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Dear Mde. Flores

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

Deloitte Touche Tohmatsu Limited is pleased to respond to the Discussion Paper *Towards a Disclosure Framework for the Notes* issued for comment by the European Financial Reporting Advisory Group (EFRAG), the Autorité des Normes Comptables (ANC) and the UK Accounting Standards Board (ASB) ('the EFRAG DP'). We note that the U.S. Financial Accounting Standards Board (FASB) has also issued a discussion paper which sets out proposals for the development of a disclosure framework for U.S. GAAP. Deloitte & Touche LLP in the U.S. has responded separately to the FASB discussion paper ('the FASB DP') and that comment letter highlights many of the broad themes outlined below.

We welcome the EFRAG DP and its objective to stimulate debate about improving the quality of disclosures in the financial statements. In contributing to this debate, we think the following issues need to be addressed. We also note that the IASB has restarted its work on the development of the *Conceptual Framework for Financial Reporting*, with a specific workstream considering the development of a disclosure framework. The EFRAG DP is a helpful contribution to that work.

Objective and Scope of this Project

In order to achieve the objective of improving the quality of information reported in the notes to the financial statements, it is critical that the volume of irrelevant and redundant information therein is decreased. It is noted in the EFRAG DP that "although reducing the length of the notes to financial statements is not the primary intent, a sharper focus on relevance will likely result in a reducing their volume, which is a legitimate expectation". We would suggest that reducing the overall length of the notes through removal of irrelevant information should be a clear objective in developing a disclosure framework – otherwise this is a missed opportunity to address the disclosure overload problem. For entities to increase the efficiency and effectiveness of the notes to financial statements, they must first decrease the volume of irrelevant and redundant information in those statements.

We agree that the current project should focus on the notes to the financial statements and not

consider the broader issues affecting corporate reporting. At this stage, there is a need to address the relevance of information disclosed in the notes and the project will potentially lose its impact if it attempts to broaden its scope beyond the requirements of accounting standards. It is important that those other aspects are considered from a placement perspective in an effort to avoid duplication of information, although we acknowledge that other aspects of financial reporting are typically governed by jurisdiction-specific requirements it is unlikely that such duplication can be completely eliminated. Notwithstanding that constraint, entities can reduce redundancy by linking relevant sections of documents to the notes to the financial statements. In addition, we strongly encourage coordination among the standard setters, regulators, and others to reduce the redundancy of information throughout the entire integrated reporting package.

There are also issues for auditors in providing assurance beyond the financial statements and it will be difficult to make progress on this front until regulators, auditing standards setters, and accounting standard setters address those challenges.

Clarifying the Purpose of the Notes to the Financial Statements

The purpose of the notes to the financial statements needs to be defined and we consider the definition proposed in the EFRAG DP a good starting point. Because clearly defining the purpose of the notes to the financial statements is a critical aspect of developing disclosure framework, it is important that the practical implications of applying this definition are analysed further. Without such analysis, it is not clear how such a definition would affect disclosure in practice and thus contribute to addressing disclosure overload.

Articulation of a Disclosure Framework

We think a disclosure framework could be helpful to the standard setter in setting requirements, and to preparers and others in reporting against them, by providing more discipline around deciding what constitutes relevant information for the purposes of the notes to the financial statements. Our concern is how this decision-making process is applied by the standard setter in developing specific disclosure requirements. In particular, it is suggested in the EFRAG DP that the application of the disclosure framework will not result in a significant change to the information currently required in the notes. We do not think that a disclosure framework that yields a broadly similar information set satisfies the objective of the project. Perhaps a more important question is how to establish whether current disclosure requirements are relevant. The standard setter should consider whether and how the information will be used. Once a standard setter understands how the information is used, it can more appropriately determine whether to require that the information be disclosed.

We are concerned that the EFRAG DP does not consider the implications of accounting standards moving towards being more principles-based and therefore placing more reliance on those preparing financial statements applying judgement on what they consider to be relevant to users of the financial statements. We think this issue is significant in addressing the disclosure overload issue. The standard setter needs to more clearly define relevance and materiality in the context of disclosures to provide preparers with more detailed guidance to assist in determining more appropriate disclosures. That is, disclosures should relate to the financial information presented and not give information on what the figures would have been if different judgements were made.

Strengthening the application of materiality to disclosures

We agree with the assessment in the EFRAG DP that materiality judgements play a fundamental role in ensuring the notes convey information that is relevant to understanding the specific factors impacting an entity's financial performance and position and we agree with that assessment. The application of the concept of materiality as it applies to disclosures (particularly qualitative information) is not sufficiently developed in the IFRS literature. This leads to ambiguity in practice about what information is considered necessary and sufficient to satisfy disclosure requirements, again contributing to the current disclosure overload problem. Such ambiguity makes analysing the "materiality" of an individual disclosure problematic, which can lead to a view that it is easier and safer to provide all of the disclosures specified in the literature even if some may in fact be immaterial. In the absence of guidance about how to apply the concept of materiality to disclosures, preparers, legal advisers, auditors, regulators, and others may continue to apply this approach, which in our view, would run counter to the objective of this project.

