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Dear Ms Flores

Discussion Paper – Towards a Disclosure Framework for the Notes

We appreciate the opportunity to comment on the above discussion paper. We have consulted within the KPMG network and this letter represents the views of the KPMG network.

There is an ongoing and healthy debate over the value and relevance of corporate reporting in general, and the increased volume and complexity of financial statements in particular. We share many of the concerns expressed and are committed to work with other interested parties to enhance corporate reporting.

Against this background, EFRAG's initiative to stimulate discussion on a disclosure framework for disclosures in notes to financial statements, a key aspect in this wider debate, is very welcome.

Subsequent to the publication of EFRAG's paper we note that the UK Financial Reporting Council (FRC) has published a paper *Thinking about disclosures in a broader context* (October 2012), which builds on EFRAG's work. The International Integrated Reporting Council (IIRC) has also released a working draft of a prototype international integrated reporting framework. Most importantly, the International Accounting Standards Board (IASB) has announced that disclosure will be an agenda priority and that it will host a disclosure forum bringing together preparers, auditors, regulators and investors to assess strategies for improving the quality of financial reporting disclosures; initiatives that we strongly support.

There is much to be applauded in EFRAG's discussion paper. However, we are disappointed that EFRAG limited its paper to the notes to the financial statements. We believe that the most effective way to improve corporate reporting is to take a holistic approach to the information provided both within and outside the financial statements, for example in the narrative sections of corporate reports. As such, while we believe that improving financial statement disclosures is important, it is only one part of what we believe is needed.

Ultimately, to become more relevant, corporate reporting must understand and respond to valid user needs. This may lead to changes that go beyond presentation and disclosure in financial statements.

We accept that enhancing the value and relevance of corporate reporting may involve a trade off on comparability. In particular, any efforts to improve the relevance of disclosures may affect comparability at the detailed level of disclosures, either from period to period for a single entity or in a single period between entities. Therefore, in seeking to understand user needs we recommend specific outreach to better understand the purpose of financial statements in corporate reporting and, based on that understanding, how to deliver the appropriate balance between a clear, understandable, relevant 'single story' and a highly detailed comprehensive 'data set' (or both, but separately, perhaps). A more holistic approach to corporate reporting may also deliver solutions to some of the issues identified by EFRAG. For example, electronic dissemination, placing standing data on company web sites rather than in the notes to the financial statements and XBRL may all be part of the solution.

Global experience in areas such as integrated reporting also must inform the debate. What is clear is that corporate reporting must consider, and where appropriate embrace, change.

While standard setters should be at the centre of efforts to enhance corporate reporting, we agree with EFRAG and others that progress will require the concerted efforts also of preparers, auditors and regulators based on a shared objective. The IASB have identified disclosure as a priority in its agenda; however, we believe that it is also important and appropriate for them now to take a wider leadership role in this debate and work with the International Auditing and Assurance Standards Board, the IIRC, and international and national regulators to understand needs and promote change. Standard setters and regulators must be challenged to work together to identify solutions, remove barriers and implement the necessary change.

We understand that such a holistic project to improve corporate reporting is a significant undertaking. While this is progressing, in the short term, we believe that there can be other ways to improve financial statement disclosures as the disclosure framework is developed.

We believe that there is already scope within International Financial Reporting Standards (IFRS) to reduce complexity and volume and improve relevance. For example, paragraph 31 of IAS 1 *Presentation of Financial Statements* states that 'an entity need not provide a specific disclosure required by IFRS if the information is not material.' In view of this, the exercise of appropriate judgement in the application of existing IFRSs should be emphasised, as certain regulators have already done, so as to promote a better organisation and presentation of financial statement disclosures in a way that forms a 'single story' together with the management commentary to explain an entity's strategy, business model, risks and performance.

