

# Feedback Statement – ‘Louder than Words: Principles and actions for making corporate reports less complex and more relevant’

## 1 Introduction

1.1 In June 2009 the Financial Reporting Council (FRC) published a discussion paper entitled ‘Louder than Words: Principles and actions for making corporate reports less complex and more relevant’. The Discussion Paper provided the results of the FRC’s initial investigation into complexity in corporate reports, and offered practical recommendations for improvement.

1.2 The purpose of this feedback statement is to:

- (a) summarise the comments received in response to the Discussion Paper; and
- (b) explain the FRC’s plans for its ongoing work on reducing complexity in corporate reporting, taking into account the feedback that was received.

## 2 Comments received

2.1 The FRC received 31 comment letters from the following stakeholder groups:

Users of financial statements	6
Preparers of financial statements	6
Accountancy bodies/other regulators	8
Auditing firms	7
Individuals/other	4

2.2 The comment letters, other than any specifically requesting confidentiality, have been placed on the public record on the FRC’s website; [http://www.frc.org.uk/about/complexity\\_panel/responses.cfm](http://www.frc.org.uk/about/complexity_panel/responses.cfm).

2.3 The FRC concluded, based on an evaluation of the responses, that there is support for further work on reducing complexity and improving relevance in corporate reporting and for the proposals in the Discussion Paper. However, many respondents noted that going forward, they would like to see the FRC

propose more specific plans for action to reduce complexity – principles alone are not enough.

2.4 The Discussion Paper posed 11 questions. A summary of the responses to these questions is set out below.

### **3 Feedback from respondents and FRC plans**

3.1 The feedback received in the comment letters is outlined below:

#### **Principles for less complex regulation**

3.2 The Discussion Paper asked:

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

3.3 To the first part of the question, responses were as follows:

Yes	77%
No	7%
Not discussed	16%

3.4 The principles for less complex regulation were well supported by most respondents – albeit with the acknowledgement that it is easier said than done. There were also some respondents who noted that many regulators may believe that they already apply these principles.

3.5 With regard to the second part of the question, four respondents noted that the FRC's Principles for less complex regulation were not perfectly aligned with the Principles of Good Regulation upon which they were based. The reason for this is that the complexity project focuses on regulatory outputs as opposed to regulatory process. As a result, the principle of accountability was not referenced in the Discussion Paper, although it still applies.

3.6 Given the support for the principles for less complex regulation, the FRC decided to adopt them without amendment.

3.7 The Discussion Paper also asked a further three questions related to the principles for less complex regulation:

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

**7) 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) 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?**

3.8 The responses to these questions provided additional support for the principles. However, some respondents cautioned against basing regulations on information management produces internally, because this may reduce comparability between entities. Also it may not meet users' needs for information beyond that used by management.

3.9 In relation to delivery of regulations in a clear, understandable way, one respondent suggested the following:

*'The recently published IFRS for SMEs provides a useful template in this area. In drafting this Standard, a concerted effort was made to: use the same format for each section; simplify the language used as far as possible; and reduce disclosure requirements.'*

*'One way [to proceed] could be to collect examples of unclear paragraphs or expressions, discuss these with the IASB and afterwards develop more detailed guidance for formulating standards'.*

## **Principles for effective communication**

3.10 The Discussion Paper asked:

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

3.11 The responses were as follows:

Yes	52%
Yes, but ...	19%
No	3%
Not discussed	26%

3.12 Most of those in the 'yes, but ...' category noted that the principles were easier said than applied.

3.13 Six respondents observed that 'open and honest' would be difficult to achieve in practice. Three letters raised a concern that being 'open and honest' will just add length to the annual report and therefore not reduce complexity. Three letters noted that achieving the principle of 'interesting and engaging' is likely to be a challenge in practice; there are many priorities for finance departments' time/resources.

3.14 Based on the feedback from the respondents and the support for the principles, the FRC decided to adopt the principles for effective communication without amendment.

