Agenda item 4

Preparers’ experience with improving effectiveness of disclosures

Global Preparers Forum workshops on disclosures- March 2016

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Objective of the session

- GPF members will share their experience of improving and rationalising disclosures and removing unnecessary disclosures. The discussion will focus in particular on the following:
  - Feedback on the steps taken so far by the IASB in helping to improve disclosure requirements.
  - Information about whether there are any further steps that the IASB should consider in the Disclosure Initiative.
  - Possibility for GPF members to share experience with each other.
- GPF members identified the following issues that affect effective communication via IFRS financial statements:
  - Complexity of:
    - transactions and events (slides 4-5);
    - requirements in IFRS Standards (slides 6-7).
  - Notes disclosure requirements in IFRS Standards
    - are overly-lengthy resulting in long Financial Reports (slide 8);
    - do not focus on the key business areas (slides 9-10).
    - materiality in IAS 1 is not clear enough (slides 12-13);
  - Possible basic principles for disclosures (slides 13-14)
  - Possible topics to cover in the workshops (slides 15-18)

Introduction

- Many preparers have made a number of changes in recent years to their Financial Reports but still the pages in the total Financial Report (Operating and Financial Review (OFR) & Consolidated Financial Statements (CFS)) have not decreased (see the example of Novartis in later slides)
- Over the last decade many IFRS standards have been developed or substantially changed
- Much of this change can be seen in the light of:
  - an effort to accommodate increasing real life complexities in financial statements
  - more and more jurisdictions adopting or allowing IFRS creating a greater community discussing new standards
- Diversity of stakeholders requires principle based standards and disclosures
- The increasing complexity of IFRS has resulted in the inability of preparers to use IFRS consolidated financial statements to communicate their financial performance and has resulted in information overload
- As a result improvements in some key areas are needed

IFRS requires deep understanding of underlying transactions........

- Introduction of fair value accounting concepts mirrors increased use of NPV and other valuation concepts that drive business performance and value generation
- IFRS forces those involved in preparing financial statements to move from backward looking “bean counters” to become forward looking business partners
- Collaboration between financial reporting departments and business functions has needed to increase
- Increasing consistency across financial reports and countries (at least in the same industry) enhances ability for reliable benchmarking

...but is this what is wanted ?

- Using the financial statements to demonstrate effective "stewardship" is increasingly difficult
- Ability to use financial statements as a communication medium with stakeholders has reduced
- Financial statements are increasingly viewed as a compliance exercise
- Internal users have increasing challenges to understand IFRS requirements and use internally
- Increased use of financial service center models requires standardized "rule" based approaches for remote teams
- Different IFRS accounting requirements for economically similar transactions implies that not all economic aspects of a transaction fit into the theoretical concept of the respective standard
- Disclosure volume increases documentation needs

Developments of IFRS are not without challenges

Focus on balance sheet

Complexity

- Sound theoretical concepts ▷ Difficult to communicate and implement
- Decreased prudence ▷ Volatility in «Comprehensive income»
- Increased transparency ▷ Lost in volume

Fair value

Disclosures

Fair Value: Application challenges

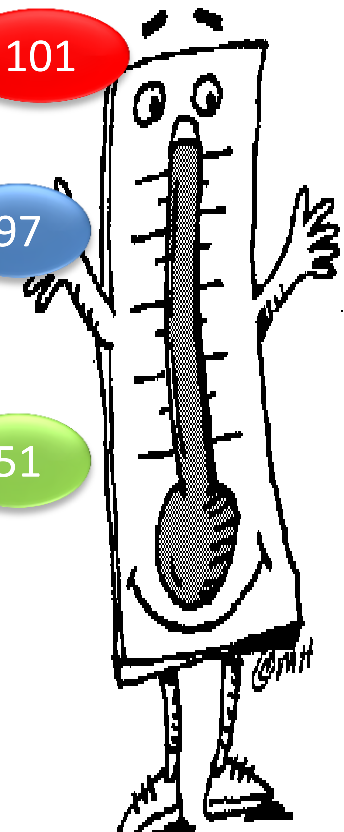
Currently IFRS are based on a mixed concept under which certain assets and liabilities are recognized at fair value, others at cost or amortized cost

1	What is fair value?	IFRS 13	In particular for unquoted assets, numerous methods and assumptions may be used
2	How to cope with diversity of inputs?	Extensive disclosures	Checklist approach leads to extensive disclosures on rather immaterial items
3	How to cope with volatility?	Comprehensive income	What use are the items below the “page break”?

