack of specific disclosure objectives

20. Many respondents identified a lack of clear, specific disclosure objectives in individual Standards as another contributor to the disclosure problem. Some of these respondents said that this problem was most significant in the older IFRS Standards. Furthermore, respondents thought the standards-level objectives included in more recently issued Standards such as IFRS 15 and IFRS 16 are still not sufficiently specific or granular. These respondents said that, in order to be useful, disclosure objectives should enable preparers and others to understand how

users of financial statements will use the disclosed information. Understanding this would help stakeholders better apply judgements around materiality.

Inconsistent/piecemeal drafting

21. Some respondents said that disclosure requirements across individual IFRS Standards are drafted very differently and that these inconsistencies contribute to the disclosure problem. Respondents attributed these inconsistencies to the piecemeal development of disclosure requirements over many years. Respondents provided examples, including:

(a) differences across Standards in terms of the mix between disclosure principles/objectives and prescriptive disclosure requirements. As described in paragraph 20, respondents observed that older Standards contain more of the former, and newer Standards more of the latter; and

(b) some, but not all, Standards require an entity to provide additional disclosure if this is needed in order to meet disclosure objectives.

Development of disclosure principles

22. The comment letters contained many varied views on this section of the Discussion Paper. This section summarises respondents' views on:

(a) developing disclosure principles in a general disclosure standard;

(b) undertaking a standards-level review; and

(c) a disclosure "framework" for the Board.

Disclosure principles in a general disclosure standard

23. The Discussion Paper asked a specific question about whether respondents think that developing disclosure principles in a general disclosure standard (also referred to in this section as "central disclosure principles") would help to solve the disclosure problem. In summary:

(a) some respondents thought this would help to solve the disclosure problem (paragraphs 24-25);

(b) some respondents thought this would not help to solve the disclosure problem (paragraph 26);

(c) many respondents thought this would go some way towards addressing the disclosure problem, but would not be enough alone. These respondents recommended other things the Board should do instead of, or as well as, developing central disclosure principles:

   (i) most suggested that the Board should perform a standards-level review (paragraphs 27-31);

   (ii) some suggested that the Board should consider developing guidance for the Board to use when developing disclosure requirements (paragraphs 32-34); or

   (iii) a few suggested the Board should develop educational materials.

24. Those that supported the development of central disclosure principles generally did so because they thought that this might encourage the application of judgement. In particular:

(a) some preparers thought that central disclosure principles could provide a common framework for preparers and regulators. They thought that such a framework might enable preparers to decrease the amount of irrelevant information included in their financial statements;

(b) similarly, some accounting bodies commented that central disclosure principles might help both preparers and auditors to document judgements in a way that will help them deal with regulator enquiries about missing disclosures. These stakeholders thought that this might also help with the problem of too much irrelevant information; and

(c) some standard-setters and regulators thought that central disclosure principles might contribute to a behavioural change. In particular, these stakeholders thought that central disclosure principles could encourage the application of judgement by preparers when deciding which information to disclose and the most effective way to organise and communicate that information.

25. Some stakeholders that supported the development of disclosure principles in a general disclosure standard added that, in their view, it is essential that such principles are focussed and concise.

26. Those that did not support the development of disclosure principles in a general disclosure standard held that view because they thought this approach would not be effective in addressing the disclosure problem. In particular:

(a) some stakeholders think the main issue is disclosure overload and that central disclosure principles would just add to this problem by introducing new additional requirements for entities to comply with. These stakeholders generally thought that the only effective way to address the problem of disclosure overload is for the Board to undertake a standards-level review;

(b) similarly, some stakeholders said that, in their view, the aim of the Disclosure Initiative should be for the Board to achieve an overall set of clear, coherent, comprehensive and concise disclosure requirements. These stakeholders thought that adding central disclosure principles on top of existing disclosure requirements would not achieve this;

(c) some stakeholders who consider the disclosure problem to be primarily behavioural thought that central disclosure principles could not affect behaviour; and

(d) similarly, some stakeholders thought that central disclosure principles would be too generic or high-level to have any practical effect on disclosure. Some of these stakeholders thought that central disclosure principles would add to the compliance burden for entities without any practical benefit in terms of the quality of disclosure. Consequently, they did not think that the development of central disclosure principles would pass the cost-benefit test.

Standards-level review

27. Many preparers, standard-setters, accounting firms and accounting bodies recommended that the Board undertake a standards-level review of disclosure requirements. Regulators were the only stakeholder group that generally

demonstrated less support for a standards-level review. Note that users of financial statements did not comment specifically about standards-level review, although one user group cautioned the Board against re-writing all existing disclosure requirements. This was because they thought such an exercise would take up valuable resources and this might not be justified by the benefits for investors.

28. Most of the preparers that recommended standards-level review thought that the Board should use a standards-level review to address disclosure overload. These preparers recommended that the Board should use a standards-level review to:

    (a) identify and remove excessive or redundant requirements; and

    (b) remove prescriptive language (such as “shall disclose” or “as a minimum”) from Standards. These preparers noted that this language is often viewed in practice as overriding materiality or enforcing a “checklist” approach;

29. Other respondents that supported standards-level review had a broader range of reasons for this. The most prevalent reasons were:

    (a) to address disclosure overload (similar to the views of most preparers described in paragraph 11);

    (b) to link specific disclosure requirements in individual Standards to materiality considerations. Many respondents with this view thought that the disclosure problem was a consequence of a lack of proper application of materiality;

    (c) to incorporate overarching disclosure principles or objectives into individual Standards. Respondents with this view generally recommended the Board should first develop central disclosure principles or objectives and then perform a subsequent standards-level review. Some suggested, for example, that the Board should develop a principle on the appropriate balance between disclosure objectives and prescriptive requirements and reflect that consistently at an individual Standard level;

(d) to develop specific disclosure objectives for each individual Standard (see also Agenda Paper 11K). Respondents with this view generally thought that development of clear objectives would help to solve the disclosure problem but that central disclosure objectives would be too generic to make a practical difference. These respondents thought that specific disclosure objectives linked to the related disclosure requirements would be useful; and

(e) to make disclosure requirements across individual IFRS Standards more consistent and coherent. Respondents with this view often observed that disclosure requirements throughout IFRS Standards have been developed over many years on a piecemeal basis.

30. Many respondents that commented on the scope of any standards-level review supported a comprehensive review of all IFRS Standards. These respondents thought that such a review would be the most effective way to address many of the problems identified in paragraphs 9-21. Comments included the following:

> "High priority should be given by the IASB to a comprehensive review of standards-level requirements. EFRAG regards this standards-level review as a critical remaining element of the Disclosure Initiative… the objective of the standards-level review should be to develop a clear, effective, coherent and comprehensive but concise package of disclosure requirements. The review should, in particular, aim to identify and remove any disclosure requirements that are disproportionate or redundant" ***European Financial Reporting Advisory Group CL#97***

> "It would be more beneficial for the disclosure principles to be reflected in the disclosure requirements within all accounting standards rather than just a targeted few. This will then embed the disclosure principles throughout IFRS and ensure that a wide range of stakeholders consider the principles at every stage when determining the appropriate accounting treatment and disclosure for a transaction or event. The standards-level review of disclosure project

should be undertaken and given higher priority" ***The Quoted Companies Alliance CL#76***

31. Nevertheless, respondents also provided many specific examples of problems that they identified in individual IFRS Standards. These examples covered a broad range of IFRS Standards. A few respondents said that the Board could consider developing disclosure principles and then applying those principles to a 'test' Standard. These respondents thought that the Board should select a Standard that respondents identified as particularly problematic for this purpose.

Disclosure "framework" for the Board

32. Some respondents of all stakeholder types thought that the Board should consider developing guidance for the Board to use when developing disclosure requirements. Respondents generally described such guidance as being a "framework" for the Board.

33. These respondents often also supported a standards-level review and thought that the Board could first develop a disclosure framework to facilitate a standards-level review. They thought this approach could achieve consistency and coherency in the disclosure requirements across IFRS Standards. Respondents also thought that the Board could use a disclosure framework to ensure that they develop disclosure requirements in future Standards in a consistent manner.

34. Some of the respondents that supported the development of a disclosure framework noted that disclosure requirements in older Standards tend to be different to those in newer Standards such as IFRS 15 and IFRS 16. The main difference identified was an increasing move in the newer Standards towards the use of disclosure principles/objectives as well as prescriptive lists of disclosure requirements. These respondents thought that a disclosure framework for the Board would help to resolve these differences, or to avoid such differences in future.