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IFRS-FA – öffentliche SITZUNGSUNTERLAGE

Sitzung:	**08. IFRS-FA / 31.08.2012 / 13:00 – 14:45 Uhr**
TOP:	**05 - Disclosure Framework**
Thema:	**Scope and Objective of a Disclosure Framework Project**
Papier:	**08_05a_IFRS-FA_Scope**

Scope and objective of a disclosure framework project

1 The ASCG understands the disclosure framework project as a synonym for a project that should address various issues relating disclosures in financial reports with the general objective to improve the quality of disclosures for users of financial reports. A major driver for the project are concerns relating the quantity of disclosures on both sides, the number of disclosure requirements developed by the IASB over the last decade and the resulting amount of information perceived by users as less relevant for making economic decisions included in financial reports prepared in accordance with IFRSs. To address those concerns the scope of a disclosure framework revolves on:

a. improvements of the standard setting process of disclosures requirements; and
b. the application of the requirements by preparers, including the way the information is presented.

2 The ASCG shares those concerns and therefore is supportive of a disclosure framework project and the pro-active work of EFRAG reflected in the Discussion Paper (EFRAG DP). Nevertheless, the ASCG thinks that the scope of issues and proposals in the EFRAG DP towards a disclosure framework are discussed on a too narrow basis and important issue are explicitly scoped out from discussion or have not been addressed in the discussion so far. The ASCG thinks a framework debate for disclosures should address disclosures on a broader basis and a wider scope.

3 Furthermore, there are doubts whether the developed proposals in the EFRAG DP would change reporting practice of preparers relating disclosures in financial reports prepared in accordance with IFRSs. While the EFRAG DP highlights missing incentives for preparers, for example to apply more carefully judgment on materiality of disclosures, the proposals in the DP in our view do not reflect those issues and an economic analysis to establish more effective mechanism and incentives for preparer in the standard setting process. The subsequent paragraphs provide the view of ASCG relating the scope of disclosures and discussion issues that should be part of the projects work towards a disclosure framework.

Scope of disclosures

4 The EFRAG DP limits the scope of the discussion to information disclosed in the notes to the financial statements. Furthermore, the proposed definition of the notes limits the disclosures in most parts to explanatory information for line items presented in the “primary” financial statements with a strong focus on information of past transactions. Hence, the EFRAG DP emphasises that some disclosure requirements in current IFRSs would be expulsed from the notes because of not meeting the definition. It is unclear in the EFRAG DP whether this information is considered not to be useful for users of financial reports or whether the information should be part of other (new) components of the entities financial reporting package or should be removed completely from IFRSs.

5 The ASCG noticed that in the debate about developing a disclosure framework many IFRS constituents of the IASB raised the wish to address disclosures on a holistic basis and in context of the financial reporting package of the entity. This may even include disclosures in management reports. The ASCG shares this view and therefore thinks a disclosure framework discussion in the limited scope of the EFRAG DP, developed from an endorsement perspective, is less useful for a framework project.

6 The ASCG also notices the EFRAG DP highlights “it is important that the notes form part of telling the ‘story’ of an entity’s financial performance and position.” With the limited scope of the notes suggested in the DP there is doubt whether the entity would be capable to do so. As a consequence of the proposals in the EFRAG DP some relevant information could only be disclosed outside of the notes and most likely the information

would not be subject to audit. The ASCG thinks that many users would consume and weight disclosures different if the information is not subject to audit and attest lower quality of these disclosures.

7 The ASCG thinks it is useful for a disclosure framework project to define the disclosures that would not be part of financial report prepared in accordance with IFRS and therefore should be scoped out from the project. Furthermore, the development of a framework project should also consider whether all the disclosures are subject to mandatory audit. Therefore, a disclosure framework project should go beyond the very narrow definition of the notes in the EFRAG DP. The role of pro-forma financial information and non-GAAP disclosures as well as the role of non-mandatory disclosures in financial reports.

Pro forma financial information and other non-GAAP disclosures

8 Recent studies and publications in some jurisdictions raised concerns relating the IFRS reporting practice of entities in context of pro forma financial information and other non-GAAP disclosures in financial reports and transaction documents. The concerns highlighted the fact that those disclosures, in some cases, have the potential to be misleading and consequently lower the quality of disclosures for users. While the issue is often referred to information relating to non-GAAP performance measures presented as line items in the financial statements, studies also highlighted this issue for disclosures in the notes to the financial statements (for example if explanation and description on non-GAAP measures receive more prominence than explanatory information for GAAP disclosures).

