

## Supporting Papers August 2017

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INTERNATIONAL VALUATION STANDARDS COUNCIL

# **IVSC Invitation to Comment**

**Issued: 15<sup>th</sup> May 2017**

**Comments Due: 15<sup>th</sup> August 2017**

**IVS Agenda Consultation 2017**



### Notice to Recipients of This Invitation to Comment

The IVSC Standards Review Board invites feedback on all matters in this Invitation to Comment. We request comments by the 15<sup>th</sup> of August 2017 by one of the following methods:

- Emailing comments to [aaronsohn@ivsc.org](mailto:aaronsohn@ivsc.org) or [kprall@ivsc.org](mailto:kprall@ivsc.org), File Reference IVSC Agenda Consultation 2017

or

- Respond using the IVSC Agenda Consultation 2017 Feedback form and send to [aaronsohn@ivsc.org](mailto:aaronsohn@ivsc.org) or [kprall@ivsc.org](mailto:kprall@ivsc.org).

All comments received are part of the IVSC's public file and are available at [www.ivsc.org](http://www.ivsc.org).

A copy of this Invitation to Comment is also available at [www.ivsc.org](http://www.ivsc.org).

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**Letter from Mark Zyla**  
**Chairman, IVSC Standards Review Board**



**MARK ZYLA**  
**CHAIRMAN, IVSC STANDARDS REVIEW BOARD**

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Dear All

Further to the publication of IVS 2017 the Standards Review Board together with the Business Valuation Board and the Tangible Assets Board have decided to publish an Agenda Consultation Paper to consult with stakeholders and other interested parties on future topics to be included in any revisions to the IVS.

The IVSC is planning to publish an agenda consultation on an annual basis as part of an open consultative standard setting process and future editions will be limited to the proposed revisions and additional chapters to be included in IVS. However, in this instance the Board felt that it was important to include introductory chapters providing an overview of the new board structure and standard setting process.

The consultation process for this IVS agenda consultation is now open. Accordingly, the Standards Review Board encourages participation within the 90 day consultation period ending the 15<sup>th</sup> of August 2017 from all individuals and organisations. The IVSC is committed to a fully open and collaborative consultation process. Thus, all comments received as part of the consultation process will be published on the IVSC website.

We look forward to your participation in the IVSC Agenda Consultation and incorporating the views and recommendations from practitioners, valuation professional organisations, academics, corporations and regulators, among others.

Kind Regards

Mark Zyla, Chair  
Standards Review Board of the IVSC





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# Introduction

## Purpose of the Invitation to Comment

The purpose of this Invitation to Comment (ITC) is to solicit feedback about:

1. The valuation topics that the IVSC should address as part of its current agenda, and
2. Additional valuation topics that stakeholders feel should be prioritised or added to IVSC's agenda.

Stakeholders are invited to comment on all matters in this ITC. Questions related to each specific valuation topic are included at the end of each chapter. In addition to the questions included within each chapter, the IVSC welcomes general feedback from respondents which may include among the following:

1. Are the valuation topics described in this ITC areas for which there is potential for significant improvement as compared to IVS 2017?
2. What is the priority of addressing each topic?
3. What should be IVSC's next step to address each topic? For example, should IVSC issue a discussion paper, an exposure draft, or take some other action?
4. Are there other major valuation topics not described in this ITC that the IVSC should consider adding to its agenda?

## Background

IVSC recently issued IVS 2017, which represented its efforts to harmonise and improve the entirety of IVS. In February 2017, the IVSC published IVS 2017 Bases of Conclusions, which represents the culmination of these existing efforts. As such, with the completion of these major projects, the IVSC has begun to consider other major projects and additional targeted improvements to IVS. On the basis of IVSC's "Gap Analysis" (as discussed in additional detail in the Gap Analysis section below) and other input from stakeholders submitted as part of the IVS 2017 consultation process, IVSC has identified the following major valuation topics to include in this ITC:

1. Non-Financial Liabilities
2. Discount Rates
3. Early Stage Valuation
4. Biological Assets
5. Extractive Industries
6. Inventory



In addition to the above topics explicitly covered in this ITC, IVSC intends to make targeted improvements to certain areas of IVS 2017, including:

1. Control Premium and Discount for Lack of Control (IVS 200 para 90)
2. Capital Structure Considerations (IVS 200 para 130)
3. Development Value

The Boards<sup>1</sup> determined that such updates do not warrant inclusion in this ITC as the scope of such projects is limited. Rather such projects will be included in future IVSC exposure drafts.

The Boards also identified certain topics for potential future projects. Such projects represent medium to longer terms goals of the IVSC, and have not been prioritised based on the Boards' view that such topics have more limited application or diversity in practice. Future projects for topics may include the issuance of exposure drafts, discussion papers, or guidance notes<sup>2</sup> and are discussed in additional detail in the Gap Analysis section below.

These topics include:

1. Analysis of Commercial Lease Transactions
2. Specialised Public Service Assets
3. Sustainability and renewable energy
4. Automated valuation models and data analytics
5. Valuation of Personal Property including Art and Antiques
6. Recovery and Resolution
7. Price vs value
8. Distressed situations
9. Valuation in markets susceptible to change
10. Privatisation
11. Alternative Financing Arrangements

The Boards acknowledge that the above topics are unlikely to represent an exhaustive list of topics that are relevant to IVSC's stakeholders. As such, as part of this ITC, stakeholders are encouraged to provide feedback on other valuation issues not described in this ITC that IVSC should consider adding to its agenda.

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<sup>1</sup> The Boards collectively refers to the Standards Review Board, the Business Valuation Board, and the Tangible Asset Board as discussed in more detail in the sections below.

<sup>2</sup> As discussed in more detail below, guidance notes will not be issued by the IVSC. Rather, the IVSC will coordinate such efforts through the Advisory Forum Working Group for Guidance Notes to be issued by respective VPOs.



### **Structure of this ITC**

This ITC includes a chapter for each of the six major valuation topics identified by the Boards.

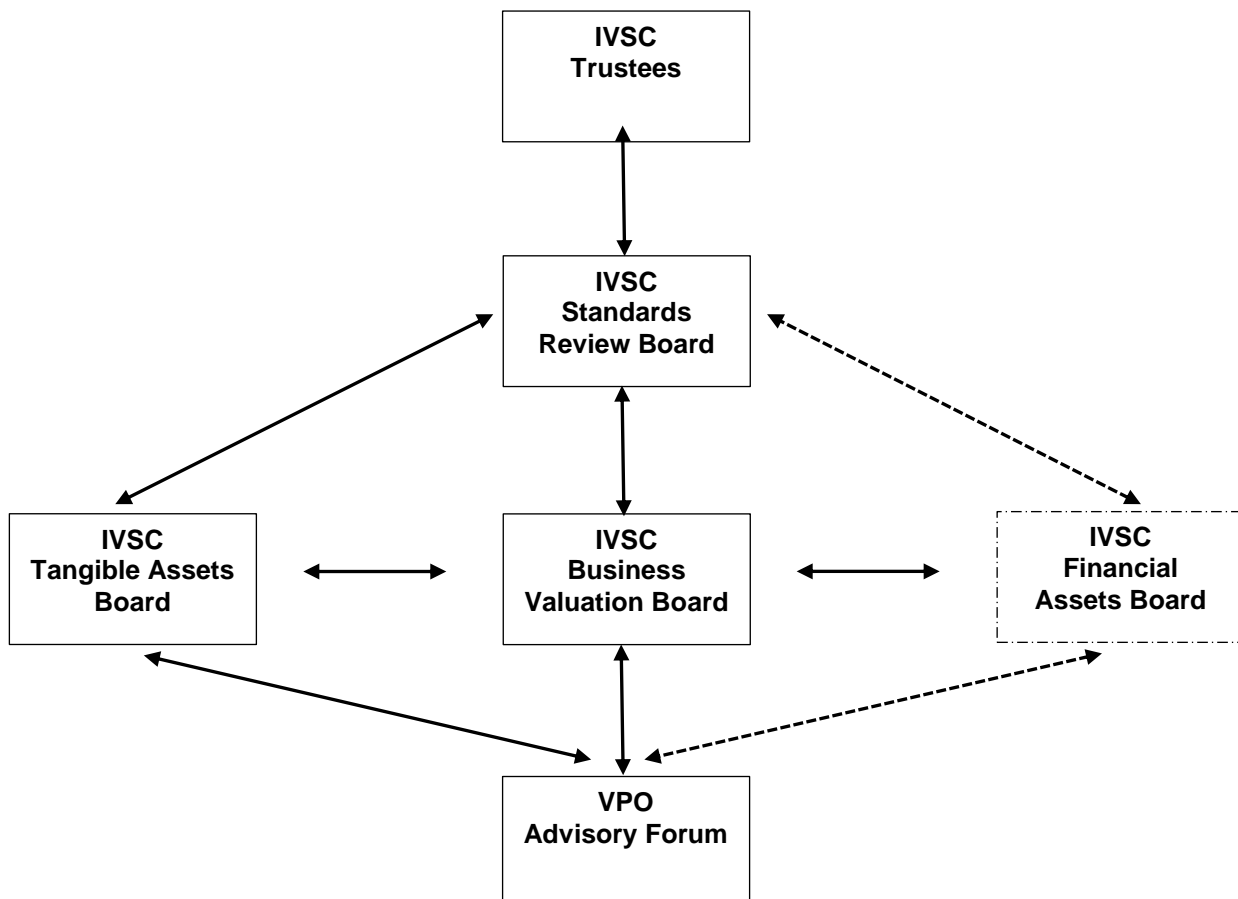
Each chapter includes:

1. A summary of the valuation topic including relevant context and history, discussion of stakeholder concerns related to the topic, and the Boards' rationale on why Standards related to the topic are necessary;
2. Potential standard setting alternatives including possible approaches the IVSC could take to develop standards related to the topic, and discussion of methodologies where relevant; and
3. Specific questions for the respondents to address to aid the IVSC in its next steps related to each topic.



# IVSC Overview and Background

## IVSC New Standard Setting Board Structure



### IVSC Standards Review Board and IVSC Board Structure

The Standards Review Board is the overarching IVS Standards Board comprising a Chair and eight other members including the Chair of each subject matter expertise board (collectively, the “Boards”), which are as follows;

- IVSC Tangible Assets Board
- IVSC Business Valuation Board
- IVS Financial Assets Board (still being assessed with Financial Instruments market participants)



#### **IVSC Standards Review Board Purpose**

- Setting strategy through the issuance of Discussion Papers and market engagement
- Identification of new market issues
- Prioritisation of work for IVS
- Providing technical input to ensure the quality, level and appropriateness of all IVS Asset Standards Exposure Drafts and future IVS
- Monitoring the standard setting and consultation process
- Communicating with the Trustees and providing final approval for IVS
- Helping achieve stakeholder recognition of IVS
- Input on technical matters that transcend the scope of the individual boards such as the IVS General Standards
- Collaborating with the AFWG and National Standard Setters to agree implementation and effective dates for future IVS
- Advising AFWG on the need for future Guidance Notes to be issued by VPO's
- Helping achieve stakeholder recognition of IVS through presentations and market engagement
- Collaborate with the IASB and other standard setters on fair value measurements

#### **IVSC Business Valuation Board Purpose**

The Business Valuation Board covers businesses and intangible assets including intellectual property and comprises a Chair and six other members. The general purpose of the Board is as follows:

- Communicating with the Standards Review Board and agreeing the agenda for future Business Valuation Standards (BVS)
- Identification of new market issues
- Prioritisation of future Business Valuation Standards through market engagement
- Setting up and leading Business Valuation Standards working groups if required
- Working with IVSC staff to provide technical input to ensure the quality, level and appropriateness of all future Business Valuation Exposure Drafts
- Leading and monitoring a transparent and inclusive Business Valuation Exposure Draft consultation process
- Finalising IVS Business Valuation standards post consultation
- Providing market feedback through publication of Basis for Conclusions and post implementation review



- Collaborating with the Advisory Forum Working Group (AFWG) and National Standard Setters to agree implementation and effective dates for future IVS

#### **IVSC Tangible Assets Board Structure and Purpose**

The Tangible Assets Board covers all tangible assets including real estate, plant and machinery and comprises a Chair and seven other members. The general purpose of the Board is as follows;

- Communicating with the Standards Review Board and agreeing the agenda for future Tangible Assets Standards
- Prioritisation of future Tangible Assets Standards through market engagement
- Setting up and leading Tangible Assets Standards working groups if required
- Drafting and providing technical input to ensure the quality, level and appropriateness of all future Tangible Assets Exposure Drafts
- Leading and monitoring a transparent and inclusive Tangible Assets Exposure Draft consultation process
- Finalising IVS Tangible Assets standards post consultation
- Providing market feedback through publication of Basis for Conclusions and post implementation review
- Collaborating with the AFWG and National Standard Setters to agree implementation and effective dates for future IVS

#### **IVSC Financial Assets Board Structure and Purpose**

The IVSC is still in the process of engaging with stakeholders to:

- Ascertain the market issues in relation to Financial Asset Standards
- Agree the market need for International Financial Asset Standards that are more comprehensive than what is currently in IVS.

If this market need is established, then the Financial Assets Board is likely to cover all financial instruments including derivatives, and will comprise a Chair and up to six other members. The general purpose of the Board is as follows:

- Communicating with the Standards Review Board and agreeing the agenda for future Financial Assets Standards
- Prioritisation of future Financial Assets Standards through market engagement
- Setting up and leading Financial Assets Standards working groups if required
- Drafting and providing technical input to ensure the quality, level and appropriateness of all future Financial Assets Exposure Drafts





## INTERNATIONAL VALUATION STANDARDS COUNCIL

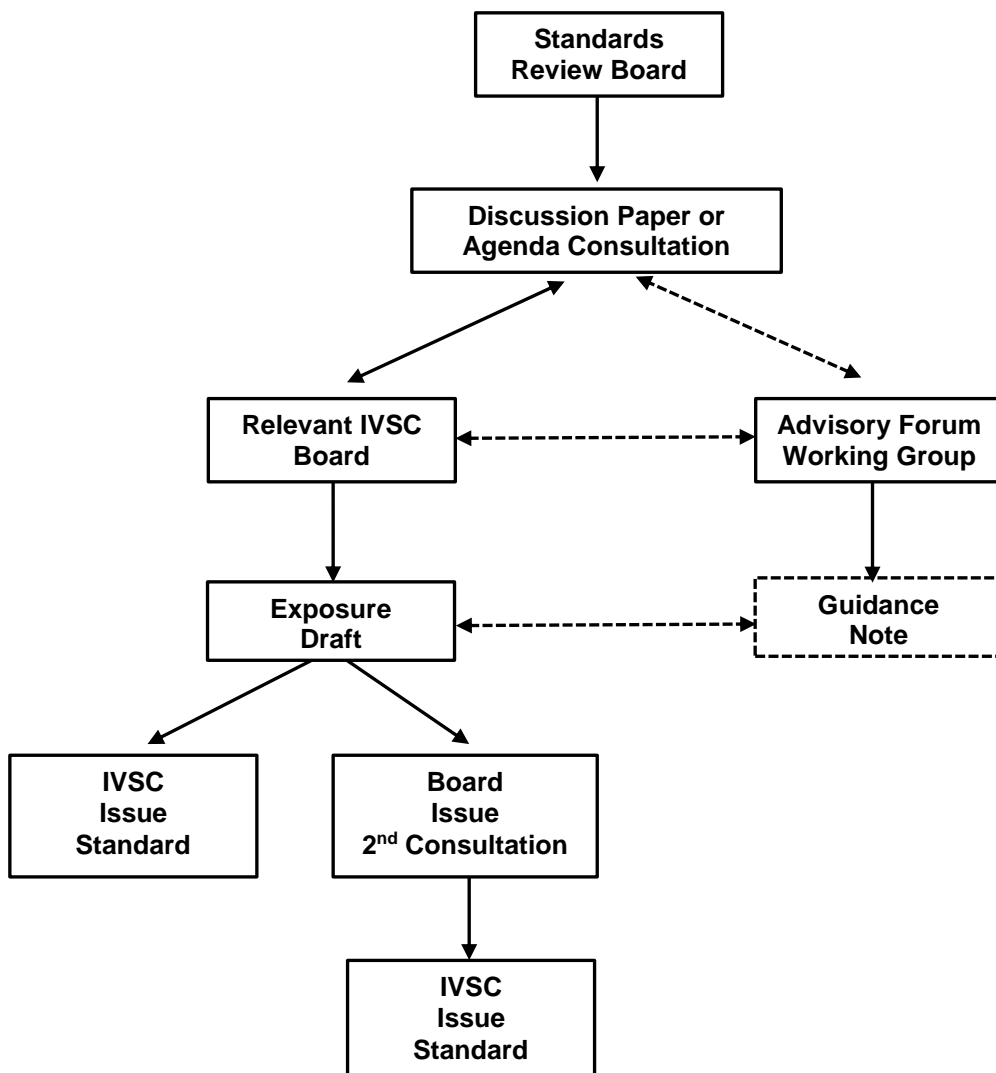
- Leading and monitoring a transparent and inclusive Financial Assets Exposure Draft consultation process
- Finalising IVS Financial Assets standards post consultation
- Providing market feedback through publication of Basis for Conclusions and post implementation review
- Collaborating with the AFWG and National Standard Setters to agree implementation and effective dates for future IVS



# IVSC Standard Setting Process

The IVSC Standards Review Board have identified the following structure for creating IVS, which are shown in the flow chart below. The provisional hierarchy of the standard setting process is;

- Discussion Paper or Agenda Consultation
- Exposure Draft
- IVS Issued Standard
- Guidance Notes





### **Discussion Papers**

Discussion Papers are preliminary exploratory papers issued by the Standards Review Board to assist in stakeholder engagement and to establish whether there is a market need for a valuation standard to be issued and to assist in the gap analysis and future prioritisation for IVS. Discussion Papers are issued by the IVSC Standards Review Board and are subject to a three-month consultation process to allow sufficient time for market engagement. Discussion Papers will either be drafted by the Boards or with the assistance of a technical writer/specialist, who has a particular expertise in the topic for discussion. Post consultation the Standards Review Board, and Business Valuation and Tangible Asset Boards (collectively the “Technical Boards”), will either determine if future guidance is required in this area or will advise the AFWG that there is a market need for additional guidance to be issued.

### **Exposure Drafts**

Exposure Drafts are issued by the relevant IVSC Board and are subject to a three-month consultation process to allow sufficient time for market engagement. IVS General Standards (*IVS 100 series*) are the responsibility of the Standards Review Board, whereas IVS Asset Standards (*IVS 200, IVS 300, IVS 400 and IVS 500 series*) are the responsibility of the relevant IVS Technical Board, but are subject to IVS Standards Review Board approval. All the IVS Boards are empowered to set up Working Groups for specialisms and these working groups will comprise a mix of IVSC Board members and international topic related technical specialists. Post consultation the Exposure Draft will either be finalised, go into secondary consultation or be passed to the IVSC Advisory Forum Working Group as a potential topic for a Guidance Note (see below). This will largely depend on the responses received as part of the consultation process and partly depend on the degree of change to the original Exposure Draft post consultation.

### **Second Consultation Documents**

Second Consultation Documents are issued by the relevant IVSC Board and are subject to a two-month consultation process to allow sufficient time for market engagement. The need for a secondary consultation will be established based on responses received through the consultation process and the degree of change needed prior to issuing the final standard. Secondary consultation papers will either be drafted by the Standards Review Board (*IVS 100 series*) or by the relevant Technical Board (*IVS 200, IVS 300, IVS 400 and IVS 500 series*).

### **International Valuation Standards**

IVS are mandatory, except where explicitly noted, and the mandatory nature of the standard is shown by the use of ‘*must*’, ‘*should*’ and ‘*may*’ as defined in IVS 2017. The only acceptable ‘*Departures*’ from IVS are specific legislative, regulatory or other authoritative requirements, which must be followed and differ from some of the requirements within IVS. There are two main types of IVS comprising IVS General Standards and IVS Asset Standards and the general details of these standards are shown below;

#### **IVS General Standards (IVS 100 series)**

These set forth requirements for the conduct of all valuation assignments including establishing the terms of a valuation engagement, bases of value, valuation approaches and methods, and reporting. They are designed to be applicable to valuations of all types of assets and for any valuation purpose.



**IVS Asset Standards (IVS 200 to 500 series)**

The Asset Standards include requirements related to specific types of assets. These requirements must be followed in conjunction with the General Standards when performing a valuation of a specific asset type. The Asset Standards include certain background information on the characteristics of each asset type that influence value and additional asset-specific requirements on common valuation approaches and methods used.

**Guidance Notes**

Guidance Notes are not issued by IVSC, but rather are issued by Valuation Professional Organisations (VPO's) and National Standard Setters, many of whom are members of the IVSC Advisory Form Working Group. Guidance Notes provide further information on the practical implementation of IVS and are set at a more detailed level and often incorporate local legislation and mandatory practices. Guidance Notes incorporate material and information on good practice appropriate for particular circumstances.



# IVS Gap Analysis

## Summary

### Background

Further to discussions with the former Standards Board and other stakeholders, the technical writers have carried out a preliminary alphabetised gap analysis on IVS 2013 and initially agreed the following alphabetised gap analysis for further prioritisation for inclusion within future editions of the IVS;

- Analysis of Commercial Lease Transactions
- *Art and Antiques*
- *Commercial Forests*
- *Contracts*
- *Credit/Debit Valuation*
- *Adjustments*
- *Deferred Revenue*
- *Depreciated Replacement Cost Method of Valuation for Financial Reporting*
- *Derivative Valuations*
- *Discount Rates*
- *Discounts and Premia*
- *Early Stage/Development Stage Valuations*
- *Expected Cash Flow*
- *Extractive Industries*
- *Funding Valuation Adjustments*
- *Inspections and Material Considerations*
- *International/Multinational Valuations*
- Inventory
- Liabilities
- Preferred Stock
- Valuation of Residential Properties
- Valuations for Taxation purposes including taxes and tax flow-through Entities
- Recovery and Resolution
- Specialised Public Service Assets
- Stock Options
- Trade Related Property
- Valuation of Individual Trade-Related Properties
- Valuation in Markets Susceptible to Change: Certainty and Uncertainty
- Valuation of Personal Property including Art and Antiques.
- Valuation of Portfolios, Collections, and Groups of Properties/Assemblage Value



### **Scope**

The IVSC Standards Review Board, IVSC Business Valuation Board and IVSC Tangible Assets Board held the first meeting of the newly constituted Boards between the 8<sup>th</sup> and 10<sup>th</sup> March. One of the main agenda items was to agree the scope and prioritisation of the IVS Gap Analysis. The Boards agree that the scope of the gap analysis should include all relevant IVSC specialisms comprising business valuation and intangible assets, financial instruments and tangible assets (i.e. land, personal property, plant and machinery and real estate).

### **Perceived Issues and Stakeholder Concerns**

Further to discussion amongst stakeholders the Boards revised the previous gap analysis identifying and revising potential IVS topics either according to specialism or in some instances highlighting that these topics were relevant across specialisms. The Boards further divided these topics into Discussion papers, International Valuation Standards to be issued by the relevant IVSC Board and Guidance Notes to be issued by the member organisations of the IVSC Advisory Forum Working Group. The Boards also agreed the following categorisation and prioritisations for these topics;

<i>Critical</i>	<i>0 to 2 years</i>
<i>Medium Term</i>	<i>2 to 5 years</i>
<i>Long Term</i>	<i>5 years plus</i>

The revised suggested IVSC gap analysis comprising topics where the Boards perceived there is a potential market need for future discussion papers to further understand the issues or future standards or guidance is as follows:



Timeframe	Board	Standard	Discussion Paper	Guidance Note
<b><u>Critical</u></b>				
Automated Valuation Models and Data Analytics in Valuation	TA		X	
Biological Assets	TA	X		
Discount Rates	BV	X		
Early Stage/Development Stage Valuations	BV	X	X	
Extractive Industries	TA	X		
Implementation Guidance	BV/TA			X
Inventory	BV	X		
Non-Financial Liabilities	BV	X		
Price vs. Value	BV/TA		X	
Review of Existing Development Value	TA	X		
Complex Capital Structures	BV	X	X	
<b><u>Medium Term</u></b>				
Analysis of Commercial Lease Transactions including Incentives	TA			X
Alternative Financing Arrangements	BV/TA		X	
Discounts and Premiums	BV			X
Infrastructure	TA			X
Privatisation	BV/TA		X	
Recovery and Resolution	BV/TA	X		
Specialised Public Service Assets	TA			X
Sustainability focusing on the Valuation of Renewable Energy	TA		X	
Trade Related Property	BV/TA		X	
Valuation in Markets Susceptible to Change: Certainty and Uncertainty	BV/TA	X		
<b><u>Long Term</u></b>				
Sustainability (other than renewable energy)	BV/TA		X	
Valuation of Personal Property including Art, Antiques, and Trophy Assets	TA	X		

The Boards note that Critical items categorized as either Discussion Paper or Guidance Note are not specifically addressed in this ITC, but are intended to be addressed in separate future publications. Additionally, as noted above, Complex Capital Structures and Development Value are not included as the scope of such projects is limited.



### **Potential Standard Alternatives**

An IVSC priority is to expand the depth of International Valuations Standards and ensure they are fit for purpose and meet market needs. In instances where there are existing national standards which may have international application, IVSC would endeavour to work with the appropriate organisations to incorporate these existing national standards within IVS.

### **Questions for Respondents**

**Question 1:** Do you agree with the current categorisation and timings of the topics contained in the gap analysis and if not why?

**Question 2:** Are there any other topics which you believe should be included or deleted from the IVS gap analysis and if so why? (Please state the relevant specialism, categorisation and timing for any proposed additional topics).





# Chapter 1 – Non-Financial Liabilities

## Summary

### Background

On February 1, 2013, the IVSC issued a discussion paper related to the valuation of liabilities, aimed at obtaining views on the scope of the project and the nature of the issues identified. IVSC received 16 responses from this initial consultation process. The previous Standards Board was in the process of updating IVS necessary to make them more applicable to liabilities prior to the publication of the IVSC Purpose, Structure and Strategy paper, where it was decided that the primary focus for the next two years was to revise and publish IVS 2017.

IVS' definition of Asset or Assets states that it includes assets, groups of assets, liabilities and groups of liabilities. Additionally, the IVS Framework also specifically states that the standards can be applied to the valuation of both assets and liabilities. Finally, IVS' definition of Market Value, among others, specifically applies to the valuation of both assets and liabilities. However, there is no definition of what constitutes a liability, little consideration of any characteristics or attributes that are specific to liabilities as opposed to assets, or standards specific to the valuation of liabilities. Additionally, preliminary investigations by the Boards have established a lack of guidance in the broader marketplace relating to the valuation of non-financial liabilities. Such factors, combined with the unique issues faced when valuing non-financial liabilities and significant divergence in practice, suggests that standards would be helpful toward improving consistency and quality in the marketplace.

The lack of standards related to non-financial liabilities represents a convergence of stakeholder feedback and the Boards' perceived need for new standards, and as such represents a critical priority topic for the IVSC. The Boards have therefore agreed that a dedicated project is required to determine appropriate valuation practice for non-financial liabilities and develop as necessary dedicated standards related to the valuation of non-financial liabilities.

### Scope

The International Accounting Standards Board (IASB) framework states that a liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits. The Financial Accounting Standards Board (FASB) defines liabilities as the probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events. The focus of this ITC is specifically non-financial liabilities.

The Boards note that certain non-financial, or operating, liabilities have distinct characteristics or regulatory environments that would likely require separate agenda topics, and therefore the Boards have proposed that such liabilities be outside the scope of this ITC and any resulting



standards. Such liabilities include: financial instruments, pension liabilities, and insurance liabilities. Additionally, the Boards propose that any initial liabilities standards not focus on financial liabilities such as notes payable, bonds payable, trust preferred securities, and deposit liabilities.

The Boards acknowledge that insurance companies price risk in the ordinary course of business as it's central to their operations. While the Boards propose excluding insurance specific liabilities from the scope, the Boards also note that methodologies and best practices utilised by the insurance industry may be informative to any future standards related to non-financial liabilities. As such, the Boards request any feedback from stakeholders on the applicability of methodologies and best practices utilised by the insurance industry, while also planning to conduct additional research in this area.

As a result of such considerations, the Boards propose that this topic focus on the following commonly occurring non-financial liabilities:

- Contractual liabilities to repair or restore an asset,
- Deferred revenue,
- Product warranties,
- Asset retirement obligations,
- Litigation contingencies,
- Guarantees,
- Indemnifications, and
- Contingent consideration.

### **Perceived Issues and Stakeholder Concerns**

Both the Boards and IVS stakeholders have observed a number of issues related to the valuation of non-financial liabilities. These unique issues and concerns related to the valuation of liabilities include the following:

#### **Lack of Observable Market Inputs:**

1. The lack of observable market information to measure the fair value of a non-financial liability as liabilities are rarely traded in the marketplace. In many cases, an entity would extinguish a non-financial liability by settling the obligation directly with the counterparty (through performance) rather than by paying another entity to assume the existing obligation.
2. In the limited circumstances when an existing non-financial liability may legally be transferred to a new obligor, the transferee may not have the same non-performance risk as the transferor.
3. The need to consider a hypothetical transaction when a restriction exists that explicitly prevents such a transfer.



4. Whether the prices of certain non-financial liabilities traded as assets represent the fair value of that instrument for the issuer.
5. Certain Bases of Value require consideration of *market participant* assumptions (e.g., Fair Value for IFRS and US GAAP); however, given the lack of market transactions for non-financial liabilities there is often uncertainty with how to define market participants, as well as to determine how market participants' assumptions may vary from that of the company recording the non-financial liability.

**Methodology:**

1. Due to the unique and varying nature of non-financial liabilities, as well as a perceived propensity to reflect risk through adjustments to cash flows, the methods used in practice to value non-financial liabilities are widely divergent and in many cases unique to that liability. This stands in contrast to intangible assets for instance, for which IVS 210 outlines various common approaches that can in many instances be used interchangeably to value different intangible assets.

**Discount Rates and Accounting for Risk:**

1. When valuing a non-financial liability, the systematic and market risks that are associated with a corresponding asset may be of less relevance when valuing non-financial liabilities. The Boards note that whereas an increased risk to an investor in an asset is rewarded by an increase in the required return and a corresponding reduction in the asset value, an increase in the risk associated with a non-financial liability should, all else equal, increase the negative value of the liability, not decrease it.
2. Some non-financial liabilities exhibit a non-linear risk profile. For instance, the Boards note that certain non-financial liabilities may be subject to milestone events. Similarly, non-financial liability outcomes may also be path dependent, meaning a payment (cash flow) in one period may be dependent on the outcomes in other periods. For these reasons, the Boards notes that in practice adjustments for risks associated with a non-financial liability are often reflected in the cash flows through probability/scenario based methods, Monte Carlo simulations, and option pricing methods, rather than in the discount rate.
3. Furthermore, whereas the WACC is appropriate for valuing businesses, the Boards note that WACC has numerous flaws when applied to the valuation of non-financial liabilities, including:
  - a. The WACC may not directly reflect the entity's credit risk
  - b. WACC is applied to net cash flow; the performance metrics used in determining the non-financial liability value may not correlate to net cash flow and may have a differing risk profile;
  - c. WACC does not reflect optionality risk (e.g., the non-linear payoff structure);



- d. WACC does not account for unsystematic risks that are often associated with non-financial liabilities (e.g., milestone events);
- e. WACC is applied to long term cash flow whereas non-financial liabilities are often short term in nature; and
- f. WACC is a post-tax rate whereas the valuation of non-financial liabilities is typically pre-tax.

### Potential Standard Alternatives

The IVS Framework identifies the three principal valuation approaches, the Market Approach, the Income Approach and the Cost Approach. Within each approach, there are various methods that have evolved and that are used to a greater or lesser extent for different types of assets and liabilities.

#### Approaches

When valuing non-financial liabilities, the Boards observe that both the Market Approach and the Cost Approach have limited application in practice. In respect to the Market Approach:

1. For many non-financial liabilities there is no market for identical or similar liabilities.
2. Similar to intangible assets, transactions involving non-financial liabilities frequently also include other assets such as in a business combination, and therefore do not provide price transparency related to specific liabilities included in the transfer.
3. The heterogeneous nature of non-financial liabilities adds to the difficulty in identifying market transactions for identical or similar assets.

Therefore, in these situations meaningful methods that are predicated on transaction data have no relevance. Furthermore, as financial instruments, pension liabilities, and insurance liabilities are excluded from this ITC, there are few liabilities for which an active market exists and for which pricing information is readily available. As such, the Boards would recommend little additional guidance as it relates to the Market Approach, but rather point to paras 20.2 and 20.3 of IVS 105 when determining whether to apply the Market Approach in the valuation of non-financial liabilities.

Under the Cost Approach, the value of non-financial liabilities is determined based on the cost to provide services or fulfil obligations. The Cost Approach is most commonly used to value assets (liabilities) when the cost incurred is determined to be highly correlated with the benefit to be received (sacrificed). As liabilities often are nonlinear in nature, the likely costs to fulfil are often of limited relevance (with the exception of certain liabilities such as deferred revenue and certain warranty obligations) when determining the value of a liability. Similar to the Market Approach, the Boards would recommend little additional guidance as it relates to the Cost Approach, but rather point to paras 60.2 and 60.3 of IVS 105 when determining whether to apply the Cost Approach in the valuation of non-financial liabilities.



Due to the unique and varying nature of liabilities, as well as the propensity to reflect risk through the adjustment of cash flows, the Income Approach methods used in practice to value non-financial liabilities are widely divergent and in many cases unique to that particular liability. This stands in contrast to intangible assets for instance, for which IVS 2017 Section 210 outlines various common approaches that can in many instances be used interchangeably with only slight modification to value different intangible assets. As such, the Boards see three discrete alternatives for future standards related to the valuation of non-financial liabilities.

**Alternative A – Broad Methodology Approach**

Consistent with IVS 210 Intangible Assets, future standards could outline broad methodologies under the Income Approach that could be applied to many non-financial liabilities. In particular, despite the aforementioned uniqueness to the valuation of certain non-financial liabilities, the Boards have observed that the majority of such methodologies reside within a continuum that bifurcates risk in varying degrees between the discount rate versus in the cash flows. More specifically, the Boards see three forms of the Discounted Cash Flow method that differ with respect to whether risk is defined in both the numerator and/or the denominator of the calculation.

1. The Bond Yield Method defines the numerator as a promised payment and the denominator is a percentage yield that adjusts for the time value of money (i.e. risk free rate), expected losses from non-payment (i.e., credit risk), and the risk premium that adjusts for rewarded (i.e., systematic) risk.
  - a. Payments that are contractually fixed are often valued using a Bond Yield Method. The usual way to determine the appropriate yield is to reference market data for similar contracts. Because the payments are contractually defined, the key valuation input is the yield, which is often determined using matrix pricing.
2. The Required (expected) Rate of Return Method (a.k.a. Scenario Based Method) defines the numerator as the expected value of future payments (the probability-adjusted value of future payments, including an adjustment for non-payment), and the discount rate in the denominator includes adjustments for the time value of money and rewarded risk.
  - a. This approach is commonly used when future payments are not contractually defined but rather vary depending upon future events. In this method cash flows are estimated as the expected value of the probability distribution (i.e. scenario based) or what is commonly referred to as the average outcome.
3. The risk-neutral method adjusts the numerator for the probability of non-payment and for rewarded risk, and the denominator adjusts for only the time value of money.
  - a. The third method adjusts the numerator for all sources of risk and discounts the resulting values by the risk-free rate of interest, as is done



in option pricing. This method can be used when valuing both a fixed promised payment (e.g., Risk-Neutral Default Method) or when valuing various possible outcomes (e.g., Risk-Neutral Option Pricing Method). The Boards note that the Risk-Neutral Option Pricing Method is the preferred methodology to quantify additional risks associated with a liability's payoff structure, for example, liabilities that may have a non-linear payoff structure such as contingent consideration.

**Alternative B – Liability Centric Methodology Approach**

Given the various differences noted above between non-financial liabilities and intangible assets, the Boards recognise a possible need to identify commonly valued non-financial liabilities and detail specific considerations and methodologies that apply for each. However, the Boards acknowledge that such an approach would be divergent from current standards and move away from a more traditional principle based approach.

**Alternative C – Hybrid Approach**

The Boards also acknowledge the possibility of a hybrid approach in which broad methodologies are outlined similar to Alternative A, but recognise that the valuation of certain non-financial liabilities may not be appropriately valued through these methodologies. For instance, the valuation of deferred revenue within a business combination is often valued through consideration of fulfilment costs plus the addition of an appropriate fulfilment margin. This methodology is unique to the valuation of deferred revenue and is not easily addressed through the discussion of broad methodologies.

## **Questions for Respondents**

**Question 1.1:** Is the valuation of non-financial liabilities a critical area that should be addressed by the IVSC? Please explain why.

**Question 1.2:** Should IVS provide a separate definition of liabilities? If yes, do you agree with the definitions provided by the FASB and IASB, please explain why?

**Question 1.3:** What non-financial liabilities do you observe in practice? For each liability, what valuation methods do you most commonly see used? Which of the non-financial liabilities you listed have the greatest diversity of valuation in practice?

**Question 1.4:** Do you agree with the decision to exclude financial liabilities from this ITC? If yes, do you think IVSC should add financial liabilities as a possible project(s) in the future?

**Question 1.5:** Do you think IVSC should add financial instruments, pension liabilities, and insurance liabilities as a possible project(s) in the future?

**Question 1.6:** Of the potential Standard Alternatives outlined above (A, B, C), which do you prefer and why?

**Question 1.7:** Are there methodologies and best practices utilised by the insurance industry that the Boards should consider for inclusion in future standards? If so, please discuss.





# Chapter 2 – Discount Rates

## Summary

### Background

The assessment of an appropriate discount rate is a significant and highly subjective assumption often required to be made by Valuers. The Boards and Stakeholders have noted significant diversity in practice and the absence of sufficient documentation supporting the rationale for discount rate assumptions.

IVS 105 Valuation Approaches and Methods, paragraph 50.29 through paragraph 50.31, outlines various methods Valuers may use and certain items a Valuer should consider; however, stakeholder feedback has noted a relative lack of specificity within the current Standards. Such factors suggest that additional standards related to discount rate derivation would be helpful toward improving consistency and quality in the marketplace. The Boards have therefore agreed that a dedicated project is required to further explore diversity in practice for the derivation of discount rates and develop, as necessary, additional standards.

### Scope

Stakeholder feedback has included multiple comments concerning more prescriptive guidance on the specific application of the methods outlined in IVS 105 paragraph 50.30 as well as guidance on when to apply each method. The Boards feel that the level of detail requested extends beyond the scope of these standards and would be challenging to write in a way that applies to all valuation purposes and markets globally. Second, the Boards believe there is sufficient technical guidance in the marketplace on the application of various discount rate methods. Finally, the Boards contend that such an approach would be divergent from current standards and move away from a principle-based approach to IVS. Rather the Boards feel that any additional standards should focus more broadly on a performance framework consistent with the *must*, *should*, and *may* criteria, targeted at the areas within discount rate derivation with the most diversity in practice.

As the Capital Asset Pricing Model (CAPM) is the most widely used model for the derivation of the cost of equity for business enterprise valuation, the below discussion first outlines the various inputs into the CAPM model and the observed diversity in practice for each input. Within the CAPM, the Boards believe that the derivation of country risk premiums and Company Specific Risk Premium (CSRP) have both the greatest diversity in practice and require the greatest degree of Valuer judgment.

### Perceived Issues and Stakeholder Concerns

Both the Boards and stakeholders have observed a number of issues related to the derivation of discount rates using the CAPM. In particular, the Boards note that the CAPM is the most widely used methodology to derive the cost of equity and related weighted average cost of capital (WACC); however, there is significant diversity in practice for the calculation of each input to the cost of equity using the CAPM. Each input, and the observed practices are outlined below:



1. Risk Free Rate

- a. The Boards observe the term for sovereign debt rates used as the risk free benchmark ranges from 10 years to 30 years. There is diversity as it relates to jurisdictions in which there is either limited trading in sovereign debt, or there are other market distortions (hyper-inflation, capital controls etc.).
- b. Given the current low interest rates environment, the Boards note the occasional use of historical or average rates rather than current spot rates.

2. Equity Risk Premium (ERP)

- a. The Boards observe a multitude of sources and methodologies used to determine the ERP (historic v forward looking approaches, arithmetic verses geometric means, etc.).
- b. In certain cases the application of an ERP which is inconsistent with the chosen risk free rate benchmark (e.g., a mismatch of selected risk free rate and the risk free rate utilised to derive the selected ERP measure).

3. Beta

- a. The Boards observe a significant diversity in the selection of betas, with no clear consensus on what approach is most commonly used. For instance the Boards observe the use of:
  - i. Both 5-year and 2-year betas.
  - ii. Both monthly and weekly betas.
  - iii. Both adjusted and raw betas.
  - iv. Different approaches to calculating beta related to the indices used, adjustments for dividends, and currency.

4. Size Premium

- a. The Boards observe that size premiums are commonly applied, but there is significant diversity in the cited source.
- b. There is also varying practice in the reference point used to determine 'size' including: the subject company, the target in a business combination context, the acquirer in a business combination context, and the comparable companies used to derive the WACC inputs.

5. Country Risk Premium

- a. The Boards believe that when valuing businesses in less developed capital markets, one must account for incremental political, economic, legal, liquidity, currency, and other risks. The Boards noted various methods and sources for the quantification of country risk premiums (CRP), including:





- i. Sovereign-Spread Model,
    - ii. Damodaran Model,
    - iii. Country Risk Ratings Models (CRRM) such as the model published by Ibbotson, and
    - iv. Premiums based on subjective judgement.
  - b. Additionally, the Boards note diversity in practice in the following factors related to international cost of capital calculations:
    - i. The currency framework:
      - The Boards note failure of some Valuers to understand the currency framework of the analysis (i.e., the currency of the cash flows and the currency in which the discount rate is denominated).
    - ii. Adjustments for relative country risk exposure (Lambda):
      - The degree of a company's risk exposure to a country is dependent on 1) its sources of operating profit; and 2) the location of its operating assets. The Boards note diversity in practice in the application of Lambda, and methodology used to derive Lambda.
    - iii. Adjustments for interplay between country risk and industry:
      - The Boards observe diversity in practice as to whether the Beta is applied to the CRP. The pivotal consideration is whether the spread in riskiness for various industries is also influenced by operation in the foreign country.
- 6. Company Specific Risk Premium (CSRP)
  - a. The Boards note significant diversity in practice and the absence of sufficient documentation in relation to the assessment of the CSRP.
  - b. The Boards observe consideration of some or all of the below factors in practice when deriving the CSRP:
    - i. Identification of the key components of the projected financial information (PFI)<sup>3</sup> and the risks of the underlying assumptions that have not been captured in the other components of the discount rate.
    - ii. Comparison of the PFI key components to:
      - Historical results of the subject company,

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<sup>3</sup> Key PFI components may include revenue and revenue growth rates, gross margins, EBITDA margins and EBITDA growth rates, EBIT margins and EBIT growth rates, effective tax rate, capital expenditures and asset turnover, and working capital.



- Historical and expected results for the broader industry,
    - Financial analyst estimates for comparable companies, and
    - Expected near term and long term growth rates of the country and/or region in which the company primarily operates.
  - iii. Comparison of prior forecasts to actual results to assess the accuracy and reliability of managements' estimates
  - iv. Reconciliation to other discount rate models including Internal Rate of Return and Weighted Average Return on Assets.
  - v. Consideration of qualitative factors
7. Capital Structure
- a. The Boards observe varying practices including:
    - i. Use of the subject company's current or target capital structure,
    - ii. Use of comparable company average or median capital structure, and
    - iii. Use of leverage ratios commonly cited by lenders.
8. Cost of debt
- a. The Boards observe varying practice including:
    - i. Use of high level rules of thumb or indices for corporate debt rates (e.g., Moody's Baa),
    - ii. Specific consideration of the credit rating and corresponding cost of debt for comparable companies,
    - iii. Use of the Company's current or expected cost of debt, and
    - iv. Use of various term lengths.

## Potential Standard Alternatives

As noted above, the Boards feel that any additional standards should focus more broadly on a performance framework consistent with the *must*, *should*, and *may* criteria targeted at the derivation of the WACC, including use of the CAPM.

### **Alternative A – Performance Framework for CAPM**

Rather than provide prescriptive guidance on the application of the CAPM, Alternative A would set out minimum thresholds for the extent of investigation, analysis, and documentation related to each input into the CAPM.

### **Alternative B – Performance Framework for Multiple Methods**



Although the Boards observe the CAPM utilised in nearly all business enterprise free cash flow valuations, Alternative B would set forth a performance framework for multiple methods of deriving the discount rate, such as those listed in IVS 105 Valuation Approaches and Methods, paragraph 50.29.

**Alternative C – Performance Framework and Reference to Prescriptive Guidance**

As noted above, IVSC has historically been of the opinion that this level of detail is too in-depth for IVS and would be difficult to write in a way that applies to all valuation purposes and markets globally. However, certain stakeholders have recommended that IVS identify and refer to best practice technical guidance. In the Boards opinion, any such guidance would be combined with a performance framework outlined in Alternative A or Alternative B above.

**Questions for Respondents**

**Question 2.1:** Are additional standards related to the derivation of discount rates a critical area that should be addressed by the IVSC? Please explain why.

**Question 2.2:** Given the extensive use of the CAPM for derivation of discount rates used in business enterprise and asset valuations, do you agree with the Boards proposal to issue new standards to target diversity in practice related to discount rate derivation? Please explain why.

**Question 2.3:** Which inputs have you observed to have diversity in practice that would benefit from additional guidance in IVS and why?

**Question 2.4:** What other methods of deriving discount rates for business enterprise valuation do you commonly observe in practice? For each method, do you commonly observe diversity in practice in its application?

**Question 2.5:** Of the potential Standard Alternatives outlined above (A, B, C), which do you prefer and why?



# Chapter 3 – Early Stage Company Valuation

## Summary

### Background

The Boards and stakeholders note significant diversity in practice for the valuation of early-stage companies. Both the BV Board and stakeholder feedback indicate that there are certain issues that arise in the valuation of early stage companies that are unique, and therefore may not be covered in current IVS. Additionally, preliminary investigations by the BV Board has established a lack of guidance specifically relating to the valuation of early stage companies. Such factors suggest that standards specific to the valuation of early-stage companies would be helpful toward improving consistency and quality in the marketplace. The Boards have therefore agreed that a dedicated project is required to determine appropriate valuation practice for early stage companies. Depending on feedback obtained from this ITC, the Boards may decide to develop an in depth discussion paper or move forward with an exposure draft related to the valuation of early-stage companies.

Additionally, we understand the AICPA has formed a Task Force, which is entitled *Valuation of Portfolio Company Investments of Venture Capital and Private Equity Funds and Other Investment Companies*. The Task Force is in the process of drafting a practice guide which is expected to have significant guidance on the valuation of early stage companies within the context of PE/VC portfolio investment valuations. An exposure draft of the AICPA handbook is expected in the summer of 2017. IVS plans to monitor the AICPA process, and where applicable and appropriate, harmonise IVS with the AICPA handbook as it relates to early-stage company valuation.

### Scope

The most noteworthy guidance regarding the valuation of early stage companies comes from the AICPA Accounting and Valuation Guide, *Valuation of Privately-Held-Company Equity Securities Issued as Compensation*, issued in 2013 (the “Valuation Guide”). The Valuation Guide lays out various stages of enterprise development including:

- Stage 1 – Enterprise has no product revenue to date and limited expense history and, typically, an incomplete management team with an idea, a plan, and possibly some initial product development.
- Stage 2 – Enterprise has no product revenue but substantive expense history because product development is under way, and business challenges are thought to be understood.
- Stage 3 – Enterprise has made significant progress in product development; key development milestones have been met (for example, hiring of a management team); and development is near completion (for example, CSRP and beta testing), but generally, there is no product revenue.



- Stage 4 – Enterprise has met additional key development milestones (for example, first customer orders or first revenue shipments) and has some product revenue, but it is still operating at a loss.
- Stage 5 – Enterprise has product revenue and has recently achieved breakthrough measures of financial success, such as operating profitability or break-even or positive cash flows.
- Stage 6 – Enterprise has an established financial history of profitable operations or generation of positive cash flows

The BV Board finds these definitions helpful for defining the scope of this ITC and intentions of any potential future standards. In general, the BV Board believes that early-stage companies can be defined as demonstrating any or all of the below factors:

- Yet to meet key technological or commercial milestones;
- No revenue or little revenue in comparison to market potential;
- Negative profitability and cash flows, or low in comparison to market potential; or
- Little certainty as to future revenue and profitability projections.

As such, for purposes of this ITC the BV Board believes that stages 1 through 5 as defined by the Valuation Guide are relevant.

### **Perceived Issues and Stakeholder Concerns**

Both the BV Board and stakeholders have observed a number of issues related to the valuation of early-stage companies. These unique issues and concerns related to the valuation of early-stage companies include the following:

#### **Limitation of Typical Valuation Methods:**

The typical methods used for business enterprise valuation are often of little relevance and/or are difficult to reliably apply when valuing business in the early stages of their life cycles. Examples include:

1. Discounted Cash Flow Method – As noted above there is little certainty as to future revenue and profitability projections. Additionally, achievement of a normalised state at which to apply a perpetuity calculation may be far into the future, well beyond the period in which reliable forecasts could be derived.
2. Guideline Publicly-traded Comparable Method – Rarely are companies in these stages of development publically traded. As such, the identification of meaningful comparable companies is difficult or impossible.
3. Comparable Transactions Method – Although transaction data (including purchase price and multiples) for similar companies may exist, multiple factors limit their usefulness.



- a. In many instances such companies are not profitable, thus forcing the Valuer to rely on revenue or book multiples.
- b. Multiples often have little relevance to current performance of the target, but rather are more often a function of the acquirer's expectations of future performance which is not known to the Valuer.
- c. Transaction prices are often a function of acquirer specific motivations, which can drive a large divergence between the fundamentals of the target and the price paid.
- d. Given the relatively small size of the targets as compared to the buyers, such acquisitions are often below the buyer's financial disclosure requirements and therefore the terms are often not known to the public.

**Accounting for Risk:**

Typical methods for estimating a discount rate (e.g., CAPM) are of less relevance. For instance:

1. For many early-stage companies, economic or industry conditions are not directly relevant because many early-stage enterprises are years away from commercialisation of their particular product or service.
2. The risk profile of many early stage companies are largely impacted by certain discrete events, such as achievement of a technological milestone. As such, companies may display a non-linear risk profile. Similarly, when estimating PFI, outcomes may also be path dependent. For these reasons, adjustments for risks are sometimes reflected in the cash flows through probability/scenario based methods, rather than in the discount rate.
3. Given the frequent need for early stage companies to conduct financing rounds, the going concern premise inherent in traditional models may not be appropriate.
4. Research has been conducted to estimate the required rates of returns of investors at various development stages; however, such research provides broad ranges that are difficult to apply in practice.

**Complex Capital Structures:**

Many (if not most) venture capital-backed and private equity-backed enterprises are financed by a combination of different equity securities, each of which provides its holders with unique rights, privileges, and preferences. Given such complex capital structures often associated with early-stage companies, there are added complexities when trying to derive the value of a certain class of security. In practice, the Boards note the following commonly used methods:

1. Probability-weighted expected return method,
2. Option pricing method,



3. Real options analysis, and
4. Current value method.

While the BV Board notes significant guidance on the application of these methods, in practice the BV Board observes a multitude of special considerations and unique circumstances that result in varying applications in practice.

**Calibration:**

Given the relative frequency in which early stage companies conduct financing, as well as the limitations of more traditional methodologies noted above, calibration of methods and assumptions at the time of the transaction date to a subsequent valuation date is often used in the valuation of early-stage companies. Calibration is helpful in assessing the reasonableness of valuations across time. Additionally, a calibration methodology can eliminate the need to consider possible control and marketability adjustments in the valuation process. However, the Boards note various issues in practice including:

1. Appropriately accounting for differences between the pre-money and post-money value as of the transaction to calculate the implied financial metrics (e.g., implied multiples) that are the basis for the calibration. Additionally, whether any changes in the risk profile or financial prospects of the company resulted from its ability to obtain financing;
2. Determining for how long and under what circumstances is a transaction a reliable indication of fair value;
3. Difficulties in applying a calibration method when using the income approach;
4. Determining what factors should be considered in assessing the relevance of a transaction that took place prior to the measurement date;
5. How control and marketability features are embedded in the transaction; and
6. How to reconcile calibration to other methodologies.

**Market Participant Framework:**

When valuing early-stage companies, many PE/VC investors frequently use transaction-specific assumptions, which are not always transparent to market participants. However, many bases of value rely on a market participant framework. Such divergent perspectives often make it conceptually challenging to reconcile market participant assumptions and investment objectives. Some issues that arise include:

1. What would market participants take into account when pricing an asset,
2. How should investor specific exit strategies be incorporated in a value measurement,
3. How should illiquidity and control be priced, and
4. What observable transactions are typically available to market participants.





## Potential Standard Alternatives

### **Alternative A – No Additional Standards Needed**

The Boards acknowledge that although the valuation of early-stage companies often require consideration of unique issues, many of the principles under which such valuations are prepared are no different than mature operating businesses. As such, there is a perspective that the valuation of early-stage companies is already addressed by current IVS.

### **Alternative B – Discussion Paper**

Given the relative lack of existing guidance, diversity of methodologies and special considerations, and lack of clear consensus related to best practice, the Boards note that a more in depth project may be needed to research best practices and potential standards alternatives. Based on feedback from this ITC, the Boards may commission a more in depth discussion paper to further explore this topic.

### **Alternative C – Performance Framework Addressing Problem Areas**

The Boards note certain aspects of the valuation of early-stage companies are specifically addressed in current IVS. As such, the Boards note that additional standards could address certain problem areas related to the valuation of early-stage companies including: discount rate considerations, complex capital structure considerations, and calibration. Consistent with current IVS, any such standards should focus more broadly on a performance framework consistent with the must, should, and may criteria targeted at these specific areas.

## Questions for Respondents

**Question 3.1:** Are additional standards for the valuation of early-stage companies a critical area that should be addressed by the IVSC? Please explain why.

**Question 3.2:** In which areas of the valuation of early-stage companies do you see the greatest diversity in practice? Are there additional areas of concern not noted above in this ITC? If so, please discuss.

**Question 3.3:** Of the potential Standard Alternatives outlined above (A, B, C), which do you prefer and why?





# Chapter 4 – Biological Assets

## Summary

### Background

IVSC initially published an Exposure Draft on “The Valuation of Forests” in November 2012, as Forestry enterprises were increasingly attracting interest both due to the increasing demand for forest products as well as from investors looking for long term stable investments. The previous IVSC Standards Board was made aware of differences in the valuation approach being adopted in different countries including practices inconsistent with the requirements of the IVS and agreed a project to address this. Another consideration at this time was that an ever-increasing number of entities involved in forestry are required to account for their interest under International Accounting Standard (IAS) 41 Agriculture, which requires the “fair value” of the “biological asset”, represented by the tree crop, to be estimated.

IVSC received 18 responses from this initial consultation process, many of which were inconsistent both in terms of valuation approach and perceived level of due diligence required. The previous Standards Board was in the process of revising the Exposure Draft for a second consultation prior to the publication of the IVSC Purpose, Structure and Strategy paper, where it was decided that the primary focus for the next two years was to revise and publish IVS 2017.

Since the publication of IVS 2017, the Tangible Assets Board has reviewed the previous gap analysis and recognised that there was a significant market need for further guidance in this area.

### Scope

The scope of this document would be the same as IAS 41, which subdivides Biological Assets into the following two categories;

- Biological Assets such as living plants and animal
- Agricultural produce such as the harvested product of the entity’s biological assets.

IAS 41 Agriculture with the exception of bearer plants provides guidance on the accounting for agricultural activity from initial recognition up to the point of harvest and requires the measurement of biological assets at fair value less costs to sell. IAS 41 uses a single treatment for both bearer biological assets and consumable biological assets. Bearer biological assets include grape vines, oil palms, dairy cows, etc. Consumable biological assets include wheat, trees for wood pulp in a plantation forest, beef cattle, etc.

From previous market feedback received, the Board felt that there was a need for international valuation standards to assist both professional valuers and users in understanding the application of those principles to the valuation of Biological Assets.



Furthermore, the Board was also alerted to some practices used to estimate the market value of Biological Assets that were inconsistent with the requirements of the IVS.

### **Perceived Issues and Stakeholder Concerns**

Both the Boards and IVS stakeholders have observed a number of issues related to the valuation of Biological Assets. These unique issues and concerns related to the valuation of Biological Assets include the following:

#### **Limitation of Typical Valuation Methods**

Some valuations of Biological Assets are being presented in financial statements prepared for statutory purposes that show significant changes from those previously submitted solely due to the adopted valuation method changing. The Board considers that this is contrary to the IVSs, in particular the definition and conceptual framework for market value contained within IVS 104 Section 30, or where prepared under IAS 41, the requirements of IFRS 13 Fair Value Measurements. The method adopted should be that appropriate to achieve the required basis of value, it should not dictate or change the basis of value. This is further shown in IVS 105 10.4, which states that; "Where more than one approach and method is used, or even multiple methods within a single approach, the conclusion of value based on those multiple approaches and/or methods should be reasonable and the process of analysing and reconciling the differing values into a single conclusion, without averaging, should be described by the valuer in the report." Some of the issues in relation to the valuation of biological assets are shown below;

1. Fair Value: There is a conceptual Issue in allocating components of Fair Value. An ever increasing number of entities involved in forestry and other biological assets are required to account for their interest under IAS 41 Agriculture, which requires the "fair value" of the "biological asset", represented by the tree crop, to be estimated. Because the trees cannot exist without the land on which they are growing this can create some conceptual difficulties in allocating the value of the complete forest to its different components.
2. Variance in valuation: IAS 41 suggests the value of the "raw land" be deducted from the value of the combined asset, with the residual representing the value of the biological asset. However, it is argued by some that this is over simplistic as the value of "raw land" is not the same as the value of land supporting a biological asset and the evidence the price of bare land ready for planting is of limited relevance. Proponents of this view argue that the interdependence of the crop and the land mean that the land makes a significant contribution to the value of the crop, and therefore deducting only the value of the bare land from the value of the biological asset overstates the value of the biological asset.
3. Alternative Uses: A difficulty in the valuation of biological assets arises if the land is worth more for an alternative use. Some valuers think that a potential alternative use might suggest that the biological asset has a negative or zero value, if the biological asset generates income to the entity when it is harvested then the biological asset will have a positive value and should be recognised as an asset regardless of the value of the land. Some disagree and argue that if the



biological assets are preventing a more valuable alternative use then they can have no value.

4. Sampling and Measurement techniques
  - a. Sampling: The four basic techniques for sampling data in a Biological Asset valuation are shown below;
    - i. Random sample unstratified
    - ii. Random sample stratified by biological asset cover type
    - iii. Systematic sample unstratified
    - iv. Systematic sample stratified

However, these sample techniques are used inconsistently across markets with varying degrees of sampling precision and the inclusion of information on generally accepted sampling and measurement techniques would substantially reduce diversity of valuation practice.

## Potential Standard Alternatives

### **Alternative A – No Additional Standards Needed**

The Boards acknowledge that although the valuation of biological assets often require consideration of unique issues, many of the principles under which such valuations are prepared are no different than other assets. As such, there is a perspective that the valuation of extractive industries is already addressed by current IVS.

### **Alternative B – Discussion Paper**

Given the relative lack of existing guidance, diversity of methodologies and special considerations, and lack of clear consensus related to best practice, the Boards note that a more in depth project may be needed to research best practices and potential standards alternatives. The Board further notes that the Foresight Land Use Futures Report (2010) commented on the need or a better appreciation of value in land use governance: *“How we value land, and the services it provides, is at the heart of decisions on land use change. However, as priorities for land use and land management shift, these need to be reflected in how we govern land use today.”* The report calls for *“A more sophisticated approach to valuing land ... to be embedded into policy cycles and into the governance mechanisms, including future incentives and regulation”* and sees the appropriate concept of value as *“a broad one, encompassing the full range of ecosystem services, whether they are marketed.”* Based on feedback from this invitation to comment, the Boards may commission a more in depth discussion paper to further explore this topic.

### **Alternative C – Performance Framework Addressing Problem Areas**

The Boards note certain aspects of the valuation of biological assets are specifically addressed in current IVS. As such, the Boards note that additional standards could address certain problems areas related to biological asset valuations including: limitations



of typical valuation methods and sampling and measurement techniques. Consistent with current IVS, any such standards should focus more broadly on a performance framework consistent with the must, should, and may criteria targeted at these specific areas.

### Questions for Respondents – Biological Assets

**Question 4.1:** Should IVS provide a standard of Biological Assets? If yes, do you agree with the title of this standard and the distinction provided by the FASB and IASB between Biological Assets and Agricultural Produce, please explain why?

**Question 4.2:** Do you observe a significant variation in valuation practice for Biological Assets? For each type of Biological Asset, what methods do you most commonly see used? Which type of the Biological Asset you listed have the greatest diversity in practice?

**Question 4.3:** Do you observe a significant variation in valuation practice for Agricultural produce? For each type of Agricultural Produce, what methods do you most commonly see used? Which type of the Agricultural Produce you listed have the greatest diversity in practice?

**Question 4.4** Is the valuation of Biological Assets critical area that should be addressed by the IVSC? Please explain why.

**Question 4.5:** Does the separation of value between the agricultural produce and its bearer plants cause issues within your market? Please explain why.

**Question 4.6:** Do you feel that there is conceptual Issue in allocating components of Fair Value? Please explain why together with your recommendations for resolving these issues.

**Question 4.7:** Do you think that potential alternative uses should be considered when valuing land as part of a Biological Asset valuation? Please explain why.

**Question 4.8:** Do you think that there are four basic sampling and measurement techniques for the valuation of Biological Assets? If not, please explain what sampling techniques have seen used in practice.

**Question 4.9:** Do you think that there are four basic sampling and measurement techniques for the valuation of Biological Assets? Do you think that the inclusion of information on generally accepted sampling and measurement techniques would substantially reduce diversity of valuation practice and if so, how?



# Chapter 5 – Extractive Industries

## Summary

### Background

In 2005 the IVSC issued Guidance Note 14 The Valuation of Properties in the Extractive Industries. It formed part of a suite of Standards, Applications and Guidance Notes that collectively made up the International Valuation Standards (IVSs). In 2008 the IVSC reviewed all its existing standards and removed the Guidance Note on Extractive Industries so IVS could incorporate additional guidance that was in the process of being developed by IASB. In July 2012, the IVSC issued a Discussion Paper on Extractive Industries as IASB staff had indicated to the IVSC that it would be helpful if some globally accepted valuation standards and guidance for the sector were developed as it would help them in any future deliberations as to the extent to which fair values are a relevant and useful measure in financial statements. Furthermore, the IVSC had also been encouraged to develop improved standards in this area by securities regulators, who were concerned at the diversity of valuation information on extractive activities presented by companies under their jurisdiction.

IVSC received 18 responses from this initial consultation process, many of which were inconsistent both in terms of valuation approach and perceived level of due diligence required. The previous standards Board was in the process of revising the Exposure Draft for a second consultation prior to the publication of the IVSC Purpose, Structure and Strategy paper, where it was decided that the primary focus for the next two year was to revise and publish IVS 2017.

Since the publication of IVS 2017 the Tangible Assets Board has reviewed it's previous gap analysis and recognised that there was a significant market need for further guidance in this area in relation to both established production operations or exploration and undeveloped and development operations.

### Scope

The scope of this document would be both mining operations and the extraction of oil and gas. In its former GN14, the IVSC combined guidance on both, with the only specific exclusion being the extraction of water from the earth. The IASB adopted a similar approach in creating a single standard, IFRS 6 Exploration for and Evaluation of Mineral Resources.

This approach is supported by the fact that there is no clear distinction between the extraction methods employed, with some metals being recovered by fluid dynamics and in situ recovery techniques that are identical to those used in secondary oil recovery.

Even though Geothermal energy production is also an extractive industry, it was felt that this should not be included, as there are some variations in valuation methodology between these industry subsectors.



Furthermore, the mining and oil and gas industries are individually among the largest in the world and the major entities specialise in one sector or the other. The skills required in each are highly specialised and therefore to be meaningful the IVS must be specific to this sector.

### **Perceived Issues and Stakeholder Concerns**

Both the BV and TAB Boards and stakeholders have observed several issues related to the valuation of extractive industries. In the Extractive Industries the appropriateness of each approach or method will depend on a number of factors including:

- Stage of project (exploration, development and production),
- Ability to identify and classify extent of reserves or resources,
- Ability to project production rate,
- Ability to project capital expenditure,
- Ability to project operating costs,
- Ability to forecast future prices for minerals/petroleum products,
- Existence of public information regarding comparable projects,
- Stage of regulatory approval, and ability to forecast risk in progressing to extraction (existence of environmental impact statements, etc),
- Certainty regarding title, and other legal considerations (non-regulatory),
- Availability of financing,
- Availability and financing of infrastructure,
- Marketing of resource considerations.

### **Limitation of Typical Valuation Methods**

The typical methods used for extractive industries valuation are often of little relevance and/or are difficult to reliably apply when valuing extractive industries.

1. **Market Approach:** The market-based approach is widely used within the Extractive Industries and is also often used in conjunction with the Cost approach for early stage exploration properties. Though widely used they are often flawed because companies are not truly comparable as risks and opportunities can be very different between compared projects/companies and though appropriate for the majority of sectors within Extractive Industries there are the following exceptions;
  - a. industrial minerals
  - b. those entirely contingent on off-take agreements
  - c. highly-illiquid/unusual sectors where there is no effective market
2. **Income Based Approach:** This approach is mainly used for reserves undergoing development. The Income-based approach may be supported by a cost- or





market-based approach, but are generally considered to be of secondary importance as they may not consider all the available technical information. Ore Reserves of all categories are most commonly valued using the DCF method. Other methods within the Income-based approach may be appropriate but are less common.

3. **Cost Based Approach:** This approach is mainly used for reserves or resources subject to exploration. The cost-based approach is one that is project specific as it largely relates to sunk or future costs that may have no relationship with other projects and therefore it is not appropriate to make sunk/future-cost comparisons with other projects. For projects requiring additional risk adjustment to reflect future exploration or evaluation, the cost-based approach (such as expected value) may take primary importance. The use of the cost approach varies according to whether users are looking at sunk costs or future costs with sunk costs looking at multiples of exploration expenditure and replacement cost and forward looking costs including expected values and in some instances using the “Kilburn Method”.

**Accounting for Risk:**

Extractive industries valuations separately consider and evaluate market (systematic) risk and asset specific risk.

1. **Discount Rate:** In order to calculate the discount rate many factors are considered including sovereign risk, systematic risk, project risk and inflation with sources likely to be derived from management and third party estimates. The typical methods for estimating a discount rates are as follows:
  - a. Management estimates
  - b. Capital Asset Pricing Model
  - c. Weighted Average Cost of Capital
2. **Country risk factors:** These factors are considered by use of one of the following methods:
  - a. Capital Asset Pricing Model
  - b. Fraser Institute's Annual Survey of Mining Companies, or similar publications
  - c. OECD country risk ratings
  - d. Transparency International's corruption index
  - e. Political risk insurance

**Inconsistency in definitions and principle**

There is currently an inconsistency in definitions and principles between Codes for Mineral Asset Valuation such as CRIRSCO, CIMVal, IMVAL, JORC, SAMREC and VALMIN), which leads to inconsistency in valuation approaches and methodologies. The



recognition of these differences and similarities will create further transparency and assist in the harmonisation of valuation processes.

## Potential Standard Alternatives

### **Alternative A – No Additional Standards Needed**

The Boards acknowledge that although the valuation of extractive industries often require consideration of unique issues, many of the principles under which such valuations are prepared are no different than other assets. As such, there is a perspective that the valuation of extractive industries is already addressed by current IVS.

### **Alternative B – Discussion Paper**

Given the relative lack of existing guidance, diversity of methodologies and special considerations, and lack of clear consensus related to best practice, the Boards note that a more in depth project may be needed to research best practices and potential standards alternatives. The Board further notes that there already a number of organisations providing standards in this area such as the International Mineral Valuation Committee (IMVAL), the Committee for Mineral Reserves International Reporting Standards (CRIRSCO) and VALMIN and furthermore there is the United Nations Framework Classification (UNFC), which is a numerical classification system, independent of language, that is designed for use in both the minerals and petroleum sectors. Based on feedback from this invitation to comment, the Boards may commission a more in depth discussion paper to further explore this topic.

### **Alternative C – Performance Framework Addressing Problem Areas**

The Boards note certain aspects of the valuation of extractive industries are specifically addressed in current IVS. As such, the Boards note that additional standards could address certain problems areas related to extractive industry valuations including: limitation of typical valuation methods, accounting for risk and inconsistency in definitions and principles. Consistent with current IVS, any such standards should focus more broadly on a performance framework consistent with the must, should, and may criteria targeted at these specific areas.

## Questions for Respondents – Extractive Industries

**Question 5.1:** Should IVSC produce combined standards and guidance for Extractive Industries or produce separate pronouncements for mining and for oil and gas? If you believe the latter, please indicate the reasons why you consider separate guidance is appropriate.

**Question 5.2:** Should the standards focus just on the valuation of reserves and resources or should it extend to other assets employed in the industry and to entire businesses in the sector? Please provide reasons for your answer.

**Question 5.3:** Which classification code or codes are most commonly used in your industry / sector? Which code do you normally use or rely on? Are you aware of differences across your / industry sector on the classification codes used? If so please indicate whether these differences cause problems in undertaking or understanding valuations.





**Question 5.4:** When valuing with a discounted cashflow do you use internal production forecasts developed by the entity's own geological and engineering specialists, external forecasts, or a combination of both and you adjust the production forecasts for risk by reserve category?

**Question 5.5:** Please indicate what methods you use or are familiar with that fall under the Cost Approach and that are used in valuing assets in the Extractive Industries. Please indicate in your experience how the cost of an equivalent asset is determined and please indicate the three most common adjustments that are made in your experience to reflect physical, functional or economic obsolescence, and what metrics are used to determine these adjustments?

**Question 5.6:** Please identify any intangible assets that are normally separately identified and valued; i. In transactions between entities in the Extractive Industries and ii. When accounting for the acquisition of a business in the Extractive Industries.

**Question 5.7:** In your experience what, if any, value is attributed to components of goodwill, eg an assembled skilled workforce, in corporate transactions in the Extractive Industries. Please briefly indicate any valuation techniques used to establish the value of goodwill in such circumstances.

**Question 5.8:** Please provide any examples of which you are aware of significant differences between the value of otherwise similar resources arising solely from different Governmental policies. Please indicate how "country risk" factors are reflected in the way in which you price or value extractive assets.



# Chapter 6 – Inventory

## Summary

### Background

IVS 2017 has no standards specific to the valuation of inventory. Additionally, preliminary investigations by the Boards have concluded that there is limited technical guidance specifically relating to the valuation of inventory. These factors, combined with the unique methodologies to value inventory, indicates that standards would be helpful toward improving consistency and quality in the marketplace. The Boards have therefore agreed that a dedicated project is required to determine appropriate valuation practice for inventory and develop as necessary dedicated standards.

