

# Disclosure of sensitive information

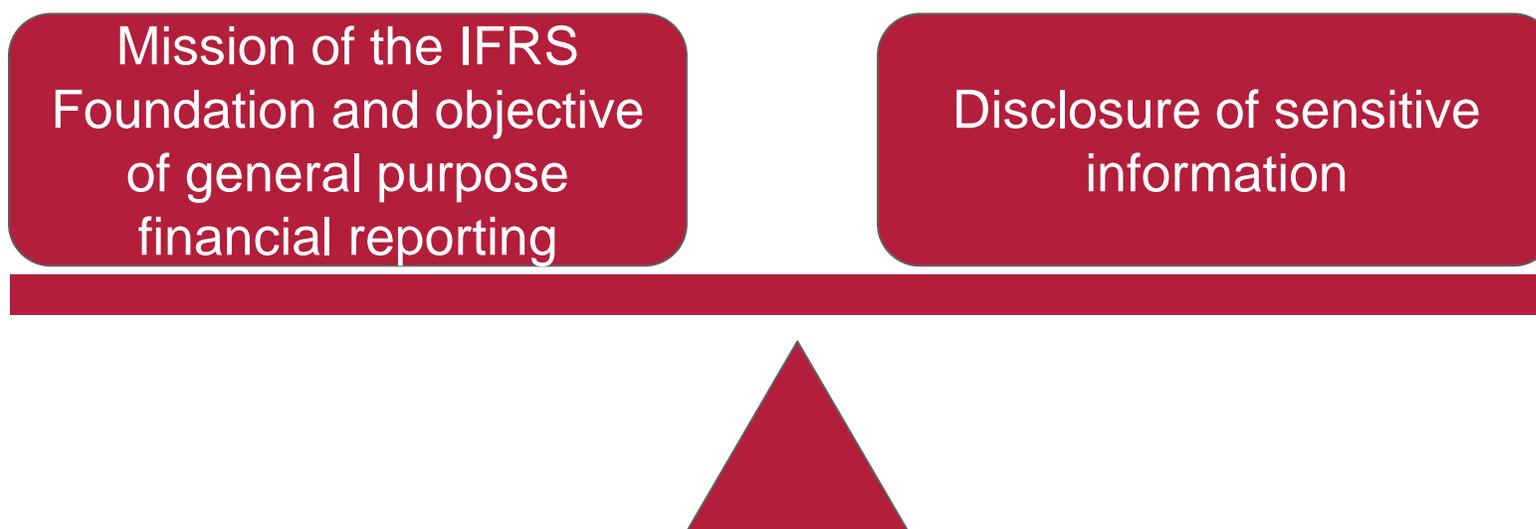
IFRS Foundation Advisory Council

March 2019

The views expressed in this presentation are those of the presenter, not necessarily those of the International Accounting Standards Board or IFRS Foundation.

# Objectives of this session

- Discuss the balance between:
  - our focus
    - the IFRS Foundation’s mission to develop IFRS Standards that bring transparency, accountability and efficiency to financial markets around the world
    - the objective of general purpose financial reporting to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity; and
  - concerns over disclosure of sensitive information



# Why are we seeking advice now?

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- Various projects focused on presentation and disclosure currently underway:
  - Goodwill and Impairment
  - Management Commentary
  - Disclosure Initiative
  - Primary Financial Statements
  - Dynamic Risk Management
- Preparers often raise the issue of sensitive information in their feedback. However, this information may be material to investors.
- To assist the Board with future deliberations on these projects
  - no general plan to revisit existing standards
  - no plan to develop a framework for sensitive information

# Questions for the Advisory Council

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1. In what situations do you think concerns about sensitive information are valid?
2. Given the mission of the IFRS Foundation and the objective of general purpose financial reporting, how should the Board approach concerns about sensitive information?

# Outline of discussion

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- What do we mean by sensitive information?
- Benefits and challenges of required disclosures of sensitive information
- Types of sensitive information
- Addressing sensitive information
- Questions for the Advisory Council

What do we mean by  
sensitive information?

