Federation of European Accountants
Fédération des Experts comptables Européens

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By e-mail: disclosure@frc.org

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Dear Ms Raval,

**Re: FRC Discussion Paper on Thinking About Disclosures in a Broader Context**

(1) FEE (the Federation of European Accountants) is pleased to provide you below with its comments in relation to the Discussion Paper on *Thinking about disclosures in a broader context* (the "Discussion Paper" or "DP") published by the Financial Reporting Council ("FRC").

**Support for the initiative**

(2) We welcome the publication of the DP. We believe that it provides a useful review of some of the major issues involved in developing an effective disclosure framework applicable to all the different elements of the annual financial report, including management commentary, corporate governance and financial statements.

(3) The International Accounting Standards Board (IASB) has announced that it intends to deal with disclosures in its conceptual framework project. We believe that the DP provides a helpful basis on deciding how to proceed. Therefore, we encourage the FRC to liaise with the IASB's as to how to deal with disclosures as part of the overall conceptual framework for financial reporting.

**Scope**

(4) We agree that disclosures would need to be considered beyond the confines of the notes to the financial statements. Therefore, we prefer the scope of the DP to that of the EFRAG, ANC and FRC Discussion Paper *Towards a Disclosure Framework for Notes*.

(5) However, we acknowledge that the above mentioned joint discussion paper with EFRAG forms an important part of the full disclosure picture but it is rather limited in scope. In order to find remedies to the shortcomings of financial reporting as we know them today (such as overload and complexity), addressing disclosures in financial statements in isolation appears to be insufficient.

(6) In our view, the debate should take a broader perspective focusing on both the financial statements and the narrative section of the annual financial report. Therefore, we support the development of the DP, which considers how a disclosure framework might apply in a broader context.

**Increasing length and complexity of the Financial Statements and its usefulness for users**

(7) Developments over the years have significantly increased the level and complexity of disclosure requirements. This evolution has intended and unintended consequences on the readability and understandability, as well as the auditability of the financial statements as a whole.

(8) The increasing volume of information has not always enhanced the accessibility and usefulness of the information presented in the financial statements as the length and complexity of the annual reports may obscure important disclosures relating to the performance of the company.

(9) There is increasing criticism that financial statements may not appropriately respond to users' needs. Those who mandate the disclosures in annual reports should consider changing their current practice of mandating detailed disclosure requirements as this may only reinforce a “checklist” approach to disclosures. They should rather describe in each standard why certain information is required to be disclosed and why it is relevant to users. A clear articulation of the objectives and a linkage to users’ needs would help companies make better judgements regarding what information should be disclosed.

(10) Therefore, having a clear understanding of the users’ needs before proceeding to mandate disclosures is more likely to result in effective and practical financial communication. Therefore, we agree with the FRC that a disclosure framework should address the question of the users’ needs.

**Holistic approach to improve financial reporting**

(11) The scope of information currently included in financial statements may not be sufficient any longer to enable users to make informed decisions. A growing number of investors increasingly seek to understand the overall performance of the company and the link between corporate financial information and the company’s strategy, business risks and governance. They are gradually extending their focus beyond financial information to key non-financial information included in the narrative section of the annual report.

(12) Therefore, a holistic approach would need to be taken to effectively tackle current issues in financial reporting and improve corporate reporting as a whole. To broaden the scope of information, we believe that the DP rightly sets out disclosure themes on page 16 capturing common types of disclosures that users would need to make informed decisions.

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**Placement criteria for disclosures**

(13) As part of this holistic approach to improve financial reporting, we support the FRC's initiative of providing some useful ideas on how to draw the boundaries between different elements of the annual financial report as on page 20 and how to develop placement criteria for disclosures as on pages 22-25 of the DP.

(14) We agree that before a final conclusion can be drawn upon the location of the disclosures, it would be necessary to identify some placement criteria to set the boundaries within the annual financial report. The development of such placement criteria would provide a structure for the financial report. It may even be a significant way forward to eliminate the currently existing inconsistencies and duplications within financial reports. A coherent disclosure framework for this purpose would ultimately improve the quality of the information provided to the users.