The most significant guidance regarding the valuation of inventory comes from Statement of Financial Accounting Standards No. 141 (SFAS 141), *Business Combinations*, issued in June 2001, and superseded by ASC 805, which provides guidance regarding measurement methods for specific assets and liabilities assumed in business combinations, including inventory. While SFAS 141 has been superseded, its guidance remains consistent with best practices applied today. Paragraph 37 of SFAS 141 provided general guidance for assigning purchase consideration to inventory assets acquired as follows:

1. Finished goods and merchandise at estimated selling prices less the sum of (a) costs of disposal and (b) a reasonable profit allowance for the acquiring entity
2. Work in process at estimated selling prices of finished goods less the sum of (a) costs to complete, (b) costs of disposal, and (c) a reasonable profit allowance for the acquiring entity based on profit for similar finished goods
3. Raw materials at current replacement costs

Additionally, we understand the AICPA has formed a Business Combinations Task Force, which is in the process of drafting a handbook with a chapter on inventory valuation. An exposure draft of the AICPA handbook is expected in the near future. IVS plans to monitor the AICPA process, and where applicable and appropriate, harmonise IVS with the AICPA handbook as it relates to inventory valuation.

### Scope

The Business Valuation Board notes that the most common context for the valuation of inventory is financial reporting related to a business combination. In this context, the definition of inventory includes raw materials, work-in-process (WIP) and finished goods. Although the SFAS 141 has been superseded, current practice remains consistent with its guidance. Specifically, two primary methods may be used to determine the value of inventory: the Replacement Cost Method and the Comparative Sales Method.

1. The Replacement Cost Method, commonly used to value raw materials, estimates the cost that the buyer would have incurred in acquiring the same amount and type of inventory in the marketplace. The components of cost under



this method may include purchasing, handling, transporting, and storing the inventory. The cost basis is then adjusted for other relevant factors, such as obsolescence and compensation to the seller for a return on expenditures.

2. The Comparative Sales Method, commonly used to value WIP and finished goods, values inventory at a base cost equivalent to the actual or expected selling price to customers in the ordinary course of business. The base cost is then adjusted for various factors, such as expenses incurred in disposition, profit commensurate with the degree of risk and amount of investment, and the time / cost required to dispose of the inventory.

Although there is general consensus that the Comparative Sales Method is the most appropriate methodology for the valuation of WIP and finished goods, stakeholder feedback and Business Valuation Board observations indicate divergence in practice in the application of the Comparative Sales Method. The Boards note little divergence in practice related to the application of the Replacement Cost Method, and also note that the methodology as addressed in IVS would also apply to inventory. As such, the focus of this ITC topic is the application of the Comparative Sales Method.

#### **Perceived Issues and Stakeholder Concerns**

Both the Boards and stakeholders have observed a number of issues related to the application of the Comparative Sales Method. As discussed above, the Comparative Sales Method is a “Top-down Approach” that begins by estimating the selling price and then subtracts costs of disposal, holding costs, and a profit allowance. When determining the value of WIP, it is also necessary to include costs to complete the WIP. Each input, and the observed practices are noted below:

1. Determining the selling price
  - a. If data is available, selling price may be estimated using product-level selling price based on the historic sales data taking into account the age of inventory on hand and expected mark-downs typically achieved, or gross profit margin using product-level data applied to the net book value of finished goods.
  - b. In practice the Boards observe that the selling price is often estimated by applying an appropriate gross profit margin to the net book value of finished goods. The projected margin for the period in which the inventory is expected to be sold is most often used to determine selling price.
  - c. The Boards note that consideration of historical margins of the target, the acquirer’s margins, and margins of the comparable companies may also be considered.
  - d. The Boards also note that in some instances market data is available to directly determine the selling price at the product level.



2. Cost of disposal

- a. The Boards note that in practice estimating the costs of disposal is based on a line-by-line analysis of the subject company's income statement. This analysis bifurcates those costs incurred pre-valuation date to buy and manufacture the inventory versus those that are incurred post-valuation date to sell the finished goods inventory. The costs of disposal typically include:
  - i. Direct selling costs such as outbound transportation (e.g., freight, shipping and handling), packaging, off-site storage costs, certain marketing costs, and sales commissions or bonuses incurred pre-valuation date.
  - ii. A portion of the overhead operating expenses of the business related to the selling effort (such as G&A and corporate overhead).
- b. Costs of disposal should exclude any expenses that are intended to provide future economic benefit and are not necessary to generate the current period revenue (e.g., R&D expenses).

3. Costs to complete WIP

- a. The Boards note that estimating the cost to complete WIP relies on a similar line-by-line analysis as the costs of disposal analysis. In practice the costs can be bifurcated into the completed portion that relates to the buying and manufacturing effort for the WIP already incurred pre-valuation date versus those costs that relate to the remaining incremental effort to be incurred for the WIP post-valuation date to bring it to the finished state. The percentage complete may be analysed individually for each expense line item: COGS, operating expenses, and the associated overhead.
- b. For COGS, the efforts remaining to complete is only applicable to the portion which is not related to materials. Since raw materials are usually added at the beginning of the manufacturing process, WIP typically includes the full amount of material cost related to the final product and, in this case, no additional purchases of materials would be required to complete the WIP. However, this assumption should be validated for accuracy and any costs associated with purchases or components should be added to the cost to complete as needed.
- c. For COGS, the percentage of complete assumption is often difficult to determine in practice. Given that portions of a manufacturing entity's WIP may be at various stages of completion at a given time, the Boards have observed that an assumption is sometimes made that on average WIP is 50 percent complete.



4. Reasonable profit allowance
  - a. The Boards note that in practice the total company profit margin on costs is typically used (i.e., EBIT or operating profit). However, in certain circumstances there may be rationale to assume different profit margins for the efforts done pre valuation date versus the efforts post valuation date. For instance, in some cases the risks assumed, value added, or intangibles contributed to the inventory pre-valuation date may not be the same as those contributed post-valuation date, thus potentially warranting different margin assumptions.
  - b. In particular, it is relevant to consider whether intellectual property (IP) has been contributed to the inventory pre or post valuation date.
5. Holding/Opportunity Costs
  - a. The Boards note that holding costs may need to be estimated in order to account for the opportunity cost associated with the time required to sell the inventory. The Boards note there is divergence in practice on the inclusion of holding costs.
6. Other issues
  - a. Pre-sold inventory – There is diversity in practice about whether pre-sold inventory should be valued higher than unsold inventory.
    - i. The rationale for valuing pre-sold inventory higher is that certain selling and marketing costs have already been incurred pre-valuation date and therefore it is not necessary to incur these costs post-valuation date.
    - ii. The rationale for valuing pre-sold inventory the same as unsold inventory is that pre-sold inventory should be valued assuming the same selling cost as unsold inventory, but the benefit of having pre-sold inventory should be captured in the backlog intangible asset when valued in a business combination.
  - b. Benefits from IP – In cases where there is IP, such as a valuable brand or technology, which contributes to a higher inventory selling price than selling prices for similar inventory without the IP. There is diversity in practice on whether a charge (i.e., royalty expense) should be included in the costs to dispose and complete calculations, so as not to attribute intangible value to the inventory. Specifically, there has been diversity in practice whether the benefit of such IP should lead to a higher inventory fair value or whether this benefit should be captured in the value of the IP. Additionally, consideration should be taken to consider at what point in the production process the IP is contributed, in order to determine if the benefits of the IP should go to the target or if a charge should be taken in the costs to complete or of disposal.



- c. Reconciliation with bottoms-up approach – While less commonly used in practice, the bottom-up approach considers the costs incurred to date when valuing WIP and finished goods, and assigns returns based on those efforts. The value derived based on the Bottom-up Approach should be the same as the value derived using the Top-down Approach.

### Potential Standard Alternatives

As noted above, as compared to other topics in this ITC the Boards see more limited diversity in practice with regard to the valuation of inventory. As such, the practical alternatives for Standards are more easily defined.

#### **Alternative A – Performance Framework for Comparative Sales Method**

Rather than provide prescriptive guidance on the application of the Comparative Sales Method, Alternative A would set out minimum thresholds for the extent of investigation, analysis, and documentation related to the inputs into Comparative Sales Method. Consistent with IVS 210 Intangible Assets, future standards could outline the Comparative Sales Method, identify the key considerations and inputs, and develop a performance framework around such.

#### **Alternative B – Unknown**

At this point the Boards have not identified additional alternatives, pending comments and suggestions from this ITC.

### Questions for Respondents

**Question 6.1:** Should IVS provide separate standards for valuing inventory? Please explain why.

**Question 6.2:** What methods for the valuation of inventory do you most commonly see used in practice?

**Question 6.3:** Do you agree with the decision to focus on the application of the Comparative Sales Method? If not, please discuss the other methods that should be included in the performance framework.



## *Consultation Paper: Financial Reporting for Heritage in the Public Sector*

This is an overview of the Consultation Paper (CP), *Financial Reporting for Heritage in the Public Sector*.

### **Project objectives:**

This Consultation Paper (CP) asks constituents for their views on financial reporting for heritage in the public sector. The objective is to:

- Improve financial reporting for heritage by public sector entities; and
- Support the comparability of heritage-related information in general purpose financial reports (GPFRs), while providing information that users need for accountability and decision making.

This is the first step towards guidance on heritage information in GPFRs.

### **The project stage:**

The IPSASB issued this CP in April 2017.

### **Next steps:**

The IPSASB seeks feedback to develop guidelines on recognition, measurement and presentation for heritage.

### **Comment deadline:**

The CP is open for public comment until September 30, 2017.

### **How to respond:**

Respondents are asked to submit their comments electronically through the IPSASB website, using the "[Submit a Comment](#)" link on the CP page. Please submit comments in both a PDF and Word file. All comments will be a matter of public record and will be posted on the website.

## Why has the IPSASB issued this Consultation Paper?

The IPSASB aims to improve financial reporting for heritage in the public sector, by considering the type of information that should be reported about heritage items and heritage-related responsibilities, including approaches to their recognition and measurement.

The holding of heritage items is a distinguishing feature of the public sector. Public sector entities preserve heritage on behalf of present and future generations. GPFR users may need information to:

- Hold entities accountable for their preservation of heritage items; and
- Make decisions on resources needed for heritage preservation.

Constituents indicated, in their responses to the IPSASB's 2014 strategy and work plan consultation, that better coverage of financial reporting for heritage should be an IPSASB priority.

IPSAS presently allows entities to report on heritage items using different practices. There are inconsistent practices with respect to classifying items as heritage. Heritage items may or may not be recognized in an entity's financial statements and different measurement approaches are used. This diversity has negative consequences for the public interest because it reduces the comparability of information reported in the financial statements.

This CP discusses financial reporting for heritage. It is an important step towards determining the appropriate reporting for heritage in the public sector. It is underpinned by *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the Conceptual Framework).

In this CP the IPSASB asks for constituents' views on:

- Identification of heritage items;
- Whether heritage items are assets for financial reporting purposes;
- Heritage asset recognition and measurement;
- Whether heritage-related obligations could be liabilities for financial reporting purposes; and
- Presentation of information on heritage items and related responsibilities.



## What are heritage items?

*Description:* Heritage items are items that are intended to be held indefinitely and preserved for the benefit of present and future generations because of their rarity and/or significance.

**IPSASB's preliminary view:** Chapter 2 of the CP has the IPSASB's preliminary view on a description of heritage items that reflects their special characteristics and distinguishes them from other phenomena for the purposes of financial reporting.

**Heritage items' rarity and/or significance** are in relation, but not limited, to their archeological, architectural, agricultural, artistic, cultural, environmental, historical, natural, scientific or technological features.

**Categories of heritage items:** Heritage items could be cultural or natural heritage. Cultural heritage consists of man-made items that could be either tangible or intangible.

**Tangible cultural heritage:** Examples include:

- Monuments, archaeological sites, historic buildings, works of art, and scientific collections;
- Underwater cultural heritage, for example, underwater buildings or sunken ships; and
- Natural history collections such as collections of insects, or mineral collections.

**Intangible cultural heritage** consists of:

- *Knowledge-in-action:* Practices, representations, expressions, knowledge; and skills that are heritage items. Examples include languages and rituals.
- *Intellectual property* such as rights over recordings of significant historical events.

**Natural heritage** covers natural features or areas. Examples include mountains, lakes and waterfalls.

## Are heritage items assets?

The special characteristics of heritage items do not prevent them from being considered as assets.

### Heritage items as assets

**IPSASB's preliminary view:** Chapter 3 of the CP has the IPSASB's preliminary view that the special characteristics of heritage items do not prevent them from being considered as assets for the purposes of financial reporting.

**Conceptual Framework:** This preliminary view draws on the Conceptual Framework, which defines an asset to be "a **resource** presently controlled by the entity as a result of a past event".

**Resource:** A resource is an item with service potential or the ability to generate economic benefits:

- Service potential is the capacity to provide services that contribute to achieving the entity's objectives, without necessarily generating net cash inflows.
- Economic benefits are cash inflows or a reduction in cash outflows, which may be derived from, for example, an asset's use in the production and sale of services.

### Heritage items as controlled resources

**Service potential** could arise, for example, when an entity that holds heritage items:

- Has objectives that include heritage-related services such as providing access to heritage items; or
- Uses heritage items to provide services independent of their heritage characteristics. For example, a heritage building used for offices.

**Economic benefits** could arise, for example, when an entity that holds heritage items:

- Uses them in the production and sale of services;
- Sells tickets to view the heritage items; or
- Loans or rents them to other entities.

**Control over a heritage resource** exists if the entity:

- Can demonstrate legal ownership (for example through a purchase document);
- Has other enforceable rights; and/or
- Can direct its use to achieve its objective.

## Should heritage assets be recognized in the financial statements?

**Recognition:** Heritage assets should be recognized in the statement of financial position if they meet the recognition criteria.

**Measurement:** In many cases it will be possible to assign a monetary value to heritage assets.

**Subsequent measurement of heritage assets** is broadly the same as subsequent measurement for other, non-heritage assets.

### Recognition of heritage assets

**IPSASB's preliminary views:** Chapter 4 of the CP includes the IPSASB's preliminary views on recognition and measurement of heritage assets. Chapter 5 has its preliminary view on subsequent measurement.

**Recognition** involves existence of an asset and an ability to measure the asset.

**Measurement** of heritage assets involves:

- Attachment of a monetary value;
- Choice of an appropriate measurement basis that meets the measurement objective; and
- Determination of whether measurement achieves the qualitative characteristics, taking into account the constraints on information.

The **measurement objective** is to select those measurement bases that most fairly reflect the entity's:

- Cost of services,
- Operational capacity, and
- Financial capacity.

### Measurement bases

Three measurement bases are identified to attach a monetary value to heritage assets:

- Historical cost;
- Market value; and
- Replacement cost.

### Measurement objective and heritage assets

Initial measurement of heritage assets could provide useful information to assess:

- *Cost of services:* For example, the initial asset expenditure provides useful information about the cost of services where heritage assets are being used over time or restored to build a current collection.
- *Operational capacity:* Information on the monetary value of heritage assets may be useful to assess resources available for the entity's operations, including service delivery.
- *Financial capacity:* Heritage assets can appreciate in value over time or generate cash flows through, for example, access fees. The monetary value of heritage assets could be relevant to assessments of financial position.

## Heritage-related obligations

The special characteristics of heritage items do not, of themselves, result in a present obligation such that an entity has little or no realistic alternative to avoid an outflow of resources.

### **Preservation of heritage items and obligations**

**Preservation of heritage items:** The CP considers whether an intention to preserve heritage items for present and future generations could give rise to a present obligation.

**Existence of a present obligation:** The CP draws on the Conceptual Framework to consider this question, and notes that:

- A moral duty to preserve heritage items does not, by itself, give rise to a present obligation.
- A present obligation is binding, so that the entity has little or no realistic alternative to avoid it.
- An obligation must be to an external party.

### **Outflows of resources**

Liabilities must involve both a present obligation and an outflow of resources. Chapter 6 of the CP notes that:

- Heritage items often involve outflows of resources to preserve heritage items for present and future generations.
- There could be *deferred* outflows of resources, by comparison to an agreed cycle of maintenance, for example.
- An ability to defer preservation resource outflows suggests that there is no present obligation.

### **Heritage-Related Past Events**

There appears to be no reason why events that could indicate existence of an obligation should be accounted for in a different way, special to heritage.

## Presentation of heritage-related information

Information on heritage items should be presented in line with existing IPSASB pronouncements.

### Presentation of information on heritage items

The CP discusses whether the special characteristics of heritage items warrant special presentation.

Chapter 7 of the CP proposes that:

- The special characteristics of heritage items do not warrant presentation objectives specific to heritage.
- Existing IPSASB pronouncements, including Recommended Practice Guidelines can be applied.
- Materiality is considered when deciding:
  - Whether a line item for heritage assets should be displayed on the face of the financial statements; and
  - What information to disclose in the notes to the financial statements.

### Heritage-related information

**Heritage assets:** Information on heritage assets might include:

- The main types of assets;
- How they are measured; and
- Resource outflows and inflows as a result of holding, acquiring and disposing of heritage assets.

**Financial statements discussion and analysis:** An entity could present information in its financial statements discussion and analysis or another GPFR.

The information presented on heritage could help users to understand the:

- Effect of heritage items on entity's operational capacity, cost of services and financial capacity;
- Extent of heritage holdings and heritage-related expenses; and
- Heritage custodial responsibilities and legislation on such responsibilities.

## Next Steps

The deadline for comments is September 30, 2017.

During the comment period, IPSASB members are available to discuss the proposals with a wide range of parties.

### How can I comment on the proposals?

The CP requests comments on both the Preliminary Views and the Specific Matters for Comment.

Respondents may provide comments and answers on all the Preliminary Views and all Specific Matters for Comment or just selected views or matters for comment. They are also welcome to comment on any other matter they think the IPSASB should consider in forming its views.

Respondents are asked to submit their comments electronically through the IPSASB website, using the **"Submit a Comment"** link. Please submit comments in both a PDF and Word file.

All comments will be considered a matter of public record and will be posted on the IPSASB website.

The IPSASB will consider all feedback and discuss responses at its public meetings after the comment period has ended.

### Stay informed

The IPSASB's website will indicate the meetings at which feedback on the CP will be discussed. The dates, and, where known, the locations of 2017 and 2018 meetings are at:

<http://www.ipsasb.org/meetings>

To stay up to date about the project, please visit:

<http://www.ipsasb.org/projects/heritage>

**Consultation Paper**  
**April 2017**  
*Comments due: September 30, 2017*

IPSAS®

*Proposed International Public Sector  
Accounting Standard®*

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# Financial Reporting for Heritage in the Public Sector

IPSASB

International Public  
Sector Accounting  
Standards Board®

This document was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening the transparency and accountability of public sector finances.

In meeting this objective, the IPSASB sets International Public Sector Accounting Standards™ (IPSAS™) and Recommended Practice Guidelines (RPGs) for use by public sector entities, including national, regional, and local governments, and related governmental agencies.

IPSAS relate to the general purpose financial statements (financial statements) and are authoritative. RPGs are pronouncements that provide guidance on good practice in preparing general purpose financial reports (GPFRs) that are not financial statements. Unlike IPSAS, RPGs do not establish requirements. Currently all pronouncements relating to GPFRs that are not financial statements are RPGs. RPGs do not provide guidance on the level of assurance (if any) to which information should be subjected.

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## Executive Summary

Currently there are a variety of practices for the financial reporting of heritage in different jurisdictions. IPSAS 17, *Property, Plant and Equipment*, allows public sector entities to choose the accounting approach they use, including whether to recognize heritage items as assets in the financial statements and, if so, the measurement base applied. This diversity reduces comparability between public sector entities. Financial reporting practices may not provide the information that users of general purpose financial reports (GPFRs) need for accountability and decision making.

This Consultation Paper (CP) asks constituents for their views on financial reporting for heritage in the public sector. Views will support the IPSASB's work to consider the need to develop additional guidance on financial reporting for heritage, in order to meet the needs of users of GPFRs for information for the purposes of accountability and decision making.

For the purposes of this CP, heritage items are described as "items that are intended to be held indefinitely and preserved for the benefit of present and future generations because of their rarity and/or significance in relation, but not limited, to their archeological, architectural, agricultural, artistic, cultural, environmental, historical, natural, scientific or technological features."

This CP discusses whether heritage items meet the definition of an asset and whether they can be measured and recognized in the financial statements. This CP also considers whether heritage preservation responsibilities could involve present obligations for entities, which should be recognized as liabilities in the financial statements. It discusses presentation of information for heritage in financial statements and other GPFRs.

The CP proposes that the special characteristics of heritage items do not prevent them from being considered as assets for the purposes of financial reporting, and that they should be recognized in the statement of financial position if they meet the recognition criteria in the Conceptual Framework. In many cases it will be possible to assign a monetary value to heritage assets. Appropriate measurement bases are historical cost, market value and replacement cost. Subsequent measurement of heritage assets can be approached in broadly the same way as subsequent measurement for other, non-heritage assets.

The CP also proposes that an intention to preserve heritage items for present and future generations, does not, of itself, result in a present obligation such that an entity has little or no realistic alternative to avoid an outflow of resources and should therefore recognize a liability. An entity should present heritage-related information in line with existing IPSASB pronouncements.

## REQUEST FOR COMMENTS

This Consultation Paper, *Financial Reporting for Heritage in the Public Sector*, was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

### **Comments are requested by September 30, 2017**

Respondents are asked to submit their comments electronically through the IPSASB website, using the “Submit a Comment” link. Please submit comments in both a PDF and Word file. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will be posted on the IPSASB website. This publication may be downloaded from the IPSASB website: [www.ipsasb.org](http://www.ipsasb.org). The approved text is published in the English language.

### **Guide for Respondents**

The IPSASB welcomes comments on all of the matters discussed in this Consultation Paper, including all Preliminary Views (PVs) and Specific Matters for Comment (SMCs). Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate and contain a clear rationale.

The PVs and SMCs in this Consultation Paper are provided below. Paragraph numbers identify the location of the PV or SMC in the text.

#### **Specific Matters for Comment—Chapter 1 (following paragraph 1.8)**

Do you agree that the IPSASB has captured all of the characteristics of heritage items and the potential consequences for financial reporting in paragraphs 1.7 and 1.8?

If not, please give reasons and identify any additional characteristics that you consider relevant.

#### **Preliminary View—Chapter 2.1 (following paragraph 2.11)**

For the purposes of this CP, the following description reflects the special characteristics of heritage items and distinguishes them from other phenomena for the purposes of financial reporting:

Heritage items are items that are intended to be held indefinitely and preserved for the benefit of present and future generations because of their rarity and/or significance in relation, but not limited, to their archeological, architectural, agricultural, artistic, cultural, environmental, historical, natural, scientific or technological features.

Do you agree with the IPSASB’s Preliminary View? If not, please provide your reasons.

#### **Preliminary View—Chapter 2.2 (following paragraph 2.12)**

For the purposes of this CP, natural heritage covers areas and features, but excludes living plants and organisms that occupy or visit those areas and features.

Do you agree with the IPSASB’s Preliminary View? If not, please provide your reasons.

#### **Preliminary View—Chapter 3 (following paragraph 3.11)**

The special characteristics of heritage items do not prevent them from being considered as assets for the purposes of financial reporting.

Do you agree with the IPSASB’s Preliminary View? If not, please provide your reasons.

**Specific Matters for Comment—Chapter 4.1 (following paragraph 4.17)**

Do you support initially recognizing heritage assets at a nominal cost of one currency unit where historical cost is zero, such as when a fully depreciated asset is categorized as a heritage asset then transferred to a museum at no consideration, or an entity obtains a natural heritage asset without consideration?

If so, please provide your reasons.

**Preliminary View—Chapter 4.1 (following paragraph 4.40)**

Heritage assets should be recognized in the statement of financial position if they meet the recognition criteria in the Conceptual Framework.

Do you agree with the IPSASB's Preliminary View? If not, please provide your reasons.

**Specific Matters for Comment—Chapter 4.2 (following paragraph 4.40)**

Are there heritage-related situations (or factors) in which heritage assets should not initially be recognized and/or measured because:

- (a) It is not possible to assign a relevant and verifiable monetary value; or
- (b) The cost-benefit constraint applies and the costs of doing so would not justify the benefits?

If yes, please describe those heritage-related situations (or factors) and why heritage assets should not be recognized in these situations.

**Preliminary View—Chapter 4.2 (following paragraph 4.40)**

In many cases it will be possible to assign a monetary value to heritage assets. Appropriate measurement bases are historical cost, market value and replacement cost.

Do you agree with the IPSASB's Preliminary View? If not, please provide your reasons.

**Specific Matters for Comment—Chapter 4.3 (following paragraph 4.40)**

What additional guidance should the IPSASB provide through its Public Sector Measurement Project to enable these measurement bases to be applied to heritage assets?

**Preliminary View – Chapter 5 (following paragraph 5.14)**

Subsequent measurement of heritage assets:

- (a) Will need to address changes in heritage asset values that arise from subsequent expenditure, consumption, impairment and revaluation.
- (b) Can be approached in broadly the same way as subsequent measurement for other, non-heritage assets.

Do you agree with the IPSASB's Preliminary View? If not, please provide your reasons.

**Specific Matters for Comment—Chapter 5 (following paragraph 5.14)**

Are there any types of heritage assets or heritage-related factors that raise special issues for the subsequent measurement of heritage assets?

If so, please identify those types and/or factors, and describe the special issues raised and indicate what guidance IPSASB should provide to address them.

**Preliminary View—Chapter 6 (following paragraph 6.10)**

The special characteristics of heritage items, including an intention to preserve them for present and future generations, do not, of themselves, result in a present obligation such that an entity has little or no realistic alternative to avoid an outflow of resources. The entity should not therefore recognize a liability.

Do you agree with the IPSASB's Preliminary View? If not, please provide your reasons.

**Preliminary View—Chapter 7 (following paragraph 7.9)**

Information about heritage should be presented in line with existing IPSASB pronouncements.

Do you agree with the IPSASB's Preliminary View? If not, please provide your reasons and describe what further guidance should be provided to address these.

# FINANCIAL REPORTING FOR HERITAGE IN THE PUBLIC SECTOR

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## Chapter 1, Introduction to Financial Reporting for Heritage in the Public Sector

### Introduction

- 1.1 *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the Conceptual Framework) identifies the holding of heritage items as a distinguishing feature of the public sector<sup>1</sup>. This consultation paper (CP) discusses financial reporting for heritage in the public sector and considers different approaches to address the information needs of users of general purpose financial reports (GPFRs), as a basis for consultation with those interested in how GPFRs can support accountability and decision making for heritage. Where the IPSASB has reached a preliminary view on a heritage-related financial reporting issue, the view is provided, along with discussion to explain how the IPSASB reached its view.

### The IPSASB's Heritage Project

- 1.2 The IPSASB first considered heritage accounting during development of IPSAS 17, *Property, Plant and Equipment* (IPSAS 17), which includes paragraphs on accounting for heritage assets. IPSAS 17 describes heritage assets and allows entities to recognize them. If an entity recognizes some or all of its heritage assets, then it needs to make disclosures identified in the Standard. However, entities are not required to apply IPSAS 17's measurement requirements. The IPSASB took a similar approach in IPSAS 31, *Intangible Assets* (IPSAS 31), which has paragraphs on accounting for intangible heritage assets, based on those in IPSAS 17. In effect, the IPSASB's approach in these two Standards acknowledged the difficult financial reporting issues raised by heritage items, and allowed preparers to determine how to account for heritage until this topic could be considered in depth.
- 1.3 In 2004 the IPSASB commenced a heritage assets project in collaboration with the United Kingdom's Accounting Standards Board (the ASB-UK). A CP, *Accounting for Heritage Assets under the Accrual Basis of Accounting*, was published in February 2006. The CP consisted of a discussion paper developed and approved by the ASB-UK, with an introduction and preface developed by the IPSASB's Heritage Assets Subcommittee. After reviewing submissions in late 2006, the IPSASB decided to defer further work until completion of its Conceptual Framework.
- 1.4 After completion of the Conceptual Framework in 2014, the IPSASB decided to reconsider financial reporting for heritage in the public sector. IPSASB constituents had indicated, in response to the 2014 strategy and work plan consultation, that developing coverage of financial reporting for heritage in its pronouncements should be an IPSASB priority.

### Challenges of Financial Reporting for Heritage

- 1.5 Worldwide there are different views on what items are heritage items; whether heritage items are assets or liabilities for financial reporting purposes; whether they should be recognized in the financial statements; and, if recognized, how they should be measured. Standard setters have also had different views on the presentation of information about heritage items, where presentation covers both:
- (a) Enhanced disclosures in the financial statements; and,

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<sup>1</sup> See, for example, paragraph 15 of the preface to the Conceptual Framework.

- (b) Presentation of information in other general purpose financial reports (GPFRs) that provide information which enhances, complements, and supplements the financial statements.
- 1.6 The financial reporting challenges may vary between countries. These challenges include the extent of funding available for heritage valuation, availability of valuation expertise and the place of heritage within competing government priorities. The main type of heritage for some countries could be natural heritage, while for others the primary focus could be historic buildings, infrastructure and artifacts dating back thousands of years.

### *Characteristics of Heritage Items*

- 1.7 Characteristics of heritage items include that:
- (a) They are often irreplaceable;
  - (b) There are often ethical, legal and/or statutory restrictions or prohibitions that restrict or prevent sale, transfer or destruction by the holder or owner; and
  - (c) They are expected to have a long, possibly indefinite, useful life due to increasing rarity and/or significance.
- 1.8 These characteristics of heritage items may have consequences for financial reporting for heritage in the following areas:
- (a) *Measurement*: Is it possible to measure heritage items in a way that reflects their service potential or their ability to generate economic benefits?
  - (b) *Value*: If assignment of monetary values does not convey the heritage significance of heritage items or their future claims on public resources, would users of GPFRs benefit more from non-financial information about heritage items, reported outside the financial statements?
  - (c) *Preservation*: If an entity's responsibility is to preserve heritage items rather than to generate cash flows from them, are heritage items resources or obligations from the entity's perspective?
  - (d) *Restrictions on use*: Given restrictions on entities' ability to use, transfer or sell heritage items, should heritage items be shown as assets in the financial statements?
  - (e) *Benefits to others*: Can a reporting entity be said to control a heritage item for financial reporting purposes, when it is held for the benefit of current and future generations?

### **Specific Matters for Comment—Chapter 1**

Do you agree that the IPSASB has captured all of the characteristics of heritage items and the potential consequences for financial reporting in paragraphs 1.7 and 1.8?

If not, please give reasons and identify any additional characteristics that you consider relevant.

### **The Public Interest and Financial Reporting for Heritage**

- 1.9 Given these financial reporting challenges and the special characteristics of heritage, the question arises of what heritage-related information users of GPFRs need for the purposes of accountability and decision making. Users may need information to:
- (a) Hold entities accountable for their preservation of heritage items; and
  - (b) Make decisions on resources needed for heritage preservation.



- 1.10 The purpose for which an entity holds heritage items could impact on the information that users of GPFRs need. For example, where an entity uses heritage items in its operations, users may need information for decision making on the entity's operational capacity and cost of services. This could have implications for information available to users for the purposes of accountability and decision making related to the entity as a whole.
- 1.11 As noted in paragraph 1.2 above, IPSAS presently allows entities to report on heritage items using different financial reporting practices. Worldwide there are inconsistent practices with respect to categorization of assets as either heritage or non-heritage, heritage items may or may not be recognized in an entity's financial statements and a variety of different measurement approaches are used. This has negative consequences for the public interest because it reduces the comparability of information reported.
- 1.12 This CP discusses financial reporting for heritage in light of constituents' concerns. It considers whether or not additional financial reporting requirements and/or guidelines are necessary, including scope for information in the financial statements and/or in other GPFRs. The IPSASB will take decisions on the nature and extent of any additional requirements in the context of feedback from constituents.

### **Approach in this Consultation Paper**

- 1.13 This CP draws on the Conceptual Framework to discuss financial reporting for heritage in the public sector. It considers what heritage-related information users of GPFRs need for the purposes of accountability and decision making, where such information should achieve the qualitative characteristics of information reported in GPFRs<sup>2</sup>. This CP draws on the Conceptual Framework's coverage of element definition, recognition and measurement, to consider whether heritage items could result in elements that should be recognized in the financial statements. Financial statement presentation issues are also discussed, drawing on the Conceptual Framework's approach to presentation, whereby presentation in the financial statements encompasses both the display and disclosure of information. Although this CP's primary focus is on information presented in the financial statements, it also notes scope to present information in other GPFRs, for example service performance information reported when an entity has heritage-related service performance objectives.
- 1.14 While the Conceptual Framework underpins this CP's consideration of financial reporting for heritage in the public sector, the IPSASB has also considered national standard setters' and the IPSASB's own pronouncements. In addition to IPSAS 17 and IPSAS 31, IPSAS 19, *Provisions, Contingent Assets and Contingent Liabilities* and the IPSASB's recommended practice guidelines (RPGs), which address information in other GPFRs, have been considered for their relevance to this project.

### **Structure of this Consultation Paper**

- 1.15 This CP covers financial reporting for heritage in the following order:
- (a) Chapter 2 describes heritage items and discusses issues related to their identification;

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<sup>2</sup> The qualitative characteristics of information included in GPFRs are the attributes that make that information useful to users and support the achievement of the objectives of financial reporting. The qualitative characteristics are relevance, faithful representation, understandability, timeliness, comparability, and verifiability. (See paragraphs 3.1 and 3.2 of the Conceptual Framework.)

- (b) Chapter 3 discusses whether or not heritage items could be assets for financial reporting purposes;
- (c) Chapter 4 discusses the recognition and initial measurement of heritage assets;
- (d) Chapter 5 examines subsequent measurement;
- (e) Chapter 6 considers obligations related to heritage items and discusses their recognition and measurement; and
- (f) Chapter 7 discusses presentation of information on heritage items in the financial statements and in other GPFRs.

## Chapter 2, Descriptions of Heritage

### Introduction

- 2.1. This chapter considers what heritage is, discusses heritage identification issues, and then proposes a description of “heritage items”, as a basis for subsequent discussion of financial reporting for heritage in the public sector. This chapter does not consider whether heritage items are assets from the perspective of a reporting entity, which is discussed in Chapter 3.

### Heritage

- 2.2. There are different views on what is meant by “heritage” and, consequently, what things should be identified as heritage items. United Nations Educational, Scientific and Cultural Organization (UNESCO) international conventions for heritage protection have defined heritage and different categories of heritage<sup>3</sup>. These definitions emphasize the importance, significance and/or value of heritage items, highlighting their sacred or historic nature and their rarity. 192 countries have ratified the UNESCO convention on protection of world heritage sites<sup>4</sup> and therefore the UNESCO meaning of heritage would appear to be widely accepted.
- 2.3. UNESCO classifies heritage as cultural and natural. The remainder of the discussion in this chapter uses these UNESCO categories as a basis for developing a description of heritage items for the purpose of financial reporting.

### Cultural Heritage

- 2.4. Cultural heritage consists of man-made heritage items that could be either tangible or intangible. Examples of tangible cultural heritage include:
- (a) Monuments, archaeological sites, historic buildings, works of art, and scientific collections;
  - (b) Underwater cultural heritage, for example, buildings that are beneath the water or sunken ships; and
  - (c) Natural history collections such as collections of insects, or mineral collections.
- 2.5. UNESCO defines intangible cultural heritage as, what this CP will call, “knowledge-in-action”. To align with financial reporting terminology, this CP also considers “intellectual property” as a second type of intangible cultural heritage:
- (a) Knowledge-in-action consists of practices, representations, expressions, knowledge; and skills that are heritage items. Examples include languages, performing arts, rituals, and traditional craftsmanship.
  - (b) Intellectual property includes rights over recordings of significant historical events and rights to use culturally significant films.

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<sup>3</sup> Article 1, 1954 *Convention for the Protection of Cultural Property in the Event of Armed Conflict with Regulations for the Execution of the Convention* defines “cultural property”, as does Article 1 of the 1970 *Convention on the Means of Prohibiting and Preventing the Illicit Import, Export and Transfer of Ownership of Cultural Property*. Article 1 of the 1972 *Convention on Protecting the World Cultural and Natural Heritage* defines “cultural heritage” and “natural heritage”. Article 1, 2001 *Convention on Safeguarding the Underwater Cultural Heritage*, defines “underwater cultural heritage”. Article 2, 2003 *Convention on Safeguarding the Intangible Cultural Heritage*, defines “intangible cultural heritage”.

<sup>4</sup> 1972 *Convention on Protecting the World Cultural and Natural Heritage*

## Natural Heritage

- 2.6. Natural heritage covers natural features or areas. Examples include natural features such as mountains, naturally occurring rock formations, and bodies of water such as lakes or waterfalls.

## Heritage Item Identification Issues

- 2.7. Some jurisdictions have developed different ways to identify heritage items. For example:
- (a) Schedules or lists enshrined in legislation or regulation;
  - (b) Criteria or principles enshrined in legislation or regulation;
  - (c) A defined review and approval process, involving expert recommendation and independent review; or
  - (d) A combination of two or more of the three approaches above.
- 2.8. However, reliance only on legislation that identifies specific items as heritage presents two potential problems:
- (a) A legislated list of heritage items could either exclude items that are, in substance, heritage items, or include items that are not, in substance, heritage items. For example, legislation may list only those heritage items that warrant special funding or a special level of protection, so that other heritage items are not listed.
  - (b) A legislated list may not remain up-to-date. For example, “new” heritage items may be identified and not be captured by the list, because, after enactment of the legislation, they are:
    - (i) Purchased or received through donation;
    - (ii) Discovered, for example through excavations that uncover previously unknown heritage items or through reassessments of items that were not viewed as heritage items; or
    - (iii) Created, for example through construction of an iconic building.
- 2.9. Given these problems with legislated lists of heritage items, other sources of information are needed to provide comprehensive and verifiable information on whether items are heritage items, such as:
- (a) Expert knowledge;
  - (b) Historical studies, research writings and media reports; or
  - (c) Established policies, systems and/or structures, which indicate that an entity expects to hold and preserve the item for present and future generations as a heritage item.
- 2.10. Although there is a view that identification of heritage items should be based on legislation, global disparities in approach mean that developing a description of heritage items for financial reporting purposes is necessary. This description identifies the special characteristics of heritage items that distinguish them.

## Description of Heritage Items

- 2.11. Given the special characteristics of heritage identified in the UNESCO conventions, and the discussion above on a principles-based approach to identification of heritage items, the IPSASB has developed the following preliminary view:

**Preliminary View—Chapter 2.1**

For the purposes of this CP, the following description reflects the special characteristics of heritage items and distinguishes them from other phenomena for the purposes of financial reporting:

Heritage items are items that are intended to be held indefinitely and preserved for the benefit of present and future generations because of their rarity and/or significance in relation, but not limited, to their archeological, architectural, agricultural, artistic, cultural, environmental, historical, natural, scientific or technological features.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons.

2.12. UNESCO conventions include living plants and organisms within natural heritage. However, individual living plants and organisms cannot be held indefinitely and preserved for present and future generations, and do not meet the proposed description of heritage items. On this basis they are excluded from further discussion in this CP.

**Preliminary View—Chapter 2.2**

For the purposes of this CP, natural heritage covers areas and features, but excludes living plants and organisms that occupy or visit those areas and features.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons.

## Chapter 3, Heritage Items as Assets

### Introduction

- 3.1. This chapter considers whether heritage items could be assets for financial reporting purposes. The Conceptual Framework states that an asset is “a resource presently controlled by the entity as a result of a past event<sup>5</sup>.” This chapter discusses each of these three aspects (resources, control and past event) in the context of heritage items, focusing particularly on the resource and control aspects. Where an asset exists it must also be measurable, before it can be recognized in financial statements, and this is considered in Chapter 4.

### Heritage Items as Resources

- 3.2. The Conceptual Framework states that a resource is an item with service potential or the ability to generate economic benefits<sup>6</sup>. Service potential is the capacity to provide services that contribute to achieving the entity’s objectives, without necessarily generating net cash inflows<sup>7</sup>. Economic benefits are cash inflows or a reduction in cash outflows<sup>8</sup>, which may be derived from, for example, an asset’s use in the production and sale of services<sup>9</sup>. Heritage items appear more likely to be held for their service potential rather than their ability to generate economic benefits<sup>10</sup>. Therefore, the discussion below focuses primarily on service potential.
- 3.3. Public sector entities’ objectives can include providing services either directly or indirectly to individuals or institutions. The objectives of an entity holding heritage items may include, for example:
- (a) Providing access to heritage items directly to individuals (for their education, appreciation, etc.);
  - (b) Holding heritage items indefinitely in a custodial capacity;
  - (c) Preserving heritage items to benefit the whole community; or
  - (d) Promoting heritage-related tourism.
- 3.4. Heritage items may also provide services that contribute to achievement of an entity’s objectives, for reasons other than their heritage characteristics. For example, a heritage building can be used as office space.

### *Heritage Items with Ability to Generate Economic Benefits*

- 3.5. Some heritage items may be able to generate economic benefits for the reporting entity. Economic benefits could arise, for example, through one or more of the following:
- (a) Use of the heritage item in the production and sale of services;
  - (b) Sale of tickets to view the heritage items and/or sale of related merchandising; and
  - (c) Loan or rent of the item to other entities.

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<sup>5</sup> Paragraph 5.6 of the Conceptual Framework.

<sup>6</sup> Paragraph 5.7 of the Conceptual Framework.

<sup>7</sup> Paragraph 5.8 of the Conceptual Framework.

<sup>8</sup> Paragraph 5.10 of the Conceptual Framework.

<sup>9</sup> Ibid.

<sup>10</sup> The Conceptual Framework refers to heritage assets in its discussion of service potential in paragraph 5.9.

**Control of a Heritage Resource**

- 3.6. The Conceptual Framework states that: “Control of the resource entails the ability of the entity to use the resource (or direct other parties on its use) so as to derive the benefit of the service potential or economic benefits embodied in the resource in the achievement of its service delivery or other objectives<sup>11</sup>.”
- 3.7. An entity is likely to have the ability to control heritage resources when it can demonstrate some or all of the following:
- (a) Legal ownership—for example through a purchase document or deed of transfer, etc.
  - (b) Other enforceable rights given to an entity that give it the ability to access or deny or restrict access. For example, an entity might:
    - (i) Decide whether to set an entrance fee to a museum and deny access to those who do not pay the fee;
    - (ii) Prohibit the use of a public square for commercial purposes; or
    - (iii) Grant other entities limited reproduction rights to a heritage film or audio-recording.
  - (c) Direct the use of heritage resources to achieve the entity’s objectives, as discussed in paragraphs 3.3 and 3.4.

**Inability to Control Knowledge-in-Action Intangible Cultural Heritage**

- 3.8. As explained in Chapter 2, one subcategory of intangible cultural heritage called “knowledge-in-action” consists of heritage items such as languages, performing arts, rituals, and traditional craftsmanship. These heritage items require continued use or enactment by living people to exist and be preserved for future generations. They fall into the description of a heritage item, but they cannot be controlled by a single entity. This is because an entity cannot gain legal ownership over people’s on-going enactment of this type of cultural heritage, cannot restrict or deny access, cannot use the resource to achieve its objectives (except in the sense that something such as a shared language is a resource for everyone’s use) and it is impossible to hold an enforceable right to service potential or the ability to generate economic benefits arising from this type of heritage item. Knowledge-in-action intangible cultural heritage is “owned” by a whole community. Therefore, because it cannot be controlled by an entity, this type of intangible cultural heritage does not meet the definition of an asset.

**Past Event for Present Control over Heritage Resources**

- 3.9. The Conceptual Framework describes the type of past event that could indicate that the entity presently controls a resource<sup>12</sup>. Past events that could indicate that an entity controls a heritage resource include:
- (a) Purchase from an external party;
  - (b) Receipt through a non-exchange transaction such as donation, confiscation or nationalization;

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<sup>11</sup> Paragraph 5.11 of the Conceptual Framework.

<sup>12</sup> Paragraph 5.13 of the Conceptual Framework.

- (c) Passing of legislation and/or signing of treaties (supported by international law) that establish a government's rights to heritage items, including rights over otherwise unclaimed lands of natural significance or otherwise contested lands, waterways and/or bodies of water; and
- (d) Construction or development.

### **Heritage Items as Assets**

3.10. From the discussion in this chapter it appears that, drawing on the Conceptual Framework, the special characteristics of heritage items<sup>13</sup> do not prevent them being:

- (a) Resources;
- (b) Presently controlled by an entity;
- (c) As a result of a past event.

3.11. The IPSASB has therefore developed the following preliminary view:

#### **Preliminary View—Chapter 3**

The special characteristics of heritage items do not prevent them from being considered as assets for the purposes of financial reporting.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons.

3.12. The next chapter will consider whether heritage assets can be measured and recognized for the purposes of financial reporting.

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<sup>13</sup> Chapter 2's description of heritage items describes the special characteristics of heritage items that distinguish them from other phenomena for the purposes of financial reporting.



## Chapter 4, Recognition and Initial Measurement of Heritage Assets

### Introduction

- 4.1. This chapter draws on the guidance in the Conceptual Framework to evaluate whether heritage items can meet the recognition criteria for assets. Chapter 3 concluded that the special characteristics of heritage items do not prevent them from being considered as assets, which is the first criterion for recognition. Therefore, this chapter focuses on the second recognition criterion, measurability at initial recognition<sup>14</sup>. Subsequent measurement is considered in Chapter 5.

### Recognition in the Conceptual Framework

- 4.2. Recognition is the process of incorporating and including an item in amounts displayed on the face of the appropriate financial statement<sup>15</sup>. The recognition criteria are that:
- (a) An item satisfies the definition of an element; and
  - (b) Can be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in GPFRs<sup>16</sup>.
- 4.3. The Conceptual Framework states that measurement involves<sup>17</sup>.
- (a) Attachment of a monetary value to the item;
  - (b) Choice of an appropriate measurement basis that meets the measurement objective; and
  - (c) Determination of whether the measurement of the item achieves the qualitative characteristics, taking into account the constraints on information in GPFRs, including that the measurement is sufficiently relevant and faithfully representative for the item to be recognized in the financial statements.
- 4.4. The objective of measurement is to select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes<sup>18</sup>.

### Heritage Assets and the Measurement Objective

- 4.5. The following paragraphs discuss the measurement objective in the context of heritage assets.

#### *Cost of Services*

- 4.6. An entity's cost of services should reflect the amount of resources expended to acquire, develop and preserve heritage assets used in the provision of services. While many heritage assets are used to provide services but are not 'consumed' (e.g. conservation land, museum collections and art), some heritage assets may depreciate such that those costs could also be relevant. Where heritage assets are being used over time (e.g. buildings) or faithfully restored or purchased to build a current

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<sup>14</sup> This chapter's discussion of initial recognition focuses on an entity's initial recognition on acquisition of heritage items rather than initial recognition on first time adoption of accrual basis IPSASs.

<sup>15</sup> Paragraph 6.1 of the Conceptual Framework.

<sup>16</sup> Paragraph 6.2 of the Conceptual Framework.

<sup>17</sup> Paragraph 6.7 of the Conceptual Framework.

<sup>18</sup> Paragraph 7.2 of the Conceptual Framework.

collection, the initial asset expenditure is important and does provide useful information about the cost of services.

#### *Operational capacity*

- 4.7. By assigning an appropriate monetary value to heritage assets<sup>19</sup>, the resulting information may be useful for users' assessments of the resources required to provide services and available for the entity's operations, which include delivery of services in future periods. Operational capacity relates to a range of services, as discussed in Chapter 3 (paragraphs 3.3 and 3.4)<sup>20</sup>.

#### *Financial capacity*

- 4.8. Heritage assets can appreciate in value over time or generate cash flows through, for example, access fees, and thereby contribute to an entity's financial capacity. Information on the monetary value of heritage assets could also be viewed as relevant to assessments of the entity's financial position. Inclusion of such information can provide information that is more faithfully representative of financial capacity.
- 4.9. Heritage assets' contribution to an entity's financial capacity may not be the primary focus for users, because heritage assets are not normally expected to raise funds through sale or as security for borrowings. In many situations the generation of cash will not have a direct relationship (or even any relationship) with the monetary value of the heritage assets. Where heritage assets cannot be sold and the cash they generate for the entity is much less than their monetary value some would argue that their measurement and recognition will overstate an entity's financial capacity.

#### Measurement of Heritage Assets and their Symbolic Value

- 4.10. Some argue that a monetary value cannot show the value of heritage assets, which is their heritage significance. From this perspective, either a monetary value understates the heritage assets' value in terms of service potential<sup>21</sup> or incorrectly implies that heritage significance can be represented with a monetary value. These are the arguments in favor of a "symbolic value" for heritage assets, which could be one currency unit.

#### **Measurement Bases**

- 4.11. The Conceptual Framework provides guidance on the selection of a measurement basis, rather than proposing a single measurement basis (or combination of bases) for all transactions, events and conditions. It identifies the following measurement bases for assets<sup>22</sup>.
- (a) Historical cost;
  - (b) Market value;

<sup>19</sup> Chapter 5 discusses subsequent expenditure. The same arguments for assignment of a monetary value are expected to apply to subsequent expenditure on heritage assets, where subsequent expenditure meets recognition criteria or, at standards level, specific criteria (appropriate to the type of asset) for capitalization versus expense.

<sup>20</sup> The Conceptual Framework describes operational capacity as "the physical and other resources currently available to support the provision of services in future periods" (paragraph 2.11) and "the capacity of the entity to support the provision of services in future periods through physical and other resources" (paragraph 7.3).

<sup>21</sup> The IPSASB's Public Sector Measurement Project is expected to consider measurement of service potential as one part of a broad consideration of measurement in IPSASs. Its recommendations could have implications for the valuation of heritage assets.

<sup>22</sup> Chapter 7 of the Conceptual Framework.

- (c) Replacement cost;
  - (d) Net selling price; and
  - (e) Value in use.
- 4.12. This section discusses the five measurement bases noted above, in the context of heritage assets, considering whether the resulting information is relevant to assessments of the cost of services, operational capacity and financial capacity.

#### *Historical Cost*

- 4.13. The Conceptual Framework describes historical cost information as relevant to assessments of cost of services, operational capacity and financial capacity, and as often being straightforward to apply, because information on the cost at acquisition is usually readily available.
- 4.14. Historical cost is likely to be available to measure heritage assets that have been purchased recently. Where historical cost information is unavailable – because, for example, heritage assets were acquired through a donation – or historical cost information has been lost, another measurement basis such as market value or replacement cost may be obtainable.
- 4.15. Where historical cost information is available but so old that it may not provide relevant information for achievement of the measurement objective, other measurement bases may be more appropriate.
- 4.16. Some take the view that there are cases where initial historical cost is zero; for example where an asset was fully depreciated before being categorized as a heritage asset and transferred to the entity, or where an entity obtains a natural heritage asset without consideration. In such cases if the controlling entity intends to incur subsequent capital expenditure, which is not separable from the underlying asset, they propose that a nominal cost of one currency unit should be used at initial recognition.
- 4.17. Those who support this approach consider that it provides useful information. They consider that this approach differs from symbolic value and is consistent with an historical cost approach. Those who do not support this approach argue that it does not provide information that is useful for decision-making and accountability purposes.

#### **Specific Matters for Comment—Chapter 4.1**

Do you support initially recognizing heritage assets at a nominal cost of one currency unit where historical cost is zero, such as when an asset was fully depreciated before being categorized as a heritage asset and transferred to the entity, or an entity obtains a natural heritage asset without consideration?

If so, please provide your reasons.

#### *Market Value*

- 4.18. Market values will be available for some heritage assets, through reference to the market values of similar items, if an active, open and orderly market exists. A market value generally supports information about operational and financial capacity.
- 4.19. However, market values in an active, open and orderly market may not be available in some circumstances. Many heritage assets have restrictions on their sale and/or disposal, which reduces the availability of market values. Where heritage assets are unique meaningful market values are unlikely to be available for them. Some heritage items, such as artwork and items of archeological

significance, are bought and sold through specialist markets, including auction houses. However, the market may not be sufficiently active, open and orderly to generate representationally faithful market values. Therefore, market values could be inappropriate in these circumstances.

### *Replacement Cost*

- 4.20. The Conceptual Framework defines replacement cost to be the “optimized depreciated replacement cost”, which is: “The most economic cost required for the entity to replace the service potential of an asset<sup>23</sup>.”
- 4.21. Replacement cost relies on the existence of other assets that would provide the same service potential as the heritage asset being valued. Where a replacement cost is available for heritage assets, it could provide useful information for assessments of cost of services, operational and financial capacity. For heritage assets used in an entity’s operations, replacement costs that reflect their value in terms of their operational use appear likely to be available and relevant. For example, a replacement cost for a heritage building used as office space could be found through reference to market values of other office buildings of a similar size and functionality. However, a replacement cost will not be available for some heritage assets, because they are irreplaceable.
- 4.22. The Conceptual Framework notes that there may be cases where replacement cost equates to estimated reproduction cost, because the most economical way of replacing service potential is to reproduce the asset<sup>24</sup>. Restoration would aim to reproduce, as closely as possible, the heritage aspects of the original item. Restoration cost could be more relevant when optimized replacement cost could be inappropriate, because the heritage asset’s service potential is embodied in heritage aspects such as a historic appearance, rather than in an optimized modern equivalent.

### *Net Selling Price*

- 4.23. The Conceptual Framework describes net selling price as being useful where the most resource-efficient course available to the entity is to sell the asset. It is not an appropriate measurement base if the entity is expected to be able to use the resource more efficiently by employing it in another way, for example by using it in the delivery of services.
- 4.24. Heritage assets are expected to be held and preserved rather than sold, and their value usually relates to their service potential<sup>25</sup>. Therefore, net selling price generally does not provide relevant measurement information for heritage assets. However, if an entity is able to sell its heritage assets and plans to do so, net selling price may be an appropriate measurement base.

### *Value in Use*

- 4.25. The Conceptual Framework explains that value in use is appropriate where it is less than the replacement cost of the resource and greater than the net selling price. The operationalization of value in use for non-cash-generating assets involves the use of replacement cost as a surrogate. Many heritage assets are non-cash-generating assets, so in these cases value-in-use would be equivalent to replacement cost.

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<sup>23</sup> Paragraphs 7.40, 7.47 and footnote 14 of the Conceptual Framework.

<sup>24</sup> Footnote 14 of the Conceptual Framework.

<sup>25</sup> Arguably, where an entity does not intend to hold heritage items indefinitely they cease to meet the special characteristics of heritage items, and accounting for them would be covered by existing IPSAS.

## Measurement and the Qualitative Characteristics and Constraints

4.26. This section considers whether heritage items' special characteristics<sup>26</sup> have implications for the ability to measure heritage assets in a way that achieves the qualitative characteristics and takes account of the constraints on information in GPFRs. The qualitative characteristics of information included in GPFRs of public sector entities are relevance, faithful representation, understandability, timeliness, comparability, and verifiability. Pervasive constraints on information included in GPFRs are materiality, cost-benefit, and achieving an appropriate balance between the qualitative characteristics.

### *Relevance and Representational Faithfulness of Monetary Values on Heritage Assets*

4.27. The Conceptual Framework explains that information is relevant if it is capable of making a difference in achieving the objectives of financial reporting. Information is capable of making a difference when it has confirmatory value, predictive value, or both. Information on the monetary value of heritage assets that entities hold supports users' ability to make decisions about entities' resources and hold entities accountable for their stewardship of heritage assets. Therefore, such information appears likely to achieve the qualitative characteristics of relevance. Monetary values for heritage assets also appear likely to provide information that supports users' assessments of entities' operational capacity and cost of services. The extent to which monetary values for heritage assets achieve the qualitative characteristic of representational faithfulness depends on the choice of measurement bases combined with other factors. For example, initial monetary values are likely to be representationally faithful in these circumstances<sup>27</sup>:

- (a) *Historical cost*: Where transaction information is available;
- (b) *Replacement cost*: Where replacement cost can be estimated simply and subjective judgments are not required; and
- (c) *Market value*: Where values are determined in an open, active and orderly markets<sup>28</sup>.

4.28. However, as noted in paragraph 4.10 above, some argue that the heritage significance of heritage assets cannot be represented by monetary values, because monetary values do not convey their value. From that perspective monetary values either do not provide relevant information or the information provided is not representationally faithful.

### *Understandability of Monetary Values on Heritage Assets*

4.29. Understandability is the quality of information that enables users to comprehend its meaning<sup>29</sup>. Monetary values for heritage assets appear more likely in many cases to provide understandable information to users, than would an absence of monetary values. Some may argue that monetary values for heritage assets could confuse users because there are often ethical, legal and/or statutory restrictions or prohibitions that restrict or prevent sale, transfer or destruction by the holder or owner of heritage assets. Disclosures on heritage asset restrictions and/or their special nature can be used

<sup>26</sup> Chapter 2's description of heritage items describes the special characteristics of heritage items that distinguish them from other phenomena for the purposes of financial reporting.

<sup>27</sup> This paragraph applies the discussion of measurement bases and their achievement of the qualitative characteristics in Chapter 7 of the Conceptual Framework.

<sup>28</sup> Paragraph 7.28 of the Conceptual Framework describes the characteristics of open, active and orderly markets.

<sup>29</sup> Paragraph 3.17 & 3.18 of the Conceptual Framework.

to further support users' understanding of the information reported. Similar restrictions on other types of assets do not prevent their recognition.

#### *Timeliness, Comparability and Verifiability*

- 4.30. Timeliness means having information available for users before it loses its capacity to be useful for accountability and decision-making purposes<sup>30</sup>. Comparability is the quality of information that enables users to identify similarities in, and differences between, two sets of phenomena<sup>31</sup>. Verifiability is the quality of information that helps assure users that information in GPFRs faithfully represents the economic and other phenomena that it purports to represent<sup>32</sup>.
- 4.31. The special characteristics of heritage items do not appear to raise issues additional to those identified in the Conceptual Framework for timeliness, comparability and verifiability of monetary values applying historical cost, replacement cost and market value. However, some may argue that monetary values attached to heritage assets could be difficult to verify.

#### *Materiality*

- 4.32. The Conceptual Framework explains that information is material if its omission or misstatement could influence the discharge of accountability by the entity, or the decisions that users make on the basis of the entity's GPFRs prepared for that reporting period. Materiality depends on both the nature and amount of the item judged in the particular circumstances of each entity. The Conceptual Framework does not specify a uniform quantitative threshold at which a particular type of information becomes material<sup>33</sup>. An entity will need to consider the materiality of their heritage asset holdings in the context of the legislative, institutional and operating environment within which it operates and prepares its GPFRs.

#### *Cost-Benefit*

- 4.33. The Conceptual Framework states that "Financial reporting imposes costs. The benefits of financial reporting should justify those costs"<sup>34</sup>.
- 4.34. Benefits of recognizing heritage assets in the Statement of Financial Position include:
- (a) Supports users' ability to:
    - (i) Hold the entity accountable for its heritage assets; and
    - (ii) Make decisions relevant to the entity as a whole and its heritage-related responsibilities;
  - (b) Provides relevant information to users of financial statements that helps them gain an overview of the financial position and performance of the entity, and which could also assist in driving improvements in an entity's performance management; and
  - (c) Improved asset accountability and management, including better identification of preservation priorities.

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<sup>30</sup> Paragraph 3.19 of the Conceptual Framework.

<sup>31</sup> Paragraph 3.21 of the Conceptual Framework.

<sup>32</sup> Paragraph 3.26 of the Conceptual Framework.

<sup>33</sup> Paragraph 3.32 to 3.34 of the Conceptual Framework.

<sup>34</sup> Paragraph 3.35 of the Conceptual Framework.

- 4.35. It may be relatively straightforward to obtain monetary values, for example, when:
- (a) Heritage assets have been purchased recently or components of heritage assets have been replaced recently, so that a transaction is identifiable and the cost at acquisition is known;
  - (b) Replacement costs are available to value heritage assets that are also operational assets; or
  - (c) An active market exists.
- 4.36. Jurisdictions and entities have argued that the cost-benefit constraint could be a factor against attaching a monetary value to heritage assets. In this view, carrying out heritage asset valuations may be a costly exercise, and not justified by the benefits of the information for users. Specifically, those that hold this view argue that:
- (a) Disclosure of units and other information can provide appropriate accountability over heritage assets; and
  - (b) Benefits of assigning a monetary value to heritage assets are frequently limited, for example, where monetary values:
    - i. Are not used in decision-making related to heritage assets, including preservation, or
    - ii. May not represent relevant or meaningful information to users.
- 4.37. Others argue that the cost concerns commonly cited are either:
- (a) Similar to costs applicable to other assets that are, nonetheless, measured for recognition, because the benefits of recognition are viewed as justifying the costs; or
  - (b) Arise in the context of first time adoption of accrual basis financial reporting, when the cost of recognizing assets generally, not only heritage assets, can be viewed as very high.
- 4.38. Some jurisdictions respond to the cost-benefit constraint by assigning a one currency unit value to heritage items. Supporters of this approach point out that, in the case of very ancient assets measured on a historical cost basis, this approach is the only way to include them in the accounts without overstating the monetary value. Others consider that it provides useful information to users of financial statements and facilitates:
- (a) Asset management; and
  - (b) Recognition of subsequent capital expenditure.
- 4.39. However, during development of the Conceptual Framework the majority of the IPSASB concluded that this approach, which assigns a symbolic value to the asset, does not meet the measurement objective, because it does not provide information for the assessment of cost of services, operational capacity or financial capacity<sup>35</sup>.

### **Recognition and Initial Measurement of Heritage Assets**

- 4.40. Based on the discussion above, the IPSASB has concluded that in many cases it is possible to assign monetary values to those heritage items that meet the definition of an asset, and that there are benefits to both users and public sector entities by so doing. The measurement bases available to entities are likely to be restricted to historical cost, market value and replacement cost (where replacement cost includes restoration cost), each of which provides information relevant to an

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<sup>35</sup> Paragraphs BC7.40-BC7.41.

assessment of one or more of the measurement objectives (cost of services, operational capacity and financial capacity). The IPSASB has therefore reached the following Preliminary Views, and requests constituents' comments on these and the related Specific Matters for Comment.

**Preliminary View—Chapter 4.1**

Heritage assets should be recognized in the statement of financial position if they meet the recognition criteria in the Conceptual Framework.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons.

**Specific Matters for Comment—Chapter 4.2**

Are there heritage-related situations (or factors) in which heritage assets should not initially be recognized and/or measured because:

- (a) It is not possible to assign a relevant and verifiable monetary value; or
- (b) The cost-benefit constraint applies and the costs of doing so would not justify the benefits?

If yes, please describe those heritage-related situations (or factors) and why heritage assets should not be recognized in these situations.

**Preliminary View—Chapter 4.2**

In many cases it will be possible to assign a monetary value to heritage assets. Appropriate measurement bases are historical cost, market value and replacement cost.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons.

**Specific Matters for Comment—Chapter 4.3**

What additional guidance should the IPSASB provide through its Public Sector Measurement Project to enable these measurement bases to be applied to heritage assets?



## Chapter 5, Subsequent Measurement of Heritage Assets

### Introduction

- 5.1. This chapter discusses the subsequent measurement of heritage assets. It builds on the IPSASB's preliminary views, reached in Chapter 4, that:
- (a) Heritage assets should be recognized in the statement of financial position if they meet the recognition criteria; and
  - (b) Historical cost, market value and replacement cost (where replacement cost includes estimated reproduction cost) are appropriate measurement bases for heritage assets, dependent on circumstances.
- 5.2. The discussion draws on the Conceptual Framework and existing IPSAS requirements for the subsequent measurement of non-heritage assets, on the basis that these illustrate approaches that could, potentially, be applied to heritage assets.

### Subsequent Measurement in the Conceptual Framework and IPSASs

- 5.3. During development of the Conceptual Framework, the IPSASB concluded that, in principle, the same considerations apply to initial and subsequent measurement<sup>36</sup>. Therefore, subsequent measurement:
- (a) Should achieve the qualitative characteristics, taking into account the constraints; and
  - (b) Has the objective to select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account and for decision-making purposes.
- 5.4. IPSAS requirements<sup>37</sup> for subsequent measurement address entities' reporting of information on:
- (a) Subsequent expenditures related to assets, and the extent to which such expenditures should be capitalized or expensed;
  - (b) Consumption of tangible and intangible assets through depreciation and amortization, while allowing that some assets (for example, land) are not consumed;
  - (c) Impairment of cash-generating and non-cash-generating assets; and
  - (d) Revaluations of assets, where a revaluation model is applied.
- 5.5. Each of these topics is considered in the following paragraphs in relation to heritage assets.

### Subsequent Measurement of Heritage Assets

- 5.6. Once a measurement basis has been applied for initial recognition of a heritage asset, subsequent measurement in the form of (a) accounting for subsequent expenditures, (b) depreciation/amortization and (c) impairment, is facilitated through the existence of an initial measurement. For example, the initial monetary value of an asset is a starting point for adjustments for any subsequent expenditure. However, a change in measurement basis (for example, moving to

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<sup>36</sup> Paragraph BC7.12 of the Conceptual Framework.

<sup>37</sup> IPSAS 17, *Property, Plant and Equipment*, IPSAS 21, *Impairment of Non-Cash-Generating Assets*, IPSAS 26, *Impairment of Cash-Generating Assets*, and IPSAS 31, *Intangible Assets*.

a revaluation model) may present the same issues as those raised at initial recognition (see Chapter 4).

### *Subsequent Expenditure*

- 5.7. Entities could expend large amounts directly on preserving heritage assets. For example, parts of heritage buildings deteriorate; those parts need to be replaced, using similar materials, to maintain their historic character. The key issue will be whether such expenditure should be expensed or capitalized. Appropriate classification is important to provide users with relevant and representationally faithful information on expenses and assets for assessments of cost of services, operational capacity and financial capacity.
- 5.8. IPSASs apply a recognition principle, whereby subsequent expenditures are recognized, increasing the carrying amount of the relevant asset, if it is probable that they confer future economic benefits or service potential for the entity and can be measured reliably. For example, IPSAS 17 states an entity will recognize in the carrying amount of an item of property, plant, and equipment the cost of replacing part of such an item when that cost is incurred, if this recognition principle applies. The carrying amount of the replaced part is then derecognized<sup>38</sup>.
- 5.9. The special characteristics of heritage items<sup>39</sup> do not appear to have any particular implications for classifying subsequent expenditure as either an expense or asset.

### *Depreciation and Amortization*

- 5.10. Many heritage assets deteriorate over time, although some, for example land and jewelry, do not. Heritage assets used in an entity's operations are likely to be consumed in line with those operations. Heritage assets held for their heritage significance are not expected to become functionally obsolete, because their heritage significance increases with age. Their useful lives can be difficult to determine, because the intention to preserve heritage assets for future generations suggests that they could be held in perpetuity or at least that their useful lives are significantly longer than those for non-heritage assets. Therefore, depreciation could be applicable to some (but not all) heritage assets and their components, to provide information relevant to assessments of cost of services and operational capacity.

### *Impairment*

- 5.11. Heritage assets may be impaired, even though they are still intended to be preserved for future generations. Subsequent measurement that reflects impairment provides relevant information for assessments of costs of service and operational capacity.

### *Revaluation*

- 5.12. This CP does not consider whether revaluation should be applied to heritage assets, but focuses on whether the special characteristics of heritage assets represent barriers to revaluation. When applying a revaluation model, entities will need to consider the pervasive constraints on information

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<sup>38</sup> Paragraphs 14 and 23-25 of IPSAS 17.

<sup>39</sup> Chapter 2's description of heritage items describes the special characteristics of heritage items that distinguish them from other phenomena for the purposes of financial reporting.

included in GPFRs<sup>40</sup>, because these will affect the frequency with which heritage assets should be revalued. For example, from a cost-benefit perspective, the benefits of providing potentially more relevant information on heritage assets that have appreciated in value should be balanced against the costs of revaluation, which could be high for heritage assets.

- 5.13. After initial measurement at historical cost use of a revaluation model subsequently would require that market values and/or information for replacement cost will need to be available. As noted in paragraph 5.6, use of the new measurement basis will raise the same issues as those discussed in Chapter 4. Where the market value or replacement cost basis has been used for initial measurement, the same basis is likely to be available for subsequent revaluation.
- 5.14. Based on the discussion above, the IPSASB has concluded that the subsequent measurement of heritage assets can be approached in broadly the same way as for other, non-heritage assets. Subsequent measurement requirements for heritage assets will need to address changes in heritage asset values that arise from subsequent expenditure, consumption, impairment and revaluation, including the frequency of determining market value and their continued availability. Approaches in existing IPSASs are relevant to development of those requirements. The IPSASB has therefore reached the following Preliminary View:

#### **Preliminary View—Chapter 5**

Subsequent measurement of heritage assets:

- (a) Will need to address changes in heritage asset values that arise from subsequent expenditure, depreciation or amortization, impairment and revaluation.
- (b) Can be approached in broadly the same way as subsequent measurement for other, non-heritage assets.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons.

#### **Specific Matters for Comment—Chapter 5**

Are there any types of heritage assets or heritage-related factors that raise special issues for the subsequent measurement of heritage assets?

If so, please identify those types and/or factors, and describe the special issues raised and indicate what guidance IPSASB should provide to address them.

<sup>40</sup> Paragraph 3.3 of the Conceptual Framework.

## Chapter 6, Heritage-Related Obligations

### Introduction

- 6.1. The description of heritage items proposed in this CP indicates that they are items intended to be held indefinitely and preserved for the benefit of present and future generations<sup>41</sup>. This chapter discusses whether the intention to preserve heritage items could give rise to liabilities.

### Conceptual Framework, Liabilities and Present Obligations

- 6.2. The Conceptual Framework defines a liability as “a present obligation of the entity for an outflow of resources that results from a past event”<sup>42</sup>. A liability is recognized when an item satisfies the definition of a liability and can be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in GPFRs<sup>43</sup>.
- 6.3. In considering whether an entity's heritage preservation intentions might give rise to present obligations, the IPSASB had in mind the following types of events or transactions:
- (a) The receipt of funding for heritage preservation activities;
  - (b) The receipt of services to preserve heritage items;
  - (c) Legislation that requires entities to preserve heritage items (including penalties for failure to preserve heritage items);
  - (d) Heritage items for which maintenance or preservation generally is needed because:
    - (i) They have deteriorated so that there is a demonstrable need to restore them;
    - (ii) Planned maintenance has been deferred; and/or
    - (iii) A need for maintenance is likely (foreseeable) in the future.

### Heritage-Related Present Obligations

- 6.4. An entity that holds heritage items is often viewed as having a moral duty to preserve them. However, this moral duty appears to be no different from that of, for example, maintaining infrastructure assets such as road networks or the electricity supply. A moral duty does not give rise to a present obligation and therefore a liability. A present obligation is either legally binding or non-legally binding, which an entity has little or no realistic alternative to avoid<sup>44</sup>. The Conceptual Framework states that an obligation must be to an external party in order to give rise to a liability<sup>45</sup>. An entity cannot be obligated to itself, even where it has publicly communicated an intention to behave in a particular way. Existing IPSASB pronouncements address obligations that could arise from the events in paragraph 6.3. It is unlikely that the types of events and transactions in bullet points 6.3(c) and (d) would, on their own, create a legally binding obligation.

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<sup>41</sup> Chapter 2 includes the following description for heritage items: “Heritage items are items that are intended to be held indefinitely and preserved for the benefit of present and future generations because of their rarity and significance in relation, but not limited, to their archeological, architectural, agricultural, artistic, cultural, environmental, historical, natural, scientific or technological features.”

<sup>42</sup> Paragraph 5.14 of the Conceptual Framework.

<sup>43</sup> Paragraph 6.2 of the Conceptual Framework.