# Sensitive information

- Information whose disclosure could result in commercial loss to an entity
- Examples:
  - litigation details (IAS 37)
  - segment information (IFRS 8)
- For purposes of today's discussion, exclude disclosures that risk shareholder litigation (eg estimates and forecasts that differ from subsequently reported actual amounts)



# Benefits and challenges of required disclosures of sensitive information

# Benefits of required disclosure

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- Benefits to capital markets as a whole may include:
  - increased market liquidity
  - more efficient allocation of limited resources
  - comparability across entities
  - the reduction of information asymmetry between management and investors
  
- Benefits to individual entities may include:
  - lower cost of capital
  - improved investor relations (may broaden shareholder diversity, increase trust in management)
  - strengthened accountability and stewardship
  - cost of disclosing sensitive information offset by mandatory disclosure by competitor

- Unequal effects
  - some information may benefit potential investors more than current investors (and vice versa)
  - challenges may be disproportionate for some entities, as sensitivity of information depends on a number of factors
    - nature of competitive environment (number of competitors, position in market)
    - diversity of stakeholders (suppliers, labour markets, competitors, regulators)
- Poor quality disclosure (overly aggregated, noncompliant or delayed)
  - undermines transparency of financial reporting for investors
  - creates tensions with auditors and regulators
  - creates an uneven playing field when some entities comply and others do not

# Challenges of required disclosures

- Unintended consequence that entities may avoid disclosure requirements by delisting, not listing or regulatory shopping
  - reduces investment opportunities
  - reduces options for raising capital
  - impedes efficient allocation of limited resources

## The need for balance

Benefits to the market as a whole may outweigh the costs to individual entities – but only if all entities are subject to the same requirements

# Types of sensitive information

# Negotiating position

Relevant disclosure	Perceived effect	Observations
Impairment loss on asset, disposal groups and non-current asset held for sale	<ul style="list-style-type: none"><li>• Potential buyers may push for lower price based on updated carrying value of asset</li></ul>	<ul style="list-style-type: none"><li>• Carrying amount may not necessarily affect asset disposal price</li><li>• Intended purpose affects measurement of asset</li></ul>
Information on revenue contribution by major customer	<ul style="list-style-type: none"><li>• Key customers, knowing their importance to the entity, may have the upper hand in negotiation</li><li>• Information may be used by competitors</li></ul>	<ul style="list-style-type: none"><li>• Relative negotiating power may be known to contracting parties</li><li>• Customers may be able to work out their importance from their internal data</li></ul>
Segment profit margin	<ul style="list-style-type: none"><li>• May be used as basis for customers to demand lower price or suppliers to demand higher price. Undermine negotiating position.</li></ul>	<ul style="list-style-type: none"><li>• Customer/supplier decision may be driven by value of product, not profit that the entity makes from the transaction</li><li>• Pressure on profit may harm investors</li></ul>

Relevant disclosure	Perceived effect	Observations
Description of capitalised intangible asset	<ul style="list-style-type: none"><li>Reveals details of R&amp;D, prompting competitors to step in</li></ul>	<ul style="list-style-type: none"><li>Peers may already be aware of competitive landscape in industry</li><li>Entities may already publicise successful projects to attract investors</li></ul>
Information on revenue contribution by major customer	<ul style="list-style-type: none"><li>Facilitate competitors targeting key customers</li><li>Reveal concentration of sales, facilitate competitive behavior</li></ul>	<ul style="list-style-type: none"><li>IFRS Standards do not require the disclosure of customer identity</li><li>Competitors may already be aware of industry landscape</li></ul>
Strategic rationale and key objectives of acquisition	<ul style="list-style-type: none"><li>Premature disclosure allows competitors to take counter-measures</li><li>Disclosure of restructuring plan lowers employee morale</li></ul>	<ul style="list-style-type: none"><li>Stakeholders may already be aware of entity's plan beforehand, but disclosure may confirm the fact</li></ul>

