



EXPOSURE DRAFT – FOR PUBLIC COMMENT

SUBJECT: IMPROVEMENTS OF EXPLANATORY NOTES TO THE FINANCIAL STATEMENTS

CPC ASKS ANY INTERESTED PARTIES TO OFFER SUGGESTIONS REGARDING THE PROPOSAL OF ISSUING A DOCUMENT AIMING AT ENHANCING THE PREPARATION AND DISCLOSURE OF NOTES TO THE FINANCIAL STATEMENTS IN BRAZIL.

SUGGESTIONS ARE WELCOME BETWEEN JANUARY 20, 2014 TO MARCH 24, 2014 AND SHOULD BE E-MAILED TO: genotasexplicativas@facpc.org.br

Introduction – Reasons for the study regarding the issuance of a CPC document on the preparation of notes to the financial statements

The volume of information disclosed in the general purpose financial statements has raised many questions by market players related to the excessive extension of material to be read, coped with the fact that it is not uncommon the existence of irrelevant information at the same time that relevant information is often absent.

Repetition of information often considered unnecessary is consequently increasing the cost of disclosures – and not their quality, which is also the focus of complaints from several participants of the market from preparers of financial statements to analysts and board members.

The presentation of financial statements, according to many, seems to adopt a “check-list approach” to the disclosures required by Statements, Interpretations and Orientations of the Brazilian Accounting Standards Committee (CPC – Comitê de Pronunciamentos Contábeis), apparently not taking into consideration the aspects of *relevance*. It has been said that the excess of information hinders an adequate decision-making process on the part of the users of the financial statements.

As far as we know, this is not a situation which is typical of Brazil. There is a strong worldwide movement aiming at finding ways to include in the financial statements solely the disclosures which are really of interest of users in order to guide their decisions about an entity.

Recent discussions and papers have debated this matter as follows:

- ASAF – Accounting Standards Advisory Forum, of IASB – International Accounting Standards Board, in its September 2013 meeting has intensely



discussed this matter and decided to propose to the board of the IASB actions to discipline the guidelines on disclosure and notes. (<http://www.ifrs.org/Meetings/Pages/ASAF-September-2013.aspx>)

- EFRAG – European Financial Reporting Advisory Group, which is mandated to recommend to the EU the adoption of the IFRS Standards, issued a recent document: *Towards a Disclosure Framework for the Notes*, discussing and gathering opinions specifically about disclosure. As a conclusion, it proposes the preparation of a specific Conceptual Framework for the presentation of these notes. (<http://www.efrag.org/Front/n2-972/Discussion-Paper---Towards-a-Disclosure-Framework-for-the-Notes.aspx>)
- IASB held a forum on this matter in the beginning of 2013 and subsequently issued the document *Discussion Forum – Financial Reporting Disclosure*, in May 2013, reporting several opinions of users, preparers and auditors regarding the difficulties related to the quality of Notes; in addition, it has recently created a group to discuss the Disclosure Initiative, although a deadline for completing this task is not yet defined. (<http://www.ifrs.org/Current-Projects/IASB-Projects/Disclosure-Initiative/Discussion-Forum-Financial-Reporting-Disclosure/Pages/Discussion-Forum-Financial-Reporting-Disclosure.aspx>)
- FASB has just issued the document *Conceptual Framework for Financial Reporting*, march 2014, for public comment.

Recent surveys, including academic works, Brazilian and international, suggest that in countries where the enforcement on adherence is not rigid to non-regulated entities or where the application of these rules is more literal and influenced by form, such as in Brazil, there is a greater need for guidance on this matter.

CPC has decided to perform a few surveys and concluded that there already is sufficient guidance regarding the amount and quality of evidence to be disclosed in the notes to financial statements; such guidance may be found in several Statements, Interpretations and Guidelines, especially in the Brazilian Basic Conceptual Statement (R1) - Conceptual Framework for Preparation and Disclosure of Financial Statements and in CPC 26 – Presentation of Financial Statements, as well as in the Brazilian Corporate Law (6.404/76), and in documents issued by several regulatory agencies.

CPC also concluded that it is convenient and feasible to reinforce the existing guidance and/or issue additional orientation about disclosures.

After analyzing this situation and considering that it may take a long time for IASB to issue a final position on this matter, CPC has decided to issue a document in order to provide general guidance and assure that it may be effectively pursued by preparers the objective of disclosing all relevant information (and only that) which, in fact, helps users of financial statements.

Due to the fact that this is an extremely relevant matter, CPC has opted to first disseminate to all interested parties in Brazil the survey performed regarding the



existing guidelines, which is described in the next chapter, as well as to request, by means of this public consultation, opinions on the convenience of the issuance or not of this document as well as on several matters which would be dealt with in the said document.

Disclosure already regulated

CPC has gathered several points already included in the Standards or in the applicable accounting literature which must be observed in the preparation and presentation of the Notes:

(Observation: We use always the word *relevance* that in our concept includes also the word *materiality*. And we use *accounting policies* that includes *criteria and practices*).