The development of indicators as proposed in the EFRAG DP along with other guidance may be helpful in strengthening the concept of materiality – particularly in its application to disclosure requirements. Materiality judgements by their very nature are professional assessments based on careful consideration of all the relevant facts and circumstances at the reporting date and we would, therefore, not support any approach that made that process a mechanical exercise. In our view, materiality judgements often demand discussion and debate to ensure all relevant factors have been considered so we are not necessarily troubled by the possibility that two different assessments may yield different conclusions about whether an item is material or not. Accordingly, we would support the development of guidance to facilitate the conduct of such assessments in a practical and efficient manner but not the imposition of a rules based approach to materiality.

We think it is for the IASB and IAASB to strengthen the concept of materiality and provide more robust guidance in line with above and that is acceptable to stakeholders including preparers, users, auditors, and regulators.

Improving Communication

We support the development of communication principles to help improve the way in which the notes are presented. In our view, whilst we see merit in the principles outlined in the EFRAG DP, there needs to be greater consideration of the inherent trade-off between relevance and comparability. If there is more emphasis on making disclosures entity-specific and thereby providing more relevant information for users there inevitably has to be some ground given up on achieving comparability. In our view, in order to enhance relevance, some level of comparability needs to be maintained to enable inter-period and inter-entity comparisons to be made. It is not clear to us that this tension has been considered fully and the standard setter will need to make some choices about whether relevance is given priority over achieving comparability (consistent with the relevance being a fundamental qualitative characteristic in the *Conceptual Framework for Financial Reporting*). Whilst some communication principles have been set out in the EFRAG DP, we think this is an area that needs further consideration and development to be useful.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 207 007 0884.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'V. Poole', written in a cursive style.

Veronica Poole
Global IFRS Leader
Technical

Appendix – Detailed Response to Questions

EFRAG Discussion Paper ‘Towards a Framework for the Notes’

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 support the notion of having ‘key principles’ to guide the development of a disclosure framework. However, the key principles set out in the EFRAG DP do not seem to articulate with the discussion and commentary in the paper itself. Accordingly, absent a context, it is difficult to understand the importance of some of the principles. For example, Principle 8 states “disclosure requirements should be principle-based and detailed rules should be avoided”. Does that suggest the standard setter should only set disclosure objectives and not specify any disclosures? Another example is Principle 3 where information about cash flows are not explicitly mentioned. Further thought needs to be given as to how the key principles are meant to operate within a disclosure framework.

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 primary objective of disclosure-related standard setting activity should be to rationalise disclosure requirements, in current and future standards, to ensure that required disclosures reflect the information that is relevant for users to understand the financial performance and position of an entity. We are concerned that unless difficult decisions are taken to identify what information is relevant (and what is not) there are likely to be only marginal changes to existing disclosure requirements. If that is the result, this will have been a lost opportunity to significantly improve the quality of financial reporting.

These two points noted above in (a) and (b) are inter-related – a strong emphasis on compliance has not only impacted the ‘overload’ problem but has also provided a disincentive for preparers to experiment with the presentation of material and look at more effective ways of communicating information in their financial statements. That said, in our view there are some very good examples in practice of how entities have developed innovative and meaningful ways of presenting financial information in preparing their annual financial statements – a point which is not fully acknowledged in the EFRAG DP and perhaps more could be learned from considering best practice in this area.

Question 2.1

In chapter 2 a definition of the purpose of the notes is proposed to assist in deciding what financial information should be required in the notes.

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

We agree that to decide what information to require to be disclosed in the notes, it is first necessary to establish what role the notes should play in relation to the primary financial statements. Without a robust definition of the purpose of the notes to the financial statements, it is likely that standard setters will continue to require information that may be helpful but is not necessarily pertinent to understanding 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?

As noted in our cover letter, the proposed definition is a good basis to start from but further work is required to explain what information is likely to meet the definition and why. We agree that the main function of the notes should be to explain and support the primary financial statements. However, we think that the notes should not be limited to historical information and given that the objective of the general purpose financial reporting is to assist users in predicting future cash flows and that financial statements are a central part of the reporting, there may be instances where it is appropriate to disclose current information about future events or forward data points. We also think that further work needs to be done to explain what is intended to be captured under “unrecognised arrangements, claims against and rights of the entity that exist at the reporting date” particularly in terms of whether that is different in scope to what is typically reported under IFRSs today. Furthermore, greater elaboration is required of the circumstances under which these ‘unrecognised’ items would trigger disclosures and what the nature of those disclosures would be. Otherwise, there is a danger that the definition does not serve as an effective boundary between the notes and other information in the corporate report.

