Financial Reporting Council

June 2013

Feedback Statement
Thinking about disclosures in a broader context

A roadmap for a disclosure framework

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1 Introduction

In October 2012, the UK Financial Reporting Council (FRC) published a discussion paper (the 'Paper') 'Thinking about disclosures in a broader context'[1], supported by the Autorité des normes Comptables (ANC) and the Accounting Standards Committee of Germany (ASCG).

The Paper complemented our joint discussion paper with the ANC and the European Financial Advisory Group (EFRAG) 'Towards a disclosure framework for the notes'[2] which focused on the notes to the financial statements.

The main messages in the Paper were that the FRC:

- believes that the development of a disclosure framework would lead to more relevant financial reporting[3]; and
- improving disclosure is, in our view, a shared responsibility, the Paper was therefore intended for standard setters, other regulators, preparers, auditors and users.

Aim of the Paper

Our aim in publishing the Paper was to:

- Recognise that a disclosure framework should consider disclosures in the financial report as a whole.
- Curtail the piecemeal approach to disclosures that is likely to continue as a result of future developments in disclosures.
- Provide a framework to influence others addressing disclosure.
- Influence the International Accounting Standards Board (IASB) before it starts its project on a disclosure framework.

The Paper presented a number of ideas intended to start the debate on disclosures. Since its publication, we welcome that the IASB has initiated its own project on disclosures. We believe that our ideas, together with the feedback received on them, will be helpful in setting the agenda for the IASB's project.

What is financial reporting?

The Paper started with a discussion of the question: what is financial reporting? It outlined the need to define the boundaries of financial reporting and suggested that disclosures that do not meet the objective of financial reporting should be placed outside the financial report. This would assist with cutting clutter. The Paper also identified three components of the financial report: management commentary, corporate governance and the financial statements.

We then set out a roadmap for a disclosure framework.

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[1] A copy of the discussion paper can be accessed at http://www.frc.org.uk/getattachment/99bc28b2-c49c-4554-b129-9a6164ba78dd/Thinking-about-disclosures-in-a-broader-contex.aspx

[2] A copy of that paper and the feedback statement can be accessed at https://www.frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/Ongoing-projects/Research/Disclosures.aspx

[3] For the purposes of our paper and this feedback statement, financial reporting refers to information typically found in an annual report, interim report or preliminary announcements.

Feedback

The comment period on the paper closed on 31 January 2013. We received 28 comment letters. A list of respondents is included in the Appendix.

The distribution of responses is as follows:

Type of respondent	
Preparers	3
User representatives	5
Accounting bodies	6
Accounting/Audit firms	8
Other	6
Total	**28**

Country	
UK	21
Australia	2
Netherlands	1
International groups	4
Total	**28**

2 Main messages

Overall, respondents welcomed the FRC's initiative and noted that the Paper is a valuable contribution to the disclosure debate. The responses indicated broad support for a disclosure framework and for the content of the Paper.

Respondents made a number of overarching comments in their letters. These are summarised below. A detailed analysis of the responses to the specific questions in the Paper is set out on pages 7-17.

Scope

There was significant support from respondents for a disclosure framework with a broad scope extending beyond the financial statements. The main comments made were that the causes of ineffective disclosure - duplication, lack of cohesion and immaterial information - can only be addressed by considering the financial report as a whole.

Clutter

Clutter in financial reporting came up as a recurring point. Although reducing the volume of disclosure was not a stated objective of the Paper, respondents commented that it remains an issue as excessive amounts of disclosure can obscure important information. Respondents noted that the drafting of disclosures should be seen as a communication rather than compliance exercise.

Respondents also noted that clutter is as much an issue for management commentary as it is for the financial statements.

Call for a co-ordinated approach

Respondents observed that disclosure requirements are set by a number of different regulators. Whilst some of these disclosures are for the benefit of shareholders, other disclosures are intended for a wider group of stakeholders.

Many respondents commented that action is required by all bodies to tackle the disclosure problem and encouraged the FRC to co-ordinate with international and national standard setters and other regulators to drive forward the disclosure agenda. Specific areas that could be aligned were the new narrative reporting regulations from the UK Department of Business Innovation and Skills (BIS) and the development of the International Integrated Reporting Framework from the International Integrated Reporting Council.

Purpose of annual financial reports

Many respondents commented that there is a need to reach agreement on the purpose of annual financial reports. Most respondents agreed with the view in the Paper that financial reports are for investors.

In particular, the discussion on the boundaries of financial reporting was welcomed as many respondents hold the view that information that is not relevant for the primary users of financial reports should be provided elsewhere.

User needs

There was widespread agreement with the approach in the Paper, which stated that the development of a disclosure framework should start with identification of users' needs.

It was evident from the responses that there is a tension between the objective of financial reporting, directed towards meeting the needs of investors, and disclosures in annual financial reports that are often aimed at a wider stakeholder group.

Placement criteria

Placement criteria were considered to be an important part of a disclosure framework, both within the financial report and outside it. See pages 11-13 for detailed comments on placement criteria.

Disclosure framework as part of the IASB's Conceptual Framework project

A number of respondents commented that it is the role of the IASB to develop a disclosure framework as part of its Conceptual Framework and that the FRC should support the IASB's initiative. Respondents considered that the action points set out in the Paper would be useful to the IASB. In this context, the point was raised that the IASB, as well as establishing a framework, should review existing disclosure requirements to ensure that they result in relevant information for users.

Principles based standards

It was clear that respondents would like disclosures in the financial report to enable an entity to 'tell its story'. They encouraged the use of principles based standards rather than a detailed list of requirements. This would provide preparers flexibility to apply their judgement.

Materiality

Materiality was considered to be a key aspect of the framework and an area where guidance would be helpful. Often respondents mentioned materiality in the context of the undesirability of immaterial information being disclosed. It was mentioned that the 'fear' of materiality judgements being challenged resulted in the 'checklist' approach, which was seen as being the line of least resistance. Materiality is discussed further on pages 14-16.

Qualities of good financial reports

It was noted that there needs to be a focus on improving the quality of disclosures. The financial report should be 'fair, balanced and understandable'. It was also noted that a disclosure framework should provide guidance around cross-referencing between reports within the annual financial report with the aim of linking related information and eliminating duplication.

Improving accessibility of information

There was recognition that users have different needs and a number of respondents suggested that disclosures should be structured or layered so that the core information is separated from the detail. Some respondents suggested that detailed information could be placed in an appendix or website and technology can be used to provide a drill down facility. Disclosures around the environment, corporate social responsibility and human rights were highlighted as non-core by some respondents.

Respondents acknowledged that there may be legal and audit obstacles associated with some of these ideas but that these should not be insurmountable.

Role of technology

Many respondents commented on using technology to facilitate the communication of large volumes of data. Several suggested that standing data (i.e. disclosures which are unchanged year on year) should be placed online.

The role of the FRC's Financial Reporting Lab in encouraging experimentation and innovation was noted.

3 Calls to action

We recognise that improving disclosures is a journey. With that in mind, we have set out a series of calls to action for all parties to consider.

FRC

When we started our project on the disclosure framework, the IASB did not have a similar project on its agenda. We believe that the IASB, as an international body, should take the lead in the development of a disclosure framework. As part of our international influencing activities, we will continue to provide input to the IASB project.

The FRC also has a number of initiatives underway which will take forward some of the ideas from feedback received on this paper. These include:

- Narrative reporting[4] - we plan to publish new guidance on narrative reporting in the UK following publication of new regulations for a strategic report from BIS.
- Exploring methods for separating core information from detailed data
- Financial Reporting Lab – the Lab is taking forward the cutting clutter agenda which includes a project on accounting policies and technology enabled reporting.
- Materiality – as a regulator and we will continue to reinforce messages around materiality.

IASB

A number of action points for the IASB were identified in the Paper. Following feedback received on it, we would recommend that the IASB:

- Defines the boundaries of financial reporting.
- Develops placement criteria.
- Provides guidance on what materiality means from a disclosure perspective.
- Includes an explicit statement around disclosure of immaterial information in its framework.
- Reduces and defines the “magnitude” terms used in IFRSs, such as “significant”, “key” and “critical”.
- Updates IAS 1 so that presentation and disclosure requirements are clearly separated.
- Sets principles based disclosure requirements.

