

On the ‘Disclosure Initiative – Principles of Disclosure’: the EAA Financial Reporting Standards Committee’s view

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Abstract

This paper summarises the contents of a comment letter produced by a working group of 12 academics in response to the International Accounting Standards Board (IASB) Discussion Paper on principles of disclosure. The comment letter was submitted by the Financial Reporting Standards Committee (FRSC) of the European Accounting Association (EAA). The work includes reviews of relevant academic literature of areas related to the various questions posed by the IASB in the Discussion Paper, including the ‘disclosure problem’ and the objective of the project, the suggested principles of effective communication, the roles of the primary financial statements and notes, the location of information and the use of performance measures. The paper also discusses the disclosure of accounting policies, the objectives of centralised disclosure, and the New Zealand Accounting Standards Board staff’s approach to disclosure.

Keywords: Disclosure, Accounting principles, IFRS

Introduction

This paper provides the views of the Financial Reporting Standards Committee (FRSC) on the Discussion Paper (DP) *Disclosure Initiative – Principles of Disclosure* (IASB, 2017) published by the International Accounting Standards Board (IASB, the Board) in March 2017.

The IASB project on Principles of Disclosure is part of the Board's general ambition to improve financial reporting communication, and is also a central part of the Board's work plan for the period 2017–21. The umbrella term for projects in this area is the *Disclosure Initiative* (DI), established in 2013 (DP, IN2, p. 4):

‘The DI is a broad-based initiative exploring how to make disclosures more effective in financial statements...’

In turn, the DI is a key part of a portfolio of projects where the common theme is ‘Better Communication in Financial Reporting.’ The portfolio also includes projects on ‘Primary Financial Statements’, ‘Management Commentary’ and ‘IFRS Taxonomy’. A driving force behind these projects is that investors have told the IASB that financial statements are often poorly presented, which makes it difficult and time-consuming for them to identify useful information (IASB project web page, October 2018).

The main objective of the Principles of Disclosure project, discussed in this paper, is described as follows (DP, IN3, p. 4):

‘...to identify disclosure issues and develop new, or clarify existing, disclosure principles in IFRS Standards to address those issues and to: a) help entities to apply better judgement and communicate information more effectively, b) improve the effectiveness of disclosures of the primary users of financial statements and, c) assist the Board to improve disclosure judgement and communicate information more effectively.’

These disclosure principles could be either high-level concepts (as for example principles of effective communication as discussed in Section 2 of this work) or general requirements for disclosing information. In terms of the International Financial Reporting Standards (IFRS), the IASB believes the project is likely to result either in amendments to IAS 1 or in the creation of a new general disclosure standard that would build on and replace the parts of IAS 1 that cover disclosures in the financial statements (IASB project web page, March 2018). It is also possible that the project leads to development of some non-mandatory guidance (cf. the Materiality Practice Statement).

The aim of the DP is to obtain stakeholders' views on (a) disclosure issues that the Board has identified during its outreach before and during this project and (b) approaches to address these issues, including the Board's preliminary views in some cases on how issues may be solved. The Board acknowledges that the DP does not cover all issues the Board would need to address with regard to an Exposure Draft of a general disclosure standard, and notes that the Board is also open to add more disclosure issues to the project.

The Financial Reporting Standards Committee (FRSC) of the European Accounting Association (EAA) responds to selected comment letter invitations where academic research can be expected to contribute to the IASB's standard-setting process. This is also supporting the IASB's evidence-based approach to standard setting (cf. Birt et al., 2016). As disclosures play an important role in both theoretical and empirical academic research, the FRSC decided to form a working group with the aim to respond to the questions posed in the DP by means of a comment letter submitted to the IASB on the 2nd October 2017. This paper builds on the comment letter, and discusses the proposals set by the Board regarding the Principles of Disclosure DP. It should be acknowledged that another working group of the FRSC conducted a comprehensive literature review and analysis of disclosure-related matters a few years ago, when addressing issues raised in the discussion paper developed jointly by European Financial Reporting Advisory Group (EFRAG), Autorité des normes comptables (ANC) in France, and the Financial Reporting Council (FRC) in the UK (EFRAG, ANC and FRC, 2012). Findings and conclusions were presented in an article by the working group members in 2013, Barker et al. (2013). The discussion paper by EFRAG, ANC and FRC (2012) suggest a disclosure framework for the notes in financial statements, and Barker et al. (2013) point at two themes for further development. First, the diagnosis of the problem needs to be developed; for example, there is not much support in prior research that information overload constitutes a significant problem for users. Second, Barker et al. (2013, p. 1) stress the need for the framework to better accommodate the context within which financial statement disclosures are used. The IASB (2017) DP has a broader scope than the EFRAG, ANC and FRC (2012) discussion paper, but the issues with regard to diagnosing the disclosure problem, and considering the context of users, remain, and accordingly we will refer to the work by Barker et al. (2013) whenever appropriate. The extensions compared to EFRAG, ANC and FRC (2012), and the corresponding work of the current FRSC working group, are described in the paragraph below.

The DP (IASB, 2017) includes eight sections with questions for comment letter submitters and the Board's preliminary views on most issues. The current paper has the corresponding structure with eight sections related to the DP and one additional concluding section. Section 1 addresses the 'disclosure problem' and refers to the perceived problems of users to find relevant information as many disclosures are, arguably, non-entity-specific but boilerplate text from IFRS Standards of little relevance. However, whether this is actually the users' perceptions or rather the preparers' view must be considered, and, in addition, even if the users find some disclosures irrelevant, the actions taken to deal with the problem may reduce the disclosures further than first intended.¹ Section 2 of the DP deals with principles of effective communication, which at first sight would seem to be somewhat out of scope for the IASB, as they are very general in nature and go beyond financial reporting it would seem closely linked to compliance and enforcement. There are seven principles (IASB, 2017, p. 21): the information provided should be (1) entity-specific; (2) described as simply and directly as possible; (3) organised in a way that highlights important matters; (4) linked when relevant to other information in the financial statements; (5) not duplicated unnecessarily;² (6) provided in a way that optimises comparability among entities and across reporting periods without compromising the usefulness of the information; and (7) provided in a format that is appropriate for that type of information. It goes without saying that adhering to the principles will improve disclosures, but they are general, somewhat vague and involve trade-offs, e.g., being

entity-specific while optimising comparability. For these principles to be successfully implemented, entities would seem to need to disregard any incentives to hide information and some Board members also note that these principles would be difficult to audit and enforce (ibid., p. 22). The third section addresses the roles of the primary financial statements and notes, where some key issues concern what is meant by 'primary', what makes the four selected statements (statements on financial position, financial performance, changes in equity and cash flows) primary and the role of the notes in relation to the primary financial statements. Section 4 concerns the location of information, where the DP proposes that certain information required by IFRS Standards may be located outside the financial statements and, in contrast, it should not be prohibited to include non-IFRS information in the financial statements in order to distinguish it from information necessary to comply with IFRS Standards. Section 5 deals with the use of performance measures in financial statements and in this section the DP discusses, among other things, what will be required for entities to present EBITDA and EBIT subtotals, and unusual items, in the statement of financial performance. Section 6 refers to the disclosure of accounting policies, where the DP suggests that general principles are needed and discusses alternative locations of accounting policy disclosures and significant judgements and assumptions. Section 7 pertains to the idea of identifying a central set of disclosure objectives. The DP identifies and evaluates two methods, one based on financial statement elements, method A (the entity's assets, liabilities, equity, income and expenses) and another method based on the entity's activities targeting prospects of future net cash inflows and accountability aspects, method B. Finally, in Section 8 the New Zealand Accounting Standards Board staff's approach to disclosure is presented. It is a two-tier approach, according to which entities first provide summary information subject to a materiality judgement (tier 1 disclosures), followed by an assessment of whether it is necessary to provide additional information (tier 2 disclosures). The assessment is based on the relative importance of the information to the entity and the amount of judgement involved in accounting for the item or the transaction.

The closing section (Section 9) includes some concluding remarks. As this paper was developed in order to respond to specific questions asked in the IASB (2017) DP, the paper will not be limited to a review of prior research but naturally also include opinions expressed by the FRSC members who contributed to the comment letter and to this paper.

1. The Disclosure Problem – Relevant and Irrelevant Information

The DP starts out by describing the 'disclosure problem' (DP, 1.5) and relies heavily on the concept of 'relevance', i.e. that the information is capable of making a difference to primary users in their decision making. The problem is divided into three components – 'not relevant enough information', 'irrelevant information' and 'ineffective communication of the information provided' (dealt with in Section 3). This way of formulating the disclosure problem emerged as a consequence of how influential stakeholders (mainly preparers) had recently described the problem, i.e. in terms information overload and the widespread use of checklist approaches by auditors and regulators, which caused entities costs for producing presumably irrelevant disclosures (e.g., ICAS/NZICA, 2011). Accordingly, the first two components of the disclosure problem suggest that too much irrelevant information is produced so that relevant

information is not considered and that the provision of relevant financial statement information must be enhanced, however, this formulation of the problem is problematic in that it has no general solution that will benefit all primary users.

Financial statements are used in many decision contexts and different items will be perceived as relevant to different primary users in different situations. In addition, it does not have to pertain to a specific disclosure item, but could refer to a combination of various disclosures, or a combination of information pieces provided at different points in time. Thus, requiring entities to present more disclosures, perceived by the standard setter as reflecting what is 'generally relevant', will still not be enough to all primary users. In contrast, it cannot be a priori determined what pieces of information that will always be considered irrelevant by a specific primary user.

