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**Discussion Paper: Towards a Disclosure Framework for the Notes**

Dear Ladies and Gentlemen

We welcome the development of the Discussion Paper "Towards a Disclosure Framework for the Notes" and appreciate the opportunity to comment.

As the Swiss enforcer of IFRS financial statements we share the view that the increasing volume of notes disclosures has not been improving equally the quality of the information in the financial statements. Rather, it appears that users find IFRS financial statements to become more and more unwieldy and difficult to understand. For this reason, we have also recommended to treat the development of a Conceptual Framework, including a Presentation and Disclosure Framework, as priority for the upcoming three-year period in our response to the IASB's Agenda Consultation 2011.

The concept of materiality and its application to notes disclosures is an important part of the Discussion Paper. Our experience as a regulator shows that the materiality concept is usually applied well to recognition and measurement principles, but less so to presentation and disclosures. It appears that preparers and auditors consider it to be safer from a compliance point of view to provide immaterial disclosures rather than applying judgement to reduce disclosures. This behaviour appears to be permitted by the wording of IFRS, which states that a specific disclosure requirement does not need to be provided if the information is not material. We believe that providing immaterial disclosures should be explicitly prohibited by IFRS (rather than just providing relief from disclosing immaterial information) and that the Disclosure Framework could include guidance for the preparers to apply the materiality concept to disclosures.

Because of the importance of transparent disclosures and our track record of findings in this area, we have defined a critical review of disclosures with respect to relevance, understandability and timeliness as an area of focus for our 2012 enforcement activities. We believe that the concepts from the Discussion Paper would support us in our work to enforce that the information in the notes does not contain facts of lesser importance or generic disclosures that have no material substance ("boilerplates") and that it is structured logically with similar topics presented together (see "Areas of Focus for the Annual Financial Statements 2012" Item No. 1 under: http://www.six-exchange-regulation.com/admission_manual/09_05_03-SER201203_en.pdf).

Our responses to the specific questions in the Discussion Paper are included in the Appendix to this letter. We would be pleased to discuss with you any questions you may have regarding our comments on the Discussion Paper "Towards a Disclosure Framework for the Notes".

Yours sincerely

**SIX Swiss Exchange Ltd**

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**APPENDIX**

**Question 1.1 – Key Principles:**

**The Discussion Paper sets out a number of key principles that should underpin a Disclosure Framework.**

**Do you agree with these key principles? If not, what alternative principles would you propose?**

We agree with the key principles, but have the following additional comments:

Item no. 5: The disclosure objective needs to be very closely linked to the presentation objective, as the disclosures in the notes amplify and explain the primary financial statements. Whether the Disclosure Framework is treated a separate project or as an integrated part of a combined Presentation and Disclosure Framework is in our view more an operational matter of the standard setter.

Item no.7&8: We agree that disclosures should be principles-based and be applied in a consistent manner across the whole set of accounting standards, including the level of granularity. However, given the fact that the topics addressed by individual accounting standards are quite diverse in terms of nature, complexity, level of judgement and uncertainty, we find it difficult to avoid a certain level of specific disclosure requirements in the individual standards. We see the role of the Disclosure Framework as providing guidance to the standard setter to draft specific disclosure requirements in a consistent manner and with a consistent level of granularity. The emphasis should clearly be on quality rather than on quantity.

**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?**

a. The feedback we obtain from issuers as well as from readers of financial statements indicate that avoiding disclosure overload is the key area to improve disclosure quality. However, in our view, disclosure overload is not simply a matter of reducing volume, but rather a question of tailoring disclosures to the nature, size, risk and complexity of an entity in order to avoid unnecessary, irrelevant and boilerplate disclosures. For example, for a very large and complex entity, the current volume of disclosures might be appropriate and necessary to understand the performance and the risks associated with the entity, whereas many of these disclosures might not be relevant for understanding a smaller and less complex entity. In practice, we frequently observe that these smaller and less complex entities aim to comply with all the detailed disclosure requirements included in the current IFRS standards and consequently might produce boilerplate disclosures.