All regulators

We also believe that there are opportunities for:

- Further research on different types of investors, their needs and the purpose of an annual financial report.
- Building consensus between regulators to ensure that there is a shared understanding of the definition of users and the purpose of a financial report.
- Identification of data that can be placed outside the annual financial report, including further consideration of audit and legal implications.

[4] Referred to as management commentary or operating and financial review in some jurisdictions.

4 A roadmap for a disclosure framework

The Paper set out a roadmap for a disclosure framework structured around four questions:

1. What information do users need?

2. Where should disclosures be located?

3. When should a disclosure be provided?

4. How should disclosures be communicated?

Question 1 - Would a disclosure framework that addresses the four questions help address the problems with disclosures?

All those who responded to this question agreed that a framework that addresses these four questions would be helpful in addressing the problems with disclosure. Of the four questions, the one that generated the most comments was: "What information users need?" The responses to this question are considered further on pages 8 to 10.

A number of respondents highlighted that the IASB should take the lead in developing a disclosure framework as part of its Conceptual Framework project; we shared this view and saw the Paper as a means of influencing the IASB's work. When we started this project in 2010, the IASB did not have a disclosure framework project on its agenda. The IASB initiated its project on disclosures in December 2012 and, in consequence, we believe that this paper has achieved one of its aims.

5 What information do users need?

The Paper sets out a road map for a disclosure framework, which starts with the identification of users' needs.

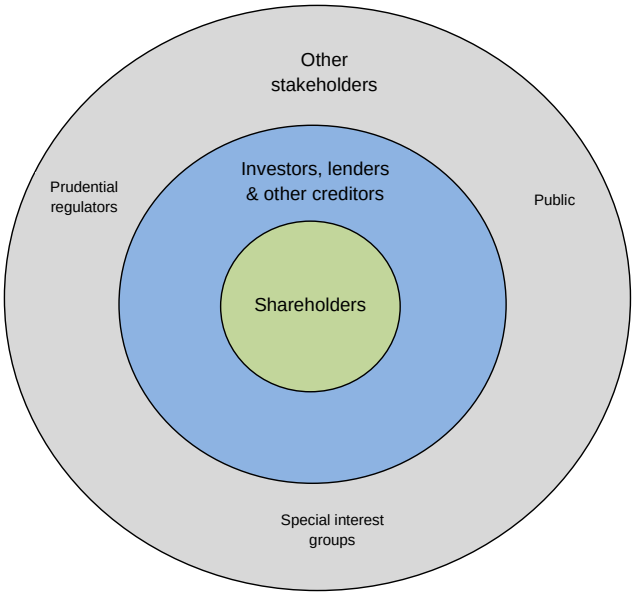
The Paper started by discussing who the users of financial reports are, concluding that investors are the primary users. It was noted that disclosures in financial reports needed to be focused on the needs of investors. This would assist in determining the information that should be included in a financial report, and the information that should be excluded.

The Paper also acknowledged that the information needs of users extend beyond the financial report.

Most respondents agreed that the information needs of a user will depend on the nature of that user and it is important to understand who the primary users of financial reports are.

Who are the users?

It was interesting to note that respondents had differing views of who the primary users of financial reports are.



Some respondents noted that it was important not to lose sight of the fact that financial reports are prepared for shareholders and that this should be their primary focus. This is a narrow definition of an investor as it is limited to equity providers.

Other respondents preferred a definition of users that was slightly broader, extending to capital providers. This is similar to the IASB definition which includes "investors, lenders and other creditors[5]".

[5] OB2 IASB's Conceptual Framework for Financial Reporting 2010

There seemed to be a consensus that financial reports were not primarily prepared for a wider stakeholder group including, for example, prudential regulators, special interest groups and the general public (illustrated in the grey shaded circle). A number of respondents commented that currently the financial report tries to meet the needs of too many different users and that it cannot and should not attempt to be "all things to all users".

Key takeaways:

The IASB has set out the objective of financial reporting and identified the users of financial reports. The responses to our paper have highlighted that there is a need to build consensus between regulators to ensure that there is a shared understanding of these concepts. Without this it will be difficult to overcome the problems associated with disclosure overload.