For assets and liabilities measured at amortized costs, these issues do not occur. However, issues do occur when the concept of fair value gets mixed with amortized cost.

Increasingly large Financial Reports- Example Novartis

Year	*Objective*	*Consequence*	*# OFR & CFS pages**
2015			101
2008	Provide information on recurring vs.non-recurring items	Introduction of Core results	97
2000	Enters US market: Listing on NYSE in May 2000	Reconciliation to US GAAP until 2006	51
1993	Provide globally recognized financial statements	Introduction of IFRS, full alignment with internal reporting	



**2015 OFR 30; CFS 71*

Disclosures do not focus on key business areas-Example Novartis

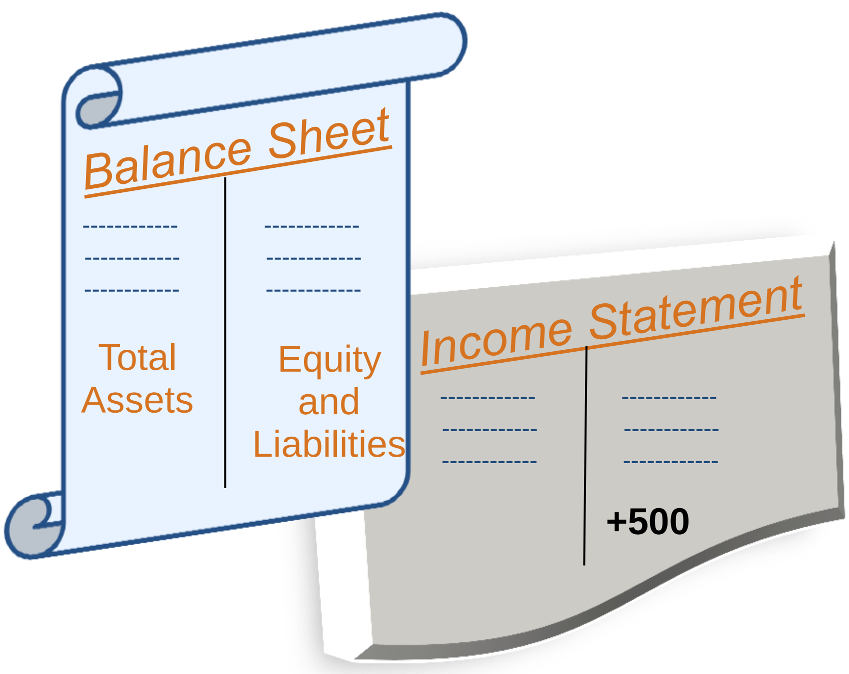
- Disclosures do not necessarily increase understanding of results
- Do not serve as a communication tool but get degraded to a pure compliance exercise

	# of pages in 2015 Annual Report	% of total assets/liabilities/ Op. Inc.$ bn
Financial instruments	*9*	*4%/17%/ -$1.1*
Share based compensation	*4*	*-$0.9*
Post employment benefits	*5*	*4%/-$0.9*
Intangible assets	*2*	*50%/ -$ 3.9*

Disclosure should help with forecast accuracy

Despite the massive disclosure volume preparers and users are of the view that not all necessary information is being provided

What else is needed?



Objectives of financial reporting

Accounting and related financial reporting is the bed-rock of a Company's report on its performance in a period to all its stakeholders

It must be an effective medium to communicate to all these stakeholders

It must be useful for internal purposes to drive performance and align behavior

The disclosure puzzle

Each standard lists related disclosure requirements, but there is no disclosure framework

One size fits all approach inherent in principle based standards

Only very basic guidance on materiality is provided in IAS 1

Preparers, auditors and regulators seem to focus on completeness instead of usefulness of disclosures (Tick-the-box approach)

- Broad review is required and initiated
- What are reasonable counter measures to the Checklist approach?
- Create tension between completeness and usefulness: Is there a maximum number of pages a user can digest?

