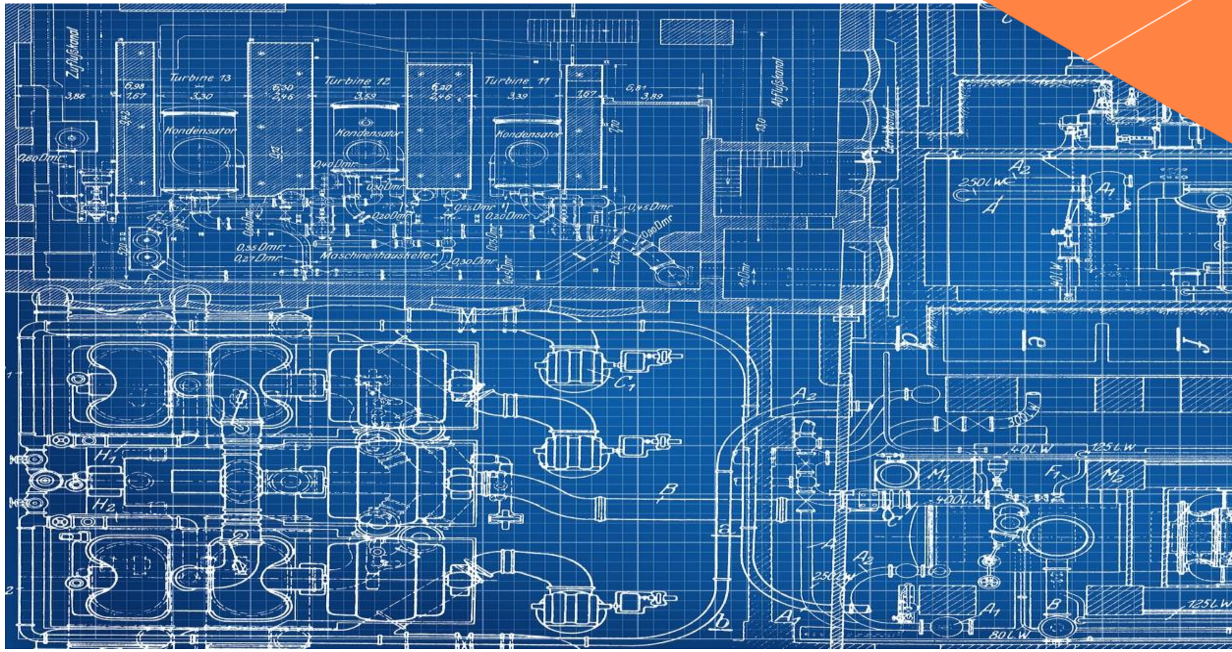
Targeted disclosure: how would it work in practice?

Blueprint for future IFRS disclosures

30 June 2021



European Financial Reporting Advisory Group

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CONTENT

Background

The overall disclosure problem

Overview of Disclosure Initiative projects

Completed projects

addressed aspects of the overall disclosure problem

- Amendments to IAS 1 and IAS 8 to clarify the definition of material
- Amendments to IAS 7 to improve disclosure of changes in financing liabilities
- Amendments to IAS 1 to remove barriers to applying judgment
- Materiality Practice Statement
- Better Communication Case Studies
- Disclosure of accounting policies
- Principles of Disclosure research project

Active projects

- Subsidiaries that are SMEs
- Targeted Standards-level Review of Disclosures

research showed that an **overarching response to help solve the overall disclosure problem** is still needed

Targeted Standards-level Review of Disclosures: Board’s pilot approach proposals

Project approach

1. Develop proposed Guidance summarising the Board's proposed new approach to developing and drafting disclosure requirements

→

2. Test the proposed Guidance
by applying it to IFRS 13 and IAS 19

Improve the Board's guidance

↓

3. Prepare an Exposure Draft of the proposed Guidance and proposed amendments to IFRS 13 and IAS 19

→

Comment period:
March – October 2021

Improve the Board's guidance

Iterative process

Current requirements

Standards-level requirements	• Individual standards contain **prescriptive requirements** for a company to disclose particular items of information • Some Standards—especially more recently issued Standards—also contain **high level disclosure objectives**
Overarching materiality requirements	• IAS 1 requires a company to apply **materiality** across its disclosures - A company need not provide a specific disclosure required by an IFRS Standard if the information is not material - A company is required to provide additional disclosures if compliance with the specific disclosure requirements in an IFRS Standard is insufficient to enable user understanding

Q: Is compliance automatically achieved by providing information in response to each prescriptive requirement in an IFRS Standard?

