Our ref: BT/EFRAG/CB
Your ref: Disclosure Framework
Via email : commentletters@efrag.org

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Mr Filippo Poli
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Dear Mr Poli

Discussion Paper: Towards a Disclosure Framework for the Notes

We welcome the opportunity to comment on the joint EFRAG, ANC and FRC Discussion Paper and support EFRAG in its efforts to move towards a globally accepted framework for the notes to the financial statements.

Our responses to the questions raised in the Discussion Paper are set out in the Appendix to this letter. These take account of and include references to our survey of preparers and users which obtained 125 responses in early December 2012.

Our main concern of the Discussion Paper is the quantum of key principles which have been included. Whilst we agree that each of the 14 principles are sensible, in our opinion, "key principles" should be limited to those that are fundamental.

We agree with the sentiments in the Discussion Paper that a "fundamental part of the purpose of the notes is to provide a faithful representation of items that are recognised in the primary financial statements". We do, however, consider that the general objective should enshrine the principle of fair presentation, or to present fairly, and that faithful presentation could usefully be introduced into the first principle.

We consider that whilst disclosure requirements may be set out in the standards, preparers, auditors and users should have reference to IAS 1, paragraph 31 which states "An entity need not provide a specific disclosure required by an IFRS if the information is not material".

If you wish to discuss anything further please do not hesitate to contact me.

Yours sincerely

Colin Burns
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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?

Response 1.1

Whilst we are generally supportive of both the idea of key principles and the content of those suggested in the Discussion Paper, we consider that the number of principles suggests they are not all key. We would suggest that the 14 key principles should be developed into one overarching objective supported by 5 key principles, one for each area of:

- Purpose and content of the notes
- Setting the disclosure requirements
- Applying the requirements
- Communicating information
- Succeeding in practice

The remaining principles could be converted into supporting guidance on how to apply or achieve each key principle. We have commented on how this may be achieved for the overarching objective and the first principle below. These should focus on what role the notes fulfil in the financial statements.

Page 21 of the Discussion Paper notes "a Fundamental part of the purpose of the notes is to provide a faithful representation of items that are recognised in the primary financial statements". We would encourage EFRAG to develop this statement into an overarching objective for the notes, whilst ensuring the fact that the notes are a subset of the financial statements that have the overall objective to "present fairly the financial position, financial performance and cashflows of an entity" [IAS 1 paragraph 15] is not overlooked.

The General Objective paragraph states:

"To ensure that all and only relevant information is disclosed in an appropriate manner, so that detailed information does not obscure relevant information in the notes to the financial statements."

However, we believe that the general objective should be set with reference to the overall aim of the financial statements as noted above, using terminology which is already widely understood. For example, the general objective could be amended to

Suggested General Objective of a Disclosure Framework:

"To ensure that the notes to the primary financial statements only provide the necessary information to present fairly the financial position, financial performance and cash flows of an entity."

Consequently Principle 1 could be amended to:

"The fundamental purpose of the notes is to provide a faithful representation of items that are recognised in the primary financial statements and of unrecognised arrangements, claims against and rights of the entity that exist at the reporting date."

Once the faithful representation principle is introduced, which encapsulates the 4 qualitative characteristics of the usefulness of information – relevance, reliability, comparability and understandability, the remainder of the principles essentially become guidance for preparers of standards rather than principles.

We would highlight that care is needed when reducing the number of principles to ensure that the five principles, both individually and collectively, need to be applied in the context of materiality, as that should be the final deciding factor in whether a disclosure is made or retained in the notes.

Notwithstanding the above comments, within principle 2b, we consider that information regarding post balance sheet events should be disclosed in the notes to the financial statements where these are material in assessing the financial position and cash flows of an entity. This is essential in providing useful information to the primary users, as that category of users are those making resource allocation decisions based on the financial statements. Practically, in order to provide useful information, disclosures relating to a reduction in asset values should be presented in the note relating to that particular asset value at the reporting date.

If this disclosure is material, and it would only be disclosed if it was, then it may affect users decisions, and so to omit that information, or to locate it somewhere else in the annual report, would reduce the usefulness of financial statements.

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?

Response 1.2

a) This is an area that was covered extensively in the ICAS/NZICA publication 'Losing the Excess Baggage'. We consider that whilst disclosure requirements may be set out in the standards, preparers and auditors should have reference to IAS 1, paragraph 31 which states "An entity need not provide a specific disclosure required by an IFRS if the information is not material". We consider that auditors are aware of this, and that preparers are generally aware of this after the event, however we do agree there is a culture of compliance with all requirements of standards which would helpfully start with preparers providing auditors with a list of disclosure requirements that have been considered to be not material. We carried out an online survey and of 125 responses, 90% thought that annual reports are too long, contain too much 'clutter' and that key messages are lost while 86% thought that existing standards, and possible queries by auditors and regulators, lead to a checklist mentality and boiler plate disclosure. The responses for non-preparers were even more convincing, with all 23 respondents in that category agreeing to each of these statements.