The IASB also should reconsider existing disclosures and where in the annual report, or perhaps elsewhere, those disclosures might more appropriately be placed. This review should be carried out topic by topic, perhaps starting with those that have attracted most criticism. We support principles-based disclosure requirements (i.e. by setting out a disclosure objective in the style of paragraph 30 of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*), supported by example disclosures (for example similar to paragraphs 31 to 36A of IFRS 5) and underpinned by judgement based on a shared understanding of materiality (see paragraph 31 of IAS 1). The importance of emphasising materiality over completeness can be seen in the expansive disclosures that are in practice presented in response to standards such as IFRS 7 *Financial Instruments: Disclosures,* despite the adoption of a principles-based approach. Only in limited cases should disclosure requirements be considered to be mandatory in all instances, perhaps where they are deemed always to be material, for example where materiality is predominantly qualitative.

Materiality is clearly key and we believe that encouraging a shared understanding among preparers, auditors and regulators of materiality, through dialogue and possibly additional guidance, will encourage confidence that valid judgements about disclosure will not be second-guessed. In this regard, we responded in March 2012 to the European Securities Markets Authority noting that we support a principles-based approach to materiality and that work should be done to promote a consistent understanding of materiality among different stakeholders.

We commend EFRAG for the leadership it has shown in this area, and encourage them to share their work with the IASB and play an active role as the debate progresses. It is now time for the standard setters, in particular the IASB, to demonstrate leadership to improve corporate reporting. We believe that this is a goal that we should all be committed to.

Our responses to the specific questions raised in the discussion paper are attached as an appendix to this letter. We would welcome the opportunity to discuss any of the matters raised in our response with you. If you have any questions, please contact either Mark Vaessen or David Littleford at +44 (0) 207 694 8871.

Yours sincerely

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Appendix

Question 1.1: ***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?***

We agree that the key principles as set out in pages 2 and 3 of the discussion paper serve as a useful first step in improving information provided in notes to financial statements, by dealing with the related issues in a logical and comprehensive manner. In particular, we support the principles that disclosure requirements should be principles-based and should be given more weight in the standard setting process, that focus should be on communicating relevant and material information in an understandable manner, and that the success of a disclosure framework would hinge on a shared commitment of all interested parties.

However, as we explained in the cover letter, we believe that any effective approach to improve corporate reporting should take a broader view by considering information provided both within and outside the financial statements. In this regard, we note that many of the key principles can be applied to information both within and outside the financial statements.

Question 1.2: ***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 these are the two areas of focus to improve financial statement disclosures in the short term. We believe that there is already scope within IFRS to achieve these, as certain regulators have already emphasised – for example, the UK FRC has published a paper, *Cutter clutter – combating clutter in annual reports* (2011). In addition, we believe that these two areas complement each other in enhancing the relevance of disclosures.

In the longer term, improvements to disclosures should be considered in the broader context, taking into account information provided both within and outside the financial statements.

Above all, improving the quality of disclosures would require a shared objective among, and the concerted efforts of, all interested parties, including standard setters, preparers, auditors and regulators. We therefore recommend further exploring these suggestions with all interested parties, with an aim to develop a disclosure framework that encourages preparers to explore these possibilities and apply judgement to enhance the relevance and understandability of disclosures. In addition, we believe that encouraging a shared understanding of the concept of materiality in the context of disclosures among all interested parties, and shifting the focus from completeness to materiality of disclosures, would in turn promote the more robust application of the materiality concept and contribute to the reduction in excessive and immaterial disclosures.

Standard setters and regulators should also be challenged to work together to identify a holistic solution, remove barriers, and implement any changes that are necessary to improve corporate reporting in general.

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 believe that the most effective way to improve corporate reporting as a whole is to take a holistic approach to information provided both within and outside the financial statements. Accordingly, we believe that in the longer term any effort to improve corporate reporting should not be limited to notes to financial statements.

Notwithstanding the above, if the project is to be focused only on the notes to financial statements, then we believe that there will be a need to define the purpose of the notes. This would help clarify the boundary for disclosures of different nature, and therefore enhance consistency and reduce duplication of the contents among the different components of a corporate report. Consideration of whether information is appropriate for the notes to financial statements or elsewhere would require a coordination between standard setters and regulators, who are generally responsible for prescribing the requirements for different components of corporate reports.