Reasons to make changes to Consolidated Financial Statements

- Increased expectations from regulators to respect the guidance in IFRS concerning:
  - Revelance to the Group's activity
  - Comparability to peers
  - Understandablity to the average reader
  - Grouping of information for easy reference
- This results in need to avoid:
  - Boilerplate and generic descriptions
  - Reduced verbatim reproduction of IFRS text
- Increased focus on:
  - Accounting policies and data specific to a preparer's activities
  - Matters raised by regulators

Possible basic principles for disclosures in Consolidated Financial Statements

Avoid boilerplate disclosures

- Delete any repetition of the IFRS standards in the accounting policies used unless it is an area of major significance to the entity in which case a brief and simple overview should be provided
- Describe mainly only those accounting policies where IFRS provides a choice or where it assists interpretation
- Retain any accounting policy description that has been specifically addressed by the exchange regulators
- Provide industry or company specific information
- The above affects in particular – Significant accounting policies

Respond to the needs and expectations of key stakeholders and regulators

- Provide meaningful disclosures meanwhile ensuring full compliance with IFRS
- Ensure reader-friendly format

Possible issues for discussion at the GPF workshop on disclosures (1/4)

Embedding accounting policies in the Notes/ improving readability

- Examples will be shared with the GPF workshop of preparers who have made changes to their notes to:
  - Incorporate accounting policies into the notes
  - To reorganise the notes to start with those most significant to the preparer’s activity

➢ We request the views of GPF workshop members on at least the following questions:
  - ❖ What is the experience of allocating accounting policy discussions to the related notes ?
  - ❖ Do GPF members share certain preparers’ fears that the SEC will take a negative view of financial statements that differ from the current US norms?

Possible issues for discussion at the GPF workshop on disclosures (2/4)

External Audit of Disclosures/ Negative Assurance

- Does all data that is required to be in the Consolidated Financial Statements (CFS) and is externally audited need to be fully included in the CFS with no cross-referencing?
- Should «negative assurance» on immaterial amounts be provided? (Many consider that this would be selective and too subjective and therefore not considered capable of external audit)

➢ We request the views of GPF workshop members on at least the following questions:

  - ❖ The IASB Staff paper considers that cross-referencing into the CFS from outside the CFS would be acceptable. What do the GPF members see as concerns to doing this?
  - ❖ Do members have views on «negative assurance» (currently an example in the draft IASB Materiality document)?

Possible issues for discussion at the GPF workshop on disclosures (3/4)

«Core» data

- Many preparers are increasingly disclosing «Core» data (which excludes many items which are considered by the preparer to be non-recurring or primarily the result of fair value requirements) to improve their communication regarding their performance
- Often this so-called «Core» data is fully extracted from the financial records and also produced for the segment reporting

- We request the views of GPF workshop members on at least the following questions:
  - ❖ Could the «Core» tables be considered segment reporting per IFRS 8?
  - ❖ Are preparers correct in labelling this «Core» data as Non-IFRS data if all data comes from the accounting records?
  - ❖ Could the workshop members envisage external auditors covering this «Core» data in their reporting?
  - ❖ Do workshop members have concerns about different regulators having differing and conflicting requirements in this regard?

Possible issues for discussion at the GPF workshop on disclosures (4/4)

Possibility to split notes into those that are Business Relevant and Others

There is a view that some of the IFRS note disclosures (even after fully implementing the amended IAS 1) are of little importance to the business activities of the preparer. A suggestion would be to split notes into two levels with the second «Other» level of a compliance nature only available as an appendix on the web site (eg it seems that certain Financial Instrument disclosures are already going in this direction).

❖ How do GPF members react to splitting the notes into two categories based on their significance to the business?

Reduce repetition in the OFR and CFS

There is a substantial duplication between the OFR and CFS.

❖ Do the GPF members have any suggestions as to how to reduce this duplication?