

STAFF PAPER

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Project	Disclosure Initiative: Principles of Disclosure		
Paper topic	Comment letter feedback—principles of effective communication		
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Objective

1. This paper provides a detailed analysis of feedback received from comment letters on Section 2 of the *Disclosure Initiative—Principles of Disclosure* Discussion Paper. Feedback from users of financial statements is summarised separately in Agenda Paper 11B. Section 2 of the Discussion Paper discusses principles of effective communication that entities should apply when preparing financial statements.
2. This paper is structured as follows:
 - (a) Key messages (paragraphs 3-5);
 - (b) Background and questions in the Discussion Paper (paragraphs 6-7);
 - (c) Principles of effective communication (paragraphs 8-25);
 - (i) developing principles of effective communication (paragraphs 8-10);
 - (ii) the seven principles of effective communication (paragraphs 11-25);
 - (d) Location of principles (paragraphs 26-34);
 - (i) non-mandatory guidance (paragraphs 27-29);
 - (ii) general disclosure standard (paragraphs 30-32);
 - (iii) some mandatory, others not (paragraphs 33-34);

- (e) Guidance on the use of formatting in the financial statements (paragraphs 35-38);
- (f) Other comments raised (paragraphs 39-41).

Key messages

3. Most respondents broadly agreed with the Board developing principles of effective communication, and with the seven principles described in the Discussion Paper. Some of these respondents said that the development of such principles would help to solve the disclosure problem, but would not be enough alone. Some respondents requested further clarification on the principles described in the Discussion Paper and suggested additional principles (paragraphs 8-25).
4. Respondents expressed mixed views as to:
 - (a) whether the Board should develop the principles as mandatory requirements or non-mandatory guidance and the best form for any non-mandatory guidance (eg illustrative examples, educational materials, Practice Statement or another form of implementation guidance) (paragraphs 26-34); and
 - (b) whether the Board should develop non-mandatory guidance on the use of formatting in financial statements (paragraphs 35-38).
5. Some respondents suggested that there should be a clearer link between the principles and the Conceptual Framework (paragraphs 39-41).

Background and questions in the Discussion Paper

6. In Section 2 of the Discussion Paper, the Board observed that when information in the financial statements is communicated ineffectively, users might have difficulty understanding the financial statements. Consequently, users might need to spend more time analysing the financial statements, overlook relevant information, or fail to identify relationships between pieces of information in different parts of the financial statements.

7. The feedback described in this paper includes the responses provided by stakeholders on the following question:

Question 3

The Board's preliminary view is that a set of principles of effective communication that entities should apply when preparing the financial statements as described in paragraph 2.6 should be developed. The Board has not reached a view on whether the principles of effective communication should be prescribed in a general disclosure standard or described in non-mandatory guidance.

The Board is also of the preliminary view that it should develop non-mandatory guidance on the use of formatting in the financial statements that builds on the guidance outlined in paragraphs 2.20-2.22.

- (a) Do you agree that the Board should develop principles of effective communication that entities should apply when preparing the financial statements? Why or why not?
- (b) Do you agree with the principles listed in paragraph 2.6? Why or why not? If not, what alternatives do you suggest, and why?
- (c) Do you think that principles of effective communication that entities should apply when preparing the financial statement should be prescribed in a general disclosure standard or issued as non-mandatory guidance?
- (d) Do you think that non-mandatory guidance on the use of formatting in the financial statements should be developed? Why or why not?

If you support the issuance of non-mandatory guidance in Question 3(c) and/or (d), please specify the form of non-mandatory guidance you suggest (see paragraph 2.13(a)-(c)) and give your reasoning.

Principles of effective communication

Developing principles of effective communication

8. Most respondents agreed that the Board should develop principles of effective communication that entities should apply when preparing the financial statements.