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 proposed definition would be helpful in better defining the type of information that would be expected to be disclosed in notes to financial statements. However, we believe that certain information such as that on non-adjusting post-balance sheet events is so integral to understanding the financial statements that it should be captured by the definition of the notes, perhaps by extending the definition to capture 'arrangements, claims against and rights of the entity existing at the date the financial statements are authorised for issue'.

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?***

We believe that the description of the approach is reasonably clear. To make corporate reporting more relevant, we agree that valid user needs should be identified and responded to.

The introduction of indicators that correspond to these user needs would facilitate the alignment of disclosure requirements with these needs. In addition, we believe that an indicator approach would help strike a balance between consistency and flexibility when developing disclosure requirements.

We believe that a category on 'information about the reporting entity as a whole' is too broad. Consistent with the proposed purpose of the notes to financial statements, we believe that this category of information should be limited to only general information that provides a relevant explanation of the amounts in the financial statements, for example, any material uncertainties over the use of the going concern assumption when preparing the financial statements.

Above all, we note that a more holistic approach should be taken in identifying user needs. In particular, we recommend specific outreach to better understand the purpose of financial statements in corporate reporting. This more holistic consideration may also lead to changes that go beyond presentation and disclosures in financial statements. For example, certain user needs may be better served by provision of information outside the financial statements, for example, by placing standing data on company web sites rather than in the notes to the financial 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?***

We note that all the user needs identified in the paper are relevant and deserve consideration. However, we note that there appears to be certain missing information. For example, it is not clear whether disclosures about significant judgements applied when preparing the financial statements are covered by any of the identified categories.

Ultimately, disclosures should not lose sight of the overall aim to serve user's valid needs. Therefore, irrespective of the actual categories identified, we believe that there should be some overarching objectives based on user's needs that serve as the guiding principle for setting disclosure requirements, and that help preparers in assessing the relevance of specific disclosures. Identifying specifically what type of information users value should be at the heart of determining which type of disclosures are relevant. We therefore believe that further outreach should be performed to determine specific types of disclosures users find to be most relevant, and then a principles-based framework should be designed that emphasises such information.

In addition, while the indicators could help providing a broad basis of what types of information may be relevant, we note that it is also important to emphasise the importance of materiality when determining the actual information to be disclosed (see our response to questions 4.1 to 4.3). Otherwise such indicators alone would run the risks of reinforcing a completeness approach towards disclosures and result in excessive and immaterial disclosures.

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?***

We note that information about risk and stewardship is essential in corporate reports. However, as noted in our cover letter and our response to question 2.1 above, we believe that the most effective way to improve corporate reporting is to take a holistic approach to information provided both within and outside the financial statements. An approach that views the financial statements as a component that is distinct from, for example, the narrative sections of corporate reports requires also consideration of the placement of disclosures.

We recommend that users' needs and preferences in respect of placement should be investigated. For example, if users prefer grouping all risk disclosures together in one single risk report, then we believe that standard setters and regulators should be challenged to work together to identify solutions and remove barriers in this regard, to facilitate the grouping of such disclosures say by allowing the use of cross-references between different components of a corporate report.

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 principles-based disclosure requirements that allow preparers to determine the disclosures that are relevant and reflective of their specific circumstances are the most effective in improving the quality of disclosures. Specifically, we believe that:

- disclosure requirements should be expressed in sufficiently clear disclosure objectives (e.g. in the style of paragraph 30 of IFRS 5);
- disclosure objectives should be supported by example disclosures that might be given to satisfy the objectives (e.g. similar to paragraphs 31 to 36A of IFRS 5); and
- the role of a robust application of materiality in determining the extent of disclosures should be emphasised (ie the role of materiality as explained in paragraph 31 of IAS 1 should be elaborated).

Contrary to what the question suggests, we do not believe that existing standards mandate detailed disclosures. For example, paragraph 31 of IAS 1 states that 'an entity need not provide a specific disclosure required by an IFRS if the information is not material.' We therefore believe that there is already scope within IFRS to reduce complexity and volume and improve relevance of disclosures.

