Louder than Words.

Principles and actions for making corporate reports less complex and more relevant

Financial Reporting Council

The Financial Reporting Council is the UK's independent regulator responsible for promoting confidence in corporate reporting and governance. For corporate reporting, the outcome we seek is this:

Corporate reports contain information which is relevant, reliable, understandable and comparable, and are useful for decision-making, including stewardship decisions.

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Louder than Words: FRC discussion paper

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Investigating complexity

Concerns about the increasing complexity and decreasing relevance of corporate reports have been growing in recent years. Many people point to the increasing length and detail of annual reports – and the regulations that govern them – as evidence that we have a problem. Others are more worried that reports no longer reflect the reality of the underlying businesses, with key messages lost in the clutter of lengthy disclosures and regulatory jargon.

Users of corporate reports tell us that so far all is not lost – but that substantial improvements can and should be made.

We set out to investigate the complexity and relevance of corporate reporting. As we began, the unfolding credit crisis raised an additional issue: the risk of further complexity arising from uncoordinated responses to the crisis by regulators and standard setters. This emphasised the importance of the coordination advocated in this paper – which was also called for by world leaders at the G20 summit in April 2009.

This discussion paper provides the results of our initial investigation and offers practical recommendations for improvement. We confined the scope of our activities to UK publicly traded companies to make the task manageable, but we hope that there are lessons here for all companies.

This paper is a first step towards reducing complexity, not the end goal. We will continue working towards implementation of our ideas after it is published. We also hope our work will stimulate productive discussions not only in the UK but around the world, and provide a platform for lasting improvement in corporate reporting.

What do you think?

When you've read this paper, we'd like to know what you think. Is what we are suggesting a logical and sensible way forward? What are your suggestions on how to move this from a debate to actual change?

Please be open-minded and frank in the feedback that you give us. To help frame the debate we have set out in the final chapter (*Questions to consider,* page 60) a possible agenda for the items you might want to discuss – but please do not let that constrain you! We would appreciate comments by 30 October 2009, by post or email to:

Melanie Kerr
Financial Reporting Council
5th Floor, Aldwych House
71-91 Aldwych
London WC2B 4HN
Email: complexity@frc.org.uk

Thanks for the support –

One of the most encouraging aspects of our research was the amount of support we received from the corporate reporting community and especially the members of our advisory panel (see *Research strategy,* page 57, for details).

A large number of individuals and organisations enthusiastically donated time to assist us with our research, and for this we are very grateful.

We have considered complexity in a broad sense, meaning anything that makes corporate reporting regulations or the reports themselves unnecessarily difficult to understand, implement or analyse. This includes missing information or irrelevant detail that obscures the overall picture.

Working with a wide range of people involved in regulating, communicating and using corporate reports, we set out to determine the causes of increasing complexity and decreasing relevance, and to develop recommendations aimed at improvement.

Corporate report preparers almost unanimously said the process of compiling a report is too complex, and so are the reports themselves. Users were not so sure, but sought a variety of improvements focused on relevance and better communication.

One widely acknowledged problem is that reports currently aim to please too many types of user. There is a need to refocus them on their primary purpose: providing investors with information that is useful for making their resource allocation decisions and assessing management's stewardship. We suggest that regulators and companies should reconsider how they address the needs of other stakeholders – for example, those with specialist interests in environmental and employee diversity issues.

Complexity in corporate reporting is a multi-faceted problem that will require changes in behaviour from all members of the corporate reporting community. Our research has convinced us that the best route to better reporting – and regulation of reporting – emphasises principles rather than rules.

So we recommend a commonsense approach based on *eight guiding principles* – four for regulation of reporting and four for effective communication in reporting.

We also make *five calls* for action in areas where it is clear that urgent change is needed.

Finally, we ask readers for their thoughts on how we can address other specific causes of complexity mentioned by interviewees that represent *opportunities for further action*.

"Complexity in corporate reporting is a multi-faceted problem that will require changes in behaviour from all members of the corporate reporting community."

1.

Four principles for less complex regulation of reporting

Principles

To provide a toolkit for improving the quality and effectiveness of regulations, regulators and standard setters should all adopt a single set of principles that govern how they set and communicate those regulations. We believe regulations should be:

- Targeted
- Proportionate
- Coordinated
- Clear.

Related calls for action

We also make the following calls for urgent change:

- Improve cash flow and net debt reporting
- Ensure disclosure requirements are relevant and proportionate to the risks
- Ensure requirements for wholly-owned subsidiaries' reporting are targeted and proportionate
- Improve usability of IFRS.

Further information starts on:
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2.

Four principles for effective communication in reporting

Principles
The lessons learned from the UK ASB's work on the Operating and Financial Review (OFR) should be extended to cover corporate reporting in its entirety. Reports should be:

- Focused
- Open and honest
- Clear and understandable
- Interesting and engaging.

Related call for action
We recommend prompt action to help focus annual reports on what's relevant and **cut clutter**.

Further information starts on:
page 39

3.

Opportunities for further action

Interviewees mentioned a large number of specific sources of complexity in corporate reporting that we summarise in the final chapter of this paper. Each one represents an opportunity to better understand issues that give rise to complexity in corporate reports. We would welcome suggestions on which of these should be tackled first and how they might best be addressed.

Further information starts on:
page 53

What do we mean by complexity?

We use the term 'complexity' throughout this paper. One thing we have learned is that it means different things to different people. So in this paper, we define it as anything that makes regulations or the reports themselves unnecessarily difficult to understand, implement or analyse.

Reports can be difficult to understand and/or analyse if they contain information that lacks relevance, and so provides clutter – or, equally, if relevant parts of the picture are missing. We consider that relevance is an aspect of complexity because missing information and irrelevant detail can obscure the overall message of a report and so add to complexity.

Is complexity really a problem?

The diversity of views was a surprise.

The preparers we interviewed almost unanimously believe that the process of compiling a corporate report is too complex, and so are the reports themselves.

In contrast, users discuss a number of shortcomings in annual reports but do not consider them too complex overall. They say they can dip in and out to find what they want. Those we interviewed do support the case for improvements to reporting, but seem to have greater concerns about 'relevance' than 'complexity'.

Both groups agree that corporate reports can be improved, while recognising that this will be an enormous challenge.

Unsurprisingly, financial instruments, share-based payments and defined benefit pension plans were most commonly cited as specific examples of complex areas in corporate reporting. One of the questions we asked was whether these or any other areas of corporate reporting are so complex that we cannot make improvements. The response was nearly unanimous: complex transactions can be explained more clearly than they are at present. We cannot make all transactions or an international business with multiple products and services simple, but we can *communicate* them more simply.

"Both users and preparers agree that corporate reports can be improved, while recognising that this will be an enormous challenge."

Remembering who the users are

Corporate reports have many different users. One consequence is that standard setters and other regulators are under pressure from all sides to make them meet all the needs of every potential stakeholder, including regulatory groups such as prudential supervisors. The reality is that we cannot meet this aspiration without running the risk that reports ultimately become OK for many but ideal for no one.

There is a need to re-establish the principle that corporate reports should be designed for their primary purpose – providing investors with information that is useful for making their resource allocation decisions and assessing management's stewardship. This is consistent with the IASB's latest thinking on the conceptual framework for financial reporting, which identified the primary users of corporate reports as 'present and potential equity investors, lenders, and other creditors'.[1] For the purposes of this paper, we consider users to be capital providers and their advisers.

