



DRSC e. V. • Zimmerstr. 30 • 10969 Berlin

EFRAG
Françoise Flores
35 Square Meeûs

B-1000 Brussels

Telefon +49 (0)30 206412-12
Telefax +49 (0)30 206412-15
E-Mail info@drsc.de

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Dear Françoise

EFRAG, ANC & FRC Discussion Paper: Towards a Disclosure Framework for the Notes

On behalf of the Accounting Standards Committee of Germany, I am writing to comment on the discussion paper *Towards a Disclosure Framework for the Notes* (hereinafter the “EFRAG-DP”) issued by the European Financial Reporting Advisory Group (EFRAG), the Autorité Des Normes Comptables (ANC) and the Financial Reporting Council of the United Kingdom (FRC) in June 2012. We generally share the same view of EFRAG, ANC and FRC by considering the subject of disclosures being an important issue for IFRS constituents. We concur with the view that improvements are needed and should start at a framework level. Therefore, we support the endeavour and appreciate the opportunity to provide our view on the disclosure issues identified in the EFRAG-DP.

Our comments, attached as an appendix to this letter, also incorporate two other discussion papers issued in the context of the development of a disclosures framework:

- FRC’s discussion paper *Thinking about disclosures in a broader context - A road map for a disclosure framework* issued in October 2012 (hereinafter the “FRC-DP”); and
- FASB’s discussion paper *Disclosure Framework* (hereinafter the “FASB-DP”) issued at the same time as the EFRAG-DP



The three discussion papers have similar objectives and we noticed the close working relations of the authors while developing the papers. However, the approaches and proposals described in the three discussion papers are different. Therefore, we think it may be beneficial to provide our comments not in isolation and solely on the EFRAG-DP.

While agreeing with the view that regulators, auditors and other constituents carry an important role of improving disclosures quality in financial reports, we focus our comments on the proposals for the disclosure framework and recommendations to the standard setter (ie the IASB). We would like to emphasise that we found the compact summary of action plans and intelligible recommendations in the FRC-DP helpful for a disclosure framework discussion and we would encourage EFRAG to provide similar information as a result of the pro-active work on the disclosure framework. As the main proposals for the IASB we identified in the EFRAG-DP:

- A definition of the notes and all disclosures in the notes should fit into the 4 + 1 categories
- A set of indicators for the relevance of disclosures should be part of the framework to assist the standard setter to decide when disclosures in the notes are required to fulfil user needs
- A set of indicators as guidance for preparers in applying materiality in context of disclosures should be part of the framework
- A communication guidance for preparer in form of communication principles

Furthermore, in our comments we highlight disclosures issues that should be added to the discussion or need more considerations in the pro-active work towards a framework for the notes.

If you would like to discuss our detailed comments and views in the appendix further, please do not hesitate to contact me.

Yours sincerely

Liesel Knorr

President

Appendix

Objective of a disclosure framework project

We understand the disclosure framework project as a synonym for a project that should address various issues relating to disclosures in financial reports and, at the same time as a project with the general objective to improve the quality of disclosures for users of financial reports. A major driver for the project are concerns over the (still increasing) quantity of disclosures which are perceived as less relevant by users for making economic decisions. We acknowledge that the main driver of the project should be the increase of the effectiveness of disclosures and not to reduce of number of disclosures.

Scope and placement of disclosures

The EFRAG-DP limits the scope of the discussion to information disclosed in the notes to the financial statements. Furthermore, the proposed definition of the notes limits the disclosures in most parts to explanatory information for line items presented in the “primary” financial statements with a strong focus on information about past transactions. Hence, the EFRAG-DP emphasises that some disclosure requirements in current IFRSs would be excluded from the notes because of not meeting the definition of the notes. It is unclear in the EFRAG-DP whether this information is considered not to be useful for users of financial reports or whether the information should be part of other (new) components of the entities financial reporting package or should be removed from IFRSs completely. In the context of current IFRS disclosures some disclosure requirements would be no longer part of the notes. We encourage EFRAG, ANC and FRC to provide more explanation whether the IASB should develop the disclosures but not as part of the notes.

We noticed that in the debate about developing a disclosure framework many constituents of the IASB raised the wish to address disclosures on a holistic basis and in context of the financial reporting package of the entity. This may even include disclosures in management reports. We share this view and we therefore consider a disclosure discussion in the limited scope, as proposed in the EFRAG-DP, as less useful for a disclosure framework debate for financial reports.