<sup>44</sup> Paragraph 5.15 of the Conceptual Framework.

<sup>45</sup> Paragraph 5.18 of the Conceptual Framework.

### Heritage-Related Outflows of Resources

- 6.5. A liability must involve an outflow of resources from the entity for it to be settled. An obligation that can be settled without an outflow of resources from the entity is not a liability<sup>46</sup>.
- 6.6. Holding heritage items is likely to involve outflows of resources over time. Given the ongoing expense of preserving heritage items for present and future generations, some have argued that a liability should be recognized to reflect these resource outflows, including deferred outflows, where deferral could be by comparison to an agreed cycle of maintenance or with respect to some other criteria. However, the ability to defer these outflows suggests that an entity does not have a present obligation for the outflow of resources.

### Heritage-Related Past Events

- 6.7. Possible past events relating to heritage preservation obligations might include when an entity:
  - (a) Acquires heritage items;
  - (b) Makes a public commitment to preserve heritage items for future generations;
  - (c) Includes a heritage preservation objective (or other statement) in its publicly available planning documents;
  - (d) Creates a plan for resource outflows necessary for preserving heritage items;
  - (e) Receives an approved budget or an appropriation or other funding for preserving heritage items;
  - (f) Receives services for which payment is due.
- 6.8. Drawing on discussion in the Conceptual Framework, an assessment of each of these past events suggests that the entity appears likely to have alternatives enabling it to avoid an outflow of resources, with the exceptions of<sup>47</sup>:
  - (a) *Receipt of funding*, if funding results in a performance obligation; and
  - (b) *Receipt of services*, if the entity has obligations (to pay for services received) arising from either a legal contract or other binding arrangement.
- 6.9. However, whether an entity has received funding or services related to heritage preservation, the arrangements are unlikely to differ from receipt of other funding with performance obligations or from any normal contract for services and there would appear to be no reason why the transaction should be accounted for in a different way.

### Heritage-Related Liabilities

- 6.10. The IPSASB acknowledges that there are many who believe that entities holding heritage items for the purposes stated in the description of heritage items developed in Chapter 2 have a moral duty to expend resources to preserve those items and to account for that duty as an obligation. The IPSASB

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<sup>46</sup> Paragraph 5.16 of the Conceptual Framework.

<sup>47</sup> The IPSASB's Revenue and Non-Exchange Expenses project considers performance obligations. If funds contain conditions/performance obligations there is a present obligation to the resource provider until they are fulfilled. In such circumstances there is an obligation to an external party. Therefore it meets the requirement discussed in paragraph 6.4.

considers, however, that the special characteristics of heritage items<sup>48</sup> do not of themselves give rise to present obligations that would result in the recognition of a liability. The IPSASB has therefore reached the following Preliminary View.

**Preliminary View—Chapter 6**

The special characteristics of heritage items, including an intention to preserve them for present and future generations, do not, of themselves, result in a present obligation such that an entity has little or no realistic alternative to avoid an outflow of resources. The entity should not therefore recognize a liability.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons.

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<sup>48</sup> Chapter 2's description of heritage items describes the special characteristics of heritage items that distinguish them from other phenomena for the purposes of financial reporting.

## Chapter 7, Presentation of Information on Heritage Items

### Introduction

- 7.1. This chapter draws on the Conceptual Framework to discuss the presentation of information for heritage in GPFRs. It discusses whether the special characteristics of heritage items—the intention to hold them indefinitely and preserve them for the benefit of present and future generations, because of their rarity and/or significance—have implications for the presentation of information in GPFRs.
- 7.2. The Conceptual Framework states that the objectives of financial reporting are to provide information about the entity that is useful to users of GPFRs for accountability and decision-making purposes<sup>49</sup>. Presentation, defined as “the selection, location and organization of information that is reported in the GPFRs<sup>50</sup>”, is one of the means by which the objectives of financial reporting are met.

### Presentation Objectives for Information on Heritage

- 7.3. In Chapter 3 of this CP the IPSASB reached the Preliminary View that the special characteristics of heritage items<sup>51</sup>, as described in Chapter 2, do not prevent them from being considered as assets for the purposes of financial reporting. In Chapters 4 and 6 the IPSASB reached Preliminary Views that:
- (a) Heritage assets should be recognized in the statement of financial position if they meet the recognition criteria in the Conceptual Framework;
  - (b) In many cases it will be possible to assign a monetary value to heritage assets and historical cost, market value and replacement cost are appropriate measurement bases for heritage assets, dependent on circumstances; and
  - (c) The special characteristics of heritage items, including an intention to preserve them for present and future generations, do not, of themselves, result in a present obligation such that an entity has little or no realistic alternative to avoid an outflow of resources and should therefore recognize a liability.
- 7.4. The IPSASB concludes that the corollary of those Preliminary Views is that the special characteristics of heritage items (whether or not recognised as assets, with any associated liabilities), do not warrant presentation objectives specific to heritage. Rather, just as for any other revenues, expenses, assets and liabilities, an entity should present information in a way that meets the objectives of financial reporting, applying existing IPSASB pronouncements, including Recommended Practice Guidelines (RPG) where appropriate<sup>52</sup>.
- 7.5. Others take the view that the special characteristics of heritage items do require enhanced disclosures, to meet users’ need for information relevant to entities’ preservation of heritage items for present and future generations.
- 7.6. In line with existing IPSASB pronouncements, an entity considers materiality when deciding whether a line item for heritage assets should be displayed on the face of the financial statements and what

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<sup>49</sup> Paragraph 2.1 of the Conceptual Framework.

<sup>50</sup> Paragraph 8.4 of the Conceptual Framework.

<sup>51</sup> Chapter 2’s heritage items description reflects their special characteristics of heritage items and distinguishes them from other phenomena for the purposes of financial reporting.

<sup>52</sup> The IPSASB has issued three RPGs; RPG 1, *Reporting on the Long-Term Sustainability of an Entity’s Finances*, RPG 2, *Financial Statement Discussion and Analysis*, and RPG 3, *Reporting Service Performance Information*.

information should be disclosed in the notes. If the entity applies one or more RPGs, it may also need to provide information in other GPFRs.

7.7 Information on recognized heritage assets might include:

- (a) The main types of heritage assets;
- (b) How heritage assets are measured, including impairment or other changes in measurement; and
- (c) Resource outflows and inflows as a result of holding, acquiring and disposing of heritage assets (for example through transfer or sale).

7.8 An entity could present information in its financial statements discussion and analysis or another GPFR to assist users to understand the:

- (a) Effect of the entity's holding of heritage items on its operational capacity, cost of services and financial capacity;
- (b) Extent of an entity's heritage holdings, encompassing any heritage items recognized as assets as well as unrecognized heritage items;
- (c) Extent of maintenance expenses; and
- (d) Nature of the entity's custodial responsibilities with respect to heritage and legislation that establishes such responsibilities.

7.9 Different entities have different portfolios of heritage items. Each entity will need to determine what information needs to be presented in light of the heritage items they hold and IPSASB pronouncements (IPSASs and, where applicable, RPGs).

**Preliminary View—Chapter 7**

Information about heritage should be presented in line with existing IPSASB pronouncements.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons and describe what further guidance should be provided to address these.



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March 2017

Discussion Paper DP/2017/1

# Disclosure Initiative—Principles of Disclosure

Comments to be received by 2 October 2017

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# **Disclosure Initiative—Principles of Disclosure**

*Comments to be received by 2 October 2017*

Discussion Paper DP/2017/1 *Disclosure Initiative—Principles of Disclosure* is published by the International Accounting Standards Board (the Board) for comment only. Comments on the Discussion Paper must be received by **2 October 2017** and should be submitted in writing to the address below or electronically via the 'Comment on a proposal' page ([go.ifrs.org/comment](http://go.ifrs.org/comment)).

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## Summary and invitation to comment

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### Why is the Board publishing this Discussion Paper?

- IN1 In response to feedback received through its *2015 Agenda Consultation*, the International Accounting Standards Board (the Board) plans to focus on projects that will improve communication in financial reporting. For this reason, Better Communication in Financial Reporting is a central theme of the Board's work for 2017–21.
- IN2 Feedback that there is a need to improve the disclosure of financial information is consistent with the feedback received by the Board in 2013 at its public Discussion Forum on Financial Reporting Disclosure, which led the Board to establish the Disclosure Initiative. The Disclosure Initiative is a broad-based initiative exploring how to make disclosures more effective in financial statements and it forms a key part of the Board's work on Better Communication in Financial Reporting.
- IN3 This Principles of Disclosure project is one of several within the Disclosure Initiative. The main objective of this project is 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 for the primary users<sup>1</sup> of financial statements; and
  - (c) assist the Board to improve disclosure requirements in Standards.
- IN4 These disclosure principles could range from high level concepts—for example, overall principles of effective communication—to general requirements for disclosing information.
- IN5 IAS 1 *Presentation of Financial Statements* contains general requirements for disclosures in the financial statements. Consequently, this Discussion Paper considers the existing requirements in IAS 1 as a starting point with a view to either:
- (a) making amendments to parts of IAS 1; or
  - (b) creating a new disclosure standard to replace parts of IAS 1.
- Throughout this Discussion Paper the term 'general disclosure standard' refers to either an amendment to IAS 1 or a new disclosure standard that replaces parts of IAS 1.
- IN6 This Discussion Paper describes and seeks stakeholders' views on:
- (a) disclosure issues that the Board has identified during its outreach before and during the project; and

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<sup>1</sup> Throughout this Discussion Paper the terms 'primary users' and 'users' refer to existing and potential investors, lenders and other creditors who must rely on general purpose financial reports for much of the financial information they need.

- (b) approaches to address these issues, including the Board's preliminary views, where these have been developed.

IN7 In this Discussion Paper the Board focuses on the issues that it identified during its outreach, therefore it does not cover all the issues that the Board would cover in an Exposure Draft of a general disclosure standard. The Board also seeks views on additional disclosure issues to address in this project.

IN8 The Board is also taking the opportunity of this public consultation to seek feedback to supplement its research in other projects. For example, feedback on this Discussion Paper will also inform the Board's Primary Financial Statements project and the Standards-level Review of Disclosures project.

### **Who will be affected if the suggestions in this Discussion Paper are implemented?**

IN9 The suggestions in this Discussion Paper might lead to an amendment to parts of IAS 1 or the issue of a new disclosure standard to replace parts of IAS 1. IAS 1 provides overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. Consequently, this Discussion Paper is relevant to all entities preparing financial statements in accordance with IFRS Standards, and all users of those financial statements. It is also relevant to auditors, regulators and other interested parties that are involved in financial reporting.

### **What does this Discussion Paper cover?**

#### **Sections in this Discussion Paper**

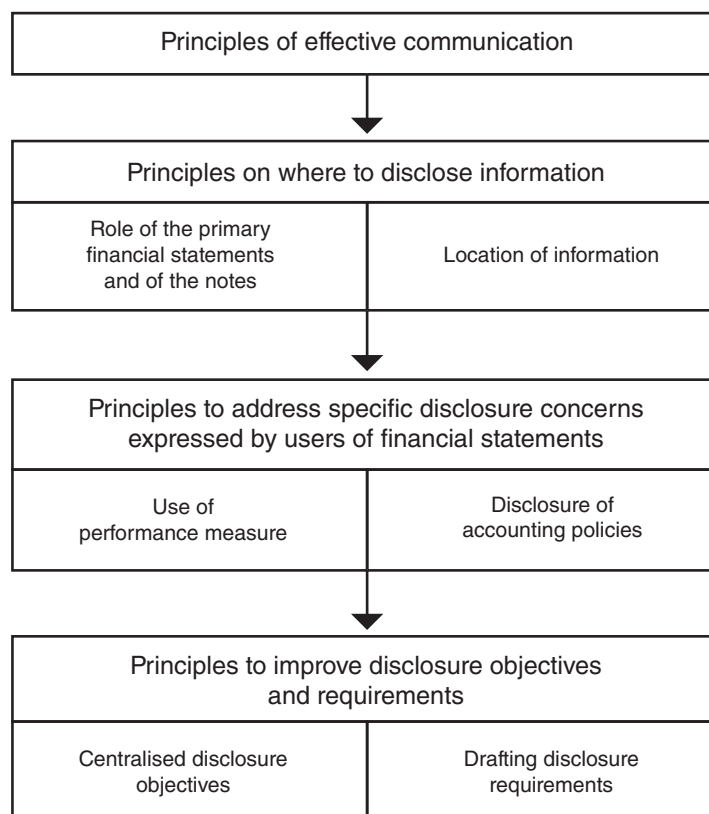
No.	Title	Summary
1	Overview of the 'disclosure problem' and the objective of this project	Summarises the main concerns that the Board has identified (collectively referred to as the 'disclosure problem'), sets out the background and objective of this project, and explains how this project interacts with the Board's other projects, including other parts of the Disclosure Initiative.
2	Principles of effective communication	Discusses principles of effective communication that entities should apply in preparing financial statements.
3	Roles of the primary financial statements and the notes	Discusses the roles of the different components of the financial statements and how those roles help to meet the objective of the financial statements.

*continued...*



...continued

No.	Title	Summary
4	Location of information	Discusses: <ul style="list-style-type: none"> <li>• when an entity can provide information that is necessary to comply with IFRS Standards outside the financial statements; and</li> <li>• when an entity can provide information that is identified as 'non-IFRS information', or by a similar labelling, within the financial statements.</li> </ul>
5	Use of performance measures in the financial statements	Discusses fair presentation of performance measures in the financial statements.
6	Disclosure of accounting policies	Discusses ways to improve how entities disclose their accounting policies.
7	Centralised disclosure objectives	Discusses the development of centralised disclosure objectives and how the Board could use them as a basis to develop and organise disclosure objectives and requirements in IFRS Standards.  Section 7 discusses two methods—Methods A and B—of developing centralised disclosure objectives.
8	New Zealand Accounting Standards Board staff's approach to drafting disclosure requirements in IFRS Standards	Describes an approach that has been developed by the staff of the New Zealand Accounting Standards Board (NZASB staff) for drafting disclosure objectives and requirements in IFRS Standards.

**Content of the Discussion Paper****Summary of the Board's preliminary views in this Discussion Paper**

IN10 The Board's preliminary views are that a general disclosure standard should include disclosure principles that:

- (a) identify, and describe the role of, the primary financial statements and the implications of that role (Section 3);
- (b) describe the role and content of the notes (Section 3);
- (c) describe when an entity can provide information that is necessary to comply with IFRS Standards outside the financial statements (Section 4);
- (d) describe when an entity can provide information that is identified as 'non-IFRS information', or by a similar labelling, within the financial statements (Section 4);
- (e) describe how performance measures can be fairly presented in financial statements (Section 5);
- (f) clarify which accounting policies are required to be disclosed (Section 6); and

- (g) identify and describe centralised disclosure objectives (Section 7).
- IN11 The Board’s preliminary views are that guidance about the following matters should be provided, either in a general disclosure standard or in non-mandatory guidance, for example, in educational material:
- (a) principles of effective communication that entities should apply when preparing financial statements (Section 2); and
  - (b) the location of accounting policy disclosures (Section 6).
- IN12 The Board’s preliminary view is that non-mandatory guidance on use of formatting in the financial statements should be developed (Section 2).
- IN13 The Board’s preliminary view is that, when subsequently drafting IFRS Standards, if the Board uses the terms ‘present’ and ‘disclose’ when describing where to provide information in the financial statements, it should also specify the intended location as being either ‘in the primary financial statements’ or ‘in the notes’ (Section 3).
- IN14 The Board’s preliminary views are that it should:
- (a) develop definitions of, and requirements for, the presentation of unusual or infrequently occurring items in the statement(s) of financial performance (Section 5); and
  - (b) clarify that the following subtotals in the statement(s) of financial performance comply with IFRS Standards if such subtotals are in accordance with paragraphs 85–85B of IAS 1 (Section 5):
    - (i) EBITDA<sup>2</sup> subtotal if an entity uses the ‘nature of expense’ method;<sup>3</sup> and
    - (ii) EBIT<sup>2</sup> subtotal under both a ‘nature of expense’ method and a ‘function of expense’ method.
- IN15 The feedback on the Board’s preliminary views in paragraph IN14 relating to presentation in the statement(s) of financial performance will be considered within the Board’s Primary Financial Statements project (see paragraph 1.17(a)).

### Terminology used in this Discussion Paper

- IN16 Some of the following terms are already defined in IFRS Standards and when this applies, a reference to the Standard is provided. Others are suggested definitions or descriptions on which the Board is soliciting comments from stakeholders and a reference to their use in this Discussion Paper is provided:

2 EBITDA: earnings before interest, taxation, depreciation and amortisation. EBIT: earnings before interest and tax.

3 Paragraphs 99–103 of IAS 1 *Presentation of Financial Statements* require expenses to be classified using either the ‘nature of expense’ method or the ‘function of expense’ method.

- (I) **Accounting policies**—the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements (paragraph 5 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*).<sup>4</sup>
- (II) **Annual report**—a single reporting package issued by an entity that includes the financial statements (discussed in paragraph 4.10).
- (III) **Centralised disclosure objectives**—a central set of disclosure objectives developed by the Board that provide a basis (or framework) for developing disclosure objectives and requirements in Standards (discussed in paragraphs 7.1 and 7.10–7.11).
- (IV) **Financial report**<sup>5</sup>—a report that provides the reporting entity’s primary users with information about the reporting entity’s economic resources, claims against the entity and changes in those economic resources and claims (paragraph 3.2 and Appendix B of the Exposure Draft of a revised *Conceptual Framework for Financial Reporting (Conceptual Framework Exposure Draft)*).
- (V) **Financial statements**<sup>6</sup>—a particular form of general purpose financial report that provides information (about the reporting entity’s assets, liabilities, equity, income and expenses) that is useful to the primary users of those statements in assessing the prospects for future net cash inflows to the entity and in assessing management’s stewardship of the entity’s resources. A complete set of financial statements comprises the primary financial statements and the notes (paragraphs 3.2 and 3.4 and Appendix B of the *Conceptual Framework Exposure Draft* and paragraph 10 of IAS 1).
- (VI) **General disclosure standard**—a term used for the purpose of this Discussion Paper to describe either an amendment to IAS 1 or a new disclosure standard that replaces parts of IAS 1 (paragraph 1.13).
- (VII) **Interim report**—a financial report containing either a complete set of financial statements (as described in IAS 1) or a set of condensed financial statements (as described in IAS 34 *Interim Financial Reporting*) for an interim period (paragraph 4 of IAS 34).
- (VIII) **Notes**—that part of the financial statements other than the primary financial statements. Notes provide further information necessary to disaggregate, reconcile and explain the items recognised in the primary financial statements and supplement the primary financial statements

4 As part of its forthcoming proposed amendments to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to clarify the distinction between accounting policies and accounting estimates, the Board is expected to propose to clarify this definition as follows: ‘Accounting policies are the specific principles and practices applied by an entity in preparing and presenting financial statements’.

5 ‘Financial report’ refers to a general purpose financial report, unless indicated otherwise.

6 ‘Financial statements’ refer to general purpose financial statements, unless indicated otherwise. General purpose financial statements are those intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs (paragraph 7 of IAS 1).

with other information that is necessary to meet the objective of financial statements (discussed in paragraphs 3.28 and 3.30).

- (IX) **Performance measure**<sup>7</sup>—for the purpose of this Discussion Paper, a summary financial measure of an entity's financial performance, financial position or cash flows (discussed in paragraph 5.2).
- (X) **Primary financial statements**—the statement of financial position, statement(s) of financial performance, statement of changes in equity and statement of cash flows (discussed in paragraph 3.19).
- (XI) **Primary users of financial statements (financial reports)**—existing and potential investors, lenders and other creditors who cannot require reporting entities to provide information directly to them and must rely on general purpose financial statements (general purpose financial reports) for much of the financial information they need (paragraph 1.5 and Appendix B of the *Conceptual Framework* Exposure Draft). The primary users are considered to have a reasonable knowledge of business and economic activities and review and analyse the information diligently (paragraph 2.35 of the *Conceptual Framework* Exposure Draft).
- (XII) **Relevant financial information**—information capable of making a difference in the decisions made by users (paragraph 2.6 and Appendix B of the *Conceptual Framework* Exposure Draft).
- (XIII) **Statement(s) of financial performance**—statement(s) presenting profit or loss and other comprehensive income.

### What are the next steps in this project?

- IN17 The views expressed in this Discussion Paper are preliminary and subject to change. The Board will consider the comments received on this Discussion Paper before deciding whether to develop an Exposure Draft containing proposals to amend or replace parts of IAS 1 and/or develop non-mandatory guidance. The feedback received will also be used to inform the Board's other projects.

<sup>7</sup> For ease of reference the term 'performance measure' has been used to refer to summary financial measures of an entity's financial position and cash flows, as well as of an entity's financial performance, for the purposes of this Discussion Paper. This is because this term appears to be well understood and widely used, and because most financial measures provided by an entity are measures of financial performance.

## Invitation to comment

The Board invites comments on all matters in this Discussion Paper and, in particular, on the questions for respondents set out at the end of each section. Comments are most helpful if they:

- (a) respond to the questions as they are set out in this Discussion Paper;
- (b) indicate the specific paragraphs or group of paragraphs to which they relate;
- (c) contain a clear rationale; and
- (d) describe any alternative that the Board should consider, if applicable.

Respondents need not comment on all of the questions and are encouraged to comment on any additional matters.

The Board will consider all comments received in writing by 2 October 2017 (180 days).

## How to comment

Comments should be submitted using one of the following methods:

<b>Electronically</b> <small>(our preferred method)</small>	Comments can be sent electronically via the 'Comment on a proposal' page at: <a href="http://go.ifrs.org/comment">go.ifrs.org/comment</a>
<b>By email</b>	Comments can be emailed to: <a href="mailto:commentletters@ifrs.org">commentletters@ifrs.org</a>
<b>By post</b>	Written comments should be sent to: IFRS Foundation 30 Cannon Street London EC4M 6XH United Kingdom

All comments will be on the public record and posted on our website unless confidentiality is requested. Such requests will not normally be granted unless supported by good reason, for example, commercial confidence. Please see our website for further details on this and on how we use your personal data.

## Section 1—Overview of the ‘disclosure problem’ and the objective of this project

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- 1.1 This section describes:
- (a) the background to the Disclosure Initiative (paragraphs 1.2–1.4);
  - (b) the disclosure problem (paragraph 1.5);
  - (c) causes of the disclosure problem (paragraphs 1.6–1.8);
  - (d) the need for principles of disclosure (paragraphs 1.9–1.10);
  - (e) the objective of this project (paragraphs 1.11–1.13);
  - (f) the objective of this Discussion Paper (paragraph 1.14); and
  - (g) interactions with the Board’s other projects (paragraphs 1.15–1.18).

### Background to the Disclosure Initiative

- 1.2 In its Agenda Consultation in 2011, the Board received feedback that financial statements are increasingly perceived as burdensome to prepare and that there are concerns about how well they meet the needs of their primary users.
- 1.3 In response to these concerns, the Board:
- (a) researched other organisations’ work on the quality of disclosures in financial reporting, some of whom suggested actions that the Board might take to improve disclosures.<sup>8</sup>
  - (b) conducted a survey on financial reporting disclosure in December 2012 seeking the views of entities that prepare financial statements, users of financial statements and other stakeholders on disclosure issues.
  - (c) hosted a public Discussion Forum on Disclosures in Financial Reporting (the Discussion Forum) in January 2013 that was attended by approximately 120 people, comprising entities that prepare financial statements, auditors, regulators, users of financial statements and standard-setters, including representatives from the organisations in (a) that had already undertaken work in this area. The purpose of the Discussion Forum was to obtain a better understanding of the problems stakeholders have raised, and to identify what action the Board might take to address them.
  - (d) published a Feedback Statement in May 2013 summarising the views expressed at the Discussion Forum and the Board’s recommended actions resulting from them.
- 1.4 In response to this feedback, in 2013 the Board launched its Disclosure Initiative, a portfolio of implementation and research projects, to address the problems identified and improve the effectiveness of disclosures in financial statements.

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<sup>8</sup> See pages 5 and 23–30 of the Feedback Statement: *Discussion Forum—Financial Reporting Disclosure* (<http://www.ifrs.org/Alerts/PressRelease/Documents/2013/Feedback-Statement-Discussion-Forum-Financial-Reporting-Disclosure-May-2013.pdf>).

## The disclosure problem

- 1.5 The Board has observed that there are three main concerns about information disclosed in general purpose financial statements (termed the ‘disclosure problem’). These are described in the following table:

**Table 1.1—The disclosure problem**

The Disclosure Problem		
1. Not enough relevant information	2. Irrelevant information	3. Ineffective communication of the information provided
Information is relevant if it is capable of making a difference in the decisions made by the primary users of financial statements. If financial statements do not provide enough relevant information, their users might make inappropriate investing or lending decisions.	Irrelevant information is undesirable because: <ul style="list-style-type: none"> <li>it clutters the financial statements so that relevant information might be overlooked or hard to find, making financial statements difficult to understand; and</li> <li>it can add unnecessary ongoing cost to the preparation of the financial statements.</li> </ul>	If information is communicated ineffectively, it makes the financial statements hard to understand and time-consuming to analyse. Additionally, users of the financial statements may overlook relevant information or fail to identify relationships between pieces of information in different parts of the financial statements.

## Causes of the disclosure problem

- 1.6 Entities need to use their judgement when deciding what information to disclose in financial statements and the most effective way to organise and communicate it. The main causes of the disclosure problem appear to be difficulties in applying this judgement.
- 1.7 The Board has received feedback that difficulties in applying judgement are often behavioural, rather than caused by the requirements in IFRS Standards. The feedback indicates that some entities, auditors and regulators approach financial statements primarily as compliance documents, rather than as a means of communication with users of the financial statements. They sometimes apply the disclosure requirements in IFRS Standards mechanically, using them as a checklist for disclosures in the financial statements, rather than applying their judgement to determine what information is relevant to users



and how best to communicate that information. Some entities have said that it is easier to use a checklist approach than to apply judgement because of time pressures, and because following a mechanical approach means that their judgement is less likely to be challenged by auditors, regulators and users of their financial statements.

- 1.8 However, the Board has also received feedback that a lack of guidance on the content and structure of the financial statements, particularly regarding disclosures in the notes, contributes to these behavioural difficulties. Some state that more, or better, guidance would help bring about changes in behaviour. Others state that IFRS Standards might discourage entities from using their judgement, pointing to the following issues:
- (a) some Standards lack clear disclosure objectives, making the purpose of some disclosure requirements unclear. This makes it difficult for entities to apply judgement in deciding what information to disclose.
  - (b) the long lists of prescriptive disclosure requirements reinforce the perception that financial statements are compliance documents. Entities therefore automatically include information that is specifically required by a Standard, rather than tailoring disclosures to their circumstances and considering whether to disclose any additional information.

### **The need for principles of disclosure**

- 1.9 Many stakeholders have suggested that the Board responds to the concerns described in paragraphs 1.5–1.8 by developing a set of disclosure principles (sometimes referred to by stakeholders as a ‘disclosure framework’)<sup>9</sup> to:
- (a) help entities apply better judgement about disclosures and communicate information more effectively;
  - (b) improve the effectiveness of disclosures for the primary users of the financial statements; and
  - (c) help the Board improve disclosure requirements in IFRS Standards.
- 1.10 The Board agrees that a set of disclosure principles could help to address the disclosure problem. However, to improve the effectiveness of disclosures in the financial statements, those principles need to be accompanied by a change in the behaviour of parties that are described in paragraph 1.7.

### **The objective of this project**

- 1.11 This Principles of Disclosure project focuses on identifying and better understanding disclosure issues, and developing new or clarifying existing disclosure principles to address those issues. A set of disclosure principles could range from high level concepts—for example, overall principles of effective communication or a basis for developing disclosure objectives and requirements (centralised disclosure objectives)—to general requirements for disclosing information. The principles would build on some of the existing requirements

<sup>9</sup> This Discussion Paper does not use the term ‘disclosure framework’ because it might cause confusion with the *Conceptual Framework for financial reporting* (Conceptual Framework).

in IAS 1 and on the concepts being developed in the Board's project to revise the existing *Conceptual Framework for Financial Reporting* (the *Conceptual Framework (2010)*).

- 1.12 Consistent with the objective of general purpose financial reporting described in the *Conceptual Framework (2010)*, and the Board's Conceptual Framework project, the Board is focusing on improving the effectiveness of disclosures for the primary users of the financial statements. The primary users of financial statements are existing and potential investors, lenders and other creditors who cannot require entities to provide information directly to them and must rely on general purpose financial statements for much of the financial information they need. The Board recognises that a wide range of parties might be interested in disclosures in financial statements. However, setting out a primary user group provides an important focus in developing disclosure principles. The Board observes that many other users will be served well by the same disclosure principles.
- 1.13 The Principles of Disclosure project is likely to result either in amendments to IAS 1 or in the creation of a new general disclosure standard to build on and replace the parts of IAS 1 that cover disclosures in the financial statements. The project might also result in the development of some non-mandatory guidance. For ease of reference, this Discussion Paper uses the term 'general disclosure standard' to refer to both possible outcomes, ie either amendments to IAS 1 or a new general disclosure standard that would replace parts of IAS 1. This project covers disclosures in the financial statements and therefore focuses primarily on the content of the notes. The parts of IAS 1 that cover the structure and content of the primary financial statements will be considered in a separate project (see paragraph 1.17(a)).<sup>10</sup>

### **The objective of this Discussion Paper**

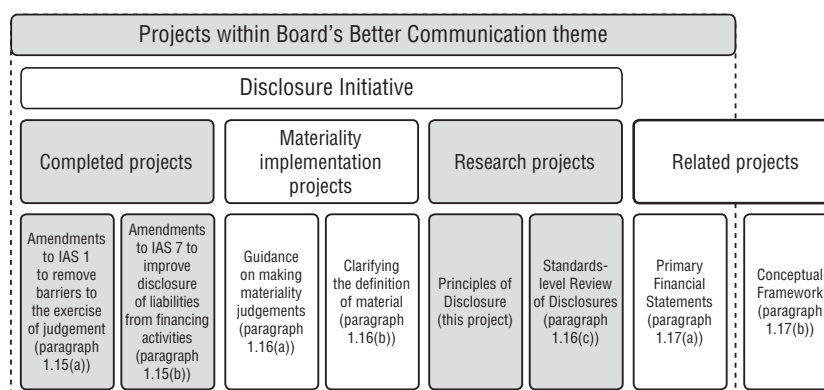
- 1.14 This Discussion Paper describes, and seeks stakeholders' views about:
- (a) disclosure issues identified through the activities in paragraph 1.3 and the Board's other outreach during this project; and
  - (b) approaches to address these issues, including the Board's preliminary views when provided.

The Board also seeks views on additional disclosure issues to address in this project.

<sup>10</sup> In some cases disclosure requirements provide flexibility for an entity either to present information in the primary financial statements or to disclose it in the notes. These requirements may be affected by both projects.

## Interactions with the Board's other projects

Figure 1.2—The Disclosure Initiative and related projects



### Projects within the Disclosure Initiative

1.15 The Board has already completed two projects that address aspects of the disclosure problem:

- (a) in December 2014, the Board published *Disclosure Initiative* (Amendments to IAS 1). These narrow-scope amendments clarified some of the requirements in IAS 1 to emphasise that entities should apply judgement when determining what information to disclose in their financial statements, and where, and in what order, the information should be provided. In particular, the amendments clarified the requirements in IAS 1 for materiality, order of the notes, subtotals in the primary financial statements and disclosure of accounting policies to address some of the concerns raised during the activities described in paragraph 1.3. This Discussion Paper refers to these amendments when discussing related topics. The amendments are effective for annual periods beginning on or after 1 January 2016.
- (b) in January 2016 the Board published *Disclosure Initiative* (Amendments to IAS 7). The amendments to IAS 7 *Statement of Cash Flows* require disclosure of changes in liabilities arising from financing activities. The amendments are effective for annual periods beginning on or after 1 January 2017.

1.16 There are currently three other projects within the Disclosure Initiative linked to this project that address the disclosure problem:

- (a) **the Materiality Practice Statement project:** the disclosure of 'not enough relevant information' and 'irrelevant information' in the financial statements has been identified as part of the disclosure

problem (see paragraph 1.5).<sup>11</sup> To address these concerns, the Board is finalising non-mandatory guidance in the form of a Practice Statement to help entities make judgements about whether information is material when preparing financial statements. In October 2015 the Board published an Exposure Draft: IFRS Practice Statement *Application of Materiality to Financial Statements*. The Board has discussed the feedback received on that Exposure Draft and plans to publish a final Practice Statement in June 2017.

- (b) **the Definition of Material project:** the Board proposes to refine the definition of ‘material’ and clarify its application. The Board expects to issue an Exposure Draft containing these proposals together with the Materiality Practice Statement.
- (c) **The Standards-level Review of Disclosures project:** the objective is to consider whether to make targeted improvements to disclosure requirements in existing Standards and to develop guidance for the Board to use when developing disclosure requirements in new and amended Standards. This research project will be informed by the disclosure principles developed in this project and by the feedback received on this Discussion Paper.

### Projects outside the Disclosure Initiative

1.17 This project interacts closely with two of the Board’s other projects outside the Disclosure Initiative:

- (a) **the Primary Financial Statements project:** the objective of this research project is to examine possible changes to the structure and content of the primary financial statements. It will be partially informed by the feedback received on this Discussion Paper.
- (b) **the Conceptual Framework project:** the *Conceptual Framework (2010)* describes the objective of, and the concepts for, general purpose financial reporting. The purpose of the Conceptual Framework project is to provide a more complete, clear and updated set of concepts, including those on the presentation and disclosure of financial information. In May 2015 the Board published an Exposure Draft of a revised *Conceptual Framework for financial reporting* (the *Conceptual Framework Exposure Draft*). The revised *Conceptual Framework* is expected to be published in 2017. The suggestions in this Discussion Paper utilise some of the concepts discussed in the Conceptual Framework project. This Discussion Paper refers to the proposals in the *Conceptual Framework Exposure Draft*, rather than the *Conceptual Framework (2010)*, because these proposals reflect the Board’s tentative decisions to update the *Conceptual Framework (2010)*.

1.18 Further information about all of the Board’s projects is available on our website: <http://www.ifrs.org/Current-Projects/IASB-Projects/Pages/IASB-Work-Plan.aspx>.

<sup>11</sup> Paragraph 2.11 of the *Conceptual Framework Exposure Draft* states that ‘...materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity’s financial report’.

## Questions for respondents

### 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 (ie either in amendments to IAS 1 or in a new general disclosure standard) would address the disclosure problem? Why or why not?

### 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?

## Section 2—Principles of effective communication

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- 2.1 This section discusses principles of effective communication that entities should apply when preparing financial statements. These principles could be included either in a general disclosure standard or in non-mandatory guidance, or in a combination of both.

### Current proposals in other documents

- 2.2 In paragraphs 7.16–7.18 of the *Conceptual Framework* Exposure Draft the Board proposes that the revised *Conceptual Framework* should specify the following presentation and disclosure objectives and principles:

- 7.16 Including specific presentation and disclosure objectives in a Standard enables an entity to identify relevant information and decide how to communicate that information in the most efficient and effective manner.
- 7.17 In setting presentation and disclosure requirements, an appropriate balance is needed between:
  - (a) giving entities the flexibility to provide relevant information that faithfully represents the entity's assets and liabilities, and the transactions and other events of the period; and
  - (b) requiring information that is comparable among entities and across reporting periods.
- 7.18 Efficient and effective communication of information also requires consideration of the following principles:
  - (a) entity-specific information is more useful than 'boilerplate' language and is more useful than information that is readily available outside the financial statements; and
  - (b) duplication of information in different parts of the financial statements is usually unnecessary and makes financial statements less understandable.

### What is the issue?

- 2.3 When information in the financial statements is communicated ineffectively, users might have difficulty understanding it, and therefore need to spend more time analysing the financial statements. Ineffective communication might also cause users to overlook relevant information or fail to identify relationships between pieces of information in different parts of the financial statements.
- 2.4 The Board has identified the following examples of ineffective communication in financial statements:
- (a) use of generic or 'boilerplate' descriptions—for example, copying requirements directly from IFRS Standards without tailoring them to explain how the entity applies those requirements to its own circumstances;

- (b) use of unclear descriptions—for example, use of technical jargon without explaining the terms or use of descriptions that provide an incomplete explanation because they assume a level of understanding that users are unlikely to have;
- (c) poor organisation of information in the financial statements—for example, inappropriate grouping of information or not providing a contents page or other navigation aids;
- (d) unclear linkage between related pieces of information in different parts of the financial statements—for example, scattering information about assets that are pledged as security for borrowings across several note disclosures without providing cross-references or other links between those disclosures;
- (e) unnecessary duplication of information—for example, when the note disclosure for inventories repeats the information in the statement of financial position without adding further information;
- (f) needlessly disclosing information in a format that is inconsistent with industry practice or changing the way information is disclosed in the financial statements from period to period without considering that this makes it difficult for users of financial statements to make comparisons of that information with other entities or between reporting periods;
- (g) using narrative disclosure when a table would be more effective; and
- (h) omitting material information or including immaterial information that might obscure material information.<sup>12</sup>

## **Approaches to addressing the issue**

2.5 This subsection:

- (a) identifies principles of effective communication (paragraphs 2.6–2.11);
- (b) considers including such principles in a general disclosure standard or in non-mandatory guidance (paragraphs 2.12–2.15); and
- (c) discusses guidance on the use of formatting in the financial statements (paragraphs 2.16–2.23).

## **Principles of effective communication**

2.6 On the basis of the feedback it has received, the Board's preliminary view is that it should develop a set of principles to help entities communicate information more effectively in the financial statements. The Board's preliminary view is also that these principles should consist of the following seven principles in (a)–(g).

The information provided should be:

<sup>12</sup> In Section 1, 'not enough relevant information' and 'irrelevant information' have been highlighted separately from 'ineffective communication' as concerns comprising the 'disclosure problem' (see paragraph 1.5), but they are also a form of ineffective communication. IFRS Standards already describe materiality (see paragraph 7 of IAS 1) and so this is not considered in the principles discussed in this section.

- (a) entity-specific, since information tailored to an entity's own circumstances is more useful than generic, 'boilerplate' language or information that is readily available outside the financial statements;
- (b) described as simply and directly as possible without a loss of material information and without unnecessarily increasing the length of the financial statements;
- (c) organised in a way that highlights important matters—this includes providing disclosures in an appropriate order and emphasising the important matters within them;
- (d) linked when relevant to other information in the financial statements or to other parts of the annual report (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.

The Board observes that an entity might need to make a trade-off between some of these principles when preparing its financial statements. For example, while tailoring disclosures to an entity's own circumstances can help to ensure that information is relevant and easier for users of the financial statements to understand, it might reduce comparability and consistency between entities and periods. The Board recommends that an entity use judgement when applying these principles in order to maximise the usefulness of the information for users of the financial statements.

- 2.7 The principles listed in paragraphs 2.6(a)–(f) were included in the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* (the *Conceptual Framework Discussion Paper*).<sup>13</sup> Many respondents to the *Conceptual Framework Discussion Paper* agreed with including them in the revised *Conceptual Framework*. However, some respondents suggested that some or all of those principles would be better placed in a Standard. The Board observes that some of those principles focus more on the preparation of financial statements than on underlying concepts. Accordingly, while developing the *Conceptual Framework Exposure Draft*, the Board proposed including in the revised *Conceptual Framework* only communication principles that also describe the underlying concepts (see paragraph 2.2).<sup>14</sup>

<sup>13</sup> See paragraph 7.50 of the *Conceptual Framework Discussion Paper*.

<sup>14</sup> See paragraphs BC7.19 and BC7.22 of the Basis for Conclusion accompanying the *Conceptual Framework Exposure Draft*.



- 2.8 The Board's preliminary views are:
- (a) that all of the principles in paragraphs 2.6(a)–(f) are principles of effective communication that should be applied when preparing financial statements; and
  - (b) there should also be a principle on formatting (paragraph 2.6(g)) for the reasons explained in paragraphs 2.17–2.19.
- 2.9 The Board also discussed the principle of cohesiveness developed in its previous Financial Statement Presentation project. That principle was described as follows:<sup>15</sup>
- An entity shall present information in its financial statements so that the relationship among items across the financial statements is clear.
- To present a cohesive set of financial statements, an entity shall present disaggregated information in the sections, categories and subcategories in the statements of financial position, comprehensive income and cash flows in a manner that is consistent across those three statements.
- 2.10 During that project there was wide support, particularly among users of financial statements, for the general idea that information should be presented in a way that makes the relationship between items across the financial statements clear. However, the specific way in which the Board proposed applying cohesiveness—namely, in conjunction with disaggregation of line items—raised concerns, particularly from entities that prepare financial statements.
- 2.11 The Board is not proposing to introduce such a principle of cohesiveness as part of this project. The Board suggests linking pieces of information in financial statements when it helps users of the financial statements to understand the relationship between them and to navigate the financial statements. The principle in paragraph 2.6(d) covers this point.

**Inclusion of principles in a general disclosure standard or in non-mandatory guidance**

- 2.12 The Board has not yet formed a preliminary view on whether the principles of effective communication listed in paragraph 2.6 should be:
- (a) described in non-mandatory guidance (paragraph 2.13); or
  - (b) prescribed in a general disclosure standard (paragraphs 2.14–2.15).

*Non-mandatory guidance*

- 2.13 Some Board members see the principles of effective communication as educational in nature. They observe that the principles would be difficult to enforce and audit, and therefore it would not be appropriate to include them in a Standard. Furthermore, they observe that if the principles are included in

<sup>15</sup> See paragraphs 57–58 of the Staff Draft of Exposure Draft *Financial Statement Presentation*, July 2010 (<http://www.ifrs.org/Current-Projects/IASB-Projects/Financial-Statement-Presentation/Phase-B/Pages/Staff-draft-of-proposed-standard.aspx>).

non-mandatory guidance, the Board would be able to combine the principles with practical guidance—for instance, including examples of their application. Non-mandatory guidance could be:

- (a) in the form of illustrative examples or implementation guidance that accompany, but do not form part of, the general disclosure standard;
- (b) in the form of a Practice Statement that does not accompany a specific Standard; or
- (c) provided as separate educational material, for example, made available on the IFRS Foundation’s website.

Non-mandatory guidance in (a) and (b) would be included in Part B of the *IFRS Bound Volume* and subject to full due process. Educational material in (c) would be subject to due process of a more limited nature.

### *General disclosure standard*

- 2.14 Other Board members suggest that the principles of effective communication should be made mandatory by inclusion in a general disclosure standard because of their importance in addressing the disclosure problem. Including principles in a Standard would give them more authority. If they are included in a general disclosure standard, the principles would also remain easily accessible, whereas they might be more easily overlooked in non-mandatory guidance.
- 2.15 Some Board members observe that communication principles could be considered an extension of the fundamental characteristics of relevance and faithful representation. Although these fundamental characteristics are described in the *Conceptual Framework (2010)* rather than in IFRS Standards, they are referred to in IAS 1 in the description of a fair presentation.<sup>16</sup> In line with this, some Board members suggest that including the principles of effective communication in a general disclosure standard would be appropriate. Furthermore, they observe that paragraphs 113–114 of IAS 1 already set out requirements on the systematic ordering or grouping of the notes that incorporate features of the principles in paragraphs 2.6(c) and (d).

### **Provision of guidance on formatting**

- 2.16 This subsection considers the following questions:
  - (a) why is the Board considering developing guidance on formatting (paragraphs 2.17–2.19)?
  - (b) what should the guidance cover (paragraphs 2.20–2.22)?
  - (c) should guidance on formatting be included in a general disclosure standard (paragraph 2.23)?

### *Why is the Board considering developing guidance on formatting?*

- 2.17 The Board has received feedback from some stakeholders, including users of financial statements, that more effective use of formatting would improve how

<sup>16</sup> Paragraphs 15 and 17(b) of IAS 1, for example, refer to these characteristics.

entities communicate information. For example, some said that more frequent use of tables and graphs, when appropriate, helps users of financial statements to understand and compare information quickly. The Board received further feedback that some entities are uncertain whether some formats, for example, graphs, can be used. Several organisations in the financial services industries have recently published reports that provide guidance on the use of tabular formats for disclosures.<sup>17</sup> Furthermore, in some of the more recent IFRS Standards, the Board has stated that it is a requirement for some disclosures to be made in a tabular format unless another format is more appropriate.<sup>18</sup>

2.18 For these reasons, the Board's preliminary view is that use of formatting should be included as one of the principles of effective communication in paragraph 2.6. The Board observes, however, that it would generally be inappropriate for IFRS Standards to prescribe a specific format for a particular disclosure requirement. The appropriate format depends on entity-specific factors, as well as on the type of information being disclosed. For example:

- (a) if an entity allocates goodwill to several cash-generating units for impairment testing applying paragraph 80 of IAS 36 *Impairment of Assets*, it might be appropriate to show the allocations in a tabular format; but
- (b) if an entity allocates all goodwill to a single cash-generating unit, a narrative explanation might be more appropriate than a table.

2.19 Nevertheless, on the basis of both the feedback it has received and the trend towards fostering better use of tables described in paragraph 2.17, the Board's preliminary view is that it should develop more detailed guidance on using formatting in the financial statements. The Board suggests that this guidance could help to improve the effectiveness of information communicated in the notes.

#### *What should the guidance cover?*

2.20 The Board has identified the following areas that the guidance might cover, along the lines discussed in paragraphs 2.21–2.22:

- (a) types of formats;
- (b) when one particular format is more appropriate than another; and
- (c) illustrative examples.

2.21 Some formats can make particular types of information disclosed in the financial statements easier to read, analyse and understand. Appropriate formatting to consider includes narrative text, lists, tables, graphs and diagrams, as discussed in the table in paragraph 2.22. Text features such as font type and size, as well as the use of bold type, underlining and colour, can be used to assist understanding or add emphasis to specific information. Advances in technology might create further ways in which to present and disclose

<sup>17</sup> Examples of such reports are those of the Enhanced Disclosure Task Force (EDTF), the European Banking Authority (EBA) and the Basel Committee on Banking Supervision (BCBS).

<sup>18</sup> See, for example, paragraphs 13C and 24A–24C of IFRS 7 *Financial Instruments: Disclosure*, paragraphs 28 and 29 of IFRS 12 *Disclosure of Interests in Other Entities* and paragraph 99 of IFRS 13 *Fair Value Measurement*.

information in financial statements. For example, content bars and text-search functions within an online electronic report might help users find information more quickly. Structured electronic data may use other features to facilitate understanding of the information. Such features may include a taxonomy data model or the use of formulae to express data relationships.

2.22 The following table explains and illustrates some common formatting types:

**Table 2.1—Common formatting types**

Formatting	Lists	Tables	Narrative text	Graphs and charts
<b>Description</b>	A list organises items consecutively.	A table organises information in rows and columns.	A narrative text is a written account of events.	Graphs and charts summarise numerical data and give them shape and form. Types include line graphs, bar charts and pie charts.
<b>When might the format be appropriate to use</b>	Lists can be used to break up long narrative text, rank items or highlight relationships between items.	Tabular formats are appropriate for presenting: (a) information that is designed for comparison; (b) values or amounts; (c) large amounts of data; and/or (d) information that needs to be described from different perspectives—for example, data over a number of reporting periods.	Narrative is appropriate if: (a) the aim is to explain detailed qualitative aspects, or to describe an event or transaction, rather than to present large amounts of quantitative data; and/or (b) the aim is to explain quantitative data or the relationship between items of data—for example, to explain significant changes in how numbers in a table were measured.	A graph or chart can be used: (a) to simplify complex data and/or highlight patterns and trends in the data, provided that they display data fairly; and/or (b) supplement data provided in another format, such as a table.

*continued...*

...continued

Formatting	Lists	Tables	Narrative text	Graphs and charts
<b>Examples of when the format might be used</b>	For disclosing an entity's subsidiaries and other related parties. For disclosing the various risks to which an entity is exposed.	For reconciliations of balances. For maturity analysis. For sensitivity analysis. For showing useful lives of assets. For disaggregation of line items in the primary financial statements.	For describing accounting policies. For describing objectives, policies and processes for managing risk and the methods used to measure the risk.	For showing sales figures by geographical area or business segment. For showing geographical concentration and amount of credit risk. Graphs and charts are often more commonly used in other kinds of reports, such as management commentary, than in the financial statements.

*Should guidance on formatting be included in a general disclosure standard?*

- 2.23 The Board's preliminary view is that the type of guidance described in paragraphs 2.20–2.22 would be more suitable in non-mandatory guidance than in a general disclosure standard.

## Summary of the Board’s preliminary views and questions for respondents

### Question 3

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

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

- (a) Do you agree that the Board should develop principles of effective communication that entities should apply when preparing the financial statements? Why or why not?
- (b) Do you agree with the principles listed in paragraph 2.6? Why or why not? If not, what alternative(s) do you suggest, and why?
- (c) Do you think that 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.

## Section 3—Roles of the primary financial statements and the notes

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3.1 This section discusses whether a general disclosure standard should describe the roles of the different components of the financial statements and how those roles meet the objective of financial statements. Such a description would guide the Board and entities in determining the appropriate location of information in the financial statements. This section:

- (a) identifies, and considers the role of, the primary financial statements and considers the implications of that role; and
- (b) considers the role and the content of the notes.

### Current requirements, guidance and proposals in other documents

3.2 Paragraph 3.4 of the *Conceptual Framework* Exposure Draft proposes the following description of the objective of financial statements:<sup>19</sup>

...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.

3.3 IAS 1 *Presentation of Financial Statements* specifies that a complete set of financial statements comprises:<sup>20</sup>

- (a) the following statements:
  - (i) statement of financial position;
  - (ii) statement(s) of profit or loss and other comprehensive income;
  - (iii) statement of changes in equity; and
  - (iv) statement of cash flows.
- (b) notes, comprising significant accounting policies and other explanatory information.

3.4 Neither the *Conceptual Framework (2010)* nor IFRS Standards consistently use a specific term to refer to the set of statements listed in paragraph 3.3(a), nor do they define their role in meeting the objective of financial statements.

3.5 Paragraph 7 of IAS 1 defines the notes as follows:

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19 Paragraph 9 of IAS 1 states that 'The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. Financial statements also show the results of the management's stewardship of the resources entrusted to it'. The Board will consider whether to align the objective of financial statements in IAS 1 with the forthcoming revised *Conceptual Framework* if it amends or replaces IAS 1 as part of this project.

20 Paragraph 10 of IAS 1 states that a complete set of financial statements comprises a statement of financial position as at the end of the period, the statements listed in paragraph 3.3(a)(ii)–(iv) for the period, comparative information in respect of the preceding period, a statement of financial position at the beginning of the preceding period in certain circumstances, and notes.

Notes contain information in addition to that presented in the statement of financial position, statement(s) of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows. Notes provide narrative descriptions or disaggregations of items presented in those statements and information about items that do not qualify for recognition in those statements.

3.6 Paragraph 112 of IAS 1 states:

The notes shall:

- (a) present information about the basis of preparation of the financial statements and the specific accounting policies used...;
- (b) disclose the information required by IFRSs that is not presented elsewhere in the financial statements; and
- (c) provide information that is not presented elsewhere in the financial statements, but is relevant to an understanding of any of them.

3.7 The *Conceptual Framework* Exposure Draft proposes clarifying that the notes include information about:<sup>21</sup>

- (a) the nature of both recognised and unrecognised elements and about the risks arising from them;
- (b) the methods, assumptions and judgements, and changes in those methods, assumptions and judgements, that affect the amounts presented or disclosed;
- (c) transactions and events that have occurred after the end of the reporting period if such information is necessary to meet the objective of financial statements described in paragraph 3.2;
- (d) forward-looking information about likely or possible future transactions and events, only if it provides relevant information about an entity's assets, liabilities and equity that existed at the end of, or during, the period (even if they are unrecognised) or income and expenses for the period; and
- (e) comparative information about preceding periods.

### What is the issue?

3.8 The Board received feedback that entities perceive the information in the statements listed in paragraph 3.3(a) to be used more frequently and be subject to more scrutiny from users, auditors and regulators than the information in the notes.

3.9 The Board has received further feedback that some users of financial statements analyse the information in the statements listed in paragraph 3.3(a) more closely than they do with information in the notes. This feedback indicates that users' decisions could be affected by whether entities present particular information separately in those statements, rather than disclosing it solely in the notes. This is supported by some academic research that provides evidence that some users

<sup>21</sup> This list is a summary of paragraphs 7.3–7.7 of the *Conceptual Framework* Exposure Draft.



of financial statements appear to react in different ways depending on how and where information is presented or disclosed in the financial statements.<sup>22</sup>

3.10 The Board has also received feedback that entities find it difficult to exercise judgement about what information should be presented in the statements listed in paragraph 3.3(a) instead of being disclosed in the notes. In some cases, IFRS Standards allow an entity to choose whether to provide information either in those statements or in the notes. However, it appears that the following use of terminology in IFRS Standards is contributing to these difficulties in exercising judgement:

- (a) there is no clear terminology used to distinguish between the statements listed in paragraph 3.3(a) and the complete set of financial statements described in paragraph 3.3, and so, in practice, a range of terms is used. For example, both ‘face of the financial statements’ and ‘primary financial statements’ are used for the statements listed in paragraph 3.3(a). Some parties have said IFRS Standards are sometimes unclear about whether the terms ‘financial statements’ and ‘statements’ refer to the complete set of financial statements or only to the statements listed in paragraph 3.3(a). The term ‘statements’ is also used to refer to other reports within the annual report—for example, to a management commentary or risk report.<sup>23</sup>
- (b) the term ‘present’ is often used in IFRS Standards to describe the inclusion of information separately in the statements listed in paragraph 3.3(a), whereas ‘disclose’ is often used to describe the inclusion of information in the notes. Some IFRS Standards contain a separate section titled ‘presentation’ that addresses presentation in the statements listed in paragraph 3.3(a), and ‘disclosures’ that addresses disclosures in the financial statements, which are usually provided in the notes.<sup>24</sup> The Board has received feedback that this is how the terms are commonly understood in practice. Although IFRS Standards commonly use these terms this way, they do not do so consistently.

### Approaches to addressing the issue

3.11 This subsection covers the following:

- (a) the use of the term ‘primary financial statements’ for the statements listed in paragraph 3.3(a) (paragraphs 3.14–3.19);
- (b) the role of such primary financial statements (paragraphs 3.20–3.23);
- (c) the implications of that role (paragraph 3.24);
- (d) the role and content of the notes (paragraphs 3.25–3.30); and

22 Some examples of such academic research are identified in *Reporting Format Effects and the IASB Conceptual Framework*, Hopkins (Kelley School of Business, Indiana University, 2014) available at: <http://www.ifrs.org/IFRS-Research/2014/Documents/Panel%20discussion%20-%20decision-useful%20information2.pdf>.

23 An example of this is paragraph 21B of IFRS 7 *Financial Instruments: Disclosures*.

24 In some cases disclosure requirements provide flexibility for an entity either to present information in the primary financial statements or disclose it in the notes.

(e) the use of the terms ‘present’ and ‘disclose’ (paragraphs 3.31–3.32).

3.12 This Discussion Paper does not discuss possible changes to the structure and content of the primary financial statements. The Board has been performing research into whether such changes are necessary in its separate Primary Financial Statements project (see paragraph 1.17(a)).

3.13 In addition, this Discussion Paper does not discuss specific cases of when to present particular information in the primary financial statements or when to disclose it in the notes. The Board might consider, in its Standards-level Review of Disclosures project (paragraph 1.16(c)), whether disclosure requirements should explicitly require information to be presented in the primary financial statements or in the notes.

**Use of the term ‘primary financial statements’ for the statements listed in paragraph 3.3(a)**

3.14 To address the concerns raised about terminology in paragraph 3.10(a) and to help with the drafting of IFRS Standards, the Board’s preliminary view is that a consistent term should be specified to describe the statements listed in paragraph 3.3(a).

3.15 The Board considered each of the following terms:

- (a) primary financial statements;
- (b) face of the financial statements;
- (c) statements;
- (d) set of statements;
- (e) main financial statements; and
- (f) summary statements.

3.16 The Board’s preliminary view is that the term ‘primary financial statements’ is the best alternative of those listed in paragraph 3.15 for the following reasons:

- (a) the term appears to be well understood and widely used. Some respondents to the *Conceptual Framework* Exposure Draft urged the Board to use this term because it is commonly used by the financial community to refer to the statements listed in paragraph 3.3(a).
- (b) the term is not currently used for other purposes, for example, the term ‘statements’ might be confused with a complete set of financial statements or other financial reports, such as management commentary, as explained in paragraph 3.10(a).
- (c) introducing a new term might create confusion, and it could take time for stakeholders to accept and recognise its use.

3.17 Some stakeholders have concerns about using the term ‘primary financial statements’ because they say it inaccurately implies that other information in the financial statements is ‘secondary’ or less important. However, the Board observes that it could mitigate these concerns by:

- (a) stating that the term ‘primary’ does not intend to imply that the notes are inferior, or that they provide secondary or less important information. Rather they provide different information and have a different role.
  - (b) explaining that the term ‘primary’ reflects the fact that the primary financial statements are usually provided at the front of an entity’s financial statements and that they are generally the starting point for analysis of those financial statements. This is because the primary financial statements provide an overview of an entity’s assets, liabilities, equity, income and expenses, and often the line items that they contain help users of financial statements navigate to the supporting information in the notes by acting as an index.
- 3.18 Some stakeholders disagree on which statements should constitute the primary financial statements:
- (a) some say that the primary financial statements should only consist of the statement(s) of financial performance (ie the statement(s) presenting profit or loss and other comprehensive income) and the statement of financial position, because these statements provide a complete summary of all recognised elements of the financial statements and comprise items that meet the definitions of the elements.<sup>25</sup>
  - (b) some say that they should only consist of the statement(s) of financial performance, the statement of financial position and the statement of changes in equity. Some stakeholders have told the Board that this is because the statement of cash flows is often not meaningful for financial institutions.
  - (c) some say that they should only consist of the statement(s) of financial performance, the statement of financial position and the statement of cash flows.
  - (d) some say that they should consist of all the statements listed in paragraph 3.3(a), together with operating segment information.
- 3.19 However, the Board’s preliminary view is that, in line with common practice and understanding, the term ‘primary financial statements’ should be used for the set of statements listed in paragraph 3.3(a).

### **The role of the primary financial statements**

- 3.20 The Board considers that users of the financial statements pay more attention to the primary financial statements than to the notes because:
- (a) the primary financial statements are usually provided at the start of the financial statements;
  - (b) the primary financial statements give an overview of an entity’s financial position, financial performance, cash flows and changes in its equity and can be used to identify areas that users might wish to investigate further;

<sup>25</sup> Paragraph 4.3 of the *Conceptual Framework* Exposure Draft states that the elements of financial statements are assets, liabilities, equity, income and expenses.

- (c) the primary financial statements are in a more standardised format than the notes and can therefore be more easily used to make comparisons between entities;
  - (d) the information in the primary financial statements is sometimes published earlier than some of the information in the notes—for example, earnings announcements and press releases sometimes summarise that information and are issued prior to publication of the financial statements as a whole; and
  - (e) the information in the primary financial statements is more likely to be included in information collected and provided by data aggregators than information in the notes.
- 3.21 The Board observes that the evidence that users of financial statements pay more attention to the primary financial statements than to the notes implies that the primary financial statements and the notes have different roles in meeting the objective of financial statements. The Board suggests that defining the role of the primary financial statements would:
- (a) assist the Board in deciding what information to permit and what information to require to be presented in the primary financial statements; and
  - (b) help entities decide whether to present an item separately in a primary financial statement, or whether to aggregate it with other items included in the primary financial statements.
- 3.22 The Board's preliminary view is that the role of the primary financial statements is to provide a structured and comparable summary of an entity's recognised assets, liabilities, equity, income and expenses, which is useful for:
- (a) obtaining an overview of the entity's assets, liabilities, equity, income and expenses;
  - (b) making comparisons between entities and reporting periods; and
  - (c) identifying items or areas within the financial statements about which users of the financial statements will seek additional information in the notes.
- 3.23 The role of the primary financial statements has been derived from the objective of financial statements in the *Conceptual Framework* Exposure Draft. This objective does not refer to providing information about cash flows because cash flows are not identified as separate elements of financial statements in the *Conceptual Framework* Exposure Draft (see explanation in paragraphs BC4.106–BC4.110 and paragraph BC7.8(b) of the Basis for Conclusions accompanying the *Conceptual Framework* Exposure Draft).<sup>26</sup> However, information about cash and cash flows is important to users of financial statements and therefore the Board recommends that the statement of cash flows, which is identified as a required statement under IAS 1, should be identified as one of the primary financial statements.

<sup>26</sup> Assets are elements and cash is a type of asset.

### **The implications of the role of the primary financial statements**

- 3.24 In addition to clarifying the role of the primary financial statements, the Board's preliminary view is that it would be helpful to set out the implications of that role as follows:
- (a) information in the primary financial statements is more prominent than information in the notes;
  - (b) it is presumed that each primary financial statement will be included in a complete set of financial statements;
  - (c) all line items in a primary financial statement are depicted in words and by a monetary amount, and are included in the totals for that statement;<sup>27</sup>
  - (d) all recognised elements are included in the totals in the primary financial statements; and
  - (e) a decision on whether to present information as a separate line item in the primary financial statements is made after considering the role of the primary financial statements. If information is not shown as a line item in the primary financial statements because it is aggregated there with other information, it might need to be disclosed separately in the notes.<sup>28</sup>

### **The role and content of the notes**

- 3.25 The Board suggests that clarifying the role of the notes would:
- (a) assist the Board in deciding what information to permit and what information to require to be disclosed in the notes when setting disclosure requirements; and
  - (b) help entities decide what information to disclose in the notes to explain and supplement the primary financial statements.
- 3.26 Several standard-setters have issued publications that consider the role and content of the notes.<sup>29</sup> Having considered this work and its own outreach and research, the Board observes that stakeholders seem to share the common view that one role of the notes is to provide further explanation of information provided in the primary financial statements. Examples of such further explanatory information include:
- (a) disaggregation and reconciliations of line items in the primary financial statements;
  - (b) descriptions of the nature of the items included in the primary financial statements; and

<sup>27</sup> On the basis of paragraph 5.2 of the *Conceptual Framework Exposure Draft*.

<sup>28</sup> Further guidance may be developed on this implication in other projects in the Disclosure Initiative (see paragraphs 3.12–3.13).

<sup>29</sup> These include 2014 FASB Exposure Draft *Conceptual Framework for Financial Reporting—Chapter 8: Notes to Financial Statements* and the 2012 EFRAG, ANC and FRC Discussion Paper *Towards a Disclosure Framework for the Notes*.

- (c) information about the methods, assumptions and judgements used in recognising and measuring the items included in the primary financial statements.
- 3.27 In addition, the Board observes that stakeholders seem to share the common view that the notes supplement information in the primary financial statements by including additional information necessary to satisfy the objective of financial statements. Examples of such supplementary information include:
- (a) information about the nature and extent of an entity's unrecognised elements; and
  - (b) information about an entity's exposure to various types of risks, such as market risk or credit risk, arising from both recognised and unrecognised elements.
- 3.28 In the light of paragraphs 3.26–3.27, the Board's preliminary view is 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 meet the objective of financial statements.
- 3.29 The Board's preliminary view is that the role of the notes as outlined in paragraph 3.28 should be included in a general disclosure standard with some of the further explanatory and supplementary information listed in paragraphs 3.26–3.27. The Board observes that this role would be consistent with the existing requirements in IAS 1 as described in paragraphs 3.5–3.6, and would clarify rather than change those requirements. The Board also observes that it would be consistent with the proposed guidance in paragraphs 7.3–7.7 of the *Conceptual Framework* Exposure Draft on the content of the notes, as described in paragraph 3.7. The Board's preliminary view is that this proposed guidance on the content of the notes should also be included in a general disclosure standard to clarify the role of the notes and to make the proposed guidance authoritative.
- 3.30 In the light of the Board's preliminary view that it should define the term 'primary financial statements', the Board would also clarify that the notes are that part of the financial statements other than the primary financial statements.

### **Use of the terms 'present' and 'disclose'**

- 3.31 As mentioned in paragraph 3.10(b), some stakeholders say that the Board should clarify the meanings of the terms 'present' and 'disclose' when using them to describe the location of information in the financial statements. The Board observed that the term 'present' usually describes providing information in the primary financial statements, whereas 'disclose' usually describes providing information in the notes. Nevertheless, the Board observes that the terms are not currently used exclusively in this way. The Board observes that confusion might arise from clarifying how 'present' and 'disclose' are used to indicate the location of information in the financial statements and then using them in this way. This is because there is only a subtle difference between the meanings of

these two words and each of these words already has a well-defined, and different, meaning in the English language. The Board also observes that if it clarifies the meaning of the words, it would need to amend existing Standards to ensure that the words are applied as defined. This would be a time-consuming task and may result in little overall benefit.

- 3.32 However, when drafting Standards in the future, the Board's preliminary view is that rather than using the terms 'present' and 'disclose' on their own to specify the location of information in the financial statements, the intended location—'in the primary financial statements' or 'in the notes'—should also be specified.

### Summary of the Board's preliminary views and questions for respondents

Question 4
<p>The Board's preliminary views are that a general disclosure standard should:</p> <ul style="list-style-type: none"> <li>• specify that the 'primary financial statements' are the statements of financial position, financial performance, changes in equity and cash flows;</li> <li>• describe the role of primary financial statements and the implications of that role as set out in paragraphs 3.22 and 3.24;</li> <li>• 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 3.26–3.27; and</li> <li>• include the guidance on the content of the notes proposed in paragraphs 7.3–7.7 of the <i>Conceptual Framework</i> Exposure Draft, as described in paragraph 3.7.</li> </ul> <p>In addition, the Board's preliminary views are that:</p> <ul style="list-style-type: none"> <li>• 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; and</li> <li>• 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'.</li> </ul> <p>Do you agree with the Board's preliminary views? Why or why not? If you do not agree, what do you suggest instead, and why?</p>

## Section 4—Location of information

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- 4.1 The Board has received feedback that duplication and fragmentation of information can make financial statements and annual reports more difficult to analyse and understand. This section discusses whether a general disclosure standard should include requirements on whether and when an entity can:
- (a) provide information that is necessary to comply with IFRS Standards outside the financial statements (see paragraphs 4.2–4.24); or
  - (b) provide information that is identified as ‘non-IFRS information’, or by a similar labelling (to distinguish it from information necessary to comply with IFRS Standards), within the financial statements (see paragraphs 4.25–4.39).

### Including information necessary to comply with IFRS Standards outside the financial statements

#### Current requirements

- 4.2 Paragraph 49 of IAS 1 *Presentation of Financial Statements* states that an entity shall clearly identify the financial statements and distinguish them from other information in the same published document.
- 4.3 Some IFRS Standards<sup>30</sup> permit an entity to provide specific information required by Standards outside the financial statements, provided that:
- (a) the information is incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report; and
  - (b) this other statement is available to users of the financial statements on the same terms as the financial statements and at the same time.
- 4.4 Two IFRS Standards contain requirements about cross-referencing that differ from those set out in paragraph 4.3:
- (a) when an entity is a first-time adopter of IFRS Standards, its first interim financial report can incorporate specified information by cross-reference to another published document (paragraph 32(b) of IFRS 1 *First-time Adoption of International Financial Reporting Standards*); and
  - (b) if an entity participates in a defined benefit plan that shares risks between entities under common control, it can incorporate specified information about the plan by cross-reference to disclosures in another group entity’s financial statements—if that group entity’s financial statements are available to users of the financial statements on the same terms and at the same time, or earlier (paragraph 150 of IAS 19 *Employee Benefits*).

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<sup>30</sup> For example, paragraph 21B of IFRS 7 *Financial Statements: Disclosures* and paragraph 31 of IFRS 14 *Regulatory Deferral Accounts*.



**What is the issue?**

- 4.5 In some jurisdictions and industries there is an overlap between the information required by IFRS Standards and the information required by legislation or regulatory authorities. Disclosure of directors' remuneration is an example of overlap of requirements in some jurisdictions. Sometimes regulatory requirements require information to be published outside the financial statements, for example, Basel Pillar 3 disclosures for banks are required to be included in a stand-alone report.<sup>31</sup> This means information in the separate report might be repeated in the financial statements.
- 4.6 The Board received feedback that there is a range of interpretations of when IFRS Standards permit information to be incorporated in the financial statements using a cross-reference from the financial statements to another statement:
- (a) some think the requirements described in paragraphs 4.3–4.4 are exceptions that only apply to those specified disclosures.
  - (b) others think that cross-referencing can be applied more generally. For example, although there is no specific permission to do so in IFRS 8 *Operating Segments*, some entities provide their segment information in management commentary, with a cross-reference from the financial statements.
- 4.7 Some respondents to the *Conceptual Framework* Discussion Paper asked the Board to provide general guidance on when cross-referencing is appropriate and to encourage cross-referencing in those cases. Some expressed the view that cross-referencing should be encouraged in some cases because it:
- (a) reduces the need for duplication of information and can shorten disclosures in the financial statements and in the rest of the annual report; and
  - (b) highlights relationships between pieces of information and enhances their understandability.
- 4.8 Nevertheless, the Board also received concerns that excessive or inappropriate cross-referencing can:
- (a) make the financial statements fragmented and difficult to understand;
  - (b) make it difficult to identify which information is part of the financial statements;
  - (c) make it difficult to discern which information has been audited;
  - (d) make it difficult to find or access the cross-referenced information, particularly if it is located outside of a single reporting package—for example, if the cross-referenced material is on the entity's public website or in a stand-alone report;

<sup>31</sup> See paragraph 6 of Part 1 of the Revised Pillar 3 disclosure requirements (<http://www.bis.org/bcbs/publ/d309.pdf>).

- (e) increase the risk that the cross-referenced material will not remain available for the same length of time as the financial statements of which it is an integral part; or
- (f) undermine information necessary to comply with IFRS Standards if such information is placed next to information that is inconsistent with IFRS Standards—for example, information that is not measured in accordance with IFRS Standards.

### Approaches to addressing the issue

- 4.9 The Board's preliminary view is 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 following requirements:
- (a) it is provided within the entity's annual report;
  - (b) its location outside the financial statements makes the annual report as a whole more understandable, the financial statements remain understandable and the information is faithfully represented; and
  - (c) it is clearly identified and incorporated in the financial statements by means of a cross-reference that is made in the financial statements.
- 4.10 The term 'annual report' is not currently defined in IFRS Standards. The Board's preliminary view is that an entity's annual report should be described as a single reporting package issued by that entity that includes the financial statements and has boundaries similar to those described in the International Standard on Auditing (ISA) 720 (Revised) *The Auditor's Responsibilities Relating to Other Information* (described in paragraphs 4.20–4.21). The Board has not discussed interim financial reporting in detail during this project, but it observes that an interim report could also be described as a single reporting package issued by an entity and that the principle in paragraph 4.9 could similarly be applied to an interim report.
- 4.11 The Board observes that the principle in paragraph 4.9 might not address all stakeholders' concerns about duplication—some of which have arisen from the existence of similar, but not identical, requirements in IFRS Standards and regulatory requirements. For example, a regulator might require an entity to disclose one piece of information that is similar to, but not the same as, a piece of information required by IFRS Standards. The entity would still have to comply with both requirements, but would not be able to use cross-referencing to avoid duplication in this case. Furthermore, there might be local requirements in a jurisdiction that restrict an entity from providing the information necessary to comply with IFRS Standards outside the financial statements.
- 4.12 When developing the principle described in paragraph 4.9, the Board discussed:
- (a) when it would be appropriate to provide information necessary to comply with IFRS Standards outside the financial statements (paragraphs 4.13–4.14);

- (b) whether to develop a principle or provide specific requirements in IFRS Standards (paragraphs 4.15–4.18);
- (c) whether to limit the location of the cross-referenced information (paragraphs 4.19–4.23); and
- (d) how to identify the cross-referenced information (paragraph 4.24).