The users' concerns about relevance suggest that regulators and companies should reconsider how, where and when they address the needs of other stakeholders. In particular, is there a better channel for discussing public policy matters that have no impact on the business that capital providers would view as significant? Annual reports are arguably not the best place for specialist commentary on environmental or employee diversity issues, for example, unless they have a material bearing on current or future activities.

"There is a need to re-establish the principle that corporate reports should be designed for their primary purpose – providing investors with information that is useful for making their resource allocation decisions and assessing management's stewardship."

What we have done so far

This project aims to reduce the complexity of corporate reporting by:

Working with different participants involved in regulating, communicating and using corporate reports.

Determining the causes of increasing complexity and decreasing relevance.

Using this knowledge to develop and promote recommendations aimed at reducing complexity of corporate reports.

The project team has worked with a variety of different user and preparer groups including company finance teams, investor relations professionals, report preparation teams and sell-side/buy-side analysts and investors. We focused on these groups since corporate reporting by listed companies is principally about preparers (who need capital) providing information to users (who have capital to invest).

During the research phase, it became clear that the credit crisis would have a significant impact on the wider economy. We reviewed our research to make sure that we understood the effects of the crisis on those preparing and using corporate reports. This convinced us that the need for high quality corporate reporting is greater than ever and that we must deliver on our efforts to help make corporate reports more understandable and relevant.

“The credit crisis convinced us that the need for high quality corporate reporting is greater than ever and that we must deliver on our efforts to help make reports more understandable and relevant.”

We have conducted research on a number of different fronts including:

Identifying and monitoring research projects that relate to complexity and relevance in corporate reporting.

Completing extensive review and analysis of other research related to improving the usefulness of corporate reports.

Spending the majority of our time engaging the corporate reporting community through face-to-face interviews, online questionnaires and round tables, all with the assistance of an experienced advisory panel.

For more specific detail on the research we performed, see *Research strategy,* page 57.

Number of research reports read

22

Number of preparers engaged

151

Number of users engaged

56

Number of other reporting community members engaged

14

Making change happen

Achieving change will not be easy. Complexity in corporate reporting is a multi-faceted problem and tackling the root causes is a long-term endeavour that will require changes in behaviour from all members of the corporate reporting community.

The causes of complexity are often interlinked. Tinkering with them individually may have unintended knock-on effects elsewhere. So a piecemeal approach may reduce pockets of complexity while overall complexity continues to escalate.

We therefore recommend a more fundamental approach based on *eight guiding principles* – four for regulation of reporting and four for effective communication in reporting.

This approach results from the most important conclusion of our research, which is that both the regulation of reporting and the reporting itself should be more principles-based. Clearly there is a need to set some specific rules and standards, but we conclude that excessive reliance on these is now a major contributor to complexity.

Those familiar with the UK Government and European Commission's thinking on Better Regulation will recognise the foundations of the principles for standard setters and other regulators. Those familiar with the UK ASB's work on the OFR will recognise the principles for those who prepare corporate reports.

Discussing and implementing our recommended principles will take time. But we believe there is a need for more urgent action on a number of points raised by the users and preparers we spoke to.

So we also make *five calls for action* in areas where it is clear that urgent change is needed.

These are discussed in the following sections, under the relevant principles.

What do we mean by the term 'principles-based regulation'?

The term as it is used in this paper means focusing on how best to achieve the desired outcome, using a combination of principles and rules – but think principles first.

What happens next

The project team will encourage all interested parties to act on our recommendations and report progress at www.frc.org.uk/complexity. Feedback and views on next steps will be reported on the website by the end of the year. Meanwhile, preparers can take immediate action by applying the principles for effective communication to their corporate reports.

Numerous reports have documented an acceptance that corporate reporting regulations should become more 'principles-based'. Given this consensus, shouldn't those setting the regulations and standards also do so within a principles-based framework? In addition to principles for technical content *in* standards and regulations, we need some principles *for* those standards and regulations themselves.

There is a tendency to focus on the technical merit or theory behind each regulation and accounting standard. While this is clearly important, there needs to be more emphasis on understanding the problem being addressed, determining the most efficient regulatory solution for the problem and delivering this solution in an understandable way. We believe that if regulators use a framework for considering these issues, then over time complexity in corporate reporting will be reduced.

In the UK, the Better Regulation Executive has been developing a set of principles for regulation-setting over a number of years and has devised some principles of good regulation. We have used its principles to develop a framework of four principles tailored to corporate reporting regulations.

1.

Targeted
Understand the problem

Regulations should focus on significant problems and be targeted to:

- Provide relevant information that meets important user needs
- Reflect the reality of the business while minimising unintended implementation consequences.

2.

Proportionate
Balance the costs and benefits of regulation

Regulators should limit constant change by intervening only when an area is high-risk and change will bring obvious benefit. Intervention should be as cost effective as possible – for example, by using management information already produced for internal purposes.

What do we mean by the term regulations?

All laws, accounting standards and other requirements that govern the content of corporate reports.

What do we mean by the term regulators?

All bodies involved in setting regulations.

3.

Coordinated

Consider what other regulators are doing

Regulators should understand what other national and international regulators are doing in a particular area. Wherever possible, they should be consistent with one another and work together in a joined-up way.

4.

Clear

Deliver an understandable solution

Being clear means keeping regulations simple and user-friendly. They need to be understood easily by those who will apply them and those who will benefit from them. Regulations should emphasise:

- A clear articulation of the desired outcome
- Principles and judgement where appropriate
- Plain language with well defined terms
- Consistent terminology
- An easy-to-follow structure.

1.

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The Better Regulation principle of targeting effectively asks regulators to keep their eye on the ball. In the context of corporate reporting, the 'ball' is a useful report.

Relevant information that meets important user needs

It is a challenge to ensure that regulations meet important user needs without going so far that some requirements are flirting with irrelevance.

Not everyone agrees that the length of reports is a problem. Many large institutional users say they are happy for reports to contain as much information as possible, and they will decide what they want to use. This appetite for information means that in regulatory consultations they will agree to requirements for information with occasional relevance and are very reluctant to agree to the removal of requirements.

Despite steadily increasing disclosure, some really important user needs are still unmet – better cash flow statements and more detailed segmental reporting notes, for example. Overall, users hinted that sometimes the balance of regulatory requirements is not quite right. The users are very interested in the core business results, so seek plenty of detail in the segmental note. But they find it less useful to see six pages on share-based payments.

“Many interview participants, both preparers and users, were concerned that corporate reporting is becoming increasingly disconnected from the reality of the business.”

Business reality

Many interview participants, both preparers and users, were concerned that corporate reporting is becoming increasingly disconnected from the reality of the business. This means that management is providing users with an increasing number of alternative performance measures to plug the gap between regulation and reality.

Some users and preparers describe this issue as ‘accounting becoming too theoretical’. Effectively, there is concern that regulators are taking their eye off the ball and making requirements that are theoretically correct but do not result in the provision of useful information.

For example, during the interview process, users of financial statements said that the usefulness of financial statements is improved if hedge accounting is used for economic hedges. They said that when hedge accounting is not allowed for an economic hedge, the financial statements do not properly reflect the economic reality of a company’s risk management strategy. Preparers agreed, and many provide alternative performance measures that show what net income would have been if they were allowed to use hedge accounting for all economic hedges.

Unintended consequences

Regulations are written with the best of intentions – but there is sometimes a difference between intended and actual outcomes.

