Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Disclosure Initiative**	**Meeting**	AASB September 2021 (M184)
Topic:	**Exposure Draft Disclosure Requirements in Australian Standards — A Pilot Approach**	**Agenda Item:**	8.1
		Date:	25 October 2021
Contact(s):	Ao Li ali@aasb.gov.au Helena Simkova hsimkova@aasb.gov.au	**Project Priority:**	Medium
		Decision-Making:	High
		Project Status:	Deciding comment letter direction

Objective of This Paper

1 At the last AASB meeting, the Board decided not to support the approach to disclosure objectives proposed by the IASB in the *IASB ED/2021/3 Disclosure Requirements in IFRS Standards—A pilot Approach*.

2 The objective of this agenda item is:

(a) for the Board to **consider** the alternative models identified by staff that could address the disclosure problems stated in the ED;

(b) to **inform** the Board of the feedback on the alternative approaches received from additional outreach; and

(c) for the Board to **decide** whether to include any alternative model in the comment letter for IASB to consider;

(d) if the Board does not wish to recommend any alternative model, to **decide** the direction of the comment letter response.

Attachments

Agenda Paper 8.2 Summary of stakeholder feedback [supporting documents folder]

Agenda Paper 8.3 ED 309 Submission Letter [supporting documents folder]

Structure

3 This paper is structured as follows:

(a) Background (paragraphs 4–8)

(b) Staff analysis of alternative approaches (paragraphs 9–22)

(c) Staff recommendations (paragraphs 23–26)

(d) Next steps (paragraphs 27–28)

Background

4 IASB ED/2021/3 (or the Australian equivalent ED 309) proposes guidance that could be used by the IASB when developing and drafting disclosure requirements in future IFRS Standards

(proposed Guidance). It intends to address stakeholders' three main concerns about the information disclosed in financial statements (disclosure problem): insufficient relevant information, too much irrelevant information, and ineffective communication of the information provided.

5 Staff provided the preliminary stakeholder feedback on the ED 309 proposals to the Board at the September 2021 meeting. The majority of respondents commented on the principles of the proposal, mainly on whether the proposed new approach would be effective in addressing the disclosure problems and feasible in practice.

6 At its September 2021 meeting, the Board decided not to support the IASB proposed disclosure approach in ED 309.[1] The Board acknowledged the IASB's effort to solve the disclosure problems. However, the Board concluded that the suggested approach would not result in the desired outcome.

7 The Board requested staff to explore alternative approaches that could help to address the disclosure problem. In response, staff have considered three alternative options (listed in Table 1) to respond to the IASB and provide the IASB with an alternative model that could help address the disclosure problems. Staff have also sought stakeholders' feedback on these options.

8 The comment period for ED 309 to AASB closed on 15 October 2021. The AASB received one comment letter after the September 2021 meeting (S2-UTS) (Agenda Paper 8.3). This respondent does not support the approach contained in ED 309 and does not think the proposed pilot approach would successfully achieve its objectives.

Staff analysis of alternative approaches

9 Staff have explored alternative approaches that could help to address the disclosure problem. Staff have identified three possible alternatives and undertaken limited targeted outreach with several stakeholders. The feedback of these stakeholders is summarised in Agenda Paper 8.2.

10 The three alternative approaches are:

(a) **Option 1**: Maintain the current disclosure requirements and reaffirm the principle of materiality in each standard by referencing the relevant materiality guidance

(b) **Option 2**: Maintain the current disclosure requirements and use the disclosure objectives as supporting guidance

(c) **Option 3**: IASB use the proposed Guidance (outlined in the ED) as a guide when developing future standards and reviewing detailed disclosure requirements

1 AASB Action Alert (issue 210), 13th September 2021

Table 1 Summary of possible alternative approaches which could help to address the disclosure problem

<table>
<tr><th>Options</th><th colspan="2">Does the alternative approach address the disclosure problem of…</th><th>Considerations</th></tr>
<tr><td rowspan="3">Option 1: Maintain the current disclosure requirements and reaffirm the principle of materiality in each standard by referencing the relevant materiality guidance (e.g. paras 7, 29–31 of IAS 1 Presentation of Financial Statements (AASB 101), and/or IFRS Practice Statement 2: Making Materiality Judgements)</td><td>1. Not enough relevant information?</td><td>No</td><td rowspan="3">1. This approach would retain the principle-based status of IFRS standards while reminding preparers that the application of materiality judgement is an overarching principle and, therefore, only material information should be disclosed.