Relevant disclosure	Perceived effect	Observations
Disclosures of items subject to confidentiality required by agreement or statute	<ul style="list-style-type: none"><li>• Result in legal disputes for breach of agreement / legal requirements</li></ul>	<ul style="list-style-type: none"><li>• Market players may already be aware of material contracts</li><li>• Disclosures can be made without identifying counterparty</li><li>• Contractual agreement with third party should not override regulatory requirement</li></ul>
Details of defence contracts subject to restrictions	<ul style="list-style-type: none"><li>• Potential prosecution for disclosing official secrets</li><li>• Facilitate competitive behaviour by industry peers</li></ul>	<ul style="list-style-type: none"><li>• Bidding process and outcome strictly controlled and widely reported in many jurisdictions</li><li>• Disclosure of detailed specification of products and government intellectual property rights not necessary</li></ul>

Relevant disclosure	Perceived effect	Observations
Uncertainty relating to going concern	<ul style="list-style-type: none"><li>• Cause further negative impact to entity's financial position</li><li>• Effects of "self-fulfilling prophecy"</li></ul>	<ul style="list-style-type: none"><li>• Disclosure of fundamental importance to financial reporting</li><li>• Market may already be aware of issue</li><li>• Fear of uncertainty increases volatility</li><li>• Transparent disclosure can reduce market over-reaction</li></ul>
Disclosure of provision for litigation	<ul style="list-style-type: none"><li>• May prejudice entity's position in legal dispute</li></ul>	<ul style="list-style-type: none"><li>• Users need to know the degree of measurement uncertainty involved</li><li>• Limited disclosure exemption allowed under IAS 37</li></ul>

# Regulatory scrutiny and reputational risks

Relevant disclosure	Perceived effect	Observations
Uncertain tax positions / Sustainability of tax strategy	<ul style="list-style-type: none"><li>• Attract scrutiny from tax authorities</li><li>• Increased cost of regulatory compliance</li></ul>	<ul style="list-style-type: none"><li>• Regulators may already have access to information regardless of disclosure</li></ul>
Disclosure of information that is reputationally harmful	<ul style="list-style-type: none"><li>• Damage brand image and reputation of entity resulting in adverse financial effects</li></ul>	<ul style="list-style-type: none"><li>• Interest groups are not primary users of financial statements</li><li>• Stakeholders have diverse views and opinions on what is reputationally damaging</li><li>• Allowing exemptions opens door to broad non-compliance with IFRS Standards</li><li>• Information may be fundamental for investors' valuations</li></ul>

# Overall observations

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- Examples of sensitive information generally:
  - are entity and fact-specific;
  - lack a common characteristic for principle-based standard-setting; and
  - are hypothetical and difficult to prove
- Mandatory disclosure partly offsets competitive disadvantage because all entities would be required to provide disclosure, while bringing market-wide benefits.
- Any disclosure exemption may:
  - be subject to abuse
  - increase investors' burden to obtain information
  - undermine confidence in the information that is available

# Overall observations (cont'd)

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- Some stakeholders may get information through other means
  - resulting in reduced sensitivity of disclosure
    - trend towards digital reporting, analysis of alternative data, and advances in computing power, eg Big Data
    - regulators and major investors have direct access to entity for some information
  - but disclosure needed in general purpose financial reports so investors have equal access to information

# Addressing sensitive information

- No accommodation for sensitivity concerns approach
  - avoids providing basis for broad non-compliance with IFRS Standards
  - Standards should not be seen as tools to facilitate avoidance of stakeholder and regulatory scrutiny
  - sensitivity may be mitigated as stakeholders may have sources of information other than financial statements

## Example from IFRS 8, *Operating Segments*

### Lack of a competitive harm exemption

- BC43 The Board discussed whether entities should be exempt from aspects of the IFRS if disclosure could cause competitive damage or erosion of shareholder value. The Board considered an alternative approach whereby entities could be required to provide reasons for non-disclosure on a ‘comply or explain’ basis.
- BC44 The Board concluded that a ‘competitive harm’ exemption would be inappropriate because it would provide a means for broad non-compliance with the IFRS. The Board noted that entities would be unlikely to suffer competitive harm from the required disclosures since most competitors have sources of detailed information about an entity other than its financial statements.
- BC45 Respondents also commented that the requirements of the IFRS would place small listed companies at a disadvantage to non-listed companies, which are outside the scope of the IFRS. The Board noted that the relative advantage/disadvantage of an entity being publicly listed is not a matter for the Board to consider.

