

IFRS Foundation
30 Cannon Street
London
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12 September 2017

Dear Sir / Madam

Discussion Paper DP/2017/1 Disclosure Initiative – Principles of Disclosure

This letter sets out the comments of the UK Financial Reporting Council (FRC) on the above Discussion Paper.

Our detailed comments on the questions asked in the discussion paper are set out in the appendix to this letter. However, we wish to bring specific attention to the following matters:

- We caution against an overly prescriptive approach to the format of financial statements. We believe that the telling of a cohesive, coherent and entity-specific story is fundamental to producing a good set of financial statements, although believe that it is possible to tell a story within a framework of comparable disclosures. We would not support an approach which potentially prohibits the disclosure of relevant information;
- We are concerned about the fragmented nature of this project and believe that certain issues are extremely difficult to consider in isolation. For instance, we believe that consideration of materiality is essential to ensuring an appropriate approach to disclosure;
- We are concerned that the proposals set out in the discussion paper fail to give sufficient regard to potential technological changes which may affect the nature, structure and format of financial reporting in the future. We believe that the detailed approach adopted in some areas may hinder or prevent future progress. We also believe that many of the detailed questions may fall to be irrelevant or of less importance in a digital reporting format;
- We do not support the suggestions to add labelling in financial statements in respect of both the category of accounting policy and non-IFRS information. We believe that such labelling will add to the clutter and complexity of reporting while adding nothing of value; and

- We urge the IASB to accelerate the standards level review of disclosures as a matter of urgency.

If you would like to discuss our comments, please contact me or Anthony Appleton on 020 7492 2432.

Yours sincerely

A handwritten signature in black ink that reads "Paul George". The signature is written in a cursive style with a vertical line to the right of the name.

Paul George
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FRC response to IASB Discussion Paper DP/2017/1 Disclosure Initiative – Principles of Disclosure

Question 1

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

- (a) Do you agree with this description of the disclosure problem and its causes? Why or why not? Do you think there are other factors contributing to the disclosure problem?**
- (b) Do you agree that the development of disclosure principles in a general disclosure standard (i.e. either in amendments to IAS 1 or in a new general disclosure standard) would address the disclosure problem? Why or why not?**

1. The FRC agrees that a disclosure problem exists and that a disclosure standard would be a step in the right direction towards addressing the issue. The articulation of the concerns, however, is at such a high level that they add little to the discussion.
2. This project represents an important opportunity to make a significant change in the quality of financial statements. We are concerned that the fragmented nature of the project will compromise its effectiveness as certain issues are being considered in isolation, without consideration of the whole picture. For instance, we do not believe that it is possible to consider the disclosure problem, without considering materiality, as immaterial disclosures are a fundamental part of the disclosure problem.
3. The FRC supports the development of disclosure principles, but urges the IASB to promulgate those principles through the existing standards as a matter of urgency in order to accelerate a step change in the nature, quantity and quality of disclosures. We believe that development of standards-level solutions will have the greatest impact on behaviour.
4. We welcome the development of communication principles and refer the IASB to the communication principles developed by the FRC, which have been well received and are considered useful.

Question 2

Sections 2-7 discuss specific disclosure issues that have been identified by the Board and provide the Board's preliminary views on how to address these issues.

Are there any other disclosure issues that the Board has not identified in this Discussion Paper that you think should be addressed as part of this Principles of Disclosure project? What are they and why do you think they should be addressed?

5. The FRC is concerned that there is insufficient consideration of the different ways in which users use financial statements, both now and possible ways that they will be used in the future. For instance, while there are a small

FRC response to IASB Discussion Paper DP/2017/1 Disclosure Initiative – Principles of Disclosure

number of users who read the full financial statements, there is a larger group who view the financial statements as a reference document. It is important that the principles of disclosure project takes into account the different ways that financial statements are used both now and how they may be used in the future.