   We also concur that the ineffective application of the materiality concept to disclosures is a major source of this problem. In our experience as a regulator, the materiality concept is usually applied well by prepares and auditors to recognition and measurement principles. However, a checklist approach is frequently used for disclosures, as preparers and auditors seem to consider it to be safer from a compliance point of view to provide unnecessary disclosures rather than applying judgement to reduce disclosures. Also, the format how disclosure requirements are written in current IFRS may further support the "checklist behaviour" by preparers.

b. Our findings from the enforcement process suggest that the way how disclosures are organised and communicated is sometimes an area for improvement, but is less problematic than the application of materiality. Based on our practical experience, most entities organise their financial statements along the structure outlined in IAS 1p114. We believe that readers are used to this structure and that it helps them to navigate through the financial statements. We see room for improvement when disclosing transactions that are affecting several line items in the primary statements. Frequently, the facts and circumstances relating to a particular transaction are spread over several notes linked to these line items, which makes it cumbersome to read and understand the transaction as a whole. We think that disclosures related to such transactions should be provided centrally in one place. If necessary, cross-references could link the various line items to that summary note describing the transaction as a whole.

We also see an imbalance between extensive quantitative disclosures (e.g. tables, break downs, roll-forwards) and relatively short and boilerplate narrative descriptions. The principle outline in chapter 5 that disclosures should be clear, balanced and concise is therefore important.

**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.**

The definition of the purpose of the notes is important because it determines what information falls within the scope of financial statements disclosures and helps to draw the boundaries to other parts of annual reports, such as corporate governance disclosures, management commentary or corporate social responsibility reporting. Additionally, the definition of the purpose can also serve as an underlying fall-back principle.

Furthermore, the purpose of the Disclosure Framework should also be defined and aligned with the purpose of the Conceptual Framework. We consider this definition to be important, because the Disclosure Framework is targeted at different user groups. Some parts, in particular the identification of the user's needs for disclosures, are primarily useful for the standard setter. The application of the requirements, in particular the application of the materiality concept, is useful for the preparers of the financial statements.

**Question 2.2:**

**Is the proposed definition of the purpose of the notes helpful in identifying relevant information that should be included in the notes? If not, how would you suggest it should be amended?**

We welcome that relevance is explicitly included in the definition and that it is linked to specific needs and to materiality. Also, we agree to limit the disclosures to items recognised in the primary statements, unrecognised arrangements and claims and rights of the entity that existed at the reporting date and support that forward looking information should only be included to the extent that it is part of the measurement or description of the items included in the definition. While additional forward looking information is useful to investors, we believe that such information are generally beyond the scope of financial statements.

Furthermore, we recommend testing the boundaries of the definition against current disclosure standards such as IFRS 7. For example, a corporate entity being exposed to foreign currency risks from future sales of products would under the current definition not provide any foreign currency risk management disclosures, if it chooses not to use financial instruments to manage the exposures. On the other hand, if the same entity uses derivatives to hedge this exposure, it would be required to provide foreign currency risk management disclosures based on the link to the derivatives recognised in the balance sheet.

**Question 3.1:**

**In chapter 3, it is proposed to identify specific users' needs that the notes should fulfill. Those users' needs are drawn from the Conceptual Framework. It is also suggested that a Disclosure Framework should include indicators to assist the standard setters to decide when additional information is required to fulfill those users' needs.**

a. **Is the description of the approach clear enough to be understandable? If not, what points are unclear?**
b. **If you do not support this approach, what alternative would you support and why?**
c. **Do you think that a category on "information about the reporting entity as a whole" should be included? If so, why?**

a. In our view, the approach in the Discussion Paper is clear.

b. We support providing guidance to standard setters on how to draw up disclosure requirements. Also, we recognise that the 3 categories "Aggregation/disaggregation of the line item", "what the item is" and

"how the item has been accounted for" are clear, homogenous and the proposed information related to these categories is meaningful and applicable to all the items in the primary statements.