Furthermore, we share the view of the FRC and support the recommendation in the supplementary FRC-DP that the IASB should define the boundaries of financial reporting for their



purposes and develop placement criteria for establishing where information should be disclosed. Such an approach would clarify the relation between the content of the notes and other reports, such as management commentary. This would also help jurisdictions applying IFRSs to develop additional national disclosure requirements or reliefs.

Pro-forma financial information and other non-GAAP disclosures

Recent studies and publications in some jurisdictions have raised concerns about the IFRS reporting practice of entities in the context of pro-forma financial information and other non-GAAP disclosures in financial reports as well as in transaction documents. The concerns highlighted the fact that these disclosures, in some cases, have the potential to be misleading and, consequently, to lower the quality of disclosures for users. While the issue is often referred to information in the context of non-GAAP performance measures presented as line items in the financial statements, the studies also highlighted this issue for disclosures in the notes to the financial statements (for example if the explanation and description on non-GAAP measures receive more prominence than explanatory information for GAAP measures).

Currently, IFRSs do not provide disclosure guidance on these issues and, as a consequence, some jurisdictions have added national regulatory guidance and requirements for financial reports prepared in accordance with IFRS. For example the Australian Securities and Investments Commission (ASIC) published regulatory guidance, including:

*“Financial information prepared other than in accordance with accounting standards must not be included in financial statements [...] Such information may **only** be included in the notes to the financial statements **in the rare circumstances** [emphasis added] where such disclosure is necessary to give a true and fair view of the financial position and performance of the entity.”* (Source: ASIC, Regulatory Guide 230 - Disclosing non-IFRS financial information, 2011, RG 230.8)

The EFRAG-DP highlights the fact that disclosures in the notes should be relevant and fulfil the need of users for information with the capability of making a difference in users economic decisions. In this context preparers can argue that additional non-GAAP disclosures and some pro-forma financial information are relevant for users, especially if this information provides insights into management measures that are relevant for the decision-making process



of the management of the entity. Hence, it could be argued that disclosures about the (dis)aggregation and reconciliation of non-GAAP measures could be relevant for users. This view is also expressed in the FRC-DP.

In this context, we point to paragraph seven of chapter one of the EFRAG-DP where EFRAG addresses concerns relating to the increased number of disclosures over the last decade. EFRAG cites that the increase of disclosure requirements and, correspondingly, increased volume of disclosures prepared *“has added to the complexity of the financial statements and may confuse rather than inform users by obscuring relevant information. In addition, such volume may result in an undue cost for preparers in managing and reporting extensive disclosures.”* Interestingly, the illustration used in the EFRAG-DP to underpin this fact indicates that pro-forma financial information and non-GAAP measures play a significant role in the increase of the number of disclosures. While we see merit in the argument that the number of explicit disclosure requirements has increased over the last years, we disagree with the wording and the technical understanding of IFRSs in the EFRAG-DP as well as with the emphasis that the illustrated increase of disclosures are produced ‘in accordance with IAS/IFRSs’. Nevertheless, the illustration highlights that the increase of disclosures also relates to non-GAAP information used by the management of the entity to communicate the financial performance and financial position.

It is not clear to us whether EFRAG considered this ongoing debate about pro-forma financial information and non-GAAP disclosures in the pro-active disclosure framework project or omitted it by intention. We think that this issue should be addressed as part of a disclosure framework project, especially on the consideration of comparability and understandability of disclosures in financial reports prepared in accordance with IFRSs and a level playing field for IFRS preparers.

We share a similar view as expressed in the FRC-DP that disclosure of measures not defined within IFRSs and adjusted measures can be disclosed within the notes to the financial statements as long as these measures are:

- a. Defined;
- b. Reconciled back to IFRS figures;
- c. Include a comparable figure for the prior year; and
- d. Consistently calculated and presented



Non-mandatory disclosures

We think a disclosure framework project needs to address, closely related to the issue of pro-forma and non-GAAP financial information, the role of non-mandatory disclosures prepared in accordance with GAAP. We notice the tendency of the IASB in recently modified or new IFRSs to avoid wording that would indicate a non-mandatory character of a disclosure. Older IASs include disclosure terminology to indicate a voluntary basis for preparers to disclose some information.

Generally, we are supportive of this tendency and think that only mandatory disclosures should be part of the IFRSs. Nevertheless, the disclosure framework project should explore whether there are ways to provide better incentives for preparers to disclose relevant information that goes beyond mandatory disclosures. Furthermore, we think in some cases preparers could (and should in compliance with IAS 1 *Presentation of Financial Statements*) provide additional relevant information not specified in any standard but for several reasons and cost implications, they back off to disclose such information in financial reports.