6. The FRC is also concerned that the proposals set out in the discussion paper give insufficient regard to potential technological changes which may affect the nature, structure and format of financial statements in the future.
7. The lack of consideration of the potential technological changes which may affect the nature, structure and format of financial statements in the future has resulted, in our view, in a focus on detailed issues which may be irrelevant or of less importance in the future, for instance, cross-referencing. Furthermore, we believe that the approach adopted may hinder or provide a barrier to future innovation. We believe that the following areas deserve consideration:
 - (i) What could or should financial reporting look like in the future?
 - (ii) In what form could information be shared between the company and the users of the financial statements in order to meet the purpose of financial statements?
 - (iii) In order to provide the appropriate level of assurance over the information, is it necessary for the financial statements to comprise a single document, or is there another form of reporting which would still enable assurance to be provided?
8. It may be, for instance, that financial reporting in digital form will permit a user to determine the level of detail that they wish to access either on particular areas of reporting or across the entire financial statements and the focus on the length of financial statements becomes less relevant. Similarly, cross referencing of the type envisaged in the Discussion Paper may not be required in digital reporting where disparate pieces of information can be easily extracted by the user according to topic or tagging schema.
9. The FRC also believes that any consideration of the future form of financial reporting should be considered in conjunction with considering the assurance that could be given over that information.

FRC response to IASB Discussion Paper DP/2017/1 Disclosure Initiative – Principles of Disclosure

Question 3

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

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

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

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

- 10. The FRC supports the development of a set of principles of effective communication and directs the IASB to the FRC's communication principles, which have been effective and well received in the UK.
- 11. In relation to the specific principles set out in paragraph 2.6, the FRC has the following views:
 - (i) The tension between disclosures that are entity specific (principle a) and those which optimise comparability among entities (principle f) highlights the need for professional judgement in applying the principles. The FRC believes that guidance on the interaction and relevant importance of these principles in different situations would be useful;
 - (ii) We believe that the principle referring to information being described simply and directly should also refer to information needing to be

FRC response to IASB Discussion Paper DP/2017/1 Disclosure Initiative – Principles of Disclosure

- understandable and comprehensive. The use of these terms would highlight the need for explanations to be sufficient; and
- (iii) We believe that the principle referring to highlighting important matters should also refer to the need for that highlighted information to be balanced. The FRC believes that it is important that users of financial statements are not misled as a result of the emphasis given to certain pieces of information within financial statements.
12. As identified earlier, we believe that the importance of some of the principles identified may become of less importance in a digital reporting era. For instance, problems of duplication of information may be less relevant, and advances in reporting may also facilitate changing the format of the information so that it may then be the choice of the user how that information is presented, rather than the choice of the preparer.
13. Regardless of advances in reporting, the FRC views cohesiveness as an important characteristic of good reporting. Annual reporting is a communication of information between an entity and the users of its financial statements; the FRC believes that for that communication to be effective, the information presented must present a cohesive story and the FRC would encourage the IASB to continue to explore the inclusion of cohesiveness as a characteristic of good reporting.
14. The FRC supports the development of principles of effective communication. We recognise that there may be some enforceability issues if they were to be issued in a disclosure standard, but believe inclusion in non-mandatory guidance may not lend sufficient prominence and weight to these important and helpful concepts.
15. In the UK, there are certain principles of effective communication which are enforceable, such as fair, balanced and comprehensive, while other principles remain best practice. The FRC encourages the IASB to explore elevating some of the communication principles such that they are enforceable, potentially within a disclosure framework, while placing the remaining principles in non-mandatory guidance.
16. In respect of formatting, the FRC advises caution in this area. The FRC believes that telling a cohesive and coherent story is vital and we would not want to prohibit the disclosure of relevant information. If the IASB were to provide guidance on formatting, the FRC urges consideration of possible future technological developments to ensure that the guidance remains relevant and does not hinder potential progress.