For example, a number of interviewees, both users and preparers, expressed concern that disclosures made in accordance with the minimum requirements of IFRS 7 *Financial Instruments: Disclosures* are not as useful as they might be. Part of the issue here is that the minimum disclosure requirements focus on specific instruments rather than the bigger picture, so meeting these requirements does not provide a good understanding of the risk management strategies used by management. This is interesting, because the standard is actually underpinned by the principle that information should be provided 'through the eyes of management'. Including a list of minimum disclosures in the standard has encouraged companies to comply with this list rather than providing information through the eyes of management; the result, according to many interviewees, is less useful information.

Call for action one:
Improve cash flow and net debt reporting

Our face-to-face interviews confirmed that users are a diverse group with very diverse needs. They did agree, though, that understanding the cash flows of the business is vital and that the cash flow statement in its current form is failing them in this regard. Preparers agree that this statement is not useful for internal management purposes either – as a consequence, many companies are voluntarily providing significant additional detail in their reports.

One of the problems with the cash flow statement is that users cannot reconcile the movement in net debt. Users like to reconcile opening and closing net debt rather than opening and closing cash because a company can borrow money at year end to increase cash balances – a reconciliation of net debt makes these transactions transparent.

There are also some issues with vague and ambiguous descriptions in the cash flow statement and there is difficulty in recalculating the amounts based on balance sheet and profit and loss movements.

During our research, users were hopeful that the IASB's joint project with the FASB on Financial Statement Presentation would address some of their cash flow reporting concerns. However, the discussion paper for this project was issued in October 2008 and feedback from users has since revealed that the proposals do not yet address the main user concerns outlined above.

Action

The FRC should launch a project to further investigate users' needs for cash flow and net debt reporting with a view to better aligning reporting with these needs, possibly through producing best practice guidance.

2.

Proportionate
Balance the costs and benefits of regulation

Regulators should limit constant change by intervening only when an area is high-risk and change will bring obvious benefit. Intervention should be as cost effective as possible – for example, by using management information already produced for internal purposes.

Constant change and growth

There is concern that regulations change too quickly – sometimes even without clear evidence that the change will bring sufficient improvement to justify the costs, such as system changes and training. Some interviewees also worry that most changes add regulations rather than taking them away, meaning the regulatory burden on companies is constantly growing.

While coping with regulations is normally a greater concern for preparers, the issue of change is difficult for users as well. Our research revealed that some users rely on more general rather than specific knowledge of the regulations to navigate reports. When the rules change very quickly, this general knowledge does not serve them well.

Regulators are often under pressure from their constituents to make changes. There is an onus on regulators to withstand pressures to make unnecessary change and on market participants to consider carefully how important their requests are before asking for change. In some instances, asking companies to use judgement, a market-led solution or guidance to stimulate good practice may be better than adding or changing regulatory requirements.

> "One way for regulators to achieve a cost effective solution is to consider the information that management uses internally to manage the business."

Cost effectiveness: consider management information first

One way for regulators to achieve a cost effective solution is to consider the information that management uses internally to manage the business. This does not mean that the information management uses will always be sufficient or appropriate for external reporting purposes; the current economic crisis made it abundantly clear that management does not always have all the right information. But it is not sensible for regulators to make disclosure requests that require companies to reformat existing information in a slightly different way. And regulators should consider whether information that management doesn't need is actually useful.

For example, during interviews most users mentioned that they do not consider valuation of intangible assets acquired in a business combination useful. Preparers note that valuing intangible assets is complex, theoretical and time consuming; and they do not use this information internally when making acquisition decisions. In addition, academic research confirms that valuation of intangible assets is one of the most time consuming areas in the audit process.[2] So preparers are spending lots of time preparing – and taking through audit – information that users do not find helpful. A more proportionate requirement might be a disclosure that uses the same information that management uses internally to make acquisition decisions.

Call for action two:
Ensure disclosure requirements are relevant and proportionate to the risks

Constant growth is of particular concern in relation to disclosure requirements. The current piecemeal approach to developing disclosures has resulted in a continually expanding and repetitive body of requirements. Further, there is no process in place for reviewing whether required disclosures are still relevant.

The increased use of fair value accounting has resulted in lengthy valuation assumption disclosures. This type of disclosure is fundamentally different from, say, segmental disclosures, which provide greater disaggregation of core business results. It would be interesting to investigate the characteristics of disclosures that users find most useful and determine how best to address the 'assumptions' and 'disaggregation' disclosures to meet user needs.

It is clear we cannot keep adding disclosures indefinitely while remaining inside the boundaries of what is feasible for companies to read and prepare. The SEC's Pozen committee addressed this issue in its final report and recommended development of a disclosure framework to bring disclosure requirements into a single source, based on consistent objectives and principles.[3]

Action

We would like to see a project on disclosure which investigates the characteristics of useful disclosures and the main objectives of financial reporting disclosure. Further, a process is needed to review existing disclosure requirements regularly for continued relevance.

Ideally, we believe another organisation could constructively kick off this work with a view to providing recommendations to the relevant regulators, including the IASB.

Call for action three:
Ensure requirements for wholly-owned subsidiaries' reporting are targeted and proportionate

Many large publicly traded companies have hundreds of wholly-owned subsidiaries. In the UK there is a requirement for each subsidiary to prepare, have audited and file a set of non-consolidated financial statements.[4] Some other countries have similar requirements whereas others do not. A careful review of this policy as part of the Company Law Review in 2001 concluded that there was not a solid case for changing the reporting requirements for subsidiaries at that time.[5] However, many of those we interviewed expressed concern at the cost of preparation and audit of these accounts because of the perception that they have few users.

Groups need to maintain accounting records for all their subsidiaries for internal control and tax purposes regardless of external reporting requirements. However, preparing lengthy GAAP disclosures for each subsidiary can have a high incremental cost, given the amounts may differ from the group accounts and the need for lower levels of materiality.

One of the benefits of the preparation and audit of subsidiary accounts is creditor protection. It may be possible to reduce the complexity of preparation without compromising this objective by better understanding the needs of users of these accounts.

Large creditors such as banks and the tax authorities have the right to more specific, tailored information, so it would be useful to investigate the number and identity of the other users of subsidiary statutory reports and the purposes for which they use these reports. This will help clarify whether different or less onerous requirements might be just as effective in providing these users with the information they need. It may also be possible to learn from the reporting models used in other countries with less extensive requirements.

Action

We recommend further study of the costs and benefits of subsidiary reporting requirements to determine if we can better match requirements to user needs and reduce the overall burden on UK companies. Improvements could result in adjustments to GAAP or other legal requirements. If the study concludes that one of the steps necessary to reduce complexity requires changes in EU and/or UK law, the prospects for early change are limited and so may need to be pursued over a period of time.

3.

Coordinated

Consider what other regulators are doing

Regulators should understand what other national and international regulators are doing in a particular area. Wherever possible, they should be consistent with one another and work together in a joined-up way.

The number of different sources of corporate reporting regulations makes life challenging for preparers of corporate reports, due to the sheer volume of requirements and the difficulty in tracking down which regulations apply to them. There is significant overlap between the different sources of requirements, which adds unnecessarily to the total regulatory burden.

Even looking only within the UK there is significant complexity, and many of the companies we interviewed for this project operate globally and so are subject to many thousands of additional pages of regulations for jurisdictions outside the UK.