Staff acknowledge that it would result in duplicating the references to materiality in individual standards. One stakeholder [auditor] considered that this approach might not add much value as practitioners should already have a sound understanding of the materiality concept. However, another two stakeholders [auditor, Professional Body] considered that the concept of materiality should be given more prominence, and duplication is one way to achieve it.

2. In comparison with the proposed objective-based disclosure approach in the ED, this approach would:

○ reaffirm the principle of materiality while not imposing additional burdens for preparers. As it maintains the current disclosure requirements, preparers would not need to second-guess the users' information needs;

○ not make audit and enforcement more challenging. Auditors and regulators can monitor whether a preparer has disclosed specific material items required by a Standard;

○ not impair the comparability of financial statements. Disclosing consistent information can help achieve comparability of financial statements. Enhanced comparability is preferred by users as they do not need to convert information from various sources into comparable forms.

3. Staff understand that the [current] more prescriptive disclosure approach would work better in a digital reporting environment than the proposed objective-based disclosure approach. A stakeholder [S2-UTS] noted that the firm-specific disclosures could result in issues with the electronic use of information. Flexibility in tagging (i.e. customised tags) was initially allowed in the US. The resultant diversity in disclosure and inconsistency in tags impeded the electronic use of the information in financial reports (see paragraphs 13–16 below for details on electronic use of information).</td></tr>
<tr><td>2. Too much irrelevant information?</td><td>Yes</td></tr>
<tr><td>3. Ineffective communication of the information provided?</td><td>No</td></tr>
</table>

Options	Does the alternative approach address the disclosure problem of…		Considerations
			Maintaining the current disclosure approach would make the transition to digital reporting easier. 4. Staff noted that the IASB deliberately does not use references to materiality in disclosure requirements of individual IFRS Standards as the materiality principle applies to all disclosure requirements.[2] Making specific reference to materiality in the disclosure requirements in individual standards could raise questions about whether materiality applies to the disclosure requirements of Standards in which the concept is not explicitly mentioned (BC72 of IASB ED/2021/3).
Option 2: Maintain the current disclosure requirements and use the disclosure objectives as supporting guidance (e.g. as implementation guidance)	1. Not enough relevant information? 2. Too much irrelevant information? 3. Ineffective communication of the information provided?	Yes No Yes	1. This approach retains the principle-based status of IFRS standards while providing additional guidance to help preparers to understand better whether certain information is helpful to users (i.e. meeting the overall and specific disclosure objectives). Therefore, it could result in more relevant disclosures and effective communication. 2. This approach could encourage entities to apply judgement when making disclosure decisions. 3. If it is not an integral part of the Standards, the guidance may not be enforceable. [Professional bodies] 4. As users' needs may change over time, this approach would require regular updates of the application guidance. 5. Having the disclosure objectives as supporting guidance may not result in the desired change. The preparers may apply the disclosure requirements from the Standards without seeking any explanation in the guidance. 6. One Disclosure Initiative Project Advisory Panel (DI PAP) member is concerned that the diversity in reporting may increase as a result of inconsistent use of supporting guidance by entities. Some entities may apply the guidance when determining

2 Staff noted that, in its September 2021 meeting, the IASB Board tentatively decided to remove the reference to ‘material’ in the requirement for principles of aggregations and disaggregation, and their application in the primary financial statements and the notes for the consideration that materiality is an overarching principle applies to all disclosure requirements.