FRC response to IASB Discussion Paper DP/2017/1 Disclosure Initiative – Principles of Disclosure

Question 4

The Board's preliminary views are that a general disclosure standard should:

- **specify that the 'primary financial statements' are statements of financial position, financial performance, changes in equity and cash flows;**
- **describe the role of primary financial statements and the implications of that role as set out in paragraphs 3.22 and 3.24;**
- **describe the role of the notes as set out in paragraph 3.28, as well as provide examples of further explanatory and supplementary information, as referred to in paragraphs 3.26 and 3.27; and**
- **include the guidance on the content of the notes proposed in paragraphs 7.3 – 7.7 of the Conceptual Framework Exposure Draft, as described in paragraph 3.7;**

In addition, the Board's preliminary views are that:

- **it should not prescribe the meaning of 'present' as presented in the primary financial statements and the meaning of 'disclose' as disclosed in the notes;**
- **if it uses the terms 'present' and 'disclose' when describing where to provide information in the financial statements when subsequently drafting IFRS standards, it should also specify the intended location as either 'in the primary financial statements' or 'in the notes'.**

Do you agree with the Board's preliminary views? Why or why not? If you do not agree, what do you suggest and why?

17. As noted above, the FRC is concerned that the proposals set out in the discussion paper give insufficient regard to potential technological changes which may affect the nature, structure and format of financial statements in the future. Although we support the general objectives of articulating the objectives of financial statements, primary financial statements and the notes, we believe that narrow definitions may hinder future technological change. We encourage the IASB to consider the future of financial reporting when determining the language used in these sections.
18. The FRC supports an articulation of the role of the primary financial statements, but have concerns that the description noted in paragraph 3.2 may be too narrow. We believe that the defined role of the primary financial statements should focus on the overall position, performance, cash flows and stewardship of the entity, rather than the individual line items; this is consistent with 3.20(b) explaining the reasons why users do focus on the primary financial statements. We also believe that year on year comparability of the primary financial statements is more important than comparability between entities, although we recognise that comparability across entities has an important role.

FRC response to IASB Discussion Paper DP/2017/1 Disclosure Initiative – Principles of Disclosure

19. The FRC supports clarifying the role of the notes, but is concerned that the description presented is too narrow. In particular the FRC believes that the role and content of notes is broader than has been articulated in the discussion paper and that notes often provide independent information on items which are not included in the primary financial statements, for instance, operating segments or related party disclosures. The notes may also provide information on sources of value or other resources which do not meet the definition of assets.
20. We note that broadening the roles of the primary financial statements and the notes, as set out in paragraphs 18 and 19 above, would also necessitate an equivalent broadening of the role of the financial statements, as set out in paragraph 3.4 of the draft conceptual framework.
21. The FRC believes both present and disclose to be terms that are well understood in the UK, but would encourage the IASB to be consistent in their usage.

Question 5

The Board's preliminary view is that a general disclosure standard should include a principle that an entity can provide information that is necessary to comply with IFRS Standards outside of the financial statements if the information meets the requirement in paragraph 4.9(a) – (c).

- (a) Do you agree with the Board's preliminary view? Why or Why not? If you do not agree, what alternative(s) do you suggest and why?**
- (b) Can you provide examples of specific scenarios, other than those currently included in IFRS Standards (see paragraphs 4.3-4.4), for which you think an entity should or should not be able to provide information necessary to comply with IFRS Standards outside the financial statements? Why? Would those scenarios meet the criteria in paragraphs 4.9(a) – (c)?**

22. The FRC believes that if it is possible to preserve the integrity of, access to and level of assurance over financial statements, then financial reporting in the future could encompass cross referencing other documents. Indeed, the future of financial reporting could move away from a 'set' of financial statements in its current form and cross referencing may be replaced by drilling down into data. The FRC believes that it is essential that the approach that the IASB adopts with respect to this matter takes account of potential developments in financial reporting in the future so that future change is not restricted. In this regard, the FRC notes the 'Core and More' concept proposed by FEE in its 2015 report and the progressive policy questions

FRC response to IASB Discussion Paper DP/2017/1 Disclosure Initiative – Principles of Disclosure

posed in the recent report by the ICAEW 'What's next for Corporate Reporting: time to decide'.