9 Currently, IFRSs do not provide disclosure guidance on this issue and in consequence some jurisdictions added national regulatory guidance and requirements. For example the ASIC published regulatory guidance, including:

"*Financial information prepared other than in accordance with accounting standards must not be included in financial statements [...] Such information may **only** be included in the notes to the financial statements **in the rare circumstances** [emphasis added]* *where such disclosure is necessary to give a true and fair view of the financial position and performance of the entity.*"

10 The EFRAG DP highlights the fact that disclosures in the notes should be relevant and fulfill the need of users for information with the capability of making a difference in users economic decisions. In this context preparers may argue that additional, on a consistent basis prepared, non-GAAP disclosures and some pro-forma financial information is relevant for users, especially if this information provides insights on management measures that are relevant for the decision making process of the management of the entity. Hence, it could be argued that disclosure like (dis)aggreation and reconciliation for non-GAAP measures could be relevant for users.

11 In this context the ASCG also points to the paragraph five of chapter one of the EFRAG DP where EFRAG addresses concerns relating the increased number of disclosures over the last decade. EFRAG states that the increase of disclosure requirements and corresponding volume increase of prepared disclosures "*has added the complexity of the financial statements and may confuse rather than inform users by obscuring relevant information. In addition, such volume may result in an undue cost for preparers in managing and reporting extensive disclosures.*" Interestingly, the illustration in the EFRAG DP used to underpin the fact indicates that pro-forma financial information and non-GAAP measures play a significant role in the increase of the number of disclosures. While the ASCG could see merit in the argument that the number of explicit disclosure requirements have been increasing over the last years, the ASCG disagrees with the wording used in the EFRAG DP and the emphasis that the illustrated increase of disclosures are produce 'in accordance with IAS/IFRSs'. Nevertheless, the illustration shows the increase of disclosures also relates to non-GAAP information used by the management of the entities to communicate the financial performance and financial position.

12 It is not clear to the ASCG whether EFRAG considered this ongoing disclosure debate relating pro-forma financial information and non-GAAP disclosures in the pro-active disclosure framework project. The ASCG thinks that this issue should be addressed as part of a disclosure framework project, especially on the consideration of comparability and understandability of disclosures in financial reports prepared in accordance with IFRSs and level playing field for IFRS preparers.

Non-mandatory disclosures

13 Closely related to the issue of pro-forma and non-GAAP financial information a disclosure framework project may need to address the role of non-mandatory disclosures prepared in accordance with GAAP. The ASCG notice the tendency of the IASB in recently modified or new published IFRSs to avoid wording that would indicate a non-mandatory character of disclosures. Older IASs included disclosures that signal a voluntary basis for preparers.

14 The ASCG is generally supportive of this tendency and thinks that only mandatory disclosures should be part of IFRSs. Nevertheless, the disclosure framework project should explore whether there are ways that provide better incentives for preparers to provide relevant information that goes beyond mandatory disclosures. The ASCG noticed that in some cases preparers think that they could provide additional relevant information on a non-mandatory basis but back off to disclose the information in financial reports for several reasons and cost implications.

15 From an economic perspective the management of the entity would only provide non-mandatory information if the expected benefits of the voluntary disclosure cover at least the expected cost of disclosure. The benefits could be seen in the ability to decrease future cash outflows (for example increase reputation and lower capital cost) or increase in future cash flows (for example increase of reputation linked with future cash inflows). Beside the cost for compiling the information the cost side would also include cost arising from disclosing potentially competitive information, cost for additional audit activities and also the potential of litigation cost relating disclosures.

Disclosure issues

Consistency of disclosure requirements

16 High priority in the scope of a disclosure framework project should be dedicated to establish effective mechanism to ensure consistent and well-balanced disclosure requirements across the IFRSs, including consistent terminology. Current IFRSs often reflect significant differences in the granularity of the requirements. The ASCG believes

that there is a relation between the different granularity of disclosure requirements in the IFRSs and the perceived unbalance of disclosures in financial reports by users.

17 The EFRAG DP addresses those concerns and discusses a wide range of considerations to structure disclosure requirements within IFRSs. However, no proposal on the different approaches was developed in the EFRAG DP.

