

Disclosure of sensitive information

Joint CMAC-GPF meeting
June 2019

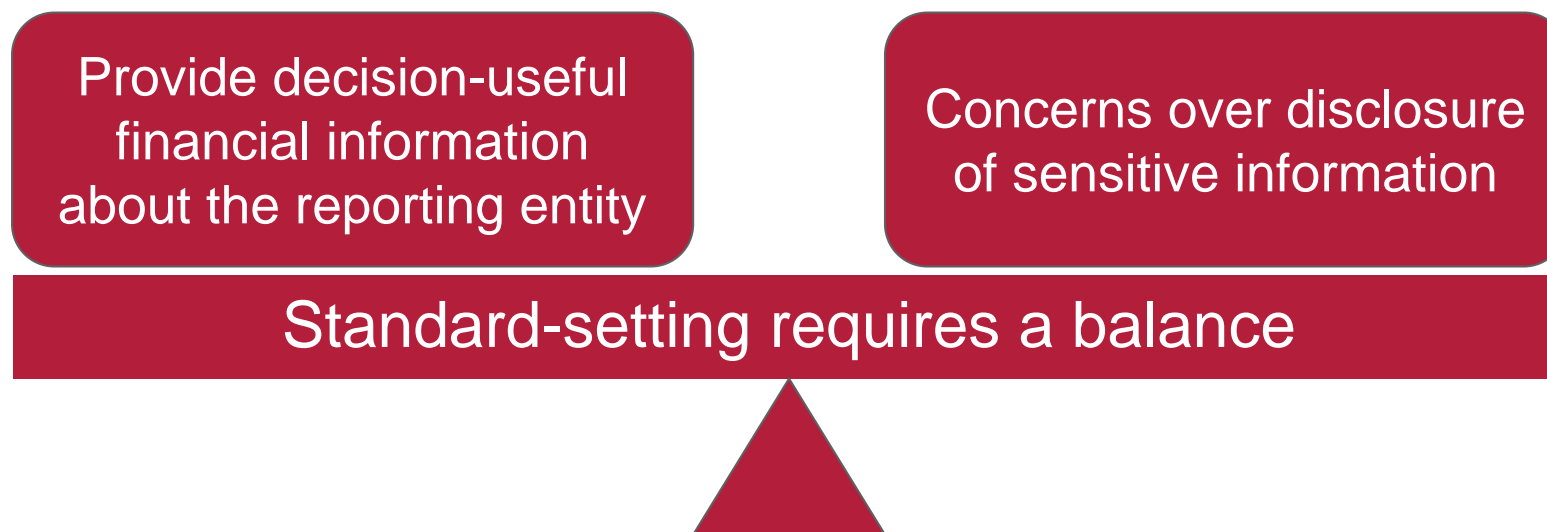
Dehao Fang

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Objectives of this session

2

- Assist the Board to identify :
 - common characteristics that would help to define sensitive information;
 - what types of sensitive information are investors interested in and why; and
 - best approach to balance investors' needs and preparers' concerns over disclosure requirements.



Why are we seeking advice now?

- Various projects that may involve disclosure of sensitive information currently underway:

Projects	Potential sources of sensitive information
Goodwill and impairment	Business strategy and acquisition objective
Management commentary	Tax strategy
Dynamic risk management	Risk position and sources of arbitrage profit

- Preparers often raise the issue of sensitive information in their feedback. However, some of this information may be material to investors.
- Board does not currently have a general approach to information sensitivity. The issue is addressed on a case-by-case basis
- 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

Outline of discussion

- 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 members

What do we mean by
sensitive information?

