Disclosure Initiative – Project Update July 2014

Introduction

1 At the July 2014 IASB meeting the IASB discussed the following topics:

(a) Amendments to IAS 7 *Statement of Cash Flows* short-term project:

(i) reconciliation of liabilities related to financing activities; and

(ii) disclosure about restrictions on cash and cash equivalents; and

(b) Amendments to IAS 1 *Presentation of Financial Statements*: Principles of Disclosure – Cross-referencing.

Amendments to IAS 7: Reconciliation of liabilities related to financing activities

2 The objective of this project is to provide information that improves investors' understanding of changes in an entity's liabilities that relate to cash flows from financing activities. The project followed requests from investors to introduce a requirement that entities must disclose and explain their net debt reconciliation.

3 IASB staff noted that the draft proposal would require liabilities for which the cash flows are or would be classified within financing activities, in accordance with paragraph 10 of IAS 7 to be reconciled to the opening and closing statement of financial position. IASB staff noted that by using the definition of financing activities in IAS 7 (…activities that result in changes in the size and composition of the contributed equity and borrowings of the entity) there is no need to define debt.[1]

4 To date, IASB staff have undertaken outreach with investors that has included a survey in order to understand what information was required by users when reviewing cash flow information and how information about debt was used. In addition, following the March IASB meeting, staff prepared illustrative examples of the proposed disclosure requirements, and discussed these with investors in order to determine whether the draft proposal would improve their understanding of the changes in an entity's liabilities that relate to cash flows from financing activities.

5 In addition, following feedback from investors, the illustrative examples were revised and were discussed at the joint meeting of the Global Preparers Forum (GPF) and Capital Markets Advisory Committee (CMAC).[2]

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1 IASB staff Agenda Paper 11B (July 2014) [http://www.ifrs.org/Meetings/MeetingDocs/IASB/2014/July/AP11B-Disclosure%20Initiative.pdf]

2 Following consultation with CMAC and GPF, the IASB staff noted the following points in regards to the revised illustrative example:

- a reconciliation of liabilities relating to financing activities provides users with the raw data required to perform their analysis of the entity;
- the amendment to IAS 7 should not prohibit disclosures from being provided on a net basis. This is because preparers might manage debt on a net basis and may already provide this information in the financial statements today. Changing to a gross reconciliation could be perceived as reducing information and limiting management's ability to explain financial and risk management strategies;

6 A summary of the key concerns raised by the IASB members during the meeting is provided in Appendix A to this paper.

IASB tentative decision

7 The IASB tentatively decided that it should include elements in the proposed updated IFRS Taxonomy only for items included in the text of the proposed amendment to IAS 7, including the Illustrative Example.

Preliminary AASB staff view

8 AASB staff can accept the proposed additional reconciliation requirements. However AASB staff remain concerned with the proposals to incorporate additional disclosure burdens on preparers. In addition, consistent with some IASB member comments at the July 2014 IASB meeting, AASB staff question to what extent the reconciliation will provide incrementally more useful information, and are concerned that it may result in duplication of disclosures.

9 In regards to the IASB tentative decision concerning the IFRS Taxonomy, staff agree with the tentative decision.

Question 1 to Board members

Do you agree with the preliminary AASB staff view outlined in paragraphs 8-9, above?

Amendments to IAS 7: Disclosure about restrictions on cash and cash equivalents

10 The objective of the discussion was to discuss improving disclosures about restrictions on cash and cash equivalents. This followed requests from investors for improved information about cash and cash equivalents, specifically the costs associated with repatriation of cash where there are foreign exchange controls or tax implications.[3]

11 IASB staff provided an overview of three options to address the investor concerns:

Option 1 – provide no additional disclosures;

Option 2 – amend IAS 7 to require disclosure of the costs that would be incurred if the cash or cash equivalents were remitted as earnings (including a distribution of profits) to a parent entity (the IASB staff recommendation); and

Option 3 – redefine ‘cash’ and ‘cash equivalents’.

- it is important that investors are able to understand the components of financing activities, because investors like to understand the nature of financing liabilities; for example distinguishing between short- and long-term liabilities; and
- much of the information is currently available in the financial statements, but it is helpful if preparers can collate the information in a table because that makes it more accessible to investors.