There have been significant cross border convergence efforts in the area of accounting standards in recent years. In fact, the removal of the SEC requirement to prepare an IFRS to US GAAP reconciliation is the only regulatory change that our interviewees will agree has decreased complexity in corporate reporting in recent years. However, this is just a drop in the bucket compared to the cost of preparing a UK annual report and a US *20F Annual Report of a Foreign Private Issuer.*

It would greatly reduce the reporting burden if each regulator first ensured that its own regulations were coordinated and consistent, and then worked with other regulators at national and international levels. However, interviewees caution against convergence of regulations for its own sake, citing concerns about quality and inheriting the pitfalls of other regulatory regimes. For example, there is concern that convergence between IFRS and US GAAP will gradually transform reporting to a US-style, rules-based system.

"It would greatly reduce the reporting burden if each regulator first ensured that its own regulations were coordinated and consistent, and then worked with other regulators at national and international levels."

Illustrative example: *UK regulations*

UK publicly traded companies must comply with the following sources of regulations when they prepare their corporate reports:

- The Companies Act (BERR)
- IFRS (for consolidated accounts) (IASB)
- UK GAAP (for non-consolidated accounts) (ASB)
- The Disclosure and Transparency Rules (FSA)
- The Listing Rules (FSA)
- The Combined Code on Corporate Governance (FRC).

Illustrative example:
Overlapping regulations

Remuneration reporting is prescribed by numerous different sources of overlapping regulations within the UK:

- Companies Act 2006
- The Listing Rules
- The Combined Code on Corporate Governance
- IAS 24 *Related Party Disclosures*
- IFRS 2 *Share-based Payment.*

With all these different sources of regulation, it isn't surprising that most preparers resort to a checklist to ensure they are compliant, rather than focusing on how best to communicate.

Illustrative example:
Terminology for grouping companies

The terms 'quoted' and 'listed' are often used to describe a company with publicly traded securities. However, in the UK we need to treat these terms with care because different sources of regulations define them and they are not synonymous.

To make matters more complicated, EU Directives use the term 'Admitted to Trading on a Regulated Market'.

Quoted

according to the Companies Act, means a company whose equity share capital is:
(i) included on the official list in accordance with the provisions of Part VI of the Financial Services and Markets Act 2000;
(ii) officially listed in an EEA state; or
(iii) admitted to the NYSE or NASDAQ.[6]

Listed

in a UK capacity, means any security that is included on the official list in accordance with Part VI of the Financial Services and Markets Act 2000. This term is used to describe which companies fall within the scope of the FSA's Listing Rules.

Admitted to Trading on a Regulated Market

in an EU capacity, means any transferable security that is traded on a regulated market, as defined by MiFID.[7] This term describes which companies fall within the scope of the FSA's Disclosure and Transparency Rules.

So in the UK at least, a company will be quoted if it is listed but not necessarily vice versa and a regulated market can be for listed or unlisted securities.

4.

Clear

Deliver an understandable solution

Being clear means keeping regulations simple and user-friendly. They need to be understood easily by those who will apply them and those who will benefit from them. Regulations should emphasise:

- A clear articulation of the desired outcome
- Principles and judgement where appropriate
- Plain language with well defined terms
- Consistent terminology
- An easy-to-follow structure.

Clarity was raised a number of times during interviews, specifically in relation to IFRS. We have used a number of IFRS examples in the following discussion, but believe the principle applies to all regulation.

Articulating the desired outcome

One of the first steps in using a more principles-based approach is making sure that preparers understand what each regulation is aiming to achieve. The FRC already takes such an approach in its role as an independent regulator of corporate reporting and governance, where its Strategic Framework focuses on 'outcomes'.[8] For example, the corporate reporting outcome seeks to ensure reports contain information which is relevant, reliable, understandable and comparable, and are useful for decision-making including stewardship decisions.

Many IFRS requirements outline a 'core principle' or an 'objective' or both – but these do not always provide a clear enough articulation of the purpose and desired outcome of the standard. Sometimes, the reason for the standard only becomes clear after reading all of it, including the basis for conclusions.

Clearly articulating the desired outcome as the first section of each standard would greatly improve the understandability and aid the move to a more principles-based system. The EU already uses a similar approach by including recitals at the front of each Directive to provide an overview of the background and intention.

"Clearly articulating the desired outcome as the first section of each standard would greatly improve the understandability and aid the move to a more principles-based system."

Emphasising principles and judgement

Many commentators argue for more principles-based regulation, but the practical reality is that this is not a decision about using principles or rules. Rather, it is a decision about how best to achieve the desired outcome through a combination of principles and rules.

Many interview participants observed that we have moved to a more rules-based system in recent years and that this has made understanding the accounting standards much more time consuming. In a principles-based system one can rely on knowledge of the principles to make quicker, more informed decisions. Under a rules-based system this is not necessarily enough – one must be aware of the small

Illustrative example:
Making the purpose of regulations clear

Paragraph 1 of IFRS 8 *Operating Segments* outlines the following core principle:

'An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates.'

The principle is vague and does not mention the 'through the eyes of management' approach that underpins the standard.

print as well, as this can have a huge effect on the accounting treatment. With a constantly increasing volume of standards, all of which must be read carefully, it is easy to see why many interviewees view greater use of principles as an antidote to the complexity they face in preparing annual reports.

One example of a very rules-based standard, which many interviewees consider could be rewritten to emphasise principles, is IFRS 2 *Share-based Payment*. Interviewees do not normally favour constant change, but this is an example of an area where many interviewees feel change is justified.

We think that a less complex regulatory regime would not use detailed rules where principles would achieve an acceptable outcome.

An extract from the IASB's own 30 November 2006 press release that accompanied the release of the standard makes it much clearer:

'The IFRS requires an entity to adopt the 'management approach' to reporting on the financial performance of its operating segments. Generally, the information to be reported would be what management uses internally for evaluating segment performance and deciding how to allocate resources to operating segments. Such information may be different from what is used to prepare the income statement and balance sheet. The IFRS therefore requires explanations of the basis on which the segment information is prepared and reconciliations to the amounts recognised in the income statement and balance sheet.'

Illustrative example:
Using simple sentence structures

Consider paragraph 34 of IFRS 2 *Share-based Payment*:

'For share-based payment transactions in which the terms of the arrangement provide either the entity or the counterparty with the choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments, the entity shall account for that transaction, or the components of that transaction, as a cash-settled share-based payment transaction if, and to the extent that, the entity has incurred a liability to settle in cash or other assets, or as an equity-settled share-based payment transaction if, and to the extent that, no such liability has been incurred.'

The following alternative makes the above requirement clearer:

Some share-based payment plans allow the entity or the counterparty to require the transaction to be settled in cash (or other assets) instead of equity instruments. To the extent that a liability to settle in cash or other assets has been incurred, the cash-settled accounting treatment (paragraph 10) should be used. The equity-settled accounting treatment (paragraph 20) should be used for the remaining parts of the transaction where no such liability has been incurred.

This rewrite does not address the underlying 'rules-based' nature of IFRS 2 but it illustrates how breaking down a very long sentence into a more simple structure can make it easier to understand.

Writing in plain language using well defined terms

One of the reasons that some regulations are unduly difficult to understand is that they are not written in plain language. It is neither possible nor desirable to eliminate all technical language from regulations, but we can write in a way that makes technical material more understandable.

Writing in plain language means using everyday terms instead of jargon and relying on simple sentence structures. When technical terms are necessary, they should be clearly defined.