A: No. Disclosure objectives and materiality requirements must also be satisfied.

The Board’s proposals

Proposed Guidance for the Board when developing and drafting disclosure requirements in future	A Disclosure requirements based on **stakeholder needs**	The Board would enhance its engagement with investors, companies and others, seeking input even earlier in the standard-setting process.
	B Detailed **disclosure objectives** in individual IFRS Standards	The Board would develop objectives that describe investor information needs in detail. Companies can only meet these objectives by applying judgement.
	C Language that encourages application of **judgement**	The Board would place the compliance requirement (‘shall’) on disclosure objectives, and minimise requirements to disclose particular items of information.

Test the proposed Guidance by applying it to the test Standards

Proposed amendments to IFRS 13 and IAS 19	• Require companies to exercise judgement by satisfying disclosure objectives that describe investor information needs. • Provide items of information—that are typically not mandatory—to help companies judge how best to satisfy specific disclosure objectives.

Disclosure requirements based on stakeholder needs

What is the issue?

Companies may not always understand why information is useful, so they find it difficult to make effective judgements

Board's main proposals

Understand what investors want:

- What information is useful and why
- What analysis they intend to perform
- How detailed the information needs to be
- Whether information is critical or 'nice-to-have'

Clearly explain investor needs in the Standards

Develop specific disclosure objectives, along with explanations of what investors may do with the information provided

Satisfying specific disclosure objectives

To help companies apply judgement in determining what to disclose to comply with specific disclosure objectives, the Board would:

- supplement each specific disclosure objective with an explanation of why investors want information and what they may do with it
- identify items of information to meet each specific disclosure objective
- explicitly link every item of information to one or more specific disclosure objectives

