CFA Institute

477 Madison Avenue
21st Floor
New York, NY
10022-5802 USA

+1 (212) 754 8012 tel
+1 (212) 756 7730 fax
info@cfainstitute.org
www.cfainstitute.org

August 28, 2014

Mr. Hans Hoogervorst
Chair
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
United Kingdom

Re: Disclosure Initiative: *Proposed Amendments to IAS 1*

Dear Mr. Hoogervorst,

CFA Institute,[1] in consultation with its Corporate Disclosure Policy Council ("CDPC")[2], appreciates the opportunity to comment on the International Accounting Standards Board's ("IASB" or "Board") Exposure Draft ("ED"), *Proposed Amendments to IAS 1*.

CFA Institute is comprised of more than 100,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to promote fair and transparent global capital markets and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality.

---

1 With offices in Charlottesville, New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 121,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 142 countries, of whom more than 113,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 138 member societies in 60 countries and territories.

2 The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

OVERALL COMMENTS

As an overall matter, we support the efforts of the IASB to improve the clarity and presentation of financial statements and enhance the effectiveness of financial reporting. However, we are concerned that this ED has been developed primarily in response to issues raised by preparers of financial statements. Our longstanding view is that the primary objective of financial statements should be to provide ***investors*** with the information necessary for them to be able to evaluate their investments. Information should be relevant, complete, understandable, comparable, consistent, and presented in a manner that is useful to investors. Thus, we believe that the IASB should actively seek input and feedback from the investor community when it undertakes initiatives to improve financial reporting.

In addition, we note that the ED focuses on only a few, relatively minor issues related to financial statement presentation and disclosure. As we have stated in the past, we believe that the Board should undertake a more comprehensive review of financial statement presentation issues because of the foundational nature of presentation. Accordingly, we believe that the IASB should reinstate the Financial Statement Presentation project and focus on the following four issues, as more fully in set out in our publication, *Financial Reporting Disclosures: Investor Perspectives on Transparency, Trust, and Volume*.[3]

- *Disaggregation* — require sufficient disaggregation of main financial statements,
- *Roll-forwards* — include roll-forwards of key balance sheet accounts with adequate disaggregation and description,
- *Cohesiveness* — implement a cohesiveness principle across financial statements such that investors are able to follow transactions through the various financial statements, and
- *Direct Cash Flow Statement* — require the use of the direct cash flow statement.

We believe a more thorough review of these issues would be a better use of the Board's time and effort than focusing on the more narrowly focused and ad-hoc changes proposed in the ED.

The stated intent of the ED is to address concerns regarding the clarity of the definition of materiality in IAS 1 and its application in practice; confusion regarding the requirements governing the presentation of specific captions in the financial statements and the ability to present subtotals; and the structure of the notes. We address each of these objectives in turn below as well as the Board's proposed changes to the presentation of other comprehensive income relates to equity-accounted investments.

[3] Hereafter referred to as the Financial Reporting Disclosures report.

SPECIFIC COMMENTS

I. A. Materiality and Aggregation

Investors Do Not Believe Financial Statements Have Too Much Immaterial Information
The Basis of Conclusions states that the IASB was *informed* at the *Financial Reporting Disclosure Discussion Forum* in January 2013 and in its related survey and by other sources that the concept of materiality is not being applied in practice as well as it could be; and that some are of the view that the main cause of problems with disclosure is that there is both the provision of too much irrelevant information and not enough relevant information in the financial statements.

While we are aware that a perception exists among preparers and auditors that financial statements are filled with immaterial information, we believe this is based on anecdotal evidence, and we are not aware of any systematic, empirical studies or evidence to substantiate or validate this assertion. In fact, our survey of investors demonstrates the opposite:

- Fully 76% of investors surveyed do not find an obvious overabundance of immaterial information within the financial statements.
- The majority (51%) of respondents to our 2012 financial reporting survey believe that the impact of enhanced materiality guidelines is unclear, because the application of materiality is a matter of judgment; if there were an obvious inclusion of immaterial information, this would not be the case.
- Another 25% of respondents indicated that the impact of enhanced materiality guidelines would not be significant, because they believe materiality is already a concept that is being applied in practice.[4]

We are particularly concerned by the language in Paragraph 31 of the ED that appears to indicate that the Board is operating under the premise that financial statements include large amounts of immaterial information:

> *Notwithstanding these specific requirements, an entity shall assess whether all of that information needs to be presented or disclosed or whether some of the information is immaterial and presenting or disclosing it would reduce the understandability of its financial statements by detracting from the material information.*

We do, however, support the statement in Paragraph 31 that:

> *An entity shall also consider whether information about matters addressed by an IFRS needs to be presented or disclosed to meet the needs of users of financial statements, even if that information is not included in the specific disclosure requirements of the IFRS.*

We believe this is an important guiding principle to assessing materiality.