Disclosure themes

The Paper sets out a number of disclosure themes which identify the information needs of users that can be met by financial reporting: management commentary; corporate governance; unrecognised amounts; risks and uncertainties; disaggregation; and explanatory material.

Question 2 - Do the disclosure themes set out [above] capture the common types of disclosures that users need?

All those who responded agreed that the disclosure themes capture the common types of disclosures needed by users.

A small number of respondents noted that the key issue is not the themes as such, but the volume of disclosures. They point out that disclosures should only be provided when they are relevant to users. Some respondents linked the themes back to the need to have a clear definition of the primary user group.

Similarly, one respondent linked the themes to the purpose of the annual financial report, noting that these are complete if the purpose is to understand the financial statements but not if the purpose is to be a repository of information requested by regulatory bodies e.g. carbon emissions, human rights.

Other comments included:

- Disclosures that are not required by an accounting framework may nonetheless be useful for some users (e.g. non-GAAP measures).
- Standard setters need to consider whether standards meet the needs of the primary users.
- A call for more research on users' needs.
- Themes are considered to be a helpful starting point for discussions on placement including using them as a tool to segregate data that does not change from year to year and to encourage innovation.
- There is some overlap of the themes with integrated reporting.

Key takeaways:

Ensuring that disclosures are relevant to users is paramount and so there is scope to do further research into (a) users' needs and (b) the purpose of the annual financial report – whether it is to provide investors with information for making their resource allocation decisions and assessing management's stewardship; or a document of record.

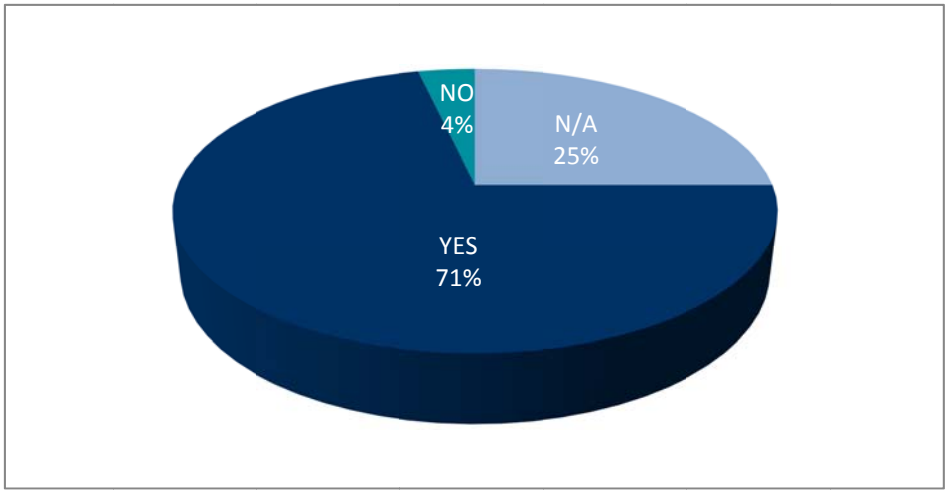
6 Where should disclosures be located?

Components of a financial report

The Paper identified three components of a financial report as management commentary, corporate governance and the financial statements.

These components are considered to be the first step in developing placement criteria.

Question 3 - Do you agree with the components of the financial report? Are there any other components that should be identified?



Most respondents believed that the components identified were comprehensive. One respondent considered that sustainability could be a fourth component. Another respondent, from Australia, disagreed with the components. They noted that the components of financial reports vary between jurisdictions and that Australian law does not consider management commentary and corporate governance to be part of the financial report.

One respondent, whilst expressing support for the components, noted that these should not be viewed as discrete parts. The component mind-set can lead to a lack of cohesiveness in financial reports, duplication and inconsistency. They considered that it would be better instead to view the three components as running throughout the annual financial report.

Conversely, some respondents commented that the components would lead to better structuring of financial reports, reduced duplication, clarifying the information in each component would ease navigation and improve comparability. One respondent suggested the key information could be identified within each component supplemented by detailed information.

A small number of respondents touched on how the components relate to integrated reporting including whether that would lead to different components.

Some respondents commented that the components were a helpful lead in to the placement discussion. In particular the idea of, moving away from the concept of 'one report' and presenting some information outside the annual financial report. Examples of the type of disclosures that respondents thought could be presented elsewhere were those that do not meet the objective of financial reporting and those that remain unchanged year-on-year. Respondents acknowledged that there may be legal and audit obstacles associated with some of these ideas but that these should not be insurmountable.

