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Dear Sir

**Discussion Paper - Towards a Disclosure Framework for the Notes (the Discussion Paper)**

We are pleased to comment on the above Discussion Paper. Following consultation with the BDO network<sup>1</sup>, this letter summarises the views of those member firms that provided comments.

We support the work carried out by EFRAG to provide input to the debate on how the quality and effectiveness of disclosures in financial statements can be improved. We agree that it is likely that this would be assisted by the development of a Disclosure Framework which sets out clear principles to be applied by preparers of financial statements, and by standard setters when establishing the disclosure requirements for new and amended accounting standards.

Although a Disclosure Framework should include clear principles to be applied in determining appropriate disclosures, we would caution against an approach which resulted in an overly prescriptive set of requirements. Instead, the outcome of the application of the principles should be disclosures which have a clear objective and which link to the needs of users of financial statements. Consequently, the ultimate content of the notes should be left to reporting entities themselves to decide.

Linked to this point, we do not believe that it would be appropriate for a Disclosure Framework to include separate consideration of materiality. Materiality is a complex judgement, which needs to be based on the specific facts and circumstances of each entity. In addition, the inclusion of a materiality threshold for the purposes of disclosures risks causing confusion among users of financial statements. Therefore, the question of whether a particular disclosure (or disclosures) might be considered material should be dealt with through the existing requirements.

Although we do not support the development of a precise model or format for the presentation of notes to financial statements, there may be merit in considering a 'two tier' approach under which the more significant accounting policies and other note disclosures, as

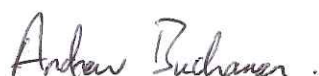
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determined by the reporting entity's management, are placed immediately after the primary financial statements, with other notes being included in a second section. A framework of criteria to be applied in determining which disclosures should be included in the first section might be helpful, and we have included some suggestions in our detailed response to question 1.2. Management might then be required to consider at each reporting date whether changes should be made to the content of each section, in the light of the reporting entity's particular circumstances.

Our responses to the detailed questions in the Discussion Paper are set out in the attached Appendix.

We hope that you will find our comments and observations helpful. If you would like to discuss any of them, please contact me at +44 (0)20 7893 3300.

Yours faithfully

A handwritten signature in cursive script that reads "Andrew Buchanan".

Andrew Buchanan

*Global Head of IFRS  
BDO IFR Advisory Limited*

### 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?*

In general, we support the concept of developing a disclosure framework for information to be presented in notes to financial statements. In addition to its use by preparers, auditors and regulators, it would be appropriate for such a framework to be applied by standard setters during the development of new accounting standards.

In relation to the key principles set out in the Discussion Paper, we have the following comments:

1. Although the approach for a disclosure framework might follow from the application of the 14 principles set out in the Discussion Paper, we are not convinced that each of them is key. We suggest that there might be one key principle for each of the five main headings, with each principle being expanded on in the more detailed guidance.
2. The general objective notes that it is 'To ensure that all and only relevant information is disclosed.....'. While this may be appropriate, there is a need to define what 'relevant information' is, and this is not currently provided by the more detailed principles that follow. We suggest that it would be appropriate to link the concept of 'relevant information' to the key qualitative characteristics set out in the Conceptual Framework of relevance and faithful representation.

In that context, we note that paragraph QC11 of the Conceptual Framework makes specific reference to materiality as an entity specific aspect of relevance. This is important, as materiality is a key concept when considering disclosures that should (and should not) be made in notes to financial statements. However, in particular because materiality is a complex and subjective judgement, we do not believe that a materiality threshold should be developed purely for disclosures. We believe that this would be likely to cause confusion, and would have the potential to be very difficult to implement in practice.

Similarly, it is not clear what is meant by 'detailed information' that might 'obscure relevant information'. We assume that the intention of the reference to detailed information is a link to the common practice of the inclusion of a substantial amount of immaterial information in the notes, but this is not what the current drafting states. It would be helpful for the intention to be clarified.

3. We note that within the Discussion Paper, there appear to be inconsistent references to the qualitative characteristics of information to be presented in the notes to financial statements. For example, while the general objective key principle refers only to 'relevant information', paragraph 11a refers to information that is 'relevant and faithfully represents the entity's financial performance and position' and chapter

2 makes specific reference to the requirements of the Conceptual Framework. It would be helpful for the document to be fully consistent in its terminology and references, which would be assisted by direct references to the Conceptual Framework. This would also be appropriate in the context of a disclosure framework being used by standard setters during the development of new accounting standards.

