



RESPONSE TO THE EFRAG DISCUSSION PAPER
TOWARDS A DISCLOSURE FRAMEWORK FOR THE NOTES

21 DECEMBER 2012

INTRODUCTION

ICAS welcomes the opportunity to comment on EFRAG's Discussion Paper, 'Towards a Disclosure Framework for the Notes.'

Our CA qualification is internationally recognised and respected. We are a professional body for over 19,000 members who work in the UK and in more than 100 countries around the world. Our members represent different sizes of accountancy practice, financial services, industry, the investment community and the public sector. Almost two thirds of our working membership work in business, many leading some of the UK's and the world's great companies.

The ICAS Charter requires its committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

The ICAS Accounting Standards Committee has considered the Discussion Paper and I am pleased to forward its comments.

Any enquiries should be addressed to Ann Buttery, Assistant Director, Technical Policy and Secretary to the Accounting Standards Committee.

KEY COMMENTS

Our key comments are as follows:

- We agree that there is a need to define the purpose of the notes, thereby providing an overriding principle to guide the development of a core framework for disclosure, and the disclosure requirements in standards.
- We believe that the principle of materiality should be given more prominence. The ICAS/NZICA publication, 'Losing the Excess Baggage', considered materiality to be key. We believe that 'all and only material information', that relates to a material line item disclosed in the financial statements, should be presented in the notes. Unnecessary information should be removed, thereby enhancing the usefulness and accessibility of the financial statements.
- We would encourage standard setters to write disclosure requirements in a less granular and more principles based way, which allows management more discretion in deciding which information is material and should therefore be disclosed.
- As well as considering relevance, we also believe it may be appropriate to consider more fully the other fundamental qualitative characteristic, faithful representation. Disclosures may be required in order to give a faithful representation of the item presented in the primary financial statements. This aspect should be considered in developing the indicators to help standard-setters decide when disclosures should be required. It may also be useful to consider the four enhancing qualitative characteristics: comparability, verifiability, timeliness and understandability.
- We agree that discussing the application of materiality would be helpful. In particular, we think it will be helpful to promote a better understanding of the relationship between relevance and materiality set out in the Conceptual Framework, i.e. that materiality is the entity-specific aspect of relevance.
- We agree with the overall spirit of the suggested approach to identifying the specific users' needs that the notes should fulfil, and including indicators to assist the standard setters to decide when the additional information is required to fulfil those users' needs. However, the scope of the intended approach needs to be extended to include any other information which is required to give a true and fair view, and greater clarity is required on the type of additional information that should be considered.

- We believe that information disclosed in the financial statements on risk should be based upon what would give a true and fair view or 'fair presentation' and that reliance should be placed on management judgement. We accept that most disclosures on risk will continue to be made outside the financial statement section of the annual report.
- We agree with the proposals for improving the way disclosures are communicated and organised. The order of the notes should be logical, linking to the order of the items contained in the primary statements themselves, with disclosures of a fundamental or pervasive nature appearing near the front.
- We believe that a clearer definition, and more consistent usage, of some of the terms referred to throughout the paper is required.

SPECIFIC RESPONSE TO THE QUESTIONS IN THE DISCUSSION PAPER

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?

Response 1.1

- Whilst we are supportive of the idea of key principles, we consider that the quantity of the principles suggests that they are not all key. We would suggest 3-5 key principles, one for each area, rather than 14, and the remaining principles could be converted into guidance on how to apply each key principle.
- The opening line of the General objective paragraph states "To ensure that all and only relevant information is disclosed"..... However, we believe that the dominant factor in determining the usefulness of information disclosed is the application of the materiality principle. Information about an item might generally be relevant but if the item is not material for that entity, it should not be disclosed in the entity's financial statements. Therefore, we suggest that the opening line should be revised to read: "To ensure that all and only material information is disclosed".....
- As well as considering the relevance of information, we also believe it may be appropriate to consider more fully the other fundamental qualitative characteristic, faithful representation. Disclosures may be required in order to give a faithful representation of the item presented in the primary financial statements. This aspect should be considered in developing the indicators to help standard setters decide when disclosures should be required. It may also be useful to consider the four enhancing qualitative characteristics: comparability, verifiability, timeliness and understandability.
- Within principle 1, we would substitute the words 'material information about' for 'relevant description of'.
- In general, we believe that the principle of materiality should be given more prominence.
- Within principle 2b, we consider that information regarding post balance sheet events should be disclosed in the notes to the financial statements as these are in fact past events by the time the financial statements are approved.
- Within principle 3 we have concerns about the suggested disclosure of alternative measurements as this could be interpreted too widely by preparers: some guidance on parameters needs to be provided in this regard.
- Within principle 12, we recommend that the wording is amended as follows: ... "that disclosing immaterial information (and information on situations that do not apply in practice to the reporting entity) may reduce the relevance and the understandability of disclosures."

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?

Response 1.2

Area a:

We agree that this is an area that requires improvement as highlighted in the ICAS/NZICA publication 'Losing the Excess Baggage'. We also believe, as per our response to question 1.1, that the distinction between 'material' and 'relevant' should be brought out more clearly.

Area b:

As also indicated in the recent FRC document, 'Thinking about Disclosures in a Broader Context', we believe that improvements in this area may develop in line with advances in technology. We do have concerns over the wording throughout as references are made to 'key', 'significant', 'material'/'relevant information' and we would welcome more consistent usage of these terms.

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.

Response 2.1

Yes, we agree that there is a need to define the purpose of the notes as an overarching principle to guide the development of a core framework for disclosure and the disclosure requirements in standards.

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?

Response 2.2

- We agree with the proposed definition of the purpose of the notes subject to the comments in our response to question 1.1 and the reference to past events. However, we think that greater clarity is required on the type of additional information that would be considered for unrecognised items. We have concerns that some of the wording uses language not clearly defined in IFRS, for example 'claims' and 'rights', which may create uncertainty regarding the exact nature of items that should or should not be disclosed. For example, should information regarding materially internally generated unrecognised intangible assets be disclosed?
- We also think that the scope needs to be extended to include any other information which is required to give a true and fair view. For example, any other information about events that may have occurred but which have not yet been verified would seem to fall out with the current scope. An example could be a potential claim where no claim has yet been received.

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?*

Response 3.1

We agree with the overall spirit of the suggested approach subject to the comments listed below:

- References to 'relevant description of' should be changed throughout to 'material information about'.
- The reference date should be the date on which the financial statements are signed off in order to reflect non-adjusting post balance sheet events as these are in fact past events by the time the financial statements are approved.
- Within paragraph 11 in chapter 3 there is a suggestion that the information in the financial statements goes beyond the numbers and items reported in the primary statements, for example, a detailed description of the structure of the group or uncertainty over going concern. In order to determine whether this information is relevant, the scope would need to be clearly defined. That is, guidance on when and under what circumstances this additional information would need to be disclosed. This may also tie in to our response at 1.1 requesting a clearer definition of some of the terms referred to throughout the paper.

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?

Response 3.2

We believe that 'all and only material information', that relates to a material line item disclosed in the financial statements, should be presented in the notes. This was a key message in the 'Losing the Excess Baggage' publication which recommended that unnecessary information should be removed thereby enhancing the usefulness of the financial statements.

The purpose of the statement in paragraph 8 (b) should be revised to ensure that the information does not solely focus on the predictive element of income statement information.

Within paragraph 8 (d), in the first line, the phrase 'about transactions' should be removed so that it reads 'Information that has a pervasive effect on the financial statements or affects many line items.'

Question 3.3

Do you agree with the way risk and stewardship are addressed in the Discussion Paper? If not, what are your views about how risk and stewardship information should be provided in the notes?

Response 3.3

We believe that information disclosed in the financial statements on risk should be based upon what would give a true and fair view or 'fair presentation' and that reliance should be placed on management judgement. We accept that most disclosures on risk will continue to be made outside the financial statement section of the annual report. The principle highlighted in paragraph 15 on page 29 is considered to be practical, subject to our concerns noted in response 1.1 in relation to 'alternative measurements'.

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?

Response 3.4

We believe that standard setters should amend their practice of mandating detailed disclosures and refer to the recommendations made in the ICAS/NZICA publication: 'Losing the Excess Baggage', some of which have been incorporated within Paragraph 60 of Chapter 3 of the discussion paper.

In particular, we would encourage standard setters to write disclosure requirements in a less granular way, which allows management more discretion in deciding which information is material and should therefore be disclosed.

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?

Response 3.5

We do not believe that establishing alternative disclosure requirements in full IFRS is appropriate. A listed company has certain reporting requirements that should not be subject to size thresholds. If the information disclosed is based on the breadth and complexity of the activities of the company and a proper assessment of users' needs and materiality is applied, then proportionate disclosure should follow.

We specifically support the 'IFRS for SMEs' as a separate accounting regime for non-public entities.

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?

Response 4.1

We strongly support the inclusion of such an approach, subject to some of the previously mentioned comments in our response to question 1.1 which call for clearer definitions of the terms 'material' and 'relevant'. We would also encourage regulators to support this approach in their actions. For example, in the UK, the FRC's Financial Reporting Review Panel includes the following narrative in their FAQs and letters:

The letter from the Conduct Committee has an appendix which lists a number of points for me to consider when preparing my next report and accounts. Do I need to reflect all of these?

You need only consider additional disclosures if they are relevant and material to your next report and accounts.

The reason that we have not given a specific disclosure is because the amount is not material. Will the Conduct Committee still insist on the disclosure being made?

Not all all. Accounting standards do not apply to immaterial items and the Conduct Committee takes the same approach. The Conduct Committee may, however, ask the company to explain why the company believes that an item is immaterial if this is not evident from the accounts. The Conduct Committee discourages companies from including unnecessary information in their accounts and would encourage companies not to include disclosures unless the additional information is material.

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.

Response 4.2

We agree that guidance for the application of materiality should be included as indicated in our response to question 1.1. We believe that the IASB should draft appropriate supporting guidance for application of its definition of materiality in the Conceptual Framework. EFRAG should encourage the IASB to liaise with the IAASB on this to secure a consistent approach in auditing standards.

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?

Response 4.3

As per our response to question 3.2, we believe that all and only material information that relates to a material line item disclosed in the financial statements should be presented in the notes. This was a key message in the 'Losing the Excess Baggage' publication which recommended that unnecessary information should be removed thereby enhancing the usefulness of the financial statements.

We would also suggest that references to "immaterial" in relation to information disclosed throughout the discussion paper are changed to "not material" to avoid any ambiguity and variation of interpretation by preparers, users and assurance providers. Use of the words "not material" will provide a more definite expression that the impact of the information is below what would be considered to be material.

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?

Response 5.1

We have no issues with the principles proposed. The order of the notes should be logical, linking to the order of the items contained in the primary statements themselves, with disclosures of a fundamental or pervasive nature appearing near the front.

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?

Response 5.2

We refer you to our response at 5.1 above. The organisation of the notes should be constructed in such a way that users should be able to follow the logic. We would support the inclusion of a summary, immediately after the accounting policies, giving details of the significant judgements applied. These could be cross-referenced to specific notes to the financial statements. We would also support the standard accounting policies being included in an appendix or on the entity's website with only policies which have changed, and the effects of those changes, disclosed within the financial statements.

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.

Response 6.1

We have no further comments.