3.15 The Discussion Paper also asked:

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

3.16 Responses to this question were varied, with many respondents mentioning ability and motivation as barriers.

## **Improve cash flow and net debt reporting**

3.17 The DP asked:

**2) 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.**

3.18 Responses were:

Yes	58%
Yes, but ...	10%
No	6%
Not discussed	26%

3.19 Whilst most respondents agree that cash flow reporting is in need of improvement, they do not tend to favour the FRC developing any kind of best practice project in this area. Instead, respondents think changes should be made by the IASB. The FRC will continue to monitor developments in relation to the IASB's project on Financial Statement Presentation and will encourage improvements in this area.

## **Disclosure project**

3.20 The Discussion Paper asked:

**4) 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?**

3.21 Respondents said:

Yes	58%
Yes, but ...	6%
No	13%
Not discussed	23%

3.22 Six letters observed that the need to identify and prioritise differing user needs will make this project challenging.

3.23 Several respondents who support the project note it will be most effective in influencing change if it is undertaken at an international level.

3.24 Internationally, the EFRAG Planning and Resource Committee (PRC) has agreed that EFRAG will lead a pro-active disclosure framework project. An Advisory Panel has been appointed, including a number of UK members, and the project team includes FRC representatives. One of the objectives of the project is to develop a set of principles for more relevant and useful disclosures in the financial statements. A discussion paper is expected to be published in 2011.

3.25 The US Financial Accounting Standards Board (FASB) is also currently running a disclosure project. The FASB project has dual objectives, which are to (a) establish an overarching framework intended to make financial statement disclosures more effective, coordinated, and less redundant, and (b) seek ways to better integrate information provided in financial statements, Management's Discussion and Analysis (MD&A), and other parts of a company's public reporting package.

3.26 The Accounting Standards Board (ASB), one of the FRC's operating bodies, has committed resources to participate in the disclosure project with EFRAG and the French ANC.

### **Subsidiary reporting**

3.27 The Discussion Paper asked:

**5) 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 regime more appropriate?**

**6) 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?**

3.28 Respondents offered a wide variety of different users for subsidiary accounts. There is no general consensus on who the main users are. For example, respondents noted:

*'Analysts also often use subsidiaries' accounts to help them understand the sectoral and geographical breakdown of a group's activities'*

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*'The primary user of a wholly-owned subsidiary's accounts should be considered to be the directors of the parent company who are responsible in turn to the shareholders of the parent company for their oversight of the subsidiary'*

*'We observe that trading subsidiary accounts are used by potential customers and suppliers who wish to assess the financial position of the legal entity with which they will be dealing rather than of the group as a whole'*

3.29 Respondents were approximately split between those who did and did not favour changes to subsidiary reporting. Views were also broadly split on whether there should be an investigation into reducing filing requirements in the case of a parent company guarantee. Many of those opposed were sceptical that this would reduce complexity, and some suggested companies would not take advantage of this option for legal reasons.

3.30 The ASB issued a Consultation Paper in August 2009 on the Future of UK GAAP. The subsequent Exposure Draft, which is expected to be published shortly, will provide additional insight into the subsidiary reporting issue.

### **Project to improve usability of IFRS**

3.31 The Discussion Paper did not raise a specific question on this proposal.

3.32 Six letters expressed support for this project. One letter from an individual noted:

*'clearly articulating the desired outcome as the first section of each standard would not only improve the understandability, but it would lead to being able to determine better whether the standard was really important in terms of materiality to a particular enterprise'.*

3.33 Given the relatively limited support for this project, the FRC does not propose to conduct any further work itself in this area. The FRC will continue to advocate that the IASB seeks to simplify the structure and language used in its standards.

### **Cutting clutter project**

3.34 No question was asked in relation to this project. However, over half the respondents supported the need to reduce the number of immaterial disclosures in annual reports. Seven respondents called on the FRC to address the materiality issue and three asserted that the Financial Reporting Review

Panel and Audit Inspection Unit were partly responsible for clutter in annual reports. In response to these concerns, the FRC has set up a project team and an Advisory Panel to carry out further work on 'cutting clutter'.

### **Opportunities for further action – as outlined in the Discussion Paper**

3.35 The Discussion Paper asked:

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

3.36 A variety of different responses were received to the list of specific sources of complexity provided. However, little consensