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IFRS-FA – öffentliche SITZUNGSUNTERLAGE

Sitzung:	**09. IFRS-FA / 20.09.2012 / 14:15 – 16:15 Uhr**
TOP:	**04 - Disclosure Framework**
Thema:	**Scope and Objective of a Disclosure Framework Project**
Papier:	**09_04a_IFRS-FA_DF_Scope**

Objective

1 Various institutions, including EFRAG and FASB, published documents in the context of the ongoing disclosure framework debate. While the intention to improve disclosures of financial reports is common in those documents, the scope and the identified disclosure issues for a disclosure framework in those documents highlight significant differences in the understanding of a disclosure framework project for financial reporting. Therefore, this paper reflects the view of ASCG staff in this context and should serve the IFRS Committee to form a view of the necessary scope of an IFRS disclosure framework project and key issues for IFRS disclosure improvements.

Scope and objective of a disclosure framework project for the IFRSs

2 The ASCG staff understand the disclosure framework project as a synonym for a project that should address various issues relating to 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 over 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 in financial reports perceived by users as less relevant for making economic decisions. To address those concerns the scope of a disclosure framework project 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.

Scope of disclosures

3 The discussion paper published by EFRAG, ANC and FRC AC *Towards a Disclosure Framework* (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 from IFRSs completely.

4 The ASCG staff noticed that in the debate about developing a disclosure framework many 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 staff share this view and therefore think a disclosure framework discussion in the limited scope of the EFRAG DP, perceived to be developed from an endorsement perspective, is less useful for a framework debate. Furthermore, important issues are scoped out from discussion or have not been addressed in the discussion so far (for example the role of non-GAAP information and non-mandatory disclosures). The ASCG staff think a framework project for disclosures should address disclosures on a broader basis and a wider scope compared to the EFRAG DP.

5 The ASCG staff also noticed the EFRAG DP highlights “*it is important that the notes form part of telling the ‘story’ of an entity’s financial performance and position*.” (Source: EFRAG DP, 2012) 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 staff

think that many users would consume and weight disclosures in a different way if the information is not subject to audit and attest lower quality of these disclosures.

6 The ASCG staff think it may be more useful for a disclosure framework project to define the disclosures that would not be part of a financial report prepared in accordance with IFRSs (instead of listing all potential disclosures within the scope of the framework project). Furthermore, the development of a framework project should also consider whether all the disclosures are subject to mandatory audit.

Pro-forma financial information and other non-GAAP disclosures

7 Recent studies and publications in some jurisdictions raised concerns about 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 in context of non-GAAP performance measures presented as line items in the financial statements, the 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 measures).

8 Currently, IFRSs do not provide disclosure guidance on this issue and in consequence some jurisdictions added national regulatory guidance and requirements. For example the Australian Securities and Investments Commission (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.*" (Source: ASIC, Regulation Impact Statement - Disclosing non-IFRS financial information, 2011, RG 230.8)

9 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 disclosures like (dis)aggreation and reconciliation for non-GAAP measures could be relevant for users.

10 In this context the ASCG staff point to the paragraph five of chapter one of the EFRAG DP where EFRAG addresses concerns relating to 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.*" (Source: EFRAG DP, 2012) Interestingly, the illustration used in the EFRAG DP to underpin this fact indicates that pro-forma financial information and non-GAAP measures play a significant role in the increase of the number of disclosures (see Appendix A in this paper). While the ASCG staff could see merit in the argument that the number of explicit disclosure requirements have been increasing over the last years, the ASCG staff disagree with the wording in the EFRAG DP and the emphasis that the illustrated increase of disclosures are produced 'in accordance with IAS/IFRSs'. Nevertheless, the illustration highlights that the increase of disclosures also relates to non-GAAP information used by the management of the entity to communicate the financial performance and financial position.

11 It is not clear to ASCG staff whether EFRAG considered this ongoing disclosure debate about pro-forma financial information and non-GAAP disclosures in the pro-active disclosure framework project. The ASCG staff think 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 a level playing field for IFRS preparers.

Non-mandatory disclosures

12 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 staff notice the tendency of the IASB in recently modified or new IFRSs to avoid wording that would indicate a non-mandatory character of a disclosure. Older IASs include disclosure terminology to indicate a voluntary basis for preparers to disclose some information.

13 Generally, the ASCG staff are supportive of this tendency and think that only mandatory disclosures should be part of the IFRSs. Nevertheless, the disclosure framework project should explore whether there are ways to provide better incentives for preparers to disclose relevant information that goes beyond mandatory disclosures. The ASCG staff noticed that in some cases preparers think 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.

