Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116 www.fasb.org Chris Barnard Germany

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- File Reference No. 2012-220
- Discussion Paper
- Disclosure Framework

Dear Sir.

Thank you for giving us the opportunity to comment on your Discussion Paper: Disclosure Framework.

Framework

The purpose of this discussion paper is to describe a possible disclosure framework that would comprehensively and consistently address the theory, effectiveness and usability of required disclosures in order to make financial statement disclosures more relevant, reliable, coordinated and understandable. The purpose of the discussion paper is not to reduce the volume of notes to financial statements; however, the FASB (Board) expects that a sharper focus on important information will result in reduced volume in most cases.

The fundamental principles underlying the possible disclosure framework are that:

- information in the notes should be unique to an entity or its industry;
- the information should not be readily available elsewhere;
- the information could make a material difference in assessing future cash flows.

These principles are sufficient and complete in order to determine the appropriate disclosure framework. However, the framework still needs to delineate the responsibility for selecting disclosures between the Board and reporting entities. This requires consideration of the extent to which entities should be permitted to make judgments about which disclosures are relevant, which will require a balance between disclosure effectiveness and comparability.

Answers to other specific questions raised by the FASB

Chapter 1—Scope and Introduction

Question 1: The details of this Invitation to Comment do not focus on the informational needs of donors to not-for-profit organizations. How, if at all, should the Board's decision process (see Chapter 2) be supplemented to consider the needs of donors? How, if at all, should not-for-profit reporting entities modify their decision-making process (see Chapter 4) for the needs of donors when deciding which disclosures to include in notes to financial statements?

Paragraph 1.9 states that: "The objective of financial reporting is to provide financial information that is useful for making investment and credit decisions". However, the needs of donors are not usually related to making investment decisions, but rather to ensure that money donated to a not-for-profit organization is spent according to the principles of the not-for-profit organization. Therefore it is important that such financial reporting disclosures should clarify and describe how the not-for-profit organization's investments have been made and how and for what purpose its money has been spent, and how these support and relate to its published not-for-profit principles.

Chapter 2—The Board's Decision Process

Question 2: Do the decision questions in this chapter and the related indicated disclosures encompass all of the information appropriate for notes to financial statements that is necessary to assess entities' prospects for future cash flows?

Yes, the decision questions G1-G4 about the reporting entity as a whole; L1-L16 about line items; and O1-O7 about other events and conditions that can affect an entity's prospects for future cash flows do encompass all of the information appropriate for notes to financial statements that is necessary to assess entities' prospects for future cash flows.

Decision questions L5, L6 and L15 are important because they help determine the extrinsic and intrinsic uncertainty of a line item or estimate. Users should clearly understand and expect that any financial statement measurement which contains subjective elements, assumptions or judgments about future events, will almost certainly turn out to be "wrong". In fact, the only thing that you can usually predict with any certainty is that the actual outcome will be different from that originally measured, estimated or predicted. Whilst most experienced users understand this concept, for some, including the general public, the increasing burdens on financial statement preparers, and greater input of skilled resources required thereon, coupled with increasing auditing requirements and oversight, may imply that the financial statements should be "correct" and that any assumptions or judgments about future events that are incorporated into financial statement measurements should be "right". When such assumptions and judgments actually turn out to have been "wrong", some users may believe that the financial statements themselves were "wrong", or had been prepared incorrectly or incompetently, and that there was a failure of process either at source, or during the auditing and oversight stage. This is mostly not the case. Therefore it is

important that we manage the expectations of users in this regard, and provide enough guidance and disclosure in order to illustrate the potential measurement uncertainty that exists in financial statement measurements that incorporate assumptions or judgments about future events.

It is important that preparers should present a range of reasonable outcomes, rather than a point estimate, when incorporating assumptions or judgments about future events in financial statement measurements. Such a range of reasonable outcomes should at least consider the following:

- 1) the change in the measurement to changing individual assumptions and/or judgments (sensitivity analysis);
- the change in the measurement to changing several assumptions and/or judgments at the same time, where the assumptions and/or judgments could reasonably be expected to change together (scenario analysis);
- 3) the dependencies assumed between the assumptions and/or judgments.

This measurement uncertainty analysis should consider materiality, and allow for those assumptions or judgments which have a significant impact on the measurement. In my opinion, such measurement uncertainty analysis will help to manage the expectations of users regarding financial statement measurements that incorporate assumptions or judgments about future events. This is both a reasonable and proportionate approach.