[4] The survey results can be found in the aforementioned Financial Reporting Disclosures report.

Focus on Increasing Quality of Disclosures, Not on Reducing Volume

While CFA Institute has never proposed that entities disclose immaterial information, it is equally important to recognize that for investors there is no such thing as too much *useful* information. We appreciate that disclosures become required as a result of the IASB's due process and that the decision-usefulness of disclosures can change over time. For example in business or interest rate cycles where impairments or changes in interest rates communicate different information about the importance of business or market risks at different times. That said, it is important to have the disclosures when the information is needed for trend analysis.

Thus, we are opposed to any initiative that has as its primary objective the goal of reducing the volume of disclosures. We do support eliminating redundant information — that is, information that is repeated more than once. Apart from this, however, we find the desire to reduce or remove disclosures inconsistent with investor views. Investors believe that the focus of disclosure reform should not be on reducing volume, but instead should be on addressing how to increase the quality, effectiveness, and completeness of financial statement disclosures.

Support Existing Definition of Materiality

We note that the ED states in Paragraph BC8 that the IASB will be undertaking a short-term project in its Disclosure Initiative to assess the existing guidance on materiality, and that assessment could result in additional guidance or education material being produced on materiality.

We do not believe that the Board should attempt to change the current definition of materiality as noted in paragraph QC11 of Chapter 3 of the Conceptual Framework:

> *Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. In other words, 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.*

We support the IASB's definition of materiality. Furthermore, materiality changes over time – take bad debt reserves as an example with changing market conditions. Accordingly, we support the language in paragraph QC11 that states:

> *Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.*

We are not convinced the language to be added, as follows, in Paragraph 31 related to the need to apply materiality to disclosures is necessary.

> *An entity need not provide a specific disclosure required by an IFRS in the financial statements, including in the notes, if the information resulting from that disclosures is not material. This is the case even if the IFRS contains a list of specific requirements or describes them as minimum requirements.*

We are of the view that materiality has been applied to disclosures for decades and that this language provides relief from disclosures at a moment in time when the disclosure might not be material but when over time a disclosure might be material (i.e. as noted above). We believe this is a matter of judgment and a specific articulation of the ability to exclude a disclosure does not consider the impact over time of changes in materiality due to changes in business or economic circumstances where trend information could be useful to investors. The lack of balance – in, for example, an allowance account – may seemingly appear as immaterial and therefore suggest a disclosure is not warranted; however that can provide very material and decision-useful information to investors on management's judgments during and through a business cycle.

The Objective of Aggregation and Disaggregation Should Be Set Forth

We are supportive of the statement in Paragraph 30A, that states:

> *When applying this and other IFRSs, an entity shall decide, taking into consideration all relevant facts and circumstances, how it aggregates or disaggregates information included in the financial statements.*

However, we believe that it should go further, by stating an objective in making this decision. We recommend inclusion of additional language to the effect that:

> *When applying this and other IFRSs an entity shall decide, taking into consideration all relevant facts and circumstances, how it aggregates or disaggregates information included in the financial statements,* ***in order to provide meaningful information to investors and a faithful representation of the entity's financial condition, results of operations, and changes in cash flows****.*

We believe that the Board should emphasize more positively the objective regarding aggregation and disaggregation than is articulated in the second half of Paragraph 30A which states:

> *An entity shall not aggregate or disaggregate information in a manner that obscures useful information such as aggregating items that have different characteristics or by overwhelming useful information with immaterial information.*

We find the aforementioned language in Paragraph 31 connotes a similar idea.

We believe that the objective of aggregation and disaggregation in the context of materiality should be to provide useful information rather than the requirement for preparers being "not to obscuring useful information" or "overwhelming useful information with immaterial information." The objective should be around providing useful information – not on requiring preparers to not obscure information. The former holds preparers to a higher standard than does the latter which simply requires they not obscure information.

The Board should also consider alternative means by which preparers may highlight important pieces of information, such as by promoting the use of better organization and layering of information in such a way that the presentation of the information itself facilitates improved communication of key messages. We find that emphasizing items of particular important to investors is a better means by which to communicate than simply requiring them to make a decision regarding aggregation/disaggregation or obscuring material information. Matters of importance or significance should be summarized and highlighted. This could be achieved by highlighting financial statement captions, footnotes, or risks important to investors relative to the current economic environment. Layering of information can be obtained by placing summary information upfront and details following it. In short, key messages should be emphasized in a way such that they are obvious and clear.