23. At the same time, the FRC recognises the importance placed by investors, under current reporting frameworks, on the annual report as a document of reference. Striking the right balance between facilitating the current use of annual reports and not inhibiting future innovation is not straightforward. In this regard we draw your attention to the reports on the use of digital forms of reporting issued by the Financial Reporting Lab. The first in the series on the current use of technology, issued in 2015, found that many users of the annual report wanted access to annual reports in a single pdf format. However, its most recent report, issued in May 2017, examined what users and preparers would want from a digitally enabled system of corporate reporting and sets out a framework for such reporting in the future.
24. We are concerned that articulation of the circumstances under which cross referencing is permitted or prohibited could introduce restrictions that hinder future innovation in reporting. We believe that permitting some cross referencing is helpful, so advise caution in ensuring that the language adopted does not stifle developments.

Question 6

The Board's preliminary view is that a general disclosure standard:

- **should not prohibit an entity from including information in its financial statements that it has identified as 'non-IFRS information' or by a similar labelling. To distinguish it from information necessary to comply with IFRS Standards; but**
- **should include requirements about how an entity provides such information as described in paragraphs 4.38(a)-(c).**

Do you agree with the Board's preliminary view? Why or why not? If you do not agree, what alternative(s) do you suggest, and why?

25. The FRC does not support the use of labelling of information as non-IFRS. In our view, such labelling would lead to clutter and confusion and we are not clear how this would relate to the taxonomy. The FRC also believes that the distinction between IFRS information and non-IFRS information may not always be clear and believes that such labelling may result in significant additional work for companies attempting to distinguish between the categories while providing no useful information for users of the financial statements.
26. As noted below, we recommend the IASB considers the principles in the ESMA guidance on alternative performance measures and, by doing so, such measures will be implicitly identified as non-IFRS. However, we strongly discourage extending the use of labelling beyond APMs.

FRC response to IASB Discussion Paper DP/2017/1 Disclosure Initiative – Principles of Disclosure

Question 7

The Board did not discuss whether any specific information – for example, information that is inconsistent with IFRS Standards – should be required to be identified as described in paragraphs 4.38(a) – (c) or should be prohibited from being included in the financial statements.

Do you think the Board should prohibit the inclusion of any specific types of additional information in the financial statements? If so, which additional information, and why?

27. The FRC does not support a principle which prohibits information. Instead, the FRC believes that the emphasis should be on encouraging companies to use appropriate judgement to determine additional information to be disclosed which is relevant for understanding the performance, position and development of the business, in a manner which is clear and concise and does not undermine the credibility of the reported IFRS numbers.

Question 8

The Board's preliminary views are that it should:

- **Clarify that the following subtotals in the statement of financial performance comply with IFRS Standards if such subtotals are presented in accordance with paragraphs 85-85B of IAS 1:**
 - **the presentation of an EBITDA subtotal if an entity uses the nature of expense method; and**
 - **the presentation of an EBIT subtotal under both a nature of expense method and a function of expense method.**
- **develop definitions of, and requirements for, the presentation of unusual or infrequently occurring items in the statement(s) of financial performance, as described in paragraphs 5.26 – 5.28**
- (a) **Do you agree with the Board's preliminary views? Why or why not? If you do not agree, what alternative action do you suggest and why?**
- (b) **Should the Board prohibit the use of other terms to describe unusual and infrequently occurring items, for example, those discussed in paragraph 5.27?**
- (c) **Are there any other issues or requirements that the Board should consider in addition to those stated in paragraph 5.28 when developing requirements for the presentation of unusual or infrequently occurring items in the statement(s) of financial performance?**

The feedback on Question 8 will be considered as part of the Board's Primary Financial Statements project.

