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Towards a Disclosure Framework for the Notes: Discussion Paper

Representing preparers' point of view, the Swedish Enterprise Accounting Group (SEAG) welcomes the opportunity to comment on the Discussion Paper.

Summary

In summary, we have the following views.

- Disclosure overload is a significant problem for both users and preparers. The problem is addressed in the Discussion Paper but we find no clear solution in the Discussion Paper. We consider this to be a significant weakness.

- We support the creation of a Disclosure Framework but we are concerned that such a framework may increase disclosure requirements. It is therefore very important that a framework only contains principles for disclosure requirements.

- We agree with the key principles described in the Discussion Paper that should underpin a Disclosure Framework.

- We agree that there is a need to define the purpose of the notes and we also find the proposed definition helpful. However, we believe that materiality should be emphasized.

- We believe that the description of the approach for identification of the needs of users is not clear enough in the Discussion Paper. The proposed needs and indicators might lead to a codification of current disclosure requirements and in the worst case increase disclosure requirements.

- We believe that standard-setters should set general disclosure principle based objectives, leaving entities to assess how to meet those objectives.

- We consider that materiality should be reinforced in a Disclosure Framework and also that judgment of what is material information is entity-specific.

- We do not support the idea that a Disclosure Framework should contain a set of communication principles.

- We believe that disclosure requirements related to the notes to the financial statements should be addressed within a broader scope taking all disclosure requirements into consideration, for the benefit of both users and preparers.

In the Appendix we address the specific questions raised in the Discussion Paper.

We are pleased to be at your service in case further clarification to our comments will be needed.

Yours sincerely,

CONFEDERATION OF SWEDISH ENTERPRISE

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The Swedish Enterprise Accounting Group (SEAG) represents more than 40 international industrial and commercial groups, most of them listed. The largest SEAG companies are active through sales or production in more than 100 countries.

Appendix

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?

Yes, we agree with the key principles.

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 think that areas for improvement are all factors that lead to disclosure overload and possibly difficulties in navigating and comparing disclosures from various entities. However, we believe that the most important problem is the overload of information without sufficient consideration for materiality.

The organization of the notes is not, from our experience, a great problem and we would prefer the current practice of presenting notes in the order as the items are presented in the financial statements rather than e.g. in order by subjective materiality or importance.

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.

Yes, we agree that there is a need to define the purpose of the notes as this would give structure to the development of new disclosure requirements and guide the preparers in the preparation 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?

The proposed definition is helpful but we would recommend emphasizing the materiality aspect of disclosed information further in the description of the purpose. We understand that materiality is covered by the concept of relevance but nevertheless materiality is often the term used in the discussions around disclosures.

Question 3.1

In chapter 3, it is proposed to identify specific users' needs that the notes should fulfill. 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 fulfill those users' needs.

(a) Is the description of the approach clear enough to be understandable? If not, what points are unclear?

No, it is not clear enough. Please refer to our answer to question 3.2.

(b) If you do not support this approach, what alternative would you support and why?

We support this approach, but it has to be expressed in a way that actually decreases the volume of disclosures, and if possible makes them more in accordance with users' needs than today.

We see a risk that the very development of a disclosure framework will increase the disclosure requirements, as another case of unintended consequences of intended action. To us, it is a matter not only of eliminating certain disclosure requirements at present but to reduce the volume. We studied also Appendix 1 to the Discussion Paper, and we found it to be of considerable value, but we noted that most of the questions got the answer: Yes. To really change present habits and to achieve a reduction of the volume of disclosures, it is important with examples of present requirements that do not meet the suggested purpose of notes.

(c) Do you think that a category on "information about the reporting entity as a whole" should be included? If so, why?

Yes, based on the arguments in the section on page 28, and on the current situation with such information, we see it as unavoidable to include such a category. However, we emphasize the reasoning in paragraph 11 on page 28 on avoiding an expansion of information about the entity as a whole.

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?

No, we find the proposed needs and indicators not really helpful when identifying relevant information. The Discussion Paper is not very concrete regarding what the needs of different users really are. Without such an analysis, it is difficult to assess what is relevant information and how the information should be disclosed. The table presented on pages 34 and 35 in the Discussion Paper can be interpreted as a codification of present disclosure requirements without a link to concrete user needs, e.g. about the degree of granularity. This is of great concern to us and also seems to be contradictory to the view that there is a disclosure overload problem. We believe that the Discussion Paper is not addressing this potential conflict in a clear way.

Question 3.3

Do you agree with the way how 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?

No, we do not fully agree with how risk and stewardship are addressed. To begin with, we note that risk and stewardship are treated together in the section on other categories to disclose information about. We would have preferred one question on risk and another on stewardship.

