

AAT RESPONSE TO THE IFAC EXPOSURE DRAFT ON “DEVELOPING AND REPORTING SUPPLEMENTARY FINANCIAL MEASURES – DEFINITION, PRINCIPLES AND DISCLOSURES”

1. EXECUTIVE SUMMARY

- 1.1 The Association of Accounting Technicians (AAT) welcomes the opportunity to comment on the IFAC’s Exposure Draft (ED) on “Developing and Reporting Supplementary Financial Measures – Definition, Principles and Disclosures” on behalf of our members employed in business who compile financial reports for both internal and external use, as well as the users of those financial reports.
- 1.2 AAT believes that the publication of this document for accountants in business can only result in benefits, primarily from a clear alignment of the principles to be applied in business with the Conceptual Framework for Financial Reporting published by the IASB as a basis for developing accounting standards generally. However, in our detailed responses to the individual questions raised in the ED we have identified a number of matters which we think merit further consideration.
- 1.3 AAT has concluded that it would be more appropriate for the guidance to be entitled “Developing and Reporting Supplementary Financial Information” and also that the term “supplementary financial information” should replace “supplementary financial measures” wherever it appears in the guidance, for the reasons set out in 2.1-2.5 of our response.
- 1.4 Whilst the seven principles set out in the guidance are all given equal prominence, we consider that greater emphasis should be placed on the importance of timeliness of supplementary management information, with precision and verifiability being of much less importance, subject to narrative explanations of the limitations to be considered when using the information (3.3.5, below).
- 1.5 Although the guidance focuses on supplementary financial information provided for external purposes and which is attached to related GAAP financial statements, we would expect the guidance to be of greater benefit if applied to information prepared for internal purposes, particularly where it comprises a standalone report. A consequence of this concept is that the need for comparability with other entities supplementing financial information should not either stifle the content or format of information presented, but both being influenced by the primary internal use of the information, even if not comparable with other entities (3.3.3, below).

2. OVERVIEW

- 2.1 Our greatest concern with the ED is the use of the term “measure” as the subject matter. Firstly, there is some ambiguity as to the interpretation of the word and it is only by considering the document in depth that it can be established that it is used in the context of principles of measurement or quantification, whereas the term “measure” can also be interpreted as “rules”.

- 2.2 In fact, the ED does not provide a definitive explanation of the term. The definition of supplementary financial measures given in 3.1 of the ED and later in Appendix A refers to “those financial measures not specifically identified by a GAAP framework”. In paragraph 3.2 (ED) there are further references to “GAAP measures” and “GAAP determined measures”. This is compounded by the fact that it is difficult to find a definition of “financial measures” in GAAP. AAT considers that if this term is to continue to be used in the ED a more substantive definition is required.
- 2.3 The use of the term “measures” also implies the ED relates to the presentation of quantifiable information, whereas information presented in narrative or qualitative form is a very important element addressed by the ED.
- 2.4 The resources listed in Appendix B (ED) do not use the term “measures” but refer to “business reporting”, “management comments”, financial reporting” and “financial information”.
- 2.5 AAT considers that a more appropriate title for the ED would be “Developing and Reporting Supplementary Financial Information” and furthermore, that references throughout the document to “supplementary financial measures” should be replaced by “supplementary financial information”.
- 2.6 AAT welcomes the underlying expectation that the principles to be applied in compiling supplementary financial information should be consistent with the principles set out in the IASB “Conceptual Framework for Financial Reporting”.
- 2.7 Issuing this guidance to accountants employed in business will provide a reminder of their professional responsibilities and duties and will assist those who may be placed under pressure by colleagues to present information with a particular bias to it.

3. RESPONSE TO QUESTIONS

Question 1
Does the title fit in the context of this IGPG or should it be replaced by different or more refined title or term?

- 3.1.1 As set out in 2.1-2.5 (above), AAT does not consider that the title of the ED conveys the subject matter or its objectives clearly. The use of the word “measures” leads to some uncertainty as to whether the guidance relates to “measurement principles” or as “rules” generally. Even when the document is considered in depth, it does not relate only to principles of measurement, but also to the disclosure of information. AAT therefore recommends that “supplementary financial measures” should be replaced by “supplementary financial information” both in the title and where used throughout the document in order to achieve greater clarity.

Question 2

Are the definitions in Appendix A suitable for this guidance? Can or should they be further clarified?
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- 3.2.1 AAT believes that the subject matter of this guidance would benefit from a clear definition of “supplementary financial measure” to ensure that it is understood to what the guidance relates. The current proposed definition is, we consider, inadequate in this respect.
- 3.2.2 Taking into account the view expressed above that the term “supplementary financial information” (2.1-2.5) is a more appropriate term than “supplementary financial measures” it is AAT’s suggestion that an appropriate definition for “supplementary financial information” might be “All reports of financial information in respect of any business, charity, public or not for profit entity, other than reports which are required to comply with GAAP or are subject to the statutory requirements of any local jurisdiction”.
- 3.2.3 The definition of “investor” requires expansion in order to avoid ambiguity. In the context of the ED an investor refers to a current or future holder of loan debt or equity in any business or not-for profit entity. The current definition could be interpreted to include trade creditors as “holders of debt” who are presumably not to be considered investors for the purposes of this guidance. In addition the definition refers to “debt or equity in a company or corporation” and thereby excludes unincorporated entities who should be included in the definition.
- 3.2.4 As a minor point, we would also point out that the grammar of the definition of “supplementary financial measure” needs correcting in that the word “measures” should be “measure”.