*When it would be appropriate to provide information necessary to comply with IFRS Standards outside the financial statements*

4.13 The Board suggests that it might be appropriate to provide information necessary to comply with IFRS Standards outside the financial statements, but within the annual report, if, for example, it:

- (a) highlights relationships between pieces of information, which may enhance their understandability; or
- (b) reduces duplication of information.

4.14 However, entities might need to limit their use of cross-referencing because excessive or inappropriate use makes the financial statements fragmented and difficult to understand.

*A principle versus specific requirements*

4.15 The Board considered whether a principle on when an entity can provide information outside the financial statements should be applicable across IFRS Standards or whether it should be applied by the Board on a case-by-case basis—that is, whether the Board should use the principle solely to determine whether to permit cross-referencing for particular requirements in Standards.

4.16 The most common reason for an entity providing information outside the financial statements appears to be to avoid duplicating information that is also required by legislation or regulatory authorities (see paragraph 4.5). Regulatory and legal requirements vary across jurisdictions and industries, and might change over time. A principle that applies to all IFRS Standards would have the following advantages over the use of specific requirements in Standards:

- (a) entities would be able to exercise judgement when applying it to their specific circumstances;
- (b) the Board would not need to make continual changes to Standards in response to changes in requirements set by legislation or by regulatory authorities; and
- (c) requirements would not need to be duplicated across Standards, which would prevent possible inconsistencies from arising in how those Standards describe the requirements.

4.17 The Board observes that having specific requirements in Standards would only be preferable to having a principle if:

- (a) the principle were not sufficiently restrictive, or if it were applied inappropriately, as it might lead to excessive or inappropriate cross-referencing, as described in paragraph 4.8; or

- (b) feedback suggests that cross-referencing is only appropriate in particular limited circumstances.

- 4.18 If a principle is included in a general disclosure standard, it might be possible to delete the specific requirements in the Standards described in paragraph 4.3. Any such change would need to go through the Board's normal due process for amending Standards.

*Limitations on the location of cross-referenced information*

- 4.19 Most Standards that permit cross-referencing for specific information (see paragraph 4.3) require information to be available to users on the same terms<sup>32</sup> as the financial statements and at the same time. The Board agrees with the concerns expressed in paragraph 4.8(d) that it might be difficult to find or access information if it is located outside of a single reporting package. Consequently, the Board's preliminary view is that a principle should only allow cross-referencing to be used to incorporate information located within the annual report. The Board observes that if an entity were required to publish information outside the annual report to comply with regulatory requirements, any information necessary to comply with IFRS Standards would still need to be repeated in the annual report. For example, a bank would not be able to incorporate information in the financial statements by cross-reference to its Basel Pillar 3 report on its website, even if this report was issued at the same time as the annual report. The Board further acknowledges that limiting the principle to information located in the annual report would not allow for requirements like those identified in paragraph 4.4, when IFRS Standards specifically permit cross-referencing of information outside the annual report. Therefore, the Board would need to consider such requirements separately.
- 4.20 As discussed in paragraph 4.10, IFRS Standards refer to, but do not define, an 'annual report'. The Board discussed the following description of an annual report contained in paragraph 12(a) of ISA 720 (Revised):<sup>33</sup>

Annual report—A document, or combination of documents, prepared typically on an annual basis by management or those charged with governance in accordance with law, regulation or custom, the purpose of which is to provide owners (or similar stakeholders) with information on the entity's operations and the entity's financial results and financial position as set out in the financial statements. An annual report contains or accompanies the financial statements and the auditor's report thereon and usually includes information about the entity's developments, its future outlook and risks and uncertainties, a statement by the entity's governing body, and reports covering governance matters.<sup>34</sup>

<sup>32</sup> Paragraph BC10 of IAS 34 *Interim Financial Reporting* clarifies that 'on the same terms' means '...that users of the financial statements should have access to the referenced material on the same basis as they have for accessing the financial statements from where the reference is made'.

<sup>33</sup> At the time of the Board discussion, ISA 720 (Revised) *The Auditor's Responsibilities Relating to Other Information* had not been issued and so the Board discussed an earlier, but almost identical, version of this description.

<sup>34</sup> ISA 720 (Revised) deals with the auditor's responsibilities relating to other information included in an entity's annual report and describes other information by reference to this definition of an annual report.

- 4.21 Paragraphs A1–A5 of ISA 720 (Revised) provide further guidance to support the description of an annual report, including examples of documents that can form part of the annual report and other stand-alone reports that typically do not. These paragraphs also clarify that law, regulation or custom might require the entity to report to owners by way of a single document (referred to by the title ‘annual report’ or by some other title) or by way of two or more separate documents that in combination serve the same purpose.
- 4.22 Since the Board discussed the principle in paragraph 4.9, it has discussed and finalised an Exposure Draft of proposed amendments to IFRS 8 and IAS 34 titled *Improvements to IFRS 8 Operating Segments* (issued in March 2017) which proposes including the following paragraph 19B in IFRS 8 which describes an entity’s annual reporting package:
- An entity’s annual reporting package is a set of one or more documents that:
- (a) is published at approximately the same time as the entity’s annual financial statements;
  - (b) communicates the entity’s annual results to users of its financial statements; and
  - (c) is publicly available, for example, on the entity’s website or in its regulatory filings.
- In addition to the annual financial statements, the annual reporting package may include a management commentary, press releases, preliminary announcements, investor presentations and information for regulatory filing purposes.
- 4.23 The Board’s description of an ‘annual reporting package’ in paragraph 4.22 is broader than its description of an ‘annual report’ in paragraph 4.10. The Board might incorporate, in the principle in paragraph 4.9, the broader term ‘annual reporting package’ proposed in the Exposure Draft of proposed amendments to IFRS 8 and IAS 34 depending on the feedback it receives on that document.

*Identification of cross-referenced information*

- 4.24 The Board suggests the following ways that entities could identify clearly the information necessary to comply with IFRS Standards that has been provided outside the financial statements (to meet the requirement in paragraph 4.9(c)):
- (a) provide in the financial statements a list of any information that forms part of the financial statements and is incorporated in them by cross-reference, together with its statement of compliance with IFRS Standards;<sup>35</sup>
  - (b) clearly identify the cross-referenced information as information necessary to comply with IFRS Standards and that forms part of the financial statements;
  - (c) ensure the cross-reference in the financial statements clearly identifies and describes the information that it relates to; and

<sup>35</sup> Paragraph 16 of IAS 1 requires an entity whose financial statements comply with IFRS Standards to make an explicit and unreserved statement of such compliance in the notes.

- (d) ensure that the cross-referenced information remains available over time as part of the annual report.

### **Providing information identified as non-IFRS within the financial statements**

- 4.25 This subsection discusses whether a general disclosure standard should include requirements on when an entity can provide information identified as ‘non-IFRS information’, or by a similar labelling, within the financial statements to distinguish it from information necessary to comply with IFRS Standards. Section 5 discusses whether a general disclosure standard should describe how performance measures can be fairly presented in the financial statements. If information identified as non-IFRS information also fits the description of a performance measure given in paragraph 5.2, the discussion in Section 5 *Use of performance measures in the financial statements* will also apply.

### **Current requirements**

- 4.26 IAS 1 states that:
- (a) the application of IFRS Standards, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation (paragraph 15 of IAS 1);
  - (b) a fair presentation requires an entity to provide additional disclosures when compliance with the specific requirements in IFRS Standards is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity’s financial position and financial performance (paragraph 17(c) of IAS 1); and
  - (c) an entity shall provide additional information if it is relevant to an understanding of the financial statements (paragraphs 55, 85 and 112(c) of IAS 1).

In addition, some other IFRS Standards state that an entity shall disclose additional information if necessary to meet the disclosure objective in that Standard.<sup>36</sup>

### **What is the issue?**

- 4.27 Some entities include information identified as ‘non-IFRS information’, ‘not part of the financial statements’, or using similar labelling, within their financial statements. This information might also be unaudited. Examples include:
- (a) summary financial measures of an entity’s financial performance, financial position or cash flows (ie performance measures as described in Section 5 (see paragraph 5.2)) that are not specified in IFRS Standards, or are measured on a basis inconsistent with IFRS Standards;
  - (b) non-financial measures of operations used by management—for example, market share, staff turnover, number of units sold per employee; and

<sup>36</sup> For example, see paragraph 92 of IFRS 16 *Leases*.

- (c) forward-looking information<sup>37</sup>—for example, management's expectations about future sales.
- 4.28 Furthermore, national regulators or standard-setters sometimes require disclosure of additional information, for example, detailed disclosures about the compensation of the entity's directors.
- 4.29 Some stakeholders have stated that some of this information appears to go beyond what is necessary to comply with IFRS Standards. They have asked the Board to clarify whether such information can be located within the financial statements. This information is sometimes referred to by stakeholders as non-IFRS information.
- 4.30 Some entities place additional information in their financial statements because they think that it enhances clarity—for example, they group related information to provide a more comprehensive explanation. Such reasoning is similar to that used by entities in support of providing information outside the financial statements (see paragraph 4.7).
- 4.31 The Board has received the following concerns about including additional information that goes beyond the information necessary to comply with IFRS Standards in the financial statements:
- (a) such additional information might obscure or undermine other information in the financial statements, particularly if that information is inconsistent with IFRS Standards and/or more prominent than information necessary to comply with IFRS Standards;
  - (b) users might find it difficult to identify which information forms part of the financial statements and has been audited; and
  - (c) the inclusion of too much additional information, even if clearly highlighted as non-IFRS information, might make the financial statements appear fragmented.
- 4.32 Several national, regional and international securities regulators have issued guidance on the inclusion of non-IFRS information in the financial statements and in other documents—for example, in press releases. Some of this guidance restricts or places conditions on the inclusion of non-IFRS information in the financial statements.

### **Approaches to addressing the issue**

- 4.33 The Board observes that there are three categories of information in financial statements:
- (a) Category A—information specifically required by IFRS Standards;
  - (b) Category B—additional information necessary to comply with IFRS Standards (see paragraph 4.26); and

<sup>37</sup> Paragraph 7.4 of the *Conceptual Framework* Exposure Draft currently proposes that 'Forward-looking information about likely or possible future transactions and events is included in the financial statements only if it provides relevant information about an entity's assets, liabilities and equity that existed at the end of, or during, the period (even if they are unrecognised) or income and expenses for the period.'

- (c) Category C—additional information that is not in Category A or Category B. This includes information that is inconsistent with IFRS Standards (see paragraph 4.39) and some non-financial information.
- 4.34 The Board observes that regulators and other stakeholders describe non-IFRS information in different ways. Some stakeholders describe non-IFRS information as any information that is not specifically required by IFRS Standards. They say that Categories B and C both comprise non-IFRS information. Other stakeholders, however, describe it as any information that is not necessary to comply with IFRS Standards. They say only Category C comprises non-IFRS information.
- 4.35 While the Board agrees with the latter view—that only Category C should be described as non-IFRS information—it suggests using that term with care due to the differing views about its meaning.
- 4.36 In paragraph 4.9, the Board observes that in some circumstances it might be appropriate to provide information necessary to comply with IFRS Standards outside the financial statements and to incorporate it in the financial statements by cross-reference. The Board observes that similar considerations apply to including additional information in the financial statements. Consequently, the Board suggests that it should not prohibit all Category C information from being provided in the financial statements.
- 4.37 The Board also observes that prohibiting the disclosure of additional information in Category C might be difficult to operationalise because Category B can be interpreted broadly—for example, the requirement for entities to provide information relevant to an understanding of the financial statements (see paragraph 4.26(c)) is a broad requirement. Consequently, it might be difficult to determine whether some information falls within Category B or within Category C. The Board has previously concluded that prohibiting entities from disclosing immaterial information, which would fall within Category C, is not operational.<sup>38</sup> Similarly, the Board observes that it would not be operational to require an entity to identify all of its Category C information included in the financial statements, which would include identifying all immaterial information. Nevertheless, the Board agrees with the concerns expressed in paragraph 4.31 and suggests that entities seek to minimise Category C information in the financial statements.
- 4.38 Nevertheless the Board observes that an entity might identify information in the financial statements as non-IFRS information, or by a similar labelling, to distinguish it from information necessary to comply with IFRS Standards (ie that the entity has identified as Category C). The Board also observes that such a distinction could be helpful for users of financial statements if an entity does include Category C information. The Board's preliminary view is that, if an entity identifies information in this way, a general disclosure standard should require the entity:

<sup>38</sup> In paragraph BC30F of IAS 1 the Board observed: 'The amendments do not actually prohibit entities from disclosing immaterial information, because the Board thinks that such a requirement would not be operational; however, the amendments emphasise that disclosure should not result in material information being obscured.'



- (a) to identify clearly such information as not being prepared in accordance with IFRS Standards and, if applicable, as unaudited;<sup>39</sup>
- (b) to provide a list of such information, together with the statement of compliance with IFRS Standards; and
- (c) to explain why the information is useful and has been included in the financial statements. For information to be useful, it must comply with the qualitative characteristics of financial information (ie it must be relevant and faithfully represented).

The Board suggests that additional information provided in accordance with the requirements of IAS 1 (ie Category B information) should not be identified by an entity in this way.

4.39 The Board did not discuss whether an entity should be required to identify Category C information in accordance with paragraphs 4.38(a)–(c) in specific circumstances. Furthermore, the Board did not discuss whether to prohibit specific Category C information from being included in the financial statements, or place any further restrictions on its inclusion.<sup>40</sup> The Board observes that it might want to consider additional restrictions applicable to information that is inconsistent with IFRS Standards—for example, because it is measured on a different basis. The following examples illustrate possible scenarios of when an entity might decide to, or be required to, provide additional information about pension plans that is measured on a different basis from IFRS Standards:

- (a) an entity might decide, or be required, to provide additional information about its pension plans that is not measured in accordance with IAS 19, for example, measured on the basis of how the local pensions regulator calculates the entity's pension obligation; or
- (b) an entity might provide additional information because it does not agree with some of the requirements in IAS 19, or because it wants to include information about the IAS 19 liability determined using an alternative valuation technique or assumptions that are not consistent with requirements in IFRS Standards.

There might be a range of views about the acceptability of including these types of additional information in the financial statements, including about whether that information is inconsistent with IFRS Standards. The Board is seeking feedback on whether to prohibit or restrict the inclusion in the financial statements of any types of information.

39 IFRS Standards do not require any information to be audited in order for financial statements to state compliance with IFRS Standards. Therefore, this Discussion Paper does not discuss whether or not this information should be audited.

40 IAS 1 already contains some restrictions on subtotals in the statements of financial performance and financial position (see paragraph 5.6).

## Summary of the Board's preliminary views and questions for respondents

### 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 financial statements if the information meets the requirements in paragraphs 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 any 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)?

### 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?

### 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?

## Section 5—Use of performance measures in the financial statements

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- 5.1 This section discusses whether a general disclosure standard should include additional requirements regarding fair presentation of performance measures in financial statements.<sup>41</sup>
- 5.2 For the purposes of this Discussion Paper, the term ‘performance measure’ refers to any summary financial measure of an entity’s financial performance, financial position or cash flows.<sup>42</sup> Performance measures are commonly used to compare an entity’s performance against management’s objectives or against the performance of other entities. Entities often use such measures when communicating with users of financial statements and for the purposes of determining management compensation.
- 5.3 In its Primary Financial Statements project (see paragraph 1.17(a)), the Board has been considering whether changes are necessary to the structure and content of the primary financial statements, including the use of performance measures. For this reason, the Board does not include a comprehensive discussion in this Discussion Paper about those performance measures that are commonly presented as line items or subtotals in the primary financial statements. This section instead focuses on general requirements for the fair presentation of performance measures in financial statements. However, the Board is taking the opportunity of this public consultation to seek feedback on two specific issues considered by the Board during its discussions about performance measures for the purposes of informing its Primary Financial Statements project and supplementing its research in that project (see paragraphs 5.18–5.28). At this stage, the Board is not seeking feedback on the structure and content of the primary financial statements, except as specified in the questions included in this Discussion Paper.

### Current requirements and guidance

- 5.4 IFRS Standards specify some amounts that are commonly used as performance measures—for example, revenue, profit or loss and earnings per share.
- 5.5 Furthermore, IAS 1 *Presentation of Financial Statements* requires an entity to:
- (a) present additional line items, headings and subtotals:
    - (i) in the statement(s) presenting profit or loss and other comprehensive income (the statement(s) of financial performance) when such presentation is relevant to an understanding of the entity’s financial performance (paragraph 85 of IAS 1); and

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<sup>41</sup> Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the *Framework* (see paragraph 15 of IAS 1).

<sup>42</sup> For ease of reference in this Discussion Paper, the term performance measure has been used to refer to financial measures of an entity’s financial position and cash flows, as well as of an entity’s financial performance.

- (ii) in the statement of financial position when such presentation is relevant to an understanding of the entity's financial position (paragraph 55 of IAS 1).
  - (b) provide additional information in the notes if it is relevant to an understanding of the financial statements (paragraph 112(c) of IAS 1).
- 5.6 In December 2014, the Board published amendments to IAS 1 (see paragraph 1.15(a)), which added the following requirements for subtotals presented in accordance with paragraphs 55 and 85 of IAS 1 (see paragraphs 55A, 85A and 85B of IAS 1):
  - (a) those subtotals shall:
    - (i) be comprised of line items made up of amounts recognised and measured in accordance with IFRS Standards;
    - (ii) be presented and labelled in a manner that makes the line items that constitute the subtotal clear and understandable;
    - (iii) be consistent from period to period; and
    - (iv) not be displayed with more prominence than the subtotals and totals specifically required in IFRS Standards for that statement.
  - (b) entities must reconcile any additional subtotals in the statement(s) presenting profit or loss and other comprehensive income with the subtotals or totals required in IFRS Standards for that statement.
- 5.7 Paragraphs 37–40 of IFRS Practice Statement *Management Commentary* provide guidance on the use of performance measures and indicators in management commentary. They describe performance measures as quantified measurements that reflect the critical success factors of an entity.

### What is the issue?

- 5.8 Many of the performance measures commonly presented as subtotals in the statement(s) of financial performance—for example, gross profit, operating profit, and earnings before interest, taxation, depreciation and amortisation (EBITDA)—are not specified in IFRS Standards. Furthermore, some entities use modified forms of commonly used measures—for example, adjusted operating profit or adjusted EBITDA. Performance measures that are not specified by IFRS Standards are sometimes referred to as non-IFRS, non-GAAP, alternative or adjusted performance measures.
- 5.9 The fact that a variety of performance measures are used by entities in their financial statements and in other communications with users of financial statements—such as earnings releases, press releases and shareholder presentations—is currently the subject of widespread interest and debate. Regulators and users of financial statements are increasingly scrutinising whether such performance measures provide helpful or misleading information.
- 5.10 The Board has received feedback that most users of financial statements support entities having some flexibility in presenting performance measures, provided that those performance measures are not misleading and are a faithful representation of the entity's performance. Users who support entities having

flexibility do so because such performance measures can provide additional information about, and a better understanding of:

- (a) the financial performance and position of an entity. Some entities and users say a standardised set of measures specified in IFRS Standards cannot cover every entity's reporting needs.
- (b) the management's view of what is important to the entity, as well as insight into how the business is managed.

5.11 Nevertheless, some users of financial statements have raised concerns about some performance measures. In particular, they have expressed concerns that:

- (a) it is difficult to understand how some performance measures are calculated because the calculations are not explained by the entity, or the performance measures are labelled unclearly;
- (b) it is not clear how some performance measures relate to other amounts in the financial statements;
- (c) it is difficult to compare some performance measures across reporting periods because the entity does not calculate these measures consistently;
- (d) it is difficult to compare some performance measures disclosed by different entities because such measures do not reflect standardised definitions—for example, the EBITDA calculation differs among entities;
- (e) some performance measures are given more prominence than performance measures specified in IFRS Standards; and
- (f) some performance measures are misleading because they do not present a neutral picture of the entity.

5.12 Most concerns cited by users of financial statements relate to the use of performance measures in the statement(s) of financial performance. Fewer concerns have been voiced about the use of such measures in the statement of financial position, and there have been even fewer concerns about the use of performance measures in other primary financial statements or in the notes.

5.13 In the statement(s) of financial performance, some entities label line items as non-recurring, unusual or infrequently occurring. Entities sometimes also use subtotals called 'normalised earnings', 'underlying earnings' or 'adjusted profit', which exclude such line items. The Board has received feedback from users of financial statements that isolation of unusual or infrequently occurring items can be helpful to them when they forecast future cash flows. However, it has also received the following concerns about isolating those items:

- (a) transactions commonly identified as 'infrequent' occur too frequently for that label to be justified;
- (b) such classification is used inconsistently by entities over time and in comparison with other entities;

- (c) insufficient information might be provided about the effects of these items, for example, their effect on operating profit might be shown, but not their effect on other line items such as financing expenses or taxation; and
- (d) although expenses are often classified as unusual or infrequent, income is rarely classified this way, so such measures can present a biased view of an entity's financial position or performance.

### **Approaches to addressing the issue**

- 5.14 A performance measure used by an entity can fall within any of the three Categories A–C described in paragraph 4.33 of Section 4 *Location of Information*. That is, it might:
- (a) be specified in IFRS Standards (Category A);
  - (b) not be specified in IFRS Standards, but necessary to comply with IFRS Standards, for example, because the performance measure is relevant to an understanding of the financial statements (Category B); or
  - (c) additional information, not (a) or (b) (Category C).
- 5.15 Users of financial statements have told the Board that performance measures are useful, both in the primary financial statements and the notes, provided they are not misleading. Consequently, the Board suggests that a general disclosure standard should not prohibit the use of specific types of performance measures, including those in Category C. Nevertheless, the Board observes that it is important to address the concerns outlined in paragraph 5.11.
- 5.16 The Board observes that the usefulness of a performance measure to users of financial statements depends on the type of entity, the reasons for using that performance measure, the way the performance measure is presented or disclosed in the financial statements (including its location and relative prominence), how it is calculated, and how clearly it is described. However, to address the concerns listed in paragraphs 5.11 and 5.13, the Board's preliminary view is that a general disclosure standard should include requirements that ensure all performance measures are fairly presented in the financial statements.
- 5.17 When developing requirements, the Board discussed:
- (a) two specific concerns about line items or subtotals in the statement(s) of financial performance (see paragraphs 5.18–5.28); and
  - (b) general requirements for all performance measures in the financial statements (see paragraphs 5.29–5.34).

### **Performance measures that are line items or subtotals in the statement(s) of financial performance**

- 5.18 Some stakeholders have asked the Board to define some performance measures commonly presented as line items and subtotals in the statement(s) of financial performance, for example, operating profit, EBIT and EBITDA. They want the Board to require performance measures to be calculated consistently over time and among entities. As explained in paragraph 5.3, the Board will consider

whether to address this in its Primary Financial Statements project, so it has limited its discussion in this Discussion Paper to the following two issues:

- (a) when presentation of EBIT and/or EBITDA in the statement(s) of financial performance can be considered a fair presentation in accordance with IFRS Standards; and
- (b) whether to provide guidance on the presentation of unusual and infrequently occurring items.

5.19 This Discussion Paper addresses these issues because:

- (a) they relate to concerns about the fair presentation of commonly used performance measures that might be disclosed in the notes as well as presented in the primary financial statements;
- (b) they were specifically discussed by the Board as part of its discussion of disclosure of performance measures in the Principles of Disclosure project, whereas other common measures, such as presentation of operating profit, were not; and
- (c) comments on this Discussion Paper would provide early feedback on these issues to helpfully inform the Primary Financial Statements project.

#### *Presentation of EBIT and EBITDA*

5.20 Though commonly reported by entities, neither EBITDA nor EBIT are required or defined by IFRS Standards. The Board observes that whether such subtotals in the statement(s) of financial performance can provide a fair presentation depends on whether the subtotals would disrupt the analysis of expenses.

5.21 The Board's preliminary view is that it should clarify the following points if an entity reports EBITDA and/or EBIT:

- (a) presenting EBITDA as a subtotal in the statement(s) of financial performance can provide a fair presentation if an entity presents an analysis of expenses on the basis of their nature (referred to as the 'nature of expense' method—paragraph 102 of IAS 1) and if the subtotals are presented in accordance with the requirements in paragraphs 85–85B of IAS 1 for using subtotals. However, presenting EBITDA as a subtotal in the statement(s) of financial performance is unlikely to achieve a fair presentation if an entity presents an analysis of expenses on the basis of their function (referred to as the 'function of expense' method—paragraph 103 of IAS 1). EBITDA excludes expenses of specified natures (for example, amortisation). So presenting EBITDA with an analysis of expenses on the basis of their function would result in a mixture of the nature of expense and function of expense methods that would disrupt the analysis of expenses.<sup>43</sup> The Board observes that this might cause confusion. Nevertheless, an entity using a function of expense method might still disclose EBITDA, for example, in the notes (see paragraphs 5.29–5.34).

<sup>43</sup> Paragraphs 99–103 of IAS 1 require expenses to be subclassified either using the nature of expense method or the function of expense method.

- (b) EBIT is usually a subtotal that fits within both the nature of expense and the function of expense methods.

5.22 The diagram below illustrates how to present EBITDA and EBIT in the statement of profit or loss using the nature of expense method:

**Diagram 5.1—Statement of profit or loss (by nature) showing presentation of EBITDA and EBIT**

Statement of profit or loss (by nature)	
Revenue	X
Changes in inventories of finished goods and work in progress	(X)
Raw materials and consumables used	(X)
Employee benefits expense	(X)
Other expenses	(X)
<b>EBITDA</b>	<b>X</b>
Depreciation and amortisation expense	(X)
<b>EBIT</b>	<b>X</b>
Interest	(X)
<b>Profit before tax</b>	<b>X</b>

*Depiction of unusual or infrequently occurring items in the statement(s) of financial performance*

5.23 The Board discussed unusual or infrequently occurring transactions in its previous Financial Statement Presentation project. That project resulted in a draft Standard, prepared by IASB staff with the US Financial Accounting Standards Board (FASB) staff, which was published on the IFRS Foundation website in July 2010 for outreach (staff draft).<sup>44</sup> Paragraphs 155–156 of the staff draft included the following planned requirements about unusual or infrequently occurring items:

<sup>44</sup> <http://www.ifrs.org/current-projects/iasb-projects/financial-statement-presentation/phase-b/Pages/staff-draft-of-proposed-standard.aspx>.



- 155 An entity shall present separately a material event or transaction that is *unusual* or occurs infrequently. An unusual or *infrequently occurring* event or transaction shall be presented separately in the appropriate section, category or subcategory in the statement of comprehensive income. A description of each unusual or infrequently occurring event or transaction and its financial effects shall be disclosed in the statement of comprehensive income or in the notes to financial statements.
- 156 An entity shall not describe any item of income or expense as an extraordinary item either in the statement of comprehensive income or in the notes.
- 5.24 The terms ‘unusual’ and ‘infrequently occurring’ were defined in Appendix A of the staff draft as follows:
- Unusual: Highly abnormal and only incidentally related to the ordinary and typical activities of an entity, given the environment in which the entity operates.
- Infrequently occurring: Not reasonably expected to recur in the foreseeable future given the environment in which an entity operates.
- 5.25 Users of the financial statements have told the Board that separate presentation or disclosure of unusual or infrequently occurring items is helpful in making forecasts about future cash flows. Consequently, the Board’s preliminary view is that it should allow entities to present such items separately. However, to respond to concerns that entities are presenting unusual or infrequently occurring items inappropriately and/or inconsistently, the Board is also of the preliminary view that a general disclosure standard should explain when and how items can be presented in the statement(s) of financial performance as unusual and/or infrequently occurring.
- 5.26 The Board observes that the requirements proposed in the staff draft could be used as a starting point for developing such requirements (see paragraphs 5.23–5.24), but that the Board should develop these further by considering the issues discussed in paragraphs 5.27–5.28 and the feedback it receives on Question 8 in this Discussion Paper.
- 5.27 The Board discussed, but did not form any preliminary views on, whether to prohibit the use of particular terms used to describe unusual and infrequently occurring items because some terms, such as ‘non-recurring’ or ‘special’, are less helpful for users of financial statements if an entity does not also explain why items are classified that way (ie the term itself is unclear as to whether the items are unusual, or infrequent, or both). Furthermore, these terms might be interpreted in a similar way to the term ‘extraordinary items’, whose use is prohibited by paragraph 87 of IAS 1. In addition, terms like ‘one-off’ suggest that the items can never recur, which is difficult to substantiate.
- 5.28 Some stakeholders suggest that the Board also address whether:
- (a) entities can use the term ‘infrequently occurring’ to describe an item or transaction that has occurred more than once within a stated period—for example, within the previous five years—or that is likely to occur in the foreseeable future.

- (b) describing an item as unusual or infrequently occurring should only depend on the particular circumstances of the entity, for example, losses from hurricanes and earthquakes might be relatively common in general, but the chances of them having a material effect on a particular entity might be remote.
- (c) the size of an item, in addition to its nature and frequency, should be considered when deciding whether to classify it as unusual or infrequently occurring. By way of illustration, while it may be fairly common for an entity to make small payments to settle legal claims, if it needs to make a significant one-off payment to settle a legal claim, should the entity separately disclose the unusually large item as unusual or infrequently occurring? Or should the Board consider a third category, for example, re-occurring items that are unusually large?
- (d) other characteristics besides the frequency or the unusual nature of an item would make separate disclosure of items of income or expense relevant for users of financial statements. For example, some respondents say the following characteristics similarly warrant separate disclosure:
  - (i) the variability of the item; and
  - (ii) whether current-period amounts represent a remeasurement of prior-period estimates.
- (e) an entity should be permitted to isolate the impact of an event that affects several line items, for example, as a consequence of a hurricane or a major economic event.

### **General requirements for all performance measures in the financial statements**

5.29 The Board responded to concerns about performance measures presented as subtotals in the statement(s) of financial performance and financial position in the December 2014 amendments to IAS 1. However, these amendments did not address other kinds of performance measures in the financial statements, such as:

- (a) those disclosed in the notes.
- (b) those presented in, or disclosed with, the primary financial statements other than subtotals in the statement(s) of financial performance and financial position. This category includes:
  - (i) additional columns in the primary financial statements that show, for example, pro forma information or operating segments.
  - (ii) other disclosures presented within or around the primary financial statements (ie on the same 'page'). An entity might disclose performance measures directly above the first line item in a primary financial statement or below the statement total.

An example is an entity disclosing EBITDA adjacent to the statement(s) of financial performance when the function of expenses method is used.

- 5.30 The Board has not received many concerns about performance measures disclosed in the notes. It would be difficult to restrict the use of performance measures in the notes because IFRS 8 *Operating Segments* requires disclosure in the notes of internal measures reported to the chief operating decision maker. Consequently, the Board's preliminary view is that it should not prohibit specific types of performance measures from being disclosed in the notes, but that additional requirements should be developed to ensure that such performance measures are not misleading.
- 5.31 However, the Board has received concerns about the types of performance measures described in paragraph 5.29(b)—that is, those that are presented in, or disclosed with, the primary financial statements, other than as subtotals in the statements of financial performance or financial position. The Board shares these concerns because users of financial statements appear to pay more attention to performance measures presented in the primary financial statements than to those disclosed in the notes (as discussed in paragraph 3.20 of Section 3). Additionally, the primary financial statements offer little space for complete explanations of such performance measures. Consequently, presenting inappropriate performance measures in the primary financial statements has the potential to be more misleading to the users of the financial statements than disclosing such measures in the notes.
- 5.32 Most users have said that performance measures presented in, or disclosed adjacent to, the primary financial statements, are useful if they are fairly presented. For this reason, the Board does not suggest restricting the type of performance measures presented in or disclosed adjacent to the primary financial statements.
- 5.33 Instead, to ensure that performance measures are fairly presented, the Board suggests applying similar requirements for subtotals in the statements of financial performance and financial position (as introduced by the December 2014 amendments to IAS 1) to all performance measures in the financial statements, whether presented in, or disclosed adjacent to, the primary financial statements or disclosed in the notes. The Board also thinks it should develop those requirements further as set out in paragraph 5.34.
- 5.34 Paragraph 15 of IAS 1 states: 'Fair presentation requires the faithful representation of the effects of transactions, other events and conditions...'. Paragraph 2.15 of the *Conceptual Framework* Exposure Draft proposes that to be a perfectly faithful representation, a depiction needs to be complete, neutral and free from error.<sup>45</sup> Considering these characteristics and the requirements introduced by the December 2014 amendments to IAS 1 (see paragraph 5.6), the Board recommends introducing requirements for all performance measures in

<sup>45</sup> Paragraphs 2.16–2.19 of the *Conceptual Framework* Exposure Draft explain these three characteristics of faithful representation. Paragraph 2.14 also states that a faithful representation depicts the substance of an economic phenomenon rather than just its legal form.

the financial statements to respond to concerns set out in paragraph 5.11. The Board's preliminary view is that these requirements should require a performance measure to be:

- (a) displayed with equal or less prominence than the line items, subtotals and totals in the primary financial statements required by IFRS Standards;
- (b) reconciled to the most directly comparable measure specified in IFRS Standards to enable users of financial statements to see how the performance measure has been calculated;
- (c) accompanied by an explanation in the notes to the financial statements of:
  - (i) how the performance measure provides relevant information about an entity's financial position, financial performance or cash flows;
  - (ii) why the adjustments to the most directly comparable measure specified in IFRS Standards in (b) have been made;
  - (iii) if the reconciliation in (b) is not possible, why not; and
  - (iv) any other information necessary to aid understanding of the measure (ie the information should provide a complete depiction).<sup>46</sup>
- (d) neutral, free from error and clearly labelled so it is not misleading;
- (e) accompanied by comparative information for all prior periods presented in the financial statements;
- (f) classified, measured and presented consistently to enable comparisons to be made over time, except when IFRS Standards require a change in presentation, as stated in paragraph 45 of IAS 1;<sup>47</sup> and
- (g) presented in a way that makes it clear whether the performance measure forms part of the financial statements and whether it has been audited.

<sup>46</sup> Such an explanation would mean that entities would have to provide their rationale for making adjustments as well as a list of all adjustments.

<sup>47</sup> Paragraph 45 of IAS 1 requires an entity to retain the presentation and classification of items from one period to the next unless another presentation or classification would be more appropriate, having regard to the criteria in IAS 8, or if an IFRS Standard requires a change in presentation.

## Summary of the Board's preliminary views and questions for respondents

### Question 8

The Board's preliminary views are that it should:

- clarify that the following subtotals in the statement(s) 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.

### 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?

## Section 6—Disclosure of accounting policies

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- 6.1 Users of financial statements often express concerns about how accounting policies<sup>48</sup> are disclosed in the financial statements. This section discusses whether further guidance should be developed, either in a general disclosure standard or in non-mandatory guidance, for example, educational material, to help entities provide more useful accounting policy disclosures.

### Current requirements

- 6.2 Paragraph 117 of IAS 1 *Presentation of Financial Statements* states:
- An entity shall disclose its significant accounting policies comprising:
- (a) the measurement basis (or bases) used in preparing the financial statements; and
  - (b) the other accounting policies used that are relevant to an understanding of the financial statements.
- 6.3 Paragraphs 119 and 121 of IAS 1 provide the following additional requirements to help entities decide which accounting policies to disclose:
- 119 In deciding whether a particular accounting policy should be disclosed, management considers whether disclosure would assist users in understanding how transactions, other events and conditions are reflected in reported financial performance and financial position. Each entity considers the nature of its operations and the policies that the users of its financial statements would expect to be disclosed for that type of entity. Disclosure of particular accounting policies is especially useful to users when those policies are selected from alternatives allowed in IFRSs. An example is disclosure of whether an entity applies the fair value or cost model to its investment property (see IAS 40 *Investment Property*). Some IFRSs specifically require disclosure of particular accounting policies, including choices made by management between different policies they allow. For example, IAS 16 requires disclosure of the measurement bases used for classes of property, plant and equipment.
- 121 An accounting policy may be significant because of the nature of the entity's operations even if amounts for current and prior periods are not material. It is also appropriate to disclose each significant accounting policy that is not specifically required by IFRSs but the entity selects and applies in accordance with IAS 8.
- 6.4 The December 2014 Amendments to IAS 1 (see paragraph 1.15(a)) removed paragraph 120 of IAS 1, which contained examples of accounting policy disclosures. The Board decided the examples were unhelpful because they did not illustrate why those accounting policies were significant.

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<sup>48</sup> 'Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements' (paragraph 5 of IAS 8). As part of its amendments to IAS 8, the Board is expected to propose clarification of this definition as follows: 'Accounting policies are the specific principles and practices applied by an entity in preparing and presenting financial statements'.

- 6.5 Paragraphs 122 and 125 of IAS 1 require an entity to disclose information about 'significant judgements and assumptions' made in applying its accounting policies:

122 An entity shall disclose, along with its significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph 125), that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

...

125 An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year....

### What is the issue?

- 6.6 Some users of financial statements and other stakeholders have told the Board that the accounting policy section of an entity's financial statements is often long and unhelpful because:

- (a) some entities do not distinguish between accounting policies necessary for users to understand the financial statements and other accounting policies.
- (b) some entities do not distinguish between the following types of accounting policies:
  - (i) those for which the entity:
    - (i) makes a choice between alternative accounting policies allowed in IFRS Standards; and/or
    - (ii) makes significant judgements and/or assumptions in applying the accounting policy.
  - (ii) other accounting policies, ie accounting policies in which the entity does not have a choice and does not make significant judgements and assumptions in applying those policies.
- (c) when describing their accounting policies, some entities replicate the requirements set out in IFRS Standards without tailoring them to their own circumstances.

As a result, users of financial statements can find it difficult to identify which information relating to the accounting policies is important.

- 6.7 The Board has also received feedback from entities that the current requirements in IFRS Standards provide too little guidance on:

- (a) what makes an accounting policy significant;
- (b) which information to disclose about a significant accounting policy; and

- (c) where to locate accounting policy disclosures in the financial statements.

### **Approaches to addressing the issue**

6.8 The Board discussed whether to develop guidance in the following areas to help entities provide more useful information for users of financial statements:

- (a) what makes an accounting policy significant (paragraphs 6.9–6.16)?
- (b) which information about a significant accounting policy should be disclosed (paragraphs 6.17–6.19)?
- (c) where should accounting policy disclosures be located in the financial statements (paragraphs 6.20–6.27)?

### **What makes an accounting policy significant?**

6.9 Stakeholders communicated the following different views about which accounting policies entities should disclose:

- (a) some institutional investors and other stakeholders say that to help users understand financial statements, entities need to disclose only those accounting policies:
  - (i) that have changed during the period; or
  - (ii) where the entity:
    - (i) makes a choice between alternative accounting policies allowed in IFRS Standards; or
    - (ii) makes significant judgements and/or assumptions in applying the accounting policy.
- (b) other stakeholders say that for users to understand the financial statements, they also need disclosure of other accounting policies, for example, all accounting policies used for material items, transactions or events.
- (c) still other stakeholders say that some users of financial statements—for example, retail investors—would benefit from disclosure of all the accounting policies used in preparing the financial statements.

6.10 Because stakeholders' views differ, as set out in paragraph 6.9, the Board's preliminary view is that it should include additional requirements in a general disclosure standard to help entities decide which accounting policies to disclose.

6.11 The Board's preliminary view is that accounting policies should be considered significant, and therefore be disclosed in accordance with paragraph 117 of IAS 1 (see paragraph 6.2), if their disclosure is necessary for the primary users of the financial statements to understand the information in the financial statements. During its discussions, the Board identified three categories of accounting policies (paragraphs 6.12–6.14).

6.12 Category 1—accounting policies that are always necessary for understanding information in the financial statements, and relate to material items, transactions or events:



- (a) those that have changed during a reporting period because the entity either was required to or chose to change the policies;
- (b) those chosen from alternatives allowed in IFRS Standards, for example, the option to measure investment property at either cost or fair value;
- (c) those developed in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in the absence of an IFRS Standard that specifically applies; and
- (d) those for which an entity is required to make significant judgements and/or assumptions as described in paragraphs 122 and 125 of IAS 1 in applying the accounting policy (see paragraph 6.5).<sup>49</sup>

The Board's preliminary view is that Category 1 accounting policies should be disclosed.

- 6.13 Category 2—accounting policies that are not in Category 1, but also relate to items, transactions or events that are material to the financial statements, either because of the amounts involved or because of their nature. The Board's preliminary view is that disclosure of these accounting policies is necessary because the related information is material and the primary users of financial statements are not expected to be IFRS experts.<sup>50</sup> If Category 2 accounting policies are not disclosed, users of the financial statements who are unfamiliar with IFRS requirements would need to consult IFRS Standards in order to understand the financial statements. For example, measurement of a deferred tax liability for prepaid expenses in accordance with IAS 12 *Income Taxes* would not typically be a Category 1 accounting policy for most entities. Therefore the accounting policy for deferred tax liabilities would be a Category 2 accounting policy if the entity has a material deferred tax liability for prepaid expenses.
- 6.14 Category 3—any other accounting policies used by an entity in preparing the financial statements and not included in Categories 1 or 2. These relate to items, transactions or events that are not material to the financial statements. The Board's preliminary view is that disclosing such accounting policies is unnecessary for the primary users to understand information in the financial statements.
- 6.15 Accounting policies that are not used by an entity in preparing the financial statements should not be disclosed because such disclosures offer no benefit to users and can make the financial statements more difficult to understand.
- 6.16 Having considered the three categories in paragraphs 6.12–6.14, the Board's preliminary view is that a general disclosure standard should:

<sup>49</sup> These accounting policies are not necessarily the same as the accounting policies that require a significant number of accounting estimates (as defined in IAS 8) to be used in applying the accounting policy.

<sup>50</sup> Paragraph 2.35 of the *Conceptual Framework* Exposure Draft states that 'Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently...'

- (a) explain the objective of providing accounting policy disclosures to help entities better understand which accounting policies to disclose, and why. The objective of disclosing accounting policies in the financial statements is to provide an entity-specific description of accounting policies that:
  - (i) have been applied by the entity in preparing its financial statements; and
  - (ii) are necessary for an understanding of the financial statements.
- (b) describe the three categories of accounting policies and clarify that the entity is required to disclose only those policies necessary for an understanding of the financial statements (ie Categories 1 and 2).
- (c) explain that an entity is not required to disclose Category 3 accounting policies. In addition, entities should not allow disclosure of any Category 3 accounting policies to obscure material information or to make the financial statements more difficult to understand.

**Which information about a significant accounting policy should be disclosed?**

- 6.17 The Board observes that ineffective disclosure of information about significant accounting policies appears to be primarily due to difficulties in applying the concept of materiality. Specifically, after identifying its significant accounting policies, an entity has difficulty assessing which information about those significant accounting policies could reasonably be expected to influence decisions made by the primary users of its financial statements. The Board is developing guidance in a Practice Statement to help entities make materiality judgements when preparing financial statements (see paragraph 1.16(a)).
- 6.18 The Board has considered whether to develop further guidance in response to concerns that some entities replicate requirements set out in IFRS Standards without tailoring them to their own circumstances. The Board suggests that entity-specific disclosures about accounting policies are the most helpful to users. This means that:
  - (a) the accounting policies have been used by the entity in preparing the financial statements; and
  - (b) an entity describes how it has applied the requirements in IFRS Standards to its own circumstances to enhance a user's understanding of that entity, rather than simply providing a generic description that could apply to many other entities. For example, disclosing that revenue on the transfer of goods is recognised when the entity satisfies the performance condition of transferring goods to a customer in accordance with the criteria in IFRS 15 *Revenue from Contracts with Customers* is an example of a generic (or boilerplate) accounting policy disclosure. An example of an entity-specific description of that entity's accounting policy for revenue recognition might include information on how the entity determines when it has transferred control of the goods to the customer.

- 6.19 The Board's preliminary view is that a general disclosure standard should clarify that an entity-specific description should be required as described in paragraph 6.16(a). The Board also identifies communication of entity-specific information as a principle of effective communication in Section 2 *Principles of effective communication*. The Board's preliminary view is that it is unnecessary to provide further guidance about the need for entities to make accounting policy disclosures entity-specific.

**Where should accounting policy disclosures be located in the financial statements?**

- 6.20 Paragraphs 113–114 of IAS 1 provide requirements on the systematic ordering of the notes. The Board discussed whether to develop further guidance to help entities judge the best location for their accounting policies to provide useful information to users of their financial statements.
- 6.21 The Board's preliminary view is that it should provide guidance that:
- (a) sets out alternatives for where accounting policies could be disclosed, as described in paragraphs 6.22–6.24; and
  - (b) explains that entities should disclose information about significant judgements and assumptions described in paragraphs 122 and 125 of IAS 1 adjacent to the disclosures about the related accounting policies, unless the entity judges that another way of organising them is more appropriate because it improves the understandability of the financial statements (paragraphs 6.25–6.27).

The Board has not yet formed a preliminary view about whether to include this guidance in a general disclosure standard or in non-mandatory guidance (or in a combination of both). Paragraphs 2.12–2.15 describe the different forms of non-mandatory guidance that the Board might use and highlight the main differences between issuing non-mandatory guidance and including requirements in a Standard.

*Location of accounting policy disclosures*

- 6.22 An entity exercises judgement in identifying which accounting policies to disclose in deciding where to disclose them in the notes, and in deciding whether to give prominence to any particular accounting policies, for example, by putting those policies first. The following alternatives could be considered for organising and locating the accounting policy disclosures:
- (a) all in a single note. Grouping all accounting policies in one place facilitates a comprehensive understanding of how the financial statements have been prepared and clarifies which information is part of the entity's accounting policies.
  - (b) individually, with each accounting policy disclosed in the same note as the information to which it relates. For example, the accounting policy for investment property might be disclosed within the investment property note. This might improve the effectiveness and understandability of the description of the accounting policy because the

information in the investment property note can illustrate how the entity has applied the accounting policy.

- (c) with a combination of (a) and (b), for example, an entity might put disclosures about accounting policies covering several items in a separate accounting policy note, but disclose the rest in the same notes as the information to which they relate.

6.23      Whichever alternative an entity selects from paragraph 6.22, the entity should clearly identify the location of its Category 1 accounting policies, for example, by describing where they are disclosed in the index of notes or on the content page of the financial statements. This would make these accounting policies easily accessible to users of financial statements.

6.24      The Board's preliminary view is that an entity should only disclose the accounting policies necessary to an understanding of the financial statements (significant accounting policies—Categories 1 and 2). If an entity chooses to disclose any Category 3 accounting policies, it could consider separating them from its significant accounting policies to help users of financial statements to identify the most important information by:

- (a) disclosing Category 3 accounting policies in a separate note or at the end of the accounting policies note. Separating Category 3 accounting policy disclosures from the disclosures about significant accounting policies reduces the risk of obscuring disclosures about significant accounting policies.
- (b) disclosing Category 3 accounting policies outside the financial statements and providing a cross-reference to their location. For example:
  - (i) presenting them in an appendix to the financial statements or in another part of the annual report; or
  - (ii) presenting them on the entity's public website.

Disclosure of Category 3 accounting policies is not necessary to comply with IFRS Standards because they relate to items, transactions or events that are not material to the financial statements and so the criteria in paragraph 4.9 would not apply.

#### *Location of significant judgements and assumptions disclosures*

6.25      IAS 1 requires an entity to disclose information about significant judgements and assumptions (see paragraph 6.5). The following locations are sometimes used for such disclosures:

- (a) alongside the related accounting policies;
- (b) in the same note as the information to which they relate; for example, disclose all significant judgements and assumptions about revenue in the revenue note (this might also be alongside the related accounting policy for revenue, depending on where the accounting policy is disclosed); or
- (c) together in a separate note.

- 6.26 Some users of financial statements have told the Board that they prefer entities to disclose information about an entity's significant accounting policies together with information about the significant judgements and assumptions made in applying those accounting policies. Some users have said that this is because accounting policy disclosures are easier to understand if they also describe how related judgements and assumptions are made in applying those policies. However, users' views differ on how to do this:
- (a) some said they prefer all of an entity's significant accounting policies, and significant judgements and assumptions, to be disclosed in a single note to provide a comprehensive understanding of how the financial statements have been prepared; and
  - (b) some prefer entities to include in a single note all information about a particular item, transaction or event, including the related accounting policy and any significant judgements and assumptions used in applying that accounting policy. For example, some users prefer all information about an entity's investment property, including the accounting policy for investment property and any significant judgements and assumptions used in applying that accounting policy, to be disclosed in the same note. Including all this information in one place provides users with a comprehensive understanding of a particular item, transaction or event.
- 6.27 To make an entity's accounting policy disclosures more useful for users of financial statements, the Board's preliminary view is that:
- (a) disclosures about significant judgements and assumptions used in applying an accounting policy should be made adjacent to the disclosure of that accounting policy, as described in paragraph 6.26(a) or paragraph 6.26(b), unless the entity judges that another location would improve the understandability of the financial statements.
  - (b) disclosures about accounting policies for which an entity is required to make significant judgements or significant assumptions should be clearly highlighted, as described in paragraph 6.23.

## Summary of the Board's preliminary views and questions for respondents

### 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 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 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.

## Section 7—Centralised disclosure objectives

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7.1 The Board has been told that a lack of clear disclosure objectives in IFRS Standards contributes to the disclosure problem. This section discusses:

- (a) whether the Board should develop a central set of disclosure objectives (centralised disclosure objectives) to provide a basis (or framework) for developing more unified disclosure objectives and requirements in Standards; and
- (b) whether the Board should consider having a single Standard, or a set of Standards, that covers all disclosures in the financial statements.

Centralised disclosure objectives would primarily address the content of the notes.<sup>51</sup>

### Current requirements, guidance and proposals in other documents

7.2 Paragraph 3.4 of the *Conceptual Framework* Exposure Draft describes the objective of financial statements as being:

...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.

7.3 Paragraph 7.16 of the *Conceptual Framework* Exposure Draft proposes the following guidance:

Including specific presentation and disclosure objectives in a Standard enables an entity to identify relevant information and decide how to communicate that information in the most efficient and effective manner.

7.4 Some recent IFRS Standards include disclosure objectives that cover disclosures required by that particular Standard.

### What is the issue?

7.5 The Board has received feedback that the objective of financial statements (see paragraph 7.2) is too general to help entities exercise judgement about what specific information to communicate to the primary users of the financial statements about the entity's assets, liabilities, equity, income and expenses, and other related transactions and events.

7.6 Some IFRS Standards do not contain disclosure objectives. The Board has been told that this makes it difficult for entities and other stakeholders to understand the purpose of some of the disclosure requirements in those Standards and therefore to exercise judgement in deciding what information should be disclosed. Some stakeholders say that the absence of disclosure objectives, coupled with lists of prescriptively written disclosure requirements (discussed in paragraph 8.4), encourages entities to apply those disclosure requirements

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<sup>51</sup> In some cases disclosure requirements provide flexibility for an entity to either present information in the primary financial statements or disclose it in the notes. Centralised disclosure objectives would also apply to these disclosure requirements.

mechanically as a checklist for the preparation of the financial statements rather than focusing on what information to communicate to users of the financial statements.

- 7.7 When IFRS Standards contain disclosure objectives, those objectives have been developed largely in isolation from each other as part of discussions on an individual topic (for example, leases). This has led to inconsistencies in the wording of disclosure objectives and to a lack of consideration for the relationships between the disclosure requirements in different Standards.

### **Approaches to addressing the issue**

- 7.8 This subsection discusses the following actions that the Board could take to address these problems:
- (a) development of centralised disclosure objectives (paragraphs 7.9–7.14):
    - (i) Method A—focusing on the different types of information disclosed about an entity’s assets, liabilities, equity, income and expenses (paragraphs 7.15–7.21);
    - (ii) Method B—focusing on information about an entity’s activities to better reflect the way users of financial statements assess prospects for future cash inflows and assess management stewardship (paragraphs 7.22–7.33);
    - (iii) a hybrid of Methods A and B (paragraphs 7.34–7.37); and
  - (b) the possibility of having a single Standard, or a set of Standards, that covers all disclosures (paragraphs 7.38–7.41).

### **Developing centralised disclosure objectives**

- 7.9 The Board observes that the problems identified in paragraphs 7.5–7.6 suggest that there is a need for disclosure objectives. The problems identified in paragraph 7.7 suggest that disclosure objectives could be improved if they are developed using a common basis, for example, on the basis of a single central set of disclosure objectives (centralised disclosure objectives), rather than focused on an individual Standard.
- 7.10 Centralised disclosure objectives could be used as an underlying basis (or framework) for developing and organising disclosure objectives and requirements in Standards that are better linked to the objective of financial statements and the role of the notes. They would also:
- (a) provide a transparent basis for the Board to develop new disclosure objectives and requirements or to review existing ones, which would promote consistency across disclosure objectives and requirements in Standards;
  - (b) help the Board to develop more focused disclosure requirements in Standards, each one designed to help to address the centralised disclosure objectives;
  - (c) help entities understand the basis for disclosure objectives and requirements in Standards and judge what information users need; and



- (d) encourage all stakeholders to make disclosure decisions on the basis of disclosure objectives that focus on the needs of the users of the financial statements, rather than to use disclosure requirements as a checklist.
- 7.11 The Board's preliminary view is that centralised disclosure objectives should be developed and included in an IFRS Standard rather than, for example, solely in a guide used by the Board for drafting Standards. This would:
- (a) make the objectives authoritative and more visible;
  - (b) ensure that the centralised disclosure objectives are considered for transactions that are not addressed specifically by disclosure objectives in individual Standards; and
  - (c) help entities identify what additional information to include in the financial statements beyond that prescribed by specific IFRS Standards in order to comply with the requirements in IAS 1 *Presentation of Financial Statements* about additional information (see paragraph 4.26).
- 7.12 The Board's preliminary view is that centralised disclosure objectives should be included in a general disclosure standard. However, the Board observes that other locations might be considered—for example, paragraphs 7.38–7.41 discuss the possibility of including all disclosure objectives and requirements together in a single Standard that covers all disclosures.
- 7.13 The Board discussed two alternative methods of developing centralised disclosure objectives. These methods were developed considering the proposed objective of financial statements in the *Conceptual Framework* Exposure Draft (see paragraph 7.2):
- (a) Method A—focusing on the different types of information disclosed about an entity's assets, liabilities, equity, income and expenses (see paragraphs 7.15–7.21); and
  - (b) Method B—focusing on information about an entity's activities (see paragraphs 7.22–7.33).
- These two methods are not mutually exclusive (see paragraphs 7.34–7.37).
- 7.14 The Board has not discussed the development or application of Methods A and B, or other methods, in detail. The description of the methods in paragraphs 7.15–7.37 is therefore intended to generate discussion about how centralised disclosure objectives might be developed, rather than to provide a comprehensive explanation about how these methods would be applied by the Board.

### **Method A—focusing on types of information**

#### *Explanation of Method A*

- 7.15 Under Method A, disclosure objectives and requirements would be developed and organised on the basis of the types of information that are disclosed. Consequently, the first step in developing centralised disclosure objectives

would be to identify what types of information are useful to the primary users of the financial statements about an entity's assets, liabilities, equity, income and expenses.<sup>52</sup>

7.16 The Board normally develops disclosure objectives and requirements in individual Standards on the basis of the types of information useful to users of the financial statements about the items within the scope of the Standard. Therefore Method A would be consistent with the Board's predominant approach. Method A would also be consistent with the Board's preliminary views on the content of the notes, which is to include specific types of information (see paragraph 3.7 of Section 3 *Roles of the primary financial statements and the notes*). Using Method A to develop centralised disclosure objectives would result in the following refinements to the Board's current approach:

- (a) it would articulate how the current approach is applied and make the process of developing disclosure objectives in Standards more transparent; and
- (b) it would provide a common starting point for developing disclosure objectives and requirements, which would be expected to lead to greater consistency between Standards. This is because all disclosure objectives and requirements would be based on the centralised disclosure objectives in a general disclosure standard, rather than focused on an individual Standard, covering a subset of the entity's assets, liabilities, equity, income and expenses and related transactions. As an example of the latter approach, IAS 19 *Employee Benefits* contains disclosure objectives and requirements for post-employment benefits that were developed by considering the information that is useful to users of financial statements about an entity's employee benefit plans.

7.17 The Board discussed, but did not form any preliminary views about, the following list of types of information that could be used as the basis for developing centralised disclosure objectives.

Information about:

- (a) the reporting entity, for example, information about the entity's activities;
- (b) methods, assumptions and judgements, for example, information about an entity's significant accounting policies;
- (c) items included in the primary financial statements, for example, further disaggregation of line items;
- (d) unrecognised items, for example, information about their nature and effect;
- (e) risks and other uncertainties, for example, information about hedging and other forms of risk mitigation;

<sup>52</sup> The objective of financial statements in the *Conceptual Framework* Exposure Draft does not refer to providing information about cash flows. Although information about cash and cash flows is important to users of financial statements, cash flows are not identified as separate elements of financial statements in the *Conceptual Framework* Exposure Draft (nevertheless assets are elements and cash is a type of asset).

- (f) management's stewardship, for example, information about management compensation and other transactions with management; and
- (g) events after the end of the reporting period, for example, information about their nature and effect.

To illustrate, an example of a centralised disclosure objective that could be used for (e) might be:

Disclose information about risks and other uncertainties to help users to understand and evaluate how risks and other uncertainties might affect the entity's financial position, financial performance and cash flows.

- 7.18 The Board observes that there are other ways of grouping information by type in the notes when considering what information should be disclosed. For example, another approach might be to identify and group information according to its purpose (for example, one such group might be the type of information necessary to understand the changes in items during the period, such as reconciliations of balances). The Board also observes that other standard-setters have considered different groupings.<sup>53</sup> If the Board decides to develop Method A, it will take other groupings into consideration.

*Illustration of approach to developing disclosure objectives and requirements that would be consistent with Method A*

- 7.19 The staff of the New Zealand Accounting Standards Board (NZASB staff) have developed an approach to drafting disclosure requirements for Standards (see Section 8 NZASB staff's approach to drafting disclosure requirements in IFRS Standards). One aspect of the NZASB staff's approach is the development of disclosure objectives and subobjectives to explain why users want particular types of information. This aspect of the NZASB staff's approach is consistent with Method A, as explained in paragraphs 8.6–8.11. The NZASB staff identified the types of information that should be disclosed to meet the objective of financial statements, and these are similar to those identified in paragraph 7.17. These types of information were then used to develop an approach for drafting objectives and requirements in IFRS Standards.

*Advantages and disadvantages of Method A*

- 7.20 Method A has the following advantages:
- (a) feedback suggests that disclosure objectives and requirements can be improved, but does not provide evidence that they need to be fundamentally changed. Method A would provide context for many of the existing disclosure objectives and requirements in Standards, therefore the Board would not need to make fundamental changes to IFRS Standards;
  - (b) it would explain and articulate the Board's current method, as explained in paragraph 7.16;

<sup>53</sup> For example, the 2014 FASB Exposure Draft *Conceptual Framework for Financial Reporting—Chapter 8: Notes to Financial Statements*; the 2012 EFRAG, ANC and FRC Discussion Paper *Towards a Disclosure Framework for the Notes*; and the NZASB staff's groupings in paragraph 8.8 of this Discussion Paper.

- (c) it would facilitate the identification of irrelevant disclosure requirements that can be removed from Standards because they do not address the disclosure objectives;
- (d) it would help entities to understand the basis for disclosure requirements in Standards, ie why that particular information is useful to users of financial statements, and help entities make materiality judgements;
- (e) it would be unlikely to change significantly the way that disclosure requirements are currently developed in IFRS Standards, and therefore unlikely to compel an entity to make significant changes to its disclosures, if that entity is already communicating information effectively; and
- (f) an entity could use each grouping of information about each type of asset, liability, equity, income and expenses as a disclosure 'building block' to organise the disclosures in its notes in the way that provides the most effective communication. For example, an entity might decide to disclose:
  - (i) all the different types of information about its property, plant and equipment together; or
  - (ii) all information of a particular type together, for example, all of the information about the key risks arising from all the entity's assets and liabilities.

7.21 Method A has the following disadvantages:

- (a) it would not provide the more fundamental changes to the way the Board develops disclosure objectives and requirements that might be necessary to encourage behavioural changes in other parties. For example:
  - (i) if disclosure objectives only add context to the existing disclosure requirements, some entities might continue to apply the disclosure requirements mechanically as a checklist without considering how to improve the communication of information to meet the disclosure objectives; and
  - (ii) minor changes to Standards might only prompt changes in views on what specific information is required to be disclosed, with no significant overall improvements in the way entities communicate that information.
- (b) if centralised disclosure objectives are based on types of information, disclosure requirements would probably still need to be provided in individual Standards for each type of asset, liability, equity, income and expense. This might still result in long lists of disclosure requirements and repetition across Standards.
- (c) the disclosure objectives might not help entities understand the reason for disclosing information because the focus would be on types of information, instead of them being directly linked to the information

that users need to assess the prospects for future net cash inflows to the entity and management's stewardship of the entity's resources.

### **Method B—focusing on the entity's activities**

#### *Explanation of Method B*

- 7.22 To address the disadvantages set out in paragraph 7.21 and respond to feedback that more fundamental changes are needed to encourage behavioural changes and improve disclosures, the Board discussed a second method: Method B. Under Method B, disclosure objectives and requirements would generally be developed and organised on the basis of the entity's main activities.
- 7.23 Specifically, under Method B, centralised disclosure objectives would be developed to address:
- (a) information necessary for understanding the basis of preparation of the financial statements; and
  - (b) information about an entity's activities that helps users assess prospects for future net cash inflows and assess management's stewardship.
- 7.24 The centralised disclosure objectives that would be developed to address the information necessary for understanding the basis of preparation of the financial statements (paragraph 7.23(a)) would be similar to those that would be developed under Method A (see paragraphs 7.17(a) and (b)) and would need to address the following types of information:
- (a) details about the reporting entity; and
  - (b) details about the methods, assumptions and judgements, for example, about an entity's significant accounting policies.
- 7.25 However, unlike Method A, Method B would develop centralised disclosure objectives to address information about the following activities of an entity with the aim of providing information that helps users of financial statements assess both prospects for future net cash inflows and management's stewardship (paragraph 7.23(b)):
- (a) its operating and investing activities, including information about:
    - (i) operating capacity;
    - (ii) operating segments; and
    - (iii) business combinations;
  - (b) its financing activities, including information about:
    - (i) liquidity and solvency; and
    - (ii) capital structure and capital management;
  - (c) discontinued operations; and
  - (d) taxation.
- 7.26 Method B focuses first on identifying activities and then considers useful information about those activities, rather than first considering what types of information to disclose about assets, liabilities, equity, income and expenses. In

this way, Method B might lead to the development of more holistic disclosure objectives and requirements than Method A, because Method B focuses on activities on an integrated basis, rather than considering different assets, liabilities, equity, income and expenses. For example, Method B would consider all operating assets together, regardless of how they are financed (ie whether they are purchased or leased) and regardless of their nature (ie whether they are tangible or intangible), with the aim of providing one set of disclosures about how operating assets contribute to operating cash flows (ie in relation to an entity's operating activities). Information about how operating assets are financed would be addressed by the disclosure objectives and requirements developed for an entity's financing activities. Information about the different nature of the assets would be addressed by the disclosure objectives and requirements for the basis of preparation of the financial statements, as they include an entity's accounting policies for different kinds of assets.

- 7.27 Method B would constitute a fundamental change in how the Board develops disclosure objectives and requirements. If Method B is considered, in most cases disclosure objectives would not be developed for individual Standards, because items and transactions spread across several Standards would be considered together. However, this would mean that the Board would need to decide how to organise centralised disclosure objectives and related disclosure requirements according to an entity's activities within Standards. The Board would also need to decide whether to prescribe the assets, liabilities, equity, income and expenses that should be categorised within the different activities—for example, as operating, financing or investing—or whether to allow the exercise of judgement in this area.
- 7.28 Disclosure objectives and requirements based on Method B might encourage entities to organise the notes in alignment with their main activities, instead of using the same order in which items are presented in the statement of financial position and statement(s) of financial performance. Some entities already use an activity-based structure when grouping information in the notes. Under Method B, entities could still adapt the structure of their financial statements to suit their circumstances, provided that they satisfy the centralised disclosure objectives.

*Illustration of approach to developing disclosure objectives and requirements consistent with Method B*

- 7.29 The Board's amendments to IAS 7 *Statement of Cash Flows* issued in January 2016 (see paragraph 1.15(b)) illustrate how Method B might be applied in practice, as they involved the development of a disclosure objective, and related disclosure requirements, for an entity's financing activities. Those amendments grouped disclosures about liabilities from several different Standards, for example, IFRS 9 *Financial Instruments* and IFRS 16 *Leases*.
- 7.30 The disclosure objective in paragraph 4.4A of the amendments to IAS 7 provides an example of how an objective might be developed for liquidity and solvency (paragraph 7.25(b)(i)). It reads:

An entity shall provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.

- 7.31 The appendix in this Discussion Paper provides two further examples of how Method B might be applied in practice when developing and organising disclosure objectives and requirements. Both show how it might be possible to apply Method B to redraft similar disclosure requirements that are currently spread across several Standards and combine them under a centralised disclosure objective on the basis of the entity's activities.

*Advantages and disadvantages of Method B*

- 7.32 Method B has the following advantages:
- (a) it is aligned with the way in which many entities think about their activities, and the preference of many users of financial statements for information disclosed by activity, as in the amendments made to IAS 7 in 2016.
  - (b) it would challenge the Board to set out clearly the reasons for disclosing information in the financial statements, by focusing disclosure objectives on the entity's activities and on the way in which the users commonly assess prospects for future net cash inflows and management's stewardship.
  - (c) it groups information about types of assets, liabilities, equity, income and expenses under a centralised disclosure objective and would therefore highlight relationships between different disclosures. Under Method B, the Board would need to be disciplined when setting disclosure requirements because these requirements would need to apply to an entire group of assets, liabilities, equity, income and expenses, rather than, for example, to a single class of assets.
  - (d) it helps prevent repetition and inconsistencies that might arise if similar disclosure objectives are developed independently across different Standards.
  - (e) it is different from the predominant method currently used by the Board and might be more likely to encourage behavioural changes, for example, discouraging a checklist approach to disclosures.
- 7.33 Method B has the following disadvantages:
- (a) it would be a significant change to the Board's current approach to developing disclosure requirements and the way stakeholders apply those requirements, the benefits of which are untested. It would require a fundamental review of disclosure objectives and requirements in IFRS Standards. Because it might make it difficult for disclosure objectives and requirements to be developed for an individual Standard, the Board could consider developing a single Standard for disclosures, which would include both the centralised disclosure objectives and the disclosure requirements. The issues involved in having a single Standard for disclosures are discussed in paragraphs 7.38–7.41.

- (b) it would require a significant change in mindset of all stakeholders and the Board, which might require considerable education and time.
- (c) some information—for example, information about related-party transactions or going concern uncertainties—might be better organised by type of information than by activity. For this reason, Method B does not consider information about the basis of preparation based on an entity's activities (see paragraph 7.24) because it would be difficult to organise this way.
- (d) it would not reflect the way all entities think about their activities and it might be costly for entities to implement the changes to their internal systems and processes in order to identify and provide information by activity rather than by type of asset, liability, equity, income or expense.
- (e) it might provide less flexibility than Method A for organising disclosures in the notes in a way that communicates the information most effectively, particularly if the Board defines which activities are classified as operating, financing and investing activities.
- (f) it might affect comparability among entities with different business activities depending on how those activities are classified—as operating, investing or financing. Furthermore, it might be difficult to distinguish between operating and financing for some activities—for example, those of financial institutions—which could lead to a lack of comparability between entities even when they are in similar industries.

**Table 7.1—Comparison of Methods A and B**

	<b>Method A</b>	<b>Method B</b>
<b>Basis for developing centralised disclosure objectives</b>	Considering the different types of information disclosed about an entity's assets, liabilities, equity, income and expenses (type of information focus).	Considering what information should be disclosed for an entity's different activities (activity focus).

*continued...*



...continued

	Method A	Method B
<b>The need for disclosure objectives to be provided in individual Standards (ie Standards-level objectives)</b>	<p>Likely to be developed to support disclosure requirements, which would still be developed in individual Standards.</p> <p>Centralised disclosure objectives would be developed to cover useful information about assets, liabilities, equity, income and expenses in general. They could then be applied more specifically as disclosure objectives in individual Standards to a particular type of asset, liability, equity, income or expense, as well as to related transactions.</p>	<p>Not likely to be developed.</p> <p>Centralised disclosure objectives would be developed to cover information about an entity's activities. It would be difficult to apply these objectives more specifically as disclosure objectives in individual Standards because activities would cover items and transactions that are subject to multiple Standards.</p>
<b>Disclosure requirements in Standards</b>	Developed on the basis of the disclosure objectives in an individual Standard.	Developed on the basis of centralised disclosure objectives.

### Hybrid of Methods A and B

- 7.34 It would be possible to combine Methods A and B into a hybrid method when developing centralised disclosure objectives. In fact, Method B already incorporates a hybrid element because information about the basis of preparation of the financial statements is identified as a type of information in Method A. It could also be argued that the Board currently applies a hybrid method in developing IFRS Standards. Whereas most Standards focus on providing information about specific types of asset or liability, income or expense, such as IAS 16 *Property, Plant and Equipment* and IFRS 15 *Revenue from Contracts with Customers*, some focus on specific activities, such as IFRS 3 *Business Combinations* and IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.
- 7.35 A hybrid method would provide the Board with more flexibility and it would benefit from some of the advantages of both methods, while reducing the disadvantages.
- 7.36 A disadvantage of a hybrid method is a lack of consistency in how the Board develops disclosure objectives and requirements. This might undermine some of the advantages listed for both methods and make it difficult to determine the location for disclosure objectives and requirements in IFRS Standards.

- 7.37 The Board has not discussed how Methods A and B could be combined to form a hybrid method, but it might discuss this when it considers the feedback received on this Discussion Paper.

**Considering a single Standard, or a set of Standards, for disclosures**

- 7.38 The Board has not discussed in detail the possibility of locating all disclosure objectives and requirements in IFRS Standards within a single Standard or set of Standards for disclosures. Such a Standard could also incorporate the principles of disclosure discussed in this project. The Board might revisit the possibility of a single Standard for disclosures after it has considered the feedback received on this Discussion Paper. For example, if centralised disclosure objectives are developed under Method B, it might be difficult to develop disclosure objectives and requirements in individual Standards. This might increase the need for the Board to consider a single Standard for disclosures that would contain the centralised disclosure objectives and disclosure requirements.
- 7.39 A single Standard for disclosures has the following advantages:
- (a) it would avoid the potential disconnect involved in having centralised disclosure objectives and principles in a general disclosure standard, but having disclosure objectives and requirements spread across multiple Standards;
  - (b) it would help the Board and its stakeholders to think about disclosure objectives and requirements as a package, in a more unified way, meaning that relationships between different disclosure requirements could be more readily identified and ensuring that disclosure requirements are developed consistently, which might lead to more effective disclosures;
  - (c) it would encourage more discipline in how the Board sets disclosure requirements, other than that imposed by the development of centralised disclosure objectives, because all disclosure requirements would be considered in relation to each other, instead of the focus being on an individual Standard;
  - (d) it would enable disclosure requirements to be arranged by topic, rather than by Standard, which may be more user-friendly, reduce duplications and highlight relationships between disclosure requirements; and
  - (e) it might be more appropriate for disclosure objectives and requirements developed under Method B.
- 7.40 A single Standard for disclosures has the following disadvantages:
- (a) taking disclosure requirements out of individual Standards might make it difficult to see how these requirements relate to the recognition and measurement requirements.
  - (b) considering disclosure requirements on a more unified basis might mean that there is less focus on the aspects of a specific class of an entity's assets, liabilities, equity, income or expenses that are relevant for that particular class. Consequently, useful information that is specific to

a particular type of transaction might be overlooked when developing disclosure objectives. For this reason there also might be a limit to how unified the disclosure objectives and requirements in Standards could be.

