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Practical Lessons in Preparing Disclosures

Most of the content of financial reports consists of disclosures required by authoritative standards. Here's practical advice on preparing better disclosures with less effort.

Under both U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS), an entity's financial statements must be accompanied by additional disclosures that further explain the entity's financial position and performance. Typically, the amount of content in the accompanying disclosures is vastly greater than the amount of content in the financial statements. But despite the qualitative and quantitative significance of such disclosures in financial reporting, accounting professionals often have little or no formal training in preparing them. In this month's column, I'll share some practical advice on preparing the disclosures that are required by authoritative standards. This advice will help you improve the effectiveness and efficiency of your organization's financial reporting function.

Why Disclosures Are Challenging

Composing and organizing the disclosures that are required by financial accounting and reporting standards are challenging tasks. One reason is that standards often don't prescribe the content in detail. Because standards setters usually intend for the content of an entity's disclosures to be highly specific to the entity, standards usually provide only broad descriptions of *what* information must be disclosed and scant guidance on *how* that information should be disclosed. As a result, preparers of financial reports typically find themselves having to exercise professional judgment to a significant degree when interpreting and applying disclosure standards. In other words, preparers are largely expected to "make it up as they go along." This reality also makes it difficult to develop and deliver formal training on disclosure preparation.

Another reason that disclosures are challenging to prepare is the sheer volume of them. Under U.S. GAAP and IFRS, there are thousands of potentially required disclosures; the disclosures made by an individual entity typically number in the hundreds. This situation is unlikely to change anytime soon because the number of required disclosures has grown and continues to grow substantially as new standards are issued.

Learning By Example

The best strategy for composing effective, standards-compliant disclosures is to study real-world examples and adapt them to your company. This is a very practical approach because the financial reports of thousands of companies are readily available to the public, in most cases for free on the Internet. What's more, Internet search engines such as Google and Yahoo! make it possible to search for specific types of disclosures and/or companies through the use of relevant key words. And many providers of value-added accounting research systems offer access to listed companies' published reports, with some systems specifically including a searchable database of disclosures.

To a lesser extent, examples may be provided in the implementation guidance of standards themselves. In such cases, I would still encourage you to study real-world disclosure examples to gain a sense of the high degree of subjective variation in them, even when they're based on the same standard.

There are a couple of cautions that you should heed when applying this "learning by example" approach. First, just because a disclosure has been made by a real company doesn't necessarily mean it's an effective way to communicate what the disclosure is intended to communicate. Disclosures often can be improved by keeping the basics of good writing in mind.

Second, you should recognize that another company's actual disclosure may be partially or wholly inappropriate for your company because, as I just noted, disclosure content tends to be entity-specific. Use your professional judgment to determine the degree to which a disclosure is—or isn't—applicable to your situation. This is especially important under U.S. GAAP because disclosure requirements can and do vary between public and private companies. In general, the more another company differs from your company, the less likely its disclosures will be appropriate for your company. When seeking appropriate disclosure examples, pay more attention to your company's industry peers, especially if they have business models similar to yours.

Process Risks

Because of the large number of potential disclosures a company might have to make, there's a significant risk that the actual disclosures will be incomplete. But that's an easy risk to mitigate. As I discussed in my April 2013 column ("The Checklist Mentality: Problem or Solution?"), you can use checklists and other practice aids during the disclosure-preparation process to avoid such problems.

While it's certainly important to put enough information in your company's disclosures, I discourage you from assuming that "more" is always "better." From a risk-management perspective, you might think that it's better to err on the side of too much disclosure rather than not enough, but in practice this often gets out of hand over time. Applying robust internal controls to the financial reporting process can often minimize costs and cycle times by preventing excessive disclosure that adds cost and time without adding value for users of financial reports.

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Another process risk is that information in a note disclosure might be out of sync with related information that appears in the body of a financial statement. This usually occurs when there's a lack of proper controls in the financial reporting process. There are several technology solutions for document-preparation workflows, so consider whether such a solution would be appropriate for your company's process.

Finally, when implementing a new or unfamiliar standard, pay attention to the standard's disclosure requirements early on. Such requirements often require system and/or process changes that may not be apparent from the recognition and measurement models alone, so don't treat them as an afterthought.

Ethics Considerations

One pervasive compliance issue in financial reporting is whether the financial statements and accompanying disclosures present the entity's finances fairly in conformity with U.S. GAAP or give a "true and fair view" of the entity's finances under IFRS. But that compliance issue is also intertwined with an ethics issue. There will be occasions when your company's management—maybe even your immediate manager—would like to withhold, downplay, or "spin" the disclosure of a particular fact. On such occasions, you may find yourself facing an ethical dilemma if management's preferred treatment isn't consistent with your interpretation of the disclosure requirements of applicable standards. On such occasions, your organization and its stakeholders will benefit from having a functioning process for resolving ethical dilemmas, such as described in the "Resolution of Ethical Conflict" section of the *IMA® Statement of Ethical Professional Practice.*

Preparing disclosures for financial reporting purposes can be challenging. By following the advice in this column, you can prepare better disclosures with less effort. **SF**

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