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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting: **February 2009, London**

Project: **IAS 34 *Interim Financial Reporting***

Subject: **Interim Reporting (Agenda Paper 12)**

THE ISSUE

1. At the January Board meeting, the staff informed the Board of a cross-cutting issue identified during the staff's work on IFRS 7 *Financial Instruments: Disclosures*. The issue is whether or not particular disclosure requirements within IFRS 7 should be mandated for interim reporting. The staff notes that this issue is recurring and also relates to Standards other than IFRS 7.

2. Many users note that some disclosure requirements of IFRS 7 would be useful to users of interim financial statements. For example, disclosures relating to fair value, reclassification and nature and extent of risks relating to financial instruments. Consequently, users have urged the Board in their responses to recent exposure drafts to mandate some proposed disclosures for interim reports.

3. Moreover, at the January Board meeting, staff working on the fair value measurement project asked the Board to amend IAS 34 *Interim Financial Reporting* to provide updated interim fair value disclosures if, for example, there is a significant change in the business or economic circumstances. The Board refrained from taking this decision and directed the staff to prepare an analysis of existing interim disclosure requirements. The Board considered this a cross-cutting and recurring issue that could be considered independently of individual projects.

4. **The objective of this paper is to analyse the existing disclosure requirements in IAS 34 and provide possible approaches on how to change the Standard to address the issue identified. This paper also includes questions to the Board.**

5. This paper sets out:
   (a) a summary of requirements in IAS 34;
   (b) possible approaches to addressing the issue;
   (c) an analysis of these approaches; and
   (d) question to the Board.

SUMMARY OF REQUIREMENTS IN IAS 34

Objective

6. The objective of IAS 34 is to prescribe:
   (a) the *minimum* content of an interim financial report; and
   (b) the principles for recognition and measurement in complete or condensed financial statements for an interim period.

7. The objective paragraph of IAS 34 states that '[T]imely and reliable interim financial reporting improves the ability of investors, creditors, and others to

understand an entity's capacity to generate earnings and cash flows and its financial condition and liquidity.'

Scope

8. IAS 34 does not mandate which entities should be required to publish interim financial reports or how and when interim reports should be published. IAS 34 applies to all interim reports described as complying with IFRSs.

Content of an interim financial report

9. Paragraphs 5 to 14 of IAS 34 state the required minimum content of interim financial statements. Paragraphs 15 to 18 specify the selected explanatory notes required. Appendix one contains an extract of selected explanatory notes.

10. The staff notes that IAS 34 does not directly mandate a list of specific disclosure requirements like many other IFRSs but instead sets out some criteria to determine what information should be disclosed in an interim report (ie an indirect approach). These include:

    (a) **Materiality –** Apart from the information specified in Appendix one of this paper, IAS 34.16 states that 'the entity shall also disclose *any* events or transactions that are *material* to an understanding of the *current* interim period' [emphasis added]. Moreover, IAS 34.25 states that 'unusual items, changes in accounting policies or estimates, and errors are recognised and <u>disclosed</u> on the basis of materiality in relation to interim period data to avoid misleading inferences that might result from non-disclosure. The overriding goal is to ensure that an interim financial report includes all information that is relevant to understanding an entity's financial position and performance during the interim period'.

    (b) **Unusual or irregular items –** IAS 34.16(c) requires disclosure in the notes of the nature and amount of items affecting assets, liabilities, equity, net income, or cash flows that are unusual because of their nature, size, or incidence. Moreover, IAS 34.16(b) requires explanatory comments about the seasonality or cyclicality of interim operations. For an entity whose business is highly seasonal, IAS 34.21 encourages financial information for the twelve months up to the end of the interim period and comparative information for the prior twelve-month period.

(c) **Change since previous reporting periods that has a significant effect on the interim financial statements –** IAS 34.15 states that 'at an interim date, an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period is more useful' ie year-to-date information. IAS 34.16(d) requires disclosure of the nature and amount of changes in estimates of amounts reported in prior interim periods of the current financial year or changes in estimates of amounts reporting in prior financial years, if those changes have a material effect in the current interim period.

11. In addition, in addressing the use of estimates, IAS 34.41 requires that all material financial information that is relevant to an understanding of the financial position or performance of the entity is appropriately <u>disclosed</u>.

12. In summary, information that should be disclosed in the notes of an interim report includes that which is:
    (a) material to the overall interim financial statements;
    (b) unusual or irregular;
    (c) a change from the previous reporting period (of the current or previous financial year) that has a significant effect on the current reporting period; or
    (d) relevant to the understanding of estimates used in the interim financial statements.