4. Key Principle 1 states that the purpose of the notes is to ‘...provide a relevant description of the items.....’. This should be redrafted to read ‘....provide relevant information about the items...’. A requirement for a description could be taken to require only qualitative disclosures, while information can be both quantitative and qualitative.
5. We disagree with the references in Key Principle 1 and 2b to the reporting date, as this would result in information about post balance sheet events not being included in the notes. This would not be consistent with the general objective, that relevant information is disclosed in an appropriate manner; material post balance sheet events are relevant for users of financial statements. Consequently, we would support an amendment of the definition as suggested in paragraph 14b of Appendix A. We also suggest that Key Principle 2b is redrafted to read ‘...on past transactions and events that have occurred.....’
6. The second sentence of Key Principle 4 refers to uncertainty and the linkage to the quantum of required disclosures. However, the reference should be to amounts that are material; this links to the need to establish clearly defined terms in the general objective paragraph, which can then be linked more clearly to the more detailed principles that then follow.
7. Key principle 8 proposes that disclosure requirements should be ‘principle-based and detailed rules should be avoided.’ We agree with the implication that, although a long list of specific requirements can be helpful, it tends to promote a ‘checklist’ approach. However, we do believe that it is appropriate to include a framework of information to be disclosed in order to meet overall disclosure objectives, in a similar way to the approach taken in IFRS 3 *Business Combinations*. Without a framework of suggested disclosures, there is a risk that disclosures made by different entities might not be comparable. Please also see our response to question 3.4.
8. Key Principle 12 states that the disclosure of immaterial information ‘reduces’ the relevance and understandability of disclosures. We do not believe that this statement should be definitive, and should instead read that immaterial information ‘may reduce’ the relevance and understandability of disclosures.

The Discussion Paper includes a number of other statements which, in our view, should not be definitive (for example, paragraph 13, and the last sentence of paragraph 18, in Chapter 4).

## 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 improvement?*

We agree that there have been many observations that financial statements have become excessively lengthy and unwieldy, with (in some cases) key disclosures being lost in the volume of information that is presented.

We believe that it is important to acknowledge that the reasons for the increasing amount of information presented in financial statements go beyond the requirements of accounting standards. Other factors include the tighter regulatory environment and an associated risk averse approach that tends to be adopted when financial statements are drafted, resulting in many entities including a wide range of disclosures to avoid the risk of questions being raised subsequently about why a particular item has been excluded. There is at least a perception that regulators in a number of jurisdictions operate to very low materiality thresholds, with the result that entities will frequently include all possible disclosures in order to avoid the risk of subsequent criticism.

In addition, entities are generally reluctant to make changes to their annual financial statements from one year to the next, due to the associated time and cost. This point is frequently overlooked, but is a major reason for additional disclosures simply being 'layered on' year after year, with only minimal consideration being given to changing disclosures brought forward from previous periods.

A disclosure framework on which the standard setters base the requirements of each standard would have the potential to assist in encouraging fuller consideration of what information should be disclosed and how.

However, we do not believe that accounting standards should set out precisely how information should be set out in the notes, although it might be appropriate to introduce a 'two tier' approach, under which the more significant accounting policies and other note disclosures, as determined by the reporting entity's management, are included in a section that appears immediately after the primary statements, with other accounting policies and notes being relegated to a second section. Entities might then be required to consider each year whether changes should be made to the content of each section, in the light of the reporting entity's particular circumstances.

It might be helpful to include a framework of criteria that management should consider in determining which disclosures should be included in the first section. This should include reference to the considerations in IAS 1.122 and 125 (significant judgements made in the process of applying the accounting policies, and sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and

liabilities within the next financial year). Additional factors to be taken into account might include:

- Significant risks and uncertainties
- Significant unusual transactions (in particular those which are non recurring)
- Information about the an entity's group (or separate entity) structure that is significant to an understanding of amounts presented in the financial statements
- New or emerging issues (such as new accounting policies, or significant changes in an entity's circumstances in comparison with prior periods)

### 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 it would be appropriate to include a definition of the purpose of the notes. Without this, it would be difficult to articulate the principles of a disclosure framework.

### 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?*

Although the proposed definition would capture some information that is relevant, we believe that it is overly restrictive. In particular:

- The proposed definition would appear to exclude post balance sheet events from the disclosures. As noted above, we believe that these are necessary disclosures where a material post balance sheet event (whether adjusting or non adjusting) has taken place.
- The terminology used in the proposed definition is different from that currently used in IFRS. Similar to our response to question 1, we believe that any definition should be conformed to existing terms in the accounting literature.
- The definition needs to extend to cover potential claims and rights, as well as those that exist at a particular date. As an example, key information for an insurance company is about those claims in relation to the reporting period which have not yet been received, but for which there is an expectation that a claim will arise (such as the effect of a severe storm shortly before a reporting date).