Main guidelines in the Conceptual Framework

The objective of the general purpose financial statements, as established in item OB2 of the Brazilian Basic Conceptual Statement (R1) – Conceptual Framework for the Preparation and Disclosure of Financial Statements is to *provide financial information about the entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.*

- 1) Useful pieces of information are those with qualitative features, which are fundamental to financial statements. These features, according to the same Basic Conceptual Statement, are the *relevance* and the *faithful representation*, which, in order to improve information quality, require that, in their texts there is comparability, verifiability, timing and comprehensibility, as follows:
 - (a) Information is *relevant* if it *is capable of making a difference in the decisions made by users*;
 - (b) In turn, *faithful representation* implies that the information has to be *complete, neutral and free of errors*;
 - (c) Finally, *comparability, verifiability, timing and comprehensibility* are qualitative features which improve the utility of relevant and reliable information (See items QC5 to QC34 of the Conceptual Framework).

The Conceptual Framework also defines that the information is *relevant* if *omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity.*



- 2) In this document, relevance is based on the *nature* or in the *magnitude* of the information, or both. Consequently, it is not possible *a priori* to identify a quantitative limit to relevance or define what would be classified as relevant in a particular situation. Consequently, the judgment on relevance shall be defined case by case.

Main general guidelines in the Pronunciamento Técnico CPC 26 – Presentation of Financial Statements

- 3) CPC 26 defines in items 29 to 31 that:
- a) The entity has to present separately in the financial statements each *relevant* class of similar items.
 - b) *If a line item is not individually material, it must be aggregated with other items either in those statements or in the notes. An item that is not sufficiently material to warrant separate presentation in those statements may warrant separate presentation in the notes.*
 - d) *An entity needs not to provide a specific disclosure required by any CPC statement if the information is not material.*
- 4) Item 113 of the same Statement defines that Notes should be presented, if possible, in a systematic manner. Each item of the financial statements must have a *cross-reference* with the respective information presented in the Notes.
- 5) Item 114 establishes that Notes are usually presented in a certain order, but that is not mandatory.
- 6) Item 117 determines that entities have to disclose *significant* accounting policies:
- (a) The measurement basis used in the preparation of financial statements;
 - (b) Other accounting policies used which are *relevant* for the comprehension of the financial statements.
- 7) Still regarding accounting policies, the entity shall disclose only the accounting policies that are *significant* and that are *specific* for its financial statements, not mentioning the policies that are not applicable.



Main requirements by the Brazilian Corporate Law

- 8) The Law 6404/76 is mandatory for Notes which *explain* the financial position and income, and mentions the obligation of presentation of accounting practices which are *specific* and which apply to *significant* businesses and events.
- 9) It covers also aspects of the *main* policies of valuation of assets and liabilities and events with *relevant* effects on equity and results.

CPC, then, points out that these documents **already determine** that:

- A. All information disclosed shall be *relevant* to external users.
- B. Only *relevant and specific* information to the entity must be disclosed, including related to accounting policies and others.
- C. The mention in Statements, Interpretations and Guidelines and in the Law of disclosure requirements shall always be interpreted in the light of the *relevance* of the information to be disclosed, even if there are expressions such as “minimum disclosure” or similar.
- D. Management and auditors’ *relevance judgement* shall be applied in the selection and presentation of summary of accounting policies of the entity and also in the analysis of probable effects of accounting practices to be adopted in the future.
- E. All relevant information that may influence the user of financial statements must be given even if there is no requirement, reference or mention in the standards or in the Law.

CPC’s Complementary Guidelines, object of this Public Consult

CPC intends to decide upon the possibility of issuing a document which reinforces what has been said in this paper and give complementary guidelines to the existing laws and standards.



The questions that should be answered by this survey are:

1. When relevant, should information be detailed and explained in order to give users an adequate understanding of the matter, with emphasis on what may represent *risks* to the entity?
2. When required by a specific standard, should the reconciliation between opening and closing balances be necessary if at least one of these balances or movement were relevant?
3. In the presentation of the summary of accounting practices, could the entity which kept these policies disclosed, in a continuous and updated way, in the website of its regulatory agency, describe them only briefly in the notes, as long as informing, in the very note itself, the names/addresses of these websites, where the referred notes could be found in greater detail? (This would not be applicable to situations in which the entity changed the accounting policy in the current period regarding the previous period, or that used a standard option given, as it is the case of choice between measure a property for investment at fair value or at cost).
4. The terminology of the Notes should be written according to the assumption that the external user, despite having a reasonable business and economic activities knowledge (financial education), does not necessarily masters the technical terms. Would this matter require the entity, as far as possible, to use account names and notes which are more accessible to the common user and not those which are used in Statements, interpretations and Guidelines applicable to the entity?
5. Should the order of presentation of Notes dealing with specific asset, liability and other figures in the financial statements come after those making reference to the operating context and to description of relevant accounting policies and should follow the relevancy of assets, liabilities, revenue and expenses to which they refer?
6. Should non-relevant information be in the Notes or in the financial statements since they could distract the user's attention from the relevant information?
7. Should the management of the entity formally state that all relevant information (and only that) is included in the Notes?
8. Finally, CPC understands that, if this document is to be made public, it should be as an Orientation. Do you agree? If not, why?



9. If you agree to this document, should it be valid for financial statements as from December 31, 2014? Or another date?

January, 16, 2014.