Aggregation Is Unduly Emphasized; Further Disaggregation Should Be Encouraged

We agree that the purpose of the primary statements is to provide information that is aggregated in a useful manner. Any conclusions that an investor can draw based upon such highly aggregated information, however, are necessarily conditional upon the investor's ability to gain a deeper understanding of the company's underlying economics. This information must be obtained from the disaggregated disclosures in the footnotes. Such disclosures are essential in helping investors to better evaluate the different financial statement elements and cash-generating processes that exist within a company. Hence, disclosures should provide sufficient disaggregated information for investors to be able to fully understand and interpret the summary information in the financial statements.

Many investors find that frequently, information in the financial statements is overly aggregated. Aggregation of information with different economic attributes, measurement bases and trends as well as from very different operations results in substantial loss of information. Indeed, the information omitted may be essential to investors' understanding of a company's financial position, changes in that position, and the implications for valuation of investments. The financial statements issued by most companies today, from the largest with extensive cross-border operations to very small, narrowly focused startups, tend to be highly summarized and condensed. This summarization is achieved by adding together unlike items to report relatively few line items in the statements, despite the disparate economic attributes of their operations. For example, many companies currently present only a single line item for revenue, which is one of the most important drivers of results. Thus, we are supportive of the language in Paragraph 31 which suggests that aggregating information that has different characteristics and may obscure information is inappropriate – we just don't see that not obscuring information should be a primary objective of deciding when disclosures are appropriate, as we highlight in the preceding section of this letter.

Disclosure is Not an Alternative to Financial Statement Presentation

Finally, the Board's intent regarding the manner in which the third principle regarding materiality (point (c) on Page 8 of the ED) has been articulated is unclear. We agree that when a standard requires a specific disclosure, the resulting information shall be assessed to determine whether investors would consider it to be material. However, the last part of this phrase on Page 8 says:

> *When a standard requires a specific disclosures, the resulting information shall be assessed to determine whether it is material and consequently whether* ***presentation or disclosure*** *of that information is warranted (emphases added).*

Further, the wording in Paragraph 29 has been changed as follows:

> *An entity shall* ***present*** ***<u>or disclose</u>*** *separately each material class of similar items. An entity shall* ***present*** ***<u>or disclose</u>*** *separately items of similar nature or function unless they are material.*

And the wording in Paragraph 30 has been changed as follows:

> *An item that is not sufficiently material to warrant separate presentation in those statements may warrant separate ~~presentation~~* ***<u>disclosure</u>*** *in the notes.*

Still further, Paragraph 31 has been added in its entirety and includes the following:

> *…an entity shall assess whether all of that information needs to be* ***presented or disclosed*** *(emphasis added)…*

There are several other places within the ED where the notion of presentation and disclosure are suggested as alternatives. We are concerned that these statements could be interpreted to mean that an entity has the ***choice*** of whether material information should either be presented on the face of the financial statements or alternatively disclosed in the footnotes.

We believe that if an item is material it should be required to be included in the basic financial statements and an entity should not have the option of instead including that information as a disclosure in the footnotes. We do not believe presentation and disclosure are substitutes for each other. Disclosures are meant to provide further information on items deemed material and presented in the basic financial statements. Furthermore, presentation of information on the face of the financial statements is preferable to its inclusion in the notes as we find information on the face of the financials garners greater attention by users of financial statements more so than does disclosures and we believe such information is better audited.

We suggest, therefore, that this wording be revised to clarify that entities do not have a choice of presenting material information in either the basic financial statements or the footnotes if the information is material or when a standard requires that the information be presented on the face of the financials. Used in the aforementioned contexts "presentation or disclosure" does not seem appropriate as they are not substitutes.

Collective Consequence of Decisions for Investors Unclear

As we step back from the changes in Paragraphs 29-31, as well as those related to Paragraph 54 discussed below, collectively we envision that the consequence could be less information for investors. While the ED doesn't seek to change the definition of materiality it appears to:

- allow disclosure to be seen as a substitute for presentation;
- emphasize aggregation over disaggregation;
- establish an aggregation objective focused on not obscuring information rather than seeking to emphasize/communicate/articulate matters of importance;
- start from a premise that financial statements include immaterial information;
- suggest that materiality is not be applied to disclosures; and
- provide preparers with affirmative relief from providing disclosures which might at a point-in-time, but not over time, be deemed immaterial.