In this context we notice the general objective of a Disclosure Framework in the EFRAG-DP, which is: “*To ensure that **all and only** [emphasis added] relevant information is disclosed in an appropriate manner, so that detailed information does not obscure relevant information in the notes to the financial statements.*” It is not clear to us (1) how the EFRAG-DP determines the basis of the general objective to disclose all and only relevant information, (2) whether this objective is considered to be enforceable as a general requirement for the notes, and consequently (3) what are the implications for preparers. Hence, we encourage EFRAG to clarify the general objective in the EFRAG-DP. For example, would the objective result in the conclusion, that an entity should disclose actual operating cash flows in the notes (if not reported on-the-face of the statement of cash flows) because there is evidence that users consider the disaggregation of operating cash flows and actual cash flow information as relevant?

Consistency in setting disclosure requirements

High priority in the scope of a disclosure framework project should be given to establishing an effective mechanism to ensure consistent and well-balanced disclosure requirements across the IFRSs, including consistent terminology. Current IFRSs often reflect significant differences in the granularity of the requirements. We think there is a strong relation between



those different granularities of the disclosure requirements in IFRSs and the perceived unbalance of information in financial reports by users.

At this stage we are not convinced that the approaches explained in the FASB-DP (a catalogue of questions to develop disclosures) and in the EFRAG-DP (the 4+1 category approach of disclosures paired with indicators of relevance) will provide an effective mechanisms to ensure the development of well-balanced disclosure requirements and avoiding inconsistencies across the full set of disclosure requirements.

We think that the recommendation in the FRC-DP for the IASB to provide overarching principles for disclosures and present these within one standard may be a good starting point. Beside the general features of disclosures, this standard could include high-level requirements for disclosures with explanation of the corresponding objective. Any derived disclosure requirements in other standards or implementation guidance for specific transactions or events should be linked back to these high-level requirements for disclosures. We think these high-level requirements could be similar to the categories developed in the EFRAG-DP, however, we think the requirements should be more granular and more specific to the elements of financial statements as well as address a broader scope of disclosures.

Guidance on materiality

Many IFRS stakeholder groups and constituents of the IASB referred to the principle of materiality and its application to disclosures as key to reducing the disclosure level in financial reports. Therefore, some constituents have asked for more guidance and indicators and new terminology that should be developed in a disclosure framework project.

We think that the concept of materiality is clearly and consistently understood as an entity-specific aspect of relevance. Hence, relevant disclosures reflect entity-specific information. It is also well understood that according to IAS 1 an entity need not provide a specific disclosure if the information is not material. Therefore, we think a disclosure framework should neither reemphasise the meaning of materiality and relevance nor should it start a completely new debate about the application of these principles. Obstacles on successful application of material judgment by preparers of financial reports may be rooted in issues that are not in the work scope of any accounting standard setter.



We understand that the EFRAG-DP developed two sets of indicators and both indicators should be part of the disclosure framework: One set of indicators for the standard setter to decide when disclosures should be required because the information is relevant, the other set of indicators for preparers as guidance on materiality whether the entity should provide information in applying the disclosure requirements. In the context of the proposed indicators it is unclear to us whether EFRAG already tested these indicators with preparers and users as well as on proposals in ongoing IFRS projects.

With reference to chapter three and chapter four in the EFRAG-DP, and particularly the table with both sets of indicators, we did not perceive the approach of indicators to be intuitive and, therefore, not to be particularly helpful. For example, the EFRAG-DP highlights that the reconciliation of changes over the period for assets and liabilities (roll-forward) is relevant if the balance of the item refers to investing or financing activities of the entity or the item is expected to be recovered or settled beyond the operating cycle of the entity. Considering this kind of indicators of relevance for setting disclosure requirements, we would like to better understand whether these indicators were tested against current proposals of roll-forwards in the IASB's projects on revenue recognition and insurance contracts and the proposed disclosures as well as discussed with users of financial statements.

Terminology for different levels of materiality

We support the recommendation in the FRC-DP that the IASB should reduce and define the terms used within IFRSs, e.g. significant, key, critical, and then use the defined terms consistently. In this context, the IASB could clarify specific terminology for disclosure requirements deemed material in all cases.



Disclosures in interim vs. annual financial reports

We think a disclosure framework project should also discuss disclosures in context of interim vs. annual financial reports and explore whether different requirements and principles should be applied. We consider this discussion to be necessary not only from a cost perspective for preparers, but the disclosure framework project should also clarify whether a different quality of disclosures in interim financial reports compared to those disclosures reported in annual reports implies different criteria for developing interim disclosure requirements. Different quality from annual reports may arise from the fact that:

- a. Interim disclosures include more estimates; and
- b. Generally, interim disclosures are not subject to a mandatory audit.