Key takeaways:

The components can be used as a basis for considering how information can be structured differently, including presentation of data outside the financial report.

Placement criteria

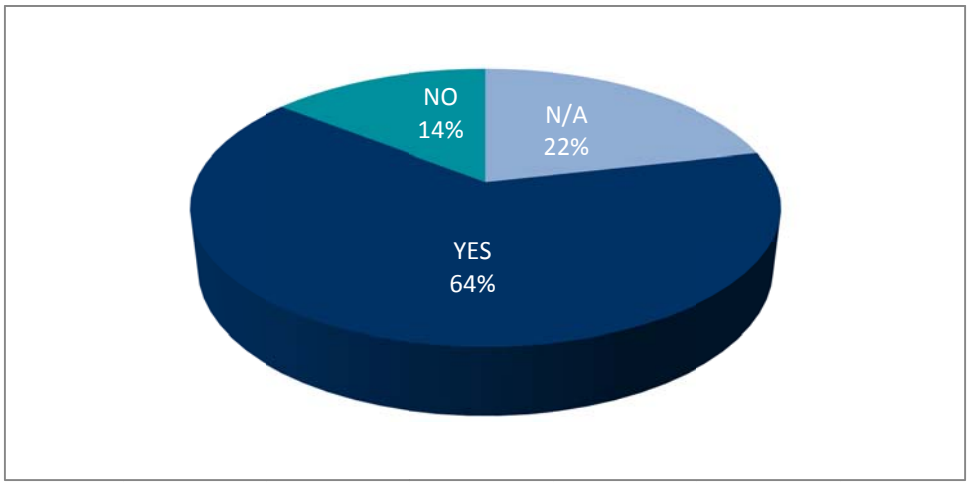
The Paper presented some ideas around placement criteria. These criteria are considered important as they provide a method of organising disclosures in a way that is more informative to users, eliminating duplication and improving cohesiveness and consistency. They could also be used to promote a more co-ordinated approach between regulators in setting disclosure requirements.

The placement criteria in the Paper were developed by identifying an objective for each component of the financial report.

Information would be disclosed in:

- Management commentary if it provides an investor with information that puts the financial statements into the context of the entity and its operating environment.
- The notes if it is essential to an understanding of the primary financial statements and its elements.
- Governance if it provides information about the responsibilities of the board in setting the company's strategic aims, supervising the management of the business and reporting to shareholders on their stewardship.

Question 4 - Do you believe that the placement criteria identified in this paper are appropriate?



There was general agreement that placement criteria are an important part of a disclosure framework. There was broad support for the placement criteria, including the idea of grouping together all risk information in, for example, a "risk report". Some noted that there was a need to clearly identify the boundaries of the components to eliminate duplication. Others, however, urged that placement criteria should be more flexible in order to allow entities to tell their own story in their own way. One respondent noted that the success of placement criteria will not only depend on getting the 'right' principles; it will also require co-operation by a number of parties.

The main concern raised by audit firms and accounting bodies was that there would be audit implications associated with moving disclosures to different parts of the financial report or online.

As noted in the feedback to the joint EFRAG/ANC/FRC discussion paper, a number of respondents expressed concerns about moving certain specific disclosures outside the notes to the financial statements, these included those in respect of related parties and post balance sheet events. Some of those respondents pointed to the need to include in the financial statements all the information that is necessary to provide a 'true and fair' view.

Key takeaways:

Placement criteria should be developed as part of the IASB's disclosure framework.

The ideas around placement can be developed further by considering placement of disclosures outside the financial report.

The audit implications of placement criteria remain a concern amongst the profession and more work needs to be done with auditors in this area.

7 When should a disclosure be provided?

The Paper discussed the concepts of proportionality and materiality.

A number of ways in which standard setters can address the issue of proportionality in disclosures, including simplifying existing requirements, principles based disclosures and differential disclosure regimes, were explored.

Whilst IFRSs clearly state that disclosures are not required if the information is not material, it was noted that materiality is being applied less robustly to disclosures than to recognition and measurement. IFRS clearly states that disclosure is only required if the information is material yet immaterial information is still being disclosed which can obscure relevant information.