We are concerned that the consequence to investors may be more aggregated information which is disclosed rather than presented on the face of the financial statements and with an objective focused on not obscuring information rather than with an objective of seeking to inform investors. We are supportive of the last sentence in Paragraph 31 which calls preparers to go beyond the minimum requirements.

I. B. Information to be Presented in the Financial Statements

Disaggregation: Encourage Beyond the Specific Line Items Presented

The result achieved by the removal of "As a minimum" from the beginning of Paragraph 54 of IAS 1 is not clear particularly when it is followed by "***shall*** include the line items." (i.e. the same "shall" language is included in Paragraph 82). This seems to more definitely require the disclosure of the items listed which follow as shall is equivalent to must. As users of the financial statements we would then expect all of the item in Paragraph 54 (a)-(r) or Paragraph 82 (a)-(i) to have been provided unless clearly immaterial.

Further, the additional language added to the end of Paragraphs 54 and 82 does not achieve the desired result of the ability to provide further disaggregation. It states:

> ***These line items*** *shall be* ***disaggregated*** *when such presentation is relevant to an understanding....*

Does the Board mean that the line items shall be **further** disaggregated (i.e. beyond the line items presented) when such presentation is deemed relevant, or does it mean that the "these line items" shall **only** be disaggregated **to the extent of** the line items presented when such a presentation is deemed relevant? (i.e. "these line items" is collectively used as a noun). We believe the Board intended the former; if so, we recommend that the sentence be clarified by the following

> ***Each of these line items*** *shall be* ***further*** *disaggregated when such presentation is relevant to an understanding....*

Referring to each of the line items and further disaggregation clarifies the Boards objective, in our view. As a rule we are supportive of greater disaggregation, we just believe clarity on the use of the language is important to achieving the desired result.

Subtotals: Caution Must Be Exercised

With respect to the guidance on the use of subtotals, the Board has stated that it does not want to propose amendments that could be seen as encouraging the proliferation of 'non-GAAP' measures. Notwithstanding this, we are very concerned that the adoption of the proposed amendments in Paragraphs 85A and 85B as well as Paragraph 55A will lead to the increased use of such measures.

As rule we don't object to subtotals per se, but our concern is that despite the conditions set forth in Paragraph 85A, there will be abuses. In particular, we believe the guidance in Paragraph 85B which states:

> *An entity shall reconcile any subtotals presented in accordance with Paragraph 85 to the subtotals or totals required by this IFRS by presenting each excluded item in the statement(s) of profit or loss and other comprehensive income.*

would appear to encourage the presentation of non-GAAP measures by suggesting that anything is acceptable as long as it reconciled to another non-specified, or not necessarily required to be most closely related, subtotal/total. It is not clear which subtotals would be reconciled to which subtotals or totals under IFRS as stated in IAS 1. Without greater disaggregation and several key subtotals/totals which entities must reconcile back to (i.e. a defined anchor for investors) the lack of comparability between entities is likely to be significant. In our view, greater ability to disaggregate and the ability to discuss the disaggregated results outside of the IFRS financial statements should facilitate managements' ability to communicate key messages to investors.

As noted by the European Securities and Markets Authorities (ESMA), securities regulators have detected a practice of isolating non-recurring transactions as a way of presenting what they want investors to believe are extraordinary, unusual or non-recurring items – despite the fact that presenting extraordinary items is not permitted by IAS 1 and that items may not actually be economically unusual or non-recurring.

Beyond this, we agree with those who have expressed the concern that the presentation of subtotals, in addition to those specified in IFRS, could be misleading or be given undue prominence. We are of the opinion that the analysis and understanding of financial statements becomes more complex if more subtotals and totals are added with the aim of isolating recurring and non-recurring transactions; and that the use of customized line items, headings and subtotals hampers the comparability of financial statements across entities. We are not concerned with striking a line per se but rather with striking a line with the selected exclusion of certain items thereby creating a non-GAAP measure.

I. C. Structure of the Notes

Organize Notes in a Manner Most Useful to Investors

We support the amendment in Paragraph 113A and further discussed in Paragraph BC19 that states:

> *When determining a systematic order for the notes, an entity may order notes in a way that gives prominence to disclosures that it views as more relevant to an understanding of its financial position or financial performance or makes the relationship between some disclosures more understandable.*

Entities should have the flexibility to highlight matters of importance, and integrate, organize and layer information accordingly. Thus, we support this amendment as it enables entities to organize information in a way that they believes best makes sense for users of financial statements. In addition to emphasizing that the entity consider the understandability and comparability of the financial statements in determining its approach to disclosure (Paragraph 113), the ED should also emphasize that entities should focus on the *importance* and *significance* of the information in the financial statements.