How will the standard setter know what disclosures are relevant to the primary users? It is not possible to know as it depends on the situation at hand, and therefore standards need to adapt to users' decision contexts in order to stay relevant. The DP tends to argue that there is some general solution to the first two components of the disclosure problem, however, the context-dependency of 'relevance' and 'irrelevance', implies the problem will have different solutions depending on the specific conditions at hand (see also Section 7). The DP does not address context-dependency; however, the Board has dealt with the problem in connection with specific IFRS Standards. IFRS 8 (Operating Segments) is a good example of this, where the idea is that users are provided with the same financial statement information about the operating segments as the entity's chief operating decision-maker (CODM), regardless of what particular items the CODM considers relevant. The information that is relevant to the CODM should be relevant to the primary users – a solution that truly addresses the first part of the disclosure problem. However, the CODM-specific feature means that the information becomes less comparable across entities and therefore less useful to primary users. This implies a conflict between entity-specific relevance and comparability across entities.

IFRS Standards aim at portraying economic phenomena in ways that fulfil accounting requirements of both relevance and faithful representation. When it comes to disclosures, there is a strong emphasis on the distinction between relevance and irrelevance in the DP, whereas faithful representation is not much referred to. As an illustration, there are 44 references to relevance in the DP compared to 10 references to faithful representation. However, a one-sided emphasis on relevance is not warranted with regard to disclosures as primary users would be expected to consider the 'package' of information received. Some pieces of disclosures will represent hard and neutral data that may not be capable of making a difference in the decisions by themselves, whereas other parts of the package will be judgemental information (management estimates) perceived as less reliable. Taken together, the sum of the pieces may constitute relevant information with a reasonable level of reliability that the user can assess and base decisions on.

The argument made that financial statements include too much irrelevant information is often put forward by preparers, who emphasise the high costs of producing financial statement information. In contrast, Barker et al. (2013) summarised the results of an academic literature review on disclosure overload from *a user perspective*, as follows (pp. 2–3):

‘...[The] academic literature indicates that the market, as a whole, reacts positively to increased disclosure, notwithstanding that individuals may feel overloaded. Positive market reactions to more disclosure have been extensively illustrated in the literature. Overall, the literature supports the need for effective organisation and communication of disclosures, while providing mixed evidence with respect to the question of disclosure overload, with a key consideration being whether the focus is on the individual investor or on the market as a whole. Many studies identify particular disclosure items, and show positive effects for firms providing the identified disclosures. This indicates that more disclosure is better than less. A word of caution is necessary however, as it is difficult to obtain ‘negative’ findings in research, such as proving that a particular disclosure item is not useful. For this reason, such results are not seen in research, and conclusive evidence on disclosure overload is hard to find.’

Actions against the disclosure of irrelevant information have been taken by the IASB in connection with the revision of IAS 1 regarding materiality and the Materiality Practice Statement. Regulators such as the FRC commit to concerns about disclosure overload, and encourage companies to remove immaterial information so that company accounts become clear and concise. For example, the FRC provides a case description in its 2015 Corporate Reporting Review (FRC, 2015) where a company has decreased its amount of seemingly irrelevant information by removing the detailed disclosures required by IFRS 2. The disclosures are viewed as immaterial as the share-based payment charge was less than 1% of profit before tax and approximately 70% of the group materiality disclosed in the auditor’s report. Mechanical thresholds of this kind for separate items such as share-based payment may make entities even more focused on being below the quantified thresholds and to have a piecemeal approach towards disclosures. In particular, poor disclosers may abuse the profit- and group materiality proxies through instrumental application. It does not seem likely that what makes information capable of influencing primary users’ decisions is arbitrarily quantified thresholds for separate items. Investors might find it relevant to learn about what conditions apply for managers who receive share-based payment even though the amount expensed was low in the current period.

Barker et al. (2013) discuss how well IFRS disclosure requirements currently work. They relate their views primarily to problems of enforceability (p. 8):

‘To some extent, the enforceability issue is already apparent in how current accounting standards are applied in practice. IAS 1 Presentation of Financial Statements, for example, states that specific disclosures required under IFRS do not have to be presented, if they are immaterial (paragraph 31). Regarding disclosure of accounting policies, the standard says that they are especially useful when they relate to areas, where there are alternatives within IFRS (paragraph 119), or for non-regulated areas (paragraph 121). In conclusion, IAS 1 encourages relevant, entity-specific information, and does not require standardized non-relevant information, yet in practice that is what is often provided. Thus, an important reason for the disclosure overload seems to be how IFRS is currently implemented, rather than the requirements in the standards. For example, enforcement agencies require the inclusion of many specific disclosure items, thus taking a rules-based approach in the enforcement action. A possible reason is that it is much easier to enforce such detailed requirements than more general disclosure principles. This, in turn, makes

it very difficult for preparers to follow principle 12.³ Unfortunately there is not much existing research on such enforcement issues.’

As one of its questions, the IASB asks for comments on the idea to develop a general disclosure standard with a set of disclosure principles. We find that there are already principles of disclosure in IFRS Standards; IAS 1 includes principles of disclosure of a more general nature and the more recent area-specific IFRS Standards tend to adopt a more principles-based approach to disclosures, in some cases even separate principles-based disclosure standards such as IFRS 7 (Financial Instruments: Disclosures) and IFRS 12 (Disclosure of Interests in Other Entities). However, these standards appear to be very difficult to enforce, and enforcement bodies may turn away from the principles in favour of specific requirements and checklists. Still, principles of disclosure together with specific requirements that logically support the principles and strong enforcement, appear to be the best option going forward. In particular, we believe more attention should be paid to the context of users of disclosures. In the DP, the IASB tends to target the ‘best-in-class’ disclosers, however, academic research shows that there will be contexts where entities have incentives *not* to disclose. For such poor disclosers, more emphasis on principles and lower emphasis on specific disclosure requirements may not, in fact, serve the primary users well (see Hellman, Carens & Moya, 2018).

2. Principles of Effective Communication

Section 2 of the DP, discusses principles of effective communication that entities should apply when preparing financial statements. Recent academic studies suggest that investors and other stakeholders request that the story they are told about the entity’s financial situation should be presented in a clear and authentic way (Paananen, Renders & Blomkvist, 2016; Cascino et al., 2014; Armstrong, Guay & Weber, 2010; Beaver, McNichols & Rhie, 2005). In order to improve communication effectiveness, we also need more knowledge about who the users are and what they demand. A recent study of who uses annual reports, based on U.S. data, Drake, Quinn & Thornock (2017) find significant variation across users based on various demographics. For example, they find that education is a major driver of financial statements usage. We believe there is a need for more research on identifying user groups in more sophisticated manners and to better understand their demands and actual usage. This would appear to be an important component when working on making financial communication more effective.

According to Bertomeu & Cheynel (2013), financial reporting is, arguably, one of the most heavily regulated areas of business activity. Still, accounting standards fail to promote socially desirable levels of disclosure (e.g. Rutherford, 2011). Disclosures are supposed to explain how the company’s accounting policies have been applied, emphasising relevance and entity-specific aspects. In addition, entities need adequate communication channels (e.g. investor/analyst meetings) and ways of structuring and presenting the financial information so that users are able to make judgements and decisions based on successful navigation through the financial statements.

Recent research tends to support the idea that additional disclosures should be linked, when relevant, to other information in the financial statements or to other parts of the annual report. This involves a need for improved navigation through the financial statements. Several studies support the assumption that individual users of annual

reports are increasingly likely to experience problems in searching and locating the information (Smith & Taffler, 2000; Hodge, Kennedy & Maines, 2004). Another important issue raised in recent research relates to considering the entity's age and volume of its private information. Thus, for entities with a large amount of private information and who are relatively young, disclosures are considered to be more important (Francis, Nanda & Olsson, 2008; Easley & O'Hara, 2004). These findings support the principle included in the DP which suggests that the information should be entity-specific. In this context we believe that the 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.

In general, more disclosures tend to reduce the information asymmetry between preparers and users (cf. Akerlof, 1970; Diamond & Verrecchia, 1991). In the empirical literature, there is generally a positive reaction of the market towards increased disclosure (Barker et al., 2013). However, more information comes at a cost and it tends to be harder to measure the costs of proposed standards than costs of existing ones (e.g. Gross & Königgruber, 2012). It is thus important that the initiatives aiming at more effective communication are not simply transformed into requests for more disclosures.

The DP asks if the Board should develop principles of effective communication that entities should apply when preparing financial statements. The question is accompanied by seven key principles of effective communication (listed in Appendix 1). At first sight it would seem to be somewhat out of scope for an accounting standard setter to prescribe such principles, as they are very general in nature and go beyond financial reporting. They would also involve challenges with regard to compliance, auditing and enforcement (acknowledged by some of the Board members in the DP, p. 22). However, we believe that developing principles of effective communication can help and motivate entities to improve their disclosures by clarifying, for example, how to deal with trade-offs between entity-specific and comparable information. All of the suggested principles seem relevant, but more work remains in order to clarify the trade-offs, for example, with regard to the principle stating that the information should be entity-specific (1) and the principle aiming at optimising comparability (6). Even though entity-specific information is required, materiality aspects make these requirements difficult to enforce. We suggest that in order to deal with this trade-off some minimum level of specific disclosure items is required in order to ensure that primary users receive a minimum amount of comparable information also from the poor disclosers (cf. Hellman et al., 2018). For the principles to be successfully implemented, entities would seem to need to be in good faith and have no incentives to hide information.

The suggested principles of effective communication and the DP's view on disclosures in general represent a more user-oriented approach towards disclosures than today and it is important that users understand and are able to successfully utilise the disclosures to be provided under the new disclosure regime. The Board may wish to consider building a detailed mapped process in order to evaluate the potential improvements achieved for users in terms of economic decision making, understandability and more diligent use of information. In this context, the use of technology should be explicitly considered. The speed and volume of information processing increase continuously and investors will need tools that enable them to find and consider the information in a timely manner. These tools may not be appropriately matched with the gradually increasing information flow from entities and information intermediaries. We suggest

that the provided framework in the DP is supported by a strategy on how to improve the effectiveness of communication process (an example is provided in Appendix 2). This is supported by the existing academic evidence on challenges that individual users experience when trying to search for and locate relevant information (Janvrin & Masha, 2010; Miller, 2010).