- (c) it would represent a fundamental change to existing Standards that might have unintended consequences.
- (d) while a more unified approach might lead to more effective disclosure objectives and requirements, it would take a long time for the Board to implement, so there would be a significant delay before any benefits of a single Standard for disclosures could be realised. Furthermore, there would still need to be a change in the behaviour of entities, auditors and regulators (as discussed in paragraphs 1.6–1.8) for this approach to result in more effective disclosures.

7.41 An alternative to having a single Standard for disclosures would be to group disclosure objectives and requirements into several Standards for disclosures, each one covering a few related topics. The Board applied this approach when developing IFRS 12 *Disclosure of Interests in Other Entities*, covering disclosure requirements that would otherwise have been spread across IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IAS 28 *Investments in Associates and Joint Ventures*. Grouping disclosures in this way might produce a similar outcome to a single Standard for disclosures that is organised by topic, and it might be easier and quicker for the Board to implement. Nevertheless, it might diminish some of the benefits of setting disclosure objectives and requirements on a more unified basis.

### Summary of the Board's preliminary views and questions for respondents

Question 11
<p>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.</p> <p>Centralised disclosure objectives could be used by the Board as a basis for developing disclosure objectives and requirements in Standards that are more unified and better linked to the overall objective of financial statements.</p> <p>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?</p>

**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 this 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.

**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?

## Section 8—New Zealand Accounting Standards Board staff’s approach to drafting disclosure requirements in IFRS Standards

8.1 This section describes an approach that has been developed by the staff of the New Zealand Accounting Standards Board (NZASB staff) for drafting disclosure requirements in IFRS Standards.<sup>54</sup> The NZASB staff’s approach:

- (a) aims to respond to concerns that the drafting of IFRS Standards can contribute to the disclosure problem; and
- (b) illustrates how disclosure objectives and requirements in IFRS Standards might be drafted, with the aim of encouraging more effective disclosures in financial statements.

The Board has not yet formed any views about the NZASB staff’s approach described in this section. If feedback on the NZASB staff’s approach is positive, the Board might consider the NZASB staff’s approach in its Standards-level Review of Disclosures project (see paragraph 1.16(c)).

8.2 The main features of the NZASB staff’s approach are:

- (a) the inclusion of disclosure objectives, comprising an overall disclosure objective for each 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, with the amount of information to be disclosed depending on the relative importance of an item or transaction to the reporting entity and the extent of judgement required in accounting for the item or transaction. The two tiers are:
  - (i) summary information, intended to provide users with an overall picture of the effect of the item or transaction. All entities would be required to disclose this information, subject only to materiality considerations (tier 1 disclosures); and
  - (ii) additional information, which an entity would consider disclosing if that information is necessary to meet the overall disclosure objective in the Standard (tier 2 disclosures).
- (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.

8.3 This section is set out as follows:

- (a) what is the issue? (paragraph 8.4);
- (b) the NZASB staff’s approach (paragraphs 8.5–8.24);

<sup>54</sup> This section provides a summary of the NZASB staff’s approach, adapted to fit in with the content of this Discussion Paper. The NZASB staff’s original proposals are available in Agenda Papers 11F–11I, discussed by the Board at its meeting in April 2015, and Agenda Papers 11A–11B, discussed by the Board at its meeting in September 2015. All agenda papers are available on the IFRS Foundation website.

- (c) costs and benefits of the NZASB staff's approach (paragraphs 8.25–8.27);
- (d) applicability of the NZASB staff's approach to other methods of developing centralised disclosure objectives (paragraphs 8.28–8.29);
- (e) examples prepared by the NZASB staff to illustrate their approach (provided after paragraph 8.29 on pages 90–97 of this Discussion Paper):
  - (i) NZASB staff example 1: Guidance on the use of judgement;
  - (ii) NZASB staff example 2: Application of the approach to IAS 16 *Property, Plant and Equipment*; and
  - (iii) NZASB staff example 3: Application of the approach to IFRS 3 *Business Combinations*.
- (f) questions for respondents (at the end of this section on page 98 of this Discussion Paper).

### What is the issue?

8.4 Entities need to use judgement when deciding what information to disclose in their financial statements and the most effective way to organise and communicate that information. The Board has received feedback that the main difficulties in applying judgement are behavioural (see paragraphs 1.6–1.7). The Board has also received feedback that IFRS Standards might discourage use of judgement in the following ways:

- (a) some Standards lack clear disclosure objectives, making the purpose of some disclosure requirements unclear. This makes it difficult for entities to apply judgement and decide what information to disclose.
- (b) some disclosure requirements use overly prescriptive language, for example, 'shall disclose' and 'at a minimum'. This wording might give the impression that the specific disclosures must be provided, regardless of whether the information is material, and might be seen to encourage a checklist approach to preparing the financial statements.

### The NZASB staff's approach

8.5 The following paragraphs describe the main aspects of the NZASB staff's approach:

- (a) disclosure objectives (paragraphs 8.6–8.11);
- (b) two tiers of disclosure requirements (paragraphs 8.12–8.19);
- (c) emphasising the use of judgement (paragraphs 8.20–8.22); and
- (d) less prescriptive language (paragraphs 8.23–8.24).

### Disclosure objectives

8.6 The NZASB staff's approach suggests that each Standard include:

- (a) an overall disclosure objective for that Standard, which would be based on the objective of financial statements (a Standards-level application of the objective of financial statements); and

- (b) more specific disclosure subobjectives for each type of information required that provide a more granular application of the overall disclosure objective in each Standard.

8.7 The overall disclosure objective in a Standard would be a broad objective intended to provide a link to the objective of financial statements. The overall disclosure objective in a Standard would also be linked to the objective of that individual Standard. For example, the overall disclosure objective for IAS 16 in paragraph 16.X1 of NZASB staff example 2 (this example starts on page 90 of this Discussion Paper) is:<sup>55</sup>

The objective of disclosing information about the entity's investment in property, plant and equipment is to help users of its financial statements to assess the effect of the entity's investment in property, plant and equipment on the financial position, financial performance and cash flows of the entity, including judgements made in accounting for that investment.

8.8 To assist entities in making judgements about what information to provide, there are specific disclosure subobjectives that support the overall disclosure objective in a Standard to explain why users need particular types of information. The NZASB staff's approach suggests the following list of types of information to develop the specific disclosure subobjectives:

- (a) information about the reporting entity;
- (b) information about the measurement bases and measurement uncertainties of the entity's assets and liabilities;
- (c) information about the key risks arising from the entity's assets and liabilities;
- (d) information about the reporting entity's financial position, financial performance and cash flows;
- (e) forward-looking information, if that information is relevant and relates to the assets and liabilities that existed at the end of, or during, the reporting period;
- (f) information about management's stewardship of the entity's resources; and
- (g) other relevant information.

8.9 Consistent with Method A in Section 7 *Centralised Disclosure Objectives*, centralised disclosure objectives could be developed for each type of information listed in paragraph 8.8. For example, a centralised disclosure objective for paragraph 8.8(b) that could be applied across IFRS Standards might be described as:

Disclose information about the measurement bases of the entity's assets and liabilities, and any associated measurement uncertainties, to help users of financial statements understand how the amounts recognised have been determined and any significant measurement uncertainties that are associated with that determination.

<sup>55</sup> This overall disclosure objective in IAS 16 has been developed considering the objective of financial statements described in paragraph 9 of IAS 1 and the objective of IAS 16 in paragraph 1 of IAS 16.

- 8.10 That centralised disclosure objective could be used as a basis for developing a specific disclosure subobjective for an individual Standard. For example, a specific disclosure subobjective for information about the measurement bases, and related measurement uncertainties, in relation to property, plant and equipment in paragraph 16.X7 of NZASB staff example 2 is:

To achieve the [overall] disclosure objective [in IAS 16], an entity shall consider whether to disclose additional information about the basis for measuring property, plant and equipment and any associated uncertainties of that measurement to help users understand how the amounts recognised have been determined and any significant measurement uncertainties associated with that determination.

- 8.11 The NZASB staff's approach illustrates one way disclosure objectives and requirements in Standards might be developed. There are other possible approaches for drafting disclosure requirements in Standards and the Board has not yet formed any views about either this aspect or other aspects of the NZASB staff's approach described in this section.

### **Two tiers of disclosure requirements**

- 8.12 In addition to disclosure objectives, the NZASB staff's approach suggests that IFRS Standards include two tiers of disclosure requirements, which would require entities to:

- (a) provide summary information, subject to a materiality judgement (tier 1 disclosures); and
- (b) assess whether it is necessary to provide additional information, depending on the relative importance of the item or transaction to the reporting entity and the amount of judgement involved in accounting for the item or transaction (tier 2 disclosures).

- 8.13 The aim of this two-tier approach to disclosing information is to provide a balance between:

- (a) ensuring a level of consistency and comparability between entities, and a level of specificity, which directs entities when judging what information is required to satisfy the overall disclosure objective in a Standard—subject to materiality, all entities would be required to provide the summary information (tier 1 disclosures).
- (b) providing entities with some flexibility to exercise judgement about what further information is needed to meet the overall disclosure objective in a Standard (tier 2 disclosures). This would guide entities to communicate in a manner that reflects their own facts and circumstances and the information needs of users of their financial statements. It would also discourage inclusion of immaterial or 'boilerplate' information.

- 8.14 The aim of the tier 1 disclosures is to provide an overall picture of the effect of the item or transaction. Tier 1 disclosures in a Standard would be selected by the Board on the basis of the types of information (from paragraph 8.8) that are necessary, in the context of the item or transaction covered by the Standard, to give an overall picture of that item or transaction.



- 8.15 Tier 1 disclosures would need to be provided by all entities if they have items or transactions within the scope of the particular Standard, except when this results in the disclosure of immaterial information.
- 8.16 The aim of tier 2 disclosures would be to specify more detailed information to accompany the tier 1 disclosures, if necessary, and to cover all types of information detailed in paragraph 8.8. Tier 2 disclosures contain two types of additional information:
- (a) additional detail about types of information that are already provided in summarised form under tier 1 (for example, paragraph 16.X5 of NZASB staff example 2 suggests additional disclosures on changes in property, plant and equipment, which provide more detail on the summary in paragraph 16.X3(c) of that example); and
  - (b) additional types of information not specifically required under tier 1 (other than potentially as part of the requirement to disclose a summary of other information necessary to provide an overall picture of the transactions—for example, see paragraph 16.X3(f) of NZASB staff example 2), which might be necessary to meet the overall disclosure objective in the Standard (for example, paragraph 16.X6(c) of NZASB staff example 2 covers information about restrictions on the use or disposal of property, plant and equipment, which is only covered in tier 2).
- 8.17 For some entities, the tier 1 disclosures about an item might be sufficient to meet the overall disclosure objective in the Standard for that item. However, if the tier 1 disclosures are not sufficient to satisfy the overall disclosure objective in the Standard, the entity would need to provide some tier 2 disclosures. For example:
- (a) a financial institution with a small investment in property, plant and equipment might need to disclose only summary information (tier 1 disclosures), or not disclose any information at all about that investment; and
  - (b) a manufacturer with a large investment in plant and equipment might need to provide both summary information (tier 1 disclosures) and some additional information (tier 2 disclosures).
- 8.18 The aim of providing specific disclosure subobjectives in Standards would be to help entities assess which tier 2 disclosures are necessary, if any. Consequently, tier 2 disclosures would be linked to the specific disclosure subobjectives.
- 8.19 The NZASB staff suggest that the requirements to disclose summary information (tier 1) and to consider disclosing additional information (tier 2), could be described in IAS 16 as follows (see also paragraphs 16.X3 and 16.X4 of NZASB staff example 2):

**Summary information**

To achieve the [overall] disclosure objective, an entity discloses summary information about its investment in property, plant and equipment to provide an overall picture of the relative importance of property, plant and equipment to the entity and the amount of judgement involved in accounting for property, plant and equipment, thereby helping users to assess, at a broad level, the effect of

property, plant and equipment on the entity's financial position, financial performance and cash flows. An entity discloses the following information:

(a) ...

#### **Additional information**

An entity shall assess whether it is necessary to disclose information about property, plant and equipment in addition to [the summary information] and, in doing so, shall [consider the factors listed, in paragraphs...]. The greater the importance of property, plant and equipment to an entity and the greater the amount of judgment involved in accounting for property, plant and equipment, the more information an entity is likely to need to disclose.

### **Emphasising the use of judgement**

8.20 The NZASB staff's approach suggests that a general disclosure standard include a few paragraphs to emphasise the need for a reporting entity to exercise judgement to determine what information to disclose, and how best to disclose it. Alternatively, these paragraphs could be included in each Standard and linked to the overall disclosure objective of that Standard.

8.21 These paragraphs would expand on paragraph 31 of IAS 1 which states:

Some IFRSs specify information that is required to be included in the financial statements, which include the notes. An entity need not provide a specific disclosure required by an IFRS if the information resulting from that disclosure is not material. This is the case even if the IFRS contains a list of specific requirements or describes them as minimum requirements. An entity shall also consider whether to provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

8.22 NZASB staff's example 1 on page 90 of this Discussion Paper provides an example of clarifying requirements on the need for judgement that could be placed in any Standard that contains disclosure requirements or in a general disclosure standard.

### **Less prescriptive language**

8.23 The NZASB staff's approach avoids using the wording 'an entity shall disclose' and 'as a minimum'. The Board has received feedback that some stakeholders think that prescriptive wording of this kind, which is used in some IFRS Standards, implies that the concept of materiality does not apply to those requirements. The Board observes that this feedback arises from a misunderstanding of the wording used in IFRS Standards. To dispel that misunderstanding, the Board clarified, in its December 2014 amendments to IAS 1, that an entity need not provide a specific disclosure required by an IFRS Standard if the information resulting from that disclosure is not material, even if the Standard contains a list of specific requirements or describes them as minimum requirements.<sup>56</sup> The NZASB staff's approach aims to address this concern by using the following wording:

<sup>56</sup> Paragraph 31 of IAS 1, also referred to in paragraph 8.21 of this Discussion Paper.

- (a) 'an entity discloses' for the tier 1 disclosures; and
- (b) 'an entity considers disclosing information about' and 'examples of information that the entity considers disclosing include' for the tier 2 disclosures.

8.24 The wording for the tier 2 disclosures would be less prescriptive than the tier 1 disclosures because the tier 2 disclosures set out further matters for the entity to consider disclosing, rather than state that the entity is required to make particular disclosures. The language used for tier 2 disclosures intends to emphasise that the entity needs to make an assessment of whether, and what, further information is necessary to meet the overall disclosure objective in a Standard.

### **Cost and benefits of the approach**

8.25 The NZASB staff's approach aims to:

- (a) provide entities with a better basis for exercising judgement when deciding what information to include in their financial statements, and how to disclose that information, which might encourage changes in behaviour;
- (b) provide entities with the flexibility to communicate in a manner that reflects their own facts and circumstances and the information needs of users of their financial statements, but still ensures some level of consistency and comparability;
- (c) address the concerns that a lack of clear disclosure objectives and long lists of disclosure requirements contribute to the disclosure problem; and
- (d) address the concerns that some disclosure requirements are written using overly prescriptive language.

8.26 Nevertheless, stakeholders might have the following concerns about the approach:

- (a) it might be simpler for entities to use specific disclosure requirements than to apply judgement when determining how to meet disclosure objectives. For example, assessing whether disclosures meet disclosure objectives requires an understanding of the needs of users of the financial statements. A checklist approach might appear simpler because of time pressures and because it can make decisions easier to explain to auditors and regulators. There is also a risk that examples of additional disclosures (that the NZASB staff suggest providing as guidance in their approach) might be used as a disclosure checklist.
- (b) some users of financial statements might be concerned about allowing entities too much flexibility in providing tier 2 disclosures because they might lose information that they usually receive or because such flexibility might affect comparability between entities and between periods.

- (c) some auditors and regulators might be concerned that a more flexible approach to providing disclosures would be more difficult to audit and regulate.
- 8.27 Some entities might be concerned about implementing the NZASB staff's approach because of perceived additional complexity and time commitment. However, the NZASB staff's approach might not be as time-consuming as some stakeholders believe because:
- (a) the approach provides some specificity to guide the determination of how to satisfy the overall disclosure objective in a Standard by:
    - (i) setting specific tier 1 disclosure requirements; and
    - (ii) including specific disclosure subobjectives to guide an entity when it decides whether to provide additional disclosures.
  - (b) although the approach might be more time-consuming initially (compared to a checklist approach), in subsequent reporting periods the entity could focus on what has changed since the previous reporting period, rather than reassess all of its disclosures each year.
  - (c) it is not necessary to wait until the year-end reporting process has begun to consider what new or revised information might be needed to meet the disclosure objectives. This assessment can be made during the year, when transactions or events occur that are likely to affect the disclosures.
  - (d) any significant transactions or events are usually reported to the market during the period, for example, in market announcements, investor briefings or interim financial reports. Such communications can be used as the basis for the disclosures in the notes. Consequently, an entity might be able to reduce its costs by closer alignment of its communication and financial reporting processes.

### **Applicability of the NZASB staff's approach to other methods of developing centralised disclosure objectives**

- 8.28 The NZASB staff's approach is consistent with the Board's preliminary views on the role and content of the notes in Section 3 *Roles of the primary financial statements and the notes* and Method A (types of information) for determining centralised disclosure objectives in Section 7.
- 8.29 If a different method is used to determine the centralised disclosure objectives, for example, Method B in Section 7, this would affect the determination of the disclosure objectives and requirements. However, the following aspects of the NZASB staff's approach could still be applied in developing disclosure objectives and requirements under a different method:
- (a) disclosure objectives would be developed to clarify why information is useful in meeting the information needs of users of the financial statements;
  - (b) disclosure objectives within a Standard would be linked to the centralised disclosure objectives or to the objective of financial statements;

- (c) each disclosure requirement would be linked to a disclosure objective;
- (d) requirements would be included to emphasise the need to exercise judgement when deciding how and what to disclose to meet the disclosure objectives; and
- (e) disclosure requirements would be written using less prescriptive wording.

## **NZASB staff's examples**

### **NZASB staff example 1—Guidance on the use of judgement**

*This is an example of clarifying paragraphs emphasising the need to use judgement and could be placed in each Standard that contains disclosure requirements or could be placed in a general disclosure standard, such as in IAS 1.*

- X1.1 To achieve the [overall] disclosure objective in a Standard, an entity shall use its judgement to determine the extent and appropriate mix of quantitative and qualitative information to disclose, including the extent of aggregation or disaggregation of that information. Assessments about the amount of information to disclose depend on the relative importance of an item or transaction to the entity (taking into account the nature and/or size of that item or transaction) and the amount of judgement involved in accounting for that item or transaction. Therefore, assessments need to take into account the extent to which the entity's financial position, financial performance or cash flows are affected by:
- (a) the item or transaction; and
  - (b) risks and uncertainties associated with the item or transaction.
- X1.2 When using judgement to determine the information to be disclosed in accordance with a Standard, an entity considers:
- (a) how much emphasis to place on particular disclosures;
  - (b) the level of detail needed (taking into account the expectation that users of financial statements should have a reasonable knowledge of business and economic activities);
  - (c) how much aggregation or disaggregation to undertake; and
  - (d) whether users of the financial statements need additional information to meet the disclosure objective.
- X1.3 An entity aggregates or disaggregates disclosures in accordance with this Standard or another IFRS Standard so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics.

### **NZASB staff example 2—Application of the NZASB staff's approach to IAS 16 *Property, Plant and Equipment***

*The redrafted disclosure section for IAS 16 covers disclosures for property, plant and equipment in their entirety, without consideration of where those requirements might be placed in specific Standards. Therefore, some of the disclosures in this example might*

*duplicate existing disclosure requirements in other Standards. The exact disclosures required, potential duplication of disclosure requirements and the preferred location of particular disclosure requirements will be addressed at a later stage if the Board considers the NZASB staff's approach further.*

***Disclosure objective***

- 16.X1 The objective of disclosing information about the entity's investment in property, plant and equipment is to help users of its financial statements to assess the effect of the entity's investment in property, plant and equipment on the financial position, financial performance and cash flows of the entity, including judgements made in accounting for that investment.

***Need for judgement***

- 16.X2 To achieve the disclosure objective, an entity shall use its judgement in accordance with paragraphs X1.1–X1.3 (see NZASB staff example 1).

***Information for disclosure***

**Summary information**

- 16.X3 To achieve the disclosure objective, an entity discloses summary information about its investment in property, plant and equipment to provide an overall picture of the relative importance of property, plant and equipment to the entity and the amount of judgement involved in accounting for property, plant and equipment, thereby helping users assess, at a broad level, the effect of property, plant and equipment on the entity's financial position, financial performance and cash flows. An entity discloses the following information:
- (a) a description of how the nature of the entity's business affects or determines the level or mix of its investment in property, plant and equipment;
  - (b) the total carrying amount of property, plant and equipment and the carrying amount of major classes of property, plant and equipment at the end of the reporting period;
  - (c) a summary of significant changes to the carrying amount of major classes of property, plant and equipment during the reporting period;
  - (d) the measurement basis used for major classes of property, plant and equipment;
  - (e) a summary of any significant uncertainties associated with the measurement of property, plant and equipment, such as a description of the nature or type of key estimates or judgements made in the measurement of property, plant and equipment; and
  - (f) a summary of any other information necessary to provide an overall picture of the entity's investment in property, plant and equipment, such as any significant restrictions on the use of property, plant and equipment.

**Additional information**

- 16.X4 An entity shall assess whether it is necessary to disclose information about property, plant and equipment in addition to that required by paragraph 16.X3 and, in doing so, shall consider the factors in paragraphs X1.1–X1.3 (see NZASB staff example 1). The greater the importance of property, plant and equipment to an entity and the greater the amount of judgement involved in accounting for property, plant and equipment, the more information an entity is likely to need to disclose.

*Changes in property, plant and equipment*

- 16.X5 To achieve the disclosure objective, an entity shall consider whether to disclose additional information about the effect of transactions and other events during the reporting period that change an entity's investment in property, plant and equipment for users to understand how transactions and events during the reporting period have changed the entity's financial position, financial performance or cash flows. For example, information that the entity considers disclosing includes a reconciliation of the carrying amount of major classes of property, plant and equipment from the beginning to the end of the reporting period, showing:
- (a) depreciation expense;
  - (b) purchases and sales of property, plant and equipment;
  - (c) gains and losses on the sale or disposal of property, plant and equipment;
  - (d) impairment losses and reversals of impairment losses; and
  - (e) revaluation increases and decreases.

*Key risks and restrictions associated with property, plant and equipment*

- 16.X6 To achieve the disclosure objective, an entity shall consider whether to disclose information relating to the nature and extent of the key risks and restrictions associated with the entity's property, plant and equipment for users to understand and evaluate how those risks and restrictions might affect the entity's ability to use, sell or otherwise derive economic benefits from its property, plant and equipment in future reporting periods. Examples of information that the entity considers disclosing include:
- (a) a description of the nature and extent of key risks to which the entity is exposed at the reporting date that could adversely affect the future recoverability of its investment in property, plant and equipment, such as through economic or technological obsolescence;
  - (b) a description of the entity's objectives and policies for managing any such risks;
  - (c) restrictions on the use or disposal of property, plant and equipment; and
  - (d) the carrying amount of property, plant and equipment pledged as security for liabilities or commitments.

*Measurement bases and related uncertainties associated with property, plant and equipment*

- 16.X7 To achieve the disclosure objective, an entity shall consider whether to disclose additional information about the basis for measuring property, plant and equipment and any associated uncertainties of that measurement to help users understand how the amounts recognised have been determined and any significant measurement uncertainties associated with that determination. Examples of information that the entity considers disclosing include:
- (a) methods and assumptions used for depreciating property, plant and equipment, such as estimated useful lives and residual values;
  - (b) methods and assumptions used in assessing property, plant and equipment for impairment;
  - (c) methods and assumptions applied if major classes of property, plant and equipment are stated at revalued amounts;
  - (d) the sensitivity of the following to changes in the methods and assumptions disclosed in accordance with paragraphs (a) to (c):
    - (i) carrying amounts of property, plant and equipment at the reporting date; and
    - (ii) changes in those carrying amounts during the reporting period; and
  - (e) changes in any of the measurement bases, methods and assumptions applied during the reporting period.

*Future changes in property, plant and equipment*

- 16.X8 To achieve the disclosure objective, an entity shall consider whether to disclose information about future transactions relating to property, plant and equipment to help users understand forthcoming changes in its investment in property, plant and equipment and assess the likely future effects of those transactions on the entity's financial position, financial performance and cash flows. For example, information that the entity considers disclosing includes commitments at the end of the reporting period that will result in future changes in the entity's investment in property, plant and equipment, such as commitments to purchase or dispose of items of property, plant and equipment.

*Other information about property, plant and equipment*

- 16.X9 To achieve the disclosure objective, an entity shall consider whether to disclose other information to help users to understand and evaluate the entity's investment in property, plant and equipment and its efficient and effective use by the entity. Examples of information that the entity considers disclosing include:
- (a) any indications that the current use of property, plant and equipment is not its highest and best use; and
  - (b) the amount of property, plant and equipment that is idle or has excess capacity.



### **NZASB staff example 3—Application of the NZASB staff’s approach to IFRS 3 *Business Combinations***

*The redrafted disclosure section for IFRS 3 covers disclosures for business combinations in their entirety, without consideration of where those requirements might be placed in specific Standards. Therefore, some of the disclosures in this example might duplicate existing disclosure requirements in other Standards. The exact disclosures required, any potential duplication of disclosure requirements, and the preferred location of particular disclosure requirements, will be addressed at a later stage if the Board considers the NZASB staff’s approach further.*

#### ***Disclosure objective***

- 3.X1 The objective of disclosing information about business combinations is to help users of the entity’s financial statements to assess the effect of business combinations on the financial position, financial performance and cash flows of the entity, including judgements made in accounting for those business combinations.

#### ***Need for judgement***

- 3.X2 To achieve the disclosure objective, an entity shall use its judgement in accordance with paragraphs X1.1–X1.3 (see NZASB staff example 1).

#### ***Information for disclosure***

##### **Summary information**

- 3.X3 To achieve the disclosure objective, an entity discloses summary information about business combinations during the reporting period to provide an overall picture of the relative importance of business combinations to the entity and the amount of judgement involved in accounting for business combinations, thereby helping users to assess, at a broad level, the effect of business combinations on the entity’s financial position, financial performance and cash flows. An entity discloses the following information:
- (a) a description of the types of businesses acquired;
  - (b) a description of the reasons for undertaking the business combinations;
  - (c) a summary of the identifiable assets acquired and liabilities assumed, the total consideration paid and the amount of any goodwill arising from acquisitions; and
  - (d) a summary of any other information necessary to provide an overall picture of the entity’s business combinations during the reporting period, such as effects of, or risks and uncertainties associated with, the business combinations.

##### **Additional information**

- 3.X4 An entity shall assess whether it is necessary to disclose information about business combinations in addition to that required by paragraph 3.X3 and, in doing so, considers the factors in paragraph X1.1–X1.3 (see NZASB staff example 1). The greater the importance of business combinations to the entity

and the greater the amount of judgement involved in accounting for business combinations, the more information an entity is likely to need to disclose.

*The effects of individual business combinations on the entity*

3.X5 To achieve the disclosure objective, an entity shall consider whether to disclose information about individual business combinations during the reporting period. The greater the effects of an individual business combination on the entity's financial position, financial performance and cash flows, the more likely it is that information about that business combination will be helpful to users of the entity's financial statements. Examples of information that the entity considers disclosing include:

- (a) a description of the acquiree, such as the name of the acquiree, the nature of the acquiree's business and the date of the acquisition;
- (b) a description of the reasons for undertaking the business combination;
- (c) the percentage of voting equity interests acquired and, if control was obtained other than as a consequence of voting equity interests acquired, a description of how control was obtained;
- (d) a summary of the business combination, which could include:
  - (i) the identifiable assets acquired and liabilities assumed at acquisition date by a major class;
  - (ii) the amount of any goodwill arising from acquisition;
  - (iii) a summary of the consideration transferred by each major class, such as cash, other tangible or intangible assets, liabilities incurred, and equity interests in the acquirer;
  - (iv) the amount of any non-controlling interest in the acquiree at the acquisition date;
  - (v) the fair value of any equity interest in the acquiree held before the business combination; and
  - (vi) a summary of any gains or losses recognised in profit or loss at the acquisition date arising from the business combination, such as a bargain purchase gain, acquisition costs expensed or a gain or loss on remeasurement of existing interests held immediately before the acquisition date.

*Changes in key risks associated with businesses acquired*

3.X6 To achieve the disclosure objective, an entity shall consider whether to disclose information relating to changes in key risks associated with businesses acquired to help users to understand and evaluate how those risks might affect the entity's financial position, financial performance and cash flows. Examples of information that the entity considers disclosing include:

- (a) a description of the nature and extent of changes in key risks to which the entity is exposed at the reporting date as a consequence of business combinations during the reporting period and a description of any changes to the entity's objectives and policies for managing any such risks;
- (b) a description of the types and classes of intangible assets recognised as a result of the business combination;
- (c) the reasons for intangible assets being considered to have indefinite useful lives;
- (d) a description of contingent liabilities assumed; and
- (e) a description of the terms and conditions of contingent consideration transferable or indemnification assets recognised.

*Changes in financial position, financial performance and cash flows arising from business combinations*

3.X7 To achieve the disclosure objective, an entity shall consider whether to disclose additional information about other effects of business combinations on the entity to help users understand how business combinations during the current or previous reporting period have affected the entity's financial position, financial performance or cash flows. Examples of information that the entity considers disclosing include:

- (a) the contribution of businesses acquired during the period to the performance of the acquirer;
- (b) gains or losses arising from the remeasurement of contingent consideration that are not measurement period adjustments;
- (c) where the initial accounting for a prior period business combination was incomplete at the end of the last reporting period, adjustments to amounts previously recognised;
- (d) the amount of, and reasons for, impairment of goodwill and other intangible assets with indefinite useful lives; and
- (e) information about transactions recognised separately from business combinations, such as a description of such transactions and the amounts recognised.

*Measurement bases and related uncertainties associated with business combinations*

3.X8 To achieve the disclosure objective, an entity shall consider whether to disclose information about the basis for measuring assets acquired, liabilities assumed, non-controlling interests in the acquiree and consideration transferred in business combinations during the reporting period and any associated uncertainties of that measurement to help users understand how the amounts recognised have been determined and any significant measurement uncertainties that are associated with that determination. Examples of information that the entity considers disclosing include:

- (a) the methods and assumptions used in determining the amounts recognised for business combinations at the acquisition date, such as the methods and assumptions used to measure the acquisition-date amounts of the assets acquired, liabilities assumed, the consideration transferred (including equity interests in the acquirer and any other non-cash consideration transferred) and non-controlling interests;
- (b) whether the accounting for a business combination has been determined on a provisional basis and, if so, the factors that could result in changes to the accounting and the assets, liabilities and equity interests or items of consideration for which the initial accounting is incomplete; and
- (c) the methods and assumptions used in assessing goodwill and other intangible assets for impairment.

*Future transactions or events related to or arising from business combinations*

3.X9 To achieve the disclosure objective, an entity shall consider whether to disclose information about likely or possible future transactions or events relating to (or arising from) businesses acquired that are relevant to an understanding of the assets acquired and liabilities assumed or incurred to help users assess the likely future effect of such transactions or events on the entity's financial position, financial performance and cash flows. Examples of information the entity considers disclosing include:

- (a) assets or components of businesses acquired during the period intended for resale;
- (b) assets or components of businesses acquired during the period intended not to be used;
- (c) descriptions of plans for any restructuring of businesses acquired during the period; and
- (d) for contingent consideration arrangements and indemnification assets, information about the range of outcomes of any such arrangements.

*Other information about business combinations*

3.Y0 To achieve the disclosure objective, an entity shall consider whether to disclose other information to help users to understand and evaluate the effects of business combinations, including information relating to the efficient and effective use of the entity's resources. For example, information the entity considers disclosing includes a description of the reasons for gains recognised in a bargain purchase.

## Questions for respondents

The feedback on Questions 14–15 will inform the Board’s Standards-level Review of Disclosures project (see paragraph 1.16(c)).

### Question 14

This section describes an approach that has been suggested by the NZASB staff for drafting disclosure objectives and requirements in IFRS Standards.

- (a) Do you have any comments on the NZASB staff’s approach to drafting disclosure objectives and requirements in IFRS Standards described in this section (the main features of the approach are summarised in paragraph 8.2 of this section)?
- (b) Do you think that the development of such an approach would encourage more effective disclosures?
- (c) Do you think the Board should consider the NZASB staff’s approach (or aspects of the approach) in its Standards-level Review of Disclosures project? Why or why not?

Note that the Board is seeking feedback on the NZASB staff’s overall approach, rather than feedback on the detailed drafting of the paragraphs on the use of judgement in the NZASB staff’s example 1 or the detailed drafting of the specific disclosure requirements and objectives included in the NZASB staff’s examples 2 and 3. In addition, the Board is not seeking feedback on where specific disclosure objectives and requirements should be located in IFRS Standards (except as specifically requested in Question 13).

### Question 15

Some stakeholders say that the way that disclosures are drafted in IFRS Standards might contribute to the ‘disclosure problem’, as described in Section 1. Some cite in particular the absence of clear disclosure objectives and the presence of long lists of prescriptively written disclosure requirements in Standards (see paragraph 8.4).

Nevertheless, other stakeholders observe that specific disclosure requirements might be simpler to use than applying judgement when determining how to meet disclosure objectives.

Do you think the way the Board currently drafts IFRS Standards contributes to the disclosure problem? Please give your reasoning. If you think the current drafting contributes to the disclosure problem, please provide examples of where drafting in Standards could be improved and why.

## Appendix—Illustration of applying Method B in Section 7

A1 This appendix provides two examples that illustrate the application of Method B to develop disclosure objectives and requirements, as described in Section 7 *Centralised disclosure objectives*. In both of the examples, the Board would need to consider where to best locate the redrafted disclosure objectives and requirements, which would replace disclosure requirements in various Standards. This appendix has been developed by the staff for illustration purposes only. The Board has not discussed the detailed drafting of the examples and is not seeking detailed comments on the drafting of the disclosure objectives and requirements.

### Example 1—Operating capacity

A2 Table A1 lists all the requirements for an entity to disclose reconciliations of opening and closing balances of operating assets that are currently spread across several Standards. The right-hand column illustrates how these requirements might be redrafted and combined applying a common objective under Method B.

**Table A1—Disclosure objective and requirements for operating capacity, developed considering the entity's operating activities:**

Existing disclosure requirements in IFRS Standards	Possible redrafting applying Method B
IAS 16 <i>Property, Plant and Equipment</i>	Operating capacity
73 <b>The financial statements shall disclose, for each class of property, plant and equipment:</b>	<i>Operating assets used by the entity to generate future revenue</i>
(a) ...	<b>C1 An entity shall disclose information that enables users to understand the changes in recognised operating assets used by the entity to generate future revenue.</b>
(e) <b>a reconciliation of the carrying amount at the beginning and end of the period showing:</b>	
(i) ...	<b>C2 To achieve the objective in paragraph C1, an entity shall:</b>
74 <b>The financial statements shall also disclose:</b>	(a) <b>consider the disclosure of quantitative information about the movements between the opening and closing balances for each significant class of operating assets in a table, unless another format is more appropriate; and</b>
(a) ...	
(c) <b>the amount of contractual commitments for the acquisition of property, plant and equipment; and</b>	

continued...

...continued

Existing disclosure requirements in IFRS Standards	Possible redrafting applying Method B
<p>(d) if it is not disclosed separately in the statement of comprehensive income, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in profit or loss.</p> <p>...</p> <p>79 Users of financial statements may also find the following information relevant to their needs:</p> <p>(a) the carrying amount of temporarily idle property, plant and equipment;</p> <p>(b) the gross carrying amount of any fully depreciated property, plant and equipment that is still in use;</p> <p>(c) ...</p> <p>Therefore, entities are encouraged to disclose these amounts.</p> <p>IAS 38 <i>Intangible Assets</i></p> <p>118 An entity shall disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:</p> <p>(a) ...</p> <p>(e) a reconciliation of the carrying amount at the beginning and end of the period showing:</p> <p>(i) ...</p>	<p>(b) provide further explanation if relevant to an understanding of increases or decreases in an entity's operating capacity to generate future revenue.</p> <p>C3 An entity shall disclose further information that is relevant to an understanding of the entity's operating assets used to generate future revenue that is not depicted in the statement of financial position, including:</p> <p>(a) information about temporarily idle operating assets and assets under construction;</p> <p>(b) information about fully depreciated or fully amortised operating assets that are still in use to generate future revenue; and</p> <p>(c) contractual commitments of future acquisition of operating assets.</p>

continued...

...continued

Existing disclosure requirements in IFRS Standards	Possible redrafting applying Method B
...	
122 An entity shall also disclose:	
(a) ...	
(b) a description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the entity's financial statements.	
(c) ...	
(e) the amount of contractual commitments for the acquisition of intangible assets.	
...	
128 An entity is encouraged, but not required, to disclose the following information:	
(a) a description of any fully amortised intangible asset that is still in use; and	
(b) a brief description of significant intangible assets controlled by the entity but not recognised as assets because they did not meet the recognition criteria in this Standard or because they were acquired or generated before the version of IAS 38 <i>Intangible Assets</i> issued in 1998 was effective.	

continued...



...continued

Existing disclosure requirements in IFRS Standards	Possible redrafting applying Method B
IFRS 6 <i>Exploration for and Evaluation of Mineral Resources</i>	
25 An entity shall treat exploration and evaluation assets as a separate class of assets and make the disclosures required by either IAS 16 or IAS 38 consistent with how the assets are classified.	
IAS 2 <i>Inventories</i>	
<b>36 The financial statements shall disclose:</b>	
(a) ...	
(d) the amount of inventories recognised as an expense during the period;	
(e) the amount of any write-down of inventories recognised as an expense in the period in accordance with paragraph 34;	
(f) the amount of any reversal of any write-down that is recognised as a reduction in the amount of inventories recognised as expense in the period in accordance with paragraph 34;	
(g) the circumstances or events that led to the reversal of a write-down of inventories in accordance with paragraph 34; and	
(h) ...	

continued...

...continued

Existing disclosure requirements in IFRS Standards	Possible redrafting applying Method B
IAS 40 <i>Investment Property</i>	
<b>76</b> In addition to the disclosures required by paragraph 75, an entity that applies the fair value model in paragraphs 33–55 shall disclose a reconciliation between the carrying amounts of investment property at the beginning and end of the period, showing the following:	
(a) ...	
...	
<b>79</b> In addition to the disclosures required by paragraph 75, an entity that applies the cost model in paragraph 56 shall disclose:	
(a) ...	
(d) a reconciliation of the carrying amount of investment property at the beginning and end of the period, showing the following:	
(i) ...	
IAS 41 <i>Agriculture</i>	
<b>49</b> An entity shall disclose:	
(a) ...	
(b) the amount of commitments for the development or acquisition of biological assets; and	
(c) ...	

continued...

...continued

Existing disclosure requirements in IFRS Standards	Possible redrafting applying Method B
<p><b>50</b> An entity shall present a reconciliation of changes in the carrying amount of biological assets between the beginning and the end of the current period. The reconciliation shall include</p> <p>(a) ...</p> <p>...</p> <p><b>55</b> If, during the current period, an entity measures biological assets at their cost less any accumulated depreciation and any accumulated impairment losses (see paragraph 30), an entity shall disclose any gain or loss recognised on disposal of such biological assets and the reconciliation required by paragraph 50 shall disclose amounts related to such biological assets separately. In addition, the reconciliation shall include the following amounts included in profit or loss related to those biological assets:</p> <p>(a) impairment losses;</p> <p>(b) reversals of impairment losses; and</p> <p>(c) depreciation.</p>	

A3 The redrafting of the disclosure requirements in Table A1 might prompt entities to provide a single disclosure in the notes showing all changes in operating assets, rather than reconciliations being fragmented throughout the notes.

### Example 2—Restricted assets

A4 Table A2 lists all of the requirements for an entity to disclose information about restricted assets that is currently spread across several Standards. The right-hand column illustrates how these requirements might be redrafted and combined applying a common objective under Method B.

**Table A2—Disclosure objective and requirements for restricted assets, developed considering the entity's financing activities<sup>57</sup>**

Existing disclosure requirements in IFRS Standards	Possible redrafting applying Method B
IFRS 7 <i>Financial Instruments: Disclosures</i>	Financing activities
<b>14 An entity shall disclose:</b>	<i>Restricted assets</i>
(a) the carrying amount of financial assets it has pledged as collateral for liabilities or contingent liabilities, including amounts that have been reclassified in accordance with paragraph 3.2.23(a) of IFRS 9; and	<b>D1 The entity shall disclose information about restricted assets that enables users to differentiate the assets that were used to support funding or collateral needs at the end of the reporting period from those that were available for potential funding needs.</b>
(b) the terms and conditions relating to its pledge.	<b>D2 Restricted assets are:</b>
IAS 16 <i>Property, Plant and Equipment</i>	(a) assets that have been pledged as collateral; and
<b>74 The financial statements shall also disclose:</b>	(b) assets that an entity thinks it was restricted from using to secure funding, for legal or other reasons.
(a) the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;	
(b) ...	
IAS 38 <i>Intangible Assets</i>	
<b>122 An entity shall also disclose:</b>	
(a) ...	
(d) the existence and carrying amounts of intangible assets whose title is restricted and the carrying amounts of intangible assets pledged as security for liabilities.	
(e) ...	

continued...

<sup>57</sup> The redraft in Table A2 is consistent with disclosure recommendations about asset encumbrance issued by the Enhanced Disclosure Task Force (EDTF) in its October 2012 report—see Figure 5 at [http://www.fsb.org/wp-content/uploads/r\\_121029.pdf](http://www.fsb.org/wp-content/uploads/r_121029.pdf).

...continued

Existing disclosure requirements in IFRS Standards	Possible redrafting applying Method B
IFRS 6 <i>Exploration for and Evaluation of Mineral Resources</i>	
25 An entity shall treat exploration and evaluation assets as a separate class of assets and make the disclosures required by either IAS 16 or IAS 38 consistent with how the assets are classified.	
IAS 2 <i>Inventories</i>	
<b>36 The financial statements shall disclose:</b>	
(a) ...	
(h) <b>the carrying amount of inventories pledged as security for liabilities.</b>	
IAS 40 <i>Investment Property</i>	
<b>75 An entity shall disclose:</b>	
(a) ...	
(g) <b>the existence and amounts of restrictions on the realisability of investment property or the remittance of income and proceeds of disposal.</b>	
(h) ...	
IAS 41 <i>Agriculture</i>	
<b>49 An entity shall disclose:</b>	
(a) <b>the existence and carrying amounts of biological assets whose title is restricted, and the carrying amounts of biological assets pledged as security for liabilities;</b>	
(b) ...	

- A5 There is currently no specific objective attached to the disclosure requirements for restricted assets, nor any clear linkage between those requirements. Table A2 also shows that the wording of similar requirements is not always harmonised across Standards and this could mean that the requirements might be interpreted differently.
- A6 The addition of a disclosure objective and the redraft of disclosure requirements in Table A2 might prompt some entities to group all information about restricted assets together. The Board has had some feedback that some users find it more useful if this information is disclosed together.





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# Alternative Performance Measures:

**ARE THEY MEETING USER NEEDS?**

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JULY 2017



**EXTERNAL REPORTING BOARD**  
*Te Kāwai Ārahi Pūrongo Mōwaho*

# Introduction

## THE EXTERNAL REPORTING BOARD

### **The External Reporting Board (XRB) is responsible for financial reporting strategy and for accounting and auditing & assurance standard setting in New Zealand.**

Our aim is to assist in giving New Zealanders trust and confidence in the financial reporting of our organisations, across the for-profit, public and not-for profit sectors. Alternative Performance Measures (APMs) are company performance measures other than those reported under Generally Accepted Accounting Practice (GAAP). They are used by companies all around the world to help them explain their performance. Examples include 'underlying profits', 'normalised profits', and EBIT (earnings before interest and tax).

We undertook this survey to better understand how APMs are viewed and whether they are effective in meeting the needs of users of financial reports in New Zealand.

## METHODOLOGY

The survey was conducted via an online questionnaire between November 2016 and January 2017. A total of 87 users, mainly individual equity investors, responded to the survey.

There was an even split between those who classified themselves as non-expert and expert in terms of their use of financial information.

The responses from the majority of both non-expert users and expert users were generally consistent. There were variations in the percentage response rates to individual questions but there were no statistical significant differences between the two groups for the use of APMs, their information needs and/or the understanding of APMs and related information.



**45.3%**

A prudent but  
non-expert user of  
financial information

**42.7%**

A professional and/or  
expert user of financial  
information

**12%**

Other  
(Consider themselves having a  
better than average expertise  
in using financial information)

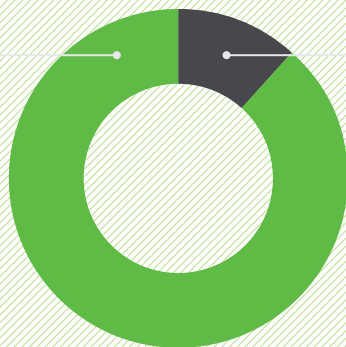
# The results in summary

## APMs ARE USED AND FOUND TO BE USEFUL FOR ASSESSING A COMPANY'S PERFORMANCE

**88.5%**

found APMs useful or sometimes useful

“MOST HELPFUL”  
“ABSOLUTELY NECESSARY”



**11.5%**

found APMs not useful

“MESSAGE THE FIGURES”  
“ROSY GLOSS ON PERFORMANCE”

Respondents use APMs to clarify, understand and assess a company's business, underlying performance and future prospects. APMs are widely used, but are also subject to a few caveats, with respondents wanting to understand why they are being used and how they have been calculated.



**67.8%**

found **multiple** APMs really useful or usually useful

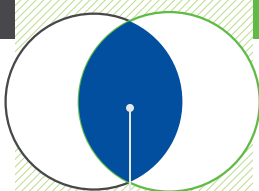
“IMPROVED USER CONFIDENCE. MANAGEMENT IS VOLUNTARILY PROVIDING ADDITIONAL INSIGHTS”

## APMs ARE MOST USEFUL WHEN VIEWED ALONGSIDE GAAP MEASURES

GAAP

**20.7%**

use GAAP as the primary measure of performance



APM

**18.4%**

use APMs as the primary measure of performance

**56.3%**

use both **GAAP** measures and **APMs** together

One of the main reasons for using APMs was the growing complexity of GAAP, and the difficulty users have determining a company's core operating business performance from GAAP financial statements.

The usefulness of APMs depended on the adjustments made, the frequency of 'unusual' or 'one-off' items, and the reasons for the company's APMs.

## APMs SHOULD BE RECONCILED OR EXPLAINED AGAINST GAAP MEASURES



**80.2%**

found the **reconciliation** or **explanation** between an APM and a GAAP measure useful, with many commenting that this information is **essential**, **vital** or **should be mandatory**



**61.4%**

recalled company **disclosing reconciliations** and **explanations**

**91.4%**

Of those, **the vast majority** understood the **reconciliation** and **explanation**

# The results in summary

## APMs ARE RELATIVELY WELL UNDERSTOOD

**71.9%**

were clear whether a company was referring to a GAAP measure or an APM

**71.4%**

understood the reason the company was using the APM, and 76.2% agreed that the APM met the intended purpose

**77.8%**

understood how the APM was calculated or derived

**83.1%**

were comfortable that APMs with accepted calculation methods (eg EBIT) were calculated in the usual way

Overall, respondents were not confused by APMs but many question why specific APMs have been used or how they have been derived.

## WHAT ARE THE MOST USEFUL APMs?

**1**

**UNDERLYING PROFIT**

**2**

**EBITDA**

Most respondents found APMs useful as they provide an insight into what management considers to be important measures. However, at the same time respondents were cautious as they believe companies tend to choose measures that show a better picture than GAAP measures.

## APMs NEED TO BE CLEAR – WHY THEY ARE BEING USED AND HOW THEY HAVE BEEN DERIVED

How can companies improve the quality and usefulness of APMs?



**Explain how the APM is derived/calculated**



**Provide comparatives for previous years and explain any changes**



**Explain why selected components are included or excluded**



**Explain why the APM is being used and is suitable**



**Indicate whether the measure is a APM or GAAP measure**



**Reconcile to the closest GAAP measure**

“Do not belittle and make insignificant legitimate expenses”

## GAAP IS TRUSTED BUT HAS LIMITATIONS

Should performance measures be limited to GAAP measures?



**68.7%**  
No



**16.9%**  
Yes



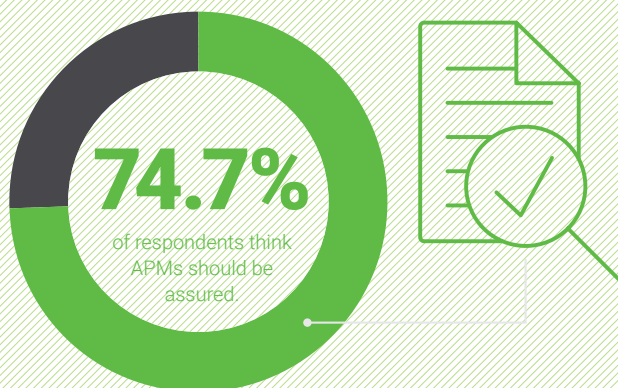
**14.4%**  
Don't know

Respondents are looking for measures that provide an indication of the company's 'core' operating activities. APMs, used in conjunction with, or to supplement, GAAP measures often provide this additional detail.

“Let managers tell their story”

# The results in summary

## ASSURANCE NEEDS TO BE CLARIFIED



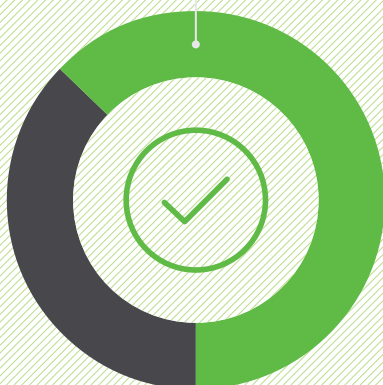
Respondents indicate a lack of clarity and understanding over when APMs have been assured. The respondents presumed APMs were assured because they were derived from audited financial statements and/or because the auditor is required to review the whole annual report for consistency.

While the majority of respondents felt that having APMs assured by an independent auditor would provide greater confidence in the measure, many felt this would be difficult to achieve in practice, as there is often no standardised definition for the APM, the audit may be of little value.

## HOW CAN WE IMPROVE GAAP MEASURES OF A COMPANY'S PERFORMANCE?

**66.3%** support

Accounting standards should provide more information about a company's 'core operations' or 'underlying performance'



There was also some support for:



**Principle-based definition of operating profit**



**More subtotals in the income statement**



**Standardised calculation of selected APMs**



**More disaggregated information in the income statement**



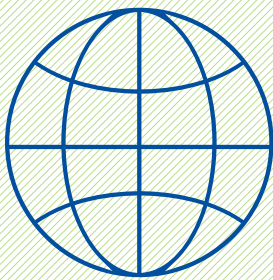
**Definitions for non-recurring, one-off, and infrequent items**



**Standardised definitions for selected APMs, such as EBIT and EBITDA**

# What does this mean for XRB?

**OUR GOAL IS TO ENSURE THE REPORTING OF CORPORATE PERFORMANCE MEASURES REMAIN APPROPRIATE, CREDIBLE AND MEET USER NEEDS**



## **INTERNATIONAL INFLUENCE AND PARTICIPATION**

- We will maintain our strategy of influencing the work of the international standard setting boards to ensure accounting and assurance standards are appropriate for, and continue to be trusted in, New Zealand; and
- We will continue to actively participate and contribute to the International Accounting Standards Board (IASB®) Disclosure Initiative project to ensure improved communication in financial reporting and improved disclosure of performance measures in financial statements.



## **OPEN CONSTITUENT ENGAGEMENT**

- We will actively engage with companies, directors and regulators on the communication of APMs and related information (including any related assurance information) in annual reports and/or other media; and
- We will facilitate and encourage continued discussion to improve corporate reporting.



**EXTERNAL REPORTING BOARD**  
*Te Kāwai Ārahi Pūrongo Mōwaho*





EXTERNAL REPORTING BOARD  
*Te Kāwai Ārahi Pūrongo Mōwaho*

# **Alternative Performance Measures: A New Zealand user-needs survey**

**July 2017**

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Appendix: Survey Questionnaire



## EXECUTIVE SUMMARY

### Introduction

1. The External Reporting Board (XRB) surveyed external users of financial reports between November 2016 and January 2017 to find out whether they find Alternative Performance Measures (APMs) useful.
2. APMs are company performance measures other than those reported in a company's financial statements. Examples of APMs include "underlying profits", "normalised profits", EBIT (earnings before interest and tax) and EBITDA (earnings before interest, tax, depreciation and amortisation).
3. The objective of the survey was to determine, among other matters:
  - Whether external users of company reports find APMs useful, or are confused by the reported APM information commonly disclosed by companies;
  - Whether and how the presentation and disclosure of company performance to external users can be improved; and
  - Whether external users understand the specific APMs and related information that are disclosed by companies.
4. The XRB was also interested to know whether there was a difference in the views and/or information needs between users who consider themselves to be "prudent but non-expert users of financial information" (non-expert users) and those who consider themselves to be "professional and/or expert users of financial information" (expert users).
5. A total of 87 users, mainly individual equity investors, responded to the survey. While the survey did not use a randomly-directed sample, the survey elicited a reasonable response with a wide range of views from the respondents.
6. Seventy-five respondents responded to the question about their level of expertise (whether they consider themselves to be non-expert users or expert users of financial information). Of these, 34 indicated they were non-expert users and 32 indicated they were expert users. The 9 remaining respondents classified themselves as "Other"<sup>1</sup>.
7. The responses from the majority of both non-expert users and expert users were generally consistent. There were variations in the percentage response rates to individual questions but there were no statistical significant<sup>2</sup> differences between the two groups for the use of APMs, their information needs and/or their understanding of APMs and related information.

### Overall conclusion

8. A wide range of views were obtained, covering extreme views both for and against the usefulness of APMs. Views range from a respondent who does "not invest in companies which fail to provide an APM" to another respondent who "takes no notice of APMs". However, notwithstanding the wide range of views, the majority of the respondents provided a clear and consistent message.

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<sup>1</sup> The survey asked respondents for further comment if they indicate "Other". Comments in the "Other" group indicate the respondents generally consider themselves to have better than average experience and expertise in using and understanding financial information.

<sup>2</sup> Except for the response to Question 6 relating to requests for APMs from companies, Chi-square tests conducted on each question indicated no significant differences in the responses between the non-expert users and the expert users.

9. APMs are widely used by, and are considered useful to, the majority of the 87 respondents to the survey, subject to caveats about the disclosure of the APMs and related information. While some respondents were sometimes perplexed by the reasons given by companies for the APMs and/or their adjustments, the majority of respondents, whether non-expert users or expert users, do not in general appear to be confused by the APMs and/or their related information. Instead, most of the respondents appear to be discerning in their use of the APMs and the related information disclosed by companies. Respondents make various comments and suggestions to improve the disclosure of APMs and related information, including the desire for the information to be subject to assurance and having clear definitions for terms like “recurring” and “non-recurring”, indicating they understood and recognised the current limitations of APMs.
10. In summary:
- Respondents use APMs but they are used as a supplement to, or in conjunction with, GAAP measures: APMs are not usually used by respondents as the primary indicator of company performance on their own;
  - Respondents find the disclosure of APMs, including multiple APMs, to be useful for different purposes: however, these were subject to caveats about their use and the appropriateness of the adjustments that companies make in deriving the APMs;
  - Respondents consider additional information and explanations accompanying APMs, particularly reconciliations between APMs and GAAP measures, to be useful, “vital” and “essential” to understand the APMs: however, respondents consider companies were either not disclosing, or not explaining clearly, why APMs rather than GAAP measures were useful for assessing company performance;
  - Respondents generally understand the purpose and additional information about the APMs: however, they did not necessarily always agree with the choice of the APMs, their purpose, their adjustments or their related explanations;
  - Respondents prefer APMs to have clear definitions and conform to standardised definitions: respondents consider companies that make further adjustments to APMs that have a “standard” definition or calculation undermined the comparability of the APMs, and hence their usefulness;
  - Respondents appear to use APM cautiously, “with grain of salt”: they question the company’s purpose and intentions for disclosing APMs and the adjustments made (especially the tendency for APMs to paint a “rosier” picture than GAAP measures); and
  - Respondents want APMs and related information to be assured: however, the lack of clarity whether the APM and related information has been subject to assurance made it difficult to determine if the APM and related information were appropriate, neutral, credible and reliable.

## SECTION 1: INTRODUCTION

### Background

11. The External Reporting Board (XRB) launched a survey in November 2016 to find out whether external users of company reports find Alternative Performance Measures (APMs) useful.
12. APMs are company performance measures other than those reported in a company's financial statements. Examples of APMs include "underlying profits", "normalised profits", EBIT (earnings before interest and tax) and EBITDA (earnings before interest, tax, depreciation and amortisation).
13. There is a growing international trend for companies to disclose APMs. Regulators and, more recently, international standard setters are taking an increased interest in such reporting.
14. The XRB was keen to gain a better understanding of external users' information needs, including their need for APMs. The focus of the survey on the needs of external users of financial information is consistent with the XRB's user-needs research strategy. The responses to the survey and the findings from the survey will help inform the XRB on future decisions about the requirements of XRB's standards, as well as inform discussions on policy matters, both locally and internationally.

### Research objective

15. The objective of the survey was to determine, among other matters:
  - Whether external users of company reports find APMs useful, or are confused by the reported APM information commonly disclosed by companies;
  - Whether and how the presentation and disclosure of company performance to external users can be improved; and
  - Whether external users understand the specific APMs and related information that are disclosed by companies.
16. The XRB was also interested to know whether there was a difference in the views and/or information needs between users who consider themselves to be "prudent but non-expert users of financial information" (non-expert users) and those who consider themselves to be "professional and/or expert users of financial information" (expert users).

### Period of survey

17. The survey was open for three months from early November 2016 to the end of January 2017.

### Methodology and sample

18. The survey was a web-based survey using the application, SurveyMonkey, and comprised a questionnaire containing 24 questions.
19. The survey was directed at external users of company reports who are familiar with APMs or have views about the use of APMs. While the survey did not use a randomly-directed sample, the survey elicited a reasonable response with a wide range of views from the respondents.
20. Respondents were encouraged to supplement their responses with additional comments, explanations and/or reasons to support their response. Many did.
21. The survey was disseminated to users in the following ways:

- Directly by email to the XRB's Communique recipients and database of financial report users;
- Through the internet on the XRB's website and on LinkedIn; and
- Through the New Zealand Shareholders' Association in a newsletter to their members.

22. A copy of the survey questionnaire is attached to this report as **Appendix 1**.

### Terminology and definitions

23. Terminology used by companies for APMs may differ. Commonly disclosed APMs include "underlying profits", "adjusted profits", "normalised profit" and EBITDA.
24. In the survey, APMs are stated to be performance measures other than those reported in an entity's financial statements (referred to as GAAP measures). For the purpose of the survey, the following working definitions were used:
- A "GAAP measure" is one that is taken directly from a line item or a sub-total that is presented on the face of the company's financial statements, for example, "profit before tax", "profit from continuing operations", "profit for the year"; and
  - An "APM" is one that adds to, or subtracts from, a GAAP measure selected line items from the financial statements or components of that GAAP measure. For example, deducting interest, depreciation and amortisation expenses from "profit before tax" to derive EBITDA or deducting "one-off" or "non-recurring" items to derive an "underlying profit".

### Types of questions/areas of focus

25. Besides different terminology used by companies, APMs disclosed by companies may be significantly different from the measures of performance presented on the face of the company's financial statements.
26. In some instances, a company may disclose more than one APM. Even when the same term is used for an APM, different companies may calculate the APM differently by making different adjustments to the "standard" calculation of the APM.
27. APMs are often not subject to any assurance (audit or review) by auditors as they may not form part of the audited financial statements.
28. Given these factors, our survey focused on eliciting external users' views on three key areas:
- Are APMs useful to users for making decisions about company performance?
  - How can performance measures be improved (including whether APMs and related information should be assured)? and
  - Are specific APMs disclosed by companies understandable to users?

### Summary of respondent information

#### *Total number of respondents:*

29. A total of 87 users responded to the survey.
30. Not all 87 respondents answered every question in the survey. However, all relevant responses to each question were analysed and considered in drafting the findings. The percentage figures reported for each question is therefore based on the number of responses to each question (which is sometimes less than 87 responses).

#### *Breakdown of respondent by user group:*

31. A total of 75 respondents answered the question asking them to indicate which user group (or user groups) best describes them or the organisation they work for. Respondents could classify themselves under more than one user group for example, a respondent could be both an “individual equity investor” and an “intermediary/advisor to investors”. The numbers in each user group are as follows:
- 73 respondents indicated the “individual equity investor”/“individual debt investor” groups;
  - 6 respondents indicated the “institutional equity investor”/“institutional debt investor” groups;
  - 8 respondents indicated the “intermediary/advisor to investors” group; and
  - 20 have been classified broadly as “Others” (comprising other creditors, financial/prudential regulators, media commentators and others).
32. Of the 75 respondents:
- 57 respondents classified themselves under only one user group;
  - 16 respondents classified themselves under more than one user group; and
  - 2 respondents classified themselves only as “Other” (a Chartered Accountant (CA) and a respondent from the Education sector).

#### *Breakdown of respondent expertise:*

33. A total of 75 respondents answered the question asking them to indicate whether they consider themselves to be “a prudent but non-expert user of financial information” or “a professional and/or expert user of financial information”:
- 34 indicated they were “a prudent but non-expert user of financial information”;
  - 32 indicated they were “a professional and/or expert user of financial information”; and
  - 9 classified themselves as “Other”.
34. The survey asked respondents for further comment if they indicate “Other”. Comments in the “Other” group indicate the respondents generally consider themselves to have a better than average experience and expertise in using and understanding financial information.

## SECTION 2: ANALYSIS OF SURVEY RESPONSES

36. Section 2 summarises the responses and the many additional comments from respondents by question.

### Are APMs useful?

37. Questions 1 to 7 of the survey asked users about the use and usefulness of APMs.

#### Q1 Are APMs useful to you for assessing company performance when you are making decisions about a company?

Response	# Respondents	%
Yes	58	66.7
Sometimes	19	21.8
No	10	11.5
<b>Total</b>	<b>87</b>	<b>100%</b>
<i># Comments</i>	<i>38</i>	<i>43.6%</i>

38. In general, APMs are used and are considered useful by the respondents for assessing company performance. However, respondents gave a wide range of views, from “I take no notice of APMs, relying instead on information in notes to the financial statements” to “...APMs are more important than financial accounting measures such as NPAT [net profit after tax]”. One respondent commented that “Profit before tax as a measure has now become cluttered with irrelevant numbers that are not measures of trading performance”.
39. A majority of the respondents (66.7% of the 87 respondents to this question) considered APMs to be useful, with another 21.8% considering APMs to be “sometimes useful”. These respondents described the APMs as “most helpful”, “very important” and “absolutely necessary”. APMs were seen to help respondents to clarify, understand, determine and/or assess the nature of a company’s business, its primary business activity, its underlying performance and/or its future prospects (excluding “one-off” transactions). APMs were also considered helpful where valuation changes impacted on company performance and as an indication of management’s view of the company’s “core earnings” and “transitory earnings”. Respondents indicated that core earnings are useful for estimating future earnings.
40. Of the 87 respondents, 11.5% did not find APMs to be useful: these respondents had little confidence in APMs and some were suspicious of management’s intentions in disclosing APMs. These respondents viewed APMs as a means to “massage the figures”, to put a “rosy gloss on performance” and to best suit what the company wants to portray to users.
41. Respondents were concerned, among other matters, about the different APMs used and their different definitions, the lack of consistency in the treatment of the adjustments, the lack of transparency in the reasons for disclosing the APMs and that APMs may mask undisclosed issues about the company and/or its strategy. Many respondents also raised concerns about companies classifying items of recurring nature as “one-offs” in APMs. APMs were considered useful only if they were transparent (and reconciled to GAAP measures), consistent (over time), comparable (with other companies), unbiased and were subject to assurance.

**Q2 Thinking about these two measures, which would you usually use as the primary indicator for assessing company performance when making your decisions about a company?**

Response	# Respondents	%
GAAP measure	18	20.7
APM	16	18.4
Both	49	56.3
Neither	4	4.6
<b>Total</b>	<b>87</b>	<b>100%</b>
<i>Comments</i>	29	33.3%

42. While the respondents used APMs, the APMs were not usually used as the primary indicator of company performance: respondents usually used APMs in conjunction with GAAP measures. Of the 87 respondents to this question, 56.3% used both GAAP measures and APMs together, whereas only 18.4% used APMs as the primary indicator and 20.7% used GAAP measures as the primary indicator.
43. Over a third of respondents making a comment placed GAAP measures before APMs. Comments from these respondents included: “The APM measures are inconsistent between the companies, so [they are] not comparable. They are confusing and detract from the GAAP measures”.
44. However, respondents also included comments about the weaknesses of GAAP measures alone and/or the need to supplement GAAP measures with APM information. Their comments included: “GAAP are the first metrics. But GAAP is always backward looking so I end up looking at APMs to get an idea of what next year's GAAP numbers might be.” Several respondents used reported earnings to estimate their own performance metrics: net operating profit after tax (NOPAT), free cash flows or “primary business operating profits”. For these financial statement users “more information is better”.
45. Regardless of whether the APMs were used as a primary indicator or in conjunction with GAAP measures, respondents subjected the disclosure of APMs to various caveats, for example, the usefulness of APMs depended on the adjustments made, the frequency of “unusual” or “one-off” items, the company’s situation and the reasons for the APMs.

**Q3 Where disclosed, do you find the additional information, reconciliation or explanation between a GAAP measure and an APM:**

Response	# Respondents	%
Really useful	30	34.9
Usually useful	39	45.3
Less than useful	11	12.8
Not useful	6	7.0
<b>Total</b>	<b>86</b>	<b>100%</b>
<i>Comments</i>	28	32.5%

46. Asked about the usefulness of the additional information, reconciliation or explanation between an APM and a GAAP measure, an overwhelming majority (80.2%) of the 86 respondents to this question considered the information, where disclosed, to be “really useful” or “usually useful”. Many considered this information to be “essential”, “vital” and “should be mandatory”.

47. The additional information was considered useful to determine, understand and assess the relevance, usefulness and comparability of the APM and its calculation. One respondent also commented that financial statements are now “so complicated” that only “so-called experts” can understand them. They suggested a need to get back to basics to the presentation of “concise, readable financial information”. One respondent’s view was that if a shareholder “with an average IQ” cannot understand the financial information, then it is “overly complicated”.
48. However, 19.8% of the respondents considered the additional information, reconciliation or explanation, where disclosed, to be “less than useful” or “not useful”. Comments included the information being ambiguous, inconsistent, complex and difficult to understand. One respondent indicated that reconciliations were incomplete and suggested: “Candid commentary is important to understand WHY those adjustments are taking place”.

**Q4 Do you find the disclosure of multiple APMs by a company as indicators of its performance to be:**

Response	# Respondents	%
Really useful	13	14.9
Usually useful	46	52.9
Less than useful	19	21.8
Not useful	9	10.4
<b>Total</b>	<b>87</b>	<b>100%</b>
# Comments	24	27.5%

49. On the disclosure of multiple APMs by a company as indicators of its performance, the majority of the 87 respondents to the question (67.8%) found the APMs to be “really useful” or “usually useful”. The following comments reflected this sentiment: “If reconciled to GAAP we in fact get more information than by each measure alone”; and “Don't have a problem with multiple APMs as I will make my own judgement on which measures, GAAP or non-GAAP, are most relevant to my assessment. However, standardisation of non-GAAP measures would be useful so that it is clear how the measure has been calculated”.
50. Other positive comments on this question included improved user confidence because management is voluntarily providing additional information and useful as an insight into what management considers is important. However, one respondent considered the disclosure of multiple APMS useful as an indication of “alarm bells ringing loud and clear” about the company.
51. Of the respondents, a significant minority (32.2% of 87 respondents) considered multiple APMs to be “less than useful” or “not useful”. Most of the comments focussed on the negative impacts on users (confuses and overloads the user), negative impressions about the company (to “fudge” figures, to hide poor performance or underlying issues, has the appearance of obfuscation and risks looking suspicious) and negative impressions on the wider reporting and corporate landscape (impacts on the credibility of accounting and profit measurement and adds to the “wild west” image of corporate behaviour). However, the comments also indicated many respondents used the multiple APMs disclosed by companies cautiously, in the context of exercising their own judgement or as only a guide when assessing the company.



**Q5 Which of the following APM(s) do you think would be useful for a company to disclose? [Please tick as many as appropriate]**

Response	# Respondents	%
“Underlying” or “normalised” profit/ earnings (profit for the year less non-recurring, infrequently occurring and/or unusual items)	59	68.6
EBITDA (earnings before interest, taxes, depreciation and amortisation)	57	66.3
EBITDAF (earnings before interest, taxes, depreciation, amortisation and fair value adjustments)	45	52.3
Other (please indicate below the APM and how you would calculate or derive it)	14	16.3
<b>Total</b>	<b>86</b>	<b>~*</b>
<i># Comments</i>	36	11.5%

52. On the question of which APM would be useful for a company to disclose, all the three APMs suggested in the survey (underlying profit, EBITDA and EBITDAF) were considered by most respondents to be useful to disclose. (The respondents to this question could indicate as many of the suggested APMs as appropriate). Underlying profit was most frequently indicated by the 86 respondents to this question as useful to disclose at 68.6%, followed closely by EBITDA at 66.3% and EBITDAF at 52.3%.
53. Some respondents consider different APMs have their use depending on the company and/or industry, for example, “All are useful for explaining performance but [they] must be taken with a grain of salt as companies tend to only provide those which show them in better light than GAAP numbers would suggest”. Another respondent suggested that if companies do highlight EBITDA etc, they should be required to state its particular relevance for interpreting the performance of their company or their industry. Others were more critical, for example, one respondent asked: “Since when did interest, [depreciation] and certain amortisation not become relevant expenses to an owner of a business?” The respondent was of the view that it is perverse for APMs to omit costs that have legitimately reduced profitability.
54. In general, regardless of the APM, comments from the respondents indicated the APMs would be useful only if the GAAP measure was considered less useful, the APM was relevant, variations from GAAP were well-explained and reasoned, there was consistent and clear meaning for the terms like “underlying”, “normalised” and “non-recurring” and there was a reconciliation to GAAP.