POSSBILE APPROACHES TO ADDRESS CONCERNS RAISED

13. The staff has identified the following approaches:
    (a) Approach A – do nothing ie leave the existing requirements as they are. That is, IAS 34 as currently drafted is sufficient in ensuring that entities disclose information useful to users.
    (b) Approach B – mandate specific information to be disclosed in interim financial statements (either by incorporating disclosure requirements of other Standards into IAS 34 or by specifying within other Standards which disclosure requirements are mandatory for interim financial reporting).
    (c) Approach C – provide more examples to illustrate information that should be disclosed in interim financial statements (ie provide further guidance on how to comply with the requirements of IAS 34).
    (d) Approach D – mandate the same disclosure requirements for annual and interim financial statements.
    (e) Approach E – develop a disclosure framework that applies to all financial statements.

STAFF ANALYSIS

Issues to consider

14. The staff thinks there are a number of factors that might be relevant in determining the way forward. These include:
    (a) **Nature of the issue –** the issue is (i) recurring and (ii) cross-cutting. The Board might need to revisit this issue every time it issues a new Standard or an amendment.
    (b) **Objective of IAS 34 –** IAS 34.6 states that the interim financial report is intended to provide an update on the latest complete set of annual financial statements. IAS 34 is principle-based and prescribes the *minimum* content of interim financial reports. It provides generic descriptions of items that should be included and not an exhaustive list of all items that should be included in

the interim financial report. In mandating additional disclosures the Board in effect adds to minimum requirements and changes existing practice. Moreover, various jurisdictions mandate disclosures in interim and annual reports in addition to those already required by IFRSs.

(c) **Entities that apply IAS 34 –** constituents mainly requested interim disclosures relating to financial instruments ie disclosure requirements currently in IFRS 7. IAS 34 is not sector specific and, thus, financial institutions are only a small subset of all entities applying the Standard.

(d) **Timing –** although respondents to recent exposure drafts have identified this issue, most respondents have not raised this as an urgent issue.

(e) **Resources required –** some of these approaches will require more Board and staff time and resources than other approaches. The staff notes that the IASB's current agenda might not accommodate an additional project on IAS 34.

15. The staff also notes that the Board did not consider the requirements in IAS 34 when it undertook its improvements project. There is a risk that any significant reconsideration of IAS 34 will highlight inconsistencies between IAS 34 and other standards.

Approach A – Do nothing

16. As illustrated in paragraph 10 of this paper, the staff notes that IAS 34 contains some generic guidance on the type of information that should be disclosed in the notes of interim financial statements.

17. Arguments for Approach A include:

(a) this approach is consistent with the objective of IAS 34 to mandate only the minimum content of interim financial statements, using a principle-based approach.

(b) a financial institution or any other entity should already be disclosing information that is required by IAS 34 (as discussed in paragraph 12).

Mandating such information will weaken the judgement that is required to apply and principle-based disclosure requirements.

(c) constituents have generally not identified IAS 34 as a Standard that requires the most urgent and significant change – although some users have identified this as an issue following recent amendments or proposed amendments to IFRS.

(d) this approach requires the least Board and staff resources.

18. Arguments against Approach A include:

(a) constituents might continue to request the Board mandates specific disclosures for interim financial reports when new standards or amendments are issued.

(b) this approach might result in inconsistency in (and lack of) information being disclosed by different entities as disclosures are not specifically mandated.

Approach B - mandate specific information to be disclosed in interim financial statements

19. With reference to paragraph 16 of IAS 34, the staff notes that there are a number of variations to Approach B. These include:

(a) Approach BI – to incorporate *some* specific disclosure requirements of another Standard into IAS 34. For example, IAS 34.16(g)(i) to (vi) requires some specific disclosures of segment information in interim financial reports if IFRS 8 *Operating Segments* requires the entity to disclose segment information in its annual financial statements.

(b) Approach BII – to incorporate *all* disclosure requirements of a particular Standard into IAS 34. For example, IAS 34.16(i) requires in the case of business combinations, the entity disclose *all* information required by IFRS 3 Business Combinations.

20. The staff thinks that approach BI and BII are similar except approach BII results in broader requirements for IAS 34 as *all* disclosure requirements of a particular Standard would be required in the interim financial report.