The DP discusses whether the principles should be prescribed in a general disclosure standard or issued as non-mandatory guidance. There is analytical research in the area of disclosures, however, there is a literature gap regarding the choice between mandatory standards and non-mandatory guidance (e.g., Bertomeu & Cheynel, 2013). A problem with making the principles of effective communication mandatory is that principle-based disclosure requirements appear to be more difficult to apply, audit and enforce than principle-based standards concerning classification, recognition and measurement (Barker et al., 2013). Still, entities will have incentives to communicate effectively with their investors even if the principles are not mandatory. There is a need for more research in this area, for example, it would be interesting to learn about the effects of the adoption of the ‘practice statement’ solution that the IASB chose with regard to materiality judgements.

Global standards aim to increase international comparability (e.g. Brunsson & Jacobsson, 2000), however, in order for global harmonisation to succeed a network of actors must be actively involved (standard setters, auditing and consulting experts, translators, stock exchanges, etc.). Prior research on the introduction of ISA, International Standards on Auditing, points at the importance of the network of actors involved in defining principles of how to operate in accordance with international standards (Mennicken, 2008; see also Gendron, Cooper & Townley, 2007). This also relates directly to how the information is communicated. We believe the experiences from introducing ISA are relevant to the IASB’s work on improving communication of information based on IFRS Standards.

3. The Roles of the Primary Financial Statements and Notes

Section 3 of the DP discusses the need of describing the roles of the different components of the financial statements and how those roles meet the objective of financial statements. Much of the discussion in section 3 concerns the ‘primary financial statements’, a term introduced by the IASB in 2013 in a DP on completing and revising the Conceptual Framework, however, this DP did not explain what makes a particular set of financial statements primary or provide any principle or concept to guide decision-making (Barker et al., 2014). The current DP opens up the term ‘primary’ by specifying the term as a complete set of statements including the statements of financial position, financial performance, changes in equity and cash flows as well as by describing the role of the primary financial statements. Despite this, we argue that a more in-depth explanation is still missing in the current DP.

It should be noted that the Board is undertaking a project on Primary Financial Statements with the primary aim of improving the existing guidance on financial statement presentation, restricted to the statements of financial performance and cash flows. The scope of the Primary Financial Statements project is the structure and content of the abovementioned statements, exploring issues related to the need for

additional subtotals, various options for presentation of income and expenses, use of performance measures and classification of the cash effects of interest and dividends, among others. In contrast, the main objective of the DP is to identify disclosure issues and develop new, or clarify existing, disclosure principles. The purpose of this section is to discuss, on a more general level and consistent with the DP, the roles of the primary financial statements and notes. Thus, this discussion aims at adding insights and comments related to the identification and description of the role of the primary financial statements and notes as well as the implications of those roles.

Regarding the four statements of financial position, financial performance, changes in equity and cash flows included in the term primary financial statements, we note that the DP does not prescribe whether any of the four statements is more important than the other. In line with previous scholars (e.g. Brouwer, Faramarzi & Hoogendoorn, 2014), we support this approach, as we regard the four different statements to be of equal importance. The Balance Sheet approach, widely referred to in IFRS research articles (e.g. Abela et al., 2014; Brouwer et al., 2014) and embraced by the Conceptual Framework as the leading approach in standards development (Abela et al., 2014), gives the statement of financial position conceptual primacy compared to the other statements and it is therefore important, we believe, for the Board to clearly state that the four different statements are of equal importance.

The DP (paragraph 3.18) points out that various stakeholder groups may disagree on what should be included in the primary financial statements. In particular, the statement of cash flows has been debated, and not surprisingly, as the IASB in its Conceptual Framework has not identified the statement of cash flows as a separate element of the financial statements. Scholars have, however, found support for the usefulness of the statement of cash flows. For example, Orpurt & Zang (2009) explore the impact of choosing either the direct or the indirect method for cash flow statements on future earnings response coefficients and conclude that the improved stock price informativeness of the direct method provides investors with a useful basis for estimating future earnings and cash flows. Based on a UK study, Akbar, Shah & Stark (2017) find strong support for the assertion that cash flows can have incremental value relevance relative to either earnings or funds flows. In a similar vein, Farshadfar & Monem (2013) provide Australian evidence that disaggregating operating cash flow into its components enhances the predictive ability of aggregate operating cash flow in forecasting future cash flows. As we fully agree to the idea of including the statement of cash flows among the primary financial statements, we propose that the Board would consider a change in the Conceptual Framework to not cause a conflict between standards and framework.

As a minor detail, we discuss the term primary financial statements. While we agree that the term primary financial statements is commonly used in practice and regard it as the best option of those among which the Board made its choice, the term 'primary' does raise the expectation of there being another set of statements, a secondary or subsequent set. This is also quite understandable, as the normal dictionary meaning of primary includes the concept of i) 'of chief importance' and ii) 'earliest in time or order'. Therefore, we are somewhat hesitant towards the new term. An alternative term that we believe should be considered is the term 'key', a term missing among the various options considered by the Board. A few years ago, the IAASB chose to use the term 'key' in the regulation on the Independent Auditor's Report (IAASB, 2015), where

key audit matters (KAM) represent the areas in the audit of the financial statements of most significant auditor attention. Thus, similarly to the KAM concept in auditing, the term key in the financial reporting context would represent those areas in financial reporting, which most significantly capture stakeholders' attention, i.e. the primary financial statements. To our knowledge the term 'key financial statements' is not used elsewhere in the standards. Admittedly, defining what is 'key' and 'non-key' involve a problem similar to defining what is 'primary' and 'non-primary', however, the term 'key' would in our opinion be easier to understand and use as it is commonly applied in other financial reporting settings, such as key audit matters (KAM) and key financial ratios.

Building on the Conceptual Framework, the DP sets out the role of the primary financial statements to provide a structured and comparable summary of an entity's recognised assets, liabilities, equity, income and expenses. While the role as such is described at a very generic level, we agree to the role. We would, however, like to point out that the word 'structured' may be misunderstood to imply a prescribed, specific structure, while instead the company currently may choose its own way of presentation, classification, aggregation and layout as regards presentation of information. These choices usually imply an entity-specific presentation in many ways. Scholars (e.g. Maines & McDaniel, 2000) and practitioners agree that presentation format and location of information matter. Increased comparability of financial statement information is likely to be beneficial to users. For example, the overall finding of Neel (2017, p. 658) is that cross-country accounting comparability played an important role in the previously documented economic benefits that accrued to 2005 mandatory IFRS adopters. We therefore welcome the emphasis on increased comparability of IFRS financial statements which we believe will also facilitate further digitalisation of the statements.

The DP sets out the role of the primary financial statements by specifying what the information is useful for. In our opinion, the text appears, however, somewhat repetitive in paras 3.22 and 3.22a, with the only variation in the text being the term overview instead of summary. The text reads:

‘...the role of the primary financial statements is to provide a structured and comparable summary of an entity's recognized assets, liabilities, equity, income and expenses, which is useful for: (a) obtaining an overview of the entity's assets, liabilities, equity, income and expenses;...’.

While the underlying meaning is clear, i.e. the summary is useful for obtaining an overview, this 'phrase' seems rather simple and obvious. We also question, could the two terms overview and summary be considered synonyms by some users? Thus, we argue that paragraph 3.22a might be improved and made more specific regarding what the summary is useful for. While it may be too specific to add that the overview is useful for various stakeholders in different ways, among others for decision-making and forecasting of future cash flows, we ask for some clarification on this role.

Without doubt, one role of the primary financial statements is related to providing comparable information to the users of the financial statements. As described in the Conceptual Framework, comparability is one of the enhancing qualitative characteristics, which is considered improving the usefulness of information for various stakeholders. Previous research has also made attempts to study the effects of IFRS

adoption on comparability. From a capital market perspective, Barth, Landsman, Lang & Williams (2012) document that IFRS adoption is associated with a significant increase in the comparability of financial statements across IFRS firms and a size-and-industry-matched sample of US firms. In contrast, Kvaal & Nobes (2012) express doubts about whether comparability has been achieved, as they find that national patterns of IFRS practice continue after IFRS implementation. Brüggemann, Hitz & Sellhorn (2013) conclude that there is conflicting evidence on whether the comparability objectives of the IFRS Standards have been achieved and calls for more research in this area.

The DP also points to the role of the primary financial statement in providing a useful summary for identifying items or areas within the financial statements about which the users may seek additional information in the notes. We also agree to this role but would like to add that the fulfilment of this role may be dependent on the quality of the presentation of financial statements. For example, a statement of financial performance presented in line with the minimum requirements does not, in our opinion, provide the users with much useful information for identifying important items or areas of interest in the notes. The links between the financial statements and the notes are emphasised in accounting education (Ruhl & Smith, 2013), but there is a need for more research on how these links should best be designed in order to serve the users of financial information in practice.

The DP also lists a number of points to further set out the implications of the role of the primary financial statements. Overall, we find the list of points useful and accurate, although some of the points seem rather obvious. For example, scholars have largely found support for the fact that the information in the primary financial statements is more prominent than information in the notes (see discussion in e.g. Brouwer et al., 2014). Despite this, we believe that some preparers of financial information may need clarifications. Only paragraph 3.24e is in our opinion somewhat unclear and would need further clarification. The DP sets out that the preparer should consider the role of the primary financial statements when making the decision about whether to disclose the information as a separate line item in the primary financial statements or aggregated and included in other items. We ask for some examples to help the preparer make this decision.

Section 3 is related to Section 4 of the Discussion Paper, including principles on location of information, which is discussed in the following section. Further, this section is related to other projects within the Disclosure Initiative, among others the Materiality Practice Statement project. Therefore, we shall here raise a limited number of aspects as follows.

Regarding the notes, the DP defines them as that part of the financial statements other than the primary financial statements (paragraph 3.30). While various studies indicate that notes to financial statements are indeed important to professional investors (e.g. Olbert, 1994; Gassen & Schwedler, 2010), they also indicate that investors do not perform detailed analyses based on the information provided in the notes (e.g. Barker, 2000). Also, Clor-Proell & Maines (2014) find that public company managers both choose more effortful approaches and exhibit less strategic bias under recognition (in the financial statements) than disclosure (in the notes).

The DP (paragraph 3.28) sets out that the role of the notes is to: (a) provide further information necessary to disaggregate, reconcile and explain the items recognised in the primary financial statements, and (b) supplement the primary financial statements with other information that is necessary to meeting the objective of financial statements. We fully agree with this role. The DP further prescribes that explanatory information includes information that disaggregates and reconciles line items in the primary financial statements, describes the nature of such line items and provides information about methods, assumptions and judgements as well as changes in the aforementioned, which are used to recognise and measure those line items. Examples of supplementary information include information about the nature and extent of an entity's unrecognised elements and about an entity's exposure to various types of risks, for example market risk or credit risk. We believe these examples and explanations at large are consistent with current practice but still provide some clarification for preparers of the financial statements. Contemporary research also suggests that managers provide supplemental information to mitigate the negative effects of complex financial statements on the information environment (e.g. Bagnoli & Watts, 2007; Guay, Samuels & Taylor, 2016).

Finally, the Board notes that companies have problems deciding what information should be presented in the primary financial statements and what should be disclosed in the notes. It has been suggested, that those problems are due to the inconsistent use of the terms 'present' and 'disclose' in IFRS Standards. Despite this, the DP does not prescribe the meaning of the terms 'present' and 'disclose' but agrees to be more explicit in the future when using the terms so that the subsequently emerging IFRS Standards will specify the intended location as either 'in the primary financial statements' or 'in the notes'. We believe this will be very useful and diminish current disclosure problems having occurred in practice. We also propose that the Board in subsequent revisions of existing IFRS Standards will add similar specifications of intended locations.

4. The Location of Information

Section 4 in the DP starts out from the observation from practice that duplication and fragmentation of information can make financial statements and annual reports more difficult to analyse and understand and that the Board should consider placing some required information outside the financial statements and some 'non-IFRS information' within the financial statements. Prior academic literature has examined whether the market treats disclosed financial statement information as less reliable compared to information recognised in the body of the financial statements. In efficient markets with minimal information-processing costs, one would not expect the accounting treatment (i.e. recognition versus disclosure) of the same economic event to matter. However, if there are (1) costs of processing information (Barth, Clinch & Shibano, 2003), (2) systematic biases in how investors process information, such as limited attention (Hirshleifer & Teoh, 2003), or (3) differences in perceived reliability of recognised versus disclosed items, this choice can matter to users (Ahmed, Kilic & Lobo, 2006).

From a standard-setting perspective, there are trade-offs between recognition and disclosure as regards the accounting treatment of many items (e.g. contingent liabilities), and how these trade-offs affect users' decisions has been an issue of considerable interest to standard setters, practicing professionals and academic

researchers. Many studies have analysed differences in capital-market outcomes associated with recognised versus disclosed accounting amounts (Bernard & Schipper, 1994; Schipper, 2007). Early studies establish that both components are priced, although they yield different capital market outcomes (e.g. Landsman, 1986; Harris & Ohlson, 1987; Beaver, Eger, Ryan & Wolfson, 1989; Barth, 1991). The literature proposes two potentially complementary explanations (Bernard & Schipper, 1994; Schipper, 2007; Bratten, Choudhary & Schipper, 2013): differential reliability and information processing. Differential reliability suggests that disclosed amounts are appropriately viewed by participants in an efficient market as having lower reliability, whereas information processing suggests that capital market participants face higher information processing costs for disclosed relative to recognised amounts, which can vary with the firm's information environment and disclosure quality, as well as investors' competence, cognition, and attention.

Several studies present evidence consistent with differential reliability, (Davis-Friday, Liu & Mittelstaedt, 2004; Choudhary, 2011; Bratten et al., 2013), whereas few studies explicitly examine the information processing cost explanation. Those few studies provide evidence that there is no consensus that the pricing discount observed for disclosed items relates principally (or entirely) to lower reliability (Yu, 2013; Michels, 2015). More recently, studies examine both causes of these differences and find that reliability and information processing costs provide complementary explanations for observed pricing discounts assessed on disclosed accounting amounts (Müller, Riedl & Sellhorn, 2015).

Therefore, in light of recent academic evidence, we support the Board's preliminary view that a general disclosure standard should include a principle that information necessary to comply with IFRS Standards can be provided outside the financial statements if such information meets the requirements in DP paragraphs 4.9(a)–(c) – in general. We believe that this would reduce duplication of information and further support the proposed principles of effective communication that entities should apply when preparing financial statements. However, we are concerned that because there is no definition of annual report included in the standard(s),⁴ this could mean different things in different reporting environments. Academic literature has shown persistent country differences in financial reporting, resulting in unintended consequences after standard implementation (Nobes, 2013; Forst, 2014; Felski, 2017) and thus, there is a risk that the requirements will be interpreted differently in different jurisdictions. We, like the Board, are also concerned about the excessive use of cross-referencing, which could reduce the usefulness of the financial statements.

Due to the risk of variation in what is meant by an annual report around the world, we believe the Board should consider developing a definition aligned with ISA 720 to ensure a consistent definition for both preparers and auditors. Such an initiative will have to consider issues of jurisdiction and may require collaboration with national standard setters.

Some listed firms (in countries such as Australia and the United Kingdom) are required to disclose executive and/or director compensation in a report. This disclosure may be mandated by legislation or exchange rules. A firm should be able to cross-reference executive/director compensation information to either a legally mandated report or

exchange report and still be able to comply with the criteria in DP paragraphs 4.9(a)–(c).

The DP also asks whether or not a general disclosure standard should prohibit an entity from including information in its financial statements that it has identified as ‘non-IFRS information’. In our opinion, the Board should not prohibit an entity from including ‘non-IFRS information’ in its financial statements, given that this additional information may be relevant for a better understanding of the financial statements. Thus, this ‘non-IFRS information’ may be aligned with IAS 1. Paragraph 4.27 refers to examples of unaudited information, ‘summary measures of an entity’s financial performance, financial position or cash flows’, and paragraph 5.12 mentions that ‘most concerns cited by users of financial statements relate to the use of performance measures in the statement(s) of financial performance’. However, studies on the inclusion of non-IFRS earnings measures (also known as non-GAAP or alternative earnings measures) show that these measures are mostly informative.

In the UK, Financial Reporting Standard (FRS) 3, issued in 1993, allowed (but did not require) firms to disclose additional earnings per share to the one that was required by the standard. If these additional measures were disclosed, then firms had to present them consistently over time, reconcile to the FRS3 measure and give the measures as much emphasis as the measures calculated according to the standard. Research on the disclosure of these alternative measures is relevant to our discussion, given they are located in the financial statements. Three studies analyse alternative measures in the UK, before the adoption of IFRS. While Walker & Louvari (2003) study the determinants of disclosure of non-GAAP measures by quoted companies, Choi, Lin, Walker & Young (2007) examine the adjustments made both by managers and analysts in their construction of non-IFRS and ‘street earnings’ measures, respectively, and identify the source and properties of the items where there is no agreement. Consistent with the general view on non-IFRS disclosures (as discussed above) they find that most of the adjustments made by managers are valuable, although there is a subset of management adjustments that are consistent with an attempt to mislead investors. Finally, Choi & Young (2015) document a strong positive association between non-GAAP EPS disclosure and the magnitude of transitory items. This evidence is consistent with a desire to inform capital markets.

Evidence collected from the disclosure of non-IFRS measures in South Africa is also relevant, as firms listed on the Johannesburg Securities Exchange are required to disclose in their financial statements their ‘headline earnings’ per share, in addition to the earnings per share measures required by IAS 33 (from October 2000 onwards). Firms are also required to include, in their financial statements, a reconciliation between non-IFRS and IFRS earnings, which is subject to audit. Venter, Cahan & Emanuel (2013) assess the persistence of (i) the adjustments made in the creation of non-IFRS, (ii) earnings accruals, and (iii) cash flows. Then, they analyse whether these persistence levels are reflected in price and conclude that investors price earnings components ‘in a manner that is consistent with the actual levels of persistence of these components.’ In a second study, Venter, Emanuel & Cahan (2014) find that these mandated non-IFRS earnings are more informative than the IFRS earnings, using data from 2002 to 2009.

However, one must acknowledge the evidence collected on how specific methods of disclosure of non-IFRS earnings can alter investors’ perceptions of firms’ performance.

We are referring to the situations where non-IFRS earnings measures (i) meet or beat analysts' forecasts when IFRS figures are below expectations, (ii) are created via the adjustments of recurring items, or (iii) are given more prominence than IFRS measures. Evidence of such behaviours in Europe has been associated with directors' compensation (Isidro & Marques, 2013), the institutional and economic setting where firms operate (Isidro & Marques, 2015), and the use of impression management in press releases (Guillamon-Saorin, Isidro & Marques, 2017). This evidence leads us to the discussion of how important it is to create a set of requirements on how non-IFRS information may be disclosed. The aim of these requirements is to reduce the probability of such information misleading investors (mainly the less sophisticated ones).

