

14 December 2012

European Financial Reporting Advisory Group (EFRAG)
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Belgium

Email: commentletters@efrag.org

Dear Sir/Madam

**SAICA SUBMISSION ON THE EUROPEAN FINANCIAL REPORTING
ADVISORY GROUP (EFRAG), THE FRENCH AUTORITÉ DES NORMES
COMPTABLES (ANC) AND THE UK FINANCIAL REPORTING COUNCIL
ACCOUNTING COMMITTEE (FRC) DISCUSSION PAPER ON *TOWARDS A
DISCLOSURE FRAMEWORK FOR THE NOTES***

In response to your request for comments on the EFRAG, ANC and UK's Discussion Paper on *Towards a Disclosure Framework for the Notes*, attached is the comment letter prepared by Accounting Practices Committee (APC) of The South African Institute of Chartered Accountants (SAICA). This comment letter results from deliberations of the APC, which comprises members from reporting organisations, regulators, auditors, IFRS specialists and academics.

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely

Sue Ludolph
Project Director – Financial Reporting

cc: Paul O'Flaherty (Chairman of the Accounting Practices Committee)

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GENERAL COMMENTS

We welcome the European Financial Reporting Advisory Group (EFRAG), French Autorite des Normes Comptables (ANC) and the UK Financial Reporting Council Accounting Committee (FRC) Discussion Paper on *Towards a Disclosure Framework for the Notes*, which will assist to enhance the quality of the disclosures in financial statements. This may be a journey, but the proposals in the Discussion Paper seem to be heading in the right direction.

SPECIFIC COMMENTS

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 are generally supportive of the proposed key principles in the discussion paper.

We believe that the Discussion Paper adequately identifies the issues relating to disclosures, notably, that the disclosures have become somewhat voluminous. Nonetheless, we are concerned with the view as indicated in the Discussion Paper stipulating that with the change to the definition of the purpose of the notes we are likely to see certain information that is considered to be useful being provided elsewhere. This is because moving some of the disclosures elsewhere does not deal with the issue, as some of that information may be required in order to achieve fair presentation. Thus the relevance of financial statements and what information needs to be provided must be the key focus area and not whether the required information is provided in the notes or elsewhere in the financial statements. If some voluminous information is continued to be provided, but contained elsewhere in the financial statements, the issue of voluminous information is not solved, it has just been moved elsewhere.

There is merit in considering the efforts of the International Integrated Reporting Committee, particularly when looking at providing material information in a concise manner. This is because preparers of integrated reports would have to deal with similar issues as preparers of IFRS financial statements when faced with selecting which disclosures are relevant to users.

In paragraph 11 of the Discussion Paper, it states that “...*the notes focus on past transactions up to the reporting date...*” whereas paragraph 12 states “*In arriving at the definition of the notes, there are certain types of disclosures where the boundary line is less clear. These are: ... d. non-adjusting post-balance sheet events...*” It is not obvious why a boundary line for a non-adjusting post-balance sheet event is less clear when it doesn't seem to relate to a past transaction. Clarification on how these two paragraphs are interrelated could be useful.

Question 1.2 – Understanding the problem

This Discussion Paper suggests that there are two main areas for consideration to improve the quality of disclosures:

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- 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?

The overload of the disclosures may be due to the excessive requirements in the standards, however, in the absence of application guidance on materiality it is difficult to assess whether ineffective application of materiality may have been the cause of the disclosure overload. In other words, it could have been the absence of clear guidance on how to apply materiality that has triggered the excessive disclosures.

Whilst we agree with point (b) we believe that this assumption is made on the basis that the financial statements are provided on hard copy format only, whereas over the years these have become available on an electronic platform allowing for easy navigation. Thus in this case, the manner in which the disclosures are organised often does not play a major role in improving the quality of disclosures. Even when information is provided in electronic format, that does not mean that concerns regarding the overload of disclosures is no longer an issue; instead the concern applies equally to disclosures provided in this form, it is just that it can be easier to deal with when it is in an electronic format.

It needs to be realised that while the Discussion Paper identifies issues, the setting of standards with many disclosure requirements is not the sole reason. As business has become more complex over the years, IFRS itself has become more complex, meaning that more explanations are needed to enable a user to understand the financial statements. Therefore it becomes a challenge to provide a balance between providing relevant information, which might not meet the needs of certain users, as compared to providing more information to allow a user to select which information they need.

In addition, while Chapter 5 provides some examples of how disclosures can be improved, it is contended that some of these could be used by entities presently, but companies seem reluctant to do so. For example, certain selected information could be highlighted; this includes accounting policy choices that have been selected, when a choice is available, as well as major changes from the previous year. Consideration could be given to determine why companies seem reluctant to use available options to improve disclosures.

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.

In principle we agree with the proposed definition of the purpose of the notes, subject to our response to question 1.1. In addition we propose the following changes to this definition:

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- The reference to 'relevant **description**' be changed to 'relevant **information**', as this seems to be much broader.
- To emphasise within the definition of the purpose of the notes the concept of materiality, we suggest that the changes be made to the definition as follows: *"The purpose of the notes is to provide a relevant [information in relation to] of the **material** items presented in the primary financial statements and of **material** unrecognised arrangements, claims against and rights of the entity that exist at the reporting date."* (words in bold have been added).

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?