Some of our members have expressed a preference for a standard or consistent ordering of the notes for ease of location of information. Because many of the electronic filings do not allow clicking on or a separate list of notes, it can be cumbersome to locate notes if there ordering is not consistent with the presentation on the face of the financial statements or the prior period. Improved technology would alleviate that concern for many users.

Promote Cross-Referencing in the Statement of Profit or Loss

We note that the ED retains the requirement, now in Paragraph 115, for preparers to cross-reference each item presented in the basic financial statements to the footnotes. We support the use of cross-referencing, as investors find this incredibly useful in understanding how the footnotes relate to the basic financial statements.

We would further recommend that the IASB promote the improved application of cross-referencing of the notes in the statement of profit or loss. Investors find that, while cross-referencing of the notes in the statement of financial position is generally adequate, it is less so in the statement of profit or loss. As a result, investors frequently find it difficult to reconcile how the information presented in the footnotes relates to the statement of profit or loss. Substantively, the real issue for investors is that there is little disclosure or further explanation of amounts presented in the statement of profit or loss – this is the actual issue standard setters should address on behalf of investors.

Complicating the useful of cross referencing further, is the fact that line items are cross-referenced to multiple notes and it is not clear to the user how that information in the notes reconciles to the amounts presented in the financial statements or how the notes are interrelated. In addition, if a line item is cross-referenced to multiple notes, the entity may need to consider whether greater disaggregation is needed in the basic financial statements.

CFA Institute

I. D. Disclosure of Accounting Policies

Summary of Significant Accounting Policies is Useful and Should Be Tailored
Investors find the summary of significant accounting policies has the potential to be one of the most useful footnotes, and therefore would like to see these disclosures further tailored and contextualized, so that it highlights to investors which elements are material and relevant to the enterprise.

With regard to the proposed guidance on the disclosure of accounting policies, we support the proposed amendment to the extent it will discourage preparers from including "rote" or "boilerplate" accounting policy footnotes that are not particularly relevant to their entity or consist of a mere recitation of the accounting literature. That said, we have reservations that it will likely be used to remove such a summary of significant accounting policies when investors would like such policies to be made more entity-specific and located with or contextualized by the amounts to which they relate in the financial statements.

We would encourage the Board to undertake further work with regard to how to make the disclosure of accounting policies more effective as part of its Disclosure Initiative, as stated in Paragraph BC22.

II. Presentation of Equity Method Investments in Other Comprehensive Income (OCI)

Regarding the proposed amendments to the presentation of equity method investments in OCI, we support the proposed amendment to clarify that entities shall present the share of OCI of associates and joint ventures accounted for using the equity method by whether those items will or will not be subsequently reclassified to profit or loss. As long as companies report economic effects in OCI when they occur rather than in net income, there must be clear reporting of how these effects wind their way through the financial reporting system. Only with full transparency can financial statement users have understand the economic events themselves and how the use of OCI results in reported income that excludes current period events but includes events from prior periods.

In general, we believe that few investors fully understand the origination and reclassification (recycling) of items into and out of OCI in part because of the lack of transparency regarding recycled items. Accordingly, we believe the information required to be presented by the proposed amendment is essential to understanding how the OCI "recycling system" delays the recognition of economic events on reported net income and subsequently reports those events piecemeal.

However, we do not agree with the proposal to present the share of OCI of associates and joint ventures using the equity method in aggregate as a single line item. Consistent with our comments above regarding the overuse of aggregation in the financial statements, we believe that aggregating these items into a single line item will result in the loss of important information regarding the nature of the underlying investments. Notwithstanding the fact that information on the nature of investments will still be required in by IFRS 12, *Disclosure of Interests in Other Entities,* we believe that separate presentation on the face of the financial statements is the clearest method of communicating the nature of the underlying investments.

*　*　*　*　*　*

Thank you again for the opportunity to comment on the IASB ED. If you or your staff have questions or seek further elaboration of our views, please contact either Mohini Singh, ACA, by phone at +1.434.951.4882, or by e-mail at mohini.singh@cfainstitute.org or Sandra J. Peters, CPA, CFA by phone at +1.212.754.8350 or by email at sandra.peters@cfainstitute.org.

Sincerely,

/s/ Sandra J. Peters

Sandra J. Peters CPA, CFA
Head, Financial Reporting Policy
Standards & Financial Markets Integrity Division
CFA Institute

cc:　Corporate Disclosure Policy Council