



European Financial Reporting Advisory Group  
35 Square de Meeus  
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19 December 2012

Dear Sir/Madam

**Discussion paper: Towards a Disclosure Framework for the Notes ('the discussion paper')**

We are pleased to respond to your invitation to comment on the discussion paper. Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of member firms who commented on this discussion paper. 'PricewaterhouseCoopers' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We support the European Financial Reporting Advisory Group's ('the EFRAG') efforts to improve the effectiveness of disclosures in the financial statements. We agree that the relevance and comparability of financial reporting can be improved by developing a framework for setting disclosure requirements. Such a framework would bring more consistency to the standard setting process, facilitate the development of relevant disclosure requirements, and improve the quality of disclosures for investors and other stakeholders.

We agree with the discussion paper's premise that to increase the effectiveness of disclosures, consideration must be given to their intended purpose. The primary intent of financial reporting is to provide information that assists users in assessing an entity's prospects for future cash flows when making decisions relating to that entity.

The purpose of the notes to the financial statements ('notes') should be driven by the needs of the user. It is important, however, to establish a boundary between information that is appropriate for notes and information provided through other reporting mechanisms. Notes should be limited to information about a reporting entity's historical transactions, financial performance, financial position, and estimates and assumptions that underly the financial statements. Forward-looking information should generally be excluded from notes and instead be included in management commentary or other reporting mechanisms. Establishing the boundary between disclosures in notes and disclosures elsewhere in regulatory filings would help eliminate duplication, clarify what information is covered by the audit report.

We believe that disclosure requirements should include the objective of the proposed disclosures and should be established on a standard-by-standard basis in accordance with an overall framework. Standard setters should describe the objective of the disclosure and why the information could be important to users. Articulating clear objectives will help reporting entities make better judgments regarding what information should be disclosed. The standard setter should also set out potential disclosures, whilst emphasising that all the listed disclosures may not be required. Reporting entities should then use judgment to select relevant disclosures.

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We understand the concern expressed by some preparers of financial statements that exercising judgment regarding what is relevant for disclosure can be challenging. However, we expect that many will welcome the opportunity to present only what is relevant to their users, thereby increasing the effectiveness of their disclosures.

We agree that the relevance of disclosures should include a materiality threshold. However, we believe it would be difficult for standard setters to define an additional materiality threshold for disclosures. Materiality is already a very complex judgment. Another disclosure threshold might be difficult for reporting entities to operationalise and could result in different judgments than their materiality analysis. Thus, we recommend that relevance of disclosures should be defined within the existing materiality requirements. This should reduce potential confusion and provide reporting entities with flexibility in making relevant disclosures, considering quantitative and qualitative factors.

We believe that prescribing a particular model or format for presentation of financial statements should not be the core objective of the standard setters. The focus should be on developing a framework or a principle to serve as a basis for disclosures.

To achieve success on a project as important as this, all participants in the financial reporting process, not just preparers, will need to embrace its objectives. For standard setters, outreach will be critical. To that end, a structured approach with a focus on outreach to investors and other stakeholders coupled with feedback from preparers on operationality will help create an effective road map. Regulators, legal advisers, auditors, and other participants in the financial reporting process will also need to embrace the objectives of this project and refrain from encouraging reporting entities to disclose irrelevant information. With the appropriate constructs for a more responsive and flexible disclosure regime, and the support of all constituents within the financial reporting chain, we believe reporting entities will embrace the opportunity to improve disclosure effectiveness.

Attached to this letter is Appendix A, which contains our responses to the questions included in the discussion paper and expands on our comments above. If you have any questions, please contact John Hitchins, PwC Global Chief Accountant (+44 20 7804 2497) or Mary Dolson (+44 20 7804 2930).

Yours faithfully,

A handwritten signature in black ink, appearing to read 'PricewaterhouseCoopers', written in a cursive style.

PricewaterhouseCoopers



## **APPENDIX A**

### ***Question 1.1 – Key principles***

***The Discussion Paper sets out a number of key principles that should underpin a Disclosure Framework.***

***Do you agree with these key principles? If not, what alternative principles would you propose?***

Overall we support the development of a disclosure framework for standard setting with the general objective that all and only relevant information is disclosed in an appropriate manner. We believe it is appropriate for a framework to be applied by standard setters in the standard setting process and further believe that such a framework will bring consistency to the disclosure development process.

Definition of the purpose and content of the notes is essential to assist in achieving consistency in disclosures. We agree that the notes should focus on past transactions, but should only include information that is capable of impacting a users' assessment of an entity's prospects for future cash flows. The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. These decisions are based upon the implicit or explicit assessments of an entity's prospects for future cash flows as envisaged in the Conceptual Framework for Financial Reporting as published by the International Accounting Standards Board (the Conceptual Framework). We believe that the standard setter could usefully clarify the scope of the notes. A clear boundary should be established between disclosures in the notes and other information provided by the reporting entity (e.g., Management commentary). Establishing such delineation would help eliminate duplication, clarify what information is covered by the auditor's report, and streamline financial reporting.