We are also concerned that the DP does not address the placement of information that is currently disclosed in the notes that would fail the proposed definition. Such information may not necessarily be redundant and its inclusion in other parts of the corporate reporting package may be warranted.

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?

Overall, we support the standard setter having a decision process to guide what disclosures it requires but we question whether too much emphasis has been placed on deriving a process from analysing existing disclosure requirements. It is likely that the application of such a decision process by standard setters would result in a similar set of disclosures to that required under IFRSs today. Perhaps, the more important question is whether all the currently required disclosures are relevant. Deciding whether information that is currently disclosed should be “in” or “out” is important but the standard setter should also consider whether and how the information will be used. Once the standard setter understands how the information is used, it can more appropriately determine whether to require that the information be disclosed. This is perhaps why the EFRAG DP is not very clear on how information about risk and stewardship should be addressed as these challenge the boundaries and assertions that underpin the current debate.

We believe that there should be a category to provide information about the entity as a whole because that is often essential in providing a context within which to understand the financial performance and financial position of an entity. In our view, information about the structure of the group and uncertainties about the going concern assumption are fundamental to understanding the primary financial statements of an entity. However, such a category should not be too broad to draw in general business information that is more properly placed in management commentary and in others parts of the corporate reporting package.

Question 3.2

Are the proposed users’ needs and indicators in chapter 3 helpful to identify relevant information? If not, how would you suggest amending them, or what other basis would you suggest to identify relevant information to be included in the notes?

We generally agree with the proposed approach that anchors the selection of relevant financial information in the needs of users. However, as we note above in our response to Question 3.1 expected user needs need to be tested and not merely accepted as valid and unchanging assertions.

The proposed categories appear to tie in with the purpose of the notes in supporting users’ understanding of the primary financial statements. We agree that the development of indicators is helpful in giving structure to the decision process by standard setters as long as it is clear that they are there as guidance and should not be prescriptive in how they are applied in establishing disclosure requirements. However, we have concerns about how these indicators will be operationalised and whether they provide a sufficiently robust basis to encourage the standard setter to evaluate carefully what constitutes relevant information in developing disclosure requirements.

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 that should be provided in the notes?

We recognise that risk information is essential to users' understanding the financial performance and position of an entity but as noted above, it is not clear from the EFRAG DP what is proposed in respect of risk-related disclosures. Whilst we agree with the comment in the EFRAG DP "that a better understanding of risks by investors and other users would be beneficial", the case is not made as to what role the notes should play in bringing about such an improvement. Risk and stewardship are cross-cutting issues and they need to be set within a specific context to be useful when considering note disclosures – it is not particularly helpful to address them at a general level.

The EFRAG DP refers to risk information related to the measurement of assets and liabilities. The disclosure framework should not consider the basis of measurement and our understanding is that will be dealt with by a separate chapter of the conceptual framework.

Information about an entity's risk appetite relates to how the entity is managed and therefore is more appropriately placed in management commentary.

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?

We agree that the way in which disclosure requirements are set in accounting standards does influence behaviour. However, we think it is important to analyse why that is the case. Merely re-writing existing requirements into more general principles may not necessarily change behaviour as practice is likely to adapt around a norm and may in fact result in more information being disclosed to satisfy requirements. What is required is a better articulation of the concepts of relevance and materiality. The discussion of these concepts in the *Conceptual Framework for Financial Reporting* as well as existing standards such as IAS1 is not sufficiently developed to be useful in the application of disclosure requirements.

As we indicate above, it is important for the standard setter to make clear why certain information is required to be disclosed and why it is relevant to users. Recent IFRSs have included disclosure objectives, but they are then followed by detailed lists of disclosure requirements. Such an approach promotes a 'checklist' mentality to disclosures and limits the need for preparers to exercise judgement about what relevant information should be disclosed. In our view, this is fundamental to resolving current concerns around disclosures: either the standard setter continues to list disclosures by item and reinforce compliance against a 'checklist' or more freedom is given to preparers to decide what information will best serve the

needs of users. We recognise the latter approach is more challenging as it would encourage debate amongst preparers, auditors and regulators and users about what information is essential and why, but also believe that it could lead to clearer presentation of relevant information.

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?

We agree that a 'one size fits all' approach to disclosure requirements is not satisfactory, but it is important that this point is not considered separately from materiality judgements as they are two parts of the same question.

There is merit in further developing a differential scale of disclosures requirements as set out in the FASB DP by establishing a 'minimum', 'maximum' or 'tiers' of disclosures. For example, the standard setter could require certain minimum disclosures for all entities (subject to materiality) and suggest that entities provide other disclosures that an entity could deem relevant on the basis of additional guidance or examples provided in the standard. In limited cases, the standard setter could require a single set of disclosures if that is considered the only way of addressing the needs of users.