DP paragraphs 4.38(a)-(c) suggest that if an entity discloses non-IFRS information it should:

- a) Identify clearly such information as not being prepared in accordance with IFRS Standards and, if applicable, as unaudited;
- b) Provide a list of such information, together with the statement of compliance with IFRS Standards; and
- c) Explain why the information is useful and has been included in the financial statements

Requirement (a) will eliminate the current difficulty of identifying the information that is not consistent with the standards. In fact, one of the problems at hand when collecting non-IFRS earnings information that is voluntarily disclosed, is the lack of consistency of the labels used to classify the measures, both across firms and over time. Furthermore, identifying the information that has not been audited will address the concerns mentioned in paragraph 4.27.

Requirement (b) will help users of financial statements to correctly identify the measures that are not based on IFRS. However, we feel this requirement falls a little short of its potential. In fact, we believe this list should also include the definition (or formula for calculation) of these measures. This is because the lack of consistency does not only apply to the labels used, it also exists in the way firms calculate their measures. As regards non-IFRS earnings, this was initially mentioned in a report by EFRAG (2009). For a recent literature review and analyses on US data, see Black, Christensen, Ciesielski & Whipple (2018).

Requirement (c) is aligned with Regulation G, in the US, which also requires this explanation. However, there is the risk that firms disclose explanations which are not informative and/or too vague. If that is the case, then this requirement will not provide any useful information and is superfluous. Take, for example, the justification presented by Cisco, in the press release of the last quarter of 2003 (the year when Regulation G came into effect):

'Cisco believes that this presentation of pro forma net income and pro forma net income per share provides useful information to management and investors regarding certain additional financial and business trends relating to its financial condition and results of operations. In addition, Cisco's management uses these

measures for reviewing the financial results of Cisco and for budget planning purposes.’

Finally, the DP also asks about the adequacy or not of prohibiting the inclusion of any specific types of additional information in the financial statements. In that regard we believe there are certain types of non-IFRS information that should not be included in the financial statements. This is because such location of disclosures will not add to investors’ understanding of the composition of the figures that are included in the statements. This is the case of non-financial measures, like the examples provided in paragraph 4.27 (b): market share, staff turnover, and number of units sold per employee.

Another type of non-financial disclosure which recently has been receiving a great deal of attention, is disclosures related to corporate social responsibility (which can be seen as incorporating information about environmental, social and ethical issues). In fact, a report by the Association of Chartered Certified Accountants (ACCA, 2013) states that ‘the most important sources of non-financial information for investors are sustainability/CSR reports and annual reports’. Recent European evidence on the importance of such disclosures is documented by DeVilliers & Marques (2016) and in Cahan, DeVilliers, Jeter & Standen (2016). However, as far as we know, that type of information is never disclosed within the financial statements.

5. Use of Performance Measures

In section 5, the DP evaluates the inclusion (in a general disclosure standard) of additional requirements regarding fair presentation of performance measures in financial statements. One of the questions posed has to do with the presentation of EBITDA or EBIT. As a first step, we agree with the Board’s first preliminary view that the Board should clarify that the presentation of EBITDA or EBIT as a subtotal in the statement(s) of financial performance complies with IFRS Standards if such subtotals are presented in accordance with paragraphs 85–85B of IAS 1. This is particularly important as EBITDA is one of the most commonly used performance measures used both by preparers and users of accounting information (Cascino et al., 2016; CFA Institute, 2016). One usual concern regarding the use of performance measures as EBITDA is that users of financial statements are not sure about how they have been calculated and, as a result, whether they have been calculated according to IFRS or not. The clarification that the EBITDA calculation complies with IFRS will make this performance measure much more comparable and trustworthy.

Moreover, this would reduce concerns that have been raised regarding the higher prominence that can be given to performance measures if a full non-GAAP income statement is used when reconciling to GAAP. In the answer to Question 102.10 of SEC’s May 2016 *Compliance & Disclosure Interpretations: Non-GAAP Financial Measures* it is stated that: ‘Presenting a full income statement of non-GAAP measures or presenting a full non-GAAP income statement when reconciling non-GAAP measures to the most directly comparable GAAP measures’⁵ is an example of disclosures that would cause a non-GAAP measure to be more prominent.

Along these lines, there is research evidence indicating that non-GAAP performance measures are highly associated with stock returns (Bhattacharya, Black, Christensen &

Larson, 2003; Bradshaw & Sloan, 2002; Lougee & Marquardt, 2004); although some firms may use these measures opportunistically (Marques, 2010; Brown, Christensen & Elliott, 2012; Entwistle, Feltham & Mbagwu, 2005; Black & Christensen, 2009) and less sophisticated investors are more likely to be influenced by performance measures that are not defined in accounting standards (Frederickson & Miller, 2004; Bhattacharya, Black, Christensen & Mergenthaler, 2007; Dilla, Janvrin & Jeffrey, 2012). Therefore, the clarification regarding EBITDA would help in assuring that less sophisticated investors are not being misled by disclosure of performance measures as far EBITDA is concerned.

We also agree with the Board's second preliminary view that the Board should develop definitions of, and requirements for, the presentation of unusual or infrequently occurring items in the statement(s) of financial performance, as described in DP paragraphs 5.26–5.28. Although research has found that, on average, managers use performance measures to convey information to the capital markets, there is also evidence of managers using these measures in an opportunistic way. As Marques (2017) indicates, one of the areas where opportunistic behaviour can be observed is the adjustment by managers of items that are non-recurring. This is one of the reasons why it is so important to establish requirements regarding unusual or infrequently occurring items.

There is empirical evidence regarding how the quality of adjustments (such as those made for unusual or infrequently occurring items) made by US companies when disclosing performance measures has been affected by the issuance of Regulation G by the SEC (SEC Regulation G: 17 CFR §244, SEC [2003]). This offers a comparable setting on how the introduction of regulatory requirements has had an impact on companies' disclosure practices. Overall, the evidence suggests that the quality of adjustments has improved after the issuance of Regulation G. Heflin & Hsu (2008) provide some evidence of a decline in the magnitude of the adjustments, suggesting that managers reduced the use of non-GAAP earnings to improve performance perceptions. Moreover, when they partition exclusions into special and non-special items, they find that the frequency and magnitude of both is reduced by the regulation. Kolev, Marquardt & McVay (2008) find that, on average, adjustments are of higher quality (i.e. more transitory) after regulation G.⁶ More recently, Black, Christensen, Kiosse & Steffen (2017) study whether Regulation G in the US reduced the incidence of the opportunistic use of performance measures (non-GAAP disclosures). They find that managers are more cautious when using adjusted earnings measures, as they are less likely to make adjustments to exclude recurring items that are incremental to the adjustments made by analysts.

Nevertheless, there is also evidence of unintended consequences that may have been derived from the regulation. Heflin & Hsu (2008) find that regulation G reduced firms' willingness to use non-GAAP earnings to convey permanent earnings, as the restrictions placed by the regulation made the exclusion of transitory income components more costly. Kolev et al. (2008) provide evidence that the quality of special items adjustments has decreased, suggesting that managers are shifting more recurring expenses into special items. Overall, we believe the intended outcomes would outperform the unintended consequences, as managers will likely reduce opportunism in the use of performance measures if they are subject to greater scrutiny.

The DP also asks if the Board should prohibit the use of other terms to describe unusual and infrequently occurring items. We believe that this prohibition is not necessary. In our opinion, the main issue is not how to name them, but to assure that the company provides enough transparent and detailed information in the notes to allow the users of financial statements to assess the reasonableness of adjustments. The SEC, ESMA, and CFA Institute, for instance, use the term ‘non-recurring’ when referring to items that are usually excluded from performance measures (SEC, 2003; ESMA, 2015; CFA Institute, 2016). The problem, however, is that when companies disclose the required reconciliation, the explanations that are provided about the adjustments that have been made are not transparent or granular enough (Ciesielski & Henry, 2017) so as to make them understandable. This is particularly important – as a recent study by the CFA Institute shows – since it is common practice among analysts to adjust the EBITDA number that has been published by firms, in some cases reversing questionable adjustments made by management (CFA Institute, 2016). We think, therefore, that more emphasis should be put on assuring that the description of the unusual or infrequently occurring event is disclosed with sufficient detail in the notes, as considered in DP paragraph 5.23.

Another issue discussed by the Board in this section relates to the presentation of performance measures and the need for this presentation to follow the requirements set out in the Conceptual Framework Exposure Draft (paragraph 2.15). The DP proposes that the performance measure shall follow the requirements set in DP 5.34, but refers also to DP 5.6 and paragraphs 55 and 85 of IAS 1:

- IAS 1, p. 55: An entity shall present additional line items, headings and subtotal in the statement of financial position when such presentation is relevant to an understanding of the entity’s financial position;
- IAS 1, p. 85: An entity shall present additional line items, headings and subtotal in the statement of comprehensive income and the separate income statement (if presented), when such presentation is relevant to an understanding of the entity’s financial performance.

The above paragraphs leave room for the disclosure of other accounts, whether in the balance sheet or in the income statement, provided that their disclosure is relevant to understanding the entity’s performance.

How do we know whether the disclosure of these performance measures is relevant? In the article by Marques (2017), a survey of research on performance measures is presented, which can shed light on this use. The article: ‘...shows how non-GAAP earnings have been found to be more informative than GAAP earnings in several scenarios (countries where non-GAAP disclosures are compulsory, countries where these disclosures are voluntary but regulated and countries where they are not regulated). However, in certain circumstances, these disclosures may also mislead investors. Corporate governance mechanisms can curb managers’ opportunistic use of these measures’.