3 IASB July 2014 Agenda Paper 11C [http://www.ifrs.org/Meetings/MeetingDocs/IASB/2014/July/AP11C-Disclosure%20Initiative.pdf]

12 In addition, IASB staff suggested that the list of examples in paragraph 49 could be amended to include the example of costs associated with repatriation of cash where there are foreign exchange controls or tax implications.

13 IASB staff also recommended that the amendment should clarify that the scope of the disclosures includes cash and cash equivalents held by a joint operation accounted for in accordance with IFRS 11 *Joint Arrangements*, if cash held by the joint operation is included in cash and cash equivalents of the reporting entity.

14 A summary of the key concerns raised by the IASB members during the meeting is provided in Appendix A to this paper.

<u>IASB tentative decision</u>

15 The IASB asked staff to perform further outreach to identify whether it was possible to improve disclosure about cash and cash equivalents in the short term or whether to address the topic as part of the Principles of Disclosure research project.

<u>Preliminary AASB staff view</u>

16 AASB staff agree that this is an important topic for the IASB to address. It is apparent from the feedback received by the IASB that the current disclosure requirements do not adequately address the information needs of users. AASB staff also agree with the IASB tentative decision to perform further outreach to ensure it is clear what the objective of the project is and to determine if the project can be finalised in the short-term or if a longer time period is required. AASB staff will continue to monitor the monitor the project, including opportunities for the AASB to participate in the IASB's outreach events. .

Question 2 to Board members
Do you agree with the preliminary AASB staff view outlined in paragraph 16, above?

Amendments to IAS 1: Principles of Disclosure – Cross-referencing

17 The purpose of the discussion was to obtain the preliminary views of IASB members on whether IFRS should allow, as a general concept, disclosures required by individual Standards to be presented in accompanying statements or reports (e.g. management commentary or a risk report).[4]

18 Some Standards allow an entity to incorporate disclosures located 'outside' of financial statements into financial statements by disclosing a cross-reference to that information in the financial statements. These include:

(a) IFRS 7 *Financial Instruments: Disclosures* – paragraph 21B and B6[5];

4 IASB July 2014 Agenda Paper 11E [http://www.ifrs.org/Meetings/MeetingDocs/IASB/2014/July/AP11E-Disclosure%20Initiative.pdf]

5 Paragraph B6 is excluded from the requirements of AASB 7, and paragraph 21B is substantially modified to remove the option to cross-reference information outside the financial statements.

(b) IFRS 1 *First-time Adoption of Australian Accounting Standards* paragraph 32[6];

(c) IAS 19 *Employee Benefits*, paragraph 150[6]; and

(d) IAS 34 *Interim Financial Reporting*, paragraph 16A[7].

19 The IASB staff have noted the IASB currently allows cross-referencing as it acknowledges that some information required by a Standard might be more usefully disclosed and discussed in a report accompanying the financial statements and therefore, the IASB, in some cases, provides this flexibility to give entities the ability to present information in what they think is the most useful way.

IASB feedback

20 IASB staff have provided a summary of feedback received from constituents[8]:

21 Those respondents supporting cross-referencing noted:

(a) duplication of information contributes to the 'disclosure problem', because it unnecessarily increases disclosure and impairs the understandability of information by creating clutter.

(b) some preparers view the existing possibilities to cross-reference (e.g. IFRS 7) as exceptions that only apply to the specific disclosures to which the cross-referencing guidance relates.

(c) other preparers view cross-reference requirements as being available more generally, even if an IFRS does not contain the specific wording.

(d) in response to the IASB Conceptual Framework Discussion Paper DP/2013/1, some respondents suggested that the IASB should provide guidance on when cross-referencing is appropriate and encourage cross-referencing in those cases.

(e) there were views that information not frequently changing from year to year, such as disclosure of accounting policies, could be separated to website as a form of standing data and incorporated in financial statements through cross-references

22 Those respondents with concerns regarding cross-referencing noted:

(a) some jurisdictions applying IFRS do not permit the use of existing cross-referencing options in IFRS – the AASB February Action Alert was referred to as providing an example.

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6 Paragraphs 32 and 33 of AASB 1 and paragraph 150 of AASB 119 are discussed in agenda item 18.

7 AASB staff have recommended in Agenda Paper 18.1 the additional two sentences proposed in paragraph 16A of IAS 34 that permits crossing-referencing to other statements be excluded from AASB 134.

8 IASB July 2014 Agenda Paper 11E

(b) it would be difficult to clearly identify what forms part of the IFRS financial statements and hence whether those financial statements are complete. This raises the question of whether cross-referenced information is part of a complete set of financial statements and whether the linked information is or is not prepared in accordance with IFRS.

(c) too much cross-referencing could make financial statements less understandable.

(d) cross-referencing could make financial statements less identifiable and diminish their "brand" as the source for reliable, neutral and verifiable data.

(e) audit implications:

  (i) auditors may find it difficult to verify that an entity has complied with paragraph 49 of IAS 1 – that an 'entity shall clearly identify the financial statements and distinguish them from other information in the same published document';

  (ii) perceived different quality of information between financial statements and other statements or reports;

  (iii) many jurisdictions management reports are not subject to audit and users may perceive the quality of information placed elsewhere outside of the financial statement to be different;

(f) concerns about access to information where the cross-reference referred to a location outside of the annual report (or other compliance document) e.g. a separately published document or to a website.

IASB staff proposals

23 Despite the concerns raised, the IASB staff considered two possible approaches for cross-referencing in IFRS, as outlined below:

Approach 1: The cross-referencing possibilities in particular Standards (including conditions for when cross-referencing is appropriate) should be shifted to a general principle that would apply to all disclosures. The explicitly-stated possibilities in particular standards (e.g. IFRS 7) would be removed (IASB staff recommendation).

Approach 2: As part of an overall review of all disclosures the IASB could, on an individual basis, identify those disclosures that would be eligible to be reported outside of financial statements and incorporated through cross-referencing. The IASB would also clarify the basis on which some information may be reported outside of the interim financial statements but not cross-referenced for annual reporting.

24 In addition, the IASB staff recommended that the discussion on the topic be included in the Principles of Disclosure Discussion Paper and not developed into a narrow-focus amendment to IAS 1 in the short-term.

25 A summary of the key concerns raised by the IASB members during the IASB meeting is provided in Appendix A to this paper.

IASB tentative decision

26 The IASB staff asked the staff to explore whether further guidance on the use of cross-referencing for incorporating disclosures into financial statements could be developed to form a general principle. Specifically the IASB asked the staff to consider limiting the use of cross-referencing to information disclosed in the management commentary and to circumstances in which the discrete nature and magnitude of the disclosure justifies the use of cross-referencing.

Preliminary AASB staff view

27 As noted in paragraph S204 in the AASB Supplementary Paper to the IASB *Conceptual Framework* Discussion Paper (DP/2013/1), the AASB staff think neither the revised IASB Conceptual Framework, nor IFRSs, should include comments that particular disclosures can be provided outside financial statements. The AASB staff share many of the concerns outlined in the IASB staff agenda paper.

28 In addition, as noted in paragraph S205 of the AASB Supplementary Paper to the IASB *Conceptual Framework* Discussion Paper, AASB staff consider it is not the role of the IASB to indicate where disclosures are required or permitted to be located and that should be a matter for standard setters and regulators in each jurisdiction.

29 AASB staff note that the AASB have amended AASB 7, paragraph 21B to remove the ability to cross-reference (see AASB 2014-1, paragraph 81). In June 2014, the IASB staff were made aware of the AASB's concerns, including the AASB's decision to remove the cross-referencing requirements from AASB 7. However, as noted at agenda item 22 of this meeting, the IASB have included a further cross-referencing paragraph in IFRS 7, paragraph 35C.

30 Further, as noted in agenda paper 18.1 of this meeting, the IASB are proposing to permit cross-referencing disclosure in IAS 34. AASB staff are concerned that the IASB is introducing further cross-referencing possibilities when decisions on cross-referencing in the Disclosure Initiative – Principles of Disclosure project have not yet been finalised. AASB staff consider that the IASB should not propose any further cross-referencing paragraphs to Standards until all decisions in this project have been finalised.

31 Despite these concerns, staff do not consider that the issue should be raised to the IASB at this stage of the project as the IASB staff are already sufficiently aware of the issue. AASB staff will continue to monitor the project developments.

Question 3 to Board members

Do you agree with the preliminary AASB staff views outlined in paragraphs 27–31, above?