We agree that at a conceptual level, a disclosure framework should be capable of calibrating what are 'relevant' disclosures for different types of reporting: for example: interim, annual, separate and consolidated financial statements and for different types of entities. However, it is not something that we believe needs to be resolved in developing a disclosure framework and it is more a function of how it is applied.

The concepts and principles in the disclosure framework should be applicable to framing appropriate disclosure requirements at the standards level and it is important for the success of any framework that it does not establish rules for prescribing disclosure requirements.

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 agree that a disclosure framework should clarify how the concept of materiality is applied to disclosures. In particular, we would emphasise the importance of the qualitative aspects of materiality. We question how useful in practice it will be to include statements that "immateriality could reduce the understandability and relevance of disclosures" as it is not clear that they

would address the nature of the problem. We do not believe that honest debate and differing judgements necessarily equate to a lack of consistency or a misapplication of materiality. Moreover, in our view those debates should be encouraged and are a necessary part of preparing financial statements.

It is important that the IASB and IAASB strengthen the concept of materiality to arrive at more robust application of the concept that is acceptable to regulators and others. As the application of the concept of materiality is insufficiently developed in relation to disclosures, the disclosure overload issue will continue as there is no incentive to limit the disclosure of irrelevant 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 agree that a disclosure framework should build on and develop the concept of materiality in Chapter 3 'Qualitative Characteristics of Useful Financial Information' of the Conceptual Framework, although we do not think there is anything fundamentally wrong with the concept.

Any guidance should avoid emphasising quantitative thresholds for disclosures and suggesting that materiality can be reduced to a percentage threshold applied to line items in the primary financial statements. The development of indicators may be useful in forming materiality judgements, but we would caution against developing an approach that is very detailed because there is a danger that it will encourage a checklist approach.

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?

Whilst we agree the description of the approach is clear, we question whether it will in fact lead to an improvement in the application of materiality. We also agree that the process for making materiality judgements can be improved and insofar as the proposed guidance places emphasis on qualitative aspects, we think it may prove helpful.

Materiality relies on an understanding of what financial information is relevant to users in assessing the financial performance and position of an entity. We think further work could be done to provide a more robust articulation of what information users need and why as this will help inform materiality judgements.

As noted above, the way in which the standard setter sets disclosures requirements interacts with the application of materiality. If the standard setter moves in the direction of increasing preparers' judgement in applying disclosure requirements, it must define what is relevant and therefore should be disclosed. Such application guidance is necessary to enable preparers to know what to include – and the indicators set out in the EFRAG DP are a useful first step in that direction.

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 agree that this is an area where significant improvement could be achieved, but it requires a degree of experimentation and we note that a number of entities have already made impressive improvements in the presentation and organisation of their financial statements. We do not think that such changes can be affected through an accounting standard and it is more likely that any improvements in this area will rely on preparers, auditors and regulators working with the investor community to consider what changes are necessary and how they can best be implemented. We note that in the UK, the Financial Reporting Council has established the Financial Reporting Lab which has been tasked with bringing key stakeholders together and finding practical solutions to current financial reporting issues. That initiative has the potential to serve as a pathfinder for models that can be applied elsewhere to drive changes in reporting behaviour.

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?

We think the standard setter should encourage but not strictly prescribe the way in which the notes are presented and organised as it is a matter best left to the judgement of preparers as it forms part of the broader decisions they make around how they communicate information to the markets. However, we do not support a model that allows for complete flexibility in the way in which the notes are presented and some degree of standardisation is needed to facilitate comparisons year-on-year and between entities.

Some possible improvements to the organisation of the notes include:

- Requiring a description of the business and significant current year activities at the beginning of the notes and moving accounting policies (or at least the static policies) to the end;
- Requiring that the notes follow the order of the financial statement line items (as we do not support the suggestion that it may be helpful for users for management to order the notes on the basis of what they consider to be the most relevant issues for the reporting period – that is more appropriate conveyed through management commentary); and
- Allowing for grouping of disclosures in a more meaningful way (for example, combining pension and other post-employment benefits disclosures or including a single future maturities table).

Question 6.1

Are there any other issues that you think need to be addressed to improve the quality of information reported in the notes to the financial statements? Please explain how you think these issues should be addressed and by whom.

The EFRAG DP does not deal with the pressure for additional disclosures in a more principles-based accounting environment. As standard setting continues to result in guidance that is deemed to be 'principles-based', entities generally increase their use of judgement in applying such guidance. As a result, there will be a further need to add disclosures about their judgements and how they impact comparability with other entities. The disclosure framework should address this specific issue to ensure the result of applying the framework is not to add irrelevant disclosures and potentially impair disclosure effectiveness.