FRC response to IASB Discussion Paper DP/2017/1 Disclosure Initiative – Principles of Disclosure

28. The use of EBIT and EBITDA is widespread in the UK and the FRC believes that the terms are well understood. We recognise, however, that a common approach to defining these terms could be helpful so that when an entity refers to a measure as EBIT or EBITDA, users of the accounts know that each entity has calculated it in the same way. We do not believe that defining these terms should preclude the use of other, entity specific, measures of performance. In this way, the FRC sees defining EBIT and EBITDA as an anchor point, from which entities can choose to make further adjustments where relevant and appropriate
29. The FRC supports the development of principles supporting when an item could or should be described as unusual or infrequently occurring, and therefore disclosed separately. However, we advise caution on the prohibition of specific terms as, in our experience, the translation of these terms into languages other than English can lead to unforeseen consequences. We would therefore encourage the IASB to focus on the placement of such information, rather than the label ascribed.

Question 9

The Board’s preliminary view is that a general disclosure standard should describe how performance measures can be fairly presented in financial statements, as described in paragraph 5.34.

Do you agree with the Board’s preliminary view? Why or why not? If you do not agree, what alternative action do you suggest, and why?

30. The FRC supports principles which underpin the use of alternative performance measures and would encourage the IASB to follow the principles set out in ESMA’s guidance on alternative performance measures, or introduce principles that are at least as strong as those in ESMA’s guidance.
31. With respect to the Board’s preliminary view, the FRC is concerned that the requirements set out in 5.34 will add to the clutter in financial statements, without providing greater clarity, particularly in relation to the requirements set out in 5.34(c) and the labelling requirement in (d).

FRC response to IASB Discussion Paper DP/2017/1 Disclosure Initiative – Principles of Disclosure

Question 10

The Board's preliminary views are that:

- a general disclosure standard should include requirements on determining which accounting policies to disclose as described in the paragraph 6.16; and
 - the following guidance on the location of accounting policy disclosures should be included either in a general disclosure standard or in non-mandatory guidance (or in a combination of both):
 - the alternatives for locating accounting policy disclosures, as described in paragraphs 6.22 – 6.24; and
 - the presumption that entities disclose information about significant judgements and assumptions adjacent to disclosures about related accounting policies, unless another organisation is more appropriate.
- (a) Do you agree with the Board's preliminary view that a general disclosure standard should include requirements on determining which accounting policies to disclose as described in paragraph 6.16? Why or why not? If you do not agree, what alternative proposal(s) do you suggest, and why?
- (b) Do you agree with the Board's preliminary view on developing guidance on the location of accounting policy disclosures? Why or why not? Do you think this guidance should be included in a general disclosure standard or in non-mandatory guidance (or in a combination of both)? Why?

If you support the issuance of non-mandatory guidance in Question 10(b), please specify the form of non-mandatory guidance you suggest (listed in paragraphs 2.13(a) – (c)) and give your reasoning.

32. The FRC supports the introduction of requirements on determining which accounting policies to disclose. We have reservations, however, about the three tiers proposed in paragraph 6.16, as this appears to add unnecessary complexity which is then not used in the decision of whether disclosure is required, which is by reference to materiality.
33. The FRC supports the inclusion of guidance to help an entity determine whether an accounting policy is material. These are the types of policies articulated in 6.12 (a) and (b). The FRC believes that the guidance on materiality of accounting policies could be located either within a disclosure standard or within the materiality practice statement.

FRC response to IASB Discussion Paper DP/2017/1 Disclosure Initiative – Principles of Disclosure