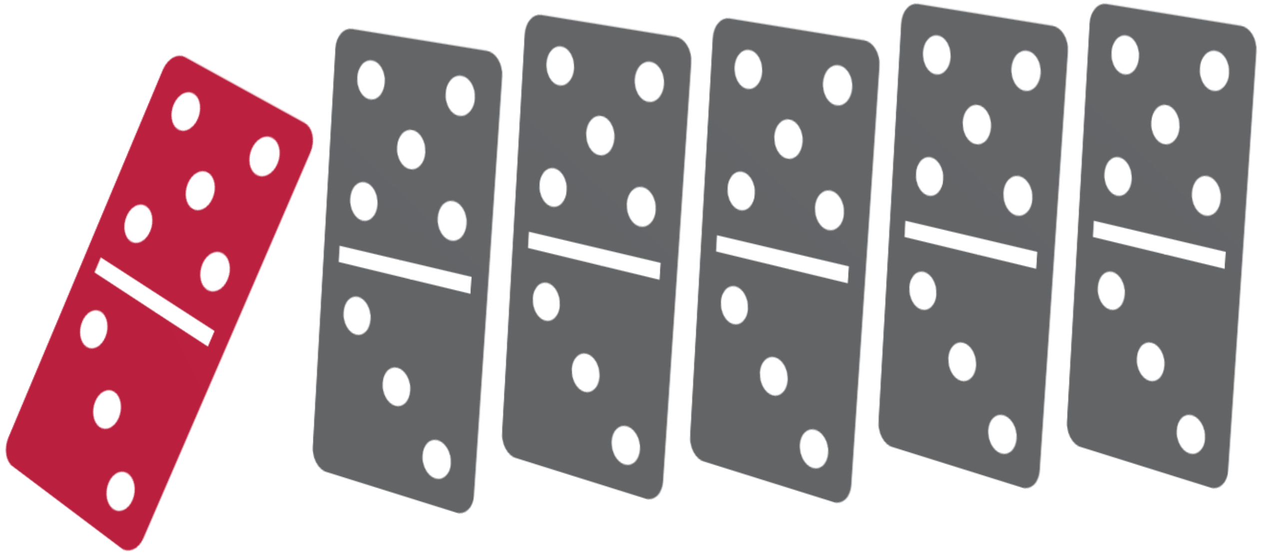
Language that encourages judgement

Current approach	Headline disclosure objective (when provided)	'An entity **shall** disclose…'	Particular items of information	'An entity **shall** disclose…'
Board's proposals	Overall and specific disclosure objectives	'An entity **shall** disclose…'	Particular items of information	'**While not mandatory**, the following information **may enable** an entity to meet the specific disclosure objective…'

Using language that the Board expects to be most effective in **shifting the focus away from applying disclosure requirements like a checklist**

Catalyst for change

"Addressing the overall disclosure problem will require all those involved in financial reporting to play their part"



The Board

Companies, auditors, regulators & others

By taking steps to improve the requirements in IFRS Standards, the Board would **kick-start the process and enable stakeholders to improve the way they approach financial statement disclosures**

How might the proposed approach affect comparability?

Risk Companies with similar circumstances could make different judgements about the information they believe meets the disclosure objectives leading to reduced comparability

However, the Board's view is that…

Uniform information and comparable information are not the same thing	If similar information is material to multiple companies, applying the proposals should result in similar disclosures
Information provided by two companies might look different, but the content would be comparable in all material respects if both have satisfied the required disclosure objectives	This is because of: • the specificity of the proposed disclosure objectives; • the requirement to comply with those objectives; and • the explicit link of each objective to items of information.

The Board expects the proposals would result in comparable information between companies when that information is:

- material to both companies

and

- useful to investors

Application of materiality should already result, when appropriate, in companies providing different sets of information

IFRS

Reflecting the proposals in the IFRS Taxonomy

An IFRS taxonomy element would be created for each…		
Overall disclosure objective	**Specific disclosure objective**	**Item of information**
Companies would use these elements to identify all information disclosed to satisfy a disclosure objective (block tagging)		Companies would not need to create their own extensions when disclosing these items of information.

Investors would be able to extract all information relating to each disclosure objective

Investors would be able to extract and compare similar items of information

Will companies need to create their own extensions?

- Sometimes—most commonly for unique or unusual items of information needed to satisfy a particular disclosure objective.
- The Board expects its proposed approach to identify information that is relevant to multiple companies. Such information would be captured in the Standards and an IFRS Taxonomy element created.

Project Overview

The timeline

March 2021	May 2021	August 2021	September 2021	15 October 2021
IASB ED	EFRAG DCL	Field test completion	Outreach events based on field test	Comment period ends

Participants can share results in one, some or all of the following ways:

- Mock note disclosures based on the proposals
- Questionnaire about developing mock disclosures
- Meeting to discuss mock disclosures, follow-up questions, issues and solutions

Based on results, we will hold outreach events to share findings and gather responses

GENERAL COMMENTS

- EFRAG supports the objective of the project
- IASB's focus is on the provision of more relevant disclosures (and less irrelevant ones) and not on changing the volume of disclosures
- EFRAG welcomes the development of a rigorous methodology
- **Developing and testing such an approach has merits and should be encouraged as we support the reduction of detailed disclosure checklists**
- EFRAG support to work more closely with users early in the process to understand what information they need, and how it is intended to be used
- EFRAG recommends to explain the relationship between individual disclosure objectives and the concept of materiality
- EFRAG invites the IASB to explain whether and how the objectives serve the stewardship objective of financial reporting
- EFRAG encourages the IASB to further consider the interaction between the proposals in the ED and the increased use of digital reporting

A LIST OF MINIMUM REQUIREMENTS?

KEY QUESTION TO EFRAG'S CONSTITUENTS

Do you agree that the IASB only mandates the overall and specific objectives for each IFRS Standard, or do you consider that the IASB should also mandate a list of minimum disclosure requirements necessary to meet the disclosure objectives?