Regarding the addressing of risk, it is a deep question whether it is riskier to conduct business in our times, but it is certainly true, paragraph 12 on page 28, that it is generally accepted that information about risk is critical to understanding the financial performance and position of an entity. Even if there is no clear divide between risks related to the financial performance and position and other risks, it is here especially important that the information that should be provided complies with the new definition of the purpose of notes. Also, the risk information should be on the entity's particulars that are relevant to the decision-making regarding that entity.

We note that the section on risk in the Discussion Paper is almost four pages long, and we understand that the information on risks that will be required due to the disclosure framework will be comprehensive. It means that the risk for too comprehensive requirements is obvious; cf. our answer to question 3.1 b.

To the contrary, the section on stewardship is only half a page. We have not here any suggestions for further reasoning on stewardship information, but we think that relevant additions could be found in the discussion regarding stewardship when the Conceptual Framework Phase A was developed.

Finally, disclosures on related parties are said, paragraph 24 on page 32, to be closely linked to the notion of stewardship. We do not find that linkage so close. Instead, we think that related parties should be a category of its own. Irrespective of how close that linkage is, we note the objective of IAS 24 *Related Party Disclosures* and find that the topic disclosures on related parties illustrate problems with a disclosure framework. We support the approach described in paragraph 5 on page 26, but it is not obvious that the requirements in the disclosure standard IAS 24 fulfil the users' needs in paragraph 5.

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 believe that standard-setters should set general disclosure principle based objectives, leaving entities to assess how to meet those objectives.

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?

Differential disclosure requirements certainly cause challenges when identifying suitable differentiating criteria and fulfilling users' needs in different circumstances. Considering the differences that would be created between reporting entities, we find that alternative requirements are not appropriate.

On the other hand, our view is that disclosures in interim statements should be restricted compared to disclosures in annual reports. We therefore believe that principles regarding disclosure objectives in interim financial statements should be formulated.

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?

Yes, we believe that such a reinforcement of materiality would be helpful and improve the quality of disclosures.

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.

Guidance can be helpful in evaluating materiality, but guidance must take into account that disclosures and appropriate levels of materiality are entity-specific. We therefore believe that it is very important that it remains as *guidance* and that it will not gain the status of additional requirements and another checklist to tick off.

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?

We acknowledge that this is a complex area. The guidance suggested is in major parts useful. However, we are very concerned that by formulating guidance on materiality, this could lead to an increase in disclosure requirements instead of serving as a base for assessing what is material information. We will give an example of this.

In the area described “Assessing materiality – exposure to cash flows arising from unrecognised items” we see an increase in information requested. This pertains mainly to items 29 to 38 where we believe the guidance is reaching too far.

Examples:

> *31 One approach is to consider the amount at which the entity would have measured the item if recognised. However, not all items have a binary nature (that is, an item with an outcome that is either nil or a fixed amount). <u>These items may instead expose an entity to a range of outcomes that are not all material. The information to be disclosed should take into consideration the full range of possible outcomes.</u>*
>
> *33 For type 2 items, the simplest approach is to consider the materiality of contractual amounts (in absolute terms). <u>This would imply that any firm commitment that is quantitatively material would likely be disclosed. This approach would capture transactions currently not disclosed – such as, commitments for salaries of employees under contract</u>.*

In this area we think that the reasoning in the FASB discussion paper could be useful where there is a discussion of magnitude, probability and timing (4.22 to 4.26). In 4.24 it is concluded that **“the probability-weighted value notion is suggested only as a way to structure thinking”**. Also, the continued discussion of probability and magnitude is of value.

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?

Our comments are based on the assumption that XBRL is not a mandatory reporting format for financial information. If that would be the case, we believe that the way that information is communicated in the notes to the financial reports would be affected and therefore also affect the way how communication issues are addressed by standard-setters.

Our general view is that the principles stated in chapter five in the Discussion Paper make sense. The question is how these principles are going to be reflected in a framework for disclosures and what difference that would make. One can get the impression from what is said in the Discussion Paper that there is room for improvement within existing requirements for disclosure in IFRS. We are therefore not convinced that a set of communication principles would make any significant difference and that they should be part of a disclosure framework. We will illustrate this with an example.

As suggested, the use of symbols and the linkage of information between disclosures will enhance the visibility of important information. Symbols can for example be used to show correspondence between the information given in notes to the same information in the primary financial statements. Within notes covering many pages symbols can also be used to connect information given in text with the similar information given in a table, it will then be easier for the reader to get a context even if the information is not presented next to each other in the note. Cross references between different notes is also helpful for a reader and this can easily be shown by symbols which will then also enhance the graphical presentation. But to very clear, this improvement can be achieved already today. We believe that the best way to achieve improved communication is through best practice and entities learning from each other.