> "Writing in plain language means using everyday terms instead of jargon and relying on simple sentence structures. When technical terms are necessary, they should be clearly defined."

Using consistent terminology

Another issue is inconsistent terminology – using different words to explain the same thing. For example, there are over 30 different expressions of probability thresholds embedded in the IFRS literature, ranging from 'remote' to 'probable' to 'virtually certain'. The reality is that each of these words is examined very closely by tens of thousands of people, many of whom reasonably assume that different words have been used because they are intended to mean something different. This is not always the case, though, and can cause considerable confusion.

And if it can cause confusion in the original English version, we should also consider this: IFRS is translated into many other languages, and not all of these can capture the intention of the different terminology.

Illustrative example:
Probability thresholds in IFRS literature

- Unavoidable
- Virtually certain
- No realistic alternative
- Substantially
- Highly
- Reasonably certain
- Majority
- Major
- Most
- Principally
- Expects
- More likely than not
- Probable
- Normally
- Likely
- Commonly
- May
- Possible
- Rarely
- Highly unlikely
- Highly abnormal
- Extremely unlikely
- Extremely rare

Easy-to-follow structure

Regulations should be structured logically, with clear headers and navigational aids. It would also help, in the context of accounting standards, if all the structures were consistent. IFRSs were written in different eras and sometimes by different national standard setters. As a result, they are structured in disparate ways. For example:

- Some recent standards clearly distinguish between recognition, derecognition, initial measurement and subsequent measurement – this makes them much easier to use, but these features are not present in earlier standards
- Sections of standards, such as ‘disclosures’ and ‘defined terms’, are not consistently located in the same place, making standards more difficult to navigate
- Some application guidance is part of the standard, while other application guidance is not.

Call for action four:
Improve usability of IFRS

The SEC's Pozen committee 'strongly supported' the FASB's Accounting Standards Codification project, which aims to condense the body of literature that comprises US GAAP into a single online source.[9] Compared with this project, the IASB already has a head start, because all its accounting standards and interpretations are already assembled in one publication. However, the IASB literature could still be improved through a project that incorporates some aspects of the FASB codification initiative, as well as some of the points addressed above (pages 30-36), by:

- Organising IASB literature around accounting topics
- Using an electronic system that allows users to view what is relevant to them, for example, IFRS applicable to 2009 year ends
- Using a consistent, easy-to-follow structure
- Stating the desired outcome for each standard.

We believe such a project would make IFRS easier to use without amending the content of the standards themselves. Further improvements, such as rewriting standards in plain language and incorporating consistent terminology, should also be considered to the extent possible.

Action

The IASB should consider a project to reorganise its standards, accompanying documents and interpretations around accounting topics, using an easy-to-follow structure and clearly expressing the desired outcomes.

To reduce complexity, it is important to focus on good communication as well as simplifying regulations. Regulations tend to lag behind what companies are actually doing, so companies need to focus on communicating important messages rather than ticking regulatory boxes if investors are going to gain a full understanding of the business.

Corporate reports are not just about the numbers. There is also need to focus on providing a high quality narrative that supplements and complements the numbers.

Our interviews revealed something of a mismatch between users' and preparers' views on effective communication. Preparers showed a commitment to investing time in good communication of their reports. But users felt that in many cases the presentation and communication of information in reports falls short of what is needed.

The ASB's *Reporting Statement: OFR* provides principles for writing the OFR that we think can apply throughout corporate reports to improve communication. We have modified these principles slightly to develop principles for effective communication.

1.

Focused

Highlight important messages, transactions and accounting policies and avoid distracting readers with immaterial clutter.

2.

Open and honest

Provide a balanced explanation of the results – the good news and the bad.

What can preparers do to help?

We urge preparers to apply these principles now, to help reduce the complexity of their reporting without waiting for regulatory change.

3.

Clear and understandable

Use plain language, only well defined technical terms, consistent terminology and an easy-to-follow structure.

4.

Interesting and engaging

Get the point across with a report that holds the reader's attention.

1.

Focused

Highlight important messages, transactions and accounting policies and avoid distracting readers with immaterial clutter.

> "Immaterial clutter also tends to mask the unique strategies and risks that apply to each company: it is rather like stamping 'May contain nuts' on every consumer food product."

Generally, if regulations require a disclosure, it goes in the report – regardless of the materiality or importance to the business. This means that reports are full of immaterial clutter that can obscure key messages or make more important information harder to find. It also tends to mask the unique strategies and risks that apply to each company: it is rather like stamping 'May contain nuts' on every consumer food product.

Interviewees gave a number of reasons for the 'kitchen sink' style of reporting including:

- Due to time pressures, preparers simply repeat disclosures made in prior years rather than considering whether they are still material
- Lack of confidence in making the judgement between disclosures that are material and those that are not
- Just as much work being required to conclude on materiality as to prepare the disclosure
- Desire to avoid lengthy debates with the auditors
- Following the leader: if another company makes a disclosure, it can influence others to follow
- Fear that a missing disclosure will be challenged by regulators.

Illustrative example:
The Financial Reporting Review Panel

The Financial Reporting Review Panel (FRRP) needs to ask companies questions in order to monitor reporting effectively. However, sometimes the FRRP asking about a particular disclosure leads to companies adding the disclosure to their reports, even if this was not the intention of the question. The FRRP has changed the text of its letters explaining that the disclosure omissions raised in the Appendix to its letters may not be material, and if immaterial do not need to be addressed.

Illustrative example:
Share-based Payment

Many companies in the FTSE 100 have share-based payment plans. They therefore apply IFRS 2 *Share-based Payment* and make all (or mostly all) the required disclosures. However, if we look more closely at some of these plans we realise that many are quite small compared to the overall size of the entity that is reporting. Consider the following data gathered from the reports of FTSE 100 companies:

	Share-based payment charge as a percentage of net income – 2007	Share-based payment charge as a percentage of net income – 2006	Number of pages for share-based payment note –2007
Company A	2.0%	2.2%	5
Company B	0.66%	0.66%	6
Company C	22%	5.2%	7
Company D	1.3%	1.7%	3

As a percentage of net income, the share-based payments charge is quite small for some companies and relatively larger for others. But whatever the size of the charge, the note disclosure is lengthy.

The other issue is that the amount of the share-based payment charge is often buried in the lengthy disclosure. So it is not always easy to see at a glance whether the plan is material – although the lengthy disclosure gives the impression that it is.

Part of the problem is that materiality is hard to define and seems to mean different things to different people. Materiality is based on both quantitative and qualitative factors, and the qualitative aspect is especially difficult to define. The safe option is therefore to include everything in reports so that users can make up their own minds. Unfortunately, this undermines the quality of reports as a whole.

Many definitions of 'material' try to divide information into two discrete categories: material and immaterial. In reality, there are items that are obviously material, those that are obviously immaterial – and a grey area in between. Items in the grey area will require consideration and judgement on whether they need to be disclosed. At present, too many items in the 'obviously immaterial' category are being disclosed.

"Materiality is based on both quantitative and qualitative factors, and the qualitative aspect is especially difficult to define.

At present, too many items in the 'obviously immaterial' category are being disclosed."

Call for action five:
Cut clutter

In order to cut clutter we need to work on making better materiality judgements and to consider whether various sources of regulation are contributing to the problem.