The remaining category on "How does the item fit into the entity's operations and financial structure" is the broadest and seems to also fulfil the role of a "catch-all" category. It appears difficult to define information requirements on the aggregated level of this category and might be helpful to define sub-categories for that purpose. The sub-categories could be defined based on the presentation in the primary financial statements and on whether particular line items are linked to other items in the financial statements.

c. We support a category on "information about the reporting entity as a whole" only to the extent that it is limited to transactions or risks affecting (several or all) primary financial statement line items, because a broader definition of this category would be inconsistent with the principles and the definition set out in chapter 2. In our view, such a category could include the important information described in item 11 of chapter 3 about the going concern assumption (which is linked to items such as liquidity, equity, cash flow and profit numbers) and the group structure (which is linked to the scope of consolidation and hence to all line items).

**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 proposed users' needs and indicators are helpful. As mentioned in chapter 3.1.b, we believe that "How does the item fit into the entity's operations and financial structure" may require further guidance.

Also, we believe that disclosures about risks are an integral part of the users' needs (see also below question 3.3).

**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 should be provided in the notes?**

Risks:

We agree that risks are a key consideration when providing disclosures on each of the four categories about users' needs and that therefore, no separate risk category for disclosures is required.

However, in order to stress the importance of risk disclosures, we suggest to provide specific examples of risk disclosures for each of the four categories.

Stewardship:

The primary source of the results of management stewardship is the statement of comprehensive income, in particular the distinction between items recognised in profit and loss or other comprehensive income. Since the purpose of the notes is to provide a relevant description about the items included in the primary financial statements, the notes will include some information to help assess management stewardship. However, we agree that the notes should not include information solely for purpose of describing management stewardship, such as a description of management's strategy.

**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 behaviors, 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?**

The detailed disclosure requirements as written in many of the current accounting standards could influence behaviours towards a checklist approach. At the same time, detailed disclosure requirements support the preparation of comparable financial statements between entities on a global basis. Our experience as a regulator shows that it is challenging to enforce certain principles of the Conceptual Framework, such as relevance or understandability, in areas where there is little or no specific guidance in the accounting standard itself.

As an example regarding comparability, we receive feedback that investors regret the loss of comparable performance measures in the segment disclosures under IFRS 8, since the standard permits the disclosure of performance measures as used for internal management reporting.

We are therefore of the opinion that a certain level of detailed disclosure requirements in the individual standards is difficult to avoid, although the level of granularity of these detailed disclosure requirements should be reduced.

In our view, the alternative approaches suggested in chapter 3 are not feasible for the following reasons:

- The proposal that preparers have complete discretion over disclosures would prevent a checklist approach, but it would most certainly reduce comparability of financial statements. It also increases the risk that disclosures prepared by management might not be unbiased, putting too much emphasis on "good news" and omitting relevant, unfavourable information. Under this approach, any enforcement activities by regulators or auditors over financial statements disclosures would be severely hampered. This bears also the risk that local standard setters might add additional disclosures requirements or that regulators might enforce the principles with varying stringency, both of which could increase diversity between different jurisdictions.
- Industry-specific disclosure requirements might produce useful results as well as comparability between entities within the same industry, however, this approach is inconsistent with the current IFRS guidance that abandoned all industry specific standards except for fair value accounting for controlled investees of investment funds. It would also lead to a whole new set of issues around defining industries and allocating entities or parts of entities to industries.
- A single set of disclosure requirements applicable to all standards would need to be written at a rather high and possibly generic level, given the diverse nature of the individual accounting standards. We have doubts whether such general disclosure requirements would distinguish themselves much from the principles. Instead, the Disclosure Framework should include guidance for the standard setters on how to draft disclosure requirements in individual accounting standards, including the level of granularity.

**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?**

Some of the proposals about different disclosure regimes are useful in the specific circumstances they are designed for, for example reduced disclosure requirements for interim financial statements or for standalone financial statements of parent companies or qualified subsidiaries. However, these proposals do not address the principal issue which is that the consolidated IFRS financial statements of listed companies have become unwieldy.