Question 3: Do any of the decision questions or the related indicated disclosures identify information that is not appropriate for notes to financial statements or not necessary to assess entities' prospects for future cash flows?

This depends on the nature and circumstances of the entity and the information provided. The decision questions as a whole are sufficient and complete, and information disclosed should be appropriate for notes to financial statements, subject to materiality.

Question 4: Would these decision questions be better applied by reporting entities instead of the Board? In other words, should the Board change its practice of establishing detailed requirements in each project and, instead, establish a single overall requirement similar to the questions in this chapter?

This question encompasses a spectrum of possibilities. It does not have to be one or the other. A principles-based approach could consider that the Board should establish a single overall requirement similar to the questions in chapter 2, subject to specific detailed requirements in specific projects that would supplement and strengthen the overall requirement. In other words, decision questions should be applied by reporting entities as they are closest to and better understand their businesses, subject to minimum underpins that would ensure a level of consistency and comparability between different entities and industries.

Question 5: Do you think that this decision process would be successful in helping the Board to set more effective disclosure requirements? If not, what would be a better approach?

Yes, I think that this decision process would be successful in helping the Board to set more effective disclosure requirements. It sets an objective framework which incorporates quantitative and qualitative factors, and should enable more efficient and targeted disclosures that can be measured against the framework.

The Board would appreciate it if respondents would apply this decision process to the FASB Accounting Standards Codification® Topics of their own choosing and identify any changes to existing disclosure requirements that would seem to result.

Applying the decision process to Financial Services-Insurance (Topic 944) would yield more complete disclosures compared with current requirements. Currently, disclosures concerning unpaid claims, acquisition costs and claims payments are required. Questions L5, L6, L15, O4 and O7 would lead to a greater focus on measurement uncertainty and disclosing qualitative and quantitative information on the amount, timing and uncertainty of cash flows arising from insurance contracts.

Chapter 3—Making Disclosure Requirements Flexible

Question 6: Would any of the possibilities in this chapter (see paragraphs 3.8 and 3.11) be a practical and effective way to establish flexible disclosure requirements?

Yes, in particular it is important to consider a more principles-based approach that would devolve judgment on disclosures to reporting entities, subject to minimum standards of disclosure that could be set by the Board. This would ensure a level of consistency and comparability in the format and content of disclosures, but would allow entities to tailor their disclosure to the nature and circumstances of the entity and the needs of users.

Question 7: If more than one approach would be practical and effective, which would work best?

I would prefer the options listed in paragraph 3.11, particularly option c, which would be workable, flexible and effective. In any event I would recommend that auditors should be required to comment more explicitly and completely on the resulting disclosure decisions of reporting entities.

Question 8: Are there other possibilities that would work better than any of the ones discussed in this chapter?

The chapter considers the spectrum of possibilities between the two extremes outlined in paragraph 3.8. This spectrum covers the full range of workable approaches.

<u>Chapter 4—Reporting Entities' Decisions about Disclosure Relevance</u>

Question 9: This chapter attempts to provide a benchmark for judgments about disclosure relevance by clarifying the objective for the judgments. Is the description of the approach clear enough to be understandable? If not, what points are unclear?

Paragraph 4.5 states that "a reporting entity should provide a disclosure if it would change users' assessments of cash flow prospects by a material amount". I agree with this. Materiality is related to relevance in the sense that material information is relevant to the fair presentation of the financial position of the reporting entity. Materiality can be considered a subset of relevance, or rather, a threshold which determines whether information is relevant. It is both an entity-specific consideration, and a user-specific consideration, and therefore depends on the particular reporting entity's situation and the perceived (or stated) tolerances of users. This dual dependence does not easily permit a rules-based or uniform quantitative materiality threshold, rather a principles-based, entity- and user-specific materiality threshold.

Given the nature of materiality, which depends on the nature and magnitude of a particular item in relation to a particular reporting entity's situation, it demands a principles-based, entity- and user-specific consideration in order to determine its threshold. This should only reasonably be determined by the particular individual reporting entity and its auditors before the event. It can not be reasonably determined by standard-setters uniformly or in isolation. Should a question of materiality arise after the event, its implications and consequences will certainly depend on the process and due consideration given to materiality by the reporting entity and its auditors before the event.

Question 10: Can this approach (or any approach that involves describing the objective for the judgments) help identify relevant disclosures? If so, what can be done to improve it? If not, is there a better alternative? What obstacles do you see, if any, to the approach described?