Sensitive information

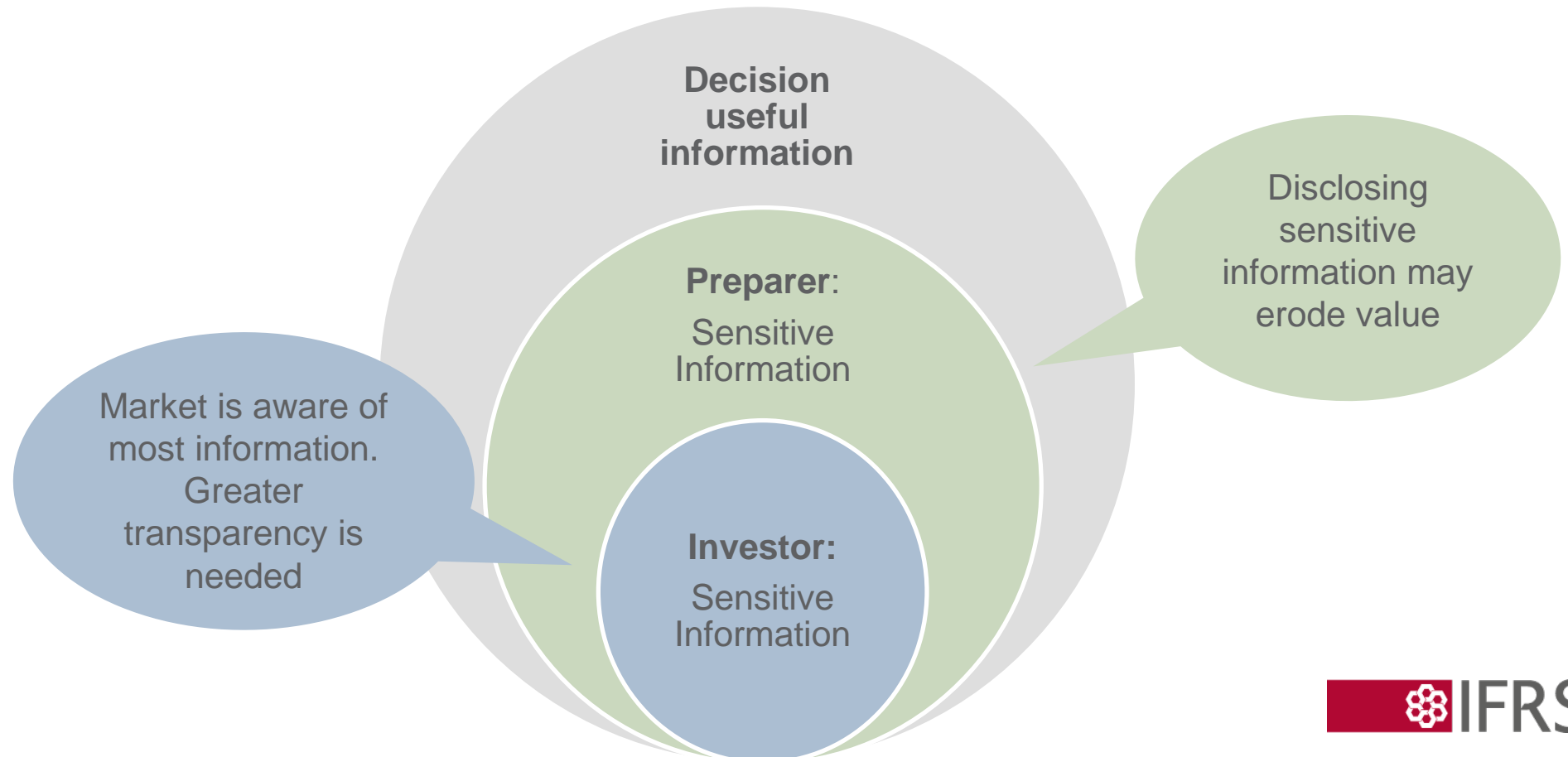
- **What do we mean by “sensitive”?**
 - Information whose disclosure could result in commercial loss to an entity
- **Examples:**
 - litigation details (IAS 37)
 - segment information (IFRS 8)
- *For purposes of today's discussion, exclude disclosures that risk shareholder litigation (eg estimates and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