We broadly agree with the proposed approach to setting the disclosure requirements in the discussion paper. We have included some specific recommendations and observations in our responses to the specific questions in this Appendix. The disclosure objective should be distinct from other objectives. Establishing alternative disclosure requirements for interim and annual financial statements is appropriate. However, we believe that the reporting requirements should not vary based on characteristics of entities such as its size, industry, etc. The standard setters should publish disclosure requirements for general purpose financial statements regardless of size of entity or industry.

Immaterial information disclosed in the notes introduces the possibility that financial statements will be considered less relevant by users. However, we believe it would be difficult for standard setters to define an additional materiality threshold for disclosures. Materiality is already a very complex judgment. Another disclosure threshold might be difficult for reporting entities to operationalise and could result in different judgments than their materiality analysis. Thus, we recommend that relevance of disclosures should be defined within the existing materiality requirements which will avoid confusion and will provide reporting entities with flexibility in making disclosures based on their facts and circumstances, considering quantitative and qualitative factors.



**Question 1.2 – Understanding the problem**

***This Discussion Paper suggests that there are two main areas for consideration to improve the quality of disclosures:***

- a. avoiding disclosure overload, which may be caused both by excessive requirements in the standards, and by ineffective application of materiality in the financial statements;***
- b. enhancing how disclosures are organised and communicated in the financial statements, to make them easier to understand and compare.***

***Do you agree that these are the two main areas for improvements?***

We agree that many have commented that financial statements have become unwieldy and there is a danger of voluminous detailed disclosures reducing the relevance of the financial statements. However, this is the result of a number of factors that go beyond standard setting and include the regulatory environment and the risk averse approach of reporting entities and their auditors. We believe that the focus of the standard setter should be to develop principle based disclosures which will result in relevant information presented in an organised and useful manner. Hence, establishing a disclosure framework and developing disclosures based on such a framework may help address the problem.

Disclosures that are well organised and presented can assist in making the financial statements more useful and understandable. However, we believe that the standard setters should not prescribe a format, method or order of presenting information in the financial statements. This should be left to the judgment of reporting entities.

**Question 2.1**

***In chapter 2 a definition of the purpose of the notes is proposed to assist in deciding what financial information should be required in the notes. Do you think that there is a need to define the purpose of the notes? If not, please provide your reasoning.***

We agree with the discussion paper's premise that in order to improve the quality of disclosures the purpose of the notes should be defined. Developing a disclosure framework based on a defined purpose would bring more consistency to the standard setting process. A disclosure framework would facilitate the development of relevant disclosure requirements on a standard by standard basis and potentially improve the quality of disclosures for investors and other stakeholders.



### **Question 2.2**

***Is the proposed definition of the purpose of the notes helpful in identifying relevant information that should be included in the notes? If not, how would you suggest it should be amended?***

We believe that the definition of the purpose of the notes is appropriate and helps identify relevant information that should be included in the notes. We agree that the purpose of notes should focus on the users of the financial statements. This will ensure that only relevant disclosures are included in the financial statements. However, the proposed definition might be too limiting because it restricts disclosures to items presented in the primary financial statements and other very specific information. Reporting entities should not be required to provide predictions or projections in notes. Accordingly, the notes should be limited to information about a reporting entity's historical transactions, financial performance, financial position, and financial statement estimates and assumptions that are relevant for a user to make assessments of the cash flow prospects of an entity.

We believe that forward-looking information should generally be excluded from notes and is best suited for management commentary or other communications that are clearly outside the audited financial statements. This allows the reporting entity to provide forward-looking information whilst taking appropriate measures to limit the potential risks associated with forward looking information. We believe this distinction is critical and any potential changes to disclosures would need to consider how to limit this type of risk. The clarification of what forms part of the audited financial statements will also help eliminate unnecessary duplication and streamline financial reporting.

We believe it is appropriate for notes to include information regarding assumptions about major sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amount of assets and liabilities. This is consistent with existing disclosure requirements under IFRS (IAS 1, paragraph 125).

### **Question 3.1**

***In chapter 3, it is proposed to identify specific users' needs that the notes should fulfil. Those users' needs are drawn from the Conceptual Framework. It is also suggested that a Disclosure Framework should include indicators to assist the standard setters to decide when additional information is required to fulfil those users' needs.***

- (a) Is the description of the approach clear enough to be understandable? If not, what points are unclear?***
- (b) If you do not support this approach, what alternative would you support and why?***
- (c) Do you think that a category on "information about the reporting entity as a whole" should be included? If so, why?***

The approach outlined in the discussion paper is clear.