**Q6 Have you requested the disclosure of an APM from a company in the past?**

Response	# Respondents	%
Yes	7	8.1
No	80	91.9
<b>Total</b>	<b>87</b>	<b>100%</b>
<i># Comments</i>	12	13.8%

55. Of the 87 respondents to the question asking whether they have requested the disclosure of an APM from a company, only 8.1% said they had, with the rest not having the need to make such a request. Respondents reported that the response from the companies, when requests were made, ranged from no response from the company to three pages of explanations about the APM.

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\* As respondents could indicate more than one option, the percentages do not add up to 100%.

56. Only respondents who classified themselves as experts asked companies for APMs. This was the only question in the survey where the responses from non-experts were statistically different from those of the experts. A respondent who said “no” to making requests commented that “I rely on my own recasting of the Income Statement...”. Such a comment is consistent with the response to Question 4 where respondents recast performance measures to fit their own valuation models. For these respondents, APMs are a useful source of information and provide a “management’s view”.

**Q7 Please tell us which APM(s) you have requested a disclosure for and why.**

<b>Total responses</b>	<b>6</b>
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57. Six respondents indicated they have made requests for further information. Notwithstanding the terminology and the wording of the response, the requests related mainly to information about underlying operating profit, that is, maintainable profits that are net of non-recurring items. This is consistent with the response to Question 5 where underlying/normalised profit/earnings was the APM that most respondents consider would be useful for companies to disclose.

**How can performance measures be improved?**

58. Questions 8 to 11 of the survey asked users how the disclosure of performance measures can be improved.

**Q8 Should company performance measures be limited to GAAP measures and be taken only from line items or sub-totals that are also presented on the face of the income statement?**

<b>Response</b>	<b># Respondents</b>	<b>%</b>
Yes	14	16.9
No	57	68.7
Don’t know	12	14.4
<b>Total</b>	<b>83</b>	<b>100%</b>
<i># Comments</i>	26	31.3%

59. A majority (68.7%) of the 83 respondents to the question did not agree company performance measures should be limited to GAAP measures and be taken only from line items or sub-totals that are also presented on the face of the income statement. The respondents highlighted the usefulness of APMs (APMs can provide insights into a business and capture underlying themes if they are appropriate and well-reasoned) and the weaknesses of GAAP (minimum GAAP measures do not have enough line items to enable a meaningful evaluation of performance). Comments in support of not limiting APMs to GAAP measures included: “While I make no use of APMs, I do not see any reason to prescribe their format”; and “We do not have enough theory to know what line items ought to be reported. Hence, at this point of time we are in an experimental stage – let managers tell their story”.
60. However, respondents suggested an emphasis on GAAP measures and for APMs not to have undue prominence. There were also numerous comments emphasising the importance of reconciliations to GAAP measures and for the APM adjustments to be appropriate. One respondent summed it up: “APMs have their place. But I think APMs should not have undue prominence and be reconciled back to GAAP information, and companies should be required to state why they use the APMs they do, and be required to be consistent year on year in what measures they give prominence...”.

61. The main reason raised by the 16.9% of respondents who considered company performance measures should be limited to GAAP measures was mainly for consistency of measurement between companies.

**Q9 To improve the GAAP measures of a company's performance, would it be useful for accounting standards to: [Please tick as many as appropriate]**

Response	# Respondents	%
Provide more information about a company's "core operations" or "underlying performance"	53	66.3%
Provide a principle-based definition of operating profit	33	41.3%
Define more sub-totals in the income statement	29	36.3%
Standardise the calculation of selected key APMs (please specify the key APMs)	29	36.3%
Provide more disaggregated information in the income statement	27	33.8%
Other (please indicate below)	6	7.5%
Don't know	5	6.3%
<b>Total</b>	<b>80</b>	<b>-*</b>
# Comments	29	36.2%

62. Users were asked how accounting standards could improve GAAP measures of performance. All the suggestions listed in the survey fared well and many respondents indicated more than one suggestion. Overall, the suggestion to "provide more information about a company's "core operations" or "underlying performance" was most favoured by respondents at 66.3%, followed by the suggestion to "provide a principle-based definition of operating profit" (41.3%). Two of the suggestions, "define more sub-totals in the income statement" and "standardise the calculation of selected key APMs" had 36.3% each followed by "provide more disaggregated information in the income statement" (33.8%).
63. Comments from respondents keen to have more information about "core operations" or "underlying performance" or "normalised profit" indicated they see this as helping to identify the underlying strength and performance of a business and to obtain information on capital employed in the continuing business. Respondents also suggested defining "non-recurring"/"one-off"/"infrequent" items. Others favoured having standardised and precise definitions for specific APMs (EBIT and EBITDA).
64. Some respondents did not consider APMs to be an accounting standard issue as APMs are entity-specific and could be unique to different business types – therefore, it would be difficult to standardise APMs. Other respondents considered it helpful to disclose more disaggregated information in the income statements provided this does not further increase "clutter".

**Q10 What information, if any, do you think should accompany the disclosure of APMs to improve their quality and usefulness to external users? [Please tick as many as appropriate]**

Response	# Respondents	%
How the APM is derived/calculated	69	85.2%
Comparative for the previous year's APM	68	84.0%
Reasons/explanations for changing the APM or its calculation from the previous year	67	82.7%

\* As respondents could indicate more than one option, the percentages do not add up to 100%.

Reasons/explanations for including or excluding selected components (eg., recurring items or non-recurring items) in calculating the APM	63	77.8%
Company's purpose or reason(s) for using the APM as a performance indicator, rather than a GAAP measure	59	72.8%
Clear identification of whether the measure is an APM or a GAAP measure	56	69.1%
Explanations/reconciliations to the closest equivalent GAAP measure	51	63.0%
Statement on whether or not the APM has been subject to any assurance	50	61.7%
Other (please indicate below)	6	7.4%
<b>Total</b>	<b>81</b>	<b>-*</b>
<i># Comments</i>	<i>20</i>	<i>24.7%</i>

65. Users were asked what information should accompany APMs to improve their quality and usefulness to external users. Respondents in general thought all the suggested disclosures were "good ideas", were "basic requirements" and would be useful if a company was deviating from GAAP.
66. All the eight suggestions in the survey were indicated by over 60% of the 81 respondents to the question (respondents could indicate as many as they thought appropriate). However, the three suggestions respondents considered could most improve the quality and usefulness of the APMs to external users were: how the APM is calculated or derived (85.2%), comparative previous year's APM (84.0%) and reasons/explanations for changing APM or its calculation from the previous year (82.7%).
67. Many comments received under this question related to assurance. The comments reflected a view that APMs should be subject to audit and auditors should comment on APMs. Some respondents make the following assumption: "...the numbers that are in the financial statements have been audited and the APM is using numbers that are in the financial statements therefore would it not be concluded that the APM is audited"?

**Q11 Where disclosed, do you agree that an APM and any related information should be assured by the entity's auditor? Please give your reasons.**

Response	# Respondents	%
Yes	62	74.7
No	21	25.3
<b>Total</b>	<b>83</b>	<b>100%</b>
<i># Comments</i>	<i>57</i>	<i>68.7%</i>

68. The question asked whether users agree an APM and any related information should be assured by the entity's auditor and reasons for the users' response. The question elicited the greatest number of comments: 68.7% of the 83 respondents included a comment.
69. A majority (74.7%) of the 83 respondents to the question said "yes". Some of the reasons stated by respondents for having assurance included those relating to:

\* As respondents could indicate more than one option, the percentages do not add up to 100%.

- The purpose and publicity of APMs – APMs usually receive more publicity than GAAP measures, purport to be “better” measures than the GAAP measures as performance measures and are relied upon as “true and fair” by users for decision-making;
  - Management behaviour – to prevent management’s selective disclosure and presentation of a better picture of the company;
  - The APM and its derivation – to ensure the APM is appropriate, consistently derived and non-recurring items are properly treated; and
  - The role of assurance – auditors are the independent referee for the shareholder.
70. Specific comments from respondents included: “It is the only way I can gain any confidence in the information provided”; “APMs are usually the publicised number...”; and “If the APM is relied upon to give a “true and fair” view of the company’s operations, then the same assurance needs to be given in respect of those measures as is given to GAAP results”.
71. Of the 83 respondents, 25.3% did not consider it important or necessary for the APMs and related information to be assured. The main reasons were: it is not possible to prescribe APM definitions to cover all circumstances, there is no standard or standardised definition to assure them against and for cost-benefit reasons. Comments included: “Surely this would be somewhat difficult for an auditor to do?”; “As there is no “standardised” APM the audit is of little value”; and “To be audited there requires an appropriate standard and guidance which can be audited to”.
72. In addition, comments from respondents indicate a lack of clarity and understanding over when APMs are considered to have been assured. The respondents presumed APMs were assured because they were derived from audited financial statements and/or because the auditor is required to review the whole annual report for consistency. For example, comments from respondents included: “You should be able to reconcile APM to GAAP, therefore the underlying numbers should already have been subject to audit”; “I don’t think it is necessary as a prescription. However, it is highly likely that a measure like EBITDA will be assured as part of the “regular” audit process”; and “...the assurance is implied because the CA [has an] obligation to read the entire report for consistency...”. In addition, one respondent commented that “APM information is typically released at the same time as audited financial statements, with an implication the APM has had some independent review”.

#### **Are APMs understandable?**

73. Questions 12 to 20 of the survey asked users whether the APMs that were disclosed by companies were understandable to them. The questions asked users for their experience with using a specific APM disclosed by a specific entity that they were familiar with.

#### **Q12 What is the APM you are using to answer these questions?**

<b>Total responses</b>	<b>62</b>
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74. The question asked users about the specific APM used to answer questions 12 to 20.
75. Of the 62 respondents who answered this question, 21 used “underlying profit”/“underlying earnings” or “normalised profit”/“normalised earnings” or some variation of those terms (for example, underlying earnings after deducting acquisition expenses or underlying operating profit after removing fair value adjustments). It was not clear from the responses whether these measures used by respondents were defined in the same way or differently from the working definition used in the survey. The survey had defined “underlying” or “normalised”

profit/earnings as profit for the year less non-recurring, infrequently occurring and/or unusual items.

76. Of the 62 respondents to the question, 19 used EBITDA or variations of EBITDA (underlying EBITDA, replacement cost EBITDA and adjusted EBITDA). Nine respondents used EBITDAF, EBITDAFI, EBIT (including normalised EBIT) and cash profit. In each case, it is unclear what further adjustments have been made to the “standard” APM. Thirteen other respondents used a variety of other one-off measures (earnings per share, any metric that eliminates fair value and distributable income).

**Q13 Was it clear to you whether the company was referring to a GAAP measure or to an APM?**

Response	# Respondents	%
Yes	46	71.9
No	18	28.1
<b>Total</b>	<b>64</b>	<b>100%</b>
<i># Comments</i>	<i>10</i>	<i>15.6%</i>

**Q14 Did you understand the purpose or reason stated by the company for using that APM?**

Response	# Respondents	%
Yes	45	71.4
No	7	11.1
Purpose not disclosed	11	17.5
<b>Total</b>	<b>63</b>	<b>100%</b>
<i># Comments</i>	<i>14</i>	<i>22.2%</i>

**Q15 Did you think the APM that was used met the intended purpose or reason stated by the company?**

Response	# Respondents	%
Yes	48	76.2
No	12	19.0
Partially	3	4.8
<b>Total</b>	<b>63</b>	<b>100%</b>
<i># Comments</i>	<i>13</i>	<i>20.6%</i>

77. Respondents were generally of the view that it was clear whether a company was referring to a GAAP measure or an APM (71.9% of 64 respondents to the Question 13) and the majority of respondents said they understood the purpose or reason stated by the company for the APM (71.4% of 63 respondents to the Question 14). In addition, a majority of respondents (76.2% of 63 respondents to the Question 15) were of the view the APM disclosed met the intended purpose or reason stated by the company.
78. Notwithstanding the majority views, there was a significant minority to each question who considered it was not clear whether the company was referring to a GAAP measure or an APM (28.1% of 64 respondents to the Question 13); did not understand the purpose or reason stated by the company for the APM, or stated that the purpose or reason was not disclosed (28.6% of 63 respondents to the Question 14); and were of the view the APM did not meet, or only partially met, the intended purpose or reason stated by the company (23.8% of 63 respondents to the Question 15).

79. Some respondents did not think the reasons given by the companies were sound. Others thought the stated purpose or reason for the APM was too generic. One respondent indicated they disagreed with the appropriateness of three out of seven adjustments to an APM and another respondent gave the example of a company that stated a particular APM was disclosed to facilitate comparisons with other entities but then proceeded make adjustments to the APM that were “non-standard” and unique to the company. Others did not understand, in relation to EBITDA, why expenses like taxation, depreciation and amortisation would need to be removed in order to facilitate comparison with other entities. Respondents considered these expenses are of the nature that are expected in the ordinary course of business activities and are important in the determination of company profit. Still other respondents assume the purpose of APMs is to enable a company to show a better performance than its GAAP measures would suggest.

**Q16 Did you understand how the company calculated or derived the APM?**

Response	# Respondents	%
Yes	49	77.8
No	14	22.2
<b>Total</b>	<b>63</b>	<b>100%</b>
<i># Comments</i>	14	22.2%

**Q17 Was the term used by the company for the APM consistent with the way in which the APM is usually calculated, as you understand it?**

Response	# Respondents	%
Yes	49	83.1
No	10	16.9
<b>Total</b>	<b>59</b>	<b>100%</b>
<i># Comments</i>	11	18.6%

80. A majority of the respondents (77.8% of 63 respondents to Question 16) said they understood how the APM disclosed by the company was calculated or derived. A majority of the respondents (83.1% of 59 respondents to Question 17) also said the term used by the company for the APM was consistent with how the APM is usually calculated. However, some respondents noted the information underlying the calculation of the APM was sometimes not easy to locate (the information being disclosed in a different part of the company report from where the APM is disclosed) or understand (because of the complex nature of the APM adjustments). Others worried about the lack of definitions and the inconsistent adjustments made to APMs. Some respondents concluded that APMs seemed to be “designed to window dress” results and “to make the “profit” look better” rather than being informative. Another respondent considered that APMs should be used only as “background” information.

**Q18 As you answered 'No' to the previous question, please briefly describe how the calculation was different.**

<b>Total responses</b>	<b>8</b>
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81. The responses to this question included “don’t know”, “no calculation was given”, “the whole statement was confusing” and “didn’t think the reason was sound”. Other comments included uncertainty about how other companies calculated the APM as the APM was not a commonly used APM; inconsistent calculation methods within the particular sector and the



company's EBITDA included adjustments for profit from discontinued operations and prior year adjustments.

**Q19 Did the company disclose any additional explanation or reconciliation between the APM and its equivalent GAAP measure?**

Response	# Respondents	%
Yes	35	61.4
No	22	38.6
<b>Total</b>	<b>57</b>	<b>100%</b>
# Comments	8	14.0%

**Q20 Did you understand the additional explanation or reconciliation between the APM and its equivalent GAAP measure?**

Response	# Respondents	%
Yes	32	91.4
No	3	8.6
<b>Total</b>	<b>35</b>	<b>100%</b>
# Comments	9	25.7%

82. On whether the company disclosed any additional explanation or reconciliation between the APM and its equivalent GAAP measure, most respondents (61.4% of 57 respondents to the Question 19) said "yes". Reconciliations were provided in various places, ranging from the chairman's report, in the notes to the financial statements, in the same document as the APM or by reference. Of the eight comments to Question 19, six indicated that full or appropriate reconciliations were provided.
83. A majority of respondents (91.4% of 35 respondents who said "yes" to Question 20) said they understood the additional explanation/reconciliation between the two measures. However, this did not mean all respondents found the information useful. Respondents noted instances where the reconciliation did not correspond with the APM that was used or explained why the APM was used, why the APM was useful and what the APM represented. Other respondents noted additional information that did not reflect the APM that was disclosed and APMs that did not present relevant information for shareholders. Some respondents did not agree with the adjustments made or with the reasonableness of the disclosed information.
84. A significant minority (38.6% of the 57 respondents to Question 19) indicated the company did not disclose any additional explanation or reconciliation between the APM and its equivalent GAAP measure. A minority (8.6% of the 35 respondents) indicated they did not understand the information provided, mainly because of the complexity of the information. However, a respondent who indicated that no additional additional explanation/reconciliation was provided indicated that they understood and reconciled the the information from other measures.

**Q21 Please tell us which of the following user group best describes you or your organisation. [Please tick as many categories as appropriate]**

Response	# Respondents	%
Individual equity investor	64	85.3%
Institutional equity investor	4	5.3%
Individual debt investor	9	12.0%



Institutional debt investor	2	2.7%
Other creditor	1	1.3%
Intermediary/advisor to investors	8	10.7%
Financial market/prudential regulator	4	5.3%
Media commentator	2	2.7%
Other (please indicate below)	13	17.3%
<b>Total respondents</b>	<b>75</b>	<b>-*</b>

85. Of the respondents, the biggest user-group was the “individual equity investor” group with 85.3% of the respondents indicating they are (or are also) in the user-group. Another 12% of respondents indicated they are (or are also) in the “individual debt investor” group. The “intermediary/advisor to investors” were also indicated by 10.7% of the respondents. Although four respondents indicated the “financial market/prudential regulator” user-group, only one indicated that as their sole user-group. The other three also indicated themselves in other user-groups (and we have not been able to verify them as financial market/prudential regulators).

86. Of the 13 respondents in the “Other” category:

- All except 2 respondents also classified themselves into one of the other user-groups; and
- Only 2 respondents fell solely into the “Other” user-group — they were a Chartered Accountant (CA) and a respondent from the Education sector.

#### Q22 Do you consider yourself to be:

Response	# Respondents	%
A prudent but non-expert user of financial information	34	45.3
A professional and/or expert user of financial information	32	42.7
Other (please indicate below)	9	12.0
<b>Total</b>	<b>75</b>	<b>100%</b>

87. Of the 75 respondents to the question, there was an almost equal split in the indication of their level of expertise in using financial information: 45.3% indicated themselves as non-expert users and 42.7% indicated themselves as expert users.

88. A further 12% of the respondents indicated themselves in the “Other” category. An analysis of the comments from these respondents indicate that, in general, most consider themselves to have better than average experience and expertise in using and understanding financial information.

#### Q23 Do you have any other comments?

<b>Total responses</b>	<b>24</b>
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89. The question asked users for any other comments that they may have as a closing question to the survey. Twenty-four respondents took the opportunity to make further comments. The comments fell broadly into comments about GAAP and comments about APMs.

\* As respondents could indicate more than one option, the percentages do not add up to 100%.

### *GAAP-related comments*

90. Most of the GAAP-related comments were on GAAP's shortcomings. Many of the comments were about GAAP and financial statements being "too complex" and "less transparent" for most end users to understand and/or less relevant to users for determining an entity's "underlying performance". Comments from respondents included: "Accounts have become far too complex to follow for most people..."; "Purely GAAP measures are too restrictive and can distort any picture of the underlying performance of a business..."; and "...GAAP income statement has gone too far away from reporting basic underlying profitability of the underlying trading figures...".
91. This was summed up by a respondent whose view was that issues with GAAP meant they were not surprised directors felt the need to include APMs in the explanations accompanying the financial statements.

### *APM-related comments*

92. APMs also received numerous negative comments from respondents. Many considered the trend of reporting APMs "worrisome" and "increasingly annoying" and wished to see an end to "non-standard" reporting. Negative comments about APMs included their lack of comparability across entities, lack of verifiability in the absence of assurance and lack of transparency in their derivation and/or explanations. Respondents were "disturbed" by the lack of consistency in reporting and the often "upward bias" of APMs compared to GAAP measures, and calling into question the neutrality, faithful representation and consistency of APMs compared to GAAP measures.
93. However, many respondents viewed APMs in a more positive light. For example, the proper and judicious use of APMs relevant to a business, properly explained and utilised in a consistent manner was considered to be a very useful additional means of understanding the financial statements of any entity. APMs were considered useful provided they were used to increase clarity and not to distort or camouflage the actual financial performance of the company and if their calculation and reasons for use were transparent.
94. Many of the respondents made suggestions for the disclosure of APMs, including:
- Define APMs clearly, conform to standardised definitions, reduce and limit the number and variety of APMs;
  - Ensure APMs are suitable;
  - Ensure APMs are reconciled back to the GAAP measures;
  - Ensure APMs do not "belittle or make insignificant legitimate expenses", even if those expenses are non-recurring in nature;
  - Define "non-recurring"/"one-off"/"infrequent" items; and
  - Ensure the disclosures are assured by an independent entity or included in an audit.

## SECTION 3: CONCLUSIONS AND IMPLICATIONS

### Are APMs useful?

95. A wide range of views were obtained, covering extreme views both for and against the usefulness of APMs. However, notwithstanding the wide range of views, the majority of the respondents provided a clear and consistent message.
96. APMs are used and are considered useful. Respondents use APMs as a means to clarify, understand, determine and/or assess the nature of a company's business, its primary business activity, its underlying performance and/or its future prospects (excluding one-off transactions), the impact of fair value changes on the company's performance and management's views about core earnings. The main reasons cited for using APMs were the complexity of GAAP and the difficulty to determine a company's core operating business performance from GAAP financial statements.
97. However, the use of APMs in conjunction with, or as a supplement to, GAAP measures and the various caveats users place on the disclosure indicate that GAAP is still trusted and relied upon by respondents, notwithstanding the many criticisms levelled against the complexity of GAAP and financial statements. A likely reason is that, unlike APMs, financial statements are audited and are a common, comparable measure across different entities.
98. Respondents note the general trend for APMs to be "rosier" than GAAP measures, that companies often publicise their APMs rather than the GAAP measures, and companies often include generic statements that the APMs are "better" reflections of company performance than GAAP measures and/or the APMs are "more comparable" as a measure of performance for companies in the industry. The comments from respondents indicate that companies may not be explaining clearly enough why the APMs, rather than GAAP measures, are useful for explaining the performance of the company. The absence of disclosures, or the lack of clear disclosures, by companies for disclosing APMs may undermine the usefulness of APMs and fuel users' suspicions about the company's intentions for disclosing APMs. Such suspicions may undermine useful information "through the eyes of management" that companies are disclosing. Respondents are keen to have clear and transparent information on the purpose and reasons for disclosing the APMs, the adjustments made to the GAAP measures to derive the APM and reconciliations back to the GAAP measures. Respondents use this information to determine if the APM information is appropriate or reasonable and for making their own adjustments as necessary.
99. Respondents recognise the various limitations of APMs, understand their usefulness under certain circumstances, and use APMs in conjunction with GAAP measures and for making their own adjustments. Multiple APMs are considered to have their uses but there is concern that if not well explained, these can have negative impacts on users, give negative impressions about the company and give negative impressions on the wider corporate reporting landscape. Many respondents also question the appropriateness of some disclosed APMs and their associated adjustments. These comments from respondents indicate that respondents are discerning in their use of APMs. However, while respondents in general may not necessarily be confused by the APMs and/or their related information, they are sometimes perplexed by the reasons stated by companies for the APMs and/or by their adjustments.

### How can performance information be improved?

100. Respondents are most interested in information about a company's "core operations" or "underlying performance". A company's operating performance minus "non-recurring", "one-off" or "infrequent" items is seen to be useful for assessing the underlying strength and performance of a company and in the continuing business.
101. The majority of respondents did not want company performance measures to be limited to GAAP measures only, many citing the shortcoming of GAAP measures as indicators of the performance of a company's "core" operating activities.
102. Respondents used terms like "recurring", "non-recurring", "one-off", "transitory" and "core" "normalised", "underlying", but it is unclear what these terms mean to the respondents and whether they can be commonly defined. For example, revaluations are seen by some to be a "core", "recurring" element of a business as it occurs in every accounting period: however, others see revaluations as "transitory" or "non-recurring". Similarly, in EBITDA, some respondents view the deductions (interest, tax, depreciation and amortisation) as "core" expenses of a business and were perplexed as to why they were excluded in a measure purporting to reflect an entity's performance.
103. The majority of respondents also want APMs and related information to be assured. These respondents note that companies communicate APMs with the same, or with more prominence, than GAAP measures. If companies intend that investors make decisions based on APMs (because they are intended to give a "better" indication of a company's performance than GAAP measures), then they should be equally reliable and verifiable as GAAP information. However, assurance may be difficult without a standard definition or guidance for APMs to be audited to.
104. Comments from respondents, however, indicate a lack of clarity about whether the APM and related information are assured or not, particularly where the information is not contained within the audited financial statements (but is disclosed in other parts of the annual report or is disclosed outside the annual report) and/or where components of the APM are taken from audited financial statements. As a minimum, information accompanying APMs should be clear on whether the APMs and related information has been subject to assurance.

### Are APMs understandable?

105. The two main APMs used by respondents to answer the questions about understandability of APMs were underlying profits and EBITDA. Respondents also indicated the use of variations to those APMs (for example, underlying EBITDA) which meant that it was not always clear whether these measures used by respondents were defined in the same way or differently from the normally accepted "standard" definitions for those APMs and what other components have been omitted to derive the APM.
106. EBITDA and EBITDAF are common APMs that are also used and considered useful by many respondents, mainly because, unlike underlying profit/earnings, these APMs have a "standard" calculation and are therefore comparable across companies. However, comments from respondents querying the appropriateness of omitting "normal", "recurring" business expenses (interest, taxation, depreciation and amortisation) in deriving EBITDA indicate the purpose of EBITDA as an APM and the reason why companies disclose EBITDA and consider the EBITDA to be a "better" or alternative performance measure than a GAAP measure may not be clear to respondents. The usefulness of these APMs are undermined somewhat by the

lack of a proper reason for their use. Their usefulness is also undermined when items outside the “standard” calculation are added back to the “standard” measures to derive “underlying” or “normalised” EBIT or EBITDA, thereby making them non-comparable across companies.

107. While respondents generally agreed the labelling of the APM was clear and they understood the purpose and additional information about the APM, they did not necessarily always agree the choice of the APM, its purpose, its adjustments or its related explanations were always appropriate. A significant minority of the respondents also indicate that the company did not disclose any additional explanation or reconciliation between the APM and its equivalent GAAP measure.

#### **Any difference in responses between non-expert and expert users?**

108. Of a total of 75 respondents who indicated their level of expertise as users of financial information, 45.3% indicated they were non-expert users and 42.7% indicated they were expert users. A further 12 % indicated themselves as “Other”<sup>3</sup>.
109. Other than Question 6, analysis using Chi-square tests shows no statistical significant differences between the responses to each question between the non-expert and the expert respondents. In other respects, the responses and additional comments indicate similar issues raised and in many cases, equally by each group.
110. A statistical difference was found in Question 6 where only the respondents who designated themselves as expert users requested APM and other additional information from companies.

#### **Conclusion**

##### *GAAP is still trusted but has limitations*

111. Users use APMs as a supplement to, or in conjunction with, GAAP measures. This, and the numerous comments made by respondents for the need for APMs to be reconciled back to GAAP, indicates GAAP measures are still “trusted” and relied upon by respondents. This is notwithstanding the criticisms levelled against the complexity of GAAP and financial statements. A likely reason is that, unlike APMs, financial statements are audited and are a common, comparable measure across different entities.

##### *Underlying profit is the preferred APM*

112. Respondents are most interested in information about a company’s “core operations” or “underlying performance”. Respondents used terms like “recurring”, “non-recurring”, “one-off”, “transitory” and “core” “normalised”, “underlying” in conjunction with underlying profit. However, it is not clear what these terms mean to the respondents and whether they can be commonly defined to include or exclude the same items.
113. There is some support from respondents for including EBIT and EBITDA on the face of financial statements. This may be because these APMs have a “standard” definition and calculation, and unlike underlying profit, are considered to be comparable across companies. As the nature of underlying profit may be unique to individual companies, respondents suggest that underlying profit should not be disclosed on the face of the financial statements but should be disclosed in the notes with appropriate accompanying information.

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<sup>3</sup> The survey asked respondents for further comment if they indicate “Other”. Comments in the “Other” group indicate the respondents generally consider themselves to have better than average experience and expertise in using and understanding financial information.

### *Clarity of reasons and additional information important*

114. The reasons for disclosing particular APMs and the additional information, reconciliations or explanations between an APM and the GAAP are considered by many respondents to be essential, vital and should be mandatory. However, companies may not be explaining, or may not be explaining clearly enough, the purpose of/reasons for the APMs they use and/or their adjustments. Many respondents consider such information could be made more useful as respondents use the information to determine the appropriateness of the APMs and the adjustments, as well as to make their own further adjustments, where necessary.
115. Some respondents query the appropriateness of omitting expenses like interest, taxation, depreciation and amortisation in deriving EBITDA. This indicates the purpose of EBITDA as an APM generally, and the reasons why companies disclose EBITDA and consider it to be an appropriate performance measure, may not be clear to respondents. The usefulness of EBITDA may be undermined by the absence of appropriate reasons for their use.
116. In addition, the usefulness of APMs like EBIT and EBITDA may also be further undermined when items outside the “standard” calculations are added back to the “standard” measures to derive “underlying” EBIT/EBITDA or “normalised” EBIT/EBITDA, thereby making them non-comparable across companies. Making further adjustments to APMs that have a “standard” definition or calculation (for example, EBIT or EBITDA being adjusted to become “underlying EBIT” or “normalised EBITDA”) means it was not always clear how they have been further adjusted from their “standard” measures, whether they continue to have the same purpose and/or are defined in the same way or differently. In this regard, disclosing the reasons and the further adjustments to such “standard” measures need to be clearly explained.

### *Assurance needs to be clarified*

117. Respondents consider APMs and related information should be assured. However, there is a lack of clarity and understanding of whether an APM and related information are assured or not, particularly where the information is not included within the audited financial statements (but are disclosed in other parts of the annual report or are disclosed outside the annual report) and/or where components of the APM are taken from audited financial statements.

### *Overall conclusion*

118. While some respondents were sometimes perplexed by the reasons given by companies for the APMs and/or their adjustments, the majority of respondents, whether non-expert users or expert users, do not in general appear to be confused by the APMs and/or their related information. Instead, the majority of respondents appear to be discerning in their use of the APMs and related information disclosed by companies. Respondents make various comments and suggestions to improve the disclosure of APMs and related information, including the desire for the information to be subject to assurance and having clear definitions for terms like “recurring” and “non-recurring”, indicating they understood and recognised the current limitations of APMs.
119. In summary:
- Respondents use APMs but they are used as a supplement to, or in conjunction with, GAAP measures: APMs are not usually used by respondents as the primary indicator of company performance on their own;

- Respondents find the disclosure of APMs, including multiple APMs, to be useful for different purposes: however, these were subject to caveats about their use and the appropriateness of the adjustments that companies make in deriving the APMs;
- Respondents consider additional information and explanations accompanying APMs, particularly reconciliations between APMs and GAAP measures, to be useful, “vital” and “essential” to understand the APMs: however, respondents consider companies were either not disclosing, or not explaining clearly, why APMs rather than GAAP measures were useful for assessing company performance;
- Respondents generally understand the purpose and additional information about the APMs: however, they did not necessarily always agree with the choice of the APMs, their purpose, their adjustments or their related explanations;
- Respondents prefer APMs to have clear definitions and conform to standardised definitions: respondents consider companies that make further adjustments to APMs that have a “standard” definition or calculation undermined the comparability of the APMs, and hence their usefulness;
- Respondents appear to use APM cautiously, “with grain of salt”: they question the company’s purpose and intentions for disclosing APMs and the adjustments made (especially the tendency for APMs to paint a “rosier” picture than GAAP measures); and
- Respondents want APMs and related information to be assured: however, the lack of clarity whether the APM and related information has been subject to assurance made it difficult to determine if the APM and related information were appropriate, neutral, credible and reliable.

## Appendix: Survey Questionnaire

- Q1 Are APMs useful to you for assessing company performance when you are making decisions about a company?
- Q2 Thinking about these two measures, which would you usually use as the primary indicator for assessing company performance when making your decisions about a company?
- Q3 Where disclosed, do you find the additional information, reconciliation or explanation between a GAAP measure and an APM:
- Really useful
  - Usually useful
  - Less than useful
  - Not useful
- Q4 Do you find the disclosure of multiple APMs by a company as indicators of its performance to be:
- Really useful
  - Usually useful
  - Less than useful
  - Not useful
- Q5 Which of the following APM(s) do you think would be useful for a company to disclose? [Please tick as many as appropriate]
- EBITDA (earnings before interest, taxes, depreciation and amortisation)
  - EBITDAF (earnings before interest, taxes, depreciation, amortisation and fair value adjustments)
  - “Underlying” or “normalised” profit/earnings (profit for the year less non-recurring, infrequently occurring and/or unusual items)
  - Other (please indicate below the APM and how you would calculate or derive it)
- Q6 Have you requested the disclosure of an APM from a company in the past?
- Q7 Please tell us which APM(s) you have requested a disclosure for and why.
- Q8 Should company performance measures be limited to GAAP measures and be taken only from line items or sub-totals that are also presented on the face of the income statement?
- Q9 To improve the GAAP measures of a company’s performance, would it be useful for accounting standards to: [Please tick as many as appropriate]
- Define more sub-totals in the income statement
  - Provide more disaggregated information in the income statement
  - Provide more information about a company’s “core operations” or “underlying performance”
  - Provide a principle-based definition of operating profit
  - Standardise the calculation of selected key APMs (please specify the key APMs)
  - Don’t know
  - Other (please indicate below)
- Q10 What information, if any, do you think should accompany the disclosure of APMs to improve their quality and usefulness to external users? [Please tick as many as appropriate]
- Clear identification of whether the measure is an an APM or a GAAP measure
  - Company’s purpose or reason(s) for using the APM as a performance indicator, rather than a GAAP measure
  - How the APM is derived/calculated
  - Reasons/explanations for including or excluding selected components (eg., recurring items or non-recurring items) in calculating the APM
  - Explanations/reconciliations to the closest equivalent GAAP measure



- Comparative for the previous year's APM
  - Reasons/explanations for changing the APM or its calculation from the previous year
  - Statement on whether or not the APM has been subject to any assurance
  - Other (please indicate below)
- Q11 Where disclosed, do you agree that an APM and any related information should be assured by the entity's auditor? Please give your reasons.
- Q12 What is the APM you are using to answer these questions?
- Q13 Was it clear to you whether the company was referring to a GAAP measure or to an APM?
- Q14 Did you understand the purpose or reason stated by the company for using that APM?
- Q15 Did you think the APM that was used met the intended purpose or reason stated by the company?
- Q16 Did you understand how the company calculated or derived the APM?
- Q17 Was the term used by the company for the APM consistent with the way in which the APM is usually calculated, as you understand it?
- Q18 As you answered 'No' to the previous question, please briefly describe how the calculation was different.
- Q19 Did the company disclose any additional explanation or reconciliation between the APM and its equivalent GAAP measure?
- Q20 Did you understand the additional explanation or reconciliation between the APM and its equivalent GAAP measure?
- Q21 Please tell us which of the following user group best describes you or your organisation. [Please tick as many categories as appropriate]
- Individual equity investor
  - Institutional equity investor
  - Individual debt investor
  - Institutional debt investor
  - Other creditor
  - Intermediary/advisor to investors
  - Financial market/prudential regulator
  - Media commentator
  - Other (please indicate below)
- Q22 Do you consider yourself to be:
- A prudent but non-expert user of financial information
  - A professional and/or expert user of financial information
  - Other (please indicate below)
- Q23 Do you have any other comments?
- Q24 We may have questions about your response and may need to contact you. Please tell us the following:
- Your first name
  - Your last name
  - Your email address
  - Contact telephone number (optional)

### Analysis of Submissions: ED NZASB 2017-1 Amendments to RDR for Tier 2 For-profit Entities

This document sets out respondents' comments on ED NZASB 2017-1, organised by ITC question.

The tables in this document show how the responses have been classified.

The classifications used for the 10 questions in the ITC are:

- A. Agree
- B Partially agree
- C Disagree
- No response

Submissions were received from the following respondents.

R#	Respondent Name	Type	Agenda item
R1	BDO New Zealand	Professional services firm	9.3.1
R2	Chartered Accountants Australia and New Zealand	Professional body	9.3.2
R3	Ernst & Young	Professional services firm	9.3.3
R4	Audit New Zealand (in consultation with the Office of the Auditor-General)	Public sector auditor	9.3.4
R5	Audit New Zealand – Tax Director	Public sector auditor	9.3.5
R6	CPA Australia	Professional body	9.3.6
R7	KPMG	Professional services firm	9.3.7
R8	Financial Markets Authority (FMA)	Regulator	9.3.8

If you would prefer to read each submission in its entirety, copies are available in the supporting Board papers.

R#	Overall comments
R1	<p>We are making this submission to you to assist the New Zealand Accounting Standards Board (NZASB) with the above Exposure Draft.</p> <p>We hope that our responses and comments are helpful.</p>
R2	<p>Chartered Accountants Australia and New Zealand (CA ANZ) welcomes the opportunity to comment on the Exposure Draft ("the ED"). We commend the New Zealand Accounting Standards Board (NZASB) for taking this opportunity to work with the Australian Accounting Standards Board (AASB) to jointly develop these proposals. In the finalising of the proposals we encourage the NZASB to continue to liaise with the AASB to ensure trans-Tasman harmonisation to the extent possible. Our responses to the specific questions raised in the ED are set out in Appendix A. Appendix B includes more information about CA ANZ.</p> <p>We support the objective of the ED, and the proposals are a useful starting point. Against this backdrop of support, we are concerned that the proposals do not go far enough to differentiate Tier 1 and Tier 2 disclosure requirements to make Tier 2 a viable alternative to Special Purpose Financial Reports. To incentivise increased uptake of General Purpose Financial Reports, an obvious distinction between the two tiers must be apparent to preparers. We recommend substantial reductions are made to the proposed disclosures for Tier 2 entities.</p>

R#	Overall comments
	<p>We also note that in Australia this joint project is part of a larger project to simplify and improve financial reporting. Therefore the proposals may need to be revisited once the outcome of the project to reform financial reporting in Australia is known.</p>
R3	<p>We are pleased to comment on the proposals set out in the NZASB Invitation to Comment <i>Exposure Drafts NZASB 2017-1: Amendments to RDR for Tier 2 for-profit entities</i>. Overall we support the Board's efforts to provide a more robust approach for determining reduced disclosure requirements (RDR) for Tier 2 for-profit entities, with a clearer focus on user needs. We generally agree the proposed RDR framework, as outlined in the Policy Statement, will help achieve this result. We have responded to your specific question as per the Invitation to Comment in the appendix attached.</p> <p>In terms of the proposed disclosures required under the RDR as amended by the ED, we are in agreement with many of the proposed disclosures required under the RDR as amended by the ED. However, we have identified a number of disclosures that have been included under the amended requirements which we believe do not meet the needs of users. Conversely, we have identified a significant number of disclosure requirements not included in the revised RDR that we consider should be so included. Please refer to our submission to the AASB for specific comments on the proposed RDR disclosures and concessions.</p>
R4	<p>We are pleased that the NZASB has developed a proposed decision-making framework (the framework) to guide the determination of disclosure concessions for the Tier 2 Reduced Disclosure Regime (RDR). An appropriate framework should contribute to more appropriate concessions being provided, concessions being consistent across the suite of standards, and a better balance of the costs and benefits of financial reporting.</p> <p>While the ED is only relevant to Tier 2 for-profit entities, we strongly encourage the NZASB to develop a similar framework as a priority that would apply to the selection of disclosure concessions to the Public Benefit Entity (PBE) Tier 2 RDR. We are concerned that the different underlying approaches to the selection of disclosure concessions between the proposed for-profit Tier 2 and existing PBE Tier 2 Frameworks may result in unnecessary differences and complexity for preparers, users, and auditors involved with both for-profit and PBE Tier 2 entities.</p> <p>Our responses to the Questions for Respondents outlined in the <i>Invitation to Comment</i> are attached. Our Tax Director will provide a separate submission to you on matters identified on the outcome of the framework to NZ IAS 12 <i>Income Taxes</i>.</p> <p>In preparing this submission, we have also consulted with our colleagues at the Office of the Auditor-General.</p>
R5	<p>The focus of this submission is to provide comments on the outcome of the application of the proposed decision making framework to NZ IAS 12 <i>Income Taxes</i> (question 4 of the Invitation to Comment).</p> <p>We disagree with certain proposed RDR changes as they remove useful information from the tax note. We do not consider that the cost of providing these disclosures exceed the benefits. Most of the required tax disclosures are summaries of the underlying tax calculations. They should not be difficult to prepare, and they provide useful information to help the reader understand the tax balances.</p> <p>The Audit New Zealand website includes a tax calculation and disclosure example, which may be a useful reference resource. This spreadsheet shows how the figures in the tax note are drawn from the underlying tax calculations.</p> <p>Detailed comments on the proposed disclosure concession for NZ IAS 12 are attached.</p>

R#	Overall comments
R6	<p>CPA Australia commends the New Zealand Accounting Standards Board (NZASB) and the Australian Accounting Standards Board (AASB) for their efforts to develop the proposals in the Consultation. We highlight below some key issues for consideration and we also provide our responses to the specific questions.</p> <p>If it has not already done so, we suggest the NZASB undertake pilot testing of the proposed RDR framework with entities that may be considering adopting it, and with entities that are already applying the existing RDR framework to assist the NZASB in assessing whether the project's objectives are likely to be fulfilled.</p> <p><b>International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)</b></p> <p>We note the reservations stated in the proposals about using the IFRS for SMEs Standard as the basis for RDR standard-setting going forward. Although the IFRS for SMEs has not been updated since the issue of some new accounting standards, it provides for simplified disclosure requirements, as well as simplified recognition and measurement requirements. We suggest the NZASB and the AASB reconsider their stance regarding using the IFRS for SMEs as a basis for reporting requirements for Tier 2 entities. It is notable that despite its limitations, the United Kingdom has successfully adopted and modified the IFRS for SMEs in developing Financial Reporting Standard 102 that is applicable to qualifying SMEs.</p> <p><b>The use of the rebuttable presumption when considering Key Disclosure Areas (KDA)</b></p> <p>We note that there are a number of instances throughout the RDR standards when there has been a decision to depart from the KDA on the basis that either costs exceed benefits or vice versa. However, we have been unable to identify any specific evidence that supports the decision to depart from the KDA within the ED or the accompanying Staff Analysis. As the NZASB has an evidence based approach to standard-setting we suggest the NZASB provides the evidence that formed the basis for the decision to depart from the KDA.</p> <p><b>Disclosure Initiative – Principles of Disclosure Discussion Paper</b></p> <p>The International Accounting Standards Board has recently issued a consultation proposing principles for disclosure within International Financial Reporting Standards (IFRS). Whilst we appreciate that the RDR project is "self-contained" we suggest the NZASB considers the IASB's proposed principles of disclosure in finalising its revised RDR framework.</p>
R7	<p>Overall we agree with the proposed RDR Framework and the outcome of its application to identifying disclosure concessions. Our submission focuses primarily on the overarching principles of the proposed RDR Framework, although we have also commented on certain specific proposed disclosure concessions.</p> <p>We have also commented on the RDR concession concerning the exemption to prepare consolidated financial statements in NZ IFRS 10. We note that this concession is not specifically addressed in the ED. However, we are concerned that that this concession will mean that in some cases the top New Zealand company will not be required to prepare consolidated financial statements and that users may not receive full information about the entity in which they have an interest.</p>

R#	Overall comments
R8	<p>As discussed, FMC reporting entities that report under Tier 2 are market services license holders. There are approximately 150 FMC reporting entities that report using tier 2. This includes:</p> <ul style="list-style-type: none"> <li>• Fund Managers</li> <li>• Large DIMS providers</li> <li>• Licensed supervisors</li> <li>• Peer-to-peer and crowd funding platform operators.</li> </ul> <p>The policy behind why they are required to report is to because they supervise, take or administer public funds and should be accountable to the public for their duties. Some smaller licensees (e.g. small DIMS) have been exempted from those requirements.</p> <p>They are considered to have lower public accountability because they don't have investor funds on their balance sheet.</p> <p>We haven't considered the detailed proposals. However, we're comfortable with the overall policy framework and key disclosure areas. In particular:</p> <ul style="list-style-type: none"> <li>• To the extent they require disclosure around the solvency and liquidity of the entity. This is important for the public to see the ability of the licensee to continue to provide them services. It is also useful because these entities often have license conditions relating to solvency.</li> <li>• To the extent that they require related party disclosures – as many licensees maybe depending on the support of related parties to provide certain funding and services, it's material information due to the nature of RP relationship as well as terms and nature of those transactions.</li> </ul>

Question 1	
Do you agree with the overarching principles on which the proposed RDR decision-making framework is based (that is, user needs and cost-benefit)? If you disagree, please explain why.	
Category (C#)	Total
A – Agree	6
B – Partially agree	-
C – Disagree	-
– No response	2
<b>Total of those providing comments</b>	<b>8</b>

R #	C #	Responses to Question 1
R1	A	Yes, we agree with these overarching principles.
R2	A	We agree with the overarching principles.

<b>R #</b>	<b>C #</b>	<b>Responses to Question 1</b>
R3	A	<p>We agree with the overarching principles on which the RDR decision-making framework is based, namely ‘user needs’ and ‘cost-benefit’. These principles are consistent with the current requirements of the New Zealand Equivalent to the International Accounting Standards Board’s (IASB) <i>Conceptual Framework for Financial Reporting</i>. We note these overarching principles were those identified and applied, albeit in a different manner, in determining Tier 2 disclosure requirements when the RDR was initially introduced. At that time, these principles were identified as those used by the IASB in determining the disclosures to be required in the <i>International Financial Reporting Standard for Small and Medium-sized Enterprises (IFRS for SMEs)</i>, with RDR disclosures being drawn from that standard where recognition and measurement requirements were the same as in NZ IFRS. Where recognition and measurement requirements were not the same, the principles of ‘user needs’ and ‘cost-benefit’ were applied directly to the NZ IFRS standard (albeit again with different operational guidance to that outlined in the proposed Policy Statement) to determine what disclosures would be required under RDR.</p> <p>With the IASB decision not to update IFRS for SMEs for some recent amendments and new IFRS standards, we agree with the Board’s proposed amended approach to identifying Tier 2 disclosure requirements, and in particular the application of user needs and cost-benefit as the overarching principles to be applied.</p>
R4	A	We agree with the proposed overarching principles. However, we recommend the framework explain the definition of financial statement users that was used in developing and applying the framework.
R5	–	
R6	A	In response to question 1, we agree with the overarching principles on which the RDR decision-making process is based. However, we recommend the term “user needs” is further elaborated upon with the framework so it better informs both the NZASB and preparers.
R7	A	<p>We agree with the overarching principles on which the RDR decision making framework is based, being ‘user needs’ and ‘cost-benefit’.</p> <p>However, we believe that some guidance or examples to illustrate or explain the type of factors the NZ Accounting Standards Board will consider when assessing ‘cost-benefit’ and ‘user needs’ would be useful to assist readers in understanding the basis on which RDR concessions are granted.</p> <p>We also note that decisions on RDR concessions are determined at an overall level. However, materiality is entity specific. We therefore suggest that the RDR Framework clarify how the RDR Framework interacts with materiality assessment at the entity level. Our preference is that it be made clear within the RDR Framework that, notwithstanding that certain disclosure concessions are provided under the RDR Framework, preparers of financial statements are still responsible to ensure that financial statements include disclosures necessary for users to understand the impact of material/significant events and transactions on the financial performance and position of an entity.</p> <p>We also note that the XRB is in the process of performing research on user needs for Tier 2 entities. We consider that the interaction between the ‘cost-benefit’ and ‘user needs’ is a key aspect of the Framework, and hence the outcome of this research is fundamental to the Framework.</p>
R8	–	

**Question 2**

Do you agree with the two Key Disclosure Areas identified as being essential to meet user needs? If you disagree with either Key Disclosure Area (including any of the specific disclosures about transactions and other events significant or material to understanding the entity's operations as represented by the financial statements), please explain which one(s) you disagree with and why?

Category (C#)	Total
A – Agree	3
B – Partially agree	3
C – Disagree	-
– No response	2
<b>Total of those providing comments</b>	<b>8</b>

R #	C #	Responses to Question 2
R1	A	<p>Yes, we agree that the Key Disclosure Areas identified are essential for meeting user needs.</p> <p>However, we question the way paragraph 28 has been set out. For example, (b)(v) dealing with commitments and contingencies could be argued directly impact on liquidity and solvency, so may be better included under (a) than (b).</p> <p>We would also suggest that (b)(v) through (vii) may be better included under a separate (third) category of Key Disclosure Areas as items that are deemed to always be significant (as a rebuttable presumption) and this need to be addressed in disclosures.</p>
		<p>We would also suggest that the requirements of the Disclosure Initiative be linked into the discussion in some matter. If the requirements of the Disclosure Initiative is not addressed in this section of the Framework, users may find it difficult to determine when a particular issue that falls within the areas of (b)(v) through (vii) could be considered not material for disclosure purposes.</p>
R2	B	<p>We agree, in principle, with the two Key Disclosure Areas.</p> <p>However, (ii) associated risks specific to a transaction or event; and (iv) significant estimates and judgements specific to a transaction or event are covered by (i) the nature of the transaction or event that makes it significant or material to the entity. On this basis we recommend that (ii) and (iv) are removed.</p>
R3	A	<p>We agree with the two key disclosure areas (KDAs) identified in the proposed Policy Statement, namely (1) current liquidity and solvency of the entity and (2) transactions and other events that are significant or material to an understanding of the entity's operations as represented by the financial statements. We consider the specific areas of disclosure identified for the latter KDA encompass those disclosures related to significant or material transactions or events that are likely to be most useful to users of the financial statements of Tier 2 entities.</p> <p>We note the framework for RDR decision making is based on a rebuttable presumption that the benefits of providing these disclosures as listed in paragraph 8 of the draft Policy Statement exceed the costs, and that unless the Board rebuts this presumption Tier 2 entities will be required to make these disclosures. Conversely, where a disclosure is not a KDA there is a rebuttable presumption that the costs of providing the disclosures exceed the benefits, and unless the presumption is rebutted Tier 2 entities are not required to make these disclosures.</p>

<i><b>R #</b></i>	<i><b>C #</b></i>	<i><b>Responses to Question 2</b></i>
		We consider the use of these rebuttable presumptions is an appropriate basis of operationalising the RDR decision making framework. However, we note the assessment of costs versus benefits, and therefore determining when these presumptions are rebutted, will inevitably involve a degree of judgement.
R4	B	<p>No, we do not fully agree with the two Key Disclosure Areas and make the following comments.</p> <p>We are concerned that wording of the first Key Disclosure Area as <b>current</b> liquidity and solvency may put too much focus on short term information and excludes appropriate focus on longer term financial viability. Users are particularly interested in any information that may provide insights into future prospects, as well as information about future financial viability (such as maturity dates for borrowings) and this important information is potentially removed by the implied short term (that is, current) focus of this Key Disclosure Area.</p> <p>We recommend that this Key Disclosure Area be renamed along the lines of “Liquidity, solvency and ongoing financial viability of the entity”.</p> <p>We are also unclear why the Boards consider that risks, associated accounting policies and significant estimates and judgements are essential for meeting user needs for the second Key Disclosure Area (transactions and events), but not the first (liquidity and solvency). We urge the Boards to reconsider this or at least explain their rationale why these matters are not equally important to both Key Disclosure Areas.</p>
R5	–	
R6	A	In response to questions 2 to 10, we are supportive of the proposals and do not have any other comments.
R7	B	<p>We generally agree with the Key Disclosure Areas identified – being information about:</p> <ul style="list-style-type: none"> <li>(i) Current liquidity and solvency; and</li> <li>(ii) Transactions and other events that are significant or material to an understanding of the entity’s operations.</li> </ul> <p>We note that paragraph 28(b)(i)–(iv) appears to be principle based, and paragraph 28(b)(v)–(viii) lists specific types of transactions. Other transactions, such as business acquisitions, business and asset disposals, share-based payments and the issue of complex financial instruments could impact the liquidity and solvency of an entity and also be material to understanding an entity’s operations.</p> <p>In our view, this second group of specific disclosures is not necessarily an exhaustive list of transactions or events that would require disclosure. If these specific items are retained we suggest that additional explanation be provided as to why these items have been separately specified within the RDR Framework. One approach would be to reflect these items in the RDR Framework as examples of the types of transactions that might be caught under paragraphs 28(a) and (b)(i)–(iv).</p>
R8	–	



<b>Question 3</b>	
Do you agree with the proposed RDR decision-making framework and operational guidance as a whole for determining RDR for Tier 2 for-profit entities? If you disagree, please explain why.	
<b>Category (C#)</b>	<b>Total</b>
A – Agree	3
B – Partially agree	3
C – Disagree	-
– No response	2
<b>Total of those providing comments</b>	<b>8</b>

<b>R #</b>	<b>C #</b>	<b>Responses to Question 3</b>
R1	A	Yes, we agree with the proposed RDR decision-making framework and operational guidance as a whole for determining RDR for Tier 2 for-profit entities.
R2	A	We agree with the proposed RDR decision-making framework.
R3	B	With the exception of those matters identified below and in our comments on specific proposed RDR concessions as detailed in our letter to the AASB, we are in agreement with the proposed joint Policy Statement as a whole for determining RDR for Tier 2 entities.
		<p>We agree with the principle of maintaining the same presentation requirements under Tier 1 and Tier 2 (with the exception of the presentation of a third statement of financial position). We acknowledge the distinction between presentation and disclosure will not always be clear and that judgement will be required in such cases. We note the IASB is currently undertaking work on this issue as part of its Principles of Disclosure (POD) project and would encourage the Board to consider the potential impact of the discussion of this matter in their POD Discussion Paper as far as it relates to the distinction for the purposes of the RDR for Tier 2 entities. In the interim, we think the guidance provided in the framework for making this distinction (paragraph 20) is generally sound. We agree with the guidance provided in paragraph 20(d), that where there is an option for provision of information either on the face of the financial statements or in the notes (e.g., NZ IAS 1.106A), this be considered a disclosure requirement and assessed against the RDR decision making framework to determine if the information is included. The choice of where this information is located, with the option to include it in the notes, would seem to suggest that it is not considered to be as key as information that is required to be presented on the face of the financial statements.</p> <p>We agree that encouraged disclosures should be reduced for Tier 2 entities (paragraph 26) and that reconciliations not be required to be prepared by such entities (paragraph 27). Further, given that NZ IFRS 8 and NZ IAS 33 do not apply to Tier 2 entities, we agree that paragraphs that refer to these two standards should be reduced for such entities. (However, please see our specific comment on NZ IAS 10.22(f)/AASB 110.22(f) in Appendix B of our letter to the AASB.)</p>

<b>R #</b>	<b>C #</b>	<b>Responses to Question 3</b>
		As noted, paragraph 23 indicates that disclosure objectives that do not themselves require an entity to provide disclosures are retained for Tier 2 entities. On applying the framework to the specific disclosures required by standards that include such disclosure objectives, it may be possible that some specific disclosures that might be considered necessary to meet the retained objective are actually reduced for Tier 2 entities (e.g., because the costs of providing the disclosure exceed the benefit, or they do not relate to a KDA). In such circumstances, where the specific disclosures are not provided because they are not required for Tier 2 entities, it might be questioned whether the entity can in fact claim compliance with Tier 2 requirements, as it would not have provided sufficient disclosure to meet the objective that remains in the standard. We suggest the Board consider whether this is an unintended consequence of retaining such disclosure objectives for Tier 2 entities.
R4	B	Other than our comments in response to question 2 above, we agree with guidance as a whole.  For greater clarity, we recommend additional guidance be added to the framework to reinforce that preparers of financial statements must still exercise judgement in determining whether a disclosure without a disclosure concession should be made on materiality grounds. This is consistent with paragraph 31 of NZ IAS 1 <i>Presentation of Financial Statements</i> . Without such guidance, there is the risk that preparers think that all disclosures must be made that do not have a disclosure concession, regardless of the materiality of the disclosure to the entity.
R5	–	
R6	A	In response to questions 2 to 10, we are supportive of the proposals and do not have any other comments.
R7	B	In general we agree with the operational guidance provided.  However, we disagree with the proposal in paragraph 39 which states that the paragraphs that require an entity to meet a stated disclosure objective should be reduced. In the absence of additional explanation, this may cause confusion for preparers in terms of whether they need to provide any of the specific disclosure requirements (which may not be reduced), as they are 'exempted' from the entire disclosure objective. Unless the entire disclosure requirement section (i.e. including the objective and specific disclosure requirement paragraphs that follow) is reduced, we believe objective paragraphs should be retained for Tier 2 entities and additional guidance provided for Tier 2 entities (please see point 4 below).
R8	–	

**Question 4**

Do you agree with the outcome of the application of the proposed RDR decision-making framework and operational guidance to the disclosure requirements in NZ IFRS to determine the disclosure requirements for Tier 2 for-profit entities? If you disagree with the outcome, please identify, with reasons:

- (a) which disclosures that are identified as requirements that you believe Tier 2 entities should not be required to provide; and
- (b) which disclosures that are identified as concessions that you believe Tier 2 entities should be required to provide.

Category (C#)	Total
A – Agree	1
B – Partially agree	5
C – Disagree	1
– No response	1
<b>Total of those providing comments</b>	<b>8</b>

R #	C #	Responses to Question 4
R1	B	We agree with the majority of proposed outcomes of the application of the proposed RDR decision-making framework and operation guidance to the disclosure requirements in NZ IFRS.
		<p>The areas that we do not necessarily agree with are as follows:</p> <p><u>Question 4(a)</u> (disclosures that should not be required)</p> <ul style="list-style-type: none"> <li>The reintroduction of qualitative and quantitative disclosures for financial instruments in NZ IFRS 7 via the removal of disclosure exemptions of paragraphs 33; 34; 35A; 35C; 35F; 35G; 35L. Based on our discussions with clients we question whether the benefits of these disclosures to users of the financial statements would exceed the costs of obtaining this information.</li> </ul>
		<p><u>Question 4(b)</u> (disclosures that should be required)</p> <ul style="list-style-type: none"> <li>The removal of disclosures around income and expense, gains and losses on each category of financial instrument by the inclusion of disclosure concessions for NZ IFRS 7 paragraph 20. In our opinion, users would generally be interested in understanding what direct impact financial instruments have on the Statement of Profit or Loss and Other Comprehensive Income.</li> <li>The removal of disclosures around transferred financial assets by the inclusion of disclosure concessions for NZ IFRS 7 paragraph 42E. In our opinion disclosures around debt factoring is useful information for users, and is not uncommon in Tier 2 entities, especially for those whose funding credit lines are under pressure.</li> <li>The removal of disclosures around non-adjusting post reporting date events related to ordinary share and potential ordinary share transactions by the inclusion of disclosure concessions for NZ IAS 10 paragraph 22(f). In our opinion users (especially any non-controlling interests) would be interested in details around changes or potential changes to share capital that could directly impact on them.</li> <li>The removal of disclosures around net exchange differences recognised in other comprehensive income by the inclusion of disclosure concessions for NZ IAS 21 paragraph 52(b). If disclosures around forex movements are required in profit or loss, we fail to see why the same requirement is also not required for other comprehensive income.</li> </ul>

R #	C #	Responses to Question 4	
		<ul style="list-style-type: none"> <li>The removal of disclosures in relation to recoverable amount based on fair value less costs of disposal, but the retention of disclosures in relation to value in use in paragraphs 134(d) and (e) of NZ IAS 36. This could lead to users erroneously using the fair value less costs of disposal to avoid disclosures.</li> </ul>	
R2	C	<p>We have not been though every disclosure in every standard and assessed it against the proposed RDR-decision making framework and operational guidance. However, overall we believe the current application of the proposed RDR-decision making framework and operational guidance has not resulted in a significant enough reduction in disclosure requirements for Tier 2 entities when compared to Tier 1. Application of the proposed RDR-decision making framework and operational guidance is highly judgemental, as evidenced by differences in the proposals between the NZASB and the AASB. We encourage both boards to revisit the application of the proposed RDR-decision making framework and operational guidance with a greater focus on what is considered to be material and significant.</p>	
R3	B	<p>Please refer to Appendix B of our letter to AASB for our comments on specific disclosure requirements of the RDR.</p> <p><u>Question 4(a)</u> (disclosures that should not be required)</p>	
		AASB 1/ NZ IFRS 1.27A	Reference to updating reconciliations required by paragraph 24 should be removed as these reconciliations are not required under RDR.
		AASB 101/ NZ IAS 1.61	While we agree that the disclosure (the amount expected to be recovered or settled after more than 12 months for each asset and liability line item) relates to a KDA (current liquidity and solvency) we question whether the benefits of providing the information would exceed the costs as stated in the analysis. We therefore suggest that this paragraph continue to be excluded under RDR.
		AASB 101/ NZ IAS 1.80A	While we agree that the disclosure (reclassification of puttable instruments) relates to a KDA (current liquidity and solvency) we question whether the benefits of providing the information would exceed the costs as stated in the analysis. We therefore suggest that this paragraph continue to be excluded under RDR.
		AASB 112/ NZ IAS 12.81(c)	We question whether reference to Tax Transparency rules is an appropriate basis for justifying retention of the reconciliation, as these disclosures serve a different purpose. Also, it is not clear if the benefits of providing this disclosure would exceed the costs in this case. If excluded under RDR this would also require that paragraphs 84 and 85 also be removed.
		AASB 119/ NZ IAS 19. 139(a)(ii)	While we agree that the level of any minimum funding requirements is a KDA relating to commitments and contingencies, we do not believe that the description of the regulatory framework in which the plan operates and the asset ceilings would fall within this and do not agree that the benefits of providing these disclosures would exceed the cost.
		AASB 119/ NZ IAS 19.146	We consider the disclosures relating to the asset liability matching strategies used by the plan or entity could be very onerous for Tier 2 entities and hence do not agree that the benefits of providing the disclosure would exceed the costs.

R #	C #	<b>Responses to Question 4</b>	
		AASB 138/ NZ IAS 38.126	We question whether the benefits of disclosing the aggregate amount of research and development expenditure recognised as expense exceed the costs. We therefore suggest that this paragraph continue to be excluded under RDR.
		<u>Question 4(b)</u> (disclosures that should be required)	
		AASB 3/ NZ IFRS 3.B64(f)	We question why the presumption is rebutted that the benefit of disclosing the breakdown of the fair value of the consideration would exceed the cost given similar disclosure for the assets and liabilities acquired under paragraph B64(i) is required for Tier 2 entities.
		AASB 3/ NZ IFRS 3.B67(a)	We question why the disclosures relating to measurement period adjustments are not considered to be a KDA (the nature of the transaction or event makes it significant or material to the entity) in a similar manner to disclosures related to prior period errors under AASB 108/NZ IAS 8.49, and therefore required by Tier 2 entities.
		AASB 7/ NZ IFRS 7.18(a)	We question whether the costs of disclosing defaults during the period would exceed the benefits of doing so. Management will know if the entity defaulted during the year, with details of such defaults providing information to users of potential financial difficulty. Such information would appear to fall within the KDA of liquidity and solvency.
		AASB 7/ NZ IFRS 7.23F	We question whether this information on forecast transactions no longer expected to occur would be costly to provide as it would be readily available. It provides valuable insights into hedging strategies, which themselves relate to managing business risks, which is a KDA.
		AASB 13/ NZ IFRS 13.93(d) and 93(h)(ii)	These disclosures relate to providing information about inputs to Level 3 fair value measurements and sensitivity to changes in unobservable inputs to such measurements. As such we question whether it is correct to regard these disclosures as not being a KDA; that is, they may be considered to relate to a 'significant estimate or judgement specific to a transaction or event'. Also, the comment in the Analysis Copy of ED 277/ED NZASB 2017-1 for paragraph 93(d) seems to suggest that it is reduced for Tier 2 entities in its entirety; however only the latter part of the paragraph is shaded.
		AASB 15/ NZ IFRS 15. 116–118	We understand the contract balances disclosures were designed as a cost-benefit trade off to require disclosure of some information that would otherwise be included in a reconciliation, but without requiring a full numerical reconciliation to be prepared. While noting that the RDR framework proposes not to require reconciliations for Tier 2 entities (paragraph 27), it also notes that the individual items of the reconciliation should be assessed against the RDR framework. Each of the line items specified in the paragraph 116-118 disclosure are intended to provide more information about the entity's performance and movements in its working capital position (see AASB 15/IFRS 15.BC341-BC342). Some of this information could be regarded as being useful in assessing both performance and liquidity. For this reason we think that at least some of this disclosure should be reconsidered for inclusion in RDR.

<b>R #</b>	<b>C #</b>	<b>Responses to Question 4</b>	
		AASB 15/ NZ IFRS 15.129	Disclosure of the practical expedients applied is proposed to be reduced for Tier 2 entities. We consider that this should be viewed as part of the accounting policy disclosure rather than a discrete disclosure requirement, and therefore falls within a KDA.
		AASB 16/ NZ IFRS 16.B52	For a sale and leaseback there can be a fine line between a financing and a derecognition. As such, the business reasons for achieving sale provides useful information to users. Such information would be readily available as it relates to the company's decisions. As such we question whether the cost of providing the disclosure would exceed the benefits.
		AASB 110/ NZ IAS 10.22(f)	Major ordinary share transactions of a Tier 2 entity would be a significant subsequent event, and therefore relate to a KDA irrespective of the fact that AASB 133/NZ IAS 33 does not apply to such entities. We suggest that only the bracketed sentence referring to AASB 133/NZ IAS 33 be removed for Tier 2 entities.
		AASB 112/ NZ IAS 12.81(e) and 82	As the amounts disclosed may effectively be related to impairment, we consider that the disclosure would relate to a KDA. Further, this disclosure has added importance where amounts relate to foreign tax provisions where different conditions (e.g., finite carry forward period) to those in Australia may apply.
		AASB 112/ NZ IAS 12.81(f)	This disclosure relates to a key tax risk, especially with BEPS / other cross border tax issues, and as such would relate to a KDA.
		AASB 119/ NZ IAS 19. 141(a) and (b)	We consider the income statement impact (current service cost and interest income or expense) relating to defined benefit plans are a KDA owing to the nature of the transaction or event that makes it significant to the entity. This is similar to the disclosure of the defined contribution expense for the period under paragraph 53. Hence we believe this disclosure should be retained for Tier 2 entities, albeit not required to be provided as part of the reconciliation referred to in paragraph 140.
		AASB 136/ NZ IAS 36. 130(f)(i)	The requirement to disclose the level in the fair value hierarchy in which the fair value measurement of the asset/CGU is categorised has been reduced on the basis that the costs exceed the benefits, but subsequently disclosures relating to fair values are required by paragraph 130(f)(iii) if they are in Level 2 or 3 of the hierarchy. As such the entity would need to determine the level in the hierarchy and the cost of disclosing it would be negligible.
		AASB 136/ NZ IAS 36. 134(e)	We question why the disclosures relating to determination of recoverable amount based on fair value are not required while disclosures that might be considered similar in nature relating to the determination of value in use are required under paragraph 134(d).
		AASB 141/ NZ IAS 41.54(a)	We do not think that the removal of this disclosure makes sense. In our view it would not be useful to provide an explanation of why fair value of a biological asset cannot be measured (paragraph 54(b)) but not disclose what type of biological asset it relates to (paragraph 54(a)). Therefore this disclosure should be retained.

R #	C #	Responses to Question 4	
		AASB Interpretation 129/ NZ SIC-29.6(d) and (e)	We consider that disclosures relating to service concession arrangements should include the details of changes to the arrangement and how it has been classified, which provides important information to users for which we would expect benefits to exceed the costs of providing the information.
		<u>Disclosures we are of mixed views and therefore the Board might wish to reconsider for Tier 2 entities</u>	
		AASB 1/ NZ IFRS 1.26	While we understand that this is considered to be guidance relating to the reconciliations required by paragraph 24, which are now removed for Tier 2 entities, we believe including disclosure relating to correction of prior period errors ought to be considered, consistent with AASB 108/NZ IAS 8.
		AASB 1/ NZ IFRS 1.32–33	Paragraph 32 refers back to paragraph 23, which is required for Tier 2 entities, but applies only to annual financial statements. Given that few disclosures required by AASB 134/NZ IAS 34 are removed under RDR we would expect that it is made clear that the base requirements of paragraph 23 apply also to interim financial statements. Similarly for paragraph 33.
		AASB 6/ NZ IFRS 6.25	We suggest that the highlighted text in this paragraph, ‘and make the disclosures required by either AASB 116/NZ IAS 16 or AASB 138/NZ IAS 38 consistent with how the assets are classified’ should not be removed for Tier 2 entities. We recognise its removal complies with the stated principle of removing general cross-references. (See our comment on this point under Specific Matter 6 in Appendix A.) However, there is considerable debate for exploration and evaluation assets as to which standard should govern their subsequent measurement and presentation/disclosure; i.e., AASB 116/NZ IAS 36 or AASB 138/NZ IAS 38. As such, we consider this text provides useful guidance on this matter.
		AASB 7/ NZ IFRS 7.22C	This disclosure relates to an important change relating to hedging introduced by AASB 9/NZ IFRS 9. The costs of disclosing this information shouldn't be high as the entity has completed the work needed to achieve hedge accounting, and it provides users with a better understanding of the entity's hedging strategies.
		AASB 7/ NZ IFRS 7.42A–42H	We believe that there should be some level of disclosure under RDR for transfers of financial assets. There often is a fine line between recognising borrowings and derecognising receivables which can make a significant difference on matters such as gearing. Providing these disclosures allows users to obtain an understanding of an entity's derecognition/transfer activities.
		AASB 12/ NZ IFRS 12.21(a)(ii)	This is an example of general guidance that we believe would be of assistance to Tier 2 entities in preparing their financial statements. (Refer to our comments on Specific Matter 5 in Appendix A.)
		AASB 12/ NZ IFRS 12.23(b)	As noted in Appendix A under Specific Matter 6, we consider that cross-referencing to other standards does not require any additional disclosure and that removal of such cross-references could result in confusion.

R #	C #	Responses to Question 4	
		AASB 15/ NZ IFRS 15.119(c)	We think that principal vs agent assessments represent a significant judgement that can have a material impact on the revenues and costs of an entity. As such we believe that a description of 'the nature of goods or service that the entity has promised to transfer, highlighting any performance obligations to arrange for another party to transfer goods or services (ie if the entity is acting as an agent)' fall under a KDA (significant estimates and judgments specific to a transaction or event).
		AASB 15/ NZ IFRS 15.B87	This paragraph introduces the application guidance in B88–B89. Deleting B87 will not remove disclosure burden, but it may make reading the disclosure requirements more confusing (unless B88–B89 is co-located with the paragraph 114 disaggregation of revenue requirement in the proposed RDR Appendix to AASB 15/NZ IFRS 15).
		AASB 15/ NZ IFRS 15.C8(a)	We do not agree with the proposal to remove the disclosure of the current period trend information when the modified retrospective transition option is chosen (i.e., the financial statement line item amounts for the current period on the basis that existing revenue standards had still applied). Although this disclosure may not strictly represent a KDA for assessing liquidity/solvency or as a significant transaction/event, this disclosure provides users with trend information to be able to assess performance between the prior year and current year in circumstances where the modified retrospective transition method is applied. This might suggest that the key disclosure areas (which do not seem to focus directly on financial performance) do not completely capture the user information needs identified on page 6 of the preface to ED 277.
		AASB 16/ NZ IFRS 16. B51(a), (b) and (d)	We question whether this information would be costly to provide as an entity would have views on why they are providing residual value guarantees. Further, as this represents guidance on the application of paragraph 51 we believe it is beneficial for such guidance to be kept for Tier 2 entities. See our response to Specific Matter 5 in Appendix A.
		AASB 101/ NZ IAS 1.78	Removal of the guidance in this paragraph seems counterintuitive considering the nature of many Tier 2 entities. Additional guidance, such as that provided here by cross referencing to other standards, is likely to be of use to such entities. Refer to our comments on Specific Matters 5 and 6 in Appendix A; this is an example of the more general points raised therein.
		AASB 101/ NZ IAS 1.131	This is a further example of general guidance that we believe would be of assistance to Tier 2 entities in preparing their financial statements.
		AASB 110/ NZ IAS 10.13	This is a further example of where we consider removal of a general cross reference to be potentially confusing. It could be taken in isolation to imply that disclosure of the dividend in the notes is not required.
		AASB 110/ NZ IAS 10.18	Removal of the general guidance provided in this paragraph seems unnecessary. If relevant to Tier 1 entities it would appear to be equally relevant to Tier 2 preparers.
		AASB 116/ NZ IAS 16.77(b)	We consider that there is significant benefit to users in understanding whether an independent valuer has been involved in determining a valuation, and that the cost of providing such disclosure would be minimal.