Perceptions over information sensitivity

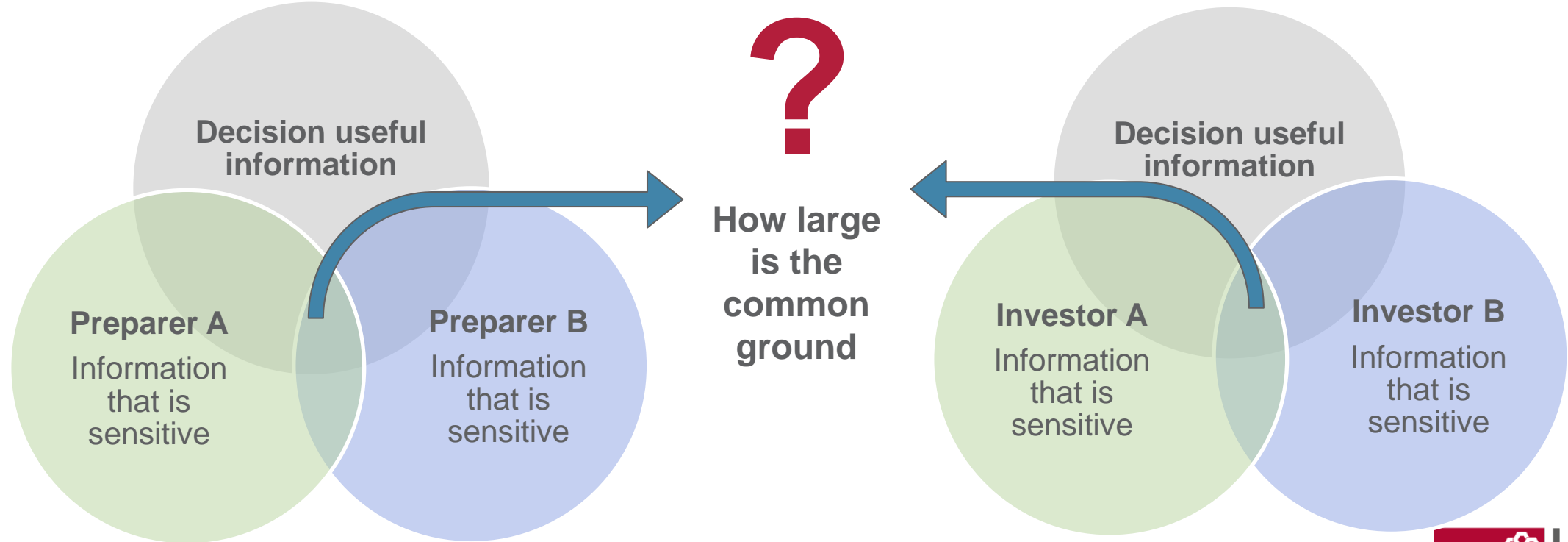
7

- Different stakeholders have different views of what information would be sensitive
- Some information that preparers think is sensitive may not be perceived as such by investors



Lack of consensus within the stakeholder groups

- Sensitive information is often
 - highly entity and fact specific
 - hypothetical and difficult to prove/disprove
- Different members within a stakeholder group may have differing perceptions about “what is sensitive information”?



Benefits and challenges of required disclosures of sensitive information

Benefits of required disclosure

10

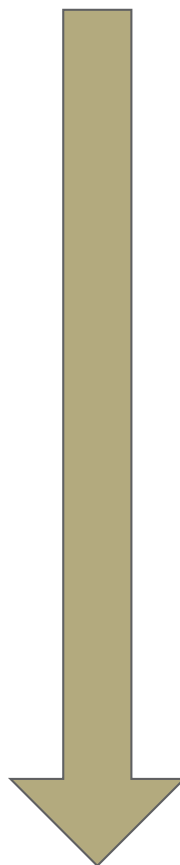
Benefits for market participants

comparability across entities

reduce information asymmetry between management and investors

increased market liquidity

more efficient allocation of limited resources



Benefits for entities

strengthened accountability and stewardship

improved investor relations (may broaden shareholder diversity, increase trust in management)

lower cost of capital

Challenges of required disclosures

11

Unequal effects

- some information may benefit potential investors more than current investors in a company's equity/debt (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 (cont'd)

