

December 19, 2012

Mr. Ian Mackintosh
Vice Chairman
International Accounting Standards Board
30 Cannon Street,
London EC4M 6XH
United Kingdom

Dear Ian,

The Canadian Accounting Standards Board (AcSB) has long supported the development of a disclosure framework for the notes to the financial statements, having proposed this at a joint AcSB/FASB/IASB meeting in Toronto in October 2003. The AcSB is therefore encouraged by the IASB's recent decision to commence work on a disclosure framework as part of the project to complete the conceptual framework.

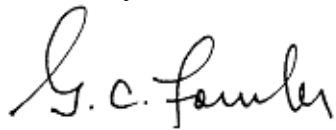
Earlier this year EFRAG issued a discussion paper Towards a Disclosure Framework for the Notes. The AcSB has reviewed the discussion paper and also obtained input from its Academic Advisory Council, its User Advisory Council and from a meeting with Canadian financial statement preparers. We are forwarding our views on a number of the issues raised in the EFRAG discussion paper in the hope that this will provide useful input to the IASB's disclosure framework project.

The AcSB is Canada's national accounting standard setting body and has a strategy of adopting IFRSs as Canadian GAAP for publicly accountable enterprises. The AcSB consists of members from a variety of backgrounds, including preparers, advisors, academics and financial statement users. Additional information about the AcSB can be found at www.frascanada.ca

The views expressed in the attachment to this letter take into account comments from individual members of the AcSB and its staff. However, they do not necessarily represent a common view of the AcSB, its Committees or staff. Formal positions of the AcSB are developed only through due process.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact the undersigned, Peter Martin, Director, Accounting Standards at +1 416 204 3276 (e-mail peter.martin@cica.ca) or Mark Walsh at +1 416 204 3453 (mark.walsh@cica.ca).

Yours truly



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DISCLOSURE FRAMEWORK***Input to the IASB from the Canadian Accounting Standards Board*****1. What is the problem a disclosure framework should address?**

A disclosure framework should guide standard setters in determining the content of note disclosures – what should be required to be disclosed and what should not be required. It should address issues such as what are the users’ needs that should be considered, what is the scope of information that should be included in financial statements and how the qualitative characteristics should be applied to disclosures. A disclosure framework would streamline the process of developing disclosure requirements and improve the consistency between the types of disclosures required in different standards. It should also assist preparers in deciding how to apply the disclosure requirements in specific standards and whether to make additional disclosures not explicitly required by the standards. The objective should be, simply, to identify the “right” disclosures.

We do not agree that the objective of a disclosure framework should be to reduce “disclosure overload”. Rather, we think that the focus should be on ensuring that note disclosures provide information that is:

- (a) relevant to users (as defined in the Conceptual Framework) and meets a cost/benefit test;
- (b) within the scope of the financial statements and necessary to complete them; and
- (c) presented in a manner that supports users in accessing and understanding the information.

Items (a) and (b) address what should be included in the notes by requiring all relevant information, subject to the cost/benefit constraint, while excluding information that is not relevant. Issue (c) addresses how the required information is communicated by the notes, including use of technical language, formatting and organization of the notes. These issues should be considered in the context of the financial statement users identified in the Conceptual Framework and the increasing ability of commonly available technology to expedite searching through large amounts of data.

Focusing on these three factors should result in appropriate disclosure requirements. This may result in more or fewer disclosures being required, and longer or shorter notes being included in financial statements. The objective should not be focused on reducing a perceived overload of disclosure, but on ensuring note disclosures and financial statements meet the objectives of financial reporting.

2. Key principles for a disclosure framework

It is important that a disclosure framework be based on the fundamental building blocks of the conceptual framework – the objective of financial reporting and the qualitative characteristics – and be viewed as an integral part of meeting the objectives of financial reporting as described in the conceptual framework. The objectives for note disclosures need to be consistent with those for recognition, measurement and presentation. In particular, presentation and disclosure are inter-related and together communicate information through the financial statements.