We agree that forward looking information should generally be excluded from notes to financial statements. An exception to this is the disclosure already required by IAS 1.125 for assumptions made about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. Other than

these, forward looking disclosures are more appropriately included in the management commentary or similar sections, which are clearly not within the audited financial statements. The distinction between what has and has not been audited is key and, if appropriately articulated, would help to increase the clarity for users of financial reports of what is and is not covered by the audit opinion.

### 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?*

The description of the approach is clear.

However, the identification of specific needs brings a risk that a disclosure framework could restrict the scope of disclosures that might be made. This is because the needs of some users of financial statements may not be taken into account, or users' needs may change over time, meaning that additional information needs to be provided. An entity might also wish to make additional disclosures, beyond those identified through consideration of the specific needs. Consequently, it is important that a disclosure framework does not place any restriction on the information to be provided, instead setting out principles to be followed in determining the disclosures to be made with entities deciding for themselves which are relevant to their specific circumstances.

We believe that information about the reporting entity as a whole should be included, as this type of information may be relevant to users of financial statements. These disclosures include related party transactions, how it has been determined that certain entities are subsidiaries and should therefore be consolidated, and foreign exchange and interest rate exposures.

### 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 agree that it is appropriate to include consideration of users' needs when developing a disclosure framework. However, as noted above, it would be important to ensure that no restrictions were placed on the information that an entity would be permitted to disclose in the notes to its financial statements. Consequently, although categories or indicators might be used to assist in identifying information to be disclosed, these should not be exclusive.

In addition, it would be important to maintain the concept of materiality throughout when determining whether disclosures should be required. However, we believe that the question of whether a particular disclosure (or disclosures) might be considered material should be dealt with through the existing requirements for determining what is, and is not, material. The inclusion of a separate materiality threshold for the purposes of disclosure would bring the risk of causing confusion among users of financial statements. We also believe that it would have the potential to be very difficult for entities to apply.

### 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?*

Risk disclosures assist users in understanding the underlying quality of earnings reported in financial statements, their sustainability and, at least to an extent, their potential volatility. Consequently, we believe that it is essential that all material risk disclosures are included as they are essential to an understanding of an entity's financial position and performance. An issue that then requires careful consideration is which information should be included within the financial statements, and which information should be included elsewhere in an annual report or other documents.

The question of which disclosures should be included within the notes to financial statements is key when considering stewardship. This links to one of the main purposes of financial statements, which is to assist in an analysis of potential future cash flows. This implies that information about related party transactions should be included as these arrangements, in particular those at off market rates, could affect future cash flows. It is debatable whether other information, such as management remuneration, falls within this category.

### Question 3.4

*Standard setters frequently mandate detailed disclosure requirements in each standard. On 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?*

It would be helpful for there to be a move away from including a specific list of detailed disclosure requirements in accounting standards. Although a list of information to be provided can be helpful, it tends to promote a 'checklist' mentality on the part of preparers. As noted above, the inclusion of a standard list of disclosures in a new accounting standard can result in a significant amount of information being carried forward from one year to the next as, once an entity has updated its accounts template for a new accounting standard it may often be considered simpler to carry forward disclosures from one year to the next rather than consider whether changes and deletions could usefully be made. Detailed disclosure requirements can also result in entities including all suggested disclosures,



regardless of their materiality, in order to minimise the risk of being challenged in future about why a particular item has been excluded.

At the other end of the scale, we would not support an approach which left entities to decide for themselves which disclosures should be made. In our view this approach would not be operational, with preparers being likely to request additional guidance to assist them in determining the disclosures to be made, and there is a risk that entities might fail to disclose certain information due to a perception of adverse consequences. There is also a significant risk that disclosures made for similar transactions and events by different entities would not be comparable.

We would, however, support an intermediate step, with standard setters providing clear disclosure objectives. It is likely that these would need to be supplemented with a framework of information that might be disclosed to meet the disclosure objectives (with the caveat that only those material items should be included), which would be a modified version of the approach adopted by the IASB for IFRS 3 as outlined in paragraph 52 of the Discussion Paper.

We would not support the development of industry specific guidance, due to the complexity that would be introduced and the loss of comparability across different industry sectors.

### 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?*

It would appear that there are three separate questions to address:

1. Would it be appropriate to introduce a differential reporting regime for entities that report in accordance with IFRS (including those that are listed on a public market, depending on their size)?
2. Should reporting requirements vary depending on whether an entity prepares interim or annual financial statements?
3. Is it appropriate for entities to be subject to differential reporting regimes depending on their status or industry?