R #	C #	Responses to Question 4	
		AASB 119/ NZ IAS 19.135	This is a specific instance of where we consider that removal of the paragraph requiring disclosures to meet a stated objective would potentially be confusing to preparers given that certain disclosures under paragraphs 139 and 140–144 as referred to here are still required to be disclosed by Tier 2 entities.
		AASB 121/ NZ IAS 21.52(b)	We consider the removal of this disclosure could potentially lead to confusion by implying that it does not need to be disclosed, when it is required by AASB 101/NZ IAS 1.106. This is also an example of where the distinction between presentation and disclosure might be considered to be somewhat blurred.
		AASB 124/ NZ IAS 24.16 and 22	This is a further example of where we consider removal of general guidance is not serving the best interests of Tier 2 preparers.
		AASB 134/ NZ IAS 34.15A	We consider that this paragraph provides useful guidance on the nature of the disclosures required and should be retained for Tier 2 entities.
		AASB 140/ NZ IAS 40.75(e)	Consistent with our comment above on AASB 116/NZ IAS 16.77(b), we believe that there is benefit to users in understanding whether an independent valuer has been involved in determining a valuation, and that the cost of providing such disclosure would be minimal.
		AASB 141/ NZ IAS 41.53	We consider that this paragraph provides useful guidance to Tier 2 entities on the disclosure of risks associated with agricultural activity (a KDA), and therefore should be retained.
R4	B	<p>We have not identified any requirements that Tier 2 entities should not be required to provide. <u>Question 4(b)</u> (disclosures that should be required)</p> <p><b>NZ IFRS 7 – Liquidity risk disclosures</b></p> <p>We agree with the Boards that the liquidity risk disclosures of NZ IFRS 7 paragraph 39 are a Key Disclosure Area. However, we disagree that all the disclosures of this paragraph should be a disclosure concession. The rationale given for the disclosure concession for 39(a) and (b) is that the costs of providing the disclosure exceed the benefits.</p> <p>We disagree with the Boards proposed disclosure concession for NZ IFRS 7 paragraph 39(a). We consider the maturity analysis for financial liabilities, excluding derivatives, required by paragraph 39 (a) provides important information about an entity's liquidity and solvency. Without such information, we consider it could be difficult to adequately assess the liquidity and solvency (and ongoing financial viability) of an entity. We are also not persuaded that the preparation of this information is likely to be costly. The liquidity information for most Tier 2 entities should be readily constructed from information on hand.</p>	
		<p>We are also concerned that as a consequence of the concession provided by paragraph 39(a), that no future cash flow information would be provided about lease liabilities recognised that would arise from the future adoption of NZ IFRS 16 <i>Leases</i>. The lease liabilities for some Tier 2 entities could be significant under NZ IFRS 16 and we consider the information could be important for users.</p> <p>We agree that a disclosure concession be provided from preparing a maturity analysis for derivatives because preparing this information can be complex and costly. Treasury systems may be required to produce such information, or entities may not be able to access such information easily to disaggregate the undiscounted value of derivatives into relevant time periods. We therefore support the disclosure concession for IFRS 7 paragraph 39(b).</p>	

R #	C #	Responses to Question 4
		<p><b>NZ IAS 16 – Valuation disclosures</b></p> <p>We disagree with removing the requirement in paragraph 77(a) and (b) for Tier 2 entities to disclose the effective date of the valuation and whether an independent valuer was involved. We consider this important information for public sector entities (both for profit and public benefit entities).</p> <p>We disagree that the costs of providing this disclosure exceeds the benefits. These disclosures should be simple for Tier 2 entities to prepare with negligible cost.</p>
R5	B	<p><u>Question 4(a)</u> (disclosures that should not be required)</p> <p><b>Paragraph 81(c) of NZ IAS 12</b></p> <p>Paragraph 81(c) requires a reconciliation from the tax on accounting profit to tax expense. This reconciliation can be the most challenging section of the tax note, and is often not as informative as the other sections of the tax note.</p> <p>The logic in the staff analysis paper for not including this as a concession is incorrect. The information provided to IRD about assessable income is not the same as that required to be disclosed by paragraph 81(c). The calculation of assessable income is used to determine the figure for current tax expense. However, this is only one of the components of tax expense. The figure for tax expense also includes prior period adjustments and movements in relation to deferred tax.</p> <p>It should also be noted that the figure for current tax expense disclosed in the financial statements is only an estimate of the tax liability that will be included in the tax return. The current tax calculation will generally be amended or refined before the tax return is filed. The information disclosed in the tax note reconciliation is of no interest to the IRD.</p> <p>It could be argued that the costs of preparing the disclosure required by paragraph 81(c) outweigh the benefits. You may wish to consider providing a disclosure concession in relation to paragraph 81(c).</p> <p><b>Paragraph 81(g)(ii) of NZ IAS 12</b></p> <p>Paragraph 81(g)(ii) requires the amount of deferred tax recognised in profit or loss for each type of temporary difference and for unused tax losses. The total of these adjustments agree to the deferred tax movements disclosed in the components of tax expense. However, the amounts for each type of temporary difference or for tax losses would often be manually calculated, and are not particularly informative.</p> <p>It could be argued that the costs of preparing the disclosure required by paragraph 81(g)(ii) outweigh the benefits. You may wish to consider providing a disclosure concession in relation to paragraph 81(g)(ii).</p> <hr/> <p><u>Question 4(b)</u> (disclosures that should be required)</p> <p><b>Paragraphs 79 and 80 of NZ IAS 12</b></p> <p>It is proposed that the disclosure of the major components of tax expense would not be required under RDR.</p> <p>This disclosure provides useful information to the readers about the main components of the tax expense balance for the year, such as current tax expense, prior period adjustments, and deferred tax movements. There should generally be no additional cost in producing this information as the components are determined in accounting for tax expense in the financial statements.</p>

<b>R #</b>	<b>C #</b>	<b>Responses to Question 4</b>
		<p><b>Paragraph 81(e) of NZ IAS 12</b></p> <p>It is proposed that the disclosure of information about unrecognised temporary differences and unrecognised tax losses would not be required under RDR.</p> <p>This disclosure provides useful information to the readers about balances that may be of benefit to the entity in future. For example, it may indicate whether an entity could potentially pay tax in the near future, or whether tax losses were available for transfer to other entities in the group. This information would also be required for consolidation purposes, as unrecognised deferred tax asset in certain subsidiaries can often be recognised at a group level. Additionally, there should be negligible cost in disclosing this information as the figures come directly from the underlying deferred tax calculation, and the disclosure itself is usually only one or two lines of text.</p> <p><b>Paragraph 81(g)(i) of NZ IAS 12</b></p> <p>It is proposed that the disclosure of information about the main components of the deferred tax balance would not be required under RDR.</p> <p>This disclosure provides useful information to help the reader understand the deferred tax balance. For example, it would disclose whether the deferred tax liability primarily related to property, plant and equipment or other adjustments. It would highlight whether the entity has recognised a deferred tax asset in relation to tax losses. It would also show deferred tax liabilities that were offset by deferred tax assets for entities that disclosed a net deferred tax balance of zero. There should be negligible cost in disclosing this information as the figures come directly from the underlying deferred tax calculation.</p>
R6	A	In response to questions 2 to 10, we are supportive of the proposals and do not have any other comments.
R7	B	<p>Our submission focusses primarily on the overarching principles of the proposed RDR Framework. Overall we agree with the outcome of the application of the RDR decision-making framework. However, we note the following matters with regard to the specific RDR concessions.</p> <p><i>Disclosure objectives</i></p> <p>As noted above, it is proposed to provide RDR concessions with respect to disclosure objective paragraphs included in a number of standards. For example the amendments propose to include RDR concessions in respect of NZ IFRS 2.44, NZ IFRS 3.59, NZ IFRS 5.30, NZ IFRS 7.7 and NZ IFRS 13.91.</p> <p>In our view, entities should not be exempt from these disclosure objectives. Rather the disclosure objectives should be met by RDR entities making the disclosures required for RDR entities. This seems to be the objective of NZ IAS 1 RDR 15.1 which states that the application of NZ IFRS RDR, with additional disclosure where necessary, is presumed to result in financial statements that achieve a fair presentation.</p> <p>We suggest that no disclosure concession be provided in respect of the disclosure objectives in the standards and that the RDR paragraph be amended to clarify that in respect of a Tier 2 entity the disclosure objective will be met when an entity complies with the RDR disclosures required by the standard, with additional disclosures where necessary.</p>

<b>R #</b>	<b>C #</b>	<b>Responses to Question 4</b>
		<p><i>Other</i></p> <p>NZ IAS 36.134 includes an RDR concession in respect of CGUs whose recoverable amount is based on fair value (NZ IAS 36.134(e)). However, there is no RDR concession in respect of CGUs whose recoverable amount is based on value in use (NZ IAS 36.134(d)). Both paragraphs relate to disclosures regarding recoverable amount. However, one is considered a Key Disclosure Area and the other is not. Given the similarity of the disclosures required by these sub-paragraphs the difference in RDR status is not clear to us and a consistent approach would seem preferable.</p>
R8	–	

<b>Question 5</b> Do you agree with the approach taken by the NZASB regarding disclosures about accounting policies? If you disagree, please explain why.	
<b>Category (C#)</b>	<b>Total</b>
A – Agree	6
B – Partially agree	-
C – Disagree	-
– No response	2
<b>Total of those providing comments</b>	<b>8</b>

<b>R #</b>	<b>C #</b>	<b>Responses to Question 5</b>
R1	A	Yes, we agree with the approach taken by the NZASB.
R2	A	We agree with this approach.
R3	A	We note the NZASB has decided to retain for Tier 2 entities all disclosures of accounting policies, including the general disclosures required by NZ IAS 1 and NZ IAS 8, as well as the more specific disclosures required within other NZ IFRS. In contrast, the AASB's proposed approach to disclosures of accounting policies relies on the Australian equivalents to NZ IAS 1 and NZ IAS 8. Under this approach, all disclosures about accounting policies contained in any of the other standards are reduced for Tier 2 entities.

<b>R #</b>	<b>C #</b>	<b>Responses to Question 5</b>
		<p>We consider that the NZASB's rationale for its approach to accounting policy disclosures as described in paragraph NZ 12.1 of the draft Policy Statement and paragraph 59 of the Invitation to Comment are well founded. We agree that removal of specific disclosures around accounting policies from a standard might be interpreted as a disclosure concession, despite the same specific disclosure being expected or required under the more general accounting policy disclosure requirements in NZ IAS 1 and NZ IAS 8. As such it is possible that inadequate or non-disclosure of accounting policies that are material to an understanding of the entity's financial statements may result. We do not consider the AASB's approach of stating within each standard that the disclosure requirements in NZ IAS 1 and NZ IAS 8 relating to accounting policies apply where relevant, will sufficiently address this possibility. Further, while reducing the accounting policy disclosures from all standards other than NZ IAS 1 and NZ IAS 8, as per the AASB's approach, will reduce certain repetition from the standards, we note that including the abovementioned statement referring to NZ IAS 1 and NZ IAS 8 in each standard will in fact create repetition of information within the standards.</p> <p>We also note the work of the IASB in relation to disclosure of accounting policies as part of its POD project, and encourage the NZASB to consider in due course the implications of this work on the disclosure of accounting policies by Tier 2 entities.</p>
R4	A	We do not have any concerns with the NZASB's proposed approach.
R5	–	
R6	A	In response to questions 2 to 10, we are supportive of the proposals and do not have any other comments.
R7	A	<p>We agree with the approach proposed by the NZASB with respect to accounting policies.</p> <p>We specifically consider that the inclusion of the disclosures about accounting policies should be driven by the same principles which drive the decision to retain or reduce the various disclosures within each accounting standard.</p>
R8	–	

**Question 6**

Do you agree with the approach taken by the NZASB regarding guidance for disclosure requirements? If you disagree, please explain why.

<b>Category (C#)</b>	<b>Total</b>
A – Agree	5
B – Partially agree	-
C – Disagree	1
– No response	2
<b>Total of those providing comments</b>	<b>8</b>

<b>R #</b>	<b>C #</b>	<b>Responses to Question 6</b>
R1	A	Yes, we agree with the approach taken by the NZASB.
R2	C	We do not support keeping guidance for disclosures where it is of a general nature.
R3	A	<p>The NZASB has decided to keep all guidance that relates to disclosures that Tier 2 entities are required to provide, on the basis that the guidance is intended to assist preparers in providing the disclosures. On the other hand, we note the AASB proposes to reduce some of the guidance for disclosures that remain in the RDR, particularly where the guidance is of a general nature and considered to be unnecessary for Tier 2 entities to meet the related disclosure requirements.</p> <p>We agree with the NZASB's approach. By their nature some entities that qualify to prepare Tier 2 financial statements (e.g., some for-profit private sector entities that do not have public accountability) might be considered to be less sophisticated in terms of the processes and resources available for financial statement preparation, including preparation of the required disclosures. On this basis, any guidance, whether general or specific, that may assist in the preparation of those disclosures would seem to be a useful inclusion in the disclosure requirements for Tier 2 entities. We note that the IASB, in developing the international equivalent standards, considered the guidance in question to be necessary or appropriate to include to assist in preparation of the related disclosures, and as such we do not think it appropriate to remove such guidance from the Tier 2 requirements.</p>
R4	A	We do not have any concerns with the NZASB's proposed approach.
R5	–	
R6	A	In response to questions 2 to 10, we are supportive of the proposals and do not have any other comments.
R7	A	We agree with the approach taken by the NZASB regarding guidance for disclosure requirements.
R8	–	

**Question 7**

Do you agree with the approach taken by the NZASB regarding cross-references to other standards that are general rather than specific? If you disagree, please explain why.

<b>Category (C#)</b>	<b>Total</b>
A – Agree	5
B – Partially agree	-
C – Disagree	1
– No response	2
<b>Total of those providing comments</b>	<b>8</b>

<b>R #</b>	<b>C #</b>	<b>Responses to Question 7</b>
R1	A	Yes, we agree with the approach taken by the NZASB.
R2	C	We do not support keeping cross-references where it is of a general nature, as the disclosure will be required by the standard dealing with a specific type of transaction or event.
R3	A	The NZASB proposes to keep cross-referencing for Tier 2 entities, while the AASB proposes to remove cross-referencing of a general nature as it considers these to be duplication of disclosure requirements. Paragraph 68 of the Invitation to Comment explains the basis for the NZASB proposal to be that removal of such cross-references to other standards might be misinterpreted as implying that Tier 2 entities are not required to comply with the disclosure requirements in the other standards. In this respect the rationale is similar to that supporting the NZASB's position on accounting policies addressed under matter 5 above. For similar reasons to those outlined at 5 above, on balance we favour the position taken by the NZASB on this issue, particularly since such a cross-reference would not result in any additional disclosure being required.
R4	A	We do not have any concerns with the NZASB's proposed approach.
R5	–	
R6	A	In response to questions 2 to 10, we are supportive of the proposals and do not have any other comments.
R7	A	We agree with the approach proposed by the NZASB regarding cross-references to other standards.
R8	–	

#### Question 8

Do you agree with the proposal to retain the approach of using an asterisk (\*) for disclosures that Tier 2 entities are not required to provide and explaining partial concessions by means of an RDR paragraph? If you disagree, please provide, with reasons, an alternative approach for consideration.

<b>Category (C#)</b>	<b>Total</b>
A – Agree	5
B – Partially agree	1
C – Disagree	-
– No response	2
<b>Total of those providing comments</b>	<b>8</b>

<b>R #</b>	<b>C #</b>	<b>Responses to Question 8</b>
R1	A	Yes, we agree with the proposal to retain the approach of using an asterisk (*) for disclosures that Tier 2 entities are not required to provide and explaining partial concessions by means of an RDR paragraph. This system currently works well and any changes therein could lead to significant confusion by preparers.

<b>R #</b>	<b>C #</b>	<b>Responses to Question 8</b>
R2	B	We believe the current approach in New Zealand works well, but we encourage trans-Tasman harmonisation in this regard.
R3	A	<p>We support the NZASB's proposal to retain the current approach of using an asterisk for disclosures that Tier 2 entities are not required to provide, and explaining partial disclosure concessions using an RDR paragraph.</p> <p>We acknowledge that alternative approaches have certain merits. For example, the AASB's current approach of highlighting/shading those disclosures that are not required for Tier 2 entities in Australia potentially makes RDR concessions more visually obvious as compared to using asterisks, and therefore easier for a user to identify. Alternatively, the AASB's proposed approach of identifying only those disclosures that Tier 2 entities are required to provide in an appendix to each relevant standard, rather than identifying disclosure concessions in the standard itself, has the advantage of enabling Tier 2 entities to see all disclosures that they are required to provide in one location, without any additional disclosures that are not required. However, we note the NZASB's current approach to using asterisks to identify disclosure concessions has been used in New Zealand for over 20 years (initially to identify differential reporting concessions, and since 2012 to identify RDR disclosure concessions), therefore preparers in New Zealand are very familiar with this approach. Thus, a New Zealand preparer is unlikely to overlook a RDR concession because it is marked with an asterisk rather than shaded, or because it is presented as a concession in the main body of the standard together with disclosures that are not required for Tier 2 entities. Furthermore, introducing the AASB's current or proposed approach in New Zealand may in fact cause confusion for preparers due to lack of familiarity, despite the potential merits of these approaches. We therefore support the retention of the NZASB's current approach to identifying RDR concessions.</p>
R4	A	We agree with the NZASB's proposed approach. Users of the accounting standards are familiar with this approach and we are not aware of any broader concerns about the current approach to identifying RDR concessions.
R5	–	
R6	A	In response to questions 2 to 10, we are supportive of the proposals and do not have any other comments.
R7	A	<p>We agree with the proposal to retain the use of an asterisk for disclosures that Tier 2 entities are not required to provide, and partial concessions made using an RDR paragraph.</p> <p>The use of asterisk and supplementary RDR paragraphs is well understood in New Zealand. Furthermore we are not aware of any issues that would necessitate a change of approach.</p>
R8	–	



<b>Question 9</b>	
Do you agree that, once approved, the amended Tier 2 disclosure requirements should be effective for annual periods beginning on or after 1 January 2019, with early application permitted for annual periods beginning on or after 1 January 2018 (with early adoption of the concessions in NZ IAS 40 permitted only when an entity also applies NZ IFRS 16)?	
<b>Category (C#)</b>	<b>Total</b>
A – Agree	6
B – Partially agree	-
C – Disagree	-
– No response	2
<b>Total of those providing comments</b>	<b>8</b>

<b>R #</b>	<b>C #</b>	<b>Responses to Question 9</b>
R1	A	Yes, we agree with the proposed effective date and restriction on early application of these requirements.
R2	A	We agree with the effective date.
R3	A	Given that it is not expected the final standard will be issued until the second half of 2017 at the earliest, we agree with the proposed application date of periods beginning on or after 1 January 2019.
		We consider that permitting early adoption for periods beginning on or after 1 January 2018 is acceptable given this implies the earliest financial year end to which the new standard could be applied is 31 December 2018. This has the advantage of providing sufficient lead time for Tier 2 entities to implement the new requirements if they wish to do so early, and also allowing the entity to apply the new requirements at the same time as it first applies NZ IFRS 15 and the amendments to NZ IFRS 7 as a consequence of NZ IFRS 9. We do not recommend moving the early application date to any time before 1 January 2018, as early adoption of the revised Tier 2 disclosures prior to applying NZ IFRS 15 and NZ IFRS 7 as amended by NZ IFRS 9 could cause a mismatch in disclosure requirements.
R4	A	We agree the mandatory effective date of 1 January 2019 should provide Tier 2 for-profit entities sufficient time to prepare the amended RDR.
R5	–	
R6	A	In response to questions 2 to 10, we are supportive of the proposals and do not have any other comments.
R7	A	We agree with the proposed effective date of 1 January 2019.  We suggest that NZ ASB clarify whether entities can early adopt the proposed RDR concessions on disclosure by disclosure basis, a standard by standard basis, or as a whole.
R8	–	

**Question 10**

Do you have any other comments on the ED?

<b>R #</b>	<b>Responses to Question 10</b>
R1	<p>We have no further comments on ED NZASB 2017-1.</p> <p>We do however raise a question on the NZASB's approach to the RDR framework for PBE Standards. Does the NZASB intend to mirror the RDR framework approach in the PBE Standards to ensure as much consistency (preferred approach) between the for-profit and PBE Standards as possible?</p>
R2	We have no other comments.
R3	<p>In terms of additional comments, we note the NZASB's proposed amendments to the RDR framework and disclosures apply only to for-profit entities and not to public benefit entities (PBEs). We understand the principles of users' needs and cost-benefit would also be applicable in the context of identifying RDR concessions in PBE Standards, and these principles are consistent with the current requirements of the PBE Conceptual Framework. We acknowledge that PBEs differ to for-profit entities in terms of their objectives and, in some cases, their transactions and the information needs of the users of their financial statements. However, we note that several disclosures identified as KDA in the proposed Practice Statement would seem to also be important to users in the PBE space, such as disclosures about accounting policies, significant estimates and judgements, impairment and related parties. Additionally, we note that in Australia, the AASB proposes to apply the amended RDR framework to not-for-profit entities. We therefore believe that it would be beneficial to consider developing an amended framework for identifying RDR disclosures and concessions in PBE Standards, albeit taking into account the inherent differences between PBEs and for-profit entities.</p> <p>We do not have any additional comments on the draft Policy Statement or accompanying ED.</p>
R4	We have no further comments.
R5	–
R6	We do not have any other comments.
R7	<p>We note that the ED does not consider the RDR concession set out in NZ IFRS 10 RDR 4.1 regarding the exemption to prepare consolidated financial statements. We understand that no change is proposed in respect of this concession as this concession relates to the scope of NZ IFRS 10, rather than disclosures.</p> <p>However, we believe that application of the concession provided in NZ IFRS 10 RDR 4.1 means that certain entities will not be required to prepare consolidated financial statements. We are concerned that certain users will not receive consolidated financial statements and hence full information about the entity in which they have an interest.</p> <p>Every company that has one or more subsidiaries is required to prepare group financial statements that comply with generally accepted accounting practice [CA 1993, section 202(1)]. The Financial Reporting Act 2013, section 7, defines group financial statements as:</p> <p>“...the statements for the group as at the balance date, or in relation to the accounting period ending at the balance date, that are required to be prepared in respect of the group by <u>an applicable financial reporting standard</u>...” [emphasis added]</p> <p>NZ IFRS 10 (being an applicable financial reporting standard) requires an entity that is a parent to present consolidated financial statements. However, the scope of NZ IFRS 10 is limited such that entities are not to prepare consolidated financial statements if four conditions are all met (NZ IFRS 10.4).</p>

<i><b>R #</b></i>	<i><b>Responses to Question 10</b></i>
	<p>Tier 2 RDR entities are exempt from one of the criteria to apply the scope exemption. Specifically, in order to qualify for the exemption RDR entities do not have to meet the criteria that their ultimate parent produces consolidated financial statements that are available for public use and comply with NZ IFRS [NZ IFRS 10.4(a)(iv)].</p> <p>Consider the following scenario:</p> <ul style="list-style-type: none"> <li>• Company A is a large company and a 100% owned subsidiary of an overseas company.</li> <li>• Company A has three subsidiaries in NZ.</li> <li>• Company A is therefore required to prepare general purpose financial statements under the Companies Act 1993.</li> <li>• Assume also that Company A qualifies to report as a Tier 2 entity under the RDR Reporting Framework.</li> <li>• Company A meets the first three scope exemptions set out in NZ IFRS 10.4.</li> </ul> <p>In this case Company A is required to prepare group financial statements in accordance with the Companies Act 1993, section 202(1), and these financial statements are required to comply with generally accepted accounting practice.</p> <p>Therefore, in the scenario described above, we believe that it is possible to interpret the requirements of the Companies Act and NZ IFRS 10 such that Company A could apply the RDR exemption in NZ IFRS 10.4, and not prepare group financial statements.</p> <p>We agree that it is not necessary that RDR entities have a parent or ultimate parent that produces publically available consolidated financial statements. However, we believe that the top company in NZ should be required to prepare consolidated financial statements where such a company is required to prepare general purpose financial statements. If our interpretation is correct then we suggest that the XRB reconsider the exemption and/or clarify NZ IFRS 10.RDR4.1. We note that the scenario detailed above also applies in respect of NZ IAS 28.17(d), where an entity may therefore apply an exemption to the application of the equity method for investments in associates in the same manner in which it may apply the consolidation exemption. We therefore recommend that the XRB consider the operation of these two items together.</p>
R8	–

10 May 2017

Mr Warren Allen  
The Chief Executive  
External Reporting Board  
PO Box 11250  
Manners St Central  
Wellington  
6142

Dear Sir

***Requests to comment on Exposure Draft ED NZASB 2017-1 Amendments to RDR for Tier 2 For-profit Entities***

Thank you for the opportunity to comment on the above Exposure Draft.

We are making this submission to you to assist the New Zealand Accounting Standards Board (NZASB) with the above Exposure Draft. We are happy for you to publish our comments publically.

In responding we have addressed the specific questions for respondents in Appendix 1.

More information on BDO is provided in Appendix 2 to this letter.

We hope that our responses and comments are helpful. Should you wish to discuss any of the points we have raised please contact me ([michael.rondel@bdo.co.nz](mailto:michael.rondel@bdo.co.nz)) should you have any queries or require further information.

Yours faithfully,



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## **Appendix 1 - Response to questions**

### **Question 1**

Do you agree with the overarching principles on which the proposed RDR decision-making framework is based (that is, user needs and cost-benefit)? If you disagree, please explain why.

**Yes, we agree with these overarching principles.**

### **Question 2**

Do you agree with the two Key Disclosure Areas identified as being essential for meeting user needs? If you disagree with either Key Disclosure Area (including any of the specific disclosures about transactions and other events significant or material to understanding the entity's operations as represented by the financial statements), please explain which one(s) you disagree with and why?

**Yes, we agree that the Key Disclosure Areas identified are essential for meeting user needs.**

**However, we question the way paragraph 28 has been set out. For example (b)(v) dealing with commitments and contingencies could be argued directly impact on liquidity and solvency, so may be better included under (a) than (b).**

**We would also suggest that (b) (v) through (vii) may be better included under a separate (third) category of Key Disclosure Areas as items that are deemed to always be significant (as a rebuttable presumption) and thus need to be addressed in disclosures.**

**We would also suggest that the requirements of the Disclosure Initiative be linked into the discussion in some manner. If the requirements of the Disclosure Initiative is not addressed in this section of the Framework, users may find it difficult to determine when a particular issue that falls within the areas of (b) (v) through (vii) could be considered not material for disclosure purposes.**

### **Question 3**

Do you agree with the proposed RDR decision-making framework and operational guidance as a whole for determining RDR for Tier 2 for-profit entities? If you disagree, please explain why.

**Yes, we agree with the proposed RDR decision-making framework and operational guidance as a whole for determining RDR for Tier 2 for-profit entities.**

### **Question 4**

Do you agree with the outcome of the application of the proposed RDR-decision making framework and operational guidance to the disclosure requirements in NZ IFRS to determine the disclosure requirements for Tier 2 for-profit entities? If you disagree with the outcome, please identify, with reasons:

- (a) which disclosures that are identified as requirements that you believe Tier 2 entities should not be required to provide; and
- (b) which disclosures that are identified as concessions that you believe Tier 2 entities should be required to provide.

**We agree with the majority of proposed outcomes of the application of the proposed RDR-decision making framework and operational guidance to the disclosure requirements in NZ IFRS.**

**The areas that we do not necessarily agree with are as follows:**

- **The reintroduction of qualitative and quantitative disclosures for financial instruments in NZ IFRS 7 via the removal of disclosure exemptions of paragraphs 33; 34; 35A; 35C; 35F; 35G; 35L. Based on our discussions with clients we question whether the benefits of these disclosures to users of the financial statements would exceed the costs of obtaining this information.**
- **The removal of disclosures around income and expense, gains and losses on each category of financial instrument by the inclusion of disclosure concessions for NZ IFRS 7 paragraph 20. In our opinion, users would generally be interested in understanding what direct impact financial instruments have on the Statement of Profit or Loss and Other Comprehensive Income.**
- **The removal of disclosures around transferred financial assets by the inclusion of disclosure concessions for NZ IFRS 7 paragraph 42E. In our opinion disclosures around debt factoring is useful information for users, and is not uncommon in Tier 2 entities, especially for those whose funding credit lines are under pressure.**
- **The removal of disclosures around non-adjusting post reporting date events related to ordinary share and potential ordinary share transactions by the inclusion of disclosure concessions for NZ IAS 10 paragraph 22(f). In our opinion users (especially any non-controlling interests) would be interested in details around changes or potential changes to share capital that could directly impact on them.**
- **The removal of disclosures around net exchange differences recognised in other comprehensive income by the inclusion of disclosure concessions for NZ IAS 21 paragraph 52(b). If disclosures around forex movements are required in profit or loss, we fail to see why the same requirement is also not required for other comprehensive income.**
- **The removal of disclosures in relation to recoverable amount based on fair value less costs of disposal to see, but the retention of disclosures in relation to value in use in paragraphs 134(d) and (e) of NZ IAS 36. This could lead to users erroneously using the fair value less costs of disposal to avoid disclosures.**

#### **Question 5**

Do you agree with the approach taken by the NZASB regarding disclosures about accounting policies? If you disagree, please explain why.

**Yes, we agree with the approach taken by the NZASB.**

#### **Question 6**

Do you agree with the approach taken by the NZASB regarding guidance for disclosure requirements? If you disagree, please explain why.

**Yes, we agree with the approach taken by the NZASB.**

**Question 7**

Do you agree with the approach taken by the NZASB regarding cross-references to other standards that are general rather than specific? If you disagree, please explain why.

**Yes, we agree with the approach taken by the NZASB.**

**Question 8**

Do you agree with the proposal to retain the approach of using an asterisk (\*) for disclosures that Tier 2 entities are not required to provide and explaining partial concessions by means of an RDR paragraph? If you disagree, please provide, with reasons, an alternative approach for consideration.

**Yes, we agree with the proposal to retain the approach of using an asterisk (\*) for disclosures that Tier 2 entities are not required to provide and explaining partial concessions by means of an RDR paragraph. This system currently works well and any change therein could lead to significant confusion by preparers.**

**Question 9**

Do you agree that, once approved, the amended Tier 2 disclosure requirements should be effective for annual periods beginning on or after 1 January 2019, with early application permitted for annual periods beginning on or after 1 January 2018 (with early adoption of the concessions in NZ IAS 40 permitted only when an entity also applies NZ IFRS 16)?

**Yes, we agree with the proposed effective date and restriction on early application of these requirements.**

**Question 10**

Do you have any other comments on the ED?

**We have no further comments on ED NZASB 2017-1.**

**We do however raise a question on the NZASB's approach to the RDR framework for PBE Standards? Does the NZASB intend to mirror the RDR framework approach in the PBE Standards to ensure as much consistency (preferred approach) between the for-profit and PBE Standards as possible?**

## **Appendix 2 - Information on BDO**

1. BDO New Zealand is a network of eleven independently owned accounting practices, with fifteen offices located throughout New Zealand.
2. BDO firms in New Zealand offer a full range of accountancy services, including business advisory, audit, taxation, risk advisory, internal audit, corporate finance, forensic accounting and business recovery and insolvency.
3. BDO in New Zealand has 88 partners and over 800 staff.
4. BDO firms throughout New Zealand have a significant number of clients in the not-for-profit sector.
5. Five BDO firms in New Zealand (BDO Auckland, BDO Christchurch, BDO Northland, BDO Waikato and BDO Wellington) are registered audit firms and thirteen audit partners are licensed auditors.
6. Internationally, BDO is the fifth largest full-service audit, tax and advisory firm in the world, with almost 60,000 people in 1,328 offices across over 152 territories.



24 May 2017

Chief Executive  
External Reporting Board  
PO Box 11250, Manners St Central  
Wellington 6142

*By email: [submissions@xrb.govt.nz](mailto:submissions@xrb.govt.nz)*

Dear Warren

**Submission on Exposure Draft ED 2017-1 Amendments to RDR for Tier 2 For-Profit Entities**

Chartered Accountants Australia and New Zealand (CA ANZ) welcomes the opportunity to comment on the Exposure Draft ("the ED"). We commend the New Zealand Accounting Standards Board (NZASB) for taking this opportunity to work with the Australian Accounting Standards Board (AASB) to jointly develop these proposals. In the finalising of the proposals we encourage the NZASB to continue to liaise with the AASB to ensure trans-Tasman harmonisation to the extent possible. Our responses to the specific questions raised in the ED are set out in Appendix A. Appendix B includes more information about CA ANZ.

We support the objective of the ED, and the proposals are a useful starting point. Against this backdrop of support, we are concerned that the proposals do not go far enough to differentiate Tier 1 and Tier 2 disclosure requirements to make Tier 2 a viable alternative to Special Purpose Financial Reports. To incentivise increased uptake of General Purpose Financial Reports, an obvious distinction between the two tiers must be apparent to preparers. We recommend substantial reductions are made to the proposed disclosures for Tier 2 entities.

We also note that in Australia this joint project is part of a larger project to simplify and improve financial reporting. Therefore the proposals may need to be revisited once the outcome of the project to reform financial reporting in Australia is known.

Should you have any queries concerning the matters in this submission, or wish to discuss them in further detail, please contact Zowie Pateman (Acting Reporting Leader) via email; [zowie.pateman@charteredaccountantsanz.com](mailto:zowie.pateman@charteredaccountantsanz.com).

Yours sincerely



**Liz Stamford**  
Head of Policy, Leadership & Advocacy  
Chartered Accountants Australia & New Zealand

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## Appendix A: Responses to specific questions

- 1 Do you agree with the overarching principles on which the proposed RDR decision-making framework is based (that is, user needs and cost-benefit)? If you disagree, please explain why.**

We agree with the overarching principles.

- 2 Do you agree with the two Key Disclosure Areas identified as being essential for meeting user needs? If you disagree with either Key Disclosure Area (including any of the specific disclosures about transactions and other events significant or material to understanding the entity's operations as represented by the financial statements), please explain which one(s) you disagree with and why?**

We agree, in principle, with the two Key Disclosure Areas. However (ii) associated risks specific to a transaction or event; and (iv) significant estimates and judgements specific to a transaction or event are covered by (i) the nature of the transaction or event that makes it significant or material to the entity. On this basis we recommend that (ii) and (iv) are removed.

- 3 Do you agree with the proposed RDR decision making framework and operational guidance as a whole for determining RDR for Tier 2 for-profit entities? If you disagree, please explain why.**

We agree with the proposed RDR decision-making framework.

- 4 Do you agree with the outcome of the application of the proposed RDR-decision making framework and operational guidance to the disclosure requirements in NZ-IFRS to determine the disclosure requirements for Tier 2 for-profit entities? If you disagree with the outcome, please identify, with reasons:**

- a) which disclosures that are identified as requirements that you believe Tier 2 entities should not be required to provide; and**
- b) which disclosures that are identified as concessions that you believe Tier 2 entities should be required to provide.**

We have not been though every disclosure in every standard and assessed it against the proposed RDR-decision making framework and operational guidance. However, overall we believe the current application of the proposed RDR-decision making framework and operational guidance has not resulted in a significant enough reduction in disclosure requirements for Tier 2 entities when compared to Tier 1. Application of the proposed RDR-decision making framework and operational guidance is highly judgemental, as evidenced by differences in the proposals between the NZASB and the AASB. We encourage both boards to revisit the application of the proposed RDR-decision making framework and operational guidance with a greater focus on what is considered to be material and significant.

- 5 Do you agree with the approach taken by the NZASB regarding disclosures about accounting policies? If you disagree, please explain why.**

We agree with this approach.

- 6 Do you agree with the approach taken by the NZASB regarding guidance for disclosure requirements? If you disagree, please explain why.**

We do not support keeping guidance for disclosures where it is of a general nature.

- 7 Do you agree with the approach taken by the NZASB regarding cross-references to other standards that are general rather than specific? If you disagree, please explain why.**

We do not support keeping cross-references where it is of a general nature, as the disclosure will be required by the standard dealing with a specific type of transaction or event.

- 8 Do you agree with the proposal to retain the approach of use of an asterisk (\*) for disclosures that Tier 2 entities are not required to provide and explaining partial concessions by means of an RDR paragraph? If you disagree, please provide, with reasons, an alternative approach for consideration.**

We believe the current approach in New Zealand works well, but we encourage trans-Tasman harmonisation in this regard.

- 9 Do you agree that, once approved, the amended Tier 2 disclosure requirements should be effective for annual periods beginning on or after 1 January 2019 with early application permitted? Early application is permitted for periods beginning on or after 1 January 2018 (with early adoption of the amended Tier 2 disclosures in NZ IAS 40 permitted only when an entity also applies NZ IFRS 16)?**

We agree with the effective date.

- 10 Do you have any other comments on the ED?**

We have no other comments.

## **Appendix B: About Chartered Accountants Australia and New Zealand**

Chartered Accountants Australia and New Zealand is a professional body comprised of over 120,000 diverse, talented and financially astute members who utilise their skills every day to make a difference for businesses the world over.

Members are known for their professional integrity, principled judgment, financial discipline and a forward-looking approach to business which contributes to the prosperity of our nations. We focus on the education and lifelong learning of our members, and engage in advocacy and thought leadership in areas of public interest that impact the economy and domestic and international markets.

We are a member of the International Federation of Accountants, and are connected globally through the 800,000-strong Global Accounting Alliance and Chartered Accountants Worldwide which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.

We also have a strategic alliance with the Association of Chartered Certified Accountants. The alliance represents 788,000 current and next generation accounting professionals across 181 countries and is one of the largest accounting alliances in the world providing the full range of accounting qualifications to students and business.



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25 May 2017

Chief Executive  
External Reporting Board  
PO Box 11250  
Manners St Central  
Wellington 6142

Dear Sir

**NZASB Invitation to Comment on Exposure Draft NZASB 2017-1**

We are pleased to comment on the proposals set out in the NZASB Invitation to Comment *Exposure Drafts NZASB 2017-1: Amendments to RDR for Tier 2 for-profit entities*. Overall we support the Board's efforts to provide a more robust approach for determining reduced disclosure requirements (RDR) for Tier 2 for-profit entities, with a clearer focus on user needs. We generally agree the proposed RDR framework, as outlined in the Policy Statement, will help achieve this result. We have responded to your specific question as per the Invitation to Comment in the appendix attached.

In terms of the proposed disclosures required under the RDR as amended by the ED, we are in agreement with many of the proposed disclosures required under the RDR as amended by the ED. However, we have identified a number of disclosures that have been included under the amended requirements which we believe do not meet the needs of users. Conversely, we have identified a significant number of disclosure requirements not included in the revised RDR that we consider should be so included. Please refer to our submission to the AASB for specific comments on the proposed RDR disclosures and concessions.

Please do not hesitate to contact us should you have any queries. We also would be happy to meet with you to discuss our comments further.

Yours faithfully  
Ernst & Young Limited

Graeme Bennett  
Partner

## Appendix A – Response to specific ITC questions

### 1. Do you agree with the overarching principles on which the proposed RDR decision-making framework is based (that is, user needs and cost-benefit)? If you disagree, please explain why

We agree with the overarching principles on which the RDR decision-making framework is based, namely 'user needs' and 'cost-benefit'. These principles are consistent with the current requirements of the New Zealand Equivalent to the International Accounting Standards Board's (IASB) *Conceptual Framework for Financial Reporting*. We note these overarching principles were those identified and applied, albeit in a different manner, in determining Tier 2 disclosure requirements when the RDR was initially introduced. At that time, these principles were identified as those used by the IASB in determining the disclosures to be required in the *International Financial Reporting Standard for Small and Medium-sized Enterprises (IFRS for SMEs)*, with RDR disclosures being drawn from that standard where recognition and measurement requirements were the same as in NZ IFRS. Where recognition and measurement requirements were not the same, the principles of 'user needs' and 'cost-benefit' were applied directly to the NZ IFRS standard (albeit again with different operational guidance to that outlined in the proposed Policy Statement) to determine what disclosures would be required under RDR.

With the IASB decision not to update IFRS for SMEs for some recent amendments and new IFRS standards, we agree with the Board's proposed amended approach to identifying Tier 2 disclosure requirements, and in particular the application of user needs and cost-benefit as the overarching principles to be applied.

### 2. Do you agree with the two Key Disclosure Areas identified as being essential for meeting user needs? If you disagree with either Key Disclosure Area (including any of the specific disclosures about transactions and other events significant or material to understanding the entity's operations as represented by the financial statements), please explain which one(s) you disagree with and why?

We agree with the two key disclosure areas (KDAs) identified in the proposed Policy Statement, namely (1) current liquidity and solvency of the entity and (2) transactions and other events that are significant or material to an understanding of the entity's operations as represented by the financial statements. We consider the specific areas of disclosure identified for the latter KDA encompass those disclosures related to significant or material transactions or events that are likely to be most useful to users of the financial statements of Tier 2 entities.

We note the framework for RDR decision making is based on a rebuttable presumption that the benefits of providing these disclosures as listed in paragraph 8 of the draft Policy Statement exceed the costs, and that unless the Board rebuts this presumption Tier 2 entities will be required to make these disclosures. Conversely, where a disclosure is not a KDA there is a rebuttable presumption that the costs of providing the disclosures exceed the benefits, and unless the presumption is rebutted Tier 2 entities are not required to make these disclosures.

We consider the use of these rebuttable presumptions is an appropriate basis of operationalising the RDR decision making framework. However, we note the assessment of costs versus benefits, and therefore determining when these presumptions are rebutted, will inevitably involve a degree of judgement.

### 3. Do you agree with the proposed RDR decision-making framework and operational guidance as a whole for determining RDR for Tier 2 for-profit entities? If you disagree, please explain why

With the exception of those matters identified below and in our comments on specific proposed RDR concessions as detailed in our letter to the AASB, we are in agreement with the proposed joint Policy Statement as a whole for determining RDR for Tier 2 entities.

We agree with the principle of maintaining the same presentation requirements under Tier 1 and Tier 2 (with the exception of the presentation of a third statement of financial position). We acknowledge the distinction

between presentation and disclosure will not always be clear and that judgement will be required in such cases. We note the IASB is currently undertaking work on this issue as part of its Principles of Disclosure (POD) project and would encourage the Board to consider the potential impact of the discussion of this matter in their POD Discussion Paper as far as it relates to the distinction for the purposes of the RDR for Tier 2 entities. In the interim, we think the guidance provided in the framework for making this distinction (paragraph 20) is generally sound. We agree with the guidance provided in paragraph 20(d), that where there is an option for provision of information either on the face of the financial statements or in the notes (e.g., NZ IAS 1.106A), this be considered a disclosure requirement and assessed against the RDR decision making framework to determine if the information is included. The choice of where this information is located, with the option to include it in the notes, would seem to suggest that it is not considered to be as key as information that is required to be presented on the face of the financial statements.

We agree that encouraged disclosures should be reduced for Tier 2 entities (paragraph 26) and that reconciliations not be required to be prepared by such entities (paragraph 27). Further, given that NZ IFRS 8 and NZ IAS 33 do not apply to Tier 2 entities, we agree that paragraphs that refer to these two standards should be reduced for such entities. (However, please see our specific comment on NZ IAS 10.22(f)/AASB 110.22(f) in Appendix B of our letter to the AASB.)

We note the discussion of disclosure objectives in paragraphs 21-23 of the Draft Policy Statement distinguishes between (a) those paragraphs that require the entity to disclose information to meet a stated objective, with no specific disclosure requirements (which are reduced for Tier 2 entities), and (b) those paragraphs that contain the disclosure objective only and do not require an entity to provide any disclosures (which are not reduced for Tier 2 entities). We find this distinction to be unclear and therefore confusing. Furthermore, based on the Exposure Draft, there then appears to be a third type of paragraph that contains a disclosure objective but also refers to the disclosures required to meet that objective (e.g., NZ IFRS 15.110), in which case the paragraph is again reduced for Tier 2 entities. We see little difference between this example from NZ IFRS 15 and the requirement in NZ IFRS 16.51 (referred to in footnote 9 on page 11 of the draft Policy Statement) which is proposed to be retained.

As noted, paragraph 23 indicates that disclosure objectives that do not themselves require an entity to provide disclosures are retained for Tier 2 entities. On applying the framework to the specific disclosures required by standards that include such disclosure objectives, it may be possible that some specific disclosures that might be considered necessary to meet the retained objective are actually reduced for Tier 2 entities (e.g., because the costs of providing the disclosure exceed the benefit, or they do not relate to a KDA). In such circumstances, where the specific disclosures are not provided because they are not required for Tier 2 entities, it might be questioned whether the entity can in fact claim compliance with Tier 2 requirements, as it would not have provided sufficient disclosure to meet the objective that remains in the standard. We suggest the Board consider whether this is an unintended consequence of retaining such disclosure objectives for Tier 2 entities.

**4. Do you agree with the outcome of the application of the proposed RDR-decision making framework and operational guidance to the disclosure requirements in NZ IFRS to determine the disclosure requirements for Tier 2 for-profit entities? If you disagree with the outcome, please identify, with reasons:**

**(a) Which disclosures that are identified as requirements that you believe Tier 2 entities should not be required to provide; and**

**(b) Which disclosures that are identified as concessions that you believe Tier 2 entities should be required to provide.**

Please refer to Appendix B of our letter to AASB for our comments on specific disclosure requirements of the RDR.



**5. Do you agree with the approach taken by the NZASB regarding disclosures about accounting policies? If you disagree, please explain why.**

We note the NZASB has decided to retain for Tier 2 entities all disclosures of accounting policies, including the general disclosures required by NZ IAS 1 and NZ IAS 8, as well as the more specific disclosures required within other NZ IFRS. In contrast, the AASB's proposed approach to disclosures of accounting policies relies on the Australian equivalents to NZ IAS 1 and NZ IAS 8. Under this approach, all disclosures about accounting policies contained in any of the other standards are reduced for Tier 2 entities.

We consider that the NZASB's rationale for its approach to accounting policy disclosures as described in paragraph NZ 12.1 of the draft Policy Statement and paragraph 59 of the Invitation to Comment are well founded. We agree that removal of specific disclosures around accounting policies from a standard might be interpreted as a disclosure concession, despite the same specific disclosure being expected or required under the more general accounting policy disclosure requirements in NZ IAS 1 and NZ IAS 8. As such it is possible that inadequate or non-disclosure of accounting policies that are material to an understanding of the entity's financial statements may result. We do not consider the AASB's approach of stating within each standard that the disclosure requirements in NZ IAS 1 and NZ IAS 8 relating to accounting policies apply where relevant, will sufficiently address this possibility. Further, while reducing the accounting policy disclosures from all standards other than NZ IAS 1 and NZ IAS 8, as per the AASB's approach, will reduce certain repetition from the standards, we note that including the abovementioned statement referring to NZ IAS 1 and NZ IAS 8 in each standard will in fact create repetition of information within the standards.

We also note the work of the IASB in relation to disclosure of accounting policies as part of its POD project, and encourage the NZASB to consider in due course the implications of this work on the disclosure of accounting policies by Tier 2 entities.

**6. Do you agree with the approach taken by the NZASB regarding guidance for disclosure requirements? If you disagree, please explain why.**

The NZASB has decided to keep all guidance that relates to disclosures that Tier 2 entities are required to provide, on the basis that the guidance is intended to assist preparers in providing the disclosures. On the other hand, we note the AASB proposes to reduce some of the guidance for disclosures that remain in the RDR, particularly where the guidance is of a general nature and considered to be unnecessary for Tier 2 entities to meet the related disclosure requirements.

We agree with the NZASB's approach. By their nature some entities that qualify to prepare Tier 2 financial statements (e.g., some for-profit private sector entities that do not have public accountability) might be considered to be less sophisticated in terms of the processes and resources available for financial statement preparation, including preparation of the required disclosures. On this basis, any guidance, whether general or specific, that may assist in the preparation of those disclosures would seem to be a useful inclusion in the disclosure requirements for Tier 2 entities. We note that the IASB, in developing the international equivalent standards, considered the guidance in question to be necessary or appropriate to include to assist in preparation of the related disclosures, and as such we do not think it appropriate to remove such guidance from the Tier 2 requirements.

**7. Do you agree with the approach taken by the NZASB regarding cross-references to other standards that are general rather than specific? If you disagree, please explain why.**

The NZASB proposes to keep cross-referencing for Tier 2 entities, while the AASB proposes to remove cross-referencing of a general nature as it considers these to be duplication of disclosure requirements. Paragraph 68 of the Invitation to Comment explains the basis for the NZASB proposal to be that removal of such cross-references to other standards might be misinterpreted as implying that Tier 2 entities are not required to comply with the disclosure requirements in the other standards. In this respect the rationale is similar to that supporting the NZASB's position on accounting policies addressed under matter 5 above. For



similar reasons to those outlined at 5 above, on balance we favour the position taken by the NZASB on this issue, particularly since such a cross-reference would not result in any additional disclosure being required.

**8. Do you agree with the proposal to retain the approach of using an asterisk (\*) for disclosures that Tier 2 entities are not required to provide and explaining partial concessions by means of an RDR paragraph? If you disagree, please provide, with reasons, an alternative approach for consideration.**

We support the NZASB's proposal to retain the current approach of using an asterisk for disclosures that Tier 2 entities are not required to provide, and explaining partial disclosure concessions using an RDR paragraph.

We acknowledge that alternative approaches have certain merits. For example, the AASB's current approach of highlighting/shading those disclosures that are not required for Tier 2 entities in Australia potentially makes RDR concessions more visually obvious as compared to using asterisks, and therefore easier for a user to identify. Alternatively, the AASB's proposed approach of identifying only those disclosures that Tier 2 entities are required to provide in an appendix to each relevant standard, rather than identifying disclosure concessions in the standard itself, has the advantage of enabling Tier 2 entities to see all disclosures that they are required to provide in one location, without any additional disclosures that are not required. However, we note the NZASB's current approach to using asterisks to identify disclosure concessions has been used in New Zealand for over 20 years (initially to identify differential reporting concessions, and since 2012 to identify RDR disclosure concessions), therefore preparers in New Zealand are very familiar with this approach. Thus, a New Zealand preparer is unlikely to overlook a RDR concession because it is marked with an asterisk rather than shaded, or because it is presented as a concession in the main body of the standard together with disclosures that are not required for Tier 2 entities. Furthermore, introducing the AASB's current or proposed approach in New Zealand may in fact cause confusion for preparers due to lack of familiarity, despite the potential merits of these approaches. We therefore support the retention of the NZASB's current approach to identifying RDR concessions.

**9. Do you agree that, once approved, the amended Tier 2 disclosure requirements should be effective for annual periods beginning on or after 1 January 2019, with early application permitted for annual periods beginning on or after 1 January 2018 (with early adoption of the concessions in NZ IAS 40 permitted only when an entity also applies NZ IFRS 16)?**

Given that it is not expected the final standard will be issued until the second half of 2017 at the earliest, we agree with the proposed application date of periods beginning on or after 1 January 2019.

We consider that permitting early adoption for periods beginning on or after 1 January 2018 is acceptable given this implies the earliest financial year end to which the new standard could be applied is 31 December 2018. This has the advantage of providing sufficient lead time for Tier 2 entities to implement the new requirements if they wish to do so early, and also allowing the entity to apply the new requirements at the same time as it first applies NZ IFRS 15 and the amendments to NZ IFRS 7 as a consequence of NZ IFRS 9. We do not recommend moving the early application date to any time before 1 January 2018, as early adoption of the revised Tier 2 disclosures prior to applying NZ IFRS 15 and NZ IFRS 7 as amended by NZ IFRS 9 could cause a mismatch in disclosure requirements.

**10. Do you have any other comments on the ED?**

As mentioned above, please refer to our letter to the AASB for our comments on the specific disclosure requirements and concessions for Tier 2 entities as proposed in the ED.

In terms of additional comments, we note the NZASB's proposed amendments to the RDR framework and disclosures apply only to for-profit entities and not to public benefit entities (PBEs). We understand the principles of users' needs and cost-benefit would also be applicable in the context of identifying RDR

concessions in PBE Standards, and these principles are consistent with the current requirements of the PBE Conceptual Framework. We acknowledge that PBEs differ to for-profit entities in terms of their objectives and, in some cases, their transactions and the information needs of the users of their financial statements. However, we note that several disclosures identified as KDA in the proposed Practice Statement would seem to also be important to users in the PBE space, such as disclosures about accounting policies, significant estimates and judgements, impairment and related parties. Additionally, we note that in Australia, the AASB proposes to apply the amended RDR framework to not-for-profit entities. We therefore believe that it would be beneficial to consider developing an amended framework for identifying RDR disclosures and concessions in PBE Standards, albeit taking into account the inherent differences between PBEs and for-profit entities.

We do not have any additional comments on the draft Policy Statement or accompanying ED.

## Appendix B: Response to Specific Matter for Comment 7

7. Do you agree with the outcome of the application of the proposed joint Policy Statement to the disclosure requirements in Australian Accounting Standards to determine the disclosures that Tier 2 entities should be required to provide? (see Proposed Tier 2 Disclosures) If you disagree with the outcome, please identify, with reasons:
- (a) which disclosures that are identified as requirements that you believe Tier 2 entities should not be required to provide; and
  - (b) which disclosures that are identified as concessions that you believe Tier 2 entities should be required to provide.
- (a) Disclosures that are identified as requirements that we believe Tier 2 entities should not be required to provide

Reference	Comment
AASB 1.27A	Reference to updating reconciliations required by paragraph 24 should be removed as these reconciliations are not required under RDR.
AASB 101.61	While we agree that the disclosure (the amount expected to be recovered or settled after more than 12 months for each asset and liability line item) relates to a KDA (current liquidity and solvency) we question whether the benefits of providing the information would exceed the costs as stated in the analysis. We therefore suggest that this paragraph continue to be excluded under RDR.
AASB 101.80A	While we agree that the disclosure (reclassification of puttable instruments) relates to a KDA (current liquidity and solvency) we question whether the benefits of providing the information would exceed the costs as stated in the analysis. We therefore suggest that this paragraph continue to be excluded under RDR.
AASB 112.81(c)	We question whether reference to Tax Transparency rules is an appropriate basis for justifying retention of the reconciliation, as these disclosures serve a different purpose. Also, it is not clear if the benefits of providing this disclosure would exceed the costs in this case. If excluded under RDR this would also require that paragraphs 84 and 85 also be removed.
AASB 119.139(a)(ii)	While we agree that the level of any minimum funding requirements is a KDA relating to commitments and contingencies, we do not believe that the description of the regulatory framework in which the plan operates and the asset ceilings would fall within this and do not agree that the benefits of providing these disclosures would exceed the cost.
AASB 119.146	We consider the disclosures relating to the asset liability matching strategies used by the plan or the entity could be very onerous for Tier 2 entities and hence do not agree that the benefits of providing the disclosure would exceed the costs.
AASB 138.126	We question whether the benefits of disclosing the aggregate amount of research and development expenditure recognised as expense exceed the costs. We therefore suggest that this paragraph continue to be excluded under RDR.

- (b) Disclosures that are identified as concessions that we believe Tier 2 entities should be required to provide

*Disclosures we believe are needed for Tier 2 entities:*

Reference	Comment
AASB 3.B64(f)	We question why the presumption is rebutted that the benefit of disclosing the breakdown of the fair value of the consideration would exceed the cost given similar disclosure for the assets and liabilities acquired under paragraph B64(i) is required for Tier 2 entities.
AASB 3.B67(a)	We question why the disclosures relating to measurement period adjustments are not considered to be a KDA (the nature of the transaction or event makes it significant or material to the entity) in a similar manner to disclosures related to prior period errors under AASB 108.49, and therefore required by Tier 2 entities.
AASB 7.18(a)	We question whether the costs of disclosing defaults during the period would exceed the benefits of doing so. Management will know if the entity defaulted during the year, with details of such defaults providing information to users of potential financial difficulty. Such information would appear to fall within the KDA of liquidity and solvency.
AASB 7.23F	We question whether this information on forecast transactions no longer expected to occur would be costly to provide as it would be readily available. It provides valuable insights into hedging strategies, which themselves relate to managing business risks, which is a KDA.
AASB 13.93(d) and 93(h)(ii)	These disclosures relate to providing information about inputs to Level 3 fair value measurements and sensitivity to changes in unobservable inputs to such measurements. As such we question whether it is correct to regard these disclosures as not being a KDA; that is, they may be considered to relate to a 'significant estimate or judgement specific to a transaction or event'. Also, the comment in the Analysis Copy of ED 277 for paragraph 93(d) seems to suggest that it is reduced for Tier 2 entities in its entirety; however only the latter part of the paragraph is shaded.
AASB 15.116-118	We understand the contract balances disclosures were designed as a cost-benefit trade off to require disclosure of some information that would otherwise be included in a reconciliation, but without requiring a full numerical reconciliation to be prepared. While noting that the RDR framework proposes not to require reconciliations for Tier 2 entities (paragraph 27), it also notes that the individual items of the reconciliation should be assessed against the RDR framework. Each of the line items specified in the paragraph 116-118 disclosure are intended to provide more information about the entity's performance and movements in its working capital position (see AASB 15.BC341-BC342). Some of this information could be regarded as being useful in assessing both performance and liquidity. For this reason we think that at least some of this disclosure should be reconsidered for inclusion in RDR.
AASB 15.129	Disclosure of the practical expedients applied is proposed to be reduced for Tier 2 entities. We consider that this should be viewed as part of the accounting policy disclosure rather than a discrete disclosure requirement, and therefore falls within a KDA.
AASB 16.B52	For a sale and leaseback there can be a fine line between a financing and a derecognition. As such, the business reasons for achieving sale provides useful information to users. Such information would be readily available as it relates to the company's decisions. As such we question whether the cost of providing the disclosure would exceed the benefits.

Reference	Comment
AASB 110.22(f)	Major ordinary share transactions of a Tier 2 entity would be a significant subsequent event, and therefore relate to a KDA irrespective of the fact that AASB 133 does not apply to such entities. We suggest that only the bracketed sentence referring to AASB 133 be removed for Tier 2 entities.
AASB 112.81(e) & AASB 112.82	As the amounts disclosed may effectively be related to impairment, we consider that the disclosure would relate to a KDA. Further, this disclosure has added importance where amounts relate to foreign tax provisions where different conditions (e.g., finite carry forward period) to those in Australia may apply.
AASB 112.81(f)	This disclosure relates to a key tax risk, especially with BEPS / other cross border tax issues, and as such would relate to a KDA.
AASB 119.141(a),(b)	We consider the income statement impact (current service cost and interest income or expense) relating to defined benefit plans are a KDA owing to the nature of the transaction or event that makes it significant to the entity. This is similar to the disclosure of the defined contribution expense for the period under paragraph 53. Hence we believe this disclosure should be retained for Tier 2 entities, albeit not required to be provided as part of the reconciliation referred to in paragraph 140.
AASB 136.130(f)(i)	The requirement to disclose the level in the fair value hierarchy in which the fair value measurement of the asset/CGU is categorised has been reduced on the basis that the costs exceed the benefits, but subsequently disclosures relating to fair values are required by paragraph 130(f)(iii) if they are in Level 2 or 3 of the hierarchy. As such the entity would need to determine the level in the hierarchy and the cost of disclosing it would be negligible.
AASB 136.134(e)	We question why the disclosures relating to determination of recoverable amount based on fair value are not required while disclosures that might be considered similar in nature relating to the determination of value in use are required under paragraph 134(d).
AASB 141.54(a)	We do not think that the removal of this disclosure makes sense. In our view it would not be useful to provide an explanation of why fair value of a biological asset cannot be measured (paragraph 54(b)) but not disclose what type of biological asset it relates to (paragraph 54(a)). Therefore this disclosure should be retained.
AASB 1055.6	We do not agree with the proposal to remove the requirement for disclosure of the budgeted statement of profit or loss and other comprehensive income. This provides insights to users on the operating performance/budgeted opex, which we consider would be of critical importance to users of public sector entities' budgeted information. As such we consider the benefits of disclosing this information would exceed the costs.
AASB Interpretation 129.6(d),(e)	We consider that disclosures relating to service concession arrangements should include the details of changes to the arrangement and how it has been classified, which provides important information to users for which we would expect benefits to exceed the costs of providing the information.

*Disclosures we are of mixed views and therefore the Board might wish to reconsider for Tier 2 entities:*

Reference	Comment
AASB 1.26	While we understand that this is considered to be guidance relating to the reconciliations required by paragraph 24, which are now removed for Tier 2 entities, we believe including disclosure relating to correction of prior period errors ought to be considered, consistent with AASB 108.

Reference	Comment
AASB 1.32-33	Paragraph 32 refers back to paragraph 23, which is required for Tier 2 entities, but applies only to annual financial statements. Given that few disclosures required by AASB 134 are removed under RDR we would expect that it is made clear that the base requirements of paragraph 23 apply also to interim financial statements. Similarly for paragraph 33.
AASB 6.25	We suggest that the highlighted text in this paragraph, 'and make the disclosures required by either AASB 116/NZ IAS 16 or AASB 138/NZ IAS 38 consistent with how the assets are classified' should not be removed for Tier 2 entities. We recognise its removal complies with the stated principle of removing general cross-references. (See our comment on this point under Specific Matter 6 in Appendix A.) However, there is considerable debate for exploration and evaluation assets as to which standard should govern their subsequent measurement and presentation/disclosure; i.e., AASB 116 or AASB 138. As such, we consider this text provides useful guidance on this matter.
AASB 7.22C	This disclosure relates to an important change relating to hedging introduced by AASB 9. The costs of disclosing this information shouldn't be high as the entity has completed the work needed to achieve hedge accounting, and it provides users with a better understanding of the entity's hedging strategies.
AASB 7.42A-42H	We believe that there should be some level of disclosure under RDR for transfers of financial assets. There often is a fine line between recognising borrowings and derecognising receivables which can make a significant difference on matters such as gearing. Providing these disclosures allows users to obtain an understanding of an entity's derecognition/transfer activities.
AASB 12.21(a)(ii)	This is an example of general guidance that we believe would be of assistance to Tier 2 entities in preparing their financial statements. (Refer to our comments on Specific Matter 5 in Appendix A.)
AASB 12.23(b)	As noted in Appendix A under Specific Matter 6, we consider that cross-referencing to other standards does not require any additional disclosure and that removal of such cross-references could result in confusion.
AASB 15.119(c)	We think that principal vs agent assessments represent a significant judgement that can have a material impact on the revenues and costs of an entity. As such we believe that a description of 'the nature of goods or service that the entity has promised to transfer, highlighting any performance obligations to arrange for another party to transfer goods or services (ie if the entity is acting as an agent)' fall under a KDA (significant estimates and judgments specific to a transaction or event).
AASB 15.B87	This paragraph introduces the application guidance in B88-B89. Deleting B87 will not remove disclosure burden, but it may make reading the disclosure requirements more confusing (unless B88-B89 is co-located with the paragraph 114 disaggregation of revenue requirement in the proposed RDR Appendix to AASB 15).
AASB 15.C8(a)	We do not agree with the proposal to remove the disclosure of the current period trend information when the modified retrospective transition option is chosen (i.e., the financial statement line item amounts for the current period on the basis that existing revenue standards had still applied). Although this disclosure may not strictly represent a KDA for assessing liquidity/solvency or as a significant transaction/event, this disclosure provides users with trend information to be able to assess performance between the prior year and current year in circumstances where the modified retrospective transition method is applied. This might suggest that the key disclosure areas (which do



Reference	Comment
	not seem to focus directly on financial performance) do not completely capture the user information needs identified on page 6 of the preface to ED 277.
AASB 16.B51(a),(b) & (d)	We question whether this information would be costly to provide as an entity would have views on why they are providing residual value guarantees. Further, as this represents guidance on the application of paragraph 51 we believe it is beneficial for such guidance to be kept for Tier 2 entities. See our response to Specific Matter 5 in Appendix A.
AASB 101.78	Removal of the guidance in this paragraph seems counterintuitive considering the nature of many Tier 2 entities. Additional guidance, such as that provided here by cross referencing to other standards, is likely to be of use to such entities. Refer to our comments on Specific Matters 5 and 6 in Appendix A; this is an example of the more general points raised therein.
AASB 101.131	This is a further example of general guidance that we believe would be of assistance to Tier 2 entities in preparing their financial statements.
AASB 110.13	This is a further example of where we consider removal of a general cross reference to be potentially confusing. It could be taken in isolation to imply that disclosure of the dividend in the notes is not required.
AASB 110.18	Removal of the general guidance provided in this paragraph seems unnecessary. If relevant to Tier 1 entities it would appear to be equally relevant to Tier 2 preparers.
AASB 116.77(b)	We consider that there is significant benefit to users in understanding whether an independent valuer has been involved in determining a valuation, and that the cost of providing such disclosure would be minimal.
AASB 119.135	This is a specific instance of where we consider that removal of the paragraph requiring disclosures to meet a stated objective would potentially be confusing to preparers given that certain disclosures under paragraphs 139 and 140-144 as referred to here are still required to be disclosed by Tier 2 entities.
AASB 121.52(b)	We consider the removal of this disclosure could potentially lead to confusion by implying that it does not need to be disclosed, when it is required by AASB 101.106. This is also an example of where the distinction between presentation and disclosure might be considered to be somewhat blurred.
AASB 124.16, 22	This is a further example of where we consider removal of general guidance is not serving the best interests of Tier 2 preparers.
AASB 134.15A	We consider that this paragraph provides useful guidance on the nature of the disclosures required and should be retained for Tier 2 entities.
AASB 140.75(e)	Consistent with our comment above on AASB 116.77(b), we believe that there is benefit to users in understanding whether an independent valuer has been involved in determining a valuation, and that the cost of providing such disclosure would be minimal.
AASB 141.53	We consider that this paragraph provides useful guidance to Tier 2 entities on the disclosure of risks associated with agricultural activity (a KDA), and therefore should be retained.

29 May 2017

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Dear Warren

## **Exposure Draft NZASB 2017-1 Amendments to RDR For Tier 2 For-Profit Entities**

We appreciate the opportunity to comment on the exposure draft *Amendments to RDR For Tier 2 For-Profit Entities* (ED NZASB 2017-1).

We are pleased that the NZASB has developed a proposed decision-making framework (the framework) to guide the determination of disclosure concessions for the Tier 2 Reduced Disclosure Regime (RDR). An appropriate framework should contribute to more appropriate concessions being provided, concessions being consistent across the suite of standards, and a better balance of the costs and benefits of financial reporting.

While the ED is only relevant to Tier 2 for-profit entities, we strongly encourage the NZASB to develop a similar framework as a priority that would apply to the selection of disclosure concessions to the Public Benefit Entity (PBE) Tier 2 RDR. We are concerned that the different underlying approaches to the selection of disclosure concessions between the proposed for-profit Tier 2 and existing PBE Tier 2 Frameworks may result in unnecessary differences and complexity for preparers, users, and auditors involved with both for-profit and PBE Tier 2 entities.

Our responses to the Questions for Respondents outlined in the *Invitation to Comment* are attached. Our Tax Director will provide a separate submission to you on matters identified on the outcome of the framework to NZ IAS 12 *Income Taxes*.

In preparing this submission, we have also consulted with our colleagues at the Office of the Auditor-General.



If you would like to discuss any of our comments, please phone me on 021 222 6107 or email me at [robert.cox@auditnz.govt.nz](mailto:robert.cox@auditnz.govt.nz).

Yours sincerely

A handwritten signature in blue ink that reads "Robert Cox". The signature is written in a cursive, slightly stylized font.

Robert Cox  
Head of Accounting

## Our responses to the questions in the Invitation to Comment

- 1 **Do you agree with the overarching principles on which the proposed RDR decision-making framework is based (that is, user needs and cost-benefit)? If you disagree, please explain why.**

We agree with the proposed overarching principles. However, we recommend the framework explain the definition of financial statement users that was used in developing and applying the framework.

- 2 **Do you agree with the two Key Disclosure Areas identified as being essential for meeting user needs? If you disagree with either Key Disclosure Area (including any of the specific disclosures about transactions and other events significant or material to understanding the entity's operations as represented by the financial statements), please explain which one(s) you disagree with and why?**

No, we do not fully agree with the two Key Disclosure Areas and make the following comments.

We are concerned that wording of the first Key Disclosure Area as **current** liquidity and solvency may put too much focus on short term information and excludes appropriate focus on longer term financial viability. Users are particularly interested in any information that may provide insights into future prospects, as well as information about future financial viability (such as maturity dates for borrowings) and this important information is potentially removed by the implied short term (that is, current) focus of this Key Disclosure Area.

We recommend that this Key Disclosure Area be renamed along the lines of "Liquidity, solvency and ongoing financial viability of the entity".

We are also unclear why the Boards consider that risks, associated accounting policies and significant estimates and judgements are essential for meeting user needs for the second Key Disclosure Area (transactions and events), but not the first (liquidity and solvency). We urge the Boards to reconsider this or at least explain their rationale why these matters are not equally important to both Key Disclosure Areas.

- 3 **Do you agree with the proposed RDR decision-making framework and operational guidance as a whole for determining RDR for Tier 2 for-profit entities? If you disagree, please explain why.**

Other than our comments in response to question 2 above, we agree with guidance as a whole.

For greater clarity, we recommend additional guidance be added to the framework to reinforce that preparers of financial statements must still exercise judgement in determining whether a disclosure without a disclosure concession should be made on materiality grounds. This is consistent with paragraph 31 of NZ IAS 1 *Presentation of Financial Statements*. Without such guidance, there is the risk that preparers think that all disclosures must be made that do not have a disclosure concession, regardless of the materiality of the disclosure to the entity.

- 4 **Do you agree with the outcome of the application of the proposed RDR-decision making framework and operational guidance to the disclosure requirements in NZ**

**IFRS to determine the disclosure requirements for Tier 2 for-profit entities? If you disagree with the outcome, please identify, with reasons:**

*Which disclosures that are identified as requirements that you believe Tier 2 entities should not be required to provide?*

We have not identified any requirements that Tier 2 entities should not be required to provide.

*Which disclosures that are identified as concessions that you believe Tier 2 entities should be required to provide?*

We provide comments of detail on certain disclosure concessions we disagree with that are proposed for NZ IFRS 7 *Financial Instruments: Disclosures* and NZ IAS 16 *Property, Plant and Equipment*.

- NZ IFRS 7 – Liquidity risk disclosures

We agree with the Boards that the liquidity risk disclosures of NZ IFRS 7 paragraph 39 are a Key Disclosure Area. However, we disagree that all the disclosures of this paragraph should be a disclosure concession. The rationale given for the disclosure concession for 39(a) and (b) is that the costs of providing the disclosure exceed the benefits.

