The Quoted Companies Alliance

Quoted Companies Alliance Materiality Roundtable
17 February 2011
Summary of Points Discussed

Background:

The Quoted Companies Alliance, through its Financial Reporting Committee is committed to improving corporate reporting and to reducing the complexity of financial statements, which has greatly increased in recent years. It has developed a Corporate Reporting Charter setting out the principles which it considers should underpin good quality reporting and this has led it to identify a small number of pro-active projects on which to concentrate in order to bring about necessary change which will be of value to preparers, users and others, especially those associated with small and mid-cap quoted companies. Initial consultations have suggested that 'materiality' is a topic on which many feel a change in approach is needed.

On 17 February 2011, the Quoted Companies Alliance held a Materiality Roundtable to bring key stakeholders together and discuss how materiality could be used to make reports less complex and improve corporate reporting more generally. Some key themes came out of the debate, which are highlighted below.

Key themes on materiality:

- **Fear of getting it wrong**

One aspect that contributes to excess in reports is the fact that no company wants to receive a letter from the Financial Reporting Review Panel and so companies will always put things to be cautious. This results in preparers' writing accounts with primary attention being placed on the perceived views of the regulator rather than the needs of their shareholders, the principal users.

- **Easier to make additional disclosure, rather than making judgment on materiality**

Preparers can view materiality decisions as more work than just adding the disclosure in. It is always easier to put something in to the financial statements rather than leave it out.

- **Everyone is part of the problem – no one party is responsible**

There seems to be a great deal of 'finger-pointing' in terms of excess complexity in reports; however, it is not one party that is at fault and everyone needs to address how they can change their behaviours.

Companies need to be persuaded to get involved in the debate and spend time thinking about materiality. This may be an area that the Quoted Companies Alliance could consider how to further promote.

- **Making reports less complex is all about changing behaviours and everyone needs to buy into this**

The FRC has a keen interest in this and will promote this in their Cutting Clutter paper, due out in April 2011.

- **Regulation and standards are part of the problem**

New accounting standards seem to have more disclosure associated with them, which can fuel the problem. An important area to explore is what more the standard-setter can do to encourage preparers to think about materiality in relation to disclosures in standards. One suggestion was examining disclosures in post-implementation reviews; another was adding a statement at the beginning of each standard that materiality should be used to determine whether a particular disclosure is necessary.

The FRC has asked the ICAEW whether it would consider reviewing its materiality guidance; the ICAEW does not have appetite for this at the moment.

The Instituted of Chartered Accountants of Scotland and the New Zealand Institute have been asked by the IASB to examine disclosures and recommend deletions and changes to requirements.

The International Auditing and Assurance Board (IAASB) has released a consultation about auditing disclosures and materiality. Changing behaviours is mentioned in this paper as well.

There is a great deal of information in accounts from certain standards that produce clutter, e.g. pensions, share-based payments, or effects on profits on profits if interest rates/exchange rates/commodity prices have changed. Investors agreed that this information is not that regularly used because they will know the variables if you have already invested in a company.

- **One size does not fit all quoted/listed companies on matters of reporting**

It was felt that part of the problem, especially for small and mid-cap quoted companies, is that standards are written for global businesses and may not be appropriate when applied in the context of a smaller company. Therefore, there could be room to change the drafting of standards or how they are applied to smaller quoted companies.

- **Reports and financial statements are too complex**

Ultimately, users are not able to understand financial statements (or the standards that are applied to them). Preparers are not producing accounts that reflect the economic reality of the company's transactions, performance or position.

Part of the problem may be that we are trying to achieve too much with one set of accounts and reports.

There is a need to reconnect with the primary users of financial statements/annual reports. It was pointed out that an investor does not just make a decision on the annual accounts and report. However, it can seem that this is the framework within which accounts are produced and approached by standard setters and the regulator.

It was queried whether greater use of technology could make reports less complex. This lead to a larger debate on does the presentation of reports and accounts matter. The concept of fragmenting the annual report may help to reduce complexity and also promote materiality.