The question of whether there was a need for various descriptors (e.g. “significant” and “key”) in IFRSs and company law to be explained was also raised.

The Paper concluded that there is a need for further guidance on how materiality should be applied to disclosures and went on to set out some ideas on how it could be applied to different components of the financial report.

Proportionality

Question 5 - How should standard setters address the issue of proportionate disclosures?

There were a number of consistent messages in the responses to this question.

Principles-based disclosure requirements

Most respondents called for principles based disclosure requirements, suggesting that lists of requirements drive “boilerplate”. Principles based disclosure requirements would allow preparers the flexibility to determine the level of disclosure that most appropriately reflect the needs of its users. A minority of respondents did, however, prefer an approach whereby a disclosure objective was supported by a list of minimum disclosure requirements, thereby ensuring a degree of comparability between individual entities.

Differential disclosure regimes

A number of respondents supported differential reporting regimes based on public accountability; others believed that size should be the differentiating criteria. Generally, there was limited support for industry specific disclosure requirements, although some noted that different disclosures for financial institutions may be appropriate.

Those that disagreed with differential disclosure regimes believed that the basis of differentiation would be arbitrary.

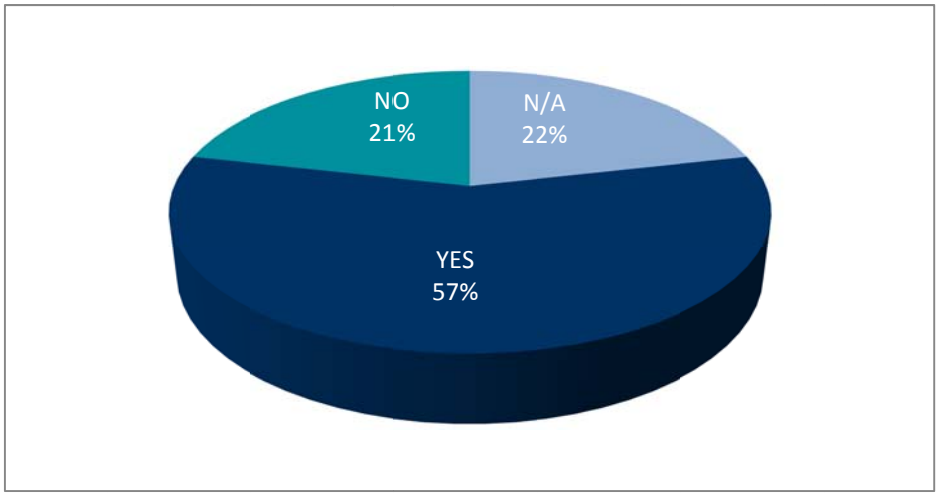
Cost benefit

There was a clear message that the costs of providing the information versus the benefits should be a consideration in standard setting.

Materiality

A small number of respondents suggested that proportionality and materiality are two sides of the same coin and that proper application of materiality would result in proportionate disclosures. Reinforcement of messages on materiality and proportionality from regulators such as the FRC's Corporate Reporting Review and Audit Quality Review were encouraged.

Question 6 - Do you agree with the framework for materiality set out in this paper? How could it be improved?



Respondents commented that the application of materiality to disclosures remains an area of difficulty.

57% of the respondents were in broad agreement with the framework for materiality set out in the Paper. One difficulty pointed out by several respondents was dealing with the fact that different users of the financial statements will have different interests and, therefore, different views about what may or may not be material.

Suggestions for areas where the framework could be improved were guidance on:

- the criteria used to make materiality judgements;
- the application of materiality to comparatives; and
- the application of materiality to items that are presented 'net'.

Respondents also commented that there was a need to place more emphasis in the framework on excluding immaterial information, which contributes to clutter, and a need for consistency between definitions used in accounting and auditing standards.

The responses to this question indicated that there is a role for the IASB to provide guidance on the application of materiality to disclosures within the disclosure framework.

21% of respondents did not agree with the framework for materiality set out in the paper. The reasons for this disagreement varied but included:

- a view that a framework for materiality is not required; and
- a disagreement over the use of a top, middle and bottom band of materiality suggested in the paper.