The FASB's proposed alternative of setting different levels of requirements for each standard is the only approach potentially suitable for large listed companies. The minimum set of requirements (Tier 1) would establish a minimum level of information and comparability, whereas the additional layers of disclosures (Tier 2 and Tier 3) applicable to situations of moderate and extensive activity or complexity, respectively, would enable and require preparers to provide additional information in areas where it is relevant and material, although the Discussion Paper does not yet define moderate or extensive activity or complexity.

We think that the FASB's approach is also suitable to achieve the goal of reducing unnecessary disclosures, although the definition of detailed disclosures for each standard and each of the three buckets seems more consistent with a rule based environment.

The approach of allocating the existing disclosure requirements into three layers to select from based on activity and complexity could be relatively easy, fast and cost-efficient to implement, since it would primarily involve reducing existing disclosure where appropriate. On the down side, it might miss an opportunity to more fundamentally re-evaluate not only the quantity, but also the quality of the currently required disclosures.

**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 are of the opinion that reinforcing the materiality concept for disclosures is an important measure to avoiding disclosure overload. Although the materiality concept for disclosures is already embedded in current IFRS guidance, we observe in practice that both prepares and auditors are hesitant to identify and remove immaterial disclosures from the financial statements. It appears to us that preparers and auditors believe that providing immaterial disclosure is safer from a compliance point of view than applying judgment to reduce disclosures. This is also supported by the wording of IAS 1p31, which permits omitting immaterial disclosures rather than requesting it.

We would therefore also welcome an explicit statement that an entity should not disclose immaterial information.

**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.**

We believe that in order to successfully reinforce the materiality concept additional guidance to help prepares and auditors to assess the materiality for disclosures would be helpful. The current Conceptual Framework includes a definition of materiality ("Information is material, if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity"), but preparers might find it difficult to apply this definition to specific detailed disclosure requirements.

**Question 4.3:**

**Is the description of the approach clear enough to be useful to improving the application of materiality? If not, what points are unclear or what alternatives would you suggest?**

We think that the concept about developing materiality indicators based on the relevance indicators included in chapter 3 is understandable. However, we suggest that the Disclosure Framework could also develop some principles about materiality, such as the following:

- The materiality concept is equally applicable to presentation and disclosures as it is to recognition and measurement.
- Disclosing immaterial information is not permitted because it is not consistent with principles of relevance and understandability of financial statements.
- Materiality is to be assessed based on whether the information could potentially influence the economic decisions of users of the financial statements.
- Materiality indicators should be quantitative and qualitative.

- Quantitative materiality needs to be assessed against various key measures or the most appropriate measure (size of the item, profit measures, total comprehensive income, equity, balance sheet measures).
- If an item is material, not necessarily all of the possible disclosures related to this item need to be provided (netting, judgements, policy choices, variability, risks); only those disclosures that are relevant need to be provided.
- Disclosures need to be assessed at each balance sheet date whether they are still material and relevant.

Regarding the items discussed separately, we have the following comments:

Maturity Analysis

We note that the maturity analysis as a way of describing liquidity risk is referenced to disclosures related to different business activities or components. In our view, such a liquidity analysis should not only include financial liabilities. In relation to financial liabilities, we would propose the following two layers of disclosures:

*Description of financial liabilities*

For material financial liabilities, such as bonds issued or bank loans, a description of the relevant contractual terms would be appropriate. This would include the repayment date, interests rates, extension or early repayment options, as well as covenants. To present the same information in the form of a maturity table does not add any benefits.

*Description of liquidity risks associated with financial liabilities*

A maturity analysis should only be provided if there is significant liquidity risk associated with the expected or contractual redemption of the financial liabilities. This could be the case if there is a duration gap between financial assets and liabilities or if the business is not currently generating sufficient cash flows in order to repay the debt by the redemption date.

In all these cases where a material liquidity risk exists, we think that a maturity analysis showing only the contractual cash outflows arising from financial liabilities is insufficient and should be supplemented by either a maturity analysis of financial assets or a description of expected cash inflows from operations or refinancing.

Exposure to cash flows from unrecognised items

*Type 1 items*

In our view, the sole criteria should be whether the item would be a material amount, if recognised, or could result in a material outflow of resources. The reason why the item was not recognised is in our view not part of the materiality assessment, but would be a disclosure to be provided if it were material.