Research Programme – Financial Statement Presentation

32 The purpose of the discussion was to consider how the IASB should respond to calls for the IASB to restart the suspended Financial Statement Presentation (FSP) project.[9]

33 IASB staff provided a brief history of the former FSP project. In addition, they pointed out that constituent demand for the project seemed to be split almost exclusively along the line dividing preparers (who generally do not support restarting the original project) and users of financial statements (supportive of the project).

34 In addition, IASB staff noted that many of the matters that were within the scope of the FSP project at the time it was suspended have been incorporated in the Conceptual Framework project and the Disclosure Initiative. The component of the FSP project that is not currently being addressed is the categorisation of the primary financial statements. Although the categorisation proposals in the FSP applied across all of the primary financial statements, they were driven from the Statement of Comprehensive Income, which is why it was characterised as performance reporting.

IASB tentative decision

35 The IASB tentatively decided to add a project to its Research Programme on *Performance Reporting*.

Preliminary AASB staff view

36 AASB staff agree with the tentative decision made by the IASB.

Question 4 to Board members

Do you agree with the preliminary AASB staff view outlined in paragraph 36, above?

9 IASB Agenda Paper 11F [http://www.ifrs.org/Meetings/MeetingDocs/IASB/2014/July/AP11F-Disclosure%20Initiative.pdf]

Appendix A: AASB staff summary of key discussion points from July 2014 IASB meeting

Amendments to IAS 7: Reconciliation of liabilities related to financing activities

37 There was general agreement in regard to the proposed reconciliation however, concerns were raised by IASB members including[10]:

(a) the proposed illustrative example was simplified and only made reference to one acquisition, however in real life, for a large company, in one year there may be several acquisitions, disposals and losses of control. In response to the staff comment that IFRS 3 *Business Combinations* would already require disclosure of this type of information, the member noted, for people to understand what is expected of them and for the example to be useful, it would have to be more complex and realistic. In addition, the IASB member noted that when the ED was published it was important to communicate that the reconciliation is not an extra burden as most of the information is already required.

(b) an IASB member pointed out that the cash flow statement is only made in the closing process once a concrete balance sheet has been prepared, and, for a company with thousands of subsidiaries, to also require the proposed reconciliation, this could delay the release of the financial reporting. In response, IASB staff noted that generally users were looking for this information and the preparers they had spoken to accepted that the information was available and they just had to collate it.

(c) an IASB board member questioned pensions being included in the second illustrative example noting that he did not think pensions would be commonly thought of as a financing activity. The IASB staff member responded that they had received mixed feedback as to whether pensions would be part of financing activities and therefore the staff had put it in the example (which they noted they did not propose putting in the ED) to demonstrate that the definition of financing activities varied among entities.

(d) an IASB member questioned whether the elements that are not necessarily on the face of the balance sheet, such as other liabilities, whether the presumption was that the entity would still have to apply the reconciliation to those items. IASB staff confirmed that this would be the case.

(e) an IASB member pointed out that the disclosure can add value, however also questioned to what extent it will provide more information and expressed doubts because of duplication between different parts of the standards.

(f) an IASB member expressed concern that the reconciliation did not make any sense for banks and questioned if staff had sort feedback from users of financial statements of banks. The IASB member recommended IASB staff seek input from analysts and if they felt it did not make sense to draft an

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10 Notes taken by AASB staff from the recording of IASB July 2014 meeting [http://media.ifrs.org/2014/IASB/July/DisclosureInitiative_AP11_AM.mp3] (accessed 12 August 2014)

exemption for entities that have assessment of liquidity situations. The IASB member further noted that if an exemption was not provided it would add to disclosure and disclosure overload, particularly for that industry. IASB staff responded by suggesting a comment could be included in the Basis for Conclusions. Another IASB member responded by pointing out that the IASB does not write industry specific standards.

<u>Amendments to IAS 7: Disclosure about restrictions on cash and cash equivalents</u>

38 Concerns raised by IASB members during the discussion included:

(a) several IASB members questioned why the proposal was restricting the disclosure to remittances on earnings, noting that the difficulty was not just earnings it was to get the money back into the general cash flow of the organisation as a whole.

(b) another IASB member commented that they had doubts on the effectiveness of the disclosure and questioned, in the proposal, where we were trying to get the cash to -was it to the direct parent, to its ultimate parent or both. The IASB member noted that it needed to get to the reporting entity where the shareholders are, not to the next level as this may be meaningless. The staff noted the proposal was to the immediate parent.