Recognition and measurement often cannot provide all the information about an item required to meet users' needs, for example an item that does not meet the definition of an asset or the criteria for recognition in financial statements. After the most appropriate recognition, measurement and presentation requirements have been determined, disclosure requirements complete the financial statements – and this will often require compensating for limitations in recognition, measurement and presentation.

Consistent with this view, we think the key principles for a disclosure framework are as follows:

- (a) The objective of note disclosure is to complete the financial statements, providing information necessary to meet the objective of financial statements (consistent with the Conceptual Framework) and that is not provided by recognition, measurement and/or presentation requirements. This requires defining the scope of financial statements. Chapter 1 of the conceptual framework addresses financial reporting rather than financial statements, thus avoiding this scope issue. However, the scope of current IFRSs is the financial statements. A disclosure framework is needed that will provide guidance

in determining the appropriate disclosures that should be included in financial statements prepared in accordance with IFRSs.

- (b) The fundamental qualitative characteristics of relevance and faithful representation as well as the enhancing characteristics and the cost/benefit constraint apply to the financial statements as a whole, including the notes. A disclosure framework should address how the qualitative characteristics should be applied in determining note disclosures. For example, is the same degree of faithful representation required for note disclosure of an unrecognized asset as is required for recognition of an asset on the balance sheet?
- (c) Paragraph QC 32 of the Conceptual Framework states “Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently”. Note disclosures should be understandable by users with these characteristics to the extent possible. Paragraph QC 32 also observes that “At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena”. A corollary of this principle is that note disclosures do not have to be easily understood by users without these characteristics, such as many retail investors. “Disclosure overload” is cited as a problem primarily for smaller investors.

3. Scope

The conceptual framework states that the objective of financial reporting is “...to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.”

Financial statements are one of several elements of financial reporting. A key issue that should be addressed by a disclosure framework is what elements of the information that meets the objective of financial reporting should be included in note disclosures – and what elements should not be included in financial statements but should be provided elsewhere. For example, should disclosure be required about investment and risk management policies, volumetric information underlying amounts presented in the primary financial statements (such as physical quantities of biological assets or mineral reserves), or the quantity and terms of orders received

(which might be viewed as an unrecognized intangible asset)? How much information about the transactions and events that resulted in an item being recorded in the financial statements should be required to be included in the notes? Should measures calculated from financial statement information such as EPS, ROCE, and debt/equity ratio be included? Defining the boundaries of financial statements will not be an easy task, but an understanding of these boundaries seems essential for setting financial statement disclosure requirements.

4. Who are the users whose information needs should be met by financial statements?

There are a variety of different types of users. They can be differentiated on two dimensions:

- (a) the decisions that the user will use the information for, e.g. to lend money, purchase equity securities etc, and
- (b) the technical sophistication of the user.

Standard setters can set disclosure requirements to meet the needs of more than one type of user, but it is unrealistic to think that disclosures can meet the needs of all users. The conceptual framework states that “Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently.” This appears to exclude most retail investors and focus on more knowledgeable professional users. Professional users require more extensive disclosures and can understand the complex information that is often required by the increasingly complex transactions that many companies are entering into. Claims of disclosure overload are usually made by less sophisticated investors or those unwilling take the time “to review and analyze the information diligently”. Most professional investors generally do not find the quantity of disclosures to be a difficulty and use technology to find specific information more easily. Members of the AcSB’s User Advisory Council are concerned about insufficient information and not disclosure overload. Financial statement notes may not be able to meet both the desire of less sophisticated users for easy to follow disclosures and the needs of professional users for more detailed information.

In contrast, disclosure requirements can be designed to meet the needs of users making a variety of different decisions. This may result in increasing the amount of information required

to be disclosed. A disclosure framework should not focus on a single user but on an identified range of users with some differences in their information needs.