Question 3

Do the principles cover all the fundamental areas for establishing a benchmark for good practice in developing and reporting supplementary measures?
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- 3.3.1 AAT has concerns in respect of the application of the principle of “verifiability”. Acknowledging that it is desirable for all supplementary financial information to be capable of verification, there are instances where this is not practical. For example, an opinion as to the valuation of an asset in the absence of a functioning open market to provide evidence of value or where undue cost or delay might arise from attempting to obtain verifiable information would not justify obtaining the information. In such cases AAT’s view is that it is preferable for an opinion or estimate to be disclosed, albeit with details of the circumstances surrounding the evaluation to enable the reader to reach their own evaluation should they wish.

- 3.3.2 When considering comparability, it is important for all presented supplementary financial information to be comparable, such as in the case of similar information relating to different periods. In addition AAT considers that it is necessary for compilers of supplementary financial information to determine and publish definitions of the main terms used if they are not immediately self-apparent.
- 3.3.3 However, AAT believes it to be unreasonable for an entity to be required to use terminology which is comparable with that used by other entities unless required by GAAP (or it chooses to do so). Frequently supplementary financial information is designed by entities to meet their own requirements to assist in specific decision making processes and those objectives will vary from entity to entity.
- 3.3.4 The principle stated under 4.4.G. (ED), requiring supplementary financial measures to be “timely” sets out the need for such to be reported at the same time as the related financial statements but it should be recognised that there will not always be related financial statements. We would suggest that “if appropriate” is added to the definition of the principle.
- 3.3.5 AAT considers that it would be helpful to stress that timeliness is the most important of the seven principles set out in the ED in that information can still be useful even if it falls short in the application of the other six principles, but if it is late it can often be of little or no use at all.
- 3.3.6 After taking into account the points that have been made in response to question 3 above, AAT is satisfied that the principles set out in the ED cover all of the fundamental areas for establishing a benchmark for good practice in developing and reporting supplementary measures.

Question 4
Is the application guidance for each principle adequate to guide good practice?

- 3.4.1 AAT’s view is that the application guidance for each principle will be adequate to guide good practice if the following are addressed:-
- 3.4.2 It should be explicitly stated in the guidance under 4.4.C (ED) that supplementary financial information does not necessarily have to be reported in fixed amounts but can be indicated by a range of values which might be relevant and may assist in providing information in a neutral fashion.
- 3.4.3 The explanation of the principle of neutrality given under section 4.4.C (ED) would be strengthened if it is made clear that there should be no bias applied when reporting matters of judgement, estimation or valuation, with prudence applied in such instances, rather than optimism.

- 3.4.4 The explanation of the principle of transparency given under section 4.4.D (ED) should follow on from the point made in 3.3.1 (above) concerning matters of judgement, estimation or valuation or that it would be appropriate for the basis of such estimations to be disclosed and possibly reported as a range of values rather than a discrete amount.
- 3.4.5 After a period of applying the guidance in practice, it may become apparent that certain aspects need to be expanded or clarified. Taking this into account AAT suggests that the guidance would benefit from a post-implementation review.

Question 5
Is the disclosure guidance for supplementary financial measures adequate to guide good practice?

- 3.5.1 In paragraph 1.3 the ED states that the guidance should provide “principles for determining the qualities a measure should have to be reported and, when reported externally, the disclosure which should accompany it”. AAT believes that the disclosures are equally important in internal reporting as well as in external reporting to avoid possible misinterpretation of the information and that this should be acknowledged in the guidance.
- 3.5.2 The “definition and purpose for the measure” described under section 5.2 (ED) should be expanded to require not only the title of the measure to be defined, but also any significant terms used in the report which are not defined within GAAP, so that users do not misunderstand the terms used in the report.
- 3.5.3 Furthermore, the “quantitative reconciliation to GAAP measures” referred to under section 5.4 (ED) could relate to an analysis or breakdown of a GAAP measure and not only adjustments and should be recognised in section 5.4 (ED).
- 3.5.4 In section 5.6 (ED) under the guidance on “accompanying contextual disclosure” the statement is made that a supplementary financial measure should be “free from error” which, while being a desirable objective, is possibly not helpful in the production of useful supplementary financial information. It is also in conflict with the explanation of transparency given under section D page 9 which states that “a supplementary financial measure should be accompanied by sufficient explanation to render it as free as practicable from uncertainty and estimation error”. AAT would recommend that this latter phrase should replace the phrase “free from error” in section 5.6 (ED).
- 3.5.5 The guidance on “accompanying contextual disclosure” given under sections 5.5 and 5.6 (ED) should be amended to make it clear that narrative information should be restricted to that which is required to assist in generating understanding of the supplementary financial information given, and to avoid confusion or difficulties for the reader arising out of an excess of information.

