Deepa Raval
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Dear Deepa,

The Financial Reporting and Analysis Committee (FRAC) of The Chartered Financial Analyst Society of the UK (CFA UK) welcomes the opportunity to respond to the Financial Reporting Council (FRC) discussion paper 'Thinking about disclosures in a broader context'.

CFA UK represents more than 10,000 investment professionals working across the financial sector. For advocacy purposes in the field of financial reporting, these members are represented by the Financial Reporting and Analysis Committee.

<u>Thinking about disclosures in a broader context</u>
Financial Reporting and Analysis Committee (FRAC),
CFA Society of the UK
Response to FRC paper 'Thinking about disclosures in a broader context'

The FRAC welcomes the chance to respond to this paper. Our responses have been informed by committee meetings and consultation with our members.

Overall
We support the FRC's proposal to focus disclosures on users, as set out in the IASB's Conceptual Framework. This means that the objective of financial reporting is clear:

> "to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity."

Furthermore, we agree with the FRC on the need to remove clutter and duplication of information. However, the investment professionals we represent are less concerned about the complexity of financial reports than the FRC document assumes: often this reflects the complexity of the companies themselves.

Different users find different pieces of information relevant. We are accustomed to selecting what we need and recognise that these needs vary according to investment purpose and approach. Consequently we do not believe that disclosures have decreased in relevance.

We are more concerned about the provision of consistent, comparable and unbiased information. Criticisms of the approach sometimes taken in management commentaries include that there is too much positive spin on information and that different approaches to measuring performance make comparisons of companies difficult. The 10-K report required by the SEC was cited as a good example of an approach that is helpful to analysts because of the more standardised framework, ensuring key areas of investor interest are covered, and the more neutral language.

1. What information do users need?

We welcome the FRC's focus on investors in the report. Clear and detailed financial statements are in the interest of both investors and companies as the former will only invest if they understand the business and its risks. Academic research has shown that investors are unwilling to invest in companies that disclose little information.

In addition, context for companies is important as it enables generalist investors to understand quickly their business strategy as well as potential risks.

(i) Do disclosure themes capture the common types of disclosures that users need?

We agree with the three broad areas that the FRC outlines as being the main components of a financial report: management commentary, corporate governance and primary financial statements. However, some users have expressed concern that information may be switched from the notes to the management commentary, such as assumptions and sensitivities for balance sheet valuations, and GAAP and non-GAAP reconciliations. Since we regard the audited notes as having a higher degree of rigour and neutrality, we would not want a narrowing of the scope of disclosure here on valuation assumptions, reconciliations or other information that reads across to the primary financial statements.

There is scope for better use of the notes, for example on segment reporting (the subject of an IASB post-implementation review), where a more detailed breakdown of financial performance and position would be helpful to aid sum-of-the-parts valuations.

We have concerns that companies put positive spin on the management commentary, rather than presenting a neutral view. We would welcome measures to minimise this.

(ii) Do you agree with the components of the financial report? Are there any other components that should be identified?

We agree with the components of the financial report.

2. Where should disclosures be located?

1. We do not think that location is as important as the principle of providing the information users need i.e. the quality and quantity of that information. Most investors use electronic versions of financial reports because it is possible to search for relevant information more quickly. It is, of course, a good thing, as the FRC suggests, to have disclosures presented in a logical manner, with information on particular issues grouped together, as far as possible, and with comprehensive signposting to help users find what they want.

2. We think that the statement on disclosure: "A disclosure is placed in the notes when non-disclosure might make the primary financial statements misleading" is not "so broad", with the implication that it is too broad. We believe that if companies are

not sure whether an omission would be misleading or not, they should err on the side of disclosure.

3. The management commentary should not be prepared “in contrast” with the primary financial statements. The commentary should be as neutral as possible. Even forward-looking statements, which are welcome in the commentary, can be presented in a relatively neutral manner with the relevant risks outlined.