We also note that the summary of responses document to the 2011 ESMA consultation "Considerations of materiality in financial reporting" highlighted a difference in understanding between preparers and users as it notes that "the majority of respondents considered the concept of materiality is generally well understood", whilst a majority of user respondents were of the "view that the materiality concept was not clearly and consistently understood."

Based on these findings, we consider that whilst disclosure overload is an issue, care needs to be taken in applying the concepts of materiality and so, as noted in our response to question 4.2, we would encourage the IASB in consultation with IAASB to publish guidance on materiality for preparers, auditors and users.

b) Whist we accept that some improvements in this area may develop in line with advances in technology such as iXBRL tagging and embedded links within annual reports we do not consider that technology is the best solution, as such links and are not subject to audit and there is the risk that links in documents or summary tools within online annual reports may inadvertently omit important information.

Throughout the document there are terms which appear to be used interchangeably, such as 'key', 'detailed', 'material' and 'relevant information' and so we would welcome more consistent usage of terminology both within this document and generally within IFRS. We note and encourage the sentiments on pages 34 and 35 of the FRC consultation paper "Thinking about disclosures in a broader context" which encourages the IASB to use the descriptors in IFRS consistently.

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.

Response 2.1

Yes. We agree there is a need to define the purpose of the notes.

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?

Response 2.2

Please refer to our answer to question 1.1. We consider that there should be a clear link to the overarching purpose of the financial statements, given the notes are a subset of the whole.

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?

Response 3.1

a) The approach is logical and we agree that the starting point should be the conceptual framework.
b) Not applicable
c) We accept the argument put forward by the Discussion Paper that there is a category of "information about the reporting entity as a whole" that provides useful information, including those outlined in paragraph 10 of chapter 3. These whole of entity issues may affect multiple balance sheet areas, but not directly, and are useful to users making resource allocation decisions by assessing the overall financial position of an entity.

    However, we agree with the Discussion Paper that care should be taken that the principle of "footnotes" is not diminished by having information which is not relevant or material to the financial position of the entity. The fifth category is essentially any other information that is required to achieve a fair presentation (or true and fair view) of the financial position, financial performance and cash flows of an entity. We would expect this to encapsulate disclosures identified in paragraph 15 of chapter 3 on risk management.

    We would therefore suggest that the scope for the standard setters is extended to include any and all information that is required to give a true and fair view – equivalent to fair presentation, whether or not it can be verified by the existence of an event or relates specifically to a line item in the primary statements.

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?

Response 3.2

The users' needs and indicators in chapter 3 are useful, however we consider that greater emphasis is required on material disclosures.

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?

Response 3.3

Whilst we agree that the principles highlighted in paragraph 15 are sensible, we believe that the example within paragraph 17b takes this a stage too far. Information disclosed in the financial statements on risk should be based upon what would be required for a 'fair presentation' of the financial position at the year end. This is based on what the position was, and is not based on changing the business model of the entity. We therefore disagree with paragraph 17b in that the fundamental basis for preparing accounts should be based on the business model of the entity, which should be set out elsewhere, and cross referred to from the notes to the financial statements.

Including valuations on the basis of a remote possibility of realising an asset or settling a liability in that manner adds to clutter and does not provide useful information for most investors.

We consider that disclosures on alternative valuation bases offering a predictive valuation of a change in business model are only useful where an entity has indicated to shareholders that it is considering a change. Otherwise we are concerned that the benefits to be gained from the disclosure framework would be outweighed by significant additional disclosures which add little benefit.

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?

Response 3.4

We support EFRAG in calling for a change in the manner of setting standards. In our survey, only 15% of 125 respondents thought that the quality of financial reporting would be harmed by reducing disclosure requirements, whereas 76% thought that quality would not be harmed. We consider that standard setters should set principles of disclosure rather than lists of detailed requirements, although guidance is always welcomed on how most entities might achieve the disclosure principle provided that any guidance is explicitly stated to be so.

We believe that standard setters should amend their practice of mandating detailed disclosure and we support the general principles within paragraph 39. We also support and draw attention to page 16 of the ICAS document "A professional Judgement Framework for Financial Reporting – An international guide for preparers, auditors, regulators and standard setters", in which 7 recommendations for standard setters are set out. Were these to be contained within the disclosure framework then higher quality, principles based standards should result.

