

Thinking about disclosures in a broader context

Submission from The Association of Investment Companies (AIC)

The Association of Investment Companies (AIC) welcomes the opportunity to respond to the FRC's discussion paper setting out a suggested roadmap for a disclosure framework.

The AIC is the trade body representing some 330 investment companies, managing assets of around £80billion. Our members are closed-ended investment companies, the vast majority of which are listed on the London Stock Exchange. Their business is to invest in a diversified portfolio of shares and securities, property and other assets to provide returns for their shareholders. Investment companies have a keen interest in the disclosure framework both in terms of their own corporate reporting and the information published by investee companies.

The FRC's discussion paper is a useful starting point for a debate on improving the quality of financial reporting. The AIC has long been concerned about the increasing length and complexity of annual reports. We **agree** with the main concerns identified by the FRC, namely that:

- financial reports have become an increasingly disjointed collection of disclosures driven by different regulatory requirements;
- disclosures have become increasingly about compliance than helpful shareholder communication; and
- disclosure failures arise because of poor quality disclosures and the overall volume of information. Both factors risk diminishing the value of reporting.

Framework

We **support** the FRC's initiative to "*develop a coherent framework within which standard setters and other regulators can set disclosure requirements and preparers and auditors can apply them*". The FRC should seek to encourage a more consistent approach to reporting by all parties involved, with a focus on improving the quality of information received by the end user.

Securing the commitment of international bodies to this framework may be difficult, at least in the short to medium term. In the first instance, we **recommend** the FRC focuses on gaining support from relevant UK parties. This will then form a foundation on which to widen support abroad. Even if international backing can only be obtained on individual elements of the framework, this will still represent significant progress towards the desired goal.

Purpose of financial reports

We agree that there is a need for disclosures contained within financial reports to be 'refocused on their purpose'. There should be a concerted move away from the belief that it is appropriate to disclose every conceivable piece of information about the company in the annual report. Disclosures in the financial report need to be more relevant, succinct and organised.

We do **not agree** with the purpose set out in the paper ie that disclosures should provide investors with "*information that is useful for making their resource allocation decisions and assessing management's stewardship*". Final reports should focus on a company's performance, financials and other key metrics. An investor's resource

allocation decisions are important to the investor and not the company. 'Public accountability' issues such as environmental factors, corporate social responsibility and human rights should not form a core part of the financial report. Instead such disclosures, unless critical to investment performance, are better suited to website disclosure.

Placement criteria

'Placement criteria' or some form of high-level principles determining when information should be located in the annual report would be helpful. Their value would be maximised if they were consistently used by standard setters when developing disclosure requirements. This might deter the piecemeal approach which currently exists. Its success will depend not only on developing the 'right' principles but also on the cooperation, support and ongoing compliance by a wide range of parties.

Components of a financial report

Carving the financial report into four distinct components, with a clear description of the type of information that each should contain, will help to improve layout, avoid repetition and cross-referencing, and improve consistency between different financial reports. Where this results in the need to re-order certain items in the short term, the administrative and financial cost of doing so will be more than outweighed by the benefits to the end user.

Proportionality and materiality

The emphasis on proportionality and materiality is welcome. This will help to ensure disclosures are relevant and targeted to the needs of users, and reduce the propensity for 'boilerplating'. We also agree with the FRC's concern about inconsistencies in the terminology used by standard setters.

Practical issues

Practical suggestions such as the use of glossaries and tables, and moving disclosures which remain unchanged year-on-year online, will also make financial reports more user-friendly. We **recommend** that the proposals go further and push for a move online of any material currently disclosed in the financial report which is not key to the year under review. For example, this might include the new disclosures on human rights issues.

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