The respondents thought that such principles would:

- (a) help entities better apply judgment in identifying relevant pieces of information;
- (b) provide useful guidance for entities about how to communicate information more effectively to users of financial statements; and

- (c) provide a useful framework for auditors and regulators in facilitating appropriate and consistent reporting of information.
9. A few of the respondents that agreed with developing principles of effective communication for entities added that, in their view:
- (a) the principles should also be followed by the Board when developing disclosure requirements in the Standards (see paragraph 41); and
- (b) the principles alone would not be enough to achieve effective communication in the financial statements. These respondents thought that additional action would be needed beyond developing principles of effective communication. Some of those respondents suggested that the Board should also:
- (i) provide illustrative examples and guidance on materiality assessments (see Agenda Paper 11D);
- (ii) develop clear centralised and standard-level disclosure objectives (see Agenda Papers 11E and 11K); and
- (iii) undertake a comprehensive review of the disclosure requirements in individual standards (see Agenda Paper 11E).
10. A few respondents disagreed with developing principles of effective communication that entities should apply when preparing the financial statements. These respondents were mostly preparers. These respondents thought that the principles would not be useful because they would not address the disclosure problem or would not significantly enhance communication in financial reporting. This is because these respondents thought that:
- (a) disclosure overload is the main cause of the disclosure problem and that developing principles of effective communication would not address disclosure overload; and
- (b) additional guidance from the Board would not provide any new insights as principles of effective communication are already available through guidance issued by accounting firms, national standard-setters and regulators.

The seven principles of effective communication

11. Section 2 of the Discussion Paper discussed seven principles of effective communication to help address the concerns raised in paragraph 6. That is, information provided should be:
- (a) entity-specific, since information tailored to an entity's own circumstances is more useful than generic, 'boilerplate' language or information that is readily available outside the financial statements;
 - (b) described as simply and directly as possible without a loss of material information and without unnecessarily increasing the length of the financial statements;
 - (c) organised in a way that highlights important matters—this includes providing disclosures in an appropriate order and emphasising the important matters within them;
 - (d) linked when relevant to other information in the financial statements or to other parts of the annual report to highlight relationships between pieces of information and improve navigation through the financial statements;
 - (e) not duplicated unnecessarily in different parts of the financial statements or the annual report;
 - (f) provided in a way that optimises comparability among entities and across reporting periods without compromising the usefulness of the information; and
 - (g) provided in a format that is appropriate for that type of information—for example, lists can be used to break up long narrative text, and tables may be preferable for data-intensive information, such as reconciliations, maturity analysis etc.
12. Most respondents broadly agreed with the content of the seven principles of effective communication described in the Discussion Paper. These respondents described the principles as appropriate and pragmatic.

13. However, some of these respondents expressed mixed views on whether the principles described in the Discussion Paper would address the disclosure problem:
- (a) some of those respondents thought the principles would help to address the disclosure problem because they would discourage boilerplate disclosures and clutter within the financial statements. These respondents thought that the principles would therefore encourage higher quality financial reporting; and
 - (b) some other respondents thought that it is unclear how the principles would change the behaviour of entities. A few of these said that this is because, in their view, the principles do not directly address the issue of ‘ineffective communication of information’.
14. A few of the respondents that agreed with the principles described in the Discussion Paper observed that the principles are broadly aligned with those developed by regulators such as the European Securities and Markets Authority (ESMA) and the French Financial Markets Authority (AMF) and other standard-setters. They added that the Board should work closely with these stakeholders in developing the principles.
15. A few respondents disagreed with the principles described in the Discussion Paper because, in their opinion, the principles are too conceptual and therefore do not provide practical guidance for entities in determining specific disclosure items. Some of these respondents said that guidance that focuses on the individual disclosure requirements in the Standards would provide the most benefit to preparers.

Tension between principles

16. Many respondents observed the natural tension between providing entity-specific information and ensuring that the information provided is comparable among entities. Some of these respondents agreed with the Board that an entity would need to make a trade-off between these principles. A few respondents suggested that the Board provide additional guidance on how entities can achieve the appropriate balance between the two principles when preparing financial statements.

Principles that should be clarified

17. There were mixed views regarding the extent to which the Board should provide further guidance on the principles described in the Discussion Paper:
- (a) a few respondents suggested that the Board should not spend a lot of time developing the principles and should instead leverage the work that other stakeholders such as those mentioned in paragraph 14, have undertaken. They added that the Board should not be overly prescriptive in describing the principles; and
 - (b) other respondents suggested that the Board provide detailed examples illustrating how the principles described in the Discussion Paper can be applied in practice, including how the principles should interact with each other and the concept of materiality.
18. Some respondents expressed concerns about the principle that information should be provided in a way that optimises comparability among entities. These respondents thought that ensuring a level of comparability among entities is the responsibility of the standard-setter. They thought that transferring that responsibility to preparers could place undue pressure on the preparers, thereby increasing the cost associated with financial reporting and stifling innovation. Consequently, a few preparers thought that this principle should instead be included as part of guidance for the Board in developing disclosure requirements in the Standards (see paragraph 41). Other respondents suggested that the Board should either:
- (a) soften the requirement from providing information in a way that optimises comparability to one that considers comparability; or
 - (b) clarify what it means for information to be comparable among entities.
19. A few respondents expressed concerns about the two principles that refer to the annual report; that is, the principles in paragraph 11(d) and 11(e). These respondents thought that the boundaries of the annual report are not always clear (see Agenda Paper 11H) and suggest that the principles should focus only on the financial statements and not on the annual report.

20. A few respondents expressed concerns about the principle that information should be organised in a way that highlights important matters. These respondents thought this principle might give the impression that some material information is more important than other material information. In their view, the way this principle is worded implies that ‘important’ and ‘material’ have different thresholds, which could necessitate another layer of assessment. These respondents suggested that the Board:
- (a) clarify whether it intended to introduce a new ‘importance’ threshold; and
 - (b) if so, provide additional guidance to aid entities in making that ‘importance’ assessment.

Additional principles

21. Some respondents also suggested that the Board should consider including a principle that information provided in the financial statements should be relevant. These respondents commented that while relevance could be covered by the principle that information should be entity-specific, relevance should be identified as a separate principle because it is closely linked to materiality. These respondents commented that materiality, and hence relevance, plays a central role in improving communication effectiveness.
22. A few respondents suggested other additional principles, such as principles that information provided should be:
- (a) timely;
 - (b) neutral;
 - (c) complete;
 - (d) verifiable; and
 - (e) presented in a transparent manner by providing meaningful breakdowns.
23. A few respondents observed that the principles described in the Discussion Paper are lengthy and suggested that the Board simplify or reduce the number of principles, in order to make them work in practice.

Principles that should be prioritised

24. Some respondents commented on the relative importance of the principles. Most of those respondents said that the principles that information should be (1) entity-specific and (2) provided in a way that optimises comparability are more important for effective communication than the other principles.
25. A few other respondents that addressed this topic said that, subject to the comments raised in paragraph 19, the principle that information should be linked when relevant to other information in the financial statements or annual report, is an important criterion and should be prominently presented.

Location of principles

26. Respondents expressed mixed views on where the principles of effective communication should be located.

Non-mandatory guidance

27. Some respondents, including most preparers and a few standard-setting and accountancy bodies, supported developing the principles as non-mandatory guidance. This is because these respondents thought it would be difficult for entities and auditors to assess whether an entity has complied with the principles, if they were mandatory requirements. These respondents thought that the compliance burden of both auditing and enforcing the principles would lead to a checklist approach, and therefore, add to the disclosure problem described in the Discussion Paper (see Agenda Paper 11E).
28. A few of these respondents also thought that the principles should not be mandatory requirements because their application could make it more difficult for entities to comply with legal requirements in some countries. For example, mandatory principles in IFRS Standards might mean entities have less flexibility to decide how best to communicate additional information required by local law or regulation.
29. Respondents had mixed views as to the form of any non-mandatory guidance on the principles of effective communication:

- (a) some respondents preferred guidance that accompanies, but does not form part of, the general disclosure standard such as illustrative examples or implementation guidance;
- (b) some respondents preferred guidance to be included in a Practice Statement that does not accompany a specific Standard; and
- (c) a few respondents preferred either illustrative examples or a Practice Statement, followed by additional separate educational materials provided on the IFRS Foundation's website.