In response to question 1, we believe that it would not be appropriate to introduce a differential reporting regime. The creation of two or more regimes under which an entity could claim full compliance with IFRS would be very likely to introduce confusion on the part of users of financial statements. For those entities that are listed on a public market, a public listing brings certain responsibilities and one of these is reporting in accordance with all of the requirements of IFRS. If an entity is smaller and/or simpler than others, then this will be reflected in the number of the requirements of IFRS that are applicable.

For question 2, we believe that it is appropriate for interim financial statements to be prepared on a simpler basis than annual financial statements. We note that IAS 34 permits a simplified approach on the basis that full year information can be found in the most recent annual financial statements.

For question 3, we do not believe that entities should be subject to different reporting requirements simply because they operate in a different industry sector. This inevitably gives rise to a loss of comparability among entities from different industry sectors. However, we do support differential reporting requirements depending on an entity's status. For example, we support a simplified reporting regime for entities that do not have equity or debt instruments listed on a public market, although we do support the existence of an option for those entities to follow the requirements of 'full' IFRS. This might be desirable due to, for example, an entity's funding arrangements or a plan to list its equity or debt instruments on a public market in future.

#### **Question 4.1**

*Chapter 4 discusses the application of materiality to disclosures. Currently, IFRS states 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 that consideration of materiality is important when determining which disclosures are required to be made. However, we would caution against an approach which might be taken to prohibit the disclosure of information in addition to that which an entity considers material. Instead, a statement might be made that materiality should be considered when determining the disclosures that are required but that this does not preclude the disclosure of additional information if an entity wishes to do so.

Consideration of materiality is complex and subjective, and requires an evaluation of both quantitative and qualitative aspects. It is also the case that judgements of what is, and is not, material can vary among individuals and organisations; regulators often question judgements that entities have made in this area. Consequently, we would not support the addition of restrictive guidance.

#### **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.*

Although materiality is an important consideration when determining what is, and is not, required to be disclosed we would not support the inclusion of guidance on the application of materiality in a Disclosure Framework.

Consistent with our comments above, we believe that it would be appropriate for materiality in the context of disclosures to be assessed in the same way as for other items to be included in an entity's financial statements. We do not believe that it would be appropriate or practicable for standard setters to introduce a defined materiality threshold for disclosures; materiality depends on a range of factors, including entity specific facts and circumstances, which can and do vary over time due to changes in economic, regulatory and other circumstances. We also consider that the introduction of a materiality threshold for disclosures would be extremely difficult for entities to apply.

### 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 do you suggest?*

Please see our response to question 4.2 above. We believe that it would be inappropriate for specific guidance on materiality to be included in a Disclosure Framework.

### Questions 5.1 and 5.2

*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?*

*Do any of the suggested methods of organising the note improve the effectiveness of disclosures? Are there different ways to organise the disclosures that you would support?*

In general, we agree with the disclosure principles set out in paragraphs 8 - 25 of the Discussion Paper.

We agree with the observation in paragraph 33 about 'Standardisation - current approach', that this can result in significant information being buried at the back of the notes section. This approach does arise in practice; it can also be the case that an entity might include certain sensitive information at the back of the notes intentionally to give less prominence to the disclosures. Consequently, we would support exploring a more flexible approach which grades disclosures according to their importance. As noted in our response to question 1.2 above, this might be in the form of 'two tier' approach, under which the more significant accounting policies and other note disclosures, as determined by the reporting entity's management, are included in a section that appears immediately after the primary statements, with other accounting policies and notes being relegated to a second section. Management might then be required to consider each year whether changes should be made to the content of each section, in the light of the reporting entity's particular circumstances.

Although this would have the potential for additional time being spent by preparers each year in the drafting of their annual financial statements, we believe that this would also have the potential benefit of a substantial improvement in the communicative quality of information set out in the notes. We would also view the potential challenge by auditors and regulators

as being beneficial, as constructive challenge has the potential to improve the quality of financial reporting.

Other than grouping the most significant information together, we would not support a requirement to group similar information as suggested in paragraphs 38 and 39. Instead, we would prefer a principle that asks for information to be presented in the notes in a way that best communicates information to users of the financial statements. This might, or might not, result in the grouping of information; clarity of disclosure can also be achieved by good linkage and cross referencing.

Although the Discussion Paper gives consideration to the future use of technology, much of the discussion in Chapter 5 appears to be based more on paper-based financial statements. We believe that it would be appropriate to give the future use of technology for financial reporting greater prominence.

#### **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.*

The question of 'disclosure overload' is often viewed primarily from a user's perspective. While it is important to focus on users of financial statements when considering how disclosure requirements might be changed and improved, it is also appropriate to take into account other factors including the practicality and cost effectiveness of proposals on preparers.