Also, Barker et al. (2013) highlight that, without strong enforcement, principles-based accounting can lead to weak accounting: ‘On the other hand, in high-incentive situations, principles-based standards tend to perform poorly, especially in the absence of strong enforcement’.

In addition, we know that GAAP implementation is influenced by legal and institutional aspects (Burgstahler, Hail & Leuz, 2006; Holthausen, 2009; Soderstrom & Sun, 2007; Armstrong, Barth, Jagolinzer & Riedl, 2010; Walker, 2010; Christensen, Hail & Leuz, 2013). These studies reveal that the informational function of accounting can be questioned in environments with low legal protection for investors, a weakly developed capital market, a weak institutional environment, and corporate governance practices that do not guarantee equal rights for the shareholders.

Another point of concern is found in the works of Watts & Zimmerman, who link the accounting practices to Jensen & Meckling’s (1976) agency theory. The manager can use her/his discretionary power in view of the accounting alternatives, aiming to maximize her/his utility function to attend to her/his preferences (Jensen & Meckling, 1998). Considering the company as a network of contracts, Watts & Zimmerman (1986) developed hypotheses to explain variations in accounting, which rested on distinct incentives among the parties.

In this context, we believe that the risk of discretion to achieve self-interest can be represented by the letter f) of item 5.11 in the DP: ‘some performance measures are misleading because they do not present a neutral picture of the entity.’ Therefore, the document recognises the possibility of that the performance measure does not represent a neutral picture of the entity, which is contrary to accounting objectives. For this reason, letter d) of item 5.34 is intended to block the disclosure of misleading information: ‘neutral, free from error and clearly labelled so it is not misleading’.

In view of all aspects raised, we agree with the view of the board to disclose performance measures in accordance with DP 5.34. Our opinion was mainly based on the empirical evidence in favour of the disclosure of these performance measures, or non-IFRS earnings. Nevertheless, an alert is due because of the possibility of misleading disclosure in some circumstances (Marques, 2017).

One way to mitigate this problem would be to change letter g) of item 34 to: ‘presented in a way that makes it clear whether the performance measure forms part of the financial statements and submit it to a compulsory audit’. By extending the performance measures to the set of financial statements, we do not agree that the manager is free to choose not to audit.

In addition, by agreeing with this change, we should take care not to increase the length of the notes to the financial statements. In the paper by Barker et al. (2013), the need for improvements in the notes to the financial statements is acknowledged: ‘...strong consensus in the financial community that disclosure in the notes to the financial statements have become unwieldy’ and ‘...far too complex to be easily understood’.

6. Disclosure of Accounting Policies

Section 6 of the DP deals with accounting policies and the fact that users of financial statements often express concerns about how accounting policies are disclosed in the financial statements. In this regard, the first question posed in the DP is related to the Board's preliminary view stating that a general disclosure standard should include requirements on determining which accounting policies to disclose. And we agree with the Board's preliminary view. Only with a clear definition of the requirements on determining which accounting policies to disclose can the effectiveness of disclosures for the users of financial statements be improved.

The disclosure of accounting policies is essential for the interpretation of financial statements by users because they can then assess methods and principles upon which firms have prepared their information on financial position and financial performance and to forecast future earnings. Lawrence (2013) shows that clear and concise accounting policy disclosures result in higher-quality financial information that is more understandable for investors. Hope (2003) finds that accounting policy disclosures are incrementally useful to analysts over and above all other annual report disclosures and reduce uncertainty about forecasted earnings. In a similar vein, Chang & Most (1985) find that analysts rate accounting policies disclosures higher than other disclosures.

The current standard (IAS 1) already requires entities to disclose 'significant accounting policies' which should allow the 'understanding of how transactions, other events and conditions are reflected in financial statements'. However, the requirement that significant accounting policies must be disclosed seems, in itself, not sufficient to ensure the usefulness of the financial information provided. In fact, the literature shows that firms tend to adopt checklists, tend to use boilerplate terminology, disclose irrelevant information and omit relevant disclosures.

The use of checklists may have negative effects in terms of reinforcing biases and decreasing auditors' professional scepticism (Asare & Wright, 2004; Pincus, 1989); having effects on judgements in areas other than the one the checklist pertains to (Rinsum, Maas & Stolker, 2018); and bears the risk of a 'tick box' mentality, where firms merely increase boilerplate disclosure (Daske, Hail, Leuz & Verdi, 2013; Christensen et al., 2013).

In fact, the use of boilerplate disclosure is a primary concern (FASB, 2012; Hoogervorst, 2013) since it may provide opportunities to hide information or to only reduce legal or reputational exposure rather than to improve informativeness. Previous studies show the use of boilerplate language in different areas such as financial instruments (Stadler & Nobes, 2014), impairment of assets (Amiraslani, Iatridis & Pope, 2013) and derivatives (Bean & Irvine, 2015). Stadler & Nobes (2014) describe how many firms had merely printed standard paragraphs about policies on financial instruments. Firms identified and described all the categories of financial instruments defined in IAS 39 even when they did not have instruments in all those categories. Amiraslani et al. (2013) find that compliance with impairment disclosures requiring a higher effort is lower than compliance with low-effort disclosure requirements, revealing a tendency to use boilerplate language. They concluded that the use of boilerplate language may be a mean to quickly comply with reporting requirements.

The use of boilerplate language is also related to disclosure of non-relevant information. To comply with reporting requirements, firms disclose information that is not relevant

to stakeholders. The disclosure of irrelevant information can lead to obscuring, intentionally or not, useful information, adding to the time needed to process the information (Jackson & Farzaneh, 2012) and complicating the work of preparers and auditors (Hoitash & Hoitash, 2018). In fact, the disclosure of information raises a competition issue, i.e. disclosures compete for users' attention (Ben-Shahar & Schneider, 2014). Additionally, it is often easier for management to include immaterial information in the financial statements rather than monitoring on an ongoing basis whether that information is material and/or justify the removal of disclosures towards auditors or regulators.

The requirement that accounting policies shall be entity-specific, significant and related to material items and the identification of categories of accounting policies by the IASB (DP 6.12) seem to be an important step to solve the problems described above. More importantly, accounting policies should be given greater prominence in financial reports. The inclusion of the summary of significant accounting policies should be sufficiently tailored or contextualised with regard to the enterprise. We consider that only the first two categories of accounting policies should be defined: category 1 (accounting policies that are always necessary for understanding financial statements and relate to material items) and category 2 (other accounting policies that relate to material items).

Guidance on what information is not required by accounting standards and pertaining to immaterial items (Category 3) should not be provided, because it is not necessary for an understanding and interpretation of the financial statements. In addition, the standard should clearly state that immaterial disclosures should be omitted. This statement is important in order to prevent supervisors and enforcement entities from acting against firms that omit immaterial disclosures. In addition, it is important to create a disincentive for auditors to encourage immaterial disclosures and the use of disclosure checklists.

As for the location of accounting policy disclosures, we consider that guidance should be included in a general disclosure standard and not as part of non-mandatory guidance. It can be argued that mandatory disclosure may be superfluous and wasteful for two reasons. First, because firms have incentives to provide voluntary disclosures in an efficient way (e.g., to lower the cost of capital) (Ross, 1979) and accounting standards per se play a limited role in firms' decisions about accounting practices (Ball, Robin & Wu, 2003; Daske et al., 2013). However, mandatory disclosure is the best tool to solve contracting and coordination issues and to avoid the under-production of information. As the issue is largely behavioural, the inclusion of the guidance in a general disclosure standard may reduce costs of processing by standardising information; make it easier for users to process it (Mahoney, 1995; Zingales, 2009); and increase comparability (Lang & Stice-Lawrence, 2015).

The Board should develop guidance on the location of accounting policy disclosures and we agree that significant judgements and assumptions should be described in the same note as the accounting policy is disclosed.

The inclusion of accounting policies in one note has several advantages: Some accounting policies are related to each other and benefit from being placed together; some policies are not directly related to a single note; and users are used to

this form of presentation since it has been the norm for many years and they are then able to locate them quickly and easily. It is probably more time consuming to locate each policy if they are spread out across the notes and it reduces standardisation across companies. But, integrating accounting policies into each note or section also have some advantages: The description of the accounting policy provides necessary context to the numbers, and this is most effective if presented together; and it may reduce duplication within the notes. The location of accounting policy disclosures in the same note as the information to which it relates will reduce the length of the note *Summary of significant accounting policies*. This note is one of those that has longer disclosures (Cheung & Lau, 2016) and reducing its length may increase the readability of the notes.

However, the guidance should not be overly prescriptive with regard to location and entities should have some flexibility to determine the form of disclosure that best meets the needs of the users of financial information. So, it is important to allow entities to use another location, if that location increases the understandability of the notes and other financial statements.

7. Centralised Disclosure Objectives

Section 7 of the DP discusses whether the Board should develop centralised disclosure objectives and if they should be included in a single standard or a set of standards that cover all disclosures in the financial statements. Centralised disclosure objectives are high-level objectives, which could form a framework to guide the IASB in setting disclosure objectives in specific standards. Currently, some standards have item-specific disclosure objectives but they are largely developed in isolation from objectives in other standards. Centralised disclosure objectives could increase coherence of objectives in individual standards. Centralised objectives would also help preparers understand how to apply disclosure requirements in individual standards.

In our opinion, the Board should develop centralised disclosure objectives. If future disclosure standards are more principles-based than today, it is essential to base them on high-level objectives in order to make the standards interpretable by preparers. In addition, even if future disclosure standards are rules-based we see it as important to have disclosure objectives. This will help the Board in the development of new standards, as well as guide preparers, auditors, users and others in the interpretation of standards.

