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31 January 2013

Dear Deepa

FRC Discussion Paper: Thinking about disclosures in a broader context

We are pleased to have the opportunity to comment on the discussion paper. We support the work carried out by the FRC and others to provide input to the debate on how the quality and effectiveness of disclosures in financial reports can be improved. We agree that it is likely that this would be assisted by the development of a Disclosure Framework which sets out clear principles to be applied by preparers of financial statements, and by standard setters and other regulators when establishing new and amended disclosure requirements for financial reports.

Our overall view is that financial reporting within annual reports has become overly complex and is in need of simplification to enable better user understanding. As was noted in the BIS consultation on the strategic report last year "Annual reports are shareholders' key tool for holding companies to account. Without transparent and useable reports shareholders cannot do this, and the effects may be widely felt."

We agree that the objective of financial reporting should be to give users the information they require to make informed financial decisions and that a company's financial report must not become a catch all for areas not related to financial reporting.

The IASB has recently released highlights of a survey conducted on financial information disclosures[1]. Those highlights note that improvements were required across all parts of the annual report, and not just the financial statements; not enough was being done to exclude immaterial information (disclosure overload); users had to sift through large amounts of data; and action was required from standard setters, preparers, auditors and regulators. These issues have all been raised in the discussion paper.

Our BDO network responded to EFRAG on the Discussion Paper - Towards a Disclosure Framework for the Notes. We enclose a copy of that response for your information.

[1] http://www.ifrs.org/Alerts/PressRelease/Pages/Joint-effort-needed-to-tackle-disclosure-problem.aspx

Questions

1. *Would a disclosure framework that addresses the four questions identified below help address the problems with disclosures?*
   - *What information do users need?*
   - *Where should disclosures be located?*
   - *When should a disclosure be provided?*
   - *How should disclosures be communicated?*

We believe that a disclosure framework that addressed these issues in relation to the financial report would be helpful. We agree that the IASB should take the lead in developing such a disclosure framework as part of the Conceptual Framework project. The recently released highlights of an IASB survey conducted on financial information disclosures underlines the need to address the problem. The highlights note that:

- over 80 per cent of respondents agreed that improvements could be made to the way financial information is disclosed. Half of those respondents felt that such improvements were required across all parts of the annual report, and not just the financial statements;
- most preparers of financial statements identified the primary problem as disclosure requirements being too extensive with not enough being done to exclude immaterial information—which has been referred to as disclosure overload;
- many users of financial statements felt that preparers could do more to improve the communication of relevant information within the financial statements, rather than leaving users to sift through large amounts of data; and
- a range of views on the underlying causes of the problem was identified. Some respondents felt that more could be done to improve the way in which accounting standards are set out. Others expressed concerns that preparers, auditors and regulators are approaching financial reporting as an exercise in compliance rather than as a means of communication.

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

We agree that the disclosure themes on page 16 and 17 capture the common types of disclosures that users need. We understand users as being investors requiring information that is useful in making their resource allocation decisions and assessing management's stewardship as noted on page 14 of the discussion paper.

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

We agree with the three components of the financial report outlined on page 20, the Management Commentary, Corporate Governance and Financial Statements.

4. *Do you believe that the placement criteria identified in this paper are appropriate?*

We believe the placement criteria are appropriate as a starting point for discussion. As noted in our Global response to the EFRAG Discussion Paper, we have concerns about excluding non-adjusting balance sheet events from the notes to the financial statements. Page 27 of the discussion paper gives as an example of a disclosure in the management commentary under the first placement criteria, the destruction of a major production plant by a fire after the balance sheet date. Arguably such a disclosure would also be required in the notes to the financial statements applying the second placement criteria as it is essential to an understanding of the primary financial statements and its elements (page 21) and would assist users to make judgments on the sustainability of reported profits and cash flows (page 23).

5. *How should standard setters address the issue of proportionate disclosures?*

We agree with the two main drivers for a proportionate disclosure regime noted on page 31. Namely the relevance of the information contained in the disclosure requirement for users of the financial reports and the cost of providing the information being justified by the benefits to users.

Publishing standards that include a specified list of detailed disclosures can lead to a boilerplate mentality with detailed disclosure being made in the year of adoption and thereafter being continued without challenge. We would support an approach that identified disclosure objectives and then supplemented this with a framework of information that might be disclosed to meet those disclosure objectives. Preparer's would then need to exercise judgment in identifying the disclosures relevant to achieving the objectives. However we also note that this may require a change in "culture" for some preparers. The recent CASS Business School survey on accounting for asset impairment[2] noted "Compliance with impairment disclosures requiring greater managerial involvement in making discretionary reporting choices (high effort) is lower than compliance with low effort disclosure requirements, revealing a tendency to use boilerplate language."

We support a differential disclosure regime based on whether or not an entity is publicly or privately owned. That is whether or not the entity's equity or debt is publicly traded.

We already have a distinction in UK GAAP and the EU Directives based on size with small companies able to adopt the FRSSE and subject to reduced requirements in legislation. To the extent that this reflects the fact that such companies are unlikely to enter into certain "complex" transactions this is not a matter of concern. However, it could be confusing to users if companies apparently adopting a common GAAP were able to account for and disclose particular material transactions in differing ways.

Industry specific disclosure requirements should be avoided if possible. However, it may be that in some instances users in certain sectors, such as banking, may identify additional disclosures that are needed for that sector and which may not be appropriate to other sectors.

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

We agree that there is a need to discuss materiality in relation to disclosures. However we believe that this needs to occur within a discussion on materiality generally and not separately

[2] Accounting for asset impairment: a test for IFRS compliance across Europe A research report by the Centre for Financial Analysis and Reporting Research, Cass Business School

as part of a disclosure framework. All parties (users, regulators, standard setters, preparers and auditors) need to have a shared understanding of materiality.

As regards the framework for materiality set out on pages 54 and 55. We agree that it is useful as a high level indication of the framework.

Materiality is both quantitative and qualitative. A"low value" line item might still be material as it is risky, subject to measurement uncertainty or is the net of two "material" items (such as net surplus/ deficit in a defined benefit scheme).

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

The 2011 BIS consultation on the future of narrative reporting proposed that companies should be able to include material in the Annual Directors Report (for example information on policies and procedures) by cross reference to information published elsewhere (for example on the company's website). We would agree that it makes sense to exclude information from the annual report and accounts which is in essence standing information and make it available in another format. However there need to be appropriate safeguards in place to ensure that this standing data remains up to date should it only be available on the company's website. We are assuming that the information on the website is not subject to audit. If it was to be audited consideration would also have to be given to the point in time at which it is audited and the process for updating this given that one of the benefits of publishing on a website is that information can be updated frequently. In addition it must be possible to identify statutory or regulatory information at a particular point in time and this must remain unchanged to ensure there is a historic record. However information required by shareholders on a real time basis could be more dynamic and subject to change.

We would be very happy to discuss our response to this consultation with you should you require. Please contact Pauline McGee (on 020 7893 3873 or at pauline.mcgee@bdo.co.uk) should this be the case.

Yours faithfully

BDO LLP.

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Partner
For and on behalf of BDO LLP