MAZARS

EFRAG
35 Square de Meeûs
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Paris, 4 January 2013

RE: invitation to comment the Discussion Paper 'Towards a Disclosure Framework for the Notes'

Dear Sir / Madam,

We are pleased to comment on the Discussion Paper 'Towards a Disclosure Framework for the Notes' published in July 2012 by the European Financial Reporting Advisory Group (EFRAG), the Autorité des Normes Comptables (ANC) in France and the Financial Reporting Council (FRC) in the United Kingdom.

We welcome the efforts exerted by the authors in addressing this complex but extremely important issue and also their constructive, principles-based and structured approach to improving disclosures which is proposed in this Discussion Paper. If the idea of a comprehensive disclosure framework is eventually embraced by the IASB, this would help improve the existing IFRS requirements and thus give an additional argument for the worldwide acceptance of the IFRSs.

We agree with the view expressed in the Discussion Paper that current practices of disclosing information in the notes to financial statements need to be improved: at times, some important information is not disclosed or disclosed improperly, and, more often, irrelevant and / or immaterial pieces of information are being presented which adds more confusion and complexity and does not always help external users understand the financial situation of the issuer.

We also agree that defining a clear objective of the notes to financial statements is an essential step in order to improve the quality of financial reporting. This should also facilitate the task of standard setters by giving them clear guidance on the scope and purpose of disclosures.

The identification of users' needs and the assessment of relevance of information satisfying these needs are as well important in developing high quality disclosures. Although we agree with most of the relevance indicators proposed by the authors, we are of the opinion that the scope of the needs category '*how the line fits into the entity's operations and financial structure*" has to be clarified: in order for general disclosure principles to be workable, clarity is the key.

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When it comes to current disclosure setting practices, we agree that the dominant 'disclosure checklist' approach is not acceptable and we propose a 3-step process for setting disclosures. We think that detailed requirements in each standard should be maintained, but – contrarily to current standard setting practices – they should be imposed only after making sure that they all meet the disclosure objectives of each standard. These specific standard-level objectives should in stem from general disclosure objectives defined at framework level. In our opinion, alternative models with strong preparers' discretion are not acceptable.

When determining detailed rules, we think that differential disclosure regimes should be introduced since such measure would help achieve disclosures that are proportionate to the users' needs. In our opinion, the two axes for differentiation could be the size of the reporting entity and whether the entity is publicly accountable or not.

Concerning the chapter on materiality, we agree that disclosing immaterial information might reduce the relevance and the understandability of financial statements. We believe nevertheless that the issue of materiality – should it relate to the primary financial statements or to the notes – is sufficiently important and complex to be dealt with by means of a dedicated project.

The communication principles proposed are clear and pertinent. We are not in favour, however, of organizing information in the notes by order of importance. The current standardized approach seems to work quite well in practice in our view.

Our detailed comments and answers to the questions raised in the Discussion Paper are provided in the appendix attached to this letter.

Should you have any questions, please do not hesitate to contact us.

Yours sincerely,

Michel Barbet-Massin
Head of Financial Reporting Technical Support

Appendix 1: detailed answers to the questions raised in the Invitation to Comment the 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?

The principles listed in pages 2 to 3 of the Discussion Paper seem conceptually sound and robust. Nevertheless, achieving compliance with these principles in practice will not be easy since the behaviour of both standard setters and preparers will have to evolve.

We would like to comment on some of the principles that should be reconsidered in our opinion. Take for instance the principle # 8 '*Disclosure requirements should be principle-based and detailed rules should be avoided*'. We disagree with the second part of this principle which states that detailed rules should be avoided. As will be explained in more detail in our answer to question 3.4, we are of the opinion that the general principles of the disclosure framework should be used to set the objectives of each and every standard, but we believe that the general principles-based objectives should also be accompanied by quite detailed requirements and / or illustrative examples as to which pieces of information on a given item satisfy users' needs and are relevant. We fear that purely principles-based disclosure requirements would leave too much room for the management to influence the content of the disclosures, and it would also give rise to endless discussions between the preparers and their auditors, and also regulators, as to why some notes were included and others not. Besides, purely principles-based and judgement prone disclosure requirements could give rise to additional risks for preparers and their auditors in the context of legal procedures and litigations: it would be more difficult to prove that the information provided was compliant and sufficient.