- 3.5.6 AAT notes and is concerned that the content of the ED appears to presume that supplementary financial measures only arise externally alongside a related GAAP based report and as a recurring exercise. In reality they can also arise as standalone information.
- 3.5.7 In relation to the location of supplementary information referred to under 5.7 (ED), AAT suggests that it should include a stronger view that such should be referred to in any related GAAP report, but should not be included in the GAAP report so that the reader is not overwhelmed by a mass of information which can cause confusion or comprehension difficulties. Although GAAP sets out minimum disclosure requirements and permits additional information to be included, this guidance should indicate a desire to keep the GAAP based report to the minimum content needed to properly understand the disclosures made. Supplementary financial information should therefore be presented separately and not intermingled with GAAP disclosures.
- 3.5.8 Taking into account that supplementary financial information is not based on GAAP it is AAT's belief that it should be explicitly required that such should always be accompanied by narrative supporting information in order to meet the principles set out in the guidance.
- 3.5.9 In particular, each report of supplementary financial information should have an objective, almost invariably to provide information as the basis for decision making or for the provision of information to interested parties. Consequently, any report containing supplementary financial information should indicate the objective of the measures to enable those reading the information, to do so within its intended context.
- 3.5.10 Furthermore, information relating to environmental and social matters are likely to be descriptive rather than quantitative so that supplementary financial information of such a nature may need to be presented as a narrative report rather than in an accounts style format.
- 3.5.11 Taking into account the above observations AAT considers that the disclosure guidance for supplementary financial measures is adequate as a basic set of principles to guide good practice. However, in due course, as referenced in 3.4.5, after a period of time AAT believes the guidance would benefit from a post-implementation review.

Question 6
Are there other resources on supplementary financial measures that should be considered for inclusion in the appendices?

- 3.6.1 AAT considers that it would be helpful to users of the guidance if it were to be made explicit that the resources listed in Appendix B (ED) are not authoritative or exhaustive in relation to the application of the guidance but that they are there instead to provide background information only.

- 3.6.2 After taking into account the comment made at 3.6.1 above AAT is unable to suggest any further resources or supplementary financial measures which could be included in Appendix B (ED).

Question 7
How useful do you find this IGPG?

- 3.7.1 AAT believes that it would be beneficial to provide published guidance to those in business responsible for compiling supplementary financial information for a number of reasons set out in 3.7.2 to 3.7.4.
- 3.7.2 Compilers are better able to resist pressures from others in their organisation who may wish to see information presented with a particular bias.
- 3.7.3 Compilers are directed to an ethos of broadly applying recognised basic concepts to their financial reports and to take responsibility for such. Where relevant they could find themselves having to justify their actions to their professional body if they breach the guidance.
- 3.7.4 It is likely that the guidance will be more useful to those involved in the preparation of financial statements for smaller entities. It is likely that those associated with larger scale entities will have, already, developed sophisticated procedures for reporting supplementary financial information, both internally and externally.

Question 8
Do there need to be additional IGPGs in the area of business reporting?

- 3.8.1 Whilst, as has already observed at 3.4.5 & 3.5.1 above, after a period of time AAT believes the guidance would benefit from a post-implementation review as a consequence of which AAT cannot foresee a need for additional standalone IGPGs in the area of business reporting, unless a demand arises for specialist guidance within specific industry sectors.

4. CONCLUSIONS

- 4.1 This guidance should enable all reports of supplementary financial information to be presented to the same professional standards as GAAP based financial statements by adopting the same basic concepts, although at the same time recognising that the purposes to which supplementary financial information is put might vary considerably as compared to GAAP financial statements.

- 4.2 The adoption of the same basic concepts should give users a high level of confidence as to the integrity of the information presented.
- 4.3 AAT is pleased to have this opportunity to comment on the Exposure Draft on “Developing and Reporting Supplementary Financial Measures – Definition, Principles and Disclosures” in view of the large proportion of our Members who are involved in the preparation of supplementary financial information for businesses worldwide.

5. ABOUT THE AAT

- 5.1 AAT is a professional body with over 50,000 full and fellow members and 75,000 student and affiliate members worldwide. Of the full and fellow members, there are approximately 46,000 Members employed in businesses and not-for-profit organisations whose role involves the preparation of financial information for internal and external users. In addition there are 4,000 Members in Practice who may provide similar services to individuals, not-for-profit organisations and the full range of business types.
- 5.2 AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.
- 5.3 Thank you for the opportunity to respond to this Exposure Draft document.

If you have any questions or would like to consult further on this issue then please contact the AAT at:

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