That said, we do note that there is a need to emphasise the use of appropriate judgement in the application of existing IFRSs, as certain regulators have already done, so as to reduce disclosure overload and promote a better organisation and presentation of financial statement disclosures in a way that forms a 'single story' together with management commentary to explain an entity's strategy, business model, risks and performance (see also our response to questions 4.1, 4.2 and 5.1). We also note that the disclosure framework should be used not just for establishing new disclosure requirements going forward but also for evaluating the existing disclosure requirements.

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 principles-based disclosure framework and disclosure requirements, coupled with a strong emphasis on valid user needs and materiality, should be flexible enough to deal with reporting by entities of different sizes and in different industries.

A differential disclosure regime might require the standard setters to establish bright-lines for eligibility criteria, potentially creating arbitrage. In addition, such a regime might be seen as reducing the role of judgement in deciding the extent of disclosures from preparers, when preparers may be best placed to make that judgement. We acknowledge that there are some limited areas where differential disclosure requirements may be appropriate, for example, earnings per share disclosures. However, we believe that these are only the very limited cases and could be dealt with without introducing a differential disclosure regime.

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 disclosure?***

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.***

As indicated in our response to question 3.4 above, we believe that appropriate judgement, in particular the application of materiality, is key to improving the relevance of corporate reporting and can help reduce disclosure of immaterial information. Immaterial information can result in clutter that can impair the understandability and relevance of disclosures. We therefore agree that the importance of materiality should be reinforced.

We support a principles-based approach to materiality and note that encouraging a shared understanding of the concept among preparers, auditors and regulators, through dialogue and possibly additional guidance, will encourage confidence that valid judgements about disclosures will not be second-guessed.

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?***

As noted in our response to questions 4.1 and 4.2, we support a principles-based approach to materiality and encourage a shared understanding of the concept among preparers, auditors and regulators.

While an indicator approach for assessing materiality can be helpful in supporting the overall principles by facilitating a more consistent application of judgement, it should be cautioned that the indicators should not unintentionally introduce a set of rules which could be contrary to the general principle. In particular, both the quantitative and the qualitative aspects of materiality should be emphasised, as an item could be material because of its magnitude and/or its nature.

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?***

As stated in our response to question 1.2, we agree that enhancing how disclosures are organised and communicated is one of the key ways to improve the relevance of disclosures. Accordingly, we support introducing communication principles that reinforce this user-centric idea. In addition, such principles would complement the principles on materiality, in that both will contribute towards more relevant and understandable disclosures.

We believe the proposed communication principles are a good start to improving disclosures, and observe that many of proposals can be implemented within today's requirements, before a disclosure framework is implemented.

Above all, we believe that the key principles should not be limited to only the notes to financial statements. As explained in our cover letter, we believe that improving disclosures requires a more holistic approach.

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?***

The organisation and presentation of notes should be driven by user needs. Generally, we believe that a mix of the 'flexible approach' and the 'grouping information approach', with appropriate cross-referencing where appropriate, would provide the most effective results and better enable an entity to tell a 'single story' about its strategy, business model, risks and performance. As set out in our response above, we believe that further outreach should be performed to identify user needs.

Above all, we note that a more holistic approach should be taken in addressing user needs and such an approach may also lead to changes that go beyond organisation and presentation of financial statements. For example, certain user needs may be better served by provision of information outside the financial statements, for example, by placing standing data on company web sites rather than in the notes to the financial statements. Standard setters and regulators must be challenged to work together to identify solutions, remove barriers and implement the necessary change.

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 acknowledge that the scope of the discussion paper is limited to the notes to financial statements. While improving financial statement disclosures is important, we believe that it is only one aspect of a larger endeavour to strengthen corporate reporting as a whole. Therefore, any future changes to setting disclosure requirements, including development of a disclosure framework, should be taken under a holistic approach considering information provided both within and outside the financial statements.