The specific needs identified in the discussion paper may restrict the scope of the disclosures. There may be additional specific needs of users which may be relevant to the understanding of the financial statements. A disclosure framework should not preclude other relevant information being included in the financial statements. Hence, we believe that the standard setter should establish an overall principle or framework for disclosures and allow reporting entities to determine what disclosures are relevant.

We believe that some information about the reporting entity as a whole may be relevant to users; for example information on currency, related party transactions or the scope of consolidation. Hence, it is useful to have such a category of disclosures. We recommend that appropriate outreach be carried out to determine the extent of the entity level information required to fulfil users' needs.

### **Question 3.2**

***Are the proposed users' needs and indicators in chapter 3 helpful to identify relevant information? If not, how would you suggest amending them, or what other basis would you suggest to identify relevant information to be included in the notes?***

We support the inclusion of users' needs in development of the disclosure framework. However, we are concerned that the categories or 'indicators' of information may be too limiting. The discussion paper suggests that notes should provide a relevant description of the items in the primary statements. It also suggests that the notes should fulfil certain categories of users' needs, such as disaggregating components of line items. We believe that specifying such categories might result in exclusion of certain other notes which may be relevant to a user and that further outreach on this question would be useful.

### **Question 3.3**

***Do you agree with the way risk and stewardship are addressed in the Discussion Paper? If not, what are your views about how risk and stewardship information that should be provided in the notes?***

We believe that the information in primary financial statements and in the notes allows users to make judgements about the stewardship of management. This is a significant area of interest for users to assess how management utilises the resources entrusted to them. Certain stewardship related disclosures, such as related party transactions, provide information that helps in assessing an entity's prospects of future cash flows and hence should form part of the notes. However, certain other specific stewardship related disclosures, such as disclosure of remuneration, would not have significant value for assessing an entity's ability to generate cash flows. Hence, we wonder whether such disclosures should form part of the notes or should be reported separately by the entity.

We believe that notes should be limited to information about a reporting entity's historical transactions, financial performance, financial position, and financial statement estimates and assumptions that are relevant for a user to assess an entity's prospects for future cash flows. We recommend that the standard setter should work closely with regulators to consider alternatives like including certain disclosures on stewardship in an alternative report or as part of other forms of financial reporting.



Information on risk will help users to assess the quality and sustainability of earnings and cash flows and thus seems consistent with objectives of financial reporting. Accordingly, including disclosures in this regard seems essential to understanding the financial statements. However, we recommend that a careful assessment is made to identify such information that needs to be included in the notes and distinguish that from other information about risks provided by the reporting entity.

#### **Question 3.4**

***Standard setters frequently mandate detailed disclosure requirements in each standard. In chapter 3, it is suggested that the way in which disclosures are established influences behaviours, and alternative approaches are discussed.***

***Do you think that standard setters should change their practice of mandating detailed disclosure requirements in each standard? If so, which of the alternative approaches discussed do you think will be the most effective in improving the quality of information in the notes?***

We suggest that the standard setters should consider changing their current practice of mandating detailed disclosure requirements as this may only reinforce a 'checklist' mentality. Some reporting entities may continue to disclose everything listed in the standards, in a response to the regulatory environment, a desire to minimise risk of the simplicity of disclosing all information collected rather than making complex judgments on materiality once information has been collected.

We believe that it is not practical or operational to develop a single, common set of requirements to be applied to every line item or rely exclusively on reporting entities to provide relevant information. Industry-based disclosure requirements are also not appropriate for the reasons identified in the discussion paper in paragraph 54.

We believe that standard setters should provide disclosure objectives in each standard to allow reporting entities to apply judgement and materiality in selecting relevant disclosures. To assist reporting entities in making these judgments, we also recommend standard setters to describe in each standard why the information could be important to users. Articulating clear objectives and linking this to the needs of users will help reporting entities make better judgments regarding what information should be disclosed.

#### **Question 3.5**

***Some standard setters have established, or have proposed establishing, differential reporting regimes on the basis that a 'one size fits all' approach to disclosures is not appropriate. They consider that reporting requirements should be more proportionate, based on various characteristics such as entity size, or whether they relate to interim or annual financial statements.***

***Do you think that establishing alternative disclosure requirements is appropriate?***

We believe that establishing alternative disclosure requirements for interim and annual financial statements seems appropriate. However, reporting requirements should not vary based on characteristics of an entity such as size or industry. The standard setters should publish disclosure



requirements for general purpose financial statements regardless of size of entity or industry. Material transactions should be subject to the same disclosure requirements regardless of size of entity or industry.