In this context, we noticed the discussion in the FASB-DP and think that a similar discussion would be beneficial for a disclosure framework project for the IFRSs and should therefore be part of it. Furthermore, it is not clear to us why this issue was omitted in the EFRAG-DP and FRC-DP.

Format and organisation of disclosures

We noticed that some IFRS stakeholder groups think the way how disclosures are reported in financial reports significantly influence the consumption of information. The EFRAG-DP, the FRC-DP and the FASB-DP address this issue and its potential improvements. However, the FASB-DP addresses the issue of how communicating information from a different angle.

The EFRAG-DP refers to high-level communications principles and emphasises the primary responsibility of the preparer in providing appropriate communication. We understand the main message of the communication chapter in the EFRAG-DP and would not disagree with the statements and the possible alternatives presented in this chapter. Nevertheless, we also found this chapter confusing and believe that more clarification is needed. Such clarification is especially needed for the relation between the communication principles in chapter five and the key principles for a successful disclosure framework in the front section of the document. Furthermore, we think that these communication principles in the FRC-DP and EFRAG-DP indicate when information is relevant and most useful to users. Therefore, we believe that it should be reconsidered whether some of the principles would better fit into the



discussion about relevance and materiality of information. Additionally, we perceived many redundancies in the discussion about relevance and materiality and the communication of information. For example, the EFRAG-DP discusses “entity-specific” information as part of the definition of the notes, as part of the discussion around materiality and relevance and, additionally, as part of the communication principles.

We lean towards the view that the discussion about communicating information should mainly focus on the discussion about the format and organisation of disclosures. For example, which information should be presented in specific format (for example in a tabular form) and whether a specific structure of disclosures (e.g., disclosures organised by major themes like risk, impairment etc.) would be particularly useful to users.

Self-standing document and cross-reference of disclosures

We think that the disclosure framework should also address the discussion whether financial reports prepared in accordance with IFRSs should be considered as a self-standing document. The EFRAG-DP highlights some recent research from other institutions in this area with discussion around possibilities to “outsource” long standing information from financial reports using cross references and other linkage mechanism. However, the EFRAG-DP has not developed specific proposals in this area.

We believe that there are merits to elaborate approaches to outsource long-standing information. However, we think it should not be part of the IASB’s framework efforts to determine which disclosures would be eligible as long-standing information. The IASB should clarify on a framework level whether and how information can be disclosed outside of the financial report; currently there is only guidance on an individual standard’s level (e.g., IFRS 7 *Financial Instruments: Disclosures*).

Review of existing IFRS disclosure requirements

As indicated above, we think setting the conceptual requirements and clarifications for IFRS disclosures on a framework level is an important and a necessary step for the IASB. However, we think that for achieving improved quality in financial reports, the efforts need to go beyond the framework level and should result in a timely review of existing disclosures in all IFRSs (including interpretations). The review should especially focus on the consolidation of

disclosure requirements as well as the replacement of existing disclosure requirements with more effective and consistent disclosure requirements. For example one of these disclosures would be the disclosure of the summary of significant accounting policies as explained below.

Disclosure of summary of significant accounting policies

The FASB-DP identifies the summary of accounting policies as one type of disclosure for short-term improvements. The FASB-DP highlights that in financial reports prepared in accordance with U.S. GAAP the summary of accounting policies sometimes describes policies that users understand or can easily find otherwise. Also, much of the summary remains constant from period to period, and some of it is irrelevant because it addresses immaterial items.

We believe most of the conclusions in the FASB-DP about reporting practice also apply to the IFRS reporting practice in the context of the summary of significant accounting policies disclosure as required in IAS 1. The summary of significant accounting policies in financial reports in many cases provides lengthy information how the entity applies the standard - often reusing the wording of the standards - with limited benefit for users, even if they have a reasonable knowledge of accounting.

Based on current reporting practice we think that this type of disclosure should be replaced by more effective disclosure requirements in IAS 1, so that compliance with the requirements results in more useful information for users. In this context we would not necessarily support the removal of the summary of significant accounting policies as considered in the FASB-DP but support changes to the current requirements in IFRSs so that the reporting entities do not achieve compliance with the intended new disclosure requirements simply by replicating the wording of the standard.

Furthermore, in light of the concept of a summary disclosure (i.e. providing a brief overview of important information of the reporting period) the focus of the summary may be extended to significant events and transaction of the reporting period (including significant events after the end of the reporting period). To stress the character of a summary of important information with respect to the reporting period in order to analyse the financial position and performance of the entity, such a summary could also be placed on top of the financial report and consequently ahead of the primary financial statements.