34. The FRC believes that further consideration should be given to whether policies that are in category 2 need to be disclosed in full, or whether a reference to the standard would be sufficient. In this regard, the FRC directs the IASB to the findings of the Financial Reporting Lab in its 2014 report on Accounting Policies. The report noted that opinion was divided on whether disclosure of an accounting policy which merely repeated the relevant IFRS was useful in annual reports and the FRC believes that this idea should be pursued further.
35. The Financial Reporting Lab's work also identified that users of accounts believe strongly that accounting policies for all material revenue should always be disclosed and we ask the IASB to have regard to this finding.
36. The FRC supports the inclusion of explicit guidance setting out some of the different options for presentation of accounting policies, but observes that such guidance does not recognise the potential changes that technological advances could bring to financial reporting. The FRC urges the IASB to consider widening the language used so that future changes as a result of technology are not prohibited.
37. For the avoidance of doubt, the FRC would not support the labelling of accounting policies as category 1, 2 or 3 as we believe that this would add to clutter and complexity, without adding useful information.
38. In the UK, significant judgments and estimates are frequently located in a single place, enabling the user of the accounts to easily identify all of those areas where decisions by the directors have had the biggest impact on the financial statements. The IASB evidence, as presented in the discussion paper, indicates that there are mixed views on where these disclosures are best located. Given these factors, the FRC does not agree with the Board's preliminary view that there should be a presumption that significant judgments and estimates should be located alongside the relevant accounting policy. Instead, we encourage the IASB to create guidance on the relative merits of each of the different presentations and explain circumstances when each may be the most useful.
39. Again, this is an area where technological changes may render this area of the guidance of less relevance. As long as data is appropriately tagged, a digital reporting environment may put the decision about how that information is presented into the hands of the user, not the preparer.

FRC response to IASB Discussion Paper DP/2017/1 Disclosure Initiative – Principles of Disclosure

Question 11

The Board's preliminary view is that it should develop a central set of disclosure objectives (centralised disclosure objectives) that consider the objective of financial statements and the role of the notes.

Centralised disclosure objectives could be used by the Board as the basis for developing disclosure objectives and requirements in Standards that are more unified and better linked to the overall objective of financial statements.

Do you agree that the Board should develop centralised disclosure objectives? Why or why not? If you do not agree, what alternative do you suggest, and why?

40. The FRC strongly supports the development of a disclosure framework to aid the development of standard setting, and believes that this is where initial effort on this project should be focussed. The FRC believes that this phase of the project should be swiftly followed by rolling the principles set out in the disclosure framework across all existing standards. The FRC is of the view that these actions will have the biggest impact in helping to address behaviours and the overall disclosure problem.

Question 12

The Board has identified, but not formed any preliminary views about, the following two methods that could be used for developing centralised disclosure objectives and therefore used as the basis for developing and organising disclosure objectives and requirements in Standards.

- **focusing on the different types of information disclosed about an entity's assets, liabilities, equity, income and expenses (Method A); or**
- **focusing on information about an entity's activities to better reflect how users commonly assess the prospects for future net cash inflows to an entity and management's stewardship of that entity's resources (Method B)**

(a) Which of these methods do you support, and why?

(b) Can you think of any other methods that could be used? If you support a different method, please describe your method and explain why you think it might be preferable to the methods described in the section.

Methods A and B are in the early stages of development and have not been discussed in detail by the Board. We will consider the feedback received on this Discussion Paper about how centralised disclosure objectives might best be developed before developing them further.

41. The FRC views Method A as having a balance sheet focus and as such is consistent with the IASB's approach to recognition and measurement; we believe that this would require the least amount of additional work to

FRC response to IASB Discussion Paper DP/2017/1 Disclosure Initiative – Principles of Disclosure

implement. While the FRC can see significant value in the disclosures which may result from the implementation of method B, we are concerned that the performance focus of this method may require either a radical rewrite of many existing standards, or runs a danger of creating a disconnect between the recognition and measurement of items in financial statements and the accompanying disclosures. Accordingly, we support Method A but believe that these categories should be further developed before a final decision is taken.

Question 13

Do you think that the Board should consider locating all disclosure objectives and requirements in IFRS Standards within a single Standard, or set of Standards, for disclosures? Why or why not?

42. The FRC does not support locating all disclosure objectives and disclosure requirements in a single Standard. We believe that the decision about what to disclose should be taken in conjunction with consideration of the relevant standard. Entities should consider whether there are material items to apply the standard to, apply the requirements of the standard and then make the appropriate required disclosures. Locating the disclosure requirements in a separate location could result in a disconnect in this process.
43. We believe that if all disclosure objectives and requirements were located in a single standard it could encourage a checklist approach mentality, often leading to disclosure of immaterial matters, thereby diverging from one of the original aims of this project.