5. Determining users' needs

Once the range of users has been identified and the scope of financial statements is understood, the disclosure framework can turn to determining the users' needs that note disclosures should address. This is not something that standard setters can, or should, do in isolation. The people who know what users need are the users. The IASB should consult extensively with users on the disclosure requirements for each new standard, with users being asked to identify the information they need (within the scope of financial statements) and to explain why they need it and how they would use this information in making decisions about providing resources to an entity. The AcSB used this process in developing Canadian standards for private enterprises and found it effective.

Whether or not the IASB follows the above process, a top down framework for users' needs should be developed. This would start with the conceptual framework's statement that "investors', lenders' and other creditors' expectations about returns depends on their assessment of the amount, timing and uncertainty of (the prospects for) future net cash flows to the entity." The users' needs framework would identify the key categories of information needed by users, consistent with the above, and ensure that the categories are comprehensive, covering all the needs of the identified users that are within the scope of financial statements, without any gaps. These categories would become the basis for considering what information should be required to be disclosed in individual standards.

6. Constraints on meeting users' needs

While the starting point in determining disclosure requirements is users' needs, a disclosure framework should also discuss possible constraints on meeting the full range of users' needs that fall within the scope of financial statements. Preparers are concerned about the cost of preparing certain disclosures that contain information that management does not need to run the business. Preparers also do not understand how certain required disclosures are useful to users and often the standard, including the Basis for Conclusions, does not adequately explain

this. Another concern is potential harm to the entity through disclosure of information that is viewed as proprietary and that would benefit competitors as well as information that might adversely affect the outcome of legal disputes.

These are not easy issues to consider since the costs and potential harm from more extensive disclosures mainly accrue to preparers while the benefit of additional information mainly accrues to users. Good disclosure may benefit preparers through a lower cost of capital but this would be difficult to factor in for a specific set of disclosures. However, a disclosure framework should at a minimum identify what types of constraints should be considered (and what types should not). It might also include factors to consider for those constraints. While a quantitative comparison of costs and benefits of disclosures is unrealistic, standard setters may be able to categorize costs and benefits, for instance as high, medium or low. Such categorization may be helpful in comparing the relative significance of costs and benefits.

Cost/benefit issues might be addressed by the IASB holding discussions attended by both users and preparers to explore the costs and benefits of contentious disclosures. The rationale for why the required disclosures have been included in a standard could also be more fully explained in the Basis for Conclusions.

7. Materiality

Larger preparers with whom we have consulted take materiality into account to some extent when developing note disclosures. In general they think their auditors are willing to agree that certain disclosures required by a standard need not be included in the company's notes because the information is immaterial to the company. However, these preparers agreed that there is often a bias not to omit disclosures required by a standard. Including the disclosure is perceived as "safer" and the effort to justify omitting it to internal management, audit committees, auditors, regulators etc. may not be worthwhile. Having the disclosure framework emphasize that the existing materiality discussion applies to disclosures would be a simple step that might be helpful to some companies but may not, in itself, significantly affect those individuals in the financial reporting supply chain with a checklist mindset.

Users recognize that preparers consider materiality in making decisions on disclosures. However, users we consulted with are concerned that preparers do not understand the way in which users utilize information and therefore are not well-positioned to decide what is material to users. Users explain that their analysis is a mosaic, bringing together many pieces of information from financial statements, other sections of financial reports and sources outside financial reports. Sometimes quite “minor” pieces of information can be important when considered with other information that the user has.

Users’ concern is over the quality of the information, not the quantity. They think that there is too much boilerplate that does not provide entity specific information, that the wording of notes is sometimes not updated sufficiently to reflect new facts and circumstances, and that the disclosures are not sufficiently transparent.

Materiality is entity specific. A disclosure framework could include some high level comments on applying materiality to disclosure decisions. However detailed guidance would be better provided as non-authoritative material outside the framework. Such guidance could be industry specific, helping financial preparers in specific industries focus on information most relevant to users of their financial statements. The development of such guidance should include discussions with both users and preparers to ensure the guidance serves to improve note disclosure.