Having concluded that centralised disclosure objectives are desirable, we continue with the difficult question of how such objectives could be developed. A basic question is if there are high-level objectives from which disclosure objectives can be deduced. The Conceptual Framework for Financial Reporting states that the objective of financial reporting is to provide information that is useful for investors and creditors in making investment and lending decisions, in forming expectations about future cash flows.⁷ More specifically, investors and creditors need information about the reporting entity's resources and claims on those resources, changes in resources and claims, and the efficiency and effectiveness of management (chapter 1). This suggests both a *valuation* and a *stewardship* perspective.

The Conceptual Framework further defines ‘useful’ as information that is relevant and faithfully represented. Relevance is supported by a focus on materiality and even information with high measurement uncertainty could be relevant (chapter 2). The objective of financial statements is more specific and is defined as ‘to provide information about an entity’s assets, liabilities, equity, income and expenses that is useful to users of financial statements in assessing the prospects for future net cash inflows to the entity and in assessing management’s stewardship of the entity’s resources’ (paragraph 3.4). There is an emphasis on financial statement items, and on both valuation and stewardship perspectives.

The references to the Conceptual Framework presented do not give much concrete guidance on what the appropriate disclosure objectives are or how they may be developed. The DP is more concrete, specifically the ‘principles of effective communication’ listed in paragraph 2.6 (see Section 3).

The objectives of disclosures will depend on financial statement users and how they use financial statements (Barker et al., 2013). Therefore, it is not clear that it is possible to develop one set of disclosure objectives that would result in relevant disclosures for most users in most situations. The Board limits intended users to investors and creditors that do not have access to direct information from management and limits their use of financial statements to prediction of future cash flows. Still, variation in user needs is likely to remain problematic for at least three reasons. First, in practice there are other users that rely on financial statements. Even if it is not the purpose of IFRS to provide information to such users, there could be unintended and costly consequences (cf. Brüggemann et al., 2013). Second, even the users in focus by the Board will take both a valuation and a stewardship perspective into account in their use of financial statements and the objectives of disclosures are likely to differ between the two usages. Third, equity investors and creditors have different economic exposures in their relation to firms, which results in different information needs. Still, the trade-offs referred to above are not new to standard setters as they have previously been addressed when developing objectives for recognition and measurement.

According to Beyer, Cohen, Lys & Walther (2010), any financial statement disclosure that provides information about the value of a firm is relevant in the valuation perspective. In the stewardship perspective, disclosures that provide information on management effort are relevant. Accordingly, the stewardship perspective implies a need for disclosures that distinguish between firm performance that results from management effort and results that are due to other factors. Even for the users in focus by the Board (investors and creditors that do not receive information directly from management) both the valuation and the stewardship perspectives can be important, as suggested in the Conceptual Framework. In addition, there are other users, such as large owners and independent board members that have a stewardship perspective. While Core, Hail & Verdi (2015) show that large ownership functions as a substitute for disclosure, Ozkan, Singer & You (2012) suggest that financial statements matter to independent board members. The difference between the valuation and stewardship perspectives is likely to have an effect on any centralised disclosure objectives that are developed. Watts (2003a, 2003b) claim that there is greater need for verifiability in financial statements for creditors than for equity investors. Watts refers to measurement, not disclosures. However, to the extent that the reasoning is transferable to the area of disclosures, it is likely to have a large impact on the way disclosures –

and disclosure objectives – should be formulated (see also discussion on enforceability below).

In addition to a variety of user needs, centralised disclosure objectives must consider differences in relevant disclosures in different situations. There are indications in the literature that simplified and comparable financial information is especially important for firms with high complexity in operations. André, Filip & Moldovan (2016) suggest that even sophisticated users may have difficulties in understanding complex operations. Beccalli, Miller & O’Leary (2015) show the need for financial disclosures in an industry characterised by high technical complexity.

While it would be impractical for the Board to develop multiple sets of disclosure objectives for different users and usages, a trade-off between different objectives is necessary. It is unlikely that any one set of centralised disclosure objectives will lead to optimal disclosure standards for all situations.

In the development of disclosure objectives, and the standards that ensue, it is also necessary to consider the likely outcome of standards in practice. The outcome will be affected by national context, managerial incentives and enforcement. An important dimension for how to think about such effects is the extent to which disclosure standards are principles-based or rules-based. Principles-based standards allow management to exercise judgement in the preparation of disclosures. This would seem a necessary condition for the provision of entity-specific information. There is, however, a potential problem that principles-based standards also give room for management to act on their incentives, to the detriment of users. This problem can be mitigated through enforcement.

There are many different incentives that could affect management in its disclosure choices. Agency costs arise when disclosures affect the relationship between management, owners and creditors (Beyer et al., 2010). André et al. (2016) and Mazzi, André, Dionysiou & Tsalavoutas (2017) show that incentives to not disclose proprietary information affect mandatory disclosure choices. These are just examples. There are many types of possible incentives that could affect management. Strong enforcement could be one way to make principles-based standards have the intended outcomes (Brown, 2011). While there is not much direct evidence on the effect of enforcement on disclosures, the literature generally reports positive effects of enforcement on recognition and measurement (e.g. Brown, Preiato & Tarca, 2014). For enforcement to work, it is necessary that standards are enforceable (and auditable). Barker et al. (2013) express serious concerns about the enforceability of principles-based disclosure standards. One way to approach the issue of enforceability may be to focus on materiality. In order for firms to disclose relevant entity-specific information it is necessary to apply materiality (e.g. Douppnik & Seese, 2001; Gleason & Mills, 2002; Liu & Mittelstaedt, 2002). We see it as positive that the Board has recently improved the materiality guidance for preparers. However, as materiality is inherently entity-specific, it will still be a challenge to make standards fully enforceable with regard to materiality.

One objective of IFRS is to achieve international harmonisation. Still, the literature has noted continuing differences in how IFRS is implemented, both for measurement (Nobes, 2013) and disclosures (Glaum, Schmidt, Street & Vogel, 2013). It is unclear to

what extent principles-based disclosure standards can contribute to increasing harmonisation.

To the extent that international differences in the implementation of IFRS reflect economic, legal and political differences, such differences contribute to more relevant financial reporting (Ball, 2016; Watts, 2006). If so, the difficulty in formulating centralised disclosure objectives is to ascertain their applicability in different national contexts.

The DP proposes two different methods of developing centralised disclosure objectives, referred to as Method A and Method B. Under Method A, disclosure objectives are organised by *type of information*. Examples of different types of information include accounting policy information, information related to disaggregation of items in primary financial statements, information about unrecognised items, and information related to risks and uncertainties. Method A is largely consistent with the way disclosure requirements are currently expressed in standards. Consequently, preparers would be familiar with this approach, but it may not lead to a fundamental change in disclosure requirements. Under Method B, disclosure objectives are organised by *activities of reporting entities*. Examples include information about operating activities, investing activities, financing activities and taxation. Method B would involve a fundamental change in how the IASB develops disclosure requirements, which – if implemented – could result in the need for substantial educational resources.

The IASB asks for opinions about each of the two methods. Before giving such opinions, we discuss the content and role of notes. The Conceptual Framework, paragraph 7.3, states that the notes contain information about both recognised and unrecognised items, including risks, and methods used and judgements made in estimating amounts. The DP (paragraph 7.17) adds that notes contain information about the reporting entity, the stewardship of management, and events after the reporting period.

It is clear that the notes are closely linked with the four primary financial statements, especially the statement of profit or loss and the statement of financial position. Centralised disclosure objectives will not be independent of the primary financial statements. For example, as disclosures about recognised items differ from disclosures about unrecognised items, the notes reflect the application of recognition criteria. Further, if more uncertainty is allowed in recognition and measurement, disclosures about this uncertainty will become more important (e.g. Blacconiere, Frederickson, Johnson & Lewis, 2011). Given the Board's intention to continue allowing a high level of judgement in the preparation of financial statements, disclosures about measurement uncertainty is expected to remain important. In addition, disclosures should be more important if earnings quality is lower (Verrecchia, 1983). Empirically, however, Francis et al. (2008) find the opposite. A different type of link is that disclosures in the notes could function as a deterrent against recognition and measurement manipulation (cf. Hope & Thomas, 2008). In summary, disclosure objectives cannot be developed in isolation from recognition and measurement objectives.

The Conceptual Framework suggests that disclosures about risk are important, even if risk is not defined (paragraphs BC7.11 and BC7.12). The literature supports this view, e.g. Yang, Yu, Liu & Wu (2018). Although research does not give a clear answer

whether Method A or B – or any other method – should be preferred, we summarise the arguments here.

First, we relate to the distinction between principles-based and rules-based standards. It appears to us that Method B would be more aligned with a principles-based approach. Therefore, to the extent that principles-based standards are preferable, Method B could have advantages. We also recognise, however, that Method A could be used to develop principles-based standards.

Second, we relate to the purpose of the notes. As discussed above, the Conceptual Framework defines the purpose of the notes in relation to financial statement elements and there are strong links between them. The more holistic approach in Method B (DP 7.26) agrees with how an analysis of a firm is conducted, i.e. analysing business operations and financing aspects separately. However, even if Method B mirrors users' actions, it may still be more useful to the user to receive information in accordance with Method A, where users may be allowed to make more independent classifications of the information.

Third, we discuss the expected goal fulfilment of Methods A and B. The three disclosure problems listed in the DP, paragraph 1.5 are: (1) not enough relevant information, (2) irrelevant information, and (3) ineffective communication. Although it is far from clear that there would be any difference in the relative success of the two methods, it is possible that the more holistic approach of Method B would have advantages in making the communication more effective. More importantly, as the Board itself points out, the key to improving disclosures is to have a change in behaviour. We do not agree with the Board's view that Method B is more likely to lead to a change in behaviour simply because it is a new approach. Novelty could easily be introduced in Method A, but we do not believe novelty per se will change behaviour.

