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For the attention of Deepa Raval
The Financial Reporting Council
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Dear Sirs

Discussion Paper: Thinking about disclosures in a broader context

We are pleased to respond to the Discussion Paper on disclosures which was published by the FRC in October 2012 and forms part of the FRC's ongoing initiative on cutting clutter in annual reports. We have responded to the questions posed in the Discussion Paper in turn below, but also have some overall comments.

Like the previous Paper on cutting clutter in annual reports, this Paper does not focus on the different disclosure requirements for different types of companies. The amount of disclosure (both in the financial statements and in surround information) included in the accounts of a large listed company such as HSBC, preparing its accounts under IFRS, is vastly greater than that included in the accounts of a medium-sized owner managed business preparing its accounts under UK GAAP. Indeed, any move to streamline or reduce disclosure requirements for listed companies can only be achieved with the support of the IASB.

We would reiterate that combating clutter and over-disclosure in the financial statements is one thing but doing so in the annual report as a whole is quite another. Larger companies continue to include significant amounts of analysis and information in the front end of their annual reports and it is not uncommon for this information to take up almost as much – or indeed as much – of the annual report as do the financial statements. Even for smaller listed or AIM companies such as those audited by the Firm, much of the annual report is taken up by the front end information.

Some of this information is provided as a result of legislation or regulation (for instance the business review information required by law to be included in the Directors' Report, and corporate governance information) but often much of the information presented is voluntary, and may be included for example to strengthen brand awareness or as a marketing tool. Because of this we continue to believe that it will be hard to cut down the size of annual reports significantly without considering whether there is scope for some or all of this information to be presented separately, for instance on a website or alternatively in an appendix to the annual report so that the financial statements themselves are given greater prominence.

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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?**

The simple answer to this is yes; a disclosure framework that covered these four areas would be helpful in providing guidance to companies on what, and how much, information they need to disclose in their financial statements. However getting to a workable solution is not a straightforward exercise.

Taking the first question as a starting point, the information that users need essentially depends on the user. There are many different users of financial statements and the needs of one user (for instance an institutional investor) will not necessarily be the same as the needs of other users (for instance employees or providers of finance. However, it is important not to lose sight of the fact that financial statements are prepared for the shareholders (whether these are institutional investors or not) and the auditors express an opinion to shareholders; they are not specifically prepared for other users and indeed the auditor owes no duty of care to any other users.

Again, the users of the accounts of a large listed company are likely to be very different from the users of the accounts of a medium-size owner managed business, which may be limited to the company's shareholders, management (who are often the same people) and bankers. It will be very difficult to determine a 'one size fits all' approach to a disclosure framework other than by permitting exemptions for certain sizes of company as is currently the case for accounts prepared by small companies.

We have covered the other three areas in the remainder of our responses.

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

The disclosure themes on page 16 generally appear sensible and indeed are all present in the disclosures currently required by financial reporting standards, company law and regulation. In our view the key issue is not so much the themes of disclosures as the sheer amount of disclosure and whether it is all absolutely necessary.

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?

Identifying the components of the financial report as management commentary, corporate governance and financial statements is in our view accurate and we do not think that any other components need to be identified. However we would note that detailed corporate governance information is not currently required to be disclosed by many companies, except perhaps incidentally for instance where disclosed as part of the expanded business review. We would also note that much of the management commentary may consist of information included voluntarily that could arguably be presented elsewhere (for instance, as noted above, on a website or in an

appendix to the annual report) but it would seem unreasonable for companies to be prevented from including such information.

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

Whilst the placement criteria identified in the Paper initially appear to be reasonable we believe there are a number of issues with the detail, not least what information is or is not subject to audit as a result of changing where such information is disclosed. Experimentation in this area is also constrained by legal requirements such as the information which is required by law to be disclosed in the Directors' Report and it would appear difficult to require for information to be disclosed under 'Corporate Governance' when most companies are not required to disclose such information.

Generally, we do not agree that information currently included in the notes (for instance in respect of related party transactions or post balance sheet events) should be moved to the front end of the annual report as it will then not be subject to audit unless the scope of the audit is extended further to include the surround information, which we do not believe is either necessary or desirable. We also do not believe that information which is currently included in the notes, for instance the accounting policies, should instead be disclosed on a website; although changes to accounting policies may be more important to users in a specific year, the accounting policies used will still be relevant to users in determining whether the accounts have been prepared in accordance with the relevant financial reporting framework. We would note, as we did in our previous letter, that IAS 1 only requires the disclosure of 'significant' accounting policies.