*Type 2 items*

For type 2 items, we believe that the scope of items should not be widened to include all types of executory contracts. In our view, the purpose of the notes should not be to disclose budgets/forecasts. Information about future cash flows should be limited to situations where they are relevant to understand specific risks, such as the aforementioned liquidity risk.

In our view, the guidance should be clear that commitments for purchases of regular goods or services would not qualify. Disclosure should be limited to items that are both material in size and non-recurring by nature, such as commitments for capital expenditure or commitments for private equity investments.

Assessing materiality – changes in balances over the period

As mentioned above, we are of the opinion that the Disclosure Framework should explicitly include as a principle that disclosures should be reviewed at each balance sheet date to assess whether they are still relevant and material. We agree, that materiality should not be assessed only based on the balance sheet date values, but that the comparative period as well as movements during the period and the qualitative value of the information should be considered.

**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?**

We welcome the emphasis that disclosures should be presented with a view to communicating information to users rather than as a compliance exercise. We believe that the principles outlined in chapter 5 are helpful to achieve this goal.

In addition, we believe that consistency in presentation should be an additional, separate principle. It is important to note that consistency in presentation does not prevent or contradict in any way the requirement to keep disclosures current and to abandon disclosures, which are no longer material or relevant.

We are of the opinion that these principles would also work in a wider context of integrated reporting.

**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?**

In our opinion, the current standardised approach generally works well in practice as it provides guidance to preparers for organising the notes and it helps trained users to navigate financial statements. However, we do read IAS 1p114 ("the entity normally presents the notes...") as giving some flexibility in organising the financial statements. We believe that a commonly accepted presentation should be permitted, as long as it is applied consistently and is in line with the aforementioned principles.

On the other hand, we do not support a fully flexible approach that may require an entity to change the priority and order of disclosures from year to year. In our opinion, it would be difficult for users to orientate themselves in the financial statements and compare them over time or within a peer group.

Instead of changing the order of the notes to prioritise information, an entity could provide a summary of the most important information of the period. This could be information such as the key drivers of the result, significant events and transactions of the period, changes in accounting policies and effects thereof, significant management judgements and estimates affecting the result (i.e. the requirements of IAS 1p122 and IAS 1p125), as well as information about risks, uncertainties, and commitments. In order to achieve the desired purpose, such a summary should be no longer than 1 or 2 pages.

For extensive financial statements, we consider the use of a glossary of abbreviations and technical terms as well as an index very helpful. We do not propose that these should be required mandatorily, but they could be added as illustrative examples for organising 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.**

Applying the proposals to related party disclosures (Appendix 1)

We think that applying the proposals to related party disclosure would lead to satisfactory results. Disclosures/descriptions about transactions and outstanding balances with related parties or persons are covered by the definition proposed in the Discussion Paper and they would be subject to the materiality test. For related party transactions and balances (for example, loans), materiality should by assessed based on the nature and size of the transaction/balance itself and based on their terms. If the terms were unusual, e.g. with an off-market interest rate or interest-free, such information would be material and need to be disclosed. On the other hand, no specific information would be required for immaterial related party loans or for related party loans with terms at arm's lengths.

Under the same approach, additional information about executive compensation would only be disclosed, if the amount of executive compensation is material or if the terms of the plan contain unusual features (e.g. extremely leveraged) that could be relevant to readers of the financial statements. We are of the opinion that such materiality-based disclosures would be sufficient for an investor's need to understand the financial position, performance and cash flows of an entity as well as the results of management stewardship.

However, other stakeholders might want to compare the terms and size of executive compensation plans across various companies and industries. For that purpose, more standardised and comparable disclosures would be required. However, we believe that such information does not necessarily fall within the scope of financial reporting and should be addressed through separate corporate governance disclosures. In our jurisdiction, for example, the executive compensation disclosure requirements of IAS 24 produce overlapping or redundant disclosures with the compensation disclosures required by corporate law and our corporate governance directive.