12

Unintended
consequence
from entity's
actions to
avoid
disclosures

- potential delisting, not listing or regulatory shopping
- may reduce investment opportunities
- may reduce options for raising capital
- may impede efficient allocation of limited resources

The need for
balance

- benefits to the market as a whole may outweigh the costs to individual entities
- require all entities to be subject to the same requirements

Types of sensitive information

Negotiating position

14

Ref	Relevant disclosure	Concerns	Counter arguments
IAS 36 / IFRS 5	Impairment loss on asset, disposal groups and non-current asset held for sale	<ul style="list-style-type: none"> Potential buyers may push for lower price based on updated carrying value of asset 	<ul style="list-style-type: none"> Carrying amount may not necessarily affect asset disposal price Intended purpose affects measurement of asset
IFRS 8	Information on revenue contribution by major customer	<ul style="list-style-type: none"> Key customers, knowing their importance to the entity, may have the upper hand in negotiation Information may be used by competitors 	<ul style="list-style-type: none"> Relative negotiating power may be known to contracting parties Customers may be able to work out their importance from their internal data
IFRS 8	Segment profit margin	<ul style="list-style-type: none"> May be used as basis for customers to demand lower price or suppliers to demand higher price. Undermine negotiating position. Pressure on profit may harm investors 	<ul style="list-style-type: none"> Customer/supplier decision may be driven by value of product, not profit that the entity makes from the transaction Customer/suppliers may already be aware of profit margin Profit margin of product may not be derived from segment profit margin

Ref	Relevant disclosure	Concerns	Counter arguments
IAS 38	Description of capitalised intangible asset	<ul style="list-style-type: none"> Reveals details of R&D, prompting competitors to step in 	<ul style="list-style-type: none"> Peers may already be aware of competitive landscape in industry Entities may already publicise successful projects to attract investors
IFRS 8	Information on revenue contribution by major customer	<ul style="list-style-type: none"> Facilitate competitors targeting key customers Reveal concentration of sales, facilitate competitive behavior 	<ul style="list-style-type: none"> IFRS Standards do not require the disclosure of customer identity Competitors may already be aware of industry landscape
Goodwill and Impairment project	Strategic rationale and key objectives of acquisition	<ul style="list-style-type: none"> Premature disclosure allows competitors to take counter-measures Disclosure of restructuring plan lowers employee morale 	<ul style="list-style-type: none"> Stakeholders may already be aware of entity's plan beforehand, but disclosure may confirm the fact

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

Uncertain positions

17

Ref	Relevant disclosure	Concerns	Counter arguments
IAS 1	Uncertainty relating to going concern	<ul style="list-style-type: none">• Cause further negative impact to entity's financial position• Effects of "self-fulfilling prophecy"	<ul style="list-style-type: none">• Disclosure of fundamental importance to financial reporting• Market may already be aware of issue• Fear of uncertainty increases volatility• Transparent disclosure can reduce market over-reaction
IAS 37	Disclosure of provision for litigation	<ul style="list-style-type: none">• May prejudice entity's position in legal dispute	<ul style="list-style-type: none">• Users need to know the degree of measurement uncertainty involved• Limited disclosure exemption allowed under IAS 37

Regulatory scrutiny and reputational risks

18

Ref	Relevant disclosure	Concerns	Counter arguments
Management Commentary Project	Uncertain tax positions / Sustainability of tax strategy	<ul style="list-style-type: none">• Attract scrutiny from tax authorities• Increased cost of regulatory compliance	<ul style="list-style-type: none">• Regulators may already have access to information regardless of disclosure
General	Disclosure of information that is reputationally harmful	<ul style="list-style-type: none">• Damage brand image and reputation of entity resulting in adverse financial effects	<ul style="list-style-type: none">• Interest groups are not primary users of financial statements• Stakeholders have diverse views and opinions on what is reputationally damaging

Addressing sensitive information

Possible standard-setting approaches to address the issue—1 *(See existing standard-setting example on slide 31)*

20

No accommodation for sensitivity concerns

- 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

What would it mean

- potential commercial loss from disclosing sensitive information could be a concern for some preparers