Although both Method A and Method B have advantages and disadvantages, in summary we believe Method A would be more useful. This method is also possible to combine with an approach that focuses on the content of disclosures.

Finally, the DP asks if disclosure objectives and requirements should be located in a single standard or included in different IFRS Standards. In this respect, the literature does not give guidance on the structure of accounting standards, as it is focused instead on the content of standards. The answer to this question largely depends on whether Method A or Method B is chosen. Locating all disclosure requirements in one single standard would be more in agreement with Method B than with Method A. If the focus is on the link between individual financial statement items and disclosures (Method A) it would seem more relevant to include disclosure objectives in different IFRS Standards.

8. New Zealand Accounting Standards Board Staff's Approach to Disclosure

In Section 8, the DP describes an approach for how to draft disclosure requirements, developed by the staff of the New Zealand Accounting Standards Board (NZASB). Their approach addresses concerns that the drafting of IFRS Standards may contribute to the disclosure problem and illustrates how the disclosure objectives and requirements

might be drafted in a way that supports more effective disclosures in financial statements.

The main features of the NZASB approach are: (a) the inclusion of disclosure objectives, comprising an overall disclosure objective for each IFRS Standard and more specific disclosure subobjectives for each type of information required to meet that overall disclosure objective; (b) the division of disclosure requirements into two tiers, where the amount of information to be disclosed relies on the relative importance of an item or transaction and the extent of judgement required. The two tiers would be (1) summary information intended to provide users with an overall picture of the effect of the item or transaction and (2) additional information that an entity would consider in order to meet the disclosure objective, (c) greater emphasis on the need to exercise judgement when deciding how and what to disclose to meet the disclosure objectives and (d) less prescriptive wording in disclosure requirements.

In our opinion, the NZASB approach provides a good and pragmatic example of how to draft disclosure requirements. In substance, the NZASB proposes to introduce specific disclosure objectives for each standard, allowing the preparer two different levels (tier 1 and tier 2) of disclosure: tier 1, intended to provide a summary disclosure as a basic level for all the users, and tier 2 for additional information if the company perceives a need to give more detailed information in order to meet the disclosure objectives. The idea of identifying a minimum basic level, defined from a user perspective, is well in line with our discussion in Section 1 on firms that provide poor disclosures and how to ensure a minimum level of disclosures for these entities in order to protect investors.

We agree with the proposed distinction between basic disclosures and additional information. The creation of different levels of disclosure, and their separate graphical evidence, could be useful for users with different information needs, as empirical research has demonstrated (Riise Johansen & Plenborg, 2013). The hierarchy suggests that the distinction is pragmatic (Bloomfield, 2012) between 'elevated' disclosure, obtained with some graphical expedient, and general disclosure.

With regard to tier 2, we think it would be useful to have some guidance showing how to enrich and/or detail tier 1 information. Some useful references are the various dimensions of disclosure proposed by Beattie, McInnes & Fearnley (2004). Their different dimensions concern time (past/present/future), and the nature of information (qualitative/quantitative, financial/non-financial). To this classification, it could be useful to add the other dimension of space (segment/entity/group). In other words, tier 2 could be used to add the above dimensions to the information given at tier 1.

We have some concerns about the disclosure objectives for each standard in the NZASB proposal. The general objectives of financial disclosure are posed in the Framework and IAS 1 and we do not see the need of more specific objectives for each group of elements ruled by each standard. Instead of specific objectives, we think it may be more useful that each standard identifies the specific topics of disclosure. Topics necessary to disclose could then be separated from possible firm-specific topics.

In summary we think the NZASB approach may provide the right balance between flexibility for companies and the availability of a minimum, mandatory level of

disclosure. For this reason, we think the Board should adopt the NZASB staff's approach in its Standards-level Review of Disclosures project, while considering clarification guidance regarding the way to enrich information at tier 2, and the proposition of having a list of topics instead of a list of objectives as proposed by NZASB, as possible improvements.

The DP also asks about the debate of stakeholders regarding the way IFRS Standards are currently drafted. Some of them say that it contributes to the 'disclosure problem' due to the absence of clear disclosure objectives and the presence of long lists of prescriptively written disclosure requirements in the IFRS Standards. However, some other stakeholders observe that specific disclosure requirements might be simpler to use than applying judgements when determining how to meet disclosure objectives.

We suggest two possible improvements for this issue, in terms of format. First, we perceive the necessity of a clearer separation of mandatory disclosure that companies have to provide in any case from disclosures dependent on the recurrence of some specific events/circumstances (e.g., under IAS 36, information about the CGU is requested only in the case of impairment/reversal of impairment recognition, para. 130d). Second, it could be useful to make cross-references in the body of each standard to the specific points of the same standard where disclosures are required. In this way, the typical 'list' at the end of the standard may be better understood.

We believe a comprehensive list of the prevailing disclosure requirements of all IFRS Standards would be useful to entities (and also to researchers).

A final suggestion concerns the relationship between notes and the 'Management Discussion and Analysis' (MD&A). Many companies, depending on jurisdiction, repeat the same information in the notes and in the MD&A (the segment information based on IFRS 8 is a classic example), or, in worst case, they do not consider the notes as the right place to include it, preferring the MD&A. We think this question should be specifically addressed by the IASB.

Conclusions

In the DP the IASB discusses several issues, identified for example through the Board's Agenda Consultations. There are perceived quality problems with disclosures, specifically that there is not enough relevant information, too much irrelevant information and that existing information is not effectively communicated. We agree that disclosures should be relevant to users. However, what constitutes relevant information is entity-specific and disclosure of such information therefore requires preparer judgement and may be difficult to enforce.

The DP suggests several ways to provide guidance both to preparers of financial statements and to the Board in developing disclosure standards. We are generally supportive of the proposed principles of effective communication (see Appendix 1), but the purpose of disclosures could be better specified. We also support the development of clearer guidance to what should be included in primary financial statements and what should be in the notes. This is of particular importance as research shows that users treat recognised and disclosed items differently. One of the principles of effective

communication is clearer links between different information in the financial statements. Consistent with this principle, it is positive that the IASB proposes to develop guidance for how performance measures such as EBITDA and EBIT are linked to IFRS. Disclosure of accounting policies is identified as particularly problematic in current practice, often containing large amounts of irrelevant information. We, therefore, agree that the Board should develop disclosure standards that help preparers discern significant accounting policies. The development of centralised disclosure objectives could be a way to make overall disclosures more entity-specific, and also to increase consistency across different disclosure standards.

Overall, we are generally positive towards the proposals put forward by the IASB in the DP. It is our opinion that many of the proposals in the DP would be helpful to preparers in achieving higher quality disclosures, especially for preparers who attempt to provide entity-specific information. However, the challenge remains to develop disclosure standards for situations where preparers have incentives not to provide relevant information. While the DP in its current stage identifies which steps the IASB should take to increase disclosure quality, it says little about how the Board could act in taking the proposed steps. We support the IASB in its effort to improve the quality of disclosures, but also note that the most difficult work remains to be done.

Notes

¹ One set of IASB actions dealing directly with the disclosure problem targets the application of the materiality concept. This is further described in Section 1, but it may be noted already here that these actions have continued since the DP (IASB, 2017), for example, in an agenda paper from October 2018, concerning disclosures of accounting policies (IASB, 2018), IASB staff recommend the Board to ‘...clarify that not all accounting policies relating to material transactions, other events or conditions are themselves material’ (p. 2). The paper explicitly refers to a user describing accounting policy disclosures as ‘probably the most visible reason why this project started in the first place. [Accounting policy disclosures] are so meaningless and eat up so much space [in the financial statements]’ (pp. 3-4). This user comment on the disclosures can be made because the disclosures are there – the opposite comment will be more difficult to make, i.e. what information will be missing in a decision context where the disclosed accounting policy matters and where the entity has incentives to disclose as little as possible?

² ‘Duplication of information’ refers to the practice of repeating information in a financial report without adding further information. As an example, the DP (IASB, 2017, p. 20) refers to when the note disclosure for inventories repeats the information in the statement of financial position without adding further information.

³ Principle 12 in the EFRAG/FRC/ANC Discussion Paper: Care should be taken in applying the materiality principle in practice, bearing in mind that disclosing immaterial information (and information on situations that do not apply in practice to the reporting entity) reduces the relevance and the understandability of disclosures.

⁴ ISA 720, ‘The Auditor’s Responsibilities Relating to Other Information’, does include a definition of ‘annual report’.

⁵ Source: <https://www.sec.gov/divisions/corpfin/guidance/nongAAPinterp.htm>

⁶ Kolev et al. (2008) define ‘high quality’ adjustments as those that are more transitory, i.e. the ‘appropriate’ items are excluded from GAAP earnings. They split total adjustments into ‘special items’ (i.e. those that are typically viewed as nonrecurring by financial statement users) and ‘other’ adjustments.

⁷ Following the Board’s approach in the Discussion Paper, we refer to the 2015 Exposure Draft (ED/2015/3) and not the Conceptual Framework adopted in 2010.

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Appendix 1. The DP List of the Principles of Effective Communication

- (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 emphasizing the important matters within them;
- (d) linked when relevant to other information in the financial statements or to other parts of the annual report (see Section 4 Location of information) 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.

Appendix 2. Example of a Strategy for Increasing the Effectiveness of Communication

Iteration 1: to explain aims and objectives of the disclosures and their connections with the objectives of the organisation

Iteration 2: to create a profile of the intended users (using stakeholder mapping to create this profile)

Iteration 3: to provide a clear description of the notes required to be delivered to the users

Iteration 4: to identify the channels and formats that will be used to communicate the information