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European Financial Reporting Advisory Group (EFRAG)
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Dear Sirs,

EFRAG - Towards a Disclosure Framework for the Notes – Discussion Paper

Introduction

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of European**Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Financial Reporting Expert Group has examined your proposals and advised on this response. A list of members of the Expert Group is at Appendix A.

Response

We welcome the opportunity to respond to this consultation. Please find our responses to the questions below:

1.1 – Key principles – Do you agree with these key principles? If not, what alternative principles would you propose?

We support the principles that assert that the disclosures should be entity specific and should amplify and explain the primary financial statement. We do not support, however, the principle that states:

"[T]he notes should focus on past transaction and other events existing at the reporting date; information about the future that is unrelated to those past transactions and other events, is not provided in the notes."

As is stated in the Discussion Paper (p71) this would not lead to the disclosure of non-adjusting post balance sheet events. We do not believe that this is consistent with the provision of useful information about the reporting entity to current and potential investors, lenders and other creditors (see The Conceptual Framework). Consequently we believe that this principle should be amended to allow for the disclosure of matters that become known up to the date the financial statements are authorised for issue.

1.2 – Understanding the problem – Do you agree that these are the two main areas for improvement?

We are in agreement that these are the two main areas for improvement though we are of the opinion that disclosure overload is of much greater importance than the organisation of disclosures in the financial statements. We would point out that disclosure overload is also caused where disclosure requirements are not proportionate to the size and risk profile of the reporting entity as well as by the ineffective application of materiality.

We do note that the development of a Disclosure Framework is only a long term solution to the problems addressed. We would like to see EFRAG challenge the International Accounting Standards Board (IASB) to take an urgent look at disclosure currently included in IFRS and in particular whether to amend current disclosures along the lines suggested by ICAS and ICANZ in Losing the Excess Baggage. Additionally we do not believe that disclosure overload is the only problem with IFRS and would urge the IASB to undertake a more thorough re-examination as disclosure cannot make up for weaknesses in the measurement model.

2.1 Do you think that there is a need to define the purpose of the notes? If not, please provide your reasoning?

As the Discussion Paper is intending to contribute to the setting of a wider Disclosure Framework, which standard setters should refer to when revising and drafting accounting standards, we think there is a need to define the purpose of the notes. Defining the purpose should also help preparers, auditors and regulators when assessing the contents and the quality of disclosure notes.

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 that it should be amended?

We agree broadly with the definition of the notes; however we do not believe that it is comprehensive enough in identifying all relevant information that should be included therein. For example, in the current definition it is not explicit as to whether the notes should include any reference to post balance sheet events. As such, we believe that the definition needs amending to ensure appropriate disclosure of post balance sheet events.

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

We believe that the description of the approach is broadly clear enough to be understandable. We also welcome the fact that clear general principles have been defined for this purpose as this approach should lead to the notes being more entity focused thereby creating a more user-friendly, entity-specific set of notes which should allow for a greater understanding of the financial statements.

However, we do note that mention is made to “the appropriate level of proportionality” (Chapter 3, para 39 e). We believe that clear, focused guidance needs to be given as to what this is as to how this should be assessed and implemented.

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

We are in agreement with this approach as we consider it important to focus attention on the needs of users. However we would point out that users of financial statements are not always the same as those who pay for their production; consequently there needs to be an assessment of proportionality which considers both the disclosure itself and also the circumstances and risk of the entity making the disclosure. What, for example, might be a proportionate disclosure for a large international bank might well not be a proportionate disclosure for a small to mid-size quoted company.

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

We do not think that a category on "information about the reporting entity as a whole" should be included within the notes. In our experience information about a reporting entity is available in the other reports published with the financial statements and we do not see merit in repeating this information.

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?

On the whole the proposed users needs and indicators in chapter 3 are helpful in identifying relevant information. However we believe that it is key to ensure that reference to materiality is mentioned throughout.

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 are in broad agreement with the way that risk and stewardship are addressed in the Discussion Paper. However in relation to risk we believe that an element of materiality should be applied to risk disclosure. Chapter 2 of the Discussion Paper states that "the notes should provide information on risks that affect reported items"; however there is no specific mention to materiality. As such, this could lead to a raft of disclosure on immaterial items which users may choose to disregard in their evaluation. Reference to materiality regarding risk, in particular to the financial impact that risk may have on the entity, should be made to ensure the notes prepared are more entity focused and applicable to users.