Key disclosure issues

Consistency of disclosure requirements

14 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 staff believe that there is a strong relation between the different granularity of the disclosure requirements in IFRSs and the perceived unbalance of information in financial reports by users.

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

Guidance on materiality

16 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 constituents have asked for more guidance and indicators and new terminology that should be developed in a disclosure framework project.

17 The ASCG staff believe 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 need not provide a specific disclosure if the information is not material. Therefore, the ASCG staff think a disclosure framework should not reemphasise the meaning of materiality and relevance as well as starting a whole new debate about 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.

18 Nevertheless, the guidance on materiality could be clarified by the IASB whether different levels of materiality also implicate different level/detail of disclosures. While this issue seems to be obvious for many, it is not addressed in current IFRSs. The ASCG staff noticed that this issue is reflected in the EFRAG DP in context of proportionality of disclosures. Furthermore, 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 new implementation guidance on individual disclosures with a dedicated discussion on materiality.

Enforcement of disclosures

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

20 The ASCG staff believe 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 better enforceable.

Disclosures in interim vs. annual financial reports

21 The ASCG staff think a disclosure framework project should also discuss disclosures in context of interim vs. annual financial reports and explore whether different requirements and principles should be applied. The ASCG staff consider this discussion not only necessary from a cost perspective for preparers. 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 include more estimates; and
b. Generally, interim disclosures are not mandatory subject to audit.

22 In this context the ASCG staff noticed the discussion in the FASB Discussion Paper *Disclosure Framework* for U.S. GAAP (FASB DP) and think a similar discussion should be part of a disclosure framework project for the IFRSs. Those issues are not addressed in the EFRAG DP.

Format and organisation of disclosures

23 Another disclosure issue is the way information is presented in financial reports. The ASCG staff noticed some IFRS stakeholder groups think the presentation of disclosures significantly influence the consumption of information. 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.

24 The ASCG staff tend to the view the disclosure framework project should focus on presentation requirements as discussed in the FASB DP. Nevertheless, the disclosure framework project could also explore, whether communications principles could be integrated in the IFRSs as discussed in the EFRAG DP.

Self-standing document and cross-reference of disclosures

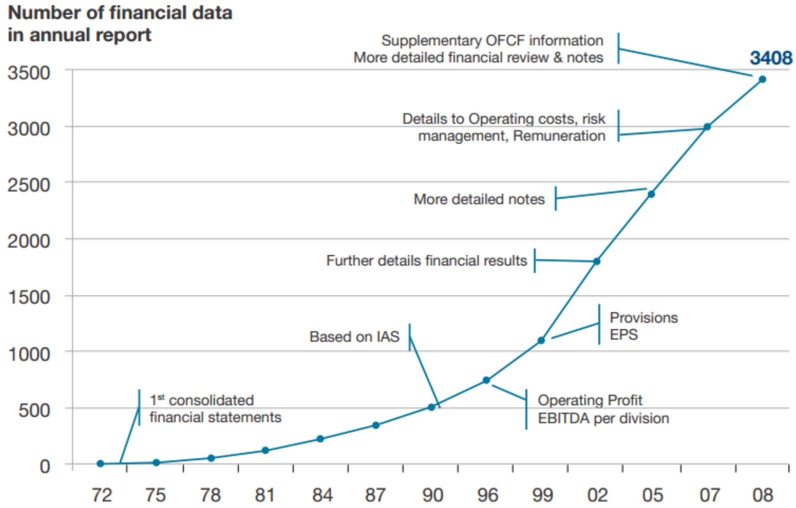
25 The ASCG staff think the disclosure framework should also address the discussion whether financial reports prepared in accordance with IFRSs should be considered as a self-standing document. The EFRAG DP highlights some recent research from other institutions in this area with discussion around possibilities to "outsource" long standing information from financial report using cross references and other linkage mechanism. 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 an improved quality of disclosures for users of financial reports. The ASCG staff think 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 in all IFRSs. The review should especially focus on the consolidation of disclosure requirements as well as replacement of disclosure 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 IASB addressed the disclosure issues as illustrated above.

Appendix A – Increase of Disclosures

5 Over the last decade the number of disclosures has been growing. This trend has led to an increase in the length of financial statements. For instance, the following graph shows the progression of purely quantitative data given in the Annual Report of a major pharmaceutical company that adopted IAS for its 1990 statements and from 1994 onwards has produced them 'in accordance with IAS/IFRS':



6 Whilst this trend can partially be explained by the greater complexity of the transactions that the entities undertake, and the economic environment they operate in, there are also other drivers of this increased volume. For example:

Source: Discussion Paper *Towards a Disclosure Framework* published by EFRAG, ANC and FRC AC (2012)