Yes, this approach can help identify relevant disclosures. It considers the relevance of disclosures in terms of materiality, and considers magnitude, probability (uncertainty) and timing (discounting) as factors that affect magnitude, and thus materiality. This is a reasonable approach that builds a more objective structure around materiality.

I agree with paragraph 4.27 that: "If it seems likely that discounting could make a difference to a reporting entity's decision, a reasonable approach would be to use, for example, the rate for low-risk government borrowings". The use of a discounting rate based on low-risk government borrowings is objective, reasonable and prudent.

Question 11: Reporting entities would need to document the reasons for their decisions about which disclosures to provide. How would reporting entities document the reasons for their disclosure decisions and how would auditors audit those decisions?

Reporting entities should document their assessment of the relevance of the disclosures that have been considered. This would consider materiality, and therefore magnitude, probability (uncertainty) and timing (discounting). Auditors should be required to comment more explicitly and completely on the resulting disclosure decisions of reporting entities using similar criteria.

¹ Individual users will have their own views after the event, which the reporting entity must preconsider in its determination of the threshold.

Chapter 5—Format and Organization

Question 12: Would any of the suggestions for format improve the effectiveness of disclosures in notes? If so, which ones? If not, why not?

I agree that disclosures should have common points of reference, as then the effects on cash flow prospects would be easier to aggregate, analyse and understand. I also agree that the understanding of notes would be enhanced by using tables, headings, cross references and highlighting.

Question 13: What other possibilities should be considered?

Changing the form or organization of disclosures in notes should be considered in total, rather than piecemeal. At the end of the day, the financial statements should represent a coherent whole as much as is possible.

Question 14: Do any of the suggested methods of organizing notes to financial statements improve the effectiveness of disclosure?

The communicative value of notes to financial statements could be substantially improved by altering and optimising the layout of the notes. I would support a more standardized, consistent and logical ordering for the notes. Paragraph 5.22 gives one example of logical order for disclosures that would be consistent with comments from users about which information they said is most relevant. This is a useful starting point.

Question 15: Are there different ways in which information should be organized in notes to financial statements?

Changing the form or organization of disclosures in notes should be considered in total, rather than piecemeal. At the end of the day, the financial statements should represent a coherent whole as much as is possible.

Chapter 6—Disclosures for Interim Financial Statements

Question 16: Do you think that any of the possibilities in this chapter would improve the effectiveness of disclosures for interim financial statements?

Given the current criticisms of interim reporting, I would expect that the possibilities in chapter 6 would improve the effectiveness of disclosures for interim financial statements. I agree with the assumptions listed in paragraph 6.7. In particular, it is clear that investors make decisions about buying, selling or holding all year long and that an interim period is an integral portion of an annual period. I view interim reporting as an update on the previous annual financial statements and an opportunity to manage users' expectations concerning the state of the reporting entity and its prospects for future cash flows. Therefore interim reporting is an opportunity to ensure that there are as few surprises as possible in reporting, especially by the time of the annual reporting.

Question 17: If you think that a framework for the Board's use in deciding on disclosure requirements for interim financial statements would improve the effectiveness of interim reporting, what factors should the Board consider when setting disclosure requirements for interim financial statements?

The factors that should be considered when setting disclosure requirements for interim financial statements would include, as a minimum: the significance of events and transactions that would affect the entity's prospects for future cash flows; the nature and amount of material changes in estimates, assumptions or judgments, and their impact on the financial statements and the entity's prospects for future cash flows; and the effect of changes in the entity's composition or capital structure during the interim period.

Question 18: If you think that a framework for reporting entities' use in deciding on disclosures for interim financial statements would improve the effectiveness of interim reporting, what factors should reporting entities consider when providing disclosures for interim financial statements?

I believe that my comments under questions 16 and 17 are also relevant here.

Chapter 7—Other Matters for Discussion

Question 20: Would the change to the requirements described in paragraph 7.8 for disclosure of the summary of accounting policies improve the effectiveness of disclosure?

I would agree that replacing the existing requirements on accounting policies with a narrower requirement based on questions L10 and L11 would reduce the volume of notes to financial statements without diminishing their relevant content.

Question 21: Should the summary of accounting policies include information about industry-specific accounting policies?

Information about industry-specific accounting policies should be provided if it would help users assess the reporting entity's prospects for future cash flows.

Yours faithfully

C.R.B.

Chris Barnard