# Possible standard-setting approaches to address the issue–2

- 'Comply or explain' approach
  - creates incentive for disclosing required information
  - allows for exemption where entity determines that costs exceeds benefits
  - effectiveness depends on market and regulatory environments

## Example from IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*

92 In extremely rare cases, disclosure of some or all of the information required by paragraphs 84–89 can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an entity need not disclose the information, but shall disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

# Possible standard-setting approaches to address the issue–2a

- ‘Comply or explain’ approach with constraints
  - similar to ‘comply or explain’ model, but
    - temporary disclosure exemption if information is truly sensitive and costly
    - require disclosure when potential cost of disclosure reduces
    - need to satisfy indicators / criteria about ‘sensitive information’ specified by the Standard
    - audit committee / board of directors could be required to take explicit responsibility for non-disclosure
  - provide auditors / regulators basis for enforcement to avoid abuse
  - indicators / criteria difficult to articulate because of fact-specific sensitivities

# Possible standard-setting approaches to address the issue–2a(cont'd)

**Example from Management Commentary project (to be discussed at April Management Commentary Consultative Group meeting – subject to change)**

## **Disclosures that would be seriously prejudicial to the interests of the entity**

The information users require from the management commentary will ordinarily be at a higher level than is useful to the entity's competitors. However, there may be occasions when the entity considers that the disclosure of detailed information about impending developments or matters in the course of negotiation would be seriously prejudicial to the interests of the entity. In such cases, the entity:

- a) Provides summarised information at the most detailed level that is not seriously prejudicial to address the matter
- b) Considers whether other disclosures in the management commentary may be misleading in the context of the excluded information and adapts the content and tone of the management commentary accordingly.
- c) Describes the process undertaken to determine that it was appropriate to exclude material information from the management commentary.

The derogation from the general requirement to disclose material information in the management commentary is applicable only where permitted by the entity's legal and regulatory environment, and is limited to those situations where disclosure would negatively impact impending developments or ongoing negotiations which are not in the public domain, for instance where the entity is in talks to acquire another entity.

# Possible standard-setting approaches to address the issue–3

- Tailored disclosure requirements to reflect concerns. For example:
  - Seek to provide relevant information indirectly via inference where possible
  - Compromise between needs of users and preparers

## Example from IFRS 7, *Financial Instruments: Disclosures*

BC35W Most respondents disagreed with the Board's proposal to require entities to disclose information on the risk exposure and the hedged rate. They commented that this would result in the disclosure of commercially sensitive information (ie the risk exposure and the hedged rate). They believed that those who do not elect to apply hedge accounting would potentially have an unfair advantage because although they do not have to disclose anything, they could nonetheless gain insight into their competitor's hedge positions. Commercial sensitivity was also of concern to those entities whose competitors are not listed companies or who do not report under IFRSs.

BC35X The Board noted that the proposal in the 2010 Hedge Accounting Exposure Draft focused on the hedged risk (ie the hedged item). Consequently, it would result in disclosures about forward looking information and the rates at which future transactions are hedged. The Board acknowledged that this would potentially provide competitors with insight into an entity's costing structure. Consequently, the Board decided not to require information to be disclosed about the total risk exposure because of the potential forward looking nature of this information. The Board also decided to change the focus of the proposed disclosure from the hedged item to the hedging instrument. In other words, the disclosure would require information on some of the terms and conditions of the hedging instrument to be provided. The Board believes that this information will still be relevant and useful for users of financial statements in inferring the exposure that an entity is exposed to and what the effects will be on future cash flows as a result of how the entity manages the particular risk.

# Possible standard-setting approaches to address the issue–4

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- Voluntary disclosure approach
  - relies on market to penalise poor disclosure
  - creates a burden for investors to obtain information
  - market may not function effectively in penalizing poor disclosure due to transparency
  - may be subject to abuse

# Questions for the Advisory Council

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1. In what situations do you think concerns about sensitive information are valid? (See slides 13 - 17)
  - Are there other types of sensitive information?
  
2. Given the mission of the IFRS Foundation and the objective of general purpose financial reporting (see slide 2), how should the Board approach concerns about sensitive information? (See slides 21 – 26)
  - Are there other possible approaches?

# Get involved

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