General disclosure standard

- 30. Some respondents, including most standard-setting bodies, accountancy bodies, accounting firms and regulators, supported prescribing principles of effective communication in a general disclosure standard. This is because they thought mandatory requirements would give the principles more authority and prominence, and thus be more effective than non-mandatory guidance in promoting a change in behaviour from entities. These respondents added that if the principles were included in a general disclosure Standard they would be easily accessible, whereas they might be overlooked in non-mandatory guidance.
- 31. A few of these respondents acknowledged that there will be audit and enforcement implications as a result of prescribing the principles in a general disclosure standard. These respondents encouraged the Board to work with auditing standard-setting bodies such as the International Auditing and Assurance Standards Board (IAASB) to ensure that the auditing standards evolve in line with the accounting standards. A few respondents observed that, in their view, auditing an entity's application of the principles described in the Discussion Paper would not be any different from auditing the application of judgements around materiality and fair presentation.
- 32. A few of these respondents also suggested that the general disclosure standard should include illustrative examples on how an entity can apply the principles.

Some mandatory, others not

33. A few respondents suggested that the Board should prescribe only some of the principles of effective communication in a general disclosure standard and describe other principles in non-mandatory guidance. For example, some thought enforceable principles should be mandatory requirements whilst those that cannot be enforced should be non-mandatory guidance. Some of these respondents also expressed similarly mixed views on the form of non-mandatory guidance to those respondents in paragraph 29.
34. Most of these respondents suggested that the Board undertake further work to determine which of the principles to prescribe in a general disclosure standard and which to describe in non-mandatory guidance. In addition:
- (a) a few respondents thought that the principles that information should be entity-specific, relevant and not duplicated unnecessarily should be prescribed in a general disclosure standard;
 - (b) a few respondents thought that the principles that relate to formatting issues, such as the principles that information should be organised in a way that highlights important matters and provided in a format that is appropriate for that type of information, should be described in non-mandatory guidance; and
 - (c) a few respondents expressed mixed views on the principle that information should be provided in a way that optimises comparability. Some of those respondents said the Board should prescribe this principle in a general disclosure standard while other respondents said the Board should describe it in non-mandatory guidance.

Guidance on the use of formatting in the financial statements

35. Many respondents, including most standard-setting bodies, thought that non-mandatory guidance on the use of formatting would be helpful. These respondents thought that the guidance would assist entities in evaluating which disclosure format is appropriate by highlighting best practices on formatting. These respondents also thought that guidance on the use of formatting could improve

comparability of financial statements for users. They added that non-mandatory guidance would give preparers the flexibility to select the format that best fits their particular circumstances.

36. Most of the respondents that supported non-mandatory guidance on the use of formatting said this should be in the form of illustrative examples or other guidance that accompanies, but does not form part of, the general disclosure standard. A few other respondents suggested that the guidance should be included in the form of a Practice Statement.
37. Some respondents, including most accounting firms, thought the Board should not develop non-mandatory guidance on the use of formatting in the financial statements. These respondents thought that guidance on the use of formatting:
- (a) is not necessary because entities should have the flexibility in determining how to present information to meet users' needs. Respondents also said that, in their view, the principle that information should be provided in a format that is appropriate for that type of information included in the seven principles of effective communication is sufficient enough guidance on formatting;
 - (b) is not helpful because formatting is not causing major issues in practice;
 - (c) may be detrimental because it could reduce the willingness of entities to take more innovative approaches to effective communication; and
 - (d) may become less relevant with advancements in technology and digital reporting. As such, any guidance developed by the Board would require regular updates in order to take account of the changing needs in communication.
38. A few respondents, mainly accounting bodies, did not object to developing further guidance on the use of formatting but thought that it should not be a priority for the Board.

Other comments raised

39. Some respondents observed that some of the principles described in the Discussion Paper overlap with the qualitative characteristics of useful financial information in the Conceptual Framework. For example, a few thought that:
- (a) the principle that information should be entity-specific relates to the qualitative characteristic of relevant information; and
 - (b) the principle that information should be described as simply and directly as possible relates to the qualitative characteristic of faithful presentation.
40. These respondents suggested that the Board should more clearly explain how each of the principles described in the Discussion Paper relates to the qualitative characteristics included in the Conceptual Framework.
41. A few respondents also suggested that the Board should incorporate the principles into the Conceptual Framework. This was so the principles would form part of the framework that the Board uses in determining disclosure requirements in the Standards. These respondents also thought the principles would serve as useful supplementary guidance to the overall objective of financial reporting.