The Discussion Paper acknowledges that to assess stewardship more information is required on strategy than is compatible with the key principles; the notes, and indeed the financial statements as a whole, therefore only provide part of the information required to assess stewardship. Whilst much of the information is often contained in other reports published with a set of financial statements we believe that any Disclosure Framework should explicitly acknowledge the limitation of financial statements alone in assessing stewardship and should encourage users to review other available pieces of information when making this assessment.

3.4 Do you think that standard setters should change their practice of mandating detailed disclosure requirements in each standard? If so, which of the alternative approached discussed do you think will be most effective in improving the quality of information in the notes?

Whilst it is important that standard setters provide sufficiently detailed requirements to ensure that companies comply with the principals of good financial reporting, the requirements could be written in a less granular way to avoid over disclosure. Consequently we support the report from ICAS and ICANZ Losing the Excess Baggage.

As is mentioned in the Discussion Paper, the application of the materiality principal is crucial to improving the quality of the notes and we would recommend that the standard setter includes specific reference to materiality in each accounting standard. We note that some preparers disclose all items required as the line item is individually material, whereas other preparers disclose only when the disclosure itself is material. We believe that being more specific about materiality would help resolve this inconsistency.

3.5 Do you think that establishing alternative disclosure requirements is appropriate?

We believe that establishing alternative disclosure requirements is an important way of addressing the disclosure overload many companies face. IFRS should acknowledge that not all companies pose the same level of risk, or have the same level of resources to devote to financial reporting, and should flex its disclosure requirements accordingly. Disclosure requirements should meet a cost benefit test and an alternative disclosure regime would recognise that the result of that test for a larger, systemically more risky, entity may well be different for a small and mid-size quoted company.

The Discussion Paper mentions the work done by ANC in proposing a reducing disclosure regime for small listed companies as well as the reduced framework available to non-publically accountable entities in Australia. Additionally the UK is introducing a reduced disclosure framework for subsidiary undertakings. We believe that these frameworks could well be suitable for small and mid-size quoted companies and believe that the IASB should challenge their assumption that only full IFRS is suitable for companies with public accountability.

4.1 Do you think that a Disclosure framework should reinforce the application of materiality, for instance with a statement that immaterial information could reduce the understandability and relevance of disclosures?

We believe that a disclosure framework should reinforce the application of materiality as this will allow preparers to produce a more focused, company specific set of notes. However we note that it may be useful to state within the notes what items that management have considered to be immaterial and therefore have not been disclosed, and also to include further information should management expect any of these omitted, immaterial amounts to become material in the next reporting period.

4.2 Do you think that a Disclosure Framework should include guidance for applying materiality? If you disagree, please provide your reasoning.

Yes, a Disclosure Framework should include specific guidance for applying materiality. This will help to ensure greater consistency in the application of materiality.

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 on the whole to be useful in improving the application of materiality particular in its focus on the continual assessment of materiality. It would be useful, however, to ensure that a comment is added to the approach for consideration of future material items – for example, whether or not they should be included when they are immaterial but management know that they will be material in the next period and then whether or not reference should be made to this within the notes.

5.1 Would the proposed communication principles improve the effectiveness of disclosures in the notes? What other possibilities should be considered?

We believe that the proposed communication principles would improve the effectiveness of disclosures in the notes. They would allow the preparation of the financial statements to move away from being a compliance exercise to being an exercise to communicate key financial information to core users. This fundamental change in approach should allow more user-focused, entity-specific financial statements to be prepared, which would increase their relevance and usability.

We do note, however, that the comment in paragraph 16 of chapter 5 ("[d]isclosures should give prominence to key items that have affected the financial performance or position of the entity, or may do so in the future") and in particular the reference to the impact on future financial performance could be inconsistent with the key principle, which states that "information about the future that is unrelated to those past transactions and other events, is not provided in the notes".

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?

There are pros and cons with each of the proposed methods for organising the notes however we believe that the current approach, which retains some flexibility within IAS1, remains the most appropriate way of organising the notes. In particular we believe that seeking to organise them on the grounds of priority would be time consuming and highly judgmental, additionally this approach would encourage users to only read the early notes which we believe would be detrimental.

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 believe that core users of the financial statements need to consulted as to what they believe constitutes quality financial information, and the user group consulted should be wider that analysts using large companies financial statements. The IASB should ensure appropriate out-reach is undertaken when considering a Disclosure Framework.

If you would like to discuss this in more detail, we would be happy to attend a meeting.

