THE
HONG KONG
ASSOCIATION
OF
BANKS
香港銀行公會

Room 525, 5/F., Prince's Building, Central, Hong Kong
Telephone: 2521 1160, 2521 1169 Facsimile: 2868 5035
Email: info@hkab.org.hk Web: www.hkab.org.hk

香港中環太子大廈5樓525室
電話：2521 1160, 2521 1169 圖文傳真：2868 5035
電郵：info@hkab.org.hk 網址：www.hkab.org.hk

1 September 2017 By email: commentletters@hkicpa.org.hk and by post

Ms. Christina Ng
Director
Standard Setting Department
Hong Kong Institute of Certified Public Accountants
37th Floor, Wu Chung House
213 Queen's Road East
Wanchai
Hong Kong

Dear Christina

IASB Discussion Paper DP/2017/1 Disclosure Initiative - Principles of Disclosure

Thank you for your letter dated 7 April 2017 inviting comments on the captioned IASB discussion paper. Our comments on the specific questions raised in the discussion paper are set out in the enclosed annex for your consideration.

Should you have any questions, please contact our Manager Ms Emily Ngan at 2526 6080 or our Officer Ms Melissa Law at 2567 1780.

Yours sincerely

Celia Shing
Secretary

Enc.

HKAB Comments on IASB Discussion Paper DP/2017/1 Disclosure Initiative - Principles of Disclosure

Question 1

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

(a) Do you agree with this description of the disclosure problem and its causes? Why or why not? Do you think there are other factors contributing to the disclosure problem?

We agree with the description set out in paragraphs 1.5 – 1.8. In particular, we observe that the comments regarding the prevalence of the checklist mentality do exist among preparers, auditors and regulators. We believe this is principally a behavioural issue.

(b) Do you agree that the development of disclosure principles in a general disclosure standard (i.e. either in amendments to IAS 1 or in a new general disclosure standard) would address the disclosure problem? Why or why not?

We consider that the development of disclosure principles would be useful, however, this may not change the behaviour of preparers, auditors and regulators. Members also express concern that the new general disclosure standard would eventually be turned into a checklist, thus compounding the disclosure problem. We believe that this is a fundamental issue that the IASB cannot be expected to solve on its own as there could be many reasons why the disclosures in financial statements and / or annual reports can be sub-optimal. We trust that it would be more effective to carry out a massive educational outreach in conjunction with the development of new general disclosure standard.

<u>Question 2</u>

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?

In general, we consider that the issues identified are fairly comprehensive. However, we are of the view that the regulatory disclosure requirements will typically lead to duplication of disclosures. While we recognise the practical challenges of ensuring consistency across regulatory bodies, we believe that a conceptual framework specific to regulatory disclosure would be useful.

<u>Question 3</u>

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?

Agree.

(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?

We agree with the principles listed in paragraph 2.6. However, as stated in our response to Question 1 above, we believe that the solution to the problem should be through a broader educational outreach.

(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?

The principles of effective communication would be useful, but it should be in the form of 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?

We support the development of non-mandatory guideline as an illustrative example to present the best practice expected by the Board. Such examples could be used to interpret what can sometimes be considered "conceptual wording", which in turn will provide clear direction to financial statements preparers.

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.

We are supportive of this approach. Please refer to details provided above.

<u>Question 4</u>

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

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

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

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

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

We agree with the Board's preliminary views as it would be a simple solution to avoid confusion.

<u>Question 5</u>

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?

In general, we agree with the Board's view which allows the flexibility to include IFRS-compliant information within the annual report as long as it meets the specified requirement set out in paragraph 4.9. In addition, we appreciate if the Board can provide more guidance on how to address the issue of potential duplication of disclosures between the accounting and regulatory requirements as mentioned in question 2 above.

(b) Can you provide any examples of specific scenarios, other than those currently included in IFRS Standards (see paragraph 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)?

The criteria in paragraph 4.9 are appropriate provided that there is clear referencing of information within the annual report. To facilitate the implementation, we encourage the Board to provide more guidance on how such cross-referencing should be performed.

<u>Question 6</u>

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?

We agree with the Board's view on the general disclosure standard. However, we are concerned that the requirement set out in paragraph 4.38(c) may result in significant amounts of additional narrative description being included in the financial statement to explain why such non-IFRS information is useful to financial statement users. We consider that flexibility should be provided to the entity in explaining the usefulness of the non-IFRS information and there should be an overriding principle that such information presented should be reconciled to the IFRS information. Such a reconciliation should be given equal prominence as non-IFRS information. We believe that the reconciliation requirement should apply to all sections of the annual report as well as to other materials (e.g. press releases and investor relations materials).