ICAEW Materiality Guidance
Current guidance on materiality, such as the ICAEW's *Guidance on Materiality in Financial Reporting by UK Entities*, quite rightly focuses on discussion of all the different factors such as size, nature and circumstances that could cause an error (such as omitted disclosure) to be material. Its guidance is geared towards ensuring that material errors are not judged immaterial, which is the highest risk in judgements of materiality. However, it should also acknowledge that lowering this risk by judging everything to be material is not having a positive impact on corporate reports overall.

Auditing standards
To focus the audit on getting the numbers right and to address situations where fraud might be disguised by sloppy accounting, auditing standards require auditors to communicate all errors to the appropriate level of management unless they are 'clearly trivial'.[10] Because it is time consuming to debate with the audit committee, managers generally try to minimise the errors that ultimately get reported to the audit committee by making changes to the financial statements.

Because 'clearly trivial' is a lower threshold than immaterial, auditors have to operate at a very low level of detail. Most people think of errors as being quantitative, but auditing standards also consider a disclosure omission to be an error. So, paradoxically, auditing standards may be causing behaviour that results in companies making immaterial disclosures.

There is a concern that disclosure omissions may be different in nature from qualitative errors in the primary financial statements because they do not necessarily add up over time. This raises the question whether disclosure omissions and quantitative errors deserve identical treatment in auditing standards.

Other regulations
Reports must comply with regulations from a variety of sources, which do not always make it perfectly clear whether their requirements apply to items that are immaterial.

As illustrated above, clutter in reports is a multi-faceted issue that will be very difficult to resolve. However, some action is already in hand. In order to help preparers make judgements and provide some examples of obviously immaterial disclosures, the FRC plans to conduct a review of 2008 annual reports during summer 2009. It will publish a short paper on its findings including, where possible, examples of how regulations may have contributed to clutter.

Action

To begin tackling clutter in reports we believe two steps are urgently necessary:

Step 1:
Preparers should remember that immaterial disclosures undermine the quality of reports and make a concerted effort to cut clutter.

Step 2:
We recommend an investigation into the way various sources of regulation are contributing to clutter in annual reports.

2.

Open and honest

Provide a balanced explanation of the results – the good news and the bad.

The interview process revealed that users are suspicious that companies do not always communicate openly and honestly. This is unsurprising, since companies certainly have an interest in making their results look as good as possible. Open and honest communication is very important to users, and many mentioned discounting companies they suspect of trying to spin the results.

Users want a balanced commentary, which provides fair discussion of strengths and weaknesses. They say that, too often, companies only talk about the good stuff. For example, companies sometimes explain a bad quarter by saying the previous quarter was exceptionally good – even when this previous quarter was not originally described as exceptionally good when the results first came out.

Adjusted measures need to be reconciled

It has become quite common for annual reports to feature a variety of alternative performance measures, either because the terms are not defined under IFRS or to get back to underlying maintainable earnings. Many preparers note that this is increasingly prevalent because the financial statements do not reflect business reality and users agree that these additional measures can be helpful. More companies are explaining and reconciling their alternative measures; but where they do not, users report much confusion and suspicion that management is trying to hide something.

“Being open and honest means coming clean on areas of weakness, not trying to cover them up with changes in report presentation.”

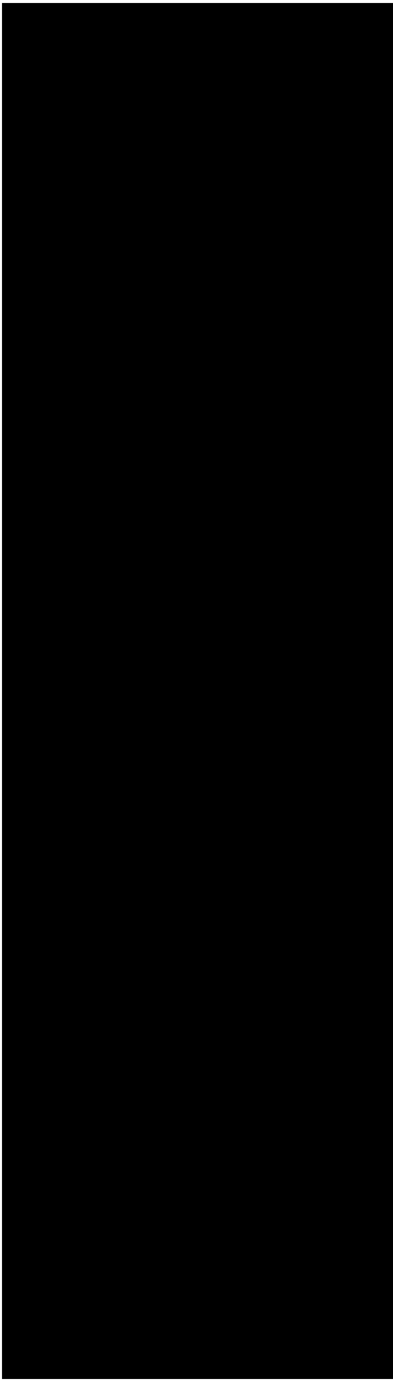
Comparable results over time

Being open and honest means coming clean on areas of weakness, not trying to cover them up with changes in report presentation. Users expressed concern that companies do not consistently present their results over time. This does not mean that users want companies to prepare reports that are identical to the prior year. But it does mean that they find it frustrating when companies change key performance indicators and segments regularly, so that they have difficulty judging how the current year compares to the previous year. It is especially troubling when they suspect the change in presentation is designed to cover-up a problem in an area of the business. Users want to see the same measures of progress used over time. If change is needed, they want to know why.

3.

Clear and understandable

Use plain language, only well defined technical terms, consistent terminology and an easy-to-follow structure.



Clear, understandable language is not only needed in regulations; it is also needed in reports themselves. Users noted that when transactions and events are not explained clearly, they start to suspect that companies are intentionally trying to obscure the results. This may not actually be the case, but it is worth taking the time to explain results clearly.

Illustrative example:
Improving communication

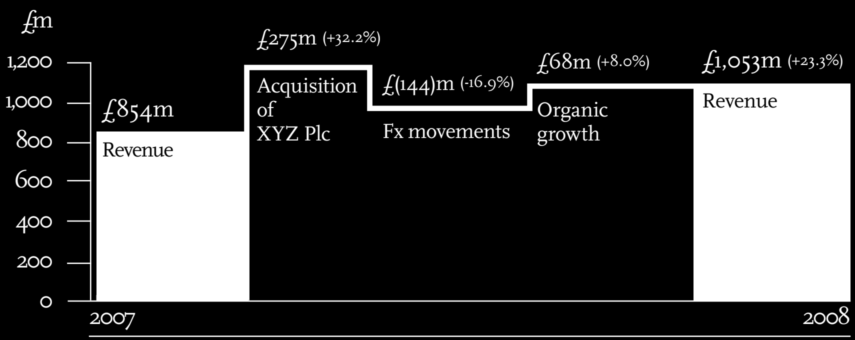
The information in the text below could be better communicated through an illustration.

Consider:

Revenues were £1,053 million in 2008, compared with £854 million in 2007, an increase of £199 million. The increase was largely due to the acquisition of XYZ Plc mid-way through the year (£275 million), offset by the fall in the pound relative to the dollar (£144 million). Overall, we achieved an organic growth rate of 8%.

Alternatively...

The chart below explains the revenue growth during 2008:



Effective communication

4.

Interesting and engaging

Get the point across with a report that holds the reader's attention.

When working through the regulatory checklist, it is easy to forget that users of reports are people too: the more interesting and engaging the report, the better it will communicate important messages to users.