Yours faithfully,

Tim Ward
Chief Executive

APPENDIX A

Quoted Companies Alliance Financial Reporting Expert Group

Anthony Carey (Chairman)	Mazars LLP
Matthew Stallabrass (Deputy Chairman)	Crowe Clark Whitehill LLP
Anthony Appleton	PKF (UK) LLP
Peter Chidgey	BDO LLP
Jack Easton	UHY Hacker Young
Ian Smith/Bill Farren	Deloitte LLP
Jonathan Ford	PricewaterhouseCoopers LLP
David Gray	DHG Management
Usman Hamid	Ernst & Young LLP
Matthew Howells	Smith & Williamson Limited
Nick Winters/James Lole	RSM Tenon Group PLC
Niraj Patel	Saffery Champness
Nigel Smethers	One Media Publishing
Chris Smith	Grant Thornton UK LLP
Paul Watts/Jonathan Lowe	Baker Tilly

- **The Quoted Companies Alliance is committed to working with boards, investors, regulators and standard-setters to promoting high quality corporate reporting by quoted companies, especially small and mid-size quoted companies.**

We will encourage the boards of quoted companies to be aware of the importance of high quality reporting in order that the market can have confidence in their businesses and in the information provided by companies generally. In order to undertake our work effectively, we will work with investors to better understand their information needs. We will also encourage standard-setters, regulators and others to set standards and other requirements that meet the genuine needs of investors in a practical way.

- **We seek to foster a culture of continuous improvement in corporate reporting.**

We will encourage companies to keep their corporate reporting under regular review and to seek ways of responding to changing market needs. Information provided should be understandable, avoid unnecessary complexity, be presented in a timely fashion and in a format that makes use of modern technology where appropriate. We will similarly encourage regulators and standard-setters to remain responsive to marketplace changes and to provide information to preparers on good practice and on reporting issues which companies generally need to address. Standard-setters should also take a strategic rather than a piecemeal approach to their work and should periodically seek to eliminate requirements which have not been found to provide useful information.

- **We believe the concept of stewardship lies at the heart of good corporate reporting.**

Directors are responsible to the shareholders for the long-term success of their businesses and this will have a bearing both on what they are expected to report on and the most suitable method of measurement in financial statements. It is likely to have implications, for example, for the circumstances in which fair values are used and for what is considered to be the most appropriate means of measuring fair value in particular situations.

- **Corporate reporting requirements should be subject to robust cost-benefit tests.**

Standard-setters need to carefully assess the costs compared to the benefits of introducing requirements and to avoid unintended consequences wherever possible. To do this, they need to be conscious of the risks of a 'one-size-fits-all' approach since quoted companies encompass both global companies with a market valuation of tens of billions of pounds and small and mid-size quoted companies with one of a relatively few million pounds. Moreover, there should be a clear and public consensus between boards, investors, standard-setters, regulators and auditors on how materiality is to be applied in practice by companies when preparing their financial statements. A proportionate approach to corporate reporting that focuses on significant disclosures and avoids clutter in the financial statements with immaterial disclosures will both improve the quality of corporate reporting and reduce the costs of providing relevant information.

- **We press for accounting standards which properly reflect economic reality when implemented.**

Standards when applied, as well as when written, should focus on principles and not rules, enabling appropriate judgement to be exercised, and in their drafting should take account of practical concerns raised when they are being prepared. In measurement terms, a theoretically optimum solution may turn out to be sub-optimal if, for example, the assumptions of active markets are not met in practice. A mission to reflect economic reality also calls for post-implementation reviews of issues arising. Furthermore, investors may well wish to distinguish between those profits that have between realised in cash and those that have not. Moreover, how best to reflect economic reality may be impacted by the time horizon over which performance is being measured. Further work on what is meant by, and how best to capture, economic reality in financial statements would be helpful. There should be a pre-eminent emphasis on economic reality when standard-setters agree on convergence programmes.

- **Standard-setters should be in close touch with their marketplace.**

In a fast-changing modern market economy, if standards are to reflect economic reality and to be practical, the standard-setters need to be fully in touch with their marketplace. Standard-setters as a team should have substantial current or recent practical experience of operating in the marketplace as a user, preparer or adviser. They should also be drawn from a broad range of backgrounds, including those related to small and mid-size quoted companies as well as to global corporations.

- **We emphasise the importance of good narrative reporting as an integral part of corporate reporting.**

Whilst the focus on narrative reporting is increasing, it has traditionally tended to be the 'Cinderella' of the corporate reporting model. To enable the development of a business to be seen in its proper context, it is essential that high quality information be provided on its strategy, its key risks and how they are being managed, the KPIs used to manage the business, current performance and future prospects, and its corporate governance.