We believe that a clear framework should be used when establishing interim disclosures so that these are not set on an ad-hoc basis.

#### **Question 4.1**

***Chapter 4 discusses the application of materiality to disclosures. Currently, IFRS state that an entity does not need to disclose information that is not material. Do you think that a Disclosure Framework should reinforce the application of materiality, for instance with a statement that states that immaterial information could reduce the understand ability and relevance of disclosures?***

We agree that application of materiality is important when determining what disclosures are relevant to a specific entity. However, by reinforcing the application of materiality in the disclosure framework the standard setter may be seen to prohibit disclosure of information. This would add further challenge to an already complex area of judgment.

Materiality is a complex assessment and has to be determined considering quantitative and qualitative aspects. Often, management's judgments on materiality are questioned by regulators. Hence, the standard setter should not be seen to restrict the disclosures in the financial statements on the basis of immateriality.

#### **Question 4.2 and 4.3**

***Chapter 4 also includes proposed guidance to assist in the application of materiality. Do you think that a Disclosure Framework should include guidance for applying materiality? If you disagree, please provide your reasoning.***

***Is the description of the approach clear enough to be useful to improving the application of materiality? If not, what points are unclear or what alternatives would you suggest?***

We believe that a disclosure framework should not include additional guidance on application of materiality. We urge standard setters not to try to make the determination of what information is material more objective by suggesting an approach for that purpose. The threshold for determining relevant disclosures should simply be materiality as assessed by reporting entities for all purposes while preparing financial statements. It would be difficult for standard setters to define an additional disclosure threshold such as relevance because it would require an analysis of entity-specific facts and circumstances. Further, another disclosure threshold might be difficult for reporting entities to operationalise and could result in different judgments than their materiality analysis.

In our view, materiality judgments can properly be made only by those who have all the facts; no general standards of materiality could be formulated to take into account all the considerations that enter into making such a judgment. Further application of materiality has evolved in response to regulation (accounting and auditing), litigation, user requests, economic volatility and other factors. The standard setter should not focus on establishing a new approach to determining materiality.





**Question 5.1 and 5.2**

**Chapter 5 includes proposals for improving the way disclosures are communicated and organised. Would the proposed communication principles improve the effectiveness of disclosures in the notes? What other possibilities should be considered?**

**Do any of the suggested methods of organising the notes improve the effectiveness of disclosures? Are there different ways to organise the disclosures that you would support?**

Overall, we agree with the communication principles identified in the discussion paper and believe that they will help in improving the effectiveness of disclosures in the notes. However, we are not convinced that prescribing ordering or format of note disclosure should be a priority for the standard setter.

Disclosures should be current and should inform and explain the substance of the transactions, going beyond the mandatory requirements when necessary. Disclosures should be clear, balanced, concise and written in plain language because that helps a user to better understand them. Headings and highlighting information may also be helpful for users but these formatting tools should be left to the reporting entity's judgment.

Linking and cross-referencing can generally be helpful, for example, if a reporting entity is clear in its notes which line item is impacted by the items being described.

We recommend the standard setter not specify a standard order for notes. If the standard setter suggested best practices, this may increase comparability and help users navigate notes. However, reporting entities are best positioned to determine what is relevant disclosure and 'best practices' should not be mandatory. Reporting entities should be able to organize their notes in the way they believe will be most effective.

We do not believe the standard setter should require reporting entities to group related information, thereby potentially resulting in the organization of notes being transaction-based. This suggestion would conflict with the objectives to achieve cohesiveness in terms of linking notes and improving comparability among reporting entities. Similarly, organising the notes based on operating, investing, and financing classifications would not necessarily improve their effectiveness. If these alternatives are explored, we recommend performing significant outreach and field-testing among preparers and users before conclusions are reached.

While other ways to organise notes may exist, we did not identify other ways in which information may be organised in notes to increase their effectiveness.

The discussion paper appears to address disclosure from a linear, paper-based perspective. This will become increasingly less important as technological advancements and the digital delivery and consumption of financial information becomes more prevalent. With improvements in technology over time, the ability to manipulate data into a standard format may be enhanced through the use of XBRL, and other formatting and organization techniques may emerge with other technological innovations. We recommend that further discussion on the disclosures should consider this aspect within its scope.



**Question 6.1**

**Are there any other issues that you think need to be addressed to improve the quality of information reported in the notes to the financial statements? Please explain how you think these issues should be addressed and by whom.**

We have not identified any other issues that need to be addressed to improve the quality of information reported in the notes. We do believe that it might be helpful if the EFRAG considers developing examples of financial statements to illustrate the practical application of the principles established in this discussion paper. This will help in visualising the impact of applying these principles and could considerably