Options	Does the alternative approach address the disclosure problem of…	Considerations
		disclosures, while others may not. The variation may compromise comparability and ultimately increase the gap between "good" and "bad" disclosures.
Option 3: IASB use the proposed Guidance (outlined in the ED) as a guide when developing future standards and reviewing detailed disclosure requirements (e.g. as part of the post-implementation reviews (PIR)).	1. Not enough relevant information? Yes 2. Too much irrelevant information? Yes 3. Ineffective communication of the information provided? Yes	1. This approach requires standard-setters to engage investors even earlier in the standard-setting process. Spending more time early in the standard-setting process to understand and articulate the information needs of users of financial statements would provide a better basis for the standard-setters to determine what disclosure is necessary and a context for preparers to make better materiality judgements. This would enable standard-setters to develop requirements that produce more relevant disclosures. The majority of the stakeholders [two DI PAP members, two auditors and Professional Body] supported disclosure objectives as guidance for standard-setters. The Professional body recommends the IASB to consider including the guidance as: ▪ an integral part of the IASB's Due Process Handbook; and/or ▪ a methodology for drafting disclosure requirements with the same rigour as requirements for recognition and measurement, which should be contained within the Conceptual Framework. 2. The users' information needs and associated disclosure objectives are reflected in disclosure requirements, which apply to all entities that adopt IFRS standards. Entities would not need to consider extra application guidance. Under this approach, the comparability of financial statements would be retained. 3. This approach does not give rise to any additional preparer burden (i.e. preparers to determine the information that would meet users' needs to satisfy the disclosure objectives) or create enforcement challenges. 4. Two stakeholders [one DI PAP member and a Professional body] considered a standard-level review of the specific disclosure requirements helpful. The complexity of financial statements could decrease by removing excessive, repetitive or redundant disclosures through, for example, PIR. Ultimately, it would result in effective communication with users.

Further considerations: A forward-looking approach embracing the development of digital financial reporting

11 Considering the future possible transition to digital reporting, staff also explored whether the proposed disclosure approach in the ED and the current disclosure requirements in IFRS Standards support the machine reading/learning technology to access the information in the financial statements.

12 Staff understand that two sets of financial statements would need to be prepared if digital financial reporting become the mainstream reporting practice in the future:

- a comprehensive digital financial data file containing voluminous machine-readable disclosures. Users would use robots to access the information and only look for relevant details (i.e. notes and narrative information).

  Disclosure requirements for this data file would be similar to a checklist that enables standardised comparability across entities. (See paragraphs 13–16 for details).

- a set of concise financial statements with reduced disclosures for users who rely on traditional paper-based financial statements.

  The disclosure requirements for these financial statements would be principle-based to allow entities to provide more relevant (e.g. firm-specific) information. (See paragraphs 17–18).

13 When financial information is accessed electronically, comprehensive disclosure requirements are preferred over principles-based requirements, as it enables standardised comparability (Rowbottom et al., 2021).[3] Users who access and analyse financial statements electronically require consistency and comparability of appropriately identified or tagged data. These users can use an algorithm to search for the information needs rather than reading the whole financial report.

14 The three disclosure issues identified by IASB in the ED may become irrelevant, particularly the issue with disclosing too much irrelevant information. Application of the materiality principle may not be required if the information is accessed and used electronically [S2-UTS].

15 Staff acknowledge that the IASB technical team works with the IFRS Taxonomy team when new disclosure requirements are developed. However, staff noted that academic research has suggested that it would be challenging to implement the proposed objective-based disclosure requirements in an environment where information is accessed electronically (Rowbottom et al., 2021). Objective-based disclosures could result in inconsistent tagging. For example, a company may tag a whole paragraph of text as 'company-specific' disclosure. The tag itself would not provide meaningful information to users and require users to read through the disclosure to classify the information. AASB staff consider that the resultant diversity in disclosure and inconsistency in tags could impede the electronic use of the information in financial reports.

16 Therefore, with the expectation that digital reporting will be the primary form for financial reporting in the future and machine reading will be widely used, staff suggest the IASB considers developing disclosure requirements that would enable electronic access to information.

17 Users of traditional paper-based financial reports will likely require more effective communication of information (i.e. less complex financial statements, less immaterial information and more firm-specific information). A set of concise financial statements that parallels the digital financial data file but with reduced disclosure might help meet the information needs for this group of

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3 Rowbottom, N., Locke, J., & Troshani, I. (2021). When the tail wags the dog? Digitalisation and corporate reporting. *Accounting, Organizations and Society*, 101226.

users. The set of concise financial statements may also supplement the digital reporting file with more firm-specific narrative statements

18 Staff are of the view[4] that the disclosure requirements for the concise financial statements should remain principle-based rather than objective-based for the reasons outlined in paragraphs AV1–AV14[5] in the BC of ED2/2021/3. When developing the disclosure requirements, the IASB could use the proposed objectives outlined in the ED as a guide (Option 3 in Table 1) and spend more time early in the standard-setting process to understand users' information needs of financial statements.

19 Staff acknowledge that this two-file approach would significantly change the current disclosure practice and may not be implemented in the near future. In addition, further research and analyses are required to understand better the likely effect of this approach on the quality of financial reporting and the associated costs, for example:

- the cost to mandate digital reporting in jurisdictions have not done so and the expected benefits;
- the cost for entities to prepare two sets of financial statements;
- any implications for audit and enforcement;
- various users of financial statements and their access to technology.