(c) an IASB member noted that the requirement seemed too broad and specificity was required. It was noted that at the moment there appeared to be possible tax planning opportunities and it was not clear whether an entity would have to disclose the most probable cost, the most advantage, or the most expensive cost and there were a range of costs depending on what option an entity may choose and it will be very situational country by country and company by company.

(d) it was noted that the proposal may be difficult to implement and may end up giving boilerplate disclosure and will not prompt preparers to explain in detail the tax planning opportunities. The IASB member further noted that they thought there would be a lot of negative reaction to the proposal.

(e) several IASB members pointed out that this was not a minor amendment. That it was a very significant change to reporting practices and noted that the IASB must be prudent and more research was required on the topic.

(f) several IASB members noted that it was unclear what the objective is, and it was also unclear what the proposed requirement was telling preparers to do.

(g) another IASB member noted that the disclosure was important disclosure and encouraged IASB staff to find a way to make it operational.

<u>Amendments to IAS 1: Principles of Disclosure – Cross-referencing</u>

39 Concerns raised by IASB members during the discussion included:

(a) several IASB members agreed on not developing a narrow focus amendment, noting it was a bigger issue.

(b) an IASB member noted at the same time everybody else is saying users need everything in the one place and that is what makes it useful and a good reference, that the IASB is saying 'we will help the duplication problem, so we will be the guys that allow people to cross-reference, and use everybody else's cross-reference material' and I think we should be careful before we go there. The Board member further suggested that the IASB should think about circumstances where the information definitely needs to be provided directly and other circumstances where it might be ok to cross refer.

(c) it was noted that even though users acknowledge duplication, and they acknowledge the possibility to do it, they say 'for us it is more useful if it is in one place' because they can see it as a whole rather than scattered around.

(d) an IASB member noted that the IASB should be very careful about parcelling up the disclosures we have in IFRS and putting them in lots of different places. The Member noted that he would prefer it to be a Standard by Standard approach to this and it should be a high hurdle before something could be moved out of the financial statements otherwise the IASB run the risk of it all fragmenting and going into different places.

(e) in response to the Chairman clarifying that the project should not be to encourage disclosure outside of the financial statements and management commentary, a board member noted that he is also concerned about the management commentary cross-reference, noting that the management commentary can be very long and most investors use annual reports as a reference document and using it to delve in and find specific bits of information and there is a big advantage of knowing you can find your tax reconciliation in the tax note rather than have to hunt through and go to different places.

(f) an IASB member suggested to alleviate the size and volume of the annual report explore putting some information, which is permanent information, and doesn't need to be repeated, into a place where people can access it easily, such as the accounting policies because they don't change.

(g) an IASB member also questioned the level of audit assurance and commented that if an entity has a management commentary that is partly audited and partly subjected to review and negative assurance but must be audited because of cross-reference to financial statements, how are they going to report on that? Staff noted that they are currently in discussion with International Auditing and Accounting Standards Board (IAASB) on the issue and that the auditors are actually ahead of the IASB and at the moment they are publicly consulting on this topic and provisions around that. The Member requested the staff provide the board with an update on the IAASB work when this is next brought to the board.

(h) an IASB member supported developing some principles that help people decide when cross-referencing is useful from a communication perspective however, did not agree with the staff recommendation about having a general principle, noting that it may result in the fragmentation of the financial statements. The member noted that she sees a real fragmentation issue when you a situation where 'see page x for information on debt maturity, see page y for information on funding costs, see proxy statement for information about share options but not other compensation.' The member stated would rather consciously identify places where we have disclosure requirements that are overlapping with significant disclosure requirements of other bodies and therefore a company may face duplication risk and then consider whether that is an area where we would permit.

(i) in response to an IASB staff comment a Board member cautioned the IASB should be cautious and not just try to say IFRS disclosure will evolve in different markets depending on how practices are there. The Board member thought it would erode the value of IFRS financial statements as a cross-border passport in knowing what you are getting when you pick up a set of IFRS financials.

(j) the Chairman suggested that both approaches should be combined – that is, to develop a general principle – a point of reference in order to determine what you are basing your detailed standard-by-standard review on.