4. We agree that risk reporting should be brought together. The accounting standard ‘IFRS 7: Financial Instruments’ allows risk disclosures to be placed outside the footnotes. Since this is an accounting standard, we can assume that it has been thoroughly audited and it could be used it as a precedent. We encourage the FRC to refer to the paper by the Enhanced Disclosure Task Force (EDTF), ‘Enhancing the Risk Disclosures of Banks’ (Oct 2012), which focuses on areas where investors seek better information about banks’ risks and makes recommendations to achieve that goal.

Do you believe that the placement criteria identified in this paper are appropriate?
We believe that the placement criteria are appropriate but have a few comments.

Firstly, investors know that important information is in the footnotes, with some reading financial reports from back to front. Consequently placing information in the footnotes will not make it less important to investors.

Secondly, scope for improvement lies in gathering similar information into categories, with better signposting and links between the different components of a report. For instance, the management commentary could point out areas of importance in the footnotes.

3. When should a disclosure be provided?
How should standard setters address the issue of proportionate disclosures?
We agree with the measures outlined by the FRC. However, most of our members analyse and invest in larger companies thus we do not tend to comment on SMEs.

Do you agree with the framework for materiality set out in this paper? How could it be improved?
We believe that the definitions for materiality laid out on pp.32-33 are fine. Furthermore, we believe that current guidance on materiality is consistent and reasonable. However, we are cautious about the FRC’s view on what constitutes “clutter” in this context. While we sympathise with removing duplication of information, users have different views on what is relevant in financial reports. We would prefer companies to err on the side of over-disclosure than under-disclosure. We appreciate that a company needs to protect its intellectual property and competitive advantage, but a lack of information may well inhibit rather than encourage support for capital investment. If a company does not provide enough information in its financial report, analysts have to do more work to make informed forecasts.

We believe that prospectus documents for IPOs have some advantages in their approach to providing material information. They are thorough and focused on giving investors the information they require to make an informed investment decision.

4. How should disclosures be communicated?
We would put less emphasis on disclosures being entity specific, beyond the obvious point that the reports are produced by and are about an individual company, with its own business model and risks. It must be remembered that investment professionals need to be able to compare companies both within and across sectors and geographic regions. In addition, if every disclosure were entity-specific, this would place more importance on management's view as opposed to more neutral disclosures.

This means that a degree of standardisation can make reports easier to use. However, we appreciate the concern of FRC that "boilerplate", or unthinking reporting by rote, could hide underlying economic reality. We agree that this should be avoided, which is why we are in favour of comprehensive disclosure.

On the topic 'Disclosures should be current', it is strange to highlight holdings of sovereign debt as an example of something that might drift in and out of disclosures. Since these holdings are often significant, we would typically expect them to be disclosed throughout the economic cycle. There is also concern over who decides what is significant. Users are keen to have consistency of information over time as well as comparability between companies.

On p.41, 'Information contained in the financial report should provide a clear link between an entity's business, financial performance and position'. Up to a point this states the obvious, but we would be concerned if it meant placing overall emphasis on seeing the full report through management's eyes. As mentioned earlier, we are concerned that this could give users a biased view of accounts.

Alternative methods for communicating information
We think that it is a good idea to put 'standing data' on a company's website wherever possible. However, any changes would need to be brought to the users' attention both online and through the financial statements.

We look forward to discussing the issues raised in this response.

Yours sincerely,

Jane Fuller
Chair, Financial Reporting and Analysis Committee
CFA Society of the UK

Tom Haywood
Policy Adviser, Financial Reporting and Analysis Committee

CFA Society of the UK

Will Goodhart,
Chief Executive
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About CFA UK and CFA Institute

The CFA Society of the UK (CFA UK) represents the interests of more than 10,000 leading members of the UK investment profession. The society, which was founded in 1955, is one of the largest member societies of CFA Institute and is committed to leading the development of the investment profession through the promotion of the highest ethical standards and through the provision of continuing education, advocacy, information and career support on behalf of its members. Most CFA UK members have earned the Chartered Financial Analyst® (CFA®) designation, or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

CFA Institute is the global association for investment professionals. It administers the CFA and CIPM curriculum and exam programs worldwide; publishes research; conducts professional development programs; and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry. CFA Institute has more than 100,000 members in 140 countries, of which more than 90,000 hold the Chartered Financial Analyst (CFA) designation.