We encourage the IASB to remove the disclosures that were considered unnecessary by the ICAS/NZICA 'Losing the Excess Baggage' paper as we believe that this would be a major step in reducing the volume of disclosures that can lead to clutter in financial statements.

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?

Response 3.5

We do not believe that the standard setters need to establish differential reporting within a particular standard, however we do support the introduction of a tiered system of reporting based on consistent underlying principles of recognition and measurement such as those being introduced in the United Kingdom and that have been introduced globally via IFRS for SMEs.

Were differential reporting to be introduced within a particular standard then this would add bright lines, and remove decisions from preparers about what is and what is not material for users of their financial statements. Instead, standards should be written in such a way that the more complex the transactions undertaken, the more disclosure is required to understand them, and the resulting position of the entity. If, for example, an entity has simple transactions, and non-complex financial instruments, principles based standards should only require the entity to disclose the information that is required to show a true and fair view. This, by definition, should be less than is required for complex transactions and financial instruments, and thus, proportionate disclosure will automatically follow.

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 understandability and relevance of disclosures?

Response 4.1

We completely support the inclusion of such an approach, subject to some of the previously mentioned comments in our response to question 1.1, including reiterating our view that IAS 1 states "An entity need not provide a specific disclosure required by an IFRS if the information is not material", thus we consider more work is required to educate preparers that they can omit information which is not material and still show a fair presentation. We would also encourage regulators to support this approach in their actions, and in their communications to preparers and auditors. In our survey, 86% of respondents agreed that the disclosure of information that is not material can obscure relevant information.

Question 4.2

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.

Response 4.2

Whilst we consider that preparers and regulators should have greater regard for what is and is not material we do not consider that additional guidance on this area would enable the step change in behaviour required. A step change will only arise from principles based standards which do not mandate lists of requirements, even if they are only meant to be applied to material items as per IAS 1, paragraph 31 as previously noted. As we noted in our response to question 1.1 a disclosure framework should have the concept of materiality as a pervasive principle and not as a separate additional consideration.

We consider that materiality is incapable of monetary definition because it has both quantitative and qualitative elements so any guidance will inevitably either by too vague to be of use, or too detailed so as to miss the point. As we noted in our response to the FRC "Cutting Clutter" paper we do consider the extant range of descriptors triggering disclosures to be unhelpful and support a move to a small number of thresholds with agreement as to how they relate to each other.

However, should guidance be considered appropriate and however well intentioned, we strongly believe that it must be written as guidance, and not rules or requirements. In writing any guidance, we would urge the IASB to carry out this task in co-operation with the IAASB in order to secure a consistent approach for preparers and auditors.

Question 4.3

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?

Response 4.3

No, further to our response to question 4.2 we do not consider that additional guidance will prove useful whilst standards contain long lists of "requirements".

Question 5.1

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?

Response 5.1

We have no issues with the principles proposed. The order of the notes should be logical, linking to the order of the items contained in the primary statements themselves.

Question 5.2

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?

Response 5.2

The methods of organisation clearly follow on from the principles. Based on our survey, 83% of respondents supported the notes being in the order of the primary financial statements, on a consistent basis year on year, rather than in the order of importance.

Whichever method preparers determine is logical, we consider that improving effectiveness of disclosures is not just about reducing the volume of disclosures. It is also about better signposting and organising, to enable the reader to find relevant information of substance and further related disclosures, and to determine what has changed since last year.

For example, disclosures about going concern can appear in various sections of the annual report. It is important that these disclosures are linked together to ensure a complete and balanced view is given, but also to avoid repetition within the annual report. We understand that duplication can arise from requirements being set out in accounting standards and from local legislation so any framework should encourage preparers to look at the annual report as a whole when considering disclosures. Local legislators can also assist by removing requirements that are already contained in accounting standards that are required to be applied in that jurisdiction.

We would also support accounting policies being included in an appendix or on the entity's website with only policies which have changed in the current reporting period being disclosed.

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.

Response 6.1

In our view regulators play too great a role in influencing the level of disclosure. As noted in the Discussion Paper, the FRC "Cutting clutter", and ICAS/NCIZA "Losing excess baggage" papers, materiality should play a key part in the amount of disclosure given and auditors and preparers need to have confidence in their ability to exercise judgement without the fear of unnecessary and costly challenge from the regulators.

We note that the UK regulatory arm of the FRC includes consideration of materiality on its website, reminding preparers that "Accounting standards do not apply to immaterial items and the Conduct Committee takes the same approach" and that "you need only consider additional disclosures if they are relevant and material to your next report and accounts." We hope that other regulators take the same view and do not pressurise the IASB to include unnecessary disclosure requirements which preparers feel obliged to comply with.