Guidance on materiality

18 Many IFRS stakeholder groups and constituents of the IASB referred to the principle of materiality and its application to disclosures as a key to reduce the disclosure level in financial reports. Therefore, some have asked for more guidance and indicators and new terminology that should be developed in a disclosure framework project.

19 The ASCG believes that the concept of materiality is clearly and consistently understood as an entity-specific aspect of relevance. Hence, relevant disclosures reflect entity-specific information. It is also well understood that an entity do not need to disclose information that is not material in accordance with IFRS. Therefore, the ASCG thinks a disclosure framework should not reemphasise the meaning of materiality and relevance as well as starting a whole new debate relating the application of those principles. Obstacles on successful application of material judgment by preparers of financial reports may be rooted in issues that are not in scope of the work of the accounting standard setter. However, the ASCG thinks that a disclosure framework could clarify some guidance on materiality.

20 The guidance could clarify whether different levels of materiality also implicate different level/volume of disclosures. While this issue seems to be obvious for many, it is not addressed in the IFRSs and could be clarified in a disclosure framework project. In addition the IASB could clarify terminology for disclosure requirements deemed as material in all cases. In the same direction the disclosure framework could set a strategy for future implementation guidance on individual disclosures with dedicated discussion on materiality.

Enforcement of disclosures

21 An issue that has been raised in context of IFRS disclosures is the enforcement of the disclosure requirements. The scope of the EFRAG DP does not address this issue and exclude the discussion on “auditability” of disclosures.

22 The ASCG believes this issue should not be excluded from a disclosure framework project. The focus on this issue should be based on the question how to structure and to define requirements to be enforceable.

Disclosures of interim vs. annual financial reports

23 The ASCG thinks a disclosure framework project should also discuss disclosures in context of interim or annual financial reports and explore whether different requirements and principles should be applied. The ASCG considers this discussion not only necessary from a cost perspective. The disclosure framework project should also clarify whether a different quality of disclosures in interim financial reports compared to those disclosures reported in annual reports imply different criteria to develop interim disclosure requirements. Different quality may arise from the facts that:

a. Interim disclosures may imply more estimates; and
b. Generally, interim disclosures are not mandatory subject to audit.

24 In this context the ASCG notices the discussion in the FASB Discussion Paper *Disclosure Framework* (FASB DP) for U.S. GAAP and thinks this discussion should also be set up for IFRSs and therefore be part of the disclosure framework scope. Those issues are not addressed in the EFRAG DP.

Format and organisation of disclosures

25 Another issue is the way disclosures are presented in financial reports. The ASCG noticed some IFRS stakeholder groups think the presentation of disclosures significantly influence the consumption of information. Furthermore, they also noticed any improvements relating the presentation of disclosures would not impact the substance of current IFRS disclosures requirements and therefore changes to presentation requirements for disclosures may be less costly to implement.

26 Both, the EFRAG DP and the FASB DP, address the presentation issue and potential improvements. However, both DPs address the issue from different angles. The EFRAG DP refers to high level communications principles and emphasises “*the primary responsibility of the preparer for good communication*”. The FASB DP focuses the discussion with detailed proposals on presentation requirements that should be developed by the standard setter.

27 The ASCG tends to the view the disclosure framework project should focus on presentation requirements to be developed by the standard setter as discussed in the FASB DP. Nevertheless, the disclosure framework project should also explore, whether the qualitative requirements of information in the IFRS conceptual framework should be enriched by the communications principles as discussed in the EFRAG DP.

Self-standing document and cross-reference of disclosures

28 Within the scope of the disclosure framework there should be discussion whether financial reports prepared in accordance with IFRSs should be considered as a self standing document or a starting basis of information for users with additional cross reference to information in other documents. The EFRAG DP highlights some recent research from other institutions in this area with discussion around possibilities to “outsource” long standing information from financial report. However, the EFRAG DP has not developed specific proposals in this area.

Consolidation and improvements of existing IFRS disclosure requirements

As mentioned above the objective of the disclosure framework project should be improved quality of disclosures for users of financial reports. The ASCG thinks this can not only be achieved be adding disclosure principles in the IFRS conceptual framework and providing more guidance on materiality. The disclosure framework project should also result in a timely review of existing disclosures. The review should especially focus on consolidation of disclosure requirements as well as to replacement of requirements with more effective disclosures. This process would also include necessary adjustments in the terminology.

Obviously, this improvement process could only be implemented in a second step after the disclosures issues were addressed.