8. Disclosures at a principles or detailed level

Some argue that detailed disclosure requirements permit a preparer to meet the wording of the requirement without being transparent and without meeting the intent behind the disclosure requirement. One user commented that disclosure requirements expressed as broad principles provide less room for a preparer not to disclose important information than do detailed requirements. On the other hand, detailed requirements are efficient for financial reporting. Generic user needs are determined once (by the standard setter) rather than by each preparer. Detailed disclosure requirements impose a degree of comparability in the information provided

by different companies and limit the opportunity for companies to be selective about what information to disclose.

The IASB currently develops detailed disclosure requirements for each standard, but also specifies disclosure objectives. The typical standard states that “If the disclosures provided in accordance with this IFRS and other IFRSs are insufficient to meet the objectives in paragraph XX, an entity shall disclose additional information necessary to meet those objectives”. This seems to be the best of both worlds, requiring specific disclosures that should meet users’ information needs in most cases, but also requiring a “step-back” by preparers to consider if additional information should be disclosed. We therefore support the continuation of this approach, although informal input from preparers suggests that the “step-back” is often not undertaken rigorously.

9. Differential disclosures

The AcSB and the IASB have each established different sets of standards for private enterprises with reduced disclosure requirements compared to those in IFRSs. These reduced disclosure requirements are driven by a focus on the needs of the users of the financial statements of private enterprises.

Users’ needs for information from public companies depend on the nature of the business and the types of transactions but not, per se, on the size of the company. Users told us that they would strongly disagree with any reduction in financial statement disclosure requirements for smaller companies. Indeed, because other sources of information are often more limited for smaller companies, the user often has to place greater reliance on the financial statements than for larger companies. The larger preparers have a similar view, considering complying with financial statement requirements a cost of raising money in the public capital markets. While these preparers may object to specific disclosure requirements, they feel there should be a level playing field with all public companies subject to the same disclosure requirements.

Any argument for differential disclosure requirements for smaller public companies must be based on cost/benefit, specifically on differences in cost. Costs include the costs to the preparer

of providing the information, costs to users of not having information easily accessible and the impact of less fulsome and transparent disclosure on the reputation of the capital markets. There may also be a case for differential disclosures for companies that have publicly-issued debt securities but no publicly-issued equity securities.

Reducing disclosures for smaller public companies can be viewed as a public policy issue that should be addressed by government and regulatory bodies rather than by standard setters.

10. Communication and organization of disclosures

While financial statements must comply with the requirements in IFRSs, they are also a communications tool. Compliance and communications do not have to be in conflict. The challenge is to comply with the requirements and to communicate relevant information in a way that is understandable. We think some of the concern over disclosure overload is a result of preparers focusing heavily on compliance but being less successful in addressing the communications aspects. Another issue is the duplication between requirements in IFRSs and regulatory requirements leading to the same or similar information being disclosed in different parts of a financial report – something that the IASB cannot address on its own but which might be the subject of discussions with IOSCO.

The conceptual framework includes understandability as an enhancing characteristic of useful financial information. A disclosure framework could include a high level discussion of how understandability applies to disclosures. Standard setters may also be able to specify the format to be used for certain disclosures, for example a tabular presentation. However, the communication aspect of the notes is ultimately the responsibility of the preparers, not of standard setters. The preparer has to decide on the most effective manner to communicate information about the company's specific results and circumstances each year and should not be constrained by the standard setter. The disclosure framework is not the right place to address communications aspects in any detail.

However, we do agree that guidance would be useful to many companies on how they might structure note disclosures and to identify best practices so that note disclosures communicate clearly and enable users to find information easily. We think most preparers intend to have their note disclosures communicate clearly but, especially in smaller entities, the individuals responsible for preparing the financial statements may not have the required time or the necessary communications expertise. There is a risk that examples in such guidance would become “standard disclosure” as we have seen with model financial statements issued by accounting bodies in Canada. Nevertheless non-authoritative guidance has the potential to enhance the effectiveness of disclosures in communicating information significantly.