21. Arguments for Approach B include:
    (a) this approach clearly specifies which disclosures are required in interim financial reports and is likely to be applied more consistently. It distinguishes between interim disclosures that require more constant updating and annual disclosures.

22. Arguments against Approach B include:
    (a) decisions on which disclosure requirements or which Standard's disclosure requirements to include might be arbitrary. This approach is not principle-based and results in a checklist of arbitrary rules.
    (b) this approach does not address the recurring and cross-cutting nature of the issue. This approach is piecemeal as the Board will continue to need to assess whether some or all disclosures requirements should be required for interim financial reporting when it issues a new Standard or amendments.
    (c) this approach mandates additional minimum requirements, which increases complexity.
    (d) Board and staff time and resources are required in determining which specific disclosure requirements or which Standard's disclosure requirements should be required for interim reporting.

23. The staff notes that alternatively interim disclosure requirements could be mandated within the individual standards. An appendix within IAS 34 could be inserted to cross-reference disclosure requirements to individual Standards. The staff believes that this approach changes the structure of the current IAS 34, which hosts recognition, measurement, presentation and disclosure within a single standard. Moreover, there is a danger that the link between presentation (of condensed statements) and disclosures would be lost or weakened.

Approach C - provide further guidance on how to comply with the requirements of IAS 34

24. The staff notes that IAS 34.17 contains a list of examples of the kinds of disclosures that are required by IAS 34.16. Moreover, it cross references other IFRSs by stating that individual IFRSs provide guidance regarding disclosures for required items.

25. Arguments for Approach C include:
    (a) this approach provides for more flexibility as disclosures will depend on the extent the disclosure examples apply to the entity.
    (b) this approach does not add to the existing principle-based requirements but only illustrates their application.
    (c) this approach cross references existing guidance on disclosures within other Standards to ensure consistency in application.
    (d) this approach requires limited Board and staff resources as it only involves adding more examples

26. Arguments against Approach C include:
    (a) this approach does not address the recurring nature of the issue ie the Board might consequentially be required to add new examples when a new Standard is issued or amended.
    (b) this approach does not mandate disclosures and hence, might not be as effective in ensuring that entities provide the disclosures as approach B.
    (c) this approach might result in an arbitrary check list of examples.

Approach D - mandate the same disclosure requirements for annual and interim financial statements

27. Arguments for Approach D include:
    (a) this approach results in disclosing the most comprehensive information in interim financial reports.

(b) this approach addresses the recurring nature of the issue as entities will by default be required to disclose any information required in annual financial reports in interim financial reports.

(c) this approach requires limited Board and staff resources as the Board will not be required to distinguish between disclosures for interim financial reports and disclosures for annual financial statements.

28. Argument against Approach D include:

(a) this approach is inconsistent with the objective of IAS 34, which only prescribes the minimum content of an interim report.

(b) this approach is unduly onerous for entities; it would eliminate the differentiation of the extent of financial reporting between annual and interim periods, which IAS 34 deliberately includes (IAS 34.6).

(c) some of the resulting disclosures might be the same as those already disclosed in the annual report. IAS 34.6 considers that in the interest of timeliness and cost considerations and to avoid repetition of information previously reported, an entity may be required or may elect to provide less information at interim dates as compared with its annual financial statements.

(d) this approach results in a mismatch between the primary statements and the notes unless the condensed format is eliminated as well. The main purpose of note disclosures is to provide information to supplement the primary statements. Note disclosures that go far beyond the granularity of the primary statements might be confusing (unless 'links' such as cross references and breakdowns of amounts were provided).

Approach E - develop a disclosure framework that applies to all financial statements

29. The staff notes that at present IFRSs do not contain an overriding disclosure framework. IAS 1 *Presentation of Financial Statements* notes that a specific disclosure requirement in a Standard or an Interpretation need not be satisfied if the information is not material. However, the staff notes that there is no guidance on how materiality should be assessed in considering disclosures. The staff thinks

that one approach to addressing the issue is to fundamentally review current disclosure requirements and to consider how disclosures interact with other parts of financial reporting. As suggested by some constituents, the Board might consider a project to develop a principle-based disclosure framework.

30. The staff is aware that Phase E of the Conceptual Framework project, *Boundaries of Financial Reporting, and Presentation and Disclosure*, aims to determine the concepts underlying display and disclosure of financial information, including the boundaries of such information, that will achieve the objective of general purpose financial reporting. However, this phase is currently inactive.