When it comes to principle # 9 '*Disclosure requirements should achieve proportionality to the entity's users' needs, and meet a reasonable cost-benefit trade-off in all circumstances. Alternative disclosure regimes may have to be put in place to achieve proportionality*', we think that the second sentence of this principle should be deleted because it refers to the practical implementation of the principle presented in the first sentence, i.e. it is a means of achieving proportionality to users' needs, rather than a principle.

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 with the description of main areas for improvement, and especially with the idea that disclosure overload should be avoided. Indeed, a disclosure framework requiring too detailed information in the notes might be counterproductive: important information might be obscured by information on events and items of secondary importance. The users of financial statements might therefore fail to identify and understand the most important messages.

From all current communication problems, we consider the 'boiler-plate' disclosures issue as the one that has to be dealt with in the first place. In fact, some parts of the notes – and in particular the significant accounting policies section – tend to be too generic and non-customized; similar descriptions can be found across entities having different activities and different financial performances. Sometimes, entities describe instruments and operations that they never really entered into! In our view, one of the main objectives of the disclosure framework should be achieving entity-specific disclosures.

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 that defining a clear purpose of the notes is an essential step in improving the existing disclosure requirements.

If we take a look at existing IFRSs, and in particular the recent ones most of which contain new voluminous disclosure requirements, we get the impression that the disclosures required by those standards have been developed without clear underlying guiding principles. In fact, it seems that some disclosures have been introduced just to please some specific users, without making sure that there is a widespread consensus as to the existence of a fundamental need for this particular information, or that this information would meet the qualitative characteristics of useful financial information as defined in the Conceptual Framework of the IFRSs.

Furthermore, the IASB has at times been tempted to add disclosures as an alternative to 'fixing' the existing measurement or presentation principles or as the final solution when joint efforts to converge accounting principles failed. An example of this is the recent 'Offsetting' project: having failed to reach a converged solution between the IFRS and the US GAAP principles for offsetting financial assets against financial liabilities, the IASB and the FASB have decided to reach convergence only by means of additional disclosures. Another example is the new standards on consolidation (IFRS 10, IFRS 11 and IFRS 12). The proportionate consolidation method being no longer permitted and SIC 12 interpretation being withdrawn and replaced by IFRS 10 with different rules for identifying control, it is likely that some items will disappear from the financial statements whereas others will appear due to different consolidation rules. In particular, some structured entities that were consolidated because of the SIC 12 risks & rewards criterion might no longer be consolidated. In order to compensate for the loss of such information in the primary statements, the IASB has introduced a new standard IFRS 12 'Disclosure of Interests in Other Entities' which will most probably lead to a significant increase in the volume of the notes.

Defining a clear purpose for disclosures would be useful in guiding standard setters and it might help solve the 'information overload' issue discussed in question 1.2. In order for it to be operational, this global objective should nevertheless be further developed into relatively detailed requirements for each standard in our view.

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 agree with the clear and concise definition proposed.

We also agree with the proposal that disclosures in the notes should mainly focus on past transactions of the reporting entity. Forward-looking information is also important, as long as it relates to and helps explain the amounts accounted for in the primary financial statements (such as, for instance, growth forecasts used in impairment tests for determining the value in use according to IAS 36). Purely forward-looking information (such as business plans), when not directly related to recognized items, is less relevant in our view. Besides, it is less verifiable and can lead to biased presentation by the management. We therefore agree with the Discussion Paper that such forward-looking information should not be part of the notes.

