

EFRAG DISCUSSION PAPER “TOWARDS A DISCLOSURE FRAMEWORK FOR THE NOTES”

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?

We broadly agree with the proposed key principles. However we find that these very principles with their precise definition of what should be in historical financial statements and the notes thereto leave some unanswered questions. For example whilst we applaud the move to sequester the financial statements as a source of historical information, other information that presently is often included with the financial statements is still important. We believe that this paper needs to be accompanied by other papers that address how to present that other information in a cohesive consistent manner. We believe that a series of papers dealing in particular with:

- Forward looking financial information;
- Information about risks; and
- Related party information including remuneration of executives and directors;

would provide a more comprehensive set of principles for financial reporting.

We also believe that it would be appropriate for the paper to contemplate the multiple ways in which financial information is presently conveyed and provide guidance how annual financial reports could act as a vehicle for linking, inter alia:

- Obligatory filings under continuous disclosure regimes;
- Presentations to analysts, shareholders at general meetings and similar presentations;
- Periodic (annual, half yearly and even quarterly) formal financial reports; and
- The use of social media.

To do so this would ensure that the proposals had the capacity to survive the dynamic developments in communication presently facing financial reporting. These papers could also canvass the use of technology such as XBRL coded information presented on the Internet.

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?

As we comment in our response to 1.1 above we believe that this paper could:

- Be more comprehensive if it dealt with the manner in which inter alia forward looking and related party information should be conveyed albeit not in the Notes;
- Address the manner in which financial information should be conveyed in the light of evolving modes of communication and the plethora of information already provided by companies.

That being said we agree that within the compass of this paper these are the two main areas for consideration. Moreover we have, as a common theme in our commentary on both financial and audit reporting matters, the principle that clarity and simplicity are paramount features of such reporting.

In Australia there has been a practice (not accepted by all parties) that wholly owned companies, however large, can provide tailored limited disclosures in their annual financial statements by using a principle referred to as “special purpose” reports – the special purpose being the perceived needs of the limited number of users. We refer to the following article in the Sydney Morning Herald :

<http://www.smh.com.au/business/car-makers-in-race-to-reduce-disclosure-20121011-27ezd.html?skin=text-only>, which compares a strict reduced disclosure regime such as that recently

introduced in Australia with the previous more flexible special purpose approach.

In some cases these practices take too far the principle of presenting only information useful to users by an unduly narrow conception of users. Our past practice in our previous firm when auditing subsidiaries of major global organizations was to recognize that there may be no commercial users of information about executive remuneration in wholly owned subsidiaries who do not already have that information. This provides a proper basis for the omission of such information. However most of the other information contained in financial statements is relevant to a broad group of users such as employees and creditors and should not be excluded other than for the reasons given in this paper.

Our view is that the principles espoused in this discussion paper provide a robust basis for assessing relevance as the criterion for determining whether a matter should be disclosed in the notes.

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.

Defining the purpose of the notes is key to deciding whether a note is necessary or whether it can be culled.

In our view one of the features of this paper is that it not only considers the purpose of notes to the financial information but also in the process seeks to define the role and function of historical financial reporting. We endorse the approach taken in this paper to both the notes and, more widely, content of the financial statements.

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?

In our opinion the proposed definition is useful.

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?

(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?

In our view the approach is clear and understandable and we support the approach.

When considering what information is necessary apart from that described in paragraph 5 of Chapter 3 of the paper, we believe that information about the reporting entity as a whole can be important particularly in respect of complex organizations. We recommend that in determining how much information should be included in the notes about "the reporting entity as a whole" consideration should be the wider issues of the positioning of the information in the notes relative to the other information that we have referred to in our response to 1.1 above, such as forward looking information and information in respect of related parties.

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 believe the indicators in chapter 3 do help identify the relevant information for inclusion in the notes.

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?

In our view the Discussion Paper provides an appropriate basis for the inclusion of information about risks and stewardship in the notes. However, in our opinion, as noted in our response to 1.1 above, this Discussion paper should sit as part of a comprehensive framework of reporting in which risk and stewardship issues are also dealt with. This expanded framework should have regards to other information about companies already present on websites and through presentations to arrive at the optimal and most efficient ways of presenting financial, risk and stewardship information.

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 change their practice in respect of setting mandated disclosure requirements because the tendency so far has been to create increasingly long lists of disclosures that may not be relevant in all circumstances. Whilst understanding the need for uniformity in disclosures, this tends to lead standard setters to create lists of prescribed disclosures.

Our preference would be for standards to prescribe disclosure principles rather than list disclosure requirements. We understand the need for those disclosure principles to be tightly drafted but believe this is a sound objective and will keep standard setters away from the temptation to evolve disclosure lists. Such lists are often an attempt to respond to events such as the credit crisis of 2007-8; as such they may or may not reflect continuing disclosure needs. Well drafted principles avoid that problem. Indeed long prescriptive lists have, in our experience, encouraged narrow interpretations to avoid their 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 do not support rigid differential reporting regimes but we see that a flexible differential reporting regime based on user needs can provide tailored financial

information without excessive clutter if honestly applied. We commend to you the Australian SAC 1 as an analysis of users needs and how they impact financial reporting.

Differential reporting however can introduce unnecessary complexity and have the potential to confuse users. Another way of looking at user based reporting needs is by assessing the need for a disclosure using relevance and materiality. The only sound reasons for the omission or inclusion of a disclosure should be relevance and materiality. Differential reporting regimes can also induce legalistic attempts by companies to stay within or move to perceived more favourable reporting regimes. Properly drafted disclosure principles with a sound understanding of the principles of materiality and relevance should be the key to improved reporting relevant to each company's circumstances.

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 ?

This question lies at the root of many of the excessive disclosures and much of the unnecessary clutter in financial reporting. A clear statement that **immaterial information reduces the understandability of financial information, and therefore should be avoided**, is in our opinion fundamental to disclosure principles.

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.

A Disclosure Framework would be enhanced by guidance in applying materiality provided it does not fall into the very trap the Disclosure Framework is trying to remove, namely becoming unduly formulaic and prescriptive rather than being principles based.

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 believe that the description of the approach is clear enough.

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?

The proposed communication principles will improve the effectiveness of disclosures. However we are of the view that the section headed Technology deserves more prominence and should be a key part of this section rather than an afterthought.

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 suggested means of organizing the notes will improve the effectiveness of disclosures.

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.

In our response above we have made the following further recommendations:

- That the Disclosure Framework for the Notes should sit within a broader frame work dealing with, inter alia, forward looking information, custodial disclosures, other disclosures such as compliance with laws and risk that are pertinent to a users understanding of a company; and
- That the proposals consider the multiplicity of ways in which information about a company is conveyed – including websites, analysts presentations and the use of social media.