31. Arguments for Approach E include:
    (a) this approach addresses disclosures in a holistic manner and addresses the recurring and cross-cutting nature of the issue.

32. Arguments against Approach E include:
    (a) this approach requires the most Board and staff resources. In considering the IASB's current agenda and the urgency of some of the major projects, the staff does not think there is enough capacity to undertake such a project.
    (b) this approach is a long-term approach and will not address the immediate requests of constituents.

QUESTION TO THE BOARD

33. What is the Board's preference in dealing with disclosures for interim periods? Do you prefer any of the approaches (A to E) or an alternative approach? Why?

Appendix One

Selected explanatory notes

15 A user of an entity's interim financial report will also have access to the most recent annual financial report of that entity. It is unnecessary, therefore, for the notes to an interim financial report to provide relatively insignificant updates to the information that was already reported in the notes in the most recent annual report. At an interim date, an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period is more useful.

16 An entity shall include the following information, as a minimum, in the notes to its interim financial statements, if material and if not disclosed elsewhere in the interim financial report. The information shall normally be reported on a financial year-to-date basis. However, the entity shall also disclose any events or transactions that are material to an understanding of the current interim period:

(a) a statement that the same accounting policies and methods of computation are followed in the interim financial statements as compared with the most recent annual financial statements or, if those policies or methods have been changed, a description of the nature and effect of the change;

(b) explanatory comments about the seasonality or cyclicality of interim operations;

(c) the nature and amount of items affecting assets, liabilities, equity, net income, or cash flows that are unusual because of their nature, size, or incidence;

(d) the nature and amount of changes in estimates of amounts reported in prior interim periods of the current financial year or changes in estimates of amounts reported in prior financial years, if those changes have a material effect in the current interim period;

(e) issuances, repurchases, and repayments of debt and equity securities;

(f) dividends paid (aggregate or per share) separately for ordinary shares and other shares;

(g) the following segment information (disclosure of segment information is required in an entity's interim financial report only if IFRS 8 *Operating Segments* requires that entity to disclose segment information in its annual financial statements):

  (i) revenues from external customers, if included in the measure of segment profit or loss reviewed by the chief operating decision maker or otherwise regularly provided to the chief operating decision maker;

(ii) intersegment revenues, if included in the measure of segment profit or loss reviewed by the chief operating decision maker or otherwise regularly provided to the chief operating decision maker;

(iii) a measure of segment profit or loss;

(iv) total assets for which there has been a material change from the amount disclosed in the last annual financial statements;

(v) a description of differences from the last annual financial statements in the basis of segmentation or in the basis of measurement of segment profit or loss;

(vi) a reconciliation of the total of the reportable segments' measures of profit or loss to the entity's profit or loss before tax expense (tax income) and discontinued operations. However, if an entity allocates to reportable segments items such as tax expense (tax income), the entity may reconcile the total of the segments' measures of profit or loss to profit or loss after those items. Material reconciling items shall be separately identified and described in that reconciliation;

(h) material events subsequent to the end of the interim period that have not been reflected in the financial statements for the interim period;

(i) the effect of changes in the composition of the entity during the interim period, including business combinations, obtaining or losing control of subsidiaries and long-term investments, restructurings, and discontinued operations. In the case of business combinations, the entity shall disclose the information required by IFRS 3 *Business Combinations*; and

(j) changes in contingent liabilities or contingent assets since the end of the last annual reporting period.

17 Examples of the kinds of disclosures that are required by paragraph 16 are set out below. Individual Standards and Interpretations provide guidance regarding disclosures for many of these items:

(a) the write-down of inventories to net realisable value and the reversal of such a write-down;

(b) recognition of a loss from the impairment of property, plant and equipment, intangible assets, or other assets, and the reversal of such an impairment loss;

(c) the reversal of any provisions for the costs of restructuring;

(d) acquisitions and disposals of items of property, plant and equipment;

(e) commitments for the purchase of property, plant and equipment;

(f) litigation settlements;

(g) corrections of prior period errors;

(h) [deleted]

(i) any loan default or breach of a loan agreement that has not been remedied on or before the end of the reporting period; and

(j) related party transactions.

18 Other Standards specify disclosures that should be made in financial statements. In that context, financial statements means complete sets of financial statements of the type normally included in an annual financial report and sometimes included in other reports. Except as required by paragraph 16(i), the disclosures required by those other Standards are not required if an entity's interim financial report includes only condensed financial statements and selected explanatory notes rather than a complete set of financial statements.