- The proposed approach makes minimum requirements an exception
- With a higher level of judgement, the proposals will likely create implementation challenges and tensions with comparability
- The success of the proposed approach depends on the IASB striking the correct balance between a tier of disclosures that are always required (that ensure a minimum level of comparability), and objectives to elicit additional entity-specific disclosures
- Absent a list of minimum disclosure requirements, the proposed approach would expose preparers to second guessing. It would also make review of such disclosures and enforcement of the requirements more difficult for auditors and regulators and may ultimately not lead to the intended changes and improvement to information relevance

OTHER CHALLENGES

On the use of less prescriptive language

- The expression ‘while non-mandatory’ might be misunderstood and result in material information being omitted
- Suggest that the IASB clarifies in the body of the proposed amendments that this expression does not mean that the items of information are voluntary and that entities should consider these items when assessing meeting the specific objectives

Users’ needs

- EFRAG also observes that different type of users may have different information needs (e.g., equity investors vs lenders) and these needs can vary over time. Assessing the ‘common information needs’ of a variety of users and the dynamic nature of their needs over time create challenges to preparers, auditors and enforcers

TESTING HOW CURRENT PRACTICES WOULD CHANGE

- Comprehensive outreach and field testing needed
- Final impact of the proposals depends, to some extent, on the willingness of preparers to undertake a change to their approach to the use of judgement. In some cases, a tendency to maintain the existing requirements or even an increase of disclosures cannot be excluded
- Assessing the costs/benefit profile, as applied to the two selected IFRS Standards, will be paramount in demonstrating the validity of the proposals
- EFRAG always considers it essential that any proposed change to the existing requirements is justified by an appropriate cost/benefit balance
- A critical feature of the revised approach to the disclosure is to define an appropriate set of minimum requirements. Understanding the potential for a loss of information would provide input on such minimum requirements
- Auditors and regulators also play a role to promote use of judgement
- Need to involve small and large entities
- **EFRAG is concerned that the response period is too short to conduct a proper field test. Therefore, EFRAG proposes a substantially longer period for consultation**

Proposed revisions to IAS 19 Disclosures

by Alex Kotliarskyi

Proposed amendments to IAS 19

Key messages from stakeholders

Focus on the risk: defined benefit plans

Investors prioritise information about future cash flow effects of defined benefit obligations

Ineffective communication about the effect of defined benefit plans on the primary financial statements is a problem

Many of today's disclosures are onerous to prepare

Board's main proposals

- **Disclosure objectives that explain and focus on key investor needs**.
- Removal of less decision-useful and costly information, such as a detailed sensitivity analysis.

Companies are **required** to satisfy disclosure objectives. Items of information will help companies to apply judgement.

Proposed disclosure objectives—defined benefit plans

Key things investors want to understand…

Amounts in the primary financial statements and how they reconcile to the detailed notes (‘an executive summary’)	Nature of promised benefits and risks the company is exposed to
Expected effects on future cash flows and the nature of those effects	How long will payments will continue to be made for closed plans
Measurement uncertainty and significant assumptions used	How and why balance sheet amounts have changed during the reporting period

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EFRAG's initial views on the IAS 19 proposals

Topic	EFRAG position	Preliminary assessment
Approach - defined benefit plans	EFRAG generally agrees that the overall disclosure objective for defined benefit plans in the ED could be useful for preparers. This will help entities to understand the overall information needs of users of financial statements in relation to defined benefit plans. EFRAG notes that the extent of the effects of the changes will depend also on the behaviour of the preparers and their appetite for a reduction of the information provided.	✓
Nature of defined benefit plans	EFRAG notes that this is not defined. This may lead to increasing narrative information without substantial improvement.	!
Benefits and costs	As for other sections, EFRAG is unable to assess whether benefits will outweigh the costs of the proposals and will obtain this information through a field test.	?
Sensitivity analysis	Current requirement proposal to be replaced with a broader objective that requires information that enables users of financial statements to understand the significant actuarial assumptions used. While this information is costly, it is also useful to users, therefore EFRAG considers that this should be mandatory.	!
Question to constituents	Do you agree with the IASB's proposal that benefits provided by the current sensitivity analysis would not outweigh the cost to entities of providing that information and, therefore, should not be required?	?