The Report Leadership initiative has come up with a number of practical ideas for making reports more interesting and engaging for investors.[11] Instead of re-inventing the wheel, we have listed some of these ideas in the following panel.

The moral of the story: dense boilerplate text that is hard to follow is neither interesting nor engaging.

Electronic communications

Electronic media presents an opportunity to make corporate reporting easier to use. Electronic communication has the potential for a 'drill-down' approach to reporting which allows users to start out with a high-level summary in the annual report and progressively drill-down to more detail.

This can improve the accessibility of reports by not swamping readers in too much detail at the outset. But it does require companies to generate data for the website, design the information appropriately for a web environment and translate it into appropriate formats. So while it may provide a partial solution for users, the price could be increased complexity for preparers.

Ideas for making reports more interesting and engaging, based on the Report Leadership initiative:

- Try to write a compelling story using a narrative sequence with a beginning, a middle and an end
- Present key messages in pull quotes, titles, bullet points, sub-headings etc
- Don't hide important information at the back of the report
- Use navigational aids on each page/spread
- Provide information visually through graphical summaries
- Provide a short summary of information that is included in each section of the report
- Include clear titles and sub-headings, and a strong typographic hierarchy.

In our face-to-face interviews, interviewees mentioned a large number of specific sources of complexity in corporate reporting.

These are summarised in this chapter in alphabetical order. Each represents an additional opportunity to understand and address the issues that give rise to complexity in corporate reports.

We would value readers' views on which of these areas should be followed up, as well as volunteers to assist with the next steps.

Opportunities for further action

Acquisition accounting	Users and preparers both say that valuation of acquired intangibles is unnecessarily complex because it is time consuming to do and does not result in useful information. *Discussed also on page 23*.
Capitalisation of research and development (R&D) costs	Users say that capitalisation of R&D costs is confusing because no two companies make the same judgements and it reduces the ability to compare entities. Even within a single entity, it is difficult because it means that costs are not shown in one place.
Choices	Users are concerned that choices in accounting standards reduce the ability to compare entities, particularly in relation to the choice of adoption dates for IFRS.
CSR agenda	Many users and preparers say that CSR information can be important; but they are concerned that overloading reports with this type of information may make them cluttered.
Defined benefit pensions	Both users and preparers say there is significant underlying complexity in relation to the valuation of pension plans. There is also a belief that pension disclosures should include future cash flows relating to pension scheme funding.
Discontinued operations	Many users consider discontinued operations accounting complex because changes in plans often result in numerous restatements for each discontinued operation. Many favour a disclosure-only treatment.
Embedded derivatives	Many preparers observe that the 'witch hunt' for embedded derivatives and the process of valuing them is complex and time consuming – and does not always yield a sensible result.
Fair value	Fair values are considered complex where there is an absence of a market for determining the value. In addition, the gain on write-down of own debt has sharply polarised opinion – with views ranging from 'inevitable' to 'absurd'.

Financial instruments: general	Users and preparers are concerned about the significant underlying complexity of financial instruments as well as the very complex and detailed accounting standards that many consider add unnecessarily to complexity in this area.
Financial instruments: risk reporting/disclosures	Both preparers and users are concerned that financial instruments disclosures made in accordance with the minimum requirements are not as useful as they could be. *Discussed also on page 20*.
Hedge accounting	Qualifying for hedge accounting treatment is time consuming for preparers. Both users and preparers have a preference for using hedge accounting treatment for economic hedges, even if they don't meet the strict requirements to qualify for hedge accounting. *Discussed also on page 19*.
Interpretive guidance	Many preparers say the proliferation of interpretive guidance for accounting standards such as IFRIC interpretations and accounting manuals produced by audit firms adds to complexity.
Parent company financial statements	Many users say that they do not use the parent company financial statements in annual reports.
Remuneration reports	Many users observe that remuneration reports are too dense to be useful. They want greater focus on important details such as how performance ties to remuneration, less boilerplate text and greater use of graphical displays of information.
Segmental reporting	Users are still looking for greater granularity and cash flow information at the segment level.
Share-based payments	Share-based payments are difficult for preparers. Because there is significant underlying complexity and the standard is very detailed and rules-based, they often need to employ an expert to help. *Discussed also on pages 33, 34 and 43*.

Glossary

ACCA	Association of Chartered Certified Accountants
AIM	Alternative Investment Market of the London Stock Exchange
ASB	UK Accounting Standards Board
BERR	UK Department for Business Enterprise & Regulatory Reform
CFA	Chartered Financial Analyst
CIMA	Chartered Institute of Management Accountants
CSR	Corporate Social Responsibility
Complexity	Characteristic that makes regulations or the reports themselves unnecessarily difficult to understand, implement or analyse
EEA	European Economic Area
EU	European Union
FASB	US Financial Accounting Standards Board
FRC	UK Financial Reporting Council
FSA	UK Financial Services Authority
FTSE 100	A market-capitalisation weighted index representing the performance of the 100 largest UK domiciled blue-chip companies
GAAP	Generally Accepted Accounting Principles
IAS	International Accounting Standard
IASB	International Accounting Standards Board
ICAEW	The Institute of Chartered Accountants in England and Wales
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standard
LSE	London Stock Exchange
NYSE	New York Stock Exchange
OFR	Operating and Financial Review (the term used to describe narrative reporting in UK annual reports)
Pozen committee	Advisory Committee on Improvements to Financial Reporting to the US SEC chaired by Robert Pozen
Principles-based	Achieving a regulatory outcome by using a combination of principles and rules but thinking principles first
Regulations	All laws, accounting standards and other requirements that govern the content of corporate reports
Regulators	All bodies involved in setting regulations
SEC	US Securities and Exchange Commission

Footnotes

1. Exposure Draft *Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics and Constraints of Decision-Useful Financial Reporting Information* paragraph OB2.
2. Beattie, Vivien, Stella Fearnley and Tony Hines DRAFT *An Analysis of Financial Statement Issues Reported as Discussed and Negotiated by Key Preparer-Side Groups in UK Listed Companies in the First and Second Years of IFRS Implementation* (2009).
3. *Final Report of the Advisory Committee on Improvements to Financial Reporting to the US SEC* (August 2008).
4. The EC Fourth Accounting Directive allows for an exemption to the requirement to prepare, audit and file subsidiary accounts in article 57 if strict conditions are met, such as a parent guarantee of the subsidiary liabilities. This exemption has not been adopted in UK law.
5. *Modern Company Law For a Competitive Economy Final Report Volume I* provides results of a consultation 'on the proposition that a wholly-owned subsidiary, in exchange for a guarantee of its liabilities by its parent company and the satisfaction of certain publicity requirements, should be exempted from the statutory requirements to prepare any financial statements'. Paragraph 8.25 of the report notes a number of reasons for retaining the existing reporting requirements, including a concern about the 'unacceptable loss of information at the individual company level' particularly for very large, British, wholly-owned subsidiaries of foreign parents.
6. Companies Act 2006 sec 385.
7. Markets in Financial Instruments Directive.
8. The FRC's strategy framework was updated in April 2009.
9. *Final Report of the Advisory Committee on Improvements to Financial Reporting to the US SEC* (August 2008).
10. *ISA (UK and Ireland) 260 paragraph 11-16.*
11. Report Leadership is a multi-stakeholder group that aims to challenge established thinking on corporate reporting. It argues that corporate reporting should be more accessible and informative. See www.reportleadership.com for further information.