<u>Question 7</u>

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?

In principle, we agree that information delivering a message that is inconsistent with IFRS Standards should not be included in the financial statements. However, from a practical point of view, we consider that it will be difficult for the Board to prepare an exhaustive list of prohibited information and scenarios as there could be many situations where non-IFRS information will be useful in contributing to a faithful representation of certain circumstances.

<u>Question 8</u>

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 5.25 – 5.28.**

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

(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?

While we acknowledge that EBIT and EBITDA are commonly used performance measurements, we believe that the disclosure of EBIT and EBITDA measures is not a mandatory requirement from this Discussion Paper. In particular, we would like to raise to the Board's attention that these measurements may not be applicable to financial institutions. For example, in retail banks, interest income is one of the primary sources of revenue and interest expense is the primary funding cost. This is different from the case of non-financial institutions that interest is regarded as a financing cost. In view of the lack of comparability of financial institutions, we suggest that EBIT and EBITDA measures be treated as "non-IFRS information" or exempt from certain industries.

(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?

We agree that the Board should prohibit the use of other terms as this can enhance consistency and users' understanding, otherwise, this may result in improper usage of "extraordinary items" which has happened in the past.

If management wishes to present such information, which may aid the users' understanding, this could be presented as non-IFRS information in its annual report or elsewhere. We encourage the Board to set a requirement for reconciling such non-IFRS information to the IFRS information.

(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?

We consider that Paragraph 5.28 provides sufficient guidance on this matter.

<u>Question 9</u>

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?

We are generally in agreement with the proposals in paragraph 5.34 and consider that this could help set some boundaries around and bring some disciplines to alternative performance measures. However, it is considered by certain member banks that the extensive requirements in respect of performance measure disclosures may discourage some preparers from including such information.

<u>Question 10</u>

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 alternative 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.**

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 you reasoning.

(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?

We agree with the Board's preliminary view as this would enable the elimination of unnecessary disclosures.

(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?

We support the issuance of non-mandatory guidance in the form of a practice statement in relation to those disclosures. Flexibility should be given to entities on disclosing their category 3 policy on a voluntary basis and allow entities to apply judgement whenever necessary. We consider that mandatory guidance is only suitable for those principles which have to be followed (i.e. category 1 and 2).

<u>Question 11</u> **The Board's preliminary view is that it should develop a central set of disclosure objectives (centralised disclosure objectives) that consider the objective of financial statements and the role of the notes.** **Centralised disclosure objectives could be used by the Board as a basis for developing disclosure objectives and requirements in Standards that are more unified and better linked to the overall objective of financial statements.**
Do you agree that the Board should develop centralised disclosure objectives? Why or why not? If you do not agree, what alternative do you suggest, and why? We consider that developing the centralised disclosure objectives could be useful but we are uncertain whether this would add value over the proposed Conceptual Framework.

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).**

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.

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

Method B would be a significant change of approach that would carry the risk of absorbing too much of the Board's time and could have unintended consequences. We do not believe that the 'disclosure problem' is the practice of the Board, and we would support Method A if the centralised disclosure objectives plan is to be pursued.

(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.

No further comments noted. Member banks agree with Method A as it is more aligned and consistent to the existing disclosure approach and could avoid those unnecessary changes.

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 disclosure? Why or why not?

We generally disagree with the approach as it would separate the disclosure requirements from the topics in individual standards to which they relate. We consider that the example of IFRS 12 quoted by the Board is effective only because the topics it addresses are closely related.

Question 14

This section describes an approach that has been suggested by the NZASB staff for drafting disclosure objectives and requirements in IFRS Standards.

Note that the Board is seeking feedback on the NZASB staff's overall approach, rather than feedback on the detailed drafting on 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).

(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 as approach would encourage more effective disclosures?

We believe that the NZASB staff's approach can align the disclosure requirements within the standard. Moreover, the two-tier disclosure requirement framework based on a materiality assessment may also help to streamline those unnecessary disclosures. However, we are not convinced that this would result in a significant improvement in the behavioural issues identified in the Discussion Paper.

(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?

We believe that there are advantages in the NZASB's approach, however, it may not have a significant positive impact if the behavioural aspects of treating everything as a checklist cannot be addressed.

<u>Question 15</u>

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.

We believe that the clarification made to IAS 1 regarding materiality and the disclosure requirements in paragraph 30A is sufficient to enable and encourage the use of judgement.