Where non-GAAP measures that are linked to the primary financial statements are included in the notes, this increases the amount of information subject to audit as the information included in the notes is specifically covered by the audit report. Companies can and do already include non-GAAP information (for instance additional earnings per share figures or EBITDA) in their financial statements and whilst this constitutes voluntary information required by IFRS to be reconciled to GAAP measures, it nonetheless is subject to audit purely by means of its inclusion in the financial statements or the notes.

We totally disagree that related party disclosures should be given in the corporate governance section of the financial report rather than in the notes to the accounts. Related party disclosures are usually considered to be 'material by nature' and therefore users are likely to want them to be subject to the independent scrutiny of an audit, which would not be the case if they were relocated unless they were specifically made subject to audit (for instance in the same way as the part of the Directors' Remuneration Report subject to audit). Also as noted elsewhere unlisted companies are not currently subject to corporate governance requirements or required to disclose corporate governance information, although some do so voluntarily. The alternatives would appear to be either (a) making other companies subject to such requirements or (b) related party disclosures dropping out of their financial statements entirely; neither of these would be appropriate in our view. Indeed there could be an argument that without related party disclosures the financial statements may not give a true and fair view.

Similarly we do not agree that disclosure of non-adjusting post balance sheet events should be included in the management commentary rather than the notes. Whilst we agree that these are unrecognised because they relate to conditions that did not exist at the balance sheet date, they nonetheless are disclosed in the financial statements precisely because of their importance to users of the financial statements and indeed their potential financial effect (including, in some cases, their effect on the appropriateness of the going concern basis of preparation). Ensuring that such disclosures are subject to audit seems to us to be necessary and this is best served by locating them in the notes to the accounts, particularly given there is nothing to prevent the

directors giving additional commentary in the directors' report or other surround information where they believe this is beneficial to users.

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

This is a difficult question and one which we do not believe is entirely down to standard setters to address.

We have been pleased to note the FRC's ongoing commitment to reducing the disclosure burden on companies, for instance the focus in the FRRP's 2012 Annual Report on ensuring that the disclosures made in the financial statements are those that are genuinely material or important – and reiterating that immaterial disclosures are not required. The issue is that companies that are subject to public or regulatory scrutiny, and particularly those that have previously been subject to FRRP enquiry, may well continue to include immaterial disclosures in order to err on the side of caution and avoid any risk of censure – over-disclosure generally being thought a safer option than under-disclosure. It is vital that monitoring bodies – not just the FRRP but also the Audit Quality Review - continue to emphasise that disclosures should be proportionate in their publications and indeed in their dealings with individual companies and firms.

Standard setters should, in our view, undertake a thorough review of extant financial reporting standards and determine where disclosures can be streamlined or for that matter dropped entirely. Each Standard should also specifically emphasise that disclosures are not required if they are not material to the entity. It may also be helpful to consider specific derogations for certain types of company – for instance requiring certain disclosures only if the entity is publicly traded on a major exchange and in addition meets certain size criteria. This would exempt smaller publicly traded companies, for instance in the UK smaller AIM companies, from some of the more onerous disclosure requirements.

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

We are generally in agreement with the concept of a framework for materiality although we do not agree that a different level of materiality is required for the primary statements compared to the notes. We agree that the wide range of terminology used in both IFRS and company law to describe similar concepts is potentially confusing and we would agree that this is an area the IASB could usefully consider. Indeed we made the point in our response on 'Cutting Clutter' that debate over the relative importance of the various terms used in IFRS and Company Law should be encouraged.

The main issue with determining a framework for materiality is that materiality may mean different things to different users of the financial statements. We would quote IAS 8 paragraph 5 which states:

Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

This extract clearly states that it is not merely the size of the item (or disclosure) but its nature that influences whether it is, or is not, material and there are a number of disclosures which users often consider material by nature, for instance related party transactions as noted above. However,

different users may well have different views on what is material by nature. The Paper refers again to share-based payment disclosures and whether the information required to be disclosed by IFRS 2 is genuinely useful to users, however as stated in our response on 'Cutting Clutter' it could be argued that such disclosures are material by nature because they would be significant to those holding investments particularly the share options or warrants in question. There may however be scope to streamline such disclosures as part of the overall review of disclosures referred to above.

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

In our view, the key issue is ensuring that disclosures are streamlined such that the information which is genuinely material (whether by size or nature) and meaningful to the users of the accounts is presented with sufficient prominence that it is not obscured by detail. We also believe as noted elsewhere in this response and in our previous response on 'Cutting Clutter' that there is scope for some of the surround information currently presented at the front of the annual report to be relocated, either to a website or to an appendix to the financial statements, which would help ensure that key financial information such as the Statement of Financial Position or Statement of Changes in Equity is not lost in the middle of the report.

We hope that this response is useful to you. If you have any questions, please contact either Tessa Park or Tim Gonzaga.

Yours faithfully

Kingston Smith LLP