Another and more important aspect affecting communication then a set of communication principles is the behavior of regulators and auditors. It is stated in the Discussion Paper (paragraph 4 on page 58) that auditors and regulators can facilitate good communication by placing less emphasis on black letter “compliance” and more on the overall quality of information. We agree with this view. A set of communication principles with preparers as the primary addressee will though not per se change the behavior of regulators or auditors. Therefore, this problem must be addressed in another way.

In the Discussion Paper alternative ways of how the notes can be presented is discussed (page 63). We do not believe that the flexible approach described in the paper, based on a year by year assessment of order of priority, is a possible way of explaining what information that is the most important. This is not a feasible approach that can be used by preparers. We believe that the real problem is that too much information must be provided. By cutting the clutter it will be easier for users to make their own assessment of which information that is essential to them.

We would also like to point out that some of the questions and examples discussed in chapter five of the Discussion Paper might have less to do with communication that with what the requirements for disclosures should be. Chapter five of Discussion Paper is therefore in some parts difficult to understand. We will give some examples.

It is stated in the Discussion Paper (page 60) that disclosures should inform and explain the substance of the transaction, going beyond the requirements if necessary. We believe that this is difficult to apply without further guidance and we question if an obligation to report something can exist without a requirement to do so. This indicates that the question is not how an entity should communicate this information but instead what information should be required by an entity regarding the substance of transactions. We therefore believe that this issue should be addressed in the context of identifying users´ needs.

We would also like to comment on the issue of display of information in the notes (Discussion Paper page 63). Here the example of share based payments is used. We believe that this example is interesting for two reasons. Firstly, one can argue that at least some of the information contained in such a note has more to do with corporate governance than with financial reporting. Secondly, the reflection in the Discussion Paper that the share based payment charge might be relatively small by comparison to us sounds like another way of stating that the information might be immaterial in some entities. This leads to the question if this is an example of a communication problem or a case of disclosure overload. We believe that this is prime example of the latter. Therefore, this example is more suited for a discussion around users´ needs and what is material financial information.

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?

As stated in our answer to question 5.1 there are many of the suggestions we are in favor of. However, we do believe there are also other ways of organizing the disclosures which will enhance the information given. We do not, however, believe that there is an optimal solution that will fit all reporting entities. It is important to allow for flexibility.

As stated on page 62 in the Discussion Paper, many annual reports present the accounting policies in note 1 followed by notes related to the income statement, notes to the balance sheet etc. As each note often includes some background information and accounting policies, much of the information given in note 1 is repeated in the following notes. An alternative is to move all possible information from note 1 to the specific note in which the related information is given.

In many annual reports there is also a note with key sources of estimation uncertainty related to different judgment areas. This information can be given in the specific notes instead. In the specific notes all information related to the item is then given in the same place. The user will then have the possibility to read about accounting policies, any potential key sources of estimation uncertainty and actual figures at the same place. This will also avoid repeating information already given in note 1 and hence lead to less information in the notes.

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.

Not only disclosure requirements under IFRS should be considered. In Sweden it has been a requirement in law for many years to present a Board of Directors Report (BoDR) as the initial “chapter” of the annual report (in practice, initially in the “finance part” of the annual report of listed company). The content of the BoDR is similar to Management Disclosures (MD) in other jurisdictions. Prior to the introduction of IFRS in Sweden all information related to policies, other than accounting policies, where presented in the BoDR, while accounting policies, disaggregation of and explanations to items in the financial statements were presented in the notes. Since IFRS has no MD some significant non-accounting policies are from 2005 presented in the notes, e.g. capital policy according to IAS 1 – alternatively in Swedish company presented both in the BoDR and in the notes. We propose that EFRAG consider the pre-2005 “Swedish model” to improve the organisation of information in the annual reports.

There are also other requirements or initiatives such as CSR and Integrated Reporting that adds to a company's "total disclosure". Especially Integrated Reporting, where IASB has an involvement, seems to not insignificantly overlap IFRS disclosure requirements. The development of Integrated Reporting could preferably be linked to a “Swedish model” approach as recommended above.

This wider approach is not within the scope of the EFRAG Discussion Paper but we recommend EFRAG to ask the IASB to consider and comment on the total financial disclosure requirements, for the benefit of both users and preparers. Information overload shall always be avoided as well as confusion related to similar or even equal information under different disclosure or presentation regimes.