The use of different levels of materiality was a common point of disagreement, even with respondents who were broadly supportive of the framework for materiality set out in the Paper.

A number of respondents were clear that clarification of the various descriptors used in accounting standards (e.g. “significant” and “key”) would be helpful. A number of respondents also commented that behavioural changes are required and that the fear of challenge by regulators and lawyers remains a barrier to removing immaterial information.

Key takeaways:

There was a clear view that the identification of different levels of materiality was an undesirable approach to take in practice but that there is merit in clarifying the various descriptors that are used in IFRSs and company law.

In addition, there does seem to be a role for some guidance on the application of materiality, including the disclosure of immaterial information. There is also a role for regulators in reinforcing some of the messages around materiality.

The IASB are encouraged to set more principles based disclosure requirements as detailed requirements may make the application of materiality more difficult.

8 How should disclosures be communicated?

The Paper developed some principles for communication to improve the quality of disclosures. It suggested that disclosures should be: entity-specific; clear, concise, and written in plain language; and current. They should also explain the substance of a transaction.

It was also suggested that information provided in the financial report should provide a clear link between the entity's business, financial performance and position.

In the context of communication, the Paper also discussed alternative methods for communicating information including presenting disclosures outside the printed annual financial report.

Question 7 - Are there other ways in which disclosures in financial reports could be improved?

Respondents considered that the method of presenting information was as important as reducing its volume. Among the ideas for improving communication suggested by respondents were:

- Exploring the role of technology, including moving some "voluntary" information out of the annual financial report and placing it on-line.
- Providing some information in an appendix to the annual financial report.
- Better signposting, organisation and linkage within the annual financial report.
- Streamlining disclosures so that important information is given prominence.
- Shorter accounting policies with a greater emphasis on how they have been applied by the entity.
- Bring together all parties involved in drafting the annual financial report to help facilitate a more joined-up approach to the financial reporting process.

Some respondents commented on how regulators and standard setters may be able to help address the issues in question. Comments included:

- Disclosures should not compensate for deficiencies in measurement or presentation principles.
- Standards should take a principles based approach, in general and in respect of their disclosure requirements specifically, to provide preparers with flexibility.
- A general reduction in the volume of disclosure requirements.
- New guidance on the application of accounting standards and other laws and regulations should encourage conciseness.

Appendix - List of respondents

	Respondent	Type	Country
1	André Pouw	Other	Netherlands
2	Westworth Kemp	Other	Australia
3	Legrand Electric Ltd	Preparer	UK
4	Institute of Chartered Accountants in England and Wales (ICAEW)	Accounting body	UK
5	Corporate Reporting Users Forum (CRUF)	User representative	International
6	Kingston Smith	Accounting/Audit firm	UK
7	CPA Australia and Institute of Chartered Accountants Australia	Accounting body	Australia
8	Makinson Cowell*	Other	UK
9	The Association of International Accountants (AIA)	Accounting body	International
10	Standard Chartered	Preparer	International
11	PwC	Accounting/Audit firm	UK
12	BDO	Accounting/Audit firm	UK
13	Institute of Chartered Accountants Scotland (ICAS)	Accounting body	UK
14	Grant Thornton	Accounting/Audit firm	UK
15	PKF	Accounting/Audit firm	UK
16	Ethical Investment Research Services (EIRIS)	Other	UK
17	Deloitte	Accounting/Audit firm	UK
18	Association of Chartered Certified Accountants (ACCA)	Accounting body	International
19	British Venture Capital Association (BVCA)	User representative	UK
20	Institute of Chartered Secretaries and Administrators (ICSA)	Other	UK
21	Association of Investment Companies (AIC)	User representative	UK
22	Baker Tilly	Accounting/Audit firm	UK
23	Quoted Companies Alliance (QCA)	User representative	UK
24	South Western Society of Chartered Accountants	Accounting body	UK
25	Ernst & Young	Accounting/Audit firm	UK
26	The City of London Law Society	Other	UK
27	BP	Preparer	UK
28	Chartered Financial Analyst Society (CFA)	User representative	UK

* Only one respondent, a capital markets advisory firm, provided comments on the questions (8 to 11) for users set out in our paper.

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