Research strategy

As a first step in the research phase of the project, we decided to focus our research on mandatory corporate reporting for UK publicly traded companies. We reasoned that the largest number of regulations apply to publicly traded entities and, as a result, the total complexity they face is the greatest. We hope that some of our recommendations will also reduce complexity faced by smaller companies, who must often cope with a disproportionate share of complexity.

We decided to focus our research primarily within the UK for practical reasons. The UK is subject to a number of EU Directives that affect corporate reporting requirements throughout the EU, therefore some of our work will be applicable in other EU member states. We also hope that some of our recommendations will reach further: for example, those that relate to the IASB will have widespread applicability.

As part of the initial research we completed significant background reading on other complexity projects and other initiatives to improve corporate reporting around the world. For a complete list of sources, see *Sources and further reading* on page 59.

Among these, one is worth noting specifically: *Final Report of the Advisory Committee on Improvements to Financial Reporting to the US SEC.* This initiative by the Pozen committee, named after its chair, had very similar aims to the FRC's own project.

The next stage of research was to issue a questionnaire with some open ended questions on causes of complexity to all FRC board members, subsidiary board members, panel members and staff. This helped us to gather ideas to support initial project planning rather than to form the main body of research.

The most significant portion of our project research was gathered during a series of face-to-face interviews with preparers and users taking place from June 2008 – October 2008. We were very pleased at how helpful all the interviewees were and how willing they were to dedicate their time and energy to helping us with our research.

Interviews each lasted for approximately 30 minutes to one hour and interviewees were asked a series of 8-10 open-ended questions on complexity in corporate reporting. The total of 51 interviews included 20 preparers, 22 users, three AIM companies and six auditors.

The following organisations assisted us by introducing us to potential interviewees:

- Confederation of British Industry (CBI)
- Corporate Reporting Users Forum (CRUF)
- 100 Group
- Quoted Companies Alliance
- London Stock Exchange (LSE).

We also had help from external organisations who completed additional research on complexity in corporate reporting for use either specifically in our paper or in their own publications:

- LSE – round table with six preparers
- CIMA – interviews with six preparers
- CFA Institute – online survey with 32 users
- ACCA – online survey with 117 preparers.

In the course of our research, certain findings warranted additional investigation. For these, additional more specialised interviews and meetings were completed to gather additional information.

Throughout the research process, we were supported by the Complexity Advisory Panel comprising:

- **Ian Mackintosh** (Chairman) Accounting Standards Board
- **Charles Tilley** Chief Executive, CIMA
- **Guy Ashton** Global Head of Company Research, Deutsche Bank
- **Guy Elliott** Finance Director, Rio Tinto
- **Jennifer Walmsley** Associate Director, Hermes Equity Ownership Services
- **Jonathan Hayward** Director, Independent Audit Limited
- **John Coombe** Chairman, Hogg Robinson Group
- **Miles Gietzmann** Professor, CASS Business School
- **Richard Aitken-Davies** President, ACCA
- **Teresa Graham** independent consultant.

The complexity project team – Melanie Kerr, Janice Lingwood and Ian Wright – were support by the various operating bodies within the FRC, particularly the Accounting Standards Board.

Sources and further reading

Order according to year of publication

ICAEW: The Corporate Report (1975)

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ICAEW: The Making of Accounting Standards – Report of the Review Committee (1988)

ICAEW: Guidelines for Financial Reporting Standards (1989)

American Institute of Certified Public Accountants: Improving Business Reporting – A Customer Focus (1994)

Better Regulation Task Force: Principles of Good Regulation (2003)

Ernst & Young (E&Y): IFRS: Observations on the Implementation of IFRS (2006)

ICAS: Principles Not Rules: A Question of Judgement (2006)

Damodaran, Aswath: The Value of Transparency and the Cost of Complexity (2006)

Report Leadership Initiative, www.reportleadership.com (2006-2008)

CFA Institute: A Comprehensive Business Reporting Model: Financial Reporting for Investors (2007)

Center for Financial Services Innovation (CSFI): Principles in Practice: An antidote to regulatory prescription (2007)

E&Y: IFRS 7 in the banking industry (2007)

UBS: Financial Reporting for Investors (2007)

PricewaterhouseCoopers: Recasting the reporting model: How to simplify and enhance communications (2008)

International Federation of Accountants (IFAC): Financial Reporting Supply Chain: Current Perspectives and Directions (2008)

The Pozen committee: Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission (2008)

IASB: Discussion Paper: Reducing Complexity in Reporting Financial Instruments (2008)

Global Accounting Alliance: Getting to the Heart of the Issue: Can Financial Reporting be Made Simpler and More Useful? (2008)

CIMA: Complexity, relevance and clarity of corporate reporting: The views of CIMA FTSE 350 Directors (2009)

Beattie, Vivien, Stella Fearnley and Tony Hines: DRAFT An Analysis of Financial Statement Issues Reported as Discussed and Negotiated by Key Preparer-side Groups in UK Listed Companies in the First and Second Years of IFRS Implementation (2009)

Questions to consider

When you've read this paper, we'd value your feedback. Is what we are suggesting a logical and sensible way forward? What are your suggestions on how to move this from a debate to actual change? Please be open-minded and frank, and send your thoughts by post or email to:

Melanie Kerr
Financial Reporting Council
5th Floor, Aldwych House
71-91 Aldwych
London WC2B 4HN
Email: complexity@frc.org.uk

We'd appreciate comments by 30 October 2009. To help frame the debate we suggest below some of the points you might want to discuss – but please feel free to raise others.

1 Can the principles for less complex regulation we propose help reduce complexity? Are there other principles that should be considered?

2 Targeted: Is cash flow reporting in need of improvement? If so, what is the best means of achieving this improvement? Consider changes to IFRS, best practice guidance, publicity campaigns, other.

3 Proportionate: Should accounting standards and other regulations be based more on the information that management produces internally?

4 Proportionate: Would a project on disclosures help stem the constant growth of accounting disclosure requirements? Could it also identify the most important disclosures, with a view to giving them greater prominence?

5 Targeted and proportionate: Who are the main users of wholly-owned subsidiary accounts? Should subsidiaries be required to file audited accounts with full disclosures? Is a more simplified reporting regime more appropriate?

6 Targeted and proportionate: Would it be desirable to eliminate the UK requirement to prepare, have audited, and file wholly-owned subsidiary accounts in the case of a parent company guarantee?

7 Coordinated: Would it increase or decrease complexity if national and international regulators worked together in a more joined-up way? Is there a risk that international regulators working together might result in imported complexity for some jurisdictions? How do we mitigate this risk?

8 Clear: Would an emphasis on delivering regulations and accounting standards in a clear, understandable way reduce complexity? How can we best move towards clearer regulations and accounting standards?

9 Do you agree that principles for effective communication can reduce complexity in corporate reporting?

10 What are the barriers to more effective communication? How might these barriers be overcome?

11 Which of the specific sources of complexity in corporate reports noted on pages 54 to 55 warrant further action? Which organisation(s) would be best placed to assist with the necessary action?

The Financial Reporting
Council Limited is a company
limited by guarantee.

Registered in England
number 2486368.

Registered Office:
5th Floor, Aldwych House
71-91 Aldwych
London WC2B 4HN

Financial Reporting Council
5th Floor, Aldwych House
71-91 Aldwych
London WC2B 4HN

www.frc.org.uk