When it comes to issues for which according to the authors 'the boundary is less clear' (such as risks and related party disclosures), we think that they should be disclosed in the notes whenever they relate directly to the primary financial statements. Indeed, we are of the opinion that major risks stemming from items recognized and unrecognized commitments existing at the reporting date should be disclosed, especially when it comes to complex financial instruments and transactions since such information should be of interest for the users.

Concerning the existing related party disclosures as required by IAS 24, many of them require explaining the proportion of amounts recognized which relate to transactions concluded with related parties. They thus relate to past transactions and should be maintained in the notes in line with the definition of the purpose of the notes as proposed in the Discussion Paper (i.e. these are not 'borderline' issues in our opinion). Besides, such information might be very important for users when making investment decisions. On the other hand, some existing requirements on stewardship – such as, for example, information on key management personnel compensation, with details to be provided by type of employee benefit – seem too far reaching and specific, and should not be imposed by accounting standard setters in our view.

Non-adjusting events after the reporting period relate to transactions that are not yet recognized in the primary statements as of reporting date, but which already took place as of the date of authorization for issue of financial statements: information on such events is therefore information on past transactions, and disclosures on such events are also in line with the general objective of the notes as defined in the Discussion Paper.

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?

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?

The identification of different types of users' needs is certainly important, and standard setters should keep these needs in mind when setting disclosure requirements.

Having considered the approach proposed in pages 26 to 31 of the Discussion Paper, we agree with the fact that disaggregating different lines and describing the terms and conditions of disaggregated items and their accounting treatment is essential in order to satisfy users' needs.

Nevertheless, we are not sure to fully understand which needs are to be addressed by the category '*how the line fits into the entity's operations and financial structure*'. When reading the proposals in pages 27 and 35, we do not really see the link between different pieces of information presented: the scope and purpose of this section do not seem clear to us. As a result, we suggest that the authors re-consider the heading of this category and its scope so that the principles of users' needs identification are concise and understandable.

When it comes to information about the reporting entity as a whole, such information might be of interest to the users. Even though some elements, such as the legal form of the reporting entity, the structure of the consolidated group, the markets in which it operates and going concern issues, do not specifically relate to individual items, disclosing them seems essential in our view. Defining the boundary between relevant and less relevant entity-wide information will not be an easy task, but we think that this issue is worth being tackled with during the next stage of the project.

Concerning the relevance indicators listed in pages 34 to 36, most of them are indeed useful and understandable, and in particular the ones relating to disaggregation, description of items and their accounting treatment. As mentioned above, since the content of the need category '*how the item fits into the entity's operations and financial* structure' is not explicit, we have difficulties in understanding to what type of information the different relevance indicators in the upper part of page 35 refer. In our opinion, this difficulty stems from the fact that the headings of these specific indicators are too vague and generic: it could be a good idea to add another column with examples of operations and items that are aimed at by the authors. This could be a way to ensure that the list of relevant information indicators is exhaustive.

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 opinion, information on risks to which the recognized and unrecognized transactions expose the entity and on how these risks are managed by the entity are two types of information which are of interest to external users. They should thus be addressed in the notes.

We are not sure however whether there is a need for measuring an entity's risk appetite, as proposed in p. 31. Were such information required, clear guidelines should be provided on the calculation of this 'risk appetite' in order to avoid diverging practices. This goes beyond the purely accounting-figures based information, and we wonder whether accounting standard setters do have a true legitimacy on this issue.

Please also see our related comments in answers to question 2.2.

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 agree with the view that the current disclosure setting practices adopted by standard setters are not optimal (please see our comment on question 2.1 for more details).

They are largely responsible for the current situation whereby entities often adopt the 'checklist' approach, and make sure each and every piece of required information is presented. Such practices are also encouraged by regulators and auditors.

We agree that existing standard setting practices should be changed in order to achieve a more user-oriented and decision-useful set of disclosures.