Possible standard-setting approaches to address the issue—2a *(See existing standard-setting example on slide 32)*

21

'Comply or explain'

- creates incentive for disclosing required information
- allows for exemption where entity determines that costs exceeds benefits

What would it mean

- decreases comparability across entities than having mandatory disclosure requirements
- more communication efforts needed between users and preparers
- statement of non-disclosure may itself cause market to respond
- effectiveness depends on market and regulatory environments

Possible standard-setting approaches to address the issue—2b *(See existing standard-setting example on slide 33)*

22

‘Comply or explain’ 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’ that would need to be specified by the Standard
 - audit committee / board of directors could be required to take explicit responsibility for non-disclosure

What would it mean

- information provided would be less timely
- statement of non-disclosure may itself cause market to respond
- 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—3 *(See existing standard-setting example on slide 34)*

23

Tailored disclosure requirements to reflect concerns

- seek to provide relevant information indirectly via inference where possible
- compromise between needs of users and preparers

What would it mean

- information may be less relevant than if provided directly

Possible standard-setting approaches to address the issue–4

24

Voluntary disclosure

- disclosure of information is voluntary at the entity's option

What would it mean

- information may be biased (possibly only 'good news' disclosed)
- relies on market to penalise poor disclosure, which may not be functioning effectively
- creates a burden for investors to obtain information
- may be subject to abuse
- may undermine confidence in the information that is currently in the financial statements

Questions for members

1. Consider the examples on slides 14-18.
 - Do you believe this information is sensitive (as described on slide 6) ?
 - If your response varies based on different facts and circumstances, what are those facts and circumstances?
 - Is there a common characteristic that would help define sensitive information?
 - Do investors need this information to be disclosed? If so, why?
2. Consider the approaches on slides 20 – 24. How could disclosure requirements best balance investors' needs and preparers' concerns?

Appendix A

Summary of feedback received from Advisory Council

- General feedback
 - Different stakeholders have different views of what sensitive information is
 - Preparers' concerns usually involve:
 - Litigation
 - Business combination / strategy disclosures
 - Remuneration
 - Confidentiality agreement
 - Objective of financial reporting is to promote transparency and reduce information asymmetry
 - Achieving this objective is more important than the need to accommodate fact-specific sensitive information
 - Should apply materiality in determining whether disclosure is needed

Feedback received from Advisory Council (cont'd)

29

- Suggestions
 - Hold lab session debate between users and preparers over potential disclosures
 - Some acceptance for comply or explain model, help to highlight potential red-flag
 - Lack of support for voluntary disclosure

Appendix B

Examples of various approaches used in
current IFRS Standards

Approach 1 - No accommodation for sensitivity concerns

31

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.

Approach 2a – ‘Comply or explain’

32

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.

Approach 2b – ‘Comply or explain’ with constraints

Example from Management Commentary project

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

1. Information in management commentary that helps users assess the prospects for future net cash inflows to the entity and assess management’s stewardship of the entity’s economic resources will ordinarily be more aggregated than information that the entity’s competitors could use to the entity’s disadvantage. However, there may be occasions when the entity considers that providing in management commentary information about impending developments or matters arising in the course of ongoing negotiations could be seriously prejudicial to the interests of the entity. In such cases, management:
 - (a) provides in the management commentary summarised information about the developments or matters that is as detailed as possible but without being seriously prejudicial to the interests of the entity;
 - (b) considers whether information in the management commentary may be misleading without the context of the excluded information and, if so, management adapts the content and tone of the management commentary accordingly; and
 - (c) describes in the management commentary the process undertaken to determine that it was appropriate to exclude material information from the management commentary.
2. The exclusion of material information discussed in the preceding paragraph is available only if permitted by the entity’s legal and regulatory environment, and is limited to situations when providing that information would cause serious prejudice to the entity’s interests in impending developments or in ongoing negotiations which are not in the public domain, for example when the entity is in negotiations to acquire another entity.

Approach 3 – Tailored disclosure requirements to reflect concerns

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.

Get involved

35

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