Subject to the proposed changes under our response to question 2.1 above, we believe that the proposed definition of the purpose of the notes will be useful in identifying relevant information that should be included in the notes.

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?*

The proposed approach is clear enough to be understandable.

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

We believe that a Disclosure Framework is needed that would give guidance to assist the standard setters to decide when additional information is required to fulfil the users' needs. The question remains as to whether disclosures should be viewed standard by standard or on a holistic basis. The current practice is that these are determined on a standard by standard basis which has led to the current concerns giving rise to the discussion paper.

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

Regarding the inclusion of an additional category on 'information about the reporting entity' our view is that disclosures should only deal with information that is relevant to the financial statements and disclosures on information that is unrelated to financial statements items should be provided elsewhere. As indicated in our response to question 1.1 above, we believe that the issue of voluminous information applies to information given elsewhere in financial statements as well as elsewhere in annual reports that include financial statements.

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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 believe the users' needs and indicators noted in this chapter are helpful in identifying relevant information.

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 that should be provided in the notes?

Whilst stewardship may be relevant, this notion may not fit well with how they define the information to be disclosed in the notes. As all information included in the notes should be subject to an audit, we also envisage that it may be a challenge issuing an audit opinion on management's stewardship. Again, this is information that can be disclosed in other reports.

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 support standard setters continuing to mandate detailed disclosure requirements in each standard. In addition, industry specific disclosures per standard, is something that could be explored as this may be helpful to users to better understand the environment in which an entity operates. We understand that this may create additional work for standard setters, but this would also assist in focusing the disclosures to those items that are relevant to a particular entity and industry.

In addition to the approaches proposed in the discussion paper, in most instances segments could be a driver for disclosures; thus some of the disclosures could even be by segment rather than by item in the statement of financial position. For example, in a conglomerate with a financial services division (segment), users of these financial statements could benefit from the detailed disclosures on financial instruments, because of the nature of that division, however, those same disclosures may not necessarily be relevant for another division within the same entity that is not financial services orientated.

Even if changes are made to requirements, standard setters will need to engage regulators to ensure they understand and support any changes. This is because regulators are likely to follow a checklist approach to disclosures. It is easier to ascertain whether required disclosures are provided than have to justify why certain

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disclosures are not provided, particularly where it is subjective as to whether disclosures should be provided or not.

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 do think that the alternative disclosure requirements may be appropriate although it may be practically difficult to achieve.

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?

Yes, we agree that a Disclosure Framework should reinforce the application of materiality, for instance with a statement that indicates that immaterial information could reduce the understandability and relevance of disclosures.

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.

One of the areas that influence the quality of the disclosures is how the concept of materiality is applied in practice. However, as noted in our response to question 2.2, the lack of application guidance on materiality may have contributed to the disclosure overload. Thus guidance on applying materiality will play a key role in changing the manner in which disclosures are currently provided.

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?

While there is some useful guidance that may assist in improving the application of materiality, it probably does not go far enough. Application guidance for materiality should ensure the principal focus will only be on items that are material for that particular entity, whereas at present generally the extent of disclosures for an item is not determined by the relative materiality of an item in the statement of financial position. Thus there is scope to only provide some of the possible disclosures for a particular item in the financial statements. For example a financial institution may have items of property, plant and equipment, but the extent of disclosures provided might be similar to that provided by an entity with substantial manufacturing

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facilities, so it is questioned whether the extent of disclosures should vary according to how significant each item is to the financial statements.

It is believed that any attempt to reduce disclosures will be difficult to achieve unless the standards themselves provide reasons as to why particular disclosures are relevant. At present disclosures are provided if an item is either qualitatively or quantitatively material, but this would have to be reconsidered if the proposals are included in a framework. As illustrated in paragraphs 25 to 28 of Chapter 4 some support only providing a maturity analysis when there is a material liquidity risk, even when the liabilities are material. Without providing a reason as to why this disclosure is relevant, it will be difficult to reduce current disclosures for material items as it could be difficult to defend any non-disclosure for a material item, unless additional guidance is provided on how to apply materiality.

At present some disclosures are only provided to enable users to compare IFRS financial statements with US GAAP financial statements. Disclosures only provided for convergence reasons are not supported. There is no reason why convergence with this particular or another other accounting framework should be a requirement, particular if it only applies to a few selected areas.

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 feel that the proposed communication principles will improve the effectiveness of disclosures in the notes.

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 are in agreement with the proposed principles for improving the effectiveness of disclosures in the notes, in particular, the principle that suggests that items be disclosed by importance. We are also fully in agreement with the statement in paragraph 34 of Chapter 5 of the Discussion Paper which indicates that currently accounting policies are not always useful as they often repeat what is already included in the standards particularly where the standards do not provide alternative approaches. To further enhance the usefulness of disclosures and improve their effectiveness, they should not only be organised by importance, but also the accounting policy and the related disclosures on a particular item on financial statements should be located in the same area in the financial statements as opposed to the current practice where the list of accounting policies are separated from the disclosures. It would also be useful to summarise those areas where entities have a choice of accounting policy and which policy they have chosen.

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Furthermore, some of the concerns that have arisen with regard to the structure of the notes could have been resolved if annual reports were provided on an electronic platform only, which allows for easy navigation.

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.

In developing a Disclosure Framework we encourage the standard setters to get Regulators to be closely involved in their development to ensure that they understand the changes and the impact these are likely to have.

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