We disagree with the Boards proposed disclosure concession for IFRS 7 paragraph 39(a). We consider the maturity analysis for financial liabilities, excluding derivatives, required by paragraph 39 (a) provides important information about an entity's liquidity and solvency. Without such information, we consider it could be difficult to adequately assess the liquidity and solvency (and ongoing financial viability) of an entity. We are also not persuaded that the preparation of this information is likely to be costly. The liquidity information for most tier 2 entities should be readily constructed from information on hand.

We are also concerned that as a consequence of the concession provided by paragraph 39(a), that no future cash flow information would be provided about lease liabilities recognised that would arise from the future adoption of NZ IFRS 16 *Leases*. The lease liabilities for some Tier 2 entities could be significant under NZ IFRS 16 and we consider the information could be important for users.

We agree that a disclosure concession be provided from preparing a maturity analysis for derivatives because preparing this information can be complex and costly. Treasury systems may be required to produce such information, or entities may not be able to access such information easily to disaggregate the undiscounted value of derivatives into relevant time periods. We therefore support the disclosure concession for IFRS 7 paragraph 39(b).

- NZ IAS 16 – Valuation disclosures

We disagree with removing the requirement in paragraph 77(a) and (b) for Tier 2 entities to disclose the effective date of the valuation and whether an

independent valuer was involved. We consider this important information for public sector entities (both for profit and public benefit entities).

We disagree that the costs of providing this disclosure exceeds the benefits. These disclosures should be simple for Tier 2 entities to prepare with negligible cost.

- 5 **Do you agree with the approach taken by the NZASB regarding disclosures about accounting policies? If you disagree, please explain why.**

We do not have any concerns with the NZASB's proposed approach.

- 6 **Do you agree with the approach taken by the NZASB regarding guidance for disclosure requirements? If you disagree, please explain why.**

We do not have any concerns with the NZASB's proposed approach.

- 7 **Do you agree with the approach taken by the NZASB regarding cross-references to other standards that are general rather than specific? If you disagree, please explain why.**

We do not have any concerns with the NZASB's proposed approach.

- 8 **Do you agree with the proposal to retain the approach of using an asterisk (\*) for disclosures that Tier 2 entities are not required to provide and explaining partial concessions by means of an RDR paragraph? If you disagree, please provide, with reasons, an alternative approach for consideration.**

We agree with the NZASB's proposed approach. Users of the accounting standards are familiar with this approach and we are not aware of any broader concerns about the current approach to identifying RDR concessions.

- 9 **Do you agree that, once approved, the amended Tier 2 disclosure requirements should be effective for annual periods beginning on or after 1 January 2019, with early application permitted for annual periods beginning on or after 1 January 2018 (with early adoption of the concessions in NZ IAS 40 permitted only when an entity also applies NZ IFRS 16)?**

We agree the mandatory effective date of 1 January 2019 should provide Tier 2 for-profit entities sufficient time to prepare for the amended RDR.

- 10 **Do you have any other comments on the ED?**

We have no further comments.

29 May 2017

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Warren Allen  
Chief Executive  
External Reporting Board  
PO Box 11250  
Manners St Central  
Wellington 6142

Dear Warren

**Exposure Draft NZASB 2017-1 Amendments to RDR For Tier 2 For-Profit Entities**

We appreciate the opportunity to comment on the exposure draft *Amendments to RDR For Tier 2 For-Profit Entities* (ED NZASB 2017-1).

The focus of this submission is to provide comments on the outcome of the application of the proposed decision marking framework to NZ IAS 12 *Income Taxes* (question 4 of the Invitation to Comment).

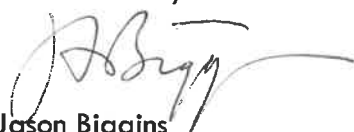
We disagree with certain proposed RDR changes as they remove useful information from the tax note. We do not consider that the cost of providing these disclosures exceeds the benefits. Most of the required tax disclosure are summaries of the underlying tax calculations. They should not be difficult to prepare, and they provide useful information to help the reader understand the tax balances.

The Audit New Zealand website includes a tax calculation and disclosure example, which may be a useful reference resource. This spreadsheet shows how the figures in the tax note are drawn from the underlying tax calculations.

Detailed comments on the proposed disclosure concessions for NZ IAS 12 are attached.

If you would like to discuss any of these comments, please call me on 021 222 4001 or email me at [Jason.Biggins@auditnz.govt.nz](mailto:Jason.Biggins@auditnz.govt.nz).

Yours sincerely



Jason Biggins  
Tax Director

## Response to Question 4 in the Invitation to Comment

**Do you agree with the outcome of the application of the proposed RDR-decision making framework and operational guidance to the disclosure requirements in NZ IFRS to determine the disclosure requirements for Tier 2 for-profit entities? If you disagree with the outcome, please identify, with reasons:**

***Which disclosures that are identified as requirements that you believe Tier 2 entities should not be required to provide?***

### *Paragraph 81(c)*

Paragraph 81(c) requires a reconciliation from tax on accounting profit to tax expense. This reconciliation can be the most challenging section of the tax note, and is often not as informative as the other sections of the tax note.

The logic in the staff analysis paper for not including this as a concession is incorrect. The information provided to IRD about assessable income is not the same as that required to be disclosed by paragraph 81(c). The calculation of assessable income is used to determine the figure for current tax expense. However, this is only one of the components of tax expense. The figure for tax expense also includes prior period adjustments and movements in relation to deferred tax.

It should also be noted that the figure for current tax expense disclosed in the financial statements is only an estimate of the tax liability that will be included in the tax return. The current tax calculation will generally be amended or refined before the tax return is filed. The information disclosed in the tax note reconciliation is of no interest to the IRD.

It could be argued that the costs of preparing the disclosure required by paragraph 81(c) outweigh the benefits. You may wish to consider providing a disclosure concession in relation to paragraph 81(c).

### *Paragraph 81(g)(ii)*

Paragraph 81(g)(ii) requires the amount of deferred tax recognised in profit or loss for each type of temporary difference and for unused tax losses. The total of these adjustments agree to the deferred tax movements disclosed in the components of tax expense. However, the amounts for each type of temporary difference or for tax losses would often be manually calculated, and are not particularly informative.

It could be argued that the costs of preparing the disclosure required by paragraph 81(g)(ii) outweigh the benefits. You may wish to consider providing a disclosure concession in relation to paragraph 81(g)(ii).

***Which disclosures that are identified as concessions that you believe Tier 2 entities should be required to provide?***

*Paragraphs 79 and 80*

It is proposed that the disclosure of the major components of tax expense would not be required under RDR.

This disclosure provides useful information to the readers about the main components of the tax expense balance for the year, such as current tax expense, prior period adjustments, and deferred tax movements. There should generally be no additional cost in producing this information as the components are determined in accounting for tax expense in the financial statements.

*Paragraph 81(e)*

It is proposed that the disclosure of information about unrecognised temporary differences and unrecognised tax losses would not be required under RDR.

This disclosure provides useful information to readers about balances that may be of benefit to the entity in future. For example, it may indicate whether an entity could potentially pay tax in the near future, or whether tax losses were available for transfer to other entities in the group. This information would also be required for consolidation purposes, as unrecognised deferred tax asset in certain subsidiaries can often be recognised at a group level. Additionally, there should be negligible cost in disclosing this information as the figures come directly from the underlying deferred tax calculation, and the disclosure itself is usually only one or two lines of text.

*Paragraph 81(g)(i)*

It is proposed that the disclosure of information about the main components of the deferred tax balance would not be required under RDR.

This disclosure provides useful information to help the reader understand the deferred tax balance. For example, it would disclose whether the deferred tax liability primarily related to property, plant and equipment or other adjustments. It would highlight whether the entity has recognised a deferred tax asset in relation to tax losses. It would also show deferred tax liabilities that were offset by deferred tax assets for entities that disclosed a net deferred tax balance of zero. There should be negligible cost in disclosing this information as the figures come directly from the underlying deferred tax calculation.



09 June 2017

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Dear Warren

### **Exposure Draft 2017-1: Amendments to RDR for Tier 2 For-profit Entities**

CPA Australia welcomes the opportunity to respond to the above Consultation. CPA Australia represents the diverse interests of more than 160,000 members in 118 countries. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders. We make this submission on behalf of our members and in the broader public interest.

CPA Australia commends the New Zealand Accounting Standards Board (NZASB) and the Australian Accounting Standards Board (AASB) for their efforts to develop the proposals in the Consultation. We highlight below some key issues for consideration and we also provide our responses to the specific questions.

If it has not already done so, we suggest the NZASB undertake pilot testing of the proposed RDR framework with entities that may be considering adopting it, and with entities that are already applying the existing RDR framework to assist the NZASB in assessing whether the project's objectives are likely to be fulfilled.

### **International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)**

We note the reservations stated in the proposals about using the IFRS for SMEs Standard as the basis for RDR standard-setting going forward. Although the IFRS for SMEs has not been updated since the issue of some new accounting standards, it provides for simplified disclosure requirements, as well as simplified recognition and measurement requirements. We suggest the NZASB and the AASB reconsider their stance regarding using the IFRS for SMEs as a basis for reporting requirements for Tier 2 entities. It is notable that despite its limitations, the United Kingdom has successfully adopted and modified the IFRS for SMEs in developing Financial Reporting Standard 102 that is applicable to qualifying SMEs.

### **The use of the rebuttable presumption when considering Key Disclosure Areas (KDA)**

We note that there are a number of instances throughout the RDR standards when there has been a decision to depart from the KDA on the basis that either costs exceed benefits or vice versa. However, we have been unable to identify any specific evidence that supports the decision to depart from the KDA within the ED or the accompanying Staff Analysis. As the NZASB has an evidence based approach to standard-setting we suggest the NZASB provides the evidence that formed the basis for the decision to depart from the KDA.

### **Disclosure Initiative – Principles of Disclosure Discussion Paper**

The International Accounting Standards Board has recently issued a consultation proposing principles for disclosure within International Financial Reporting Standards (IFRS). Whilst we appreciate that the RDR project is "self-contained" we suggest the NZASB considers the IASB's proposed principles of disclosure in finalising its revised RDR framework.



**Specific responses to questions raised**

In response to question 1, we agree with the overarching principles on which the RDR decision-making process is based. However, we recommend the term “user needs” is further elaborated upon within the framework so it better informs both the NZASB and preparers. In response to questions 2 to 10 we are supportive of the proposals and do not have any other comments.

If you require further information on any of our views expressed in this submission, please contact Ram Subramanian, CPA Australia by email at [ram.subramanian@cpaaustralia.com.au](mailto:ram.subramanian@cpaaustralia.com.au) or 03 9606 9755.

Yours sincerely



**Dr Eva Tsahuridu**  
Manager – Accounting Policy



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3 July 2017

Dear Warren

**Exposure Draft NZ ASB 2017-1: Amendments to RDR for Tier 2 For-Profit Entities**

Thank you for the opportunity to comment on the proposed *Amendments to RDR for Tier 2 For-Profit Entities* (ED NZ ASB 2017-1).

Overall we agree with the proposed RDR Framework and the outcome of its application to identifying disclosure concessions. Our submission focuses primarily on the overarching principles of the proposed RDR Framework, although we have also commented on certain specific proposed disclosure concessions.

We have also commented on the RDR concession concerning the exemption to prepare consolidated financial statements in NZ IFRS 10. We note that this concession is not specifically addressed in the ED. However, we are concerned that that this concession will mean that in some cases the top New Zealand company will not be required to prepare consolidated financial statements and that users may not receive full information about the entity in which they have an interest.

Our responses to the questions raised in the Invitation to Comment are contained in the Appendix to this letter.

*Further Information*

Please do not hesitate to contact me (Simon Lee) on 04 816 4678 if you would like to discuss our submission in greater detail.

Yours sincerely

**Simon Lee**  
National Technical Director

**Simon Wilkins**  
Partner



## Appendix

Question	KPMG Comments
<p><b>1.</b> Do you agree with the overarching principles on which the proposed RDR decision making framework is based (that is, user needs and cost-benefit)? If you disagree, please explain why.</p>	<p>We agree with the overarching principles on which the RDR framework is based, being ‘user needs’ and ‘cost-benefit’.</p> <p>However, we believe that some guidance or examples to illustrate or explain the type of factors the NZ Accounting Standards Board will consider when assessing ‘cost-benefit’ and ‘user needs’ would be useful to assist readers in understanding the basis on which RDR concessions are granted.</p> <p>We also note that decisions on RDR concessions are determined at an overall level. However, materiality is entity specific. We therefore suggest that the RDR Framework clarify how the RDR Framework interacts with materiality assessment at the entity level. Our preference is that it be made clear within the RDR Framework that, notwithstanding that certain disclosure concessions are provided under the RDR Framework, preparers of financial statements are still responsible to ensure that financial statements include disclosures necessary for users to understand the impact of material/significant events and transactions on the financial performance and position of an entity.</p> <p>We also note that the XRB is in the process of performing research on user needs for Tier 2 entities. We consider that the interaction between the ‘cost-benefit’ and ‘user needs’ is a key aspect of the Framework, and hence the outcome of this research is fundamental to the Framework.</p>
<p><b>2.</b> Do you agree with the two Key Disclosure Areas identified as being essential for meeting user needs? If you disagree with either Key Disclosure Area (including any of the specific disclosures about transactions and other events significant or material to understanding the entity’s operations as represented by the financial statements), please explain</p>	<p>We generally agree with the Key Disclosure Areas identified – being information about:</p> <ul style="list-style-type: none"> <li>(i) Current liquidity and solvency; and</li> <li>(ii) Transactions and other events that are significant or material to an understanding of the entity’s operations.</li> </ul> <p>We note that paragraphs 28(b)(i) – (iv) appear to be principle based, and paragraph 28(b)(v) – (viii) lists specific types of transactions. Other transactions, such as business acquisitions, business and asset disposals, share-based payments and the issue of complex financial instruments could impact the liquidity and solvency of an entity and also be material to understanding an entity’s operations.</p> <p>In our view, this second group of specific disclosures is not necessarily an exhaustive list of transactions or events that would require disclosure. If these specific items are retained we suggest that additional explanation be provided as to why these items</p>



Question	KPMG Comments
which one(s) you disagree with and why?	have been separately specified within the RDR Framework. One approach would be to reflect these items in the RDR Framework as examples of the types of transactions that might be caught under paragraphs 28(a) and (b)(i) – (iv).
<b>3.</b> Do you agree with the proposed RDR decision-making framework and operational guidance as a whole for determining RDR for Tier 2 for-profit entities? If you disagree, please explain why.	<p>In general we agree with the operational guidance provided.</p> <p>However, we disagree with the proposal in paragraph 39 which states that the paragraphs that require an entity to meet a stated disclosure objective should be reduced. In the absence of additional explanation, this may cause confusion for preparers in terms of whether they need to provide any of the specific disclosure requirements (which may not be reduced), as they are 'exempted' from the entire disclosure objective. Unless the entire disclosure requirement section (i.e. including the objective and specific disclosure requirement paragraphs that follow) is reduced, we believe objective paragraphs should be retained for Tier 2 entities and additional guidance provided for Tier 2 entities (please see point 4 below).</p>
<b>4.</b> Do you agree with the outcome of the application of the proposed RDR-decision making framework and operational guidance to the disclosure requirements in NZ IFRS to determine the disclosure requirements for Tier 2 for-profit entities? If you disagree with the outcome, please identify, with reasons: a) which disclosures that are identified as requirements that you believe Tier 2 entities should not be required to provide; and b) which disclosures that are identified as concessions that you believe Tier 2 entities should be required to provide.	<p>Our submission focusses primarily on the overarching principles of the proposed RDR Framework. Overall we agree with the outcome of the application of the RDR-decision making framework. However, we note the following matters with regard to the specific RDR concessions.</p> <p><i>Disclosure objectives</i></p> <p>As noted above, it is proposed to provide RDR concessions with respect to disclosure objective paragraphs included in a number of standards. For example the amendments propose to include RDR concessions in respect of NZ IFRS 2.44, NZ IFRS 3.59, NZ IFRS 5.30, NZ IFRS 7.7, and NZ IFRS 13.91.</p> <p>In our view, entities should not be exempt from these disclosure objectives. Rather the disclosure objectives should be met by RDR entities making the disclosures required for RDR entities. This seems to be the objective of NZ IAS 1 RDR15.1 which states that the application of NZ IFRS RDR, with additional disclosure where necessary, is presumed to result in financial statements that achieve a fair presentation.</p> <p>We suggest that no disclosure concession be provided in respect of the disclosure objectives in the standards and that the RDR paragraph be amended to clarify that in respect of a Tier 2 entity the disclosure objective will be met when an entity complies with the RDR disclosures required by the standard, with additional disclosures where necessary.</p>



Question	KPMG Comments
	<p><i>Other</i></p> <p>NZ IAS 36.134 includes an RDR concession in respect of CGUs whose recoverable amount is based on fair value (NZ IAS 36.134(e)). However, there is no RDR concession in respect of CGUs whose recoverable amount is based on value in use (NZ IAS 36.134(d)). Both paragraphs relate to disclosures regarding recoverable amount. However, one is considered a Key Disclosure Area and the other is not. Given the similarity of the disclosures required by these sub-paragraphs the difference in RDR status is not clear to us and a consistent approach would seem preferable.</p>
<p><b>5.</b> Do you agree with the approach taken by the NZASB regarding disclosures about accounting policies? If you disagree, please explain why.</p>	<p>We agree with the approach proposed by the NZASB with respect to accounting policies.</p> <p>We specifically consider that the inclusion of the disclosures about accounting policies should be driven by the same principles which drive the decision to retain or reduce the various disclosures within each accounting standard.</p>
<p><b>6.</b> Do you agree with the approach taken by the NZASB regarding guidance for disclosure requirements? If you disagree, please explain why.</p>	<p>We agree with the approach taken by the NZASB regarding guidance for disclosure requirements.</p>
<p><b>7.</b> Do you agree with the approach taken by the NZASB regarding cross-references to other standards that are general rather than specific? If you disagree, please explain why.</p>	<p>We agree with the approach proposed by the NZASB regarding cross-references to other standards.</p>
<p><b>8.</b> Do you agree with the proposal to retain the approach of using an asterisk (*) for disclosures that Tier 2 entities are not required to provide and explaining partial concessions by means of an RDR paragraph? If you disagree, please</p>	<p>We agree with the proposal to retain the use of an asterisk for disclosures that Tier 2 entities are not required to provide, and partial concessions made using an RDR paragraph.</p> <p>The use of asterisk and supplementary RDR paragraphs is well understood in New Zealand. Furthermore we are not aware of any issues that would necessitate a change of approach.</p>



Question	KPMG Comments
provide, with reasons, an alternative approach for consideration.	
<p><b>9.</b> Do you agree that, once approved, the amended Tier 2 disclosure requirements should be effective for annual periods beginning on or after 1 January 2019, with early application permitted for annual periods beginning on or after 1 January 2018 (with early adoption of the concessions in NZ IAS 40 permitted only when an entity also applies NZ IFRS 16)?</p>	<p>We agree with the proposed effective date of 1 January 2019.</p> <p>We suggest that NZ ASB clarify whether entities can early adopt the proposed RDR concessions on disclosure by disclosure basis, a standard by standard basis, or as a whole.</p>
<p><b>10.</b> Do you have any other comments on the ED?</p>	<p>We note that the ED does not consider the RDR concession set out in NZ IFRS 10 RDR 4.1 regarding the exemption to prepare consolidated financial statements. We understand that no change is proposed in respect of this concession as this concession relates to the scope of NZ IFRS 10, rather than disclosures.</p> <p>However, we believe that application of the concession provided in NZ IFRS 10 RDR 4.1 means that certain entities will not be required to prepare consolidated financial statements. We are concerned that certain users will not receive consolidated financial statements and hence full information about the entity in which they have an interest.</p> <p>Every company that has one or more subsidiaries is required to prepare group financial statements that comply with generally accepted accounting practice [CA 1993, section 202(1)]. The Financial Reporting Act 2013, section 7, defines group financial statements as:</p> <p>“...the statements for the group as at the balance date, or in relation to the accounting period ending at the balance date, that are required to be prepared in respect of the group by <u>an applicable financial reporting standard</u>...” [emphasis added]</p>



Question	KPMG Comments
	<p>NZ IFRS 10 (being an applicable financial reporting standard) requires an entity that is a parent to present consolidated financial statements. However, the scope of NZ IFRS 10 is limited such that entities are not to prepare consolidated financial statements if four conditions are all met (NZ IFRS 10.4).</p> <p>Tier 2 RDR entities are exempt from one of the criteria to apply the scope exemption. Specifically, in order to qualify for the exemption RDR entities do not have to meet the criteria that their ultimate parent produces consolidated financial statements that are available for public use and comply with NZ IFRS [NZ IFRS 10.4(a)(iv)]</p> <p>Consider the following scenario:</p> <ul style="list-style-type: none"> <li>▪ Company A is a large company and a 100% owned subsidiary of an overseas company.</li> <li>▪ Company A has three subsidiaries in NZ.</li> <li>▪ Company A is therefore required to prepare general purpose financial statements under the Companies Act 1993.</li> <li>▪ Assume also that Company A qualifies to report as a Tier 2 entity under the RDR Reporting Framework.</li> <li>▪ Company A meets the first three scope exemptions set out in NZ IFRS 10.4.</li> </ul> <p>In this case Company A is required to prepare group financial statements in accordance with the Companies Act 1993, section 202(1), and these financial statements are required to comply with generally accepted accounting practice.</p> <p>Therefore, in the scenario described above, we believe that it is possible to interpret the requirements of the Companies Act and NZ IFRS 10 such that Company A could apply the RDR exemption in NZ IFRS 10.4, and not prepare group financial statements.</p> <p>We agree that it is not necessary that RDR entities have a parent or ultimate parent that produces <u>publicly available</u> consolidated financial statements. However, we believe that the top company in NZ should be required to prepare consolidated financial statements where such a company is required to prepare general purpose financial statements. If our interpretation is correct then we suggest that the XRB reconsider the exemption and/or clarify NZ IFRS 10.RDR4.1. We note that the scenario detailed above also applies in respect of NZ IAS 28.17(d), where an entity may therefore apply an exemption to the application of the equity method for investments in associates in the same manner in which it may apply the consolidation exemption. We therefore recommend that the XRB consider the operation of these two items together.</p>

**From:** Jeromy Meerman <[Jeromy.Meerman@fma.govt.nz](mailto:Jeromy.Meerman@fma.govt.nz)>  
**Date:** 12 June 2017 at 1:53:34 PM NZST  
**To:** David Bassett <[David.Bassett@xrb.govt.nz](mailto:David.Bassett@xrb.govt.nz)>  
**Subject:** RE: RDR proposals - FMA submission

Dear David,

As discussed, FMC reporting entities that report under Tier 2 are market services license holders. There are approximately 150 FMC reporting entities that report using tier 2. This includes:

- Fund Managers
- Large DIMS providers
- Licensed supervisors
- Peer-to-peer and crowd funding platform operators.

The policy behind why they are required to report is to because they supervise, take or administer public funds and should be accountable to the public for their duties. Some smaller licensees (e.g. small DIMS) have been exempted from those requirements.

They are considered to have lower public accountability because they don't have investor funds on their balance sheet.

We haven't considered the detailed proposals. However, we're comfortable with the overall policy framework and key disclosure areas. In particular:

- To the extent they require disclosure around the solvency and liquidity of the entity. This is important for the public to see the ability of the licensee to continue to provide them services. It is also useful because these entities often have license conditions relating to solvency.
- To the extent that they require related party disclosures – as many licensees maybe depending on the support of related parties to provide certain funding and services, it's material information due to the nature of RP relationship as well as terms and nature of those transactions.

Happy to discuss,

Jeromy

**Jeromy Meerman** Principal Adviser, Capital Markets Disclosure

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**EXTERNAL REPORTING BOARD**

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*Te Kāwai Ārahi Pūrongo Mōwaho*

## **Policy Approach to Developing the Suite of PBE Standards**

September 2013

Approved by the XRB Board for application by the New Zealand  
Accounting Standards Board from 1 October 2013

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## Preface

1. In May 2013, the New Zealand Accounting Standards Board (NZASB) issued the PBE Standards – a new suite of standards for Tier 1 and Tier 2 public benefit entities. That initial set of standards, developed in accordance with the External Reporting Board's (XRB Board's) Accounting Standards Framework, can be regarded as the "foundation suite" of PBE Standards. It is expected that the foundation suite will be enhanced and developed over time.
2. This Policy Approach paper has been developed by the XRB Board and the NZASB to assist the NZASB in making consistent decisions when developing the suite of PBE Standards i.e. when considering enhancements and developments to the suite of PBE Standards in the future.
3. While primarily based on International Public Sector Accounting Standards, the foundation suite of PBE Standards was developed using a range of source standards: International Public Sector Accounting Standards, selected NZ IFRSs and domestic standards developed within New Zealand. Developments are likely to arise from each of these sources as changes are made to the international standards and as issues specific to New Zealand emerge.
4. Without a policy such as this, it would be possible for significant fluctuations in the NZASB's approach to developing the suite of PBE Standards to emerge over time. This Policy Approach paper therefore provides constituents with some certainty about the likely future direction of the PBE Standards suite, and provides a basis for assessing proposals for changes to the PBE Standards as they are issued by the NZASB. It also assists constituents to understand the likely implications of future changes to the PBE Standards suite for public benefit entities (PBE) groups containing for-profit entities (commonly referred to as "mixed groups").

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# Summary

## The Development Principle

In accordance with the Accounting Standards Framework, the primary purpose of developing the suite of PBE Standards is to better meet the needs of the PBE user groups (as a whole). In considering whether to initiate a development, the NZASB shall consider the following factors:

- (a) Whether the potential development will lead to higher quality financial reporting by public sector PBEs and not-for-profit entities, including public sector PBE groups and not-for-profit groups, than would be the case if the development was not made; and
- (b) Whether the benefits of a potential development will outweigh the costs, considering as a minimum:
  - (i) *relevance to the PBE sector as a whole*: for example, where the potential development arises from the issue of a new or amended IFRS, whether the type and incidence of the affected transactions in the PBE sector are similar to the type and incidence of the transactions addressed in the change to the NZ IFRS;
  - (ii) *relevance to the not-for-profit or public sector sub-sectors*: whether there are specific user needs in either of the sub-sectors, noting that IPSAS are developed to meet the needs of users of the financial reports of public sector entities;
  - (iii) *coherence*: the impact on the entire suite of PBE Standards (e.g. can the change be adopted without destroying the coherence of the suite);
  - (iv) *the impact on mixed groups*; and
- (c) In the case of a potential development arising from the issue of a new or amended IFRS, the IPSASB's likely response to the change (e.g. whether the IPSASB is developing an IPSAS on the topic).

## Application of the Development Principle

The paper includes a series of rebuttable presumptions in applying the development principle:

- (a) The NZASB will adopt a new or amended IPSAS.
- (b) The NZASB will not include an NZ IFRS that the IASB has issued on a new topic in the suite of PBE Standards unless the IPSASB addresses the issue.
- (c) In considering a change to an NZ IFRS that relates to a topic for which there is an existing PBE standard based on an IPSAS, the NZASB shall consider the factors in the development principle in determining whether to initiate a development of the PBE Standards. Particular emphasis in this case needs to be placed on the IPSASB's likely response to the change.
- (d) The NZASB will not incorporate minor amendments to NZ IFRS into the equivalent PBE Standard in advance of the IPSASB considering the change.

# 1. Introduction

1. This paper addresses the approach to developing and enhancing the suite of PBE Standards, now that the transition suite for public sector PBEs is completed. References to PBEs in this paper include references to all PBEs: public sector PBEs and not-for-profit entities, and public sector PBE groups and not-for-profit groups.
2. Triggers for possible changes to the standards are likely to come from three sources:
  - (a) the IPSASB issuing a new IPSAS or a change to an existing IPSAS (section 4.1);
  - (b) the IASB issuing a new IFRS or a change to an existing IFRS (section 4.2); and
  - (c) domestic developments within New Zealand, including both exogenous events such as changes to the legislative framework and endogenous events where the NZASB considers that developments are warranted (section 4.3).
3. This paper considers the implications of the Accounting Standards Framework for developing the suite of PBE Standards and identifies an approach to be taken for each of the triggers for possible changes to PBE Standards.

## 2. Basis for Development of PBE Standards

4. The multi-standards approach in the Accounting Standards Framework is designed to better meet the needs of users of the financial statements of PBEs. In its decision to base the development of standards for Tier 1 and Tier 2 entities on IPSAS, the XRB Board decided the following:
  149. The XRB therefore proposes that a set of PBE Accounting Standards (PAS) be developed and that they use IPSAS as their base. PAS would modify IPSAS for any recognition, measurement or disclosure matters considered inappropriate in the New Zealand context at this time. Such modifications would only be made where the IPSAS requirement in question would have a material impact on the financial position or performance being reported, and that impact would adversely detract from the financial statements' usefulness to users. Based on work to date, the number of modifications is expected to be relatively few.
  150. The XRB also proposes that PAS include other relevant standards (including domestic standards) appropriate for New Zealand and/or to address topics not covered in IPSAS.
  151. Thirdly, the XRB proposes PAS be modified to make them relevant, applicable and understandable to not-for-profit sector preparers and users. This is necessary because IPSASB has developed IPSAS for public sector entities. Some modification is desirable to enhance their usefulness in the not-for-profit context.(Accounting Standards Framework, paragraphs 149 – 151)
5. This paper uses the term 'development' to encompass any change to the suite of PBE Standards.
6. In considering the appropriateness of potential developments of the suite of PBE Standards, it is necessary to consider these developments in the context of the Accounting Standards Framework, including the impact of any developments on the quality of the financial reporting arising from those standards and the trade-off between the benefits of improvements in the quality of the resulting financial reports and the associated costs.

### 2.1 Quality of Financial Reporting

7. The suite of PBE Standards is designed to meet users' needs by providing high quality financial reporting by PBEs. It follows that any development of PBE Standards should aim to improve the quality of financial reporting. The quality of financial reporting relies on meeting the needs of users of PBE general purpose financial reports (including financial statements), while endeavouring to ensure that the costs arising from a development do not outweigh the benefits.
8. In this context, high quality financial reporting is assessed by reference to the conceptual framework for PBEs (as it applies from time to time), with primary emphasis on the objective of financial reporting and then the qualitative characteristics. A standard is more likely to lead to higher quality financial reporting if it adheres closely to the conceptual framework.
9. The categories of users of financial statements of PBEs and for-profit entities are different. The IASB's emerging Conceptual Framework identifies users of IFRS as

suppliers of resources to the entity, and notes that the decisions that they make are related to providing resources to the entity.<sup>1</sup>

10. In contrast, the IPSASB considers that the objective of financial reporting is to serve a wider group of users, being resource providers and service recipients and their representatives. The IPSASB notes that information is needed for both accountability and decision-making purposes<sup>2</sup>.
11. A development of the suite of PBE Standards will improve the quality of financial reports prepared in compliance with PBE Standards if it improves the accounting for specific transactions by better meeting the objective of financial reporting and the associated qualitative characteristics of financial reporting.
12. Further, high quality financial reporting depends on consistent treatment of similar transactions. For example, it would usually be inappropriate to require different measurement for similar liabilities in similar circumstances. As a result, any development of PBE Standards (including the conceptual framework for PBEs) should ensure that the suite is maintained as a coherent whole.
13. It follows that any developments should ensure that the needs of users are better met than they were prior to the development. Alternatively, the cost-benefit test (see next section) may be met where the needs of users are equally as well served, with a consequent benefit in some other way such as a reduction in the costs of preparing the financial statements.

## 2.2 Costs and Benefits

14. In considering a potential development of the suite of PBE Standards, the primary purpose and benefit is to improve the information provided to users of PBE financial statements.
15. Benefits need to be considered in relation to the suite of standards as a whole, in addition to the implications for a specific area of financial reporting. The benefit of aligning the PBE Standards with NZ IFRS to the extent possible is that this will reduce differences between the financial statements of PBEs and for-profit entities. This benefit is particularly relevant to entities that are members of mixed groups<sup>3</sup> and users of PBE financial statements whose familiarity with financial statements arises from experience in the for-profit sector. However, for other preparers that are not part of a mixed group, there may be additional preparation costs as a result of changes in accounting standards that might not otherwise arise.
16. The PBE Standards are largely based on IPSAS in accordance with the Accounting Standards Framework and, therefore, careful consideration is required before making any change to a PBE standard based on an IPSAS in circumstances other than as a consequence of the IPSASB issuing a new or amended IPSAS (as

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<sup>1</sup> New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting 2010*, paragraph OB2.

<sup>2</sup> IPSASB, *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*, January 2013, paragraphs 2.1–2.4.

<sup>3</sup> For the purposes of this paper, a mixed group is a PBE group that includes at least one material for-profit subsidiary where that for-profit subsidiary applies accounting policies that differ from those of the mixed group and that may need to be adjusted under the consolidation standards.



discussed further below in paragraph 28). In addition, the benefit of using IPSAS to the extent possible is that IPSAS are a suite of standards that comprise a coherent package. It also reduces standard-setting costs as the IPSASB documents are readily available for application in New Zealand with little additional work. Reducing the time spent on setting the base standards releases resources for working with the international standard setters and for necessary domestic projects.

17. In developing a coherent suite of PBE Standards, it will generally be relatively low cost to add additional guidance for all PBEs, or for sub-groups of PBEs such as not-for-profit entities. However, it is expected that recognition and measurement requirements will be common to all PBEs. Further, using recognition and measurement requirements developed from a number of sources creates the potential for inconsistencies within the suite of PBE Standards, such as applying different measurement requirements to similar liabilities. Care should be taken to minimise the impact of such inconsistencies, if they cannot be eliminated.
18. At times, there is a tension between reducing the costs borne by preparers within mixed groups – that is the elimination of differences between PBE Standards and NZ IFRS that are not sector-specific – and improving the suite of PBE Standards taken as a whole. This policy takes the view that reducing the costs on preparers within mixed groups should be considered to the extent that these costs can be reduced whilst meeting the needs of the wider range of users of financial statements of public sector PBEs and not-for profit entities (including public sector and not-for-profit groups) through a complete and coherent suite of PBE Standards.

### 3. The Development Principle

19. In accordance with the Accounting Standards Framework, the primary purpose of developing the suite of PBE Standards is to better meet the needs of PBE user groups (as a whole). In considering whether to initiate a development, the NZASB shall consider the following factors:
- (a) Whether the potential development will lead to higher quality financial reporting by public sector PBEs and not-for-profit entities, including public sector PBE groups and not-for-profit groups, than would be the case if the development was not made; and
  - (b) Whether the benefits of a potential development will outweigh the costs, considering as a minimum:
    - (i) *relevance to the PBE sector as a whole*: for example, where the potential development arises from the issue of a new or amended IFRS, whether the type and incidence of the affected transactions in the PBE sector are similar to the type and incidence of the transactions addressed in the change to the NZ IFRS;
    - (ii) *relevance to the not-for-profit or public sector sub-sectors*: whether there are specific user needs in either of the sub-sectors, noting that IPSAS are developed to meet the needs of users of the financial reports of public sector entities;
    - (iii) *coherence*: the impact on the entire suite of PBE Standards (e.g. can the change be adopted without destroying the coherence of the suite);
    - (iv) *the impact on mixed groups*; and
  - (c) In the case of a potential development arising from the issue of a new or amended IFRS, the IPSASB's likely response to the change (e.g. whether the IPSASB is developing an IPSAS on the topic).
20. The NZASB will need to exercise its judgement in balancing the factors in the development principle because, in many cases, there will need to be a trade-off between these factors. This policy provides a basis for making such a trade-off decision: it cannot replace the application of judgement by the NZASB with a series of bright-line rules.

## 4. Application of the Development Principle

21. The following sections are designed to assist in the application of the factors in the development principle. They consider, in turn, potential developments of the suite of PBE Standards that might arise from developments in IPSAS and NZ IFRS as well as addressing issues that might arise within New Zealand. Although this paper treats each of these developments separately, it is likely that specific developments will need to be considered from a number of perspectives. For example, the NZASB may have planned to continue to update PBE IAS 34 *Interim Financial Reporting* in line with developments of NZ IAS 34 *Interim Financial Reporting* to retain consistent interim reporting across all sectors (section 4.2). However, if the IPSASB were to issue a standard addressing interim reporting, this new IPSAS would be considered as a development resulting from an enhancement to IPSAS (section 4.1).

### 4.1 New or Amended IPSAS

22. **There is a rebuttable presumption that the NZASB will adopt a new or amended IPSAS. It is expected that such changes will lead to higher quality financial reporting by PBEs in New Zealand and the factors in the development principle are presumed to be met.**
23. This rebuttable presumption is based on the expectation that the IPSASB has considered the needs of the wide range of users of public sector financial statements in developing and enhancing the suite of IPSAS.
24. Depending on the circumstances, it may be appropriate to amend a recently issued or newly amended IPSAS in the process of adoption in New Zealand. Examples of possible amendments include:
- (a) improving the quality of the IPSAS in the New Zealand context by, for example, adding guidance to enable not-for-profit entities and public sector PBEs to apply the standard consistently or adding guidance to assist not-for-profit entities in applying the standard, given that the standard has been developed for application by public sector PBEs;
  - (b) amendments necessary to maintain the coherence of the suite of PBE Standards;
  - (c) excluding options that are not relevant in the New Zealand context; or
  - (d) amending the scope of an IPSAS if the IPSAS conflicts with a legislative requirement, or a legislative requirement addresses the same issue for public sector entities. However, in these circumstances, it may be appropriate to adopt the IPSAS for not-for-profit entities.

## 4.2 New or Amended NZ IFRS

25. New or amended NZ IFRS will require the NZASB to consider whether to initiate a development of the PBE standards in the following circumstances:<sup>4</sup>
- (a) an IFRS that the IPSASB has used as the basis for an IPSAS is changed;
  - (b) the IASB issues an IFRS on a new topic; and
  - (c) there is a change to an NZ IFRS that has been used as the basis for a PBE Standard<sup>5</sup>.

### 4.2.1 An IFRS that the IPSASB has used as the basis for an IPSAS is changed

26. As noted earlier, the PBE Standards are primarily based on IPSAS. In turn, many IPSAS are primarily based on IFRS. Examples of such standards are PBE IPSAS 16 *Investment Property* and PBE IPSAS 17 *Property, Plant and Equipment*, which are based on IAS 40 *Investment Property* and IAS 16 *Property, Plant and Equipment*, respectively. Accordingly, there are likely to be many instances in which a new or amended NZ IFRS relates to a topic covered by an existing IPSAS standard that has been incorporated into the PBE standards.
27. **In considering a change to an NZ IFRS that relates to a topic for which there is an existing PBE standard based on an IPSAS, the NZASB shall consider the factors in the development principle in determining whether to initiate a development of the PBE Standards. Particular emphasis in this case needs to be placed on the IPSASB's likely response to the change.**
28. Given the presumption in paragraph 22 that any standard issued by the IPSASB will be included in the PBE Standards, there are considerable potential costs and risks associated with "getting ahead of the IPSASB". Therefore, the NZASB needs to decide whether to develop a PBE standard ahead of the IPSASB or to wait for the IPSASB's response. If the issue is already on the IPSASB's active work plan, the NZASB would normally wait for the IPSASB to complete its work, unless the NZASB is of the view that there is an urgent need for action in New Zealand or the NZASB is of the view that the IPSAS is unlikely to be appropriate in the New Zealand context.
29. **Furthermore, in the case of minor amendments to an NZ IFRS, there is a rebuttable presumption that the change should not be incorporated into the equivalent PBE Standard in advance of the IPSASB considering the change.** This is because minor amendments are less likely to meet the cost-benefit test, particularly when the potential costs and risks associated with getting ahead of the IPSASB are taken into account.

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<sup>4</sup> An amendment to an NZ IFRS can fall into more than one of the above categories, for example, an NZ IFRS on a new topic might also result in changes to other NZ IFRS that fall into category (a) and/or (c).

<sup>5</sup> The NZ IFRS applying to PBEs were "frozen" in 2011, pending the establishment of the XRB and the anticipated development of PBE Standards. The "frozen" NZ IFRS that the NZASB has included in the PBE Standards are PBE IFRS 3 *Business Combinations*, PBE IFRS 4 *Insurance Contracts*, PBE IFRS 5 *Non-current Assets Held For Sale and Discontinued Operations*, PBE IAS 12 *Income Taxes* and PBE IAS 34 *Interim Financial Reporting*, together with NZ IFRIC 12 *Service Concession Arrangements* and NZ-SIC 29 *Service Concession Arrangements: Disclosures* (which are the basis for PBE IFRS 45 *Service Concession Arrangements: Operator*).

30. Where there is a major change to an IFRS for which there is an existing IPSAS and where the IPSASB is unlikely to address the change in an acceptable time frame, the NZASB could either develop a domestic modification to the PBE Standard or assist the IPSASB to develop an IPSAS. Options for assisting the IPSASB include offering to provide staff resources for the IPSASB or partnering with the IPSASB to update a specific IPSAS in the light of the major change. It may be more effective to assist the IPSASB because any uncertainties about the IPSASB's approach to the issue will be resolved sooner rather than later. However, the level of effort required to develop an IPSAS based on an IFRS for international use is likely to be significantly higher than developing a PBE Standard based on an IFRS or its equivalent NZ IFRS for use in New Zealand. The IPSASB's due process, multi-constituency reach and less regular meetings leads to a standards development process for the IPSASB that is more time consuming and complex.

#### *4.2.2 The IASB issues an IFRS on a new topic*

31. An example of a new topic is where the IASB is considering issuing a standard on rate-regulated activities.
- 32. There is a rebuttable presumption that the NZASB will not include an NZ IFRS that the IASB has issued on a new topic in the suite of PBE Standards unless the IPSASB addresses the issue.**
33. As noted in paragraph 35, some NZ IFRS were included in the suite of PBE Standards to maintain current practice until the IPSASB addresses the related issues. This rationale does not apply to an NZ IFRS on a new topic. Also, given the PBE standards are primarily based on IPSAS in accordance with the Accounting Standards Framework, adding further PBE standards based on NZ IFRS is unlikely to be consistent with the objectives of that Framework.
34. In considering whether to rebut the presumption, the NZASB should consider whether the new standard both leads to a major improvement in the quality of financial reporting and fills a gap in the suite of PBE Standards (as distinct from a gap in NZ IFRS). This is unlikely to arise.

#### *4.2.3 An NZ IFRS that the NZASB has included in the PBE Standards is changed*

35. The NZASB has included selected "frozen" NZ IFRS in the suite of PBE Standards (see footnote 5) in order to maintain current practice until the IPSASB addresses the related issues.
- 36. In considering a change to an NZ IFRS that is included in the suite of PBE Standards, the NZASB shall consider the factors in the development principle in determining whether to initiate a development of the PBE Standards.**
37. However, in situations where there is no equivalent IPSAS on the topic and the IPSASB is not expected to create such a standard in the foreseeable future, the IPSASB's likely response to the change would be less relevant. This will impact on the overall assessment of the costs and benefits of including the NZ IFRS development in the PBE standards. This is because the potential problems

associated with “getting ahead of the IPSASB” (as discussed in paragraph 28 above) are less likely to arise.

38. An implication of this policy is that those PBE Standards based on a “frozen” NZ IFRS (see footnote 5) may need to be updated to align with the current equivalent NZ IFRS.

### 4.3 Domestic Developments

39. Domestic developments include developing standards to meet specific requirements in New Zealand.
40. The suite of PBE Standards contains standards directly addressing issues relevant to New Zealand, including PBE FRS 42 *Prospective Financial Statements* and PBE FRS 43 *Summary Financial Statements*. Further domestic standards may be developed where a need arises when an issue of importance in New Zealand is not addressed in a standard issued by the IPSASB (section 4.1) or the IASB (section 4.2).
- 41. In determining whether to initiate the development of a domestic standard for inclusion in the PBE suite, the NZASB will consider the factors in the development principle. Assuming the NZASB determines that the development of a domestic standard would improve the quality of financial reporting by PBEs, the NZASB will first consider whether there is an international pronouncement addressing the relevant issue that is applicable in the New Zealand context.**
42. The Accounting Standards Framework presumes that New Zealand will be a standards-taker rather than a standards-maker whenever possible, for a range of reasons, including:
- (a) the quality derived by an international due process;
  - (b) the prospect of international comparability; and
  - (c) the limited resources available for the domestic development of standards.
43. It follows that the NZASB will develop domestic standards or guidance that result in a material improvement in information available to users of financial statements when:
- (a) there is no other source of material available internationally; or
  - (b) the available international guidance is not targeted specifically towards addressing New Zealand issues.

Results: SPFR Framework Survey

Special Purpose Financial Reporting Framework for use by For-Profit Entities

Number of participants: 206

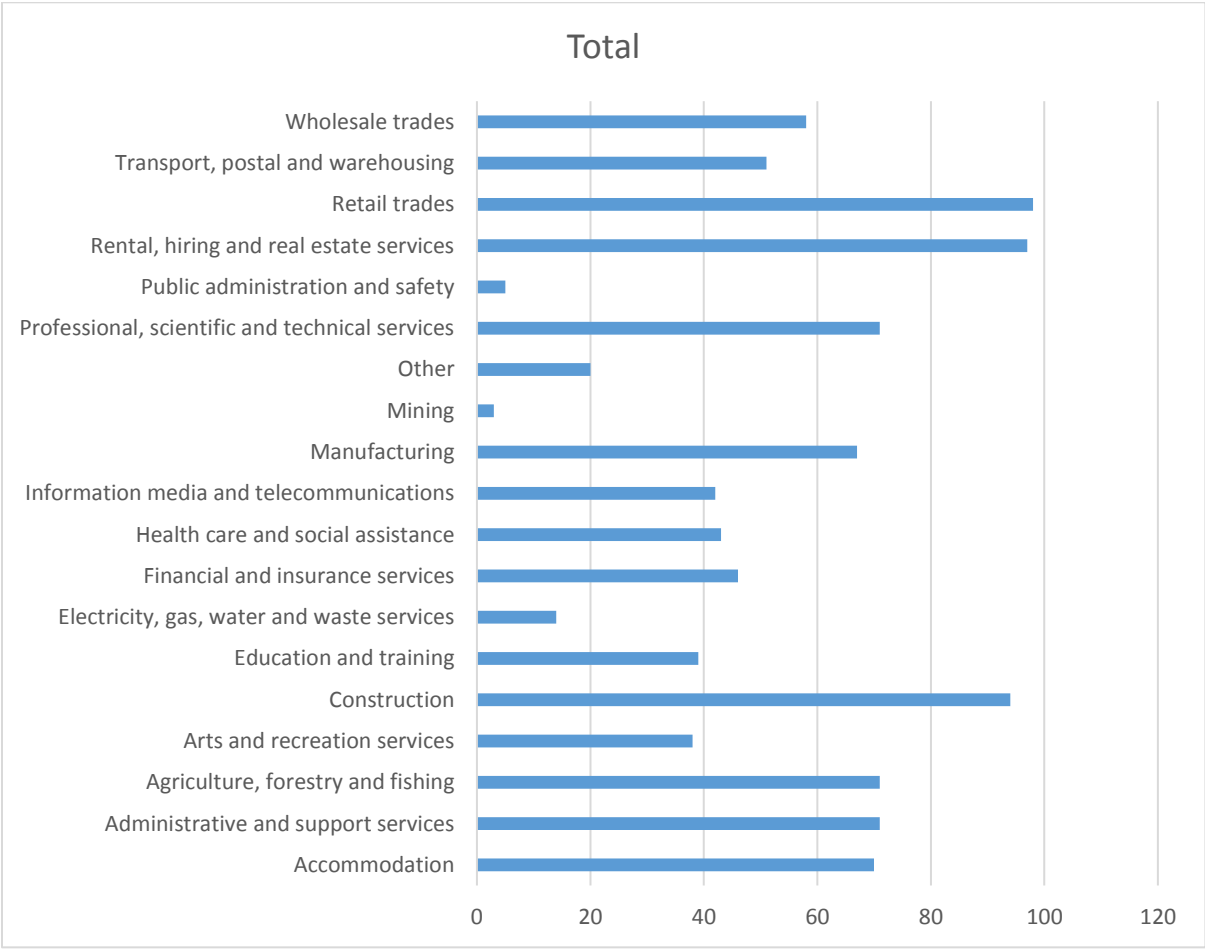
Q2 - When preparing special purpose financial statements, do you use the optional special purpose financial reporting guidance we issued — A Special Purpose Financial Reporting Framework for use by For-Profit Entities (SPFR for FPEs)?

75% yes

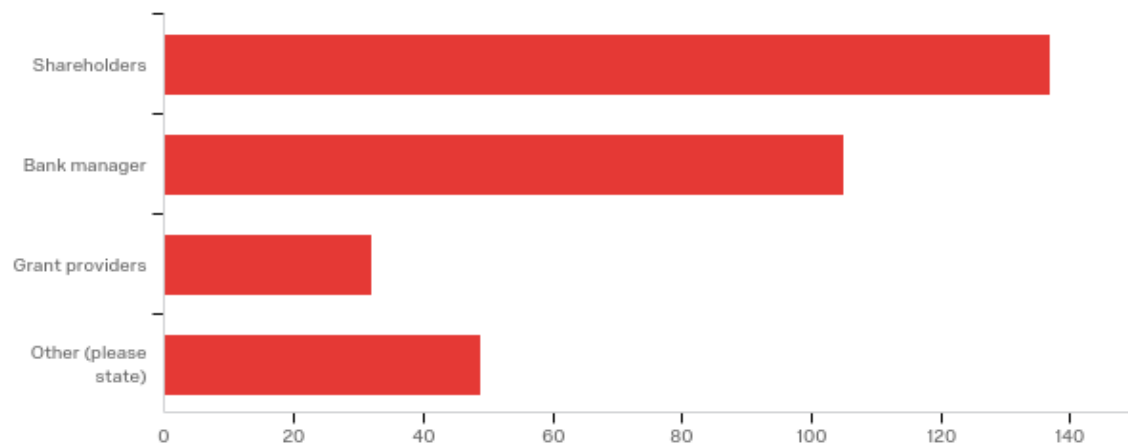
Q8 - What other frameworks do you use?

- A blend of NZICA, XRB and IR
- Accounting software model financial statements
- Compliance with entity's rules or founding document
- Hayes Knight (templates)
- Tier 3 and 4 reporting for Charities
- Relevant old GAAP principles Financial Reporting Order IFRS
- Society Office guidelines

Q3 - What industry/profession are the entities in for which you are preparing special purpose financial statements?



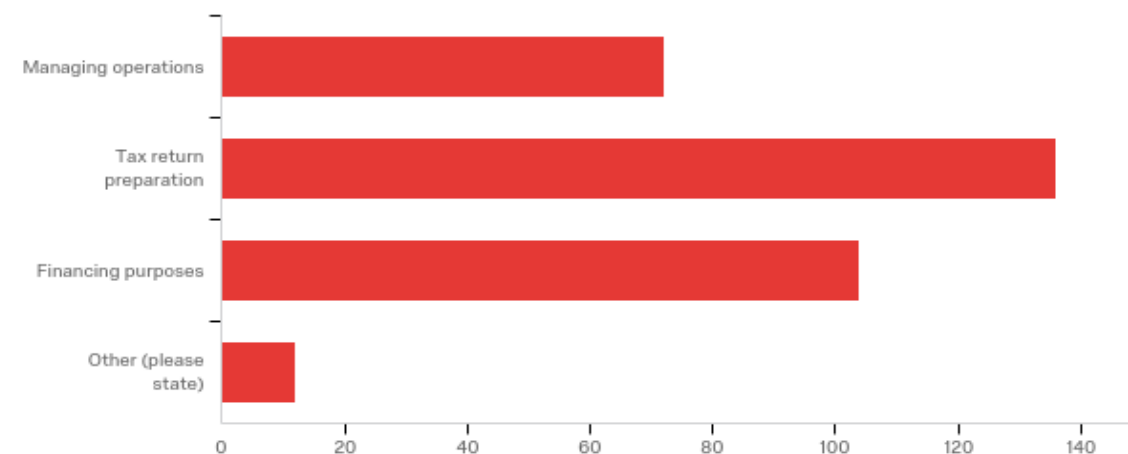
#### Q4 - Who are the users of the special purpose financial statements?



#### Other identified users include:

- Prospective purchasers
- IRD
- Government stakeholders
- Mortgage brokers
- Suppliers
- Lawyers – for relationship issues

#### Q5 - What are the special purpose financial statements used for?



#### Other identified uses:

- Business buy/ sell,
- Insurance for turnover
- Grants / charities services
- Trust Deed Compliance
- Audit compliance



## Q6 - What feedback have you received from the users of the special purpose financial statements that you think we need to know?

Overwhelming response that clients are happy with the reporting, but the language could be simplified.

Majority felt that clients are really just wanting to know what their tax obligations are and the status of the P&L and Balance Sheet. Very few interested in the other notes.

Some banking covenants requirement is GAAP

Examples of other comments:

*"They don't understand them, the profession produces financial statements in a language that clients don't speak really...they are largely dis-engaged about financial statements and I wonder if there wasn't a Tax Department whether many would even do them...and perhaps one day that's the real risk that cash reporting will rule the day for SME's".*

*"Mainly the users of the special purpose reports have a management interest in the organisation and therefore often will use internal management reports instead, or are financiers who have the ability to request all of the additional information they need for their purposes, therefore most users don't actually rely on the information in the reports".*

*"happy with the format , all positive , we sell the format as being superior to the most basic ird approved format , used by bookkeepers"*

*"Align well with old GAAP and provide a good framework for entities to follow who don't 'fit' anywhere with the new reporting regimes but who wish to/need to report properly- it would be good if use of this was encouraged more by CAANZ to avoid so many 'special purpose prepare what you like' situations."*

There appears to be confusion with some of our members over when the optional SPFR should be used:

*"Tier 4 reporting for Charities has been very time consuming, cash basis is of questionable merit , format is excessively prescriptive"*

*"For some, the requirements are over the top, excessive and add to the cost of compliance - residential body corporates (unit titles) immediately come to mind. Despite being deemed 'for profit' such entities are better suited to a simplified not -for-profit regime. Another group are small businesses."*

*"For small businesses the notes to the accounts add extra cost to the client, however I feel add no value. Even though I go through the Financial Statements with all of my clients at their annual meeting, they only read the Profit and Loss and Balance Sheet. As they are all on Xero, they are up to date with these anyway. Abridged Financial Statements for businesses under a certain size would be desirable."*

## Q7 - What areas of SPFR for FPEs do you find difficult to apply in practice?

62% of respondents felt that they were not too difficult, although many noted that there were still a lot of notes that they felt “cluttered” reporting unnecessarily.

Main areas noted were:

**Equity** - enhancing the illustrative example of movements in equity and how it links to the balance sheet

**Group / business combinations** - Framework doesn't appear well designed for group structures, how do you deal with equity investments? More guidance on consolidations is needed. Found that whether consolidation is a requirement or not for large multi entity groups is hard to identify. Some guidance in this area would be helpful especially in common situations where the costs of consolidation would out way the benefits.

**Related Party – comments were** - Difficult to identify all related parties and getting sufficient information from clients

**Goodwill – comments were** - Impractical to assess goodwill annually

**Need to Opt up** - to NZ IFRS RDR for investments, livestock etc as the SPFR use of reserves is old school

**Investments at market value** - have opted out

## Q9 - Are there any other areas of SPFR for FPEs which could be amended to improve its usefulness?

- **Goodwill** - Would be better to allow for the option of Goodwill to be recorded at cost with an appropriate note. Maybe within a \$ parameter of say under \$500,000.
- **Consolidation** - Allowance to not consolidate but provide a detailed note on this that indicates that Group entity reports should be distributed together.
- Alignment to the IRD tax reconciliation
- **Tax effect disclosures** in the tax note add no real value. Also the tax expense should always be followed by the tax asset/liability so the client can understand their tax position in a single note. The P&L/Balance Sheet ordering does not make a lot of sense in this area.
- Some of the **disclosures could be optional** rather than compulsory for small entities. Currently the requirements don't feel much different to the old GAAP.

Other comments that were raised, but fit outside of this PIR are:

*“have a separate one for not for profits, so incorporated societies can apply them as well”*

*“Extend the number of entities that can apply SPFR”*

*“Perhaps more tiers at the lower annual turnover end. But as has happened, IRD needs for example can require more the for profit compliance. And of course annual financials can be avoided for nine or less shareholders under the Companies Act. Why IRD, Companies Office, XRB, CAANZ and probably others couldn't get their act together and have one standard (with tiers) is beyond some people*

**Key point raised by many, templates are time consuming and therefore costly to set up so need to ensure that any changes add real value**



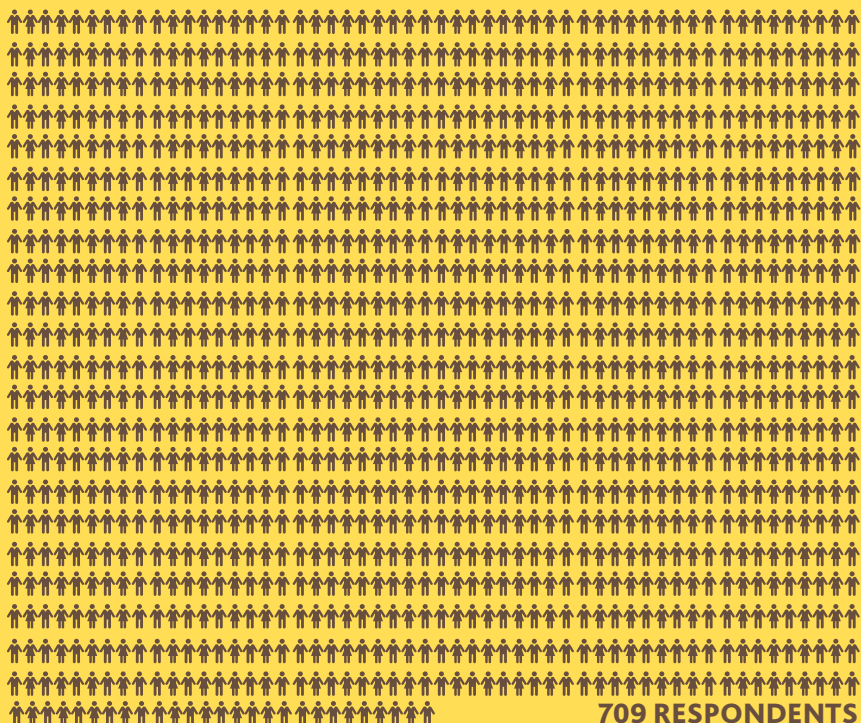
A background image showing several hands of different skin tones stacked together in a supportive gesture, symbolizing teamwork and community. The hands are positioned in the center and right side of the frame, with some fingers pointing upwards and others downwards. The skin tones range from light to dark, and some hands have visible jewelry like rings and a beaded bracelet.

# FINANCIAL REPORTING PREPAREDNESS

## A SURVEY OF PREPAREDNESS AT APRIL 2017

Charities and Not-for-Profit organisations have completed their first financial reporting under Public Benefit Entity Standards. We asked these organisations what their thoughts were and the learnings from this process. We share below the responses received from 709 charities who were registered on the Charities Register.





56%

KNOW ABOUT THE CHANGES IN  
FINANCIAL REPORTING AND HAD SOME  
KNOWLEDGE

53%

OF RESPONDENTS HAVE PAID  
EMPLOYEES

80%

AGREE THAT CHARTITIES SERVICES HAVE  
MADE SUFFICIENT AND APPROPRIATE  
RESOURCES AVAILABLE TO CHARITIES  
IN RESPECT OF FINANCIAL REPORTING  
CHANGES

55%

FOUND IT TOOK THEM BETWEEN ONE  
AND FIVE HOURS TO COMPLETE THEIR  
FINANCIAL REPORT IN THE NEW FORMAT

62%

FOUND ASSISTANCE WITH THE NEW  
FINANCIAL REPORTING STANDARDS FROM  
AN EXTERNAL ACCOUNTANT

64%

REQUIRED SOME ASSISTANCE WITH THE  
NEW FINANCIAL REPORTING STANDARDS

43%

OF RESPONDENTS ARE TIER 3 CHARITIES

41%

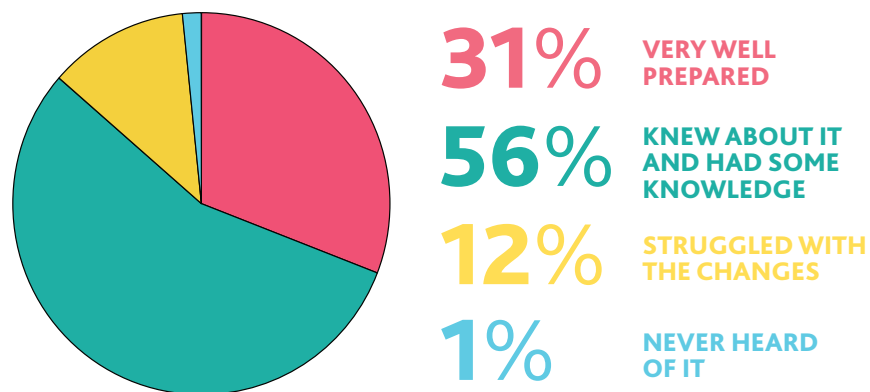
OF RESPONDENTS ARE INCORPORATED  
SOCIETIES

52%

SPENT NO ADDITIONAL MONEY ON THE NEW  
REPORTING FORMAT IN THE LAST YEAR

## WE ASKED

### How well prepared were you for the changes in Financial Reporting?



Nearly one third of respondents were well prepared. This is a credit to the Government agencies such as Charities Services and XRB, and other organisations that have been working on these changes since March 2013. The remaining two thirds have some level of planning and have made an attempt at coming to grips with the changes. Less than 2% of the respondents had no idea that there had actually been a change.

Overall we see the community as reasonably well prepared.

This is in contrast with the experiences seen by Charities Services who in their newsletter in March 2017 reported that approximately 40% of charities in a sample checked by them had not implemented the new standards in any manner. They identified in that report that the principal area of non compliance was in the Tier 4 standards. This would indicate to us that there is a lower level of understanding, or even awareness of the requirements of charities to the financial reporting standards. The survey done by BDO was principally done by respondents that were engaged in the sector and had an understanding of the financial reporting standards. We are of the view that the bulk of non respondents would have fallen into the category identified by Charity Services as non complying.

### Do you require any assistance with the new financial reporting standards?



About two thirds of respondents required some assistance with the new PBE standards. This is not a surprise given the level of change and the complexities moving forward from non existing or very basic accounting standards to internationally modelled standards.

The main source of assistance came from external accountants, many of whom had a rapid learning curve to the new standards. In workshops held over the previous three years prior to the start of the standards, it was evident that charities had a better understanding of the impending changes than external accountants. With the assistance of CAANZ, Charities Services and the XRB running roadshows and webinars, accountants caught up very quickly. They are now seen by the community as the go to people for assistance with PBE standards.

The second most popular source of assistance was the Charities Services website which has comprehensive information well laid out for charities to use on no charge basis.

#### CHARITIES WEBSITE

50%

#### EXTERNAL ACCOUNTANT

62%

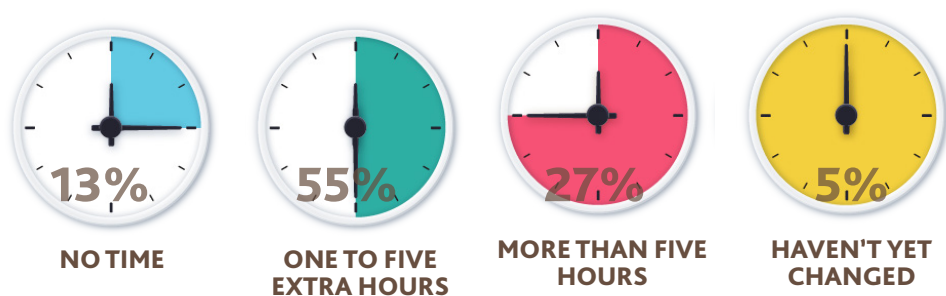
#### DIA STAFF

13%

#### COMMUNITY GROUP

9%

## How much longer did it take you to complete your Financial Report in the new format?



In discussions with accountants throughout the country and with Charities Services officials, there has been a consensus that it has taken longer for charities to complete their financial report this year as opposed to previous years. This was reflected in the survey in that 55% of charities responding stated that it took them between 1 to 5 additional hours to complete their financial report. A further 27% stated that they spent more than 5 hours on the new report. The additional time taken appears to be low in relation to the additional time it has taken for charities to lodge their annual report with Charities Services.

Disturbingly, 5% of respondents have not yet changed to the new financial reporting format. This is low in comparison to the Charities Services experience in reviewing annual reports which would indicate that 40% of charities have yet to make the change. There is clearly more work to be done in this area.







Have Charities Services made sufficient and appropriate resources available to your charity in respect of Financial Reporting changes?



AGREE

80%

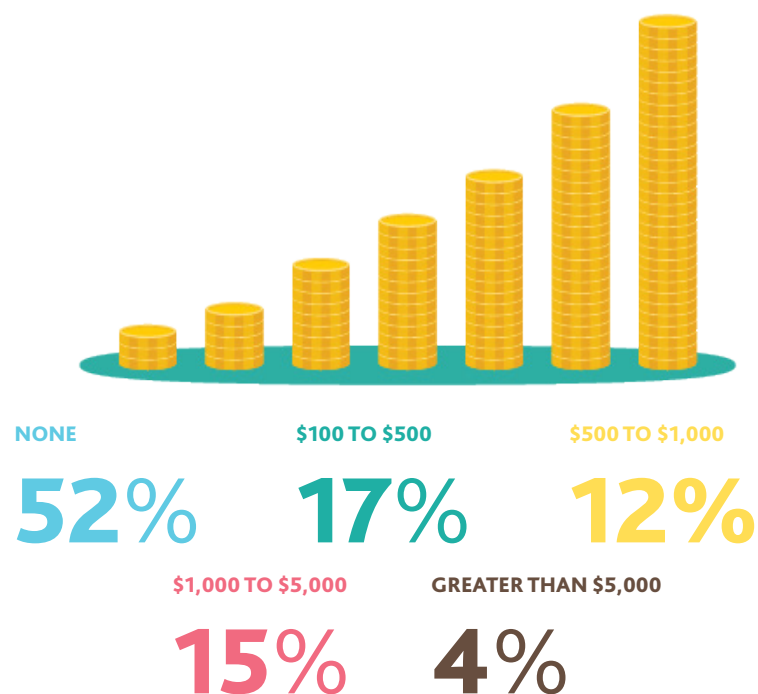


DISAGREE

20%

Respondents overwhelmingly (80%) rated Charities Services highly in the resourcing made available to charities in respect of financial reporting changes. This is a credit to the preparation work that Charities Services have put into making the changes as easy as possible.

## What additional money did you spend on the new reporting format in the last year?



The resourcefulness of charities is seen in that 52% of respondents did not spend any money in adapting to the new changes. This is impressive given the complexity of the changes. Only 15% spent over \$1,000 in coming to grips with the extensive and complicated accounting standards that were introduced. This would indicate that charities use the free resources from the Charities Services website and were able to obtain information from accountants at low or no costs.

## What is the ONE thing you would need from Charities Services to make your transition easier?

Respondents were asked to comment on the one thing that they would need from Charities Services to make their transition easier for the new financial reporting systems. Below is a small representation of the respondent's views.

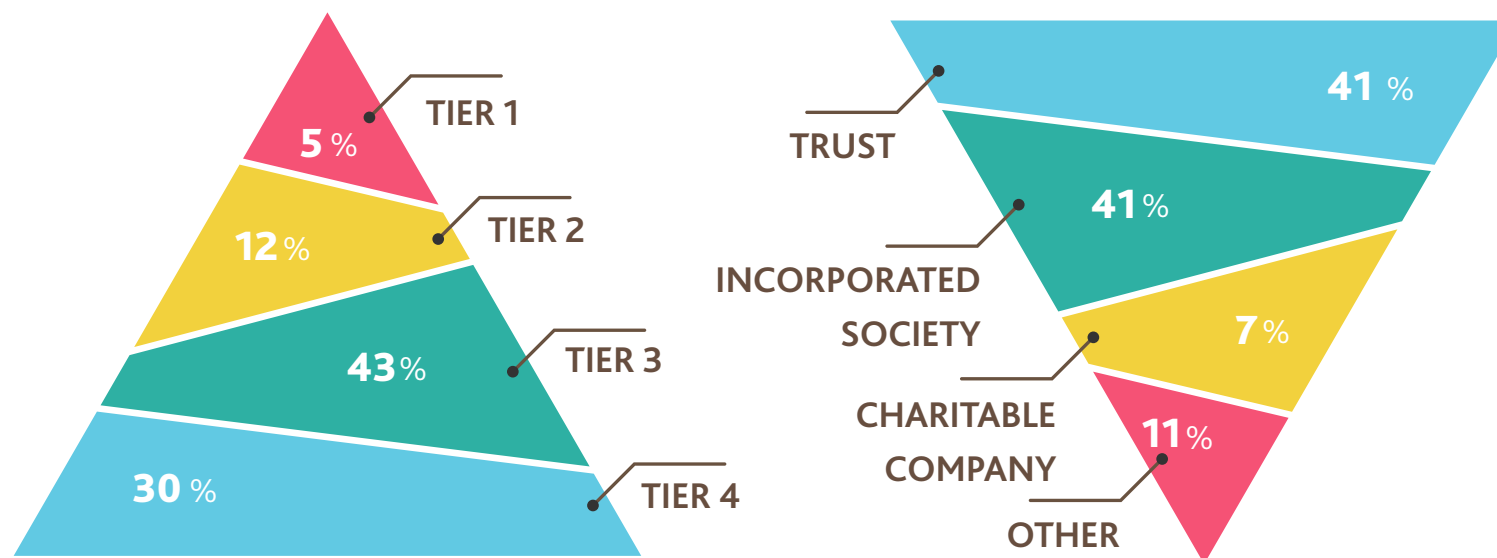
- ▶ Better template
- ▶ Easier to use template
- ▶ Not restating comparative made sense and was helpful
- ▶ A free accountant
- ▶ Clear and simple templates with good notes
- ▶ Better explanations around cashflow preparation
- ▶ Thank goodness we use Xero and they had templates
- ▶ Statement of Service Performance was not easy to understand

The overall comment is that the template was seen as not easy to use by some of the respondents. We struggle to see how much easier this could have been made given what was available in Excel and in PDF on the Charities website. The other comments regarding the more explanations on the Statement of Cashflow, we believe is valid and has been taken up by Charities Services in the free webinars which they are giving to Tier 3 charities.

The Statement of Service Performance is still a work in progress with all charities having had a first go at it in 2016. We believe that we will see refinements in this in the years to come.



## About Respondents & their structure



\*8.31% DON'T KNOW OF ANY TIERS


18% of respondents were either Tier 1 or Tier 2. As these organisations have more resources available to them they have found the transitioning easier than the respondents in Tier 3, which made up 43% and Tier 4, which made up 31% of the charities who responded.

In this survey there has been a much lower response rate from Tier 4 organisations, which is not surprising given that organisations of that size would be mainly run by volunteers and not have an infrastructure in place to take part in this type of survey.

40% of respondents were Trusts, with a further 41% as Incorporated Societies. The remainder was made up of Charitable Companies and other which were not specified.

53% of respondents had employed paid staff and 48% did not.





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