

FEE Conference on 18 September

Corporate reporting of the future

Good afternoon, ladies and gentlemen.

First and foremost I would like to thank FEE for having EFRAG participate in this high level conference, looking ahead into corporate reporting of the future. I would like also to congratulate FEE for its support to overall improvement of communication between companies and investors, a direction that is a key driver for EFRAG's activities.

The success of a better integration of various corporate reports including the financial report would undoubtedly serve investors and other users of company reports. Integration of information means a significant gain in relevance, as well as significant reduction costs of reporting analysis. Much has to be accomplished by various stakeholders before such a stream of improvements come to the fore. And EFRAG believes that in promoting improvements in the financial reporting arena, it can valuably contribute to the overall effort.

This is the reason why EFRAG initiated two years ago, as part of what we call our "proactive activities", that is our contribution to stimulating debate where improvement in financial reporting is needed, a research effort into ways to improve effectiveness of disclosures to financial statements. This project has been run as a partnership with the UK ASB and the French ANC and has led to the publication of a joint discussion paper on 12 July this year. Early in 2011, the FASB had expressed an interest in cooperating with us on the subject, after EFRAG had presented its Disclosure Framework project at an international meeting of accounting standard bodies, bringing evidence to the FASB that we were pursuing similar goals. The FASB has issued its Discussion Paper on the same date as we have, and has developed similar thinking, hence reflecting on our shared efforts.

Looking at the surface of things, everyone would agree that the volume of disclosures has grown into a source of heavy concern, and various

expressions have flourished in order to describe the phenomenon. Investors are said being no longer able “to see the wood for the trees” and disclosures are described as “costly and burdensome” while users continue to complain that the information they need is not provided.

The difficulty is such that there have been a series of various recent initiatives intended to remedy the situation. For example, the UK Financial Reporting Council has published its recommendation to “cutting the clutter” and has started its Financial Reporting Lab from which best practices are expected to emerge, an initiative that EFRAG intends to promote replicating in Europe. The French ANC has tried to contribute to making IFRS financial reporting less of a hurdle for small listed companies. The Institute of Chartered Accountants of Scotland, together with the New Zealander National Standard Setter, has proposed to reduce the number of requirements significantly and to promote a more efficient way of complying with them.

All these initiatives have contributed to highlighting the phenomenon and creating international consensus in the request being put to the IASB to consider developing a Disclosure Framework as a high priority.

It comes as rather paradoxical that the IASB’s efforts driven by the search for greater transparency in financial reporting would translate in practice by relevant information being obscured. If I had to summarise our thinking in a few words I would say that our efforts should lead to turning what has become a compliance exercise into a communication performance. Effective communication to investors and users at a reasonable cost is the objective.

EFRAG and his partners do not believe that progress can be made in cutting into current requirements without being driven by a fair understanding and analysis of users’ needs. If a disclosure requirement is relevant for one company out of a hundred, it should be prescribed and applied in ways so that ninety-nine companies do not provide any information while the hundredth complies with the requirement.

There is not one single magic decision to make to reach the objective of more effective communication. In our discussion paper we have

addressed successively the various areas where improvement is needed if effectiveness in financial reporting is to be regained.

What is to be considered?

A first series of questions deals with how the standard setter is setting disclosure requirements. Should the standard setter set requirements differently from how it is done today? In many of EFRAG comment letters we have recommended that the IASB adopts more principle based disclosure requirements. We observe indeed that detailed and very prescriptive requirements tend to defeat the strength of an overall disclosure principle and objective and suggest tight compliance attitudes, what we call the “ticking the box mentality”. Would more flexibility in the application of more demanding principles produce all the relevant, and only the relevant information, that is useful to users? If so, what is the level at which such flexibility should be provided? More flexibility means more judgment. What is the cost involved in a more thoughtful approach to providing disclosures? Wouldn't this make it even more difficult for smaller entities? Would the requirements remain auditable and enforceable? Are there differences in users' needs that would justify differential disclosure regimes so as to ensure that disclosure requirements are cost effective in all circumstances?

A second series of questions deals with the application of materiality in practice. Is there a need for more guidance on how to apply materiality in practice? Is there a need for more guidance on how to apply materiality to disclosures? Is materiality assessed as it should, qualitatively and not quantitatively only? Is materiality well understood as the entity-specific aspect of relevance? In other words, are issuers relying on appropriate guidance to determine what to disclose? Are they encouraged by auditors and enforcers to filter useless information out of financial reports? How to get rid of the sticking view that providing always more information, whether relevant or not, is better and safer? How many auditors' requests or enforcement decisions have led to eliminate immaterial items? Would less prescriptive requirements be favourable to a better application of materiality in practice?

Finally a third approach to improving disclosures in practice lies in a few communication principles. What are the ways to present information so that users grasp quickly and easily what they should understand and know when making economic decisions and assessing stewardship? The paper reminds everyone of a few – rather straightforward – communication principles that issuers should be encouraged to observe.

With our work we intend to initiate debate. At this stage we suggest a series of key principles and set forth a few proposals, however we leave a lot of questions open, and this is well intended. Our goal is to have European views emerge from the debate, so that all participants feel invited to contribute to forming the European view, not that they feel they have to fight preliminary views that they would dislike or that would raise their concerns. We are also interested to learn about the views of stakeholders outside of Europe as they are expected to have influence on the IASB's ultimate decisions.

There is a last aspect of our joint Discussion Paper that I wish to highlight and explain. We have very intentionally restricted the scope of our work to the application of a disclosure framework to the notes of financial statements.

In doing so, we are not overlooking that the IASB has chosen to dedicate its efforts to financial reporting overall, and not restrict itself to financial statements. The IASB can therefore be expected to approach its disclosure framework from a wider perspective, to embrace financial reporting as a whole.

To do so the IASB needs to cover a much wider ground than what is encompassed in our paper. A definition of financial reporting and of its various components remains to be developed. Very importantly placement criteria for each of the various components need to be defined. In restricting our paper to the notes to financial statements, we propose one of the required placement criteria, i.e. what should belong to the notes to financial statements. Progress in how to set requirements, help proper application of materiality in practice and promote sound communication in practice can be expected to be valid when and if applied in the wider context of financial reporting.

We have observed that 1) most jurisdictions – and this is the case of the EU – have delegated to the IASB the responsibility for setting requirements applicable to financial statements, not to financial reporting in general; therefore delineating what belongs to financial statements can be seen as having priority in the work of the IASB, without impeding later progress in a wider context; 2) there is urgency in bringing concrete improvements in practice, and embracing immediately the wider context would undoubtedly delay implementation in practice of revised disclosure requirements. It is fair to say that the disclosure overload and lack of effectiveness triggered by compliance with IFRS strikes the notes to financial statements first and foremost.

Those who today make their best efforts to promote integrated reporting may consider our approach as counter-intuitive to the progress they wish to suggest. We in EFRAG however are committed in our proactive activities to adopt practical approaches to the improvement of financial reporting. In the present circumstance, the problem identified that can be remedied by the IASB lies with financial statements. This is the reason why we believe that the IASB should tackle it with a high level of priority, addressing the necessary broader picture only when improvements to disclosures in the notes to financial statements are already well underway. In the meanwhile EFRAG will take its share in activating the debate about disclosures in a wider context.

I hope that these few words are inviting you to assess our proposals and to respond to the many questions that we raise in our discussion paper. I wish you an interesting read.

Thank you for your attention!