Stakeholder feedback related to digital financial reporting

20 Stakeholders [AAP, S2-UTS, one DI panel member] observed an increasing trend of technology being used to access, read and analyse financial statements. Feedback from users of financial reports suggested that digital financial reporting may help them perform better decision-making analyses.

21 A few stakeholders [e.g. S2-UTS, AAP members, one DI panel member, one preparer, and a Professional body] also considered digital reporting an effective approach to addressing the disclosure problems. One stakeholder commented that digital reporting enables users to access the information disclosed in a way that suits users' needs and capacity, as opposed to 'one size fits all' financial statements.

22 The currently open-for-comment AASB Invitation to Comment ITC 46 *AASB Agenda Consultation 2022-2026* will provide an opportunity to gather further feedback on digital financial reporting. The AASB Board recommends digital financial reporting as a potential project for its 2022-2026 work program.

Staff Recommendations

23 Based on the analysis above, staff consider that Option 3 could address all disclosure problems raised in the ED. Therefore staff are of the view that the comment letter recommends the IASB consider using the proposed Guidance (outlined in the ED) as a guide when developing future standards.

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4 Based on the staff analysis in Agenda paper 15.1, September 2021 (M183) and the Board decision to not support the IASB proposed disclosure approach in the ED with concerns that the proposed approach might not be operational in practice and might not achieve its intended outcome.

5 Paragraphs AV1–AV14 of the BC for ED/2021/3 outlines the concerns expressed by three IASB Board members who voted against the ED. They are concerned that the objective-based disclosure requirements in IFRS Standards without requiring disclosure of specific items will a) increase enforcement challenges; b) be more burdensome for preparers of financial statements and increase reliance on materiality judgements; and c) impair comparability for users of financial statements by introducing a more flexible approach to disclosures.

24 However, staff acknowledge that the standard-setting process needs to accommodate the evolving technology and its effect on the future of financial reporting. Therefore, staff also suggest the comment letter recommends that the IASB explicitly consider the future forms of digital reporting and the machine reading/learning technology used by users of financial statements.

25 As an example, staff suggest including in the comment letter the two-file reporting model, which embraces digital financial reporting as outlined in paragraphs 11—18.

26 However, staff also note that the comment letter should acknowledge that digital reporting and wide use of machine reading may not be implemented in the near term. Therefore, developing disclosure requirements for the two-file model might be just one of the possible forward-looking solutions, and further research in this area would be warranted.

Questions to the Board:

Q1: Do Board members agree with the staff recommendation to recommend the IASB consider using the proposed Guidance (outlined in the ED) as a guide when developing future standards (Option 3)?

Q2: If the Board members disagree with the staff recommendations in Q1, which proposed alternative option(s), if any, does the Board support?

Q3: Do Board members agree with the staff recommendation that the comment letter includes consideration of future forms digital reporting and the machine reading/learning technology used to access information in the financial statements?

Q4: Do Board members agree to include in the comment letter example of the two-file reporting model?

Q5: Do Board members agree to suggest IASB undertake further research into the future forms of reporting (e.g. use of machine reading) to better understand its impact on disclosure and financial reporting in the future?

Q6: For the purpose of responding to IASB on ED/2021/3, do Board members have any other comments to include in the submission letter?

Next steps

27 Staff are not seeking the Board's approval of a draft comment letter at this meeting, as the comment letter is not due to the IASB until 12 January 2022. However, staff recommend finalising and approving the comment letter out-of-session via the Chair or subcommittee due to the tight deadline.

28 Assuming the Board agrees with the staff's recommendations above, staff suggest the following timeline:

Task	Timing
Staff to draft submission letter to the IASB	By 26 November 2021
Review/Approve submission out of session via the Chair or subcommittee	By 10 December 2021

Task	Timing
Staff to address the comments and the Chair or subcommittee to approve the final submission letter	By 20 December 2021
AASB staff submit a final submission to IASB	By 12 January 2022

Questions to Board members

Q7: Do Board members agree with the staff recommendation to approve the final comment letter to the IASB out-of-session via the Chair? If not, do Board members prefer to form a subcommittee to approve the final comment letter to the IASB?

Q8: Do Board members agree with the suggested next steps and timeline? If not, what do Board members suggest?