Thinking about disclosures in a broader context

A Discussion paper issued by the Financial Reporting Council

Comments from ACCA to the FRC
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ACCA welcomes the opportunity to comment on the matters raised in the FRC’ s discussion paper. The ACCA Global Forum for Corporate Reporting has considered the matters raised and their views are represented in the following.

SUMMARY

ACCA supports the FRC discussion paper (DP) as a helpful contribution to the global issue of disclosure. We have supported the IASB developing a disclosure framework as part of its new agenda to achieve proper balance on disclosure, simplification potentially and greater consistency of disclosures within the IFRS as a whole. While there was a certain overlap with the EFRAG discussion paper on the same subject this DP has been able to extend the thinking beyond the financial statements.

As a contribution to developing a disclosure framework the DP is adopting the right approach. We agree that improving disclosures needs to be addressed both in how the standards are written by IASB, but also in the quality of the application by preparers, auditors and the enforcement regulators. There is a great deal that could be done to improve the presentation of financial statements even before any changes to IFRS were implemented – in other words much of the scope for improvements in disclosure is about how IFRS are used, not in how they are written.

However the evidence and case for a disclosure problem in IFRS that must be addressed merited more space than this DP provides. Also the depth and extent of disclosures on any one issue that should be required might have been further addressed.

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The DP rightly considers the annual report as a whole and the criteria which should determine where disclosure items should be 'placed'. However any practical implementation of any proposals must recognise that the degree of standardisation and compulsion about disclosure in financial statements as compared to management commentary for example may be very different. In that context we do not agree with the identification of related party transactions and post balance sheet events as not appropriate for the financial statements.

We very much support that disclosures should be proportional and that different disclosure regimes are appropriate for unlisted entities and subsidiarie.

Further exploration of the guidance on materiality is needed for disclosures as well as for other issues.

SPECIFIC COMMENTS

These are set out below and in response to the specific questions raised for comment.

Proposed responses to FRC's questions

Q1. Would a disclosure framework that addresses the four questions identified help address the problems with disclosures?

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Yes. A disclosure framework should be able to help deliver more coherent and consistent approach to setting requirements. It should also help preparers and others with an approach to applying the disclosure requirements which will concentrate on those that are most important to improve the communication between preparers and users of the reports.

All of the questions are relevant. A question less covered in the DP is to what is the appropriate extent and depth for disclosures to be required or provided? Also given the scope, how should the disclosure requirements of interim reports be set as compared to full annual reports?

While we agree that the quality of the disclosures required and the disclosures provided could be improved and could well be reduced, we do not think that the DP details sufficiently the current disclosure problems or assesses their impact. To say on page 4 that "Financial reports have become a disjointed collection of disclosures" seems to be an overstatement of the issue. To the extent that the DP intends to encourage IASB to take on a disclosure framework project, the importance of such a project needs to be better justified in the context of competing demands on the IASB's agenda.

Q2. Do the disclosure themes set out on page 16 of this paper capture the common types of disclosures that users need?

Yes.

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Q3. Do you agree with the components of the financial report as identified on page 20? Are there any other components that should be identified?

Yes a division into management commentary, corporate governance and financial statements seems a helpful basis to begin with. The development of integrated reporting may lead to different content elements, but some of these might be said to be subsumed within management commentary. These three components capture the main drivers behind the disclosure of information – the more standardised financial statements, the more "through the eyes of management" commentary and the stewardship-related governance disclosures.

Q4. Do you believe the placement criteria identified in this paper are appropriate?

There are two related assumptions behind the proposed placement criteria which are not given sufficient discussion.

Firstly financial statements need not be considered as a stand-alone document, but have to be seen as a component of a larger set of reports which the DP calls the financial report. Secondly the other components (management commentary and governance) would be mandatory requirements in the same way as the financial statements. We are not sure that those two assumptions will always hold.

We are not satisfied that even making the assumptions above, the placement criteria will always produce a sensible answer. One of the distinguishing characteristics of the management commentary (MC) as opposed to the financial statements (FS) is that the first allows a

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“through the eyes of management” approach whereas the latter is a more standardised and comparable approach to reporting the performance and financial position of the entity. This would be undermined by for example including non-GAAP measures (such as EPS variants) with equal prominence in the FS and including post balance sheet events in the MC. On related party disclosures these seem as much about the truth and fairness of the numbers included in the FS not being at fair value and at arm’s length, as about governance. Indeed post balance sheet event disclosures are also warning users that an assumption that the FS represent the best indicator to current performance and position may not be justified.

Q5. How should standard setters address the issue of proportionate disclosure?

It seems reasonable to begin with where we are. Currently standards such as IFRS include recognition that the FS of listed or public interest entities need a level of disclosure that may not be justified for others where the users of the accounts may have different concerns – hence full IFRS as compared to IFRS for SMEs. In our view all listed companies of whatever size should be required to meet the same disclosure requirements.

Equally there may be certain presentation and disclosure issues which may not be very meaningful or that can be justified in terms of cost/benefits, when looking at the financial statements of a subsidiary where the consolidated accounts of the group are equally available. These seem two proportionality dimensions to consider.

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Q6. Do you agree with the framework for materiality set out in this paper (pages 54 and 55)? How could it be improved?

The framework is presented helpfully as a decision tree. However the more detailed factors set out in the EFRAG paper might be incorporated here. For example in considering when a roll forward should be provided, the nature of the balance needs to be taken into account as it may not be helpful for working capital balances for example. The framework should make clear whether the movement should be judged net or gross.

The framework might also address the question of whether full disclosure is needed where an item was material in the comparative period, but not in the current period.

Q7. Are there other ways in which disclosures in financial reports could be improved?

We think that the main issues have been touched on by the DP.

Other comments

We are not sure that the term 'financial report' is ideal. The meaning in the definition is clear enough, but the scope will clearly include much non-financial information. In that regard we are not clear what the box about non-financial information on page 17 was intended to mean. Is it to be taken as a scope exclusion for the DP? That would be a mistake in our view. Any disclosure framework ought to cover non-financial information as well as financial.

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The different levels of disclosures on pages 33 and 34 may not be a very helpful approach. There should be the one definition of materiality, though of course in presenting the information regard should be had for giving prominence to the most significant disclosures. Multiple layers proposed on page 34 or the bullet points on page 35 engender more complexity and application problems than they might help.

We agree that in setting regulations some consistency in use of terms to denote a level of significance would be helpful and we do not think that is currently in place even within one system of standards such as IFRS. Indeed IFRS seem to be adding more shades of meaning – for instance in the leasing proposals the level 'more than insignificant'. The problems these create on translation into other languages only highlight the issue. However we are not sure that the ranking proposed on page 35 is the right answer for standard setting or when applying the standards. Logically is everything which is not significant, insignificant? How is the distinction between 'not material' and 'immaterial' to be explained?

The meaning of the final paragraph on page 33 might be clarified with an example.

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