EFRAG’s initial views on the IAS 19 proposals

Topic	EFRAG position	Preliminary assessment
Defined contribution plans	EFRAG expected additional disclosure requirements to reflect certain risks especially around hybrid plans.	!
Other employee benefits	EFRAG agrees with the overall disclosure objective for these types of benefits (short-term, other long-term and termination benefits)	✓
Multi-employer plans	Compliance with overall disclosure objective is insufficient to communicate the risks, therefore EFRAG agrees with the proposed specific objectives	✓

Proposed changes to IFRS13 disclosures

Michael & Diane Weidner

Proposed amendments to IFRS 13

Key messages from stakeholders

Proper application of materiality is critical. Detailed disclosures often:

- focus on immaterial fair value measurements; and
- do not contain information about material fair value measurements.

Today's disclosures are onerous to prepare

Investors rarely ask a company questions about its detailed fair value measurement disclosures

Board's main proposals

- **Disclosure objectives that explain and focus on key investor needs.**
- Require companies to focus on the appropriate level of detail.
- Removal of a perceived Level 3 checklist by avoiding reference to particular levels of the fair value hierarchy.

Companies are **required** to satisfy disclosure objectives. Items of information will help companies to apply judgement.

Proposed disclosure objectives—fair value measurements

Key things investors want to understand….

The **exposure to uncertainties** associated with **material** fair value measurements

Amount, nature and other characteristics of items measured at fair value—including how subjective the measurements are*

Measurement uncertainty and significant techniques and inputs used

Reasonably possible alternative fair value measurements

How and why fair value measurements have changed during the reporting period

* A similar disclosure objective is proposed for items not measured at fair value in the statement of financial position but for which fair value is disclosed in the notes

EFRAG's initial views on the IFRS 13 proposals

Topic	EFRAG position	Preliminary assessment
Approach	Overall and specific disclosure objectives for items measured at fair value or for which fair values are disclosed could be useful to understand the information needs of users	✓
Sensitivity disclosures L3	More pertinent than alternative fair values. EFRAG is also concerned about trade-off between costs and benefits and increasing the burden on preparers significantly	!
Question to constituents	Do you agree with the EFRAG position that the proposal on the provision of alternative fair values is too burdensome and raises issues of understandability, or do you consider that the benefit to users would outweigh the costs? Do you have any alternative proposals to provide information that would allow users to evaluate the possible outcomes of the fair value measurements at the end of the reporting period?	?
Mandatory items	EFRAG agrees with these proposals	✓
Judgement	Significant judgements and assumptions are useful as entities should have some flexibility to determine the form and level of disclosure that best meets users' needs. Level of judgement must not be so high that it may impair the level of relevance, reliability and comparability of the information. Therefore, EFRAG recommends to the IASB to investigate further the practical application of the disclosure requirements.	!

Fair values in company valuation (non-financial)

Type of fair value	Balance sheet (Net debt/Equity)	Income/Cash flow (Enterprise value)
IFRS 9 Financial instruments (IFRS13 Level 1 or 2)	Included in net debt Low importance	*(Effects from hedging difficult to exclude)*
IAS 40 Property (IFRS 13 Level 3)	Included in equity High importance	-
IAS 41 Biological/Forest (IFRS 13 Level 3)	-	Affect estimates High importance
IAS 19 Pensions (IFRS 13 Level 1-3)	Included in net debt High importance	-
IAS 36 Impairments (IFRS13 Level 3)	Included in equity Low importance	-
IAS 16/IAS 38 (IFRS 13 Level 3)	Included in equity No importance	-

Peter Malmqvist – EFRAG User Panel, 2021-06-30

Comments on EFRAG draft comment letter

EFRAG's draft comment letter is available here on EFRAG's website: www.efrag.org

Comment deadline: 15 October 2021

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