Nevertheless, considering the alternatives proposed and described in pages 39 to 41 of the Discussion Paper, we believe that the best way to proceed would be to maintain detailed requirements in each standard. This is because in our view none of the other four models would work in practice:

- Regarding the two models giving a lot of discretion to the preparers ('*what is disclosed depends upon preparer*' and '*general disclosure objectives*'), we disapprove them since they would leave too much space for judgement and biased choice for the management as to which pieces of information should be included in the notes. This approach would also make any comparison across entities virtually impossible.

- Concerning the '*industry level prescriptions*' model, we are not convinced that this approach could be easily implemented for the following reasons:

    - It would imply defining the segmentation of different industries and in particular boundaries between industries that may have common features. This would not be easy because of the great diversity of industries that exist worldwide, and even within the same country.

    - Once such segmentation is obtained, identifying the pieces of information relevant for each and every industry would also be a challenging task.

    - Furthermore, multi-industry companies would potentially be concerned by several sets of different disclosure requirements.

- Finally, regarding the approach '*single set of requirements for all items and transactions*', we consider that some pieces of information are relevant for some specific items and less relevant for others: we do not support the 'one size fits all' approach.

The detailed requirements model, as we imagine it, would however be different from the existing IFRS disclosure practice. This approach would imply a 3-step standard setting process:

Step 1: at framework level, defining the general objectives of the notes.

Step 2: defining standard-level objectives that are relevant to the items and transactions covered by the standard and fully consistent with the general objectives of the notes as defined in step 1.

Step 3: setting the specific disclosure requirements that are necessary to meet the standard level objectives.

According to this approach, defining a general framework for the notes is the crucial step which will allow establishing disclosure requirements that will be consistent throughout all standards and will help limit the information overload.

From the IFRS perspective, the first-time implementation of this new standard setting approach would be quite time-consuming since both future standards under development and also all disclosure requirements in existing standards would be concerned: the IASB would have to :

a) define the general framework-level objectives;
b) make sure that existing standard-level objectives comply to the general framework level objectives;
c) introduce standard-level disclosure objectives to standards that currently have none, and
d) also review the existing detailed requirements to make sure that they comply with both standard-level and framework-level 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?

We agree with the idea that introducing differential disclosure regimes might help improve the decision-usefulness of the information disclosed and could also reduce the burden that preparing disclosures currently represents for some entities.

We would like to pinpoint that the IFRS framework already contains some differentiated presentation requirements: for example, the standards IAS 33 'Earnings per share' and IFRS 8 'Operating segments' apply mandatorily only to entities the shares of which are traded in a public market, or which are in the process of filing for the purpose of issuing shares in a public market.

In our opinion, the two axes for differentiation could be the size of the reporting entity and whether the entity is publicly accountable or not. We therefore support the proposal of the ANC that a reduced disclosure regime should be introduced for small listed companies, and we believe that such a proposal could be applied to larger entities that are not publicly accountable. This would help achieve disclosures that are proportionate to the users' needs.

The problem with the size-based approach lies of course with defining the boundary between 'large', 'medium-sized' and 'small'. We are of the opinion that standards setters should not provide such definition and that they should entrust this task with local enforcers.

If different disclosure regimes were to be introduced depending on the size of entities and on the public accountability criterion, this could call into question the relevance of maintaining several sets of standards (such as full IFRSs and IFRS for SMEs). In some jurisdictions, some entities have elected to apply IFRS for SMEs to their separate financial statements, whereas they are consolidated within a larger group reporting under full IFRSs. The rationale for such a choice is often to avoid burdensome disclosures at the separate entity level. For such groups, having a single set of accounting principles but different disclosure regimes would help avoid situations whereby the consolidating entity has to make adjustments to the accounts of its subsidiaries.

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?

We agree with the idea that an explicit statement saying that 'disclosing immaterial information reduces the relevance and the understandability of financial statements' should in theory lead to less information overload in the notes to financial statements. This seems sound from the conceptual point of view. Nevertheless, we are afraid that the application of this principle would not be easy to obtain in practice, since the preparers of financial statements as well as their auditors would be confronted to the highly judgemental area of materiality.

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.

In our opinion, significant research work has already been carried out and technical material prepared on the subject of materiality in accounting: take, for instance, the IAASB guidance on materiality (International Standards on Auditing ISA 320 *'Materiality in planning and performing audit'* and ISA 450 *'Evaluation of misstatements identified during the audit'* contain some principles of quantitative materiality assessment), or the outreach made by ESMA in 2012 on considerations of materiality in financial reporting (ESMA has recently published a summary of responses received on its consultation paper).

We do not think that the best means for tackling this complex issue would be by 'starting from scratch' and by including it as a separate objective within a larger project on disclosure framework. Given the importance of and difficulties encountered when applying the materiality principle, we are of the opinion that a separate project devoted to materiality should be led, and the issuer of such guidance should try to capitalize on previous outreach and research.

As already explained in our comment letter sent to ESMA on 30th March 2012 (please see the second appendix to this comment letter), we share the view that there is no common understanding among the different stakeholders on how the concept of materiality should be applied in financial reporting: the assessment of materiality made by enforcers (securities regulators, courts…) may differ significantly from the one made by 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?

As explained in our comment letter on the above-mentioned ESMA consultation paper, the guidance on materiality in accounting should remain principles-based and set the following principle as its primary objective: financial statements should provide information that is useful for primary users for decision-making. Materiality is a significant area where management exercises its judgment. Each situation being unique, any systematic, rules-based approach in that matter would lead in our view to a lack of relevance.

We agree with the idea expressed in p. 49 of the Discussion Paper that the analysis of materiality for the purposes of including information in the notes might differ from the assessment made when deciding whether an individual item presented in the primary financial statements is material. That is, some operations and items (such as unusual or highly risky transactions) might need to be described in the notes although their carrying amount or P&L impact is relatively insignificant if compared to the total assets of the entity or its net profit or loss. Similarly, some important lines might need no additional information if they relate to the ordinary activities of the entity and present no significant change with respect to their historical level.

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?

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?

We agree with the idea underpinning this Discussion Paper that disclosure requirements should be applied with a view to communicating information to users rather than a compliance exercise.

We also believe that most of the proposals relating to the communication principles described in pages 60 to 63 (such as 'entity-specific', 'current', 'clear and balanced' and 'linked' disclosures) truly make sense, and would help improve financial reporting if they are explicitly imposed on the preparers of financial statements within a disclosure framework.

We are as well favourable to the 'grouping principle' since grouped information would be more understandable for the users. Take for instance the case of tax-related disclosures: currently, most preparers present two different notes – one, to explain the profit or loss impact in relation to the tax income or expense for the period, and another note to explain the tax-related assets and liabilities recognized in the statement of financial position. A grouped presentation of these items would make more sense in our opinion.

We have noted that most of the preparers and users of financial statements (including but not limited to auditors and enforcers) have got used to the current more or less 'standardized' format described in p. 62 of the Discussion Paper. This current dominant approach helps to find the information needed rapidly and compare the notes of the same entity throughout different periods and also quite easily compare the performance of different entities. The current practice being quite satisfactory in our view, we do not see why one specific format for organizing the notes should be imposed on the preparers.

We are afraid that the introduction of the 'flexible' approach (whereby the most significant information would be included in the notes first) would have too high a cost of preparation as compared to the benefit of such 'prioritized' information for the users: each year, preparers would have to rethink the best way of sequencing different notes which could be quite challenging and time-consuming.

Were the 'flexible' approach chosen for its conceptual benefits, the disclosure framework should contain more guidance on the prioritization of information for this approach to be operational.

<u>Appendix 2:</u> MAZARS comment letter on ESMA Consultation Paper 'Considerations of materiality in financial reporting'