**Differential disclosure regime**

(15) The DP considers the development of a differential disclosure regime which would set different levels of disclosure requirements. Differentiation could be based on the type of financial statements, the size, the industry or the public accountability of the reporting entity (as on pages 30-31 of the DP).

(16) It is also considered that there would be a minimum set of requirements and each preparer would add more layers of information based on the relative importance of the item in the context of its own financial statements. This could potentially imply that the preparer would need to assess different levels of materiality from a disclosure perspective as indicated on page 34 of the DP.

(17) While we agree that the materiality principle, if properly applied, could help in defining what constitutes relevant information about the reporting entity and therefore should be included in the notes, we are concerned that the approach proposed in the DP on pages 34 and 52-53 is complex and would likely be difficult to implement. Materiality is necessarily a matter of professional judgement that cannot be reduced to a mechanical exercise.

(18) Instead of proportionality of disclosures based purely on materiality of the disclosure item, we could envisage that disclosures could be supplemented by further information depending on the extent and the complexity of the transactions.

(19) To this end, a disclosure framework could establish minimum disclosure requirements that would need to be supplemented by further information when the nature and extent of transactions cannot be explained concisely. As an example, entities that enter into derivative contracts would be required to provide basic information about these instruments (fair value, maturity, etc.). An entity that makes extensive use of derivatives would be required to provide more detailed information for example with respect to the methods and processes used to determine fair value, etc. This more detailed information would not be required for entities that have a limited number of derivatives in place (reflecting the fact that entities making limited use of such contracts are not expected to have complex processes in place).

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**Materiality**

(20) As mentioned above, materiality is necessarily a matter of professional judgement applied to the financial statements as a whole that cannot be reduced to a mechanical exercise. Therefore, it is difficult to provide a very detailed description of materiality that can be applied at disclosure level.

(21) We acknowledge that the understanding and application of this concept may differ in practice among preparers, auditors, users of financial statements as well as enforcement authorities.

(22) Significant diversity in practice in the application of materiality in IFRSs among preparers, auditors, enforcers and among different entities is undesirable.

(23) Materiality is currently defined within the IFRSs. It is regarded as an entity-specific aspect of relevance based on the nature or function, or both, of items to which the information relates. Hence, materiality is by definition subject to judgement (i.e. all facts and circumstances have to be taken into account) and both qualitative and quantitative considerations are required. Therefore, it would be unrealistic to expect that uniformity in the application of the concept of materiality could be achieved.

(24) We would support the development of further guidance, in relation to materiality, in particular on qualitative factors, but only at a global level. In addition, we would like to note that auditing standard setters, such as the IAASB, provide additional guidance on this issue to auditors. In our view, it is important that any further guidance developed by the IASB is consistent with the guidance of the IAASB.

**Communication of disclosures**

(25) We agree with the proposed communication principles on page 38 of the DP.

(26) Regarding the methods of organising the notes, we tend to agree with an approach, which would include the disclosures in the notes in order of priority with the most significant information included first.

**Auditor's involvement**

(27) Although it is not addressed in the DP, there are aspects related to the auditability of financial statement disclosures which should also be taken into account while developing a disclosure framework.

(28) To respond to stakeholders' demands for assurance and to audit requirements imposed by regulators, it is important that management, who remains responsible for preparing information, ensures that disclosed information is supported by sufficient and appropriate evidence.

(29) This may not be possible where the information in disclosures is derived from systems which are separate from the main accounting systems and thus might not be subject to the same internal controls. This might mean that they are more challenging to audit.

(30) It should also be noted that the increasing amount of qualitative and forward-looking information in financial reporting, which require management's judgement and estimation, also increases the level of judgement that auditors need to exercise. Therefore, the "auditability" of such disclosures is also an element that should be considered when developing a disclosure framework, as is also the case for financial reporting standards.

For further information on this letter, please contact Tibor Siska, Project Manager, at the FEE Secretariat on +32 2 285 40 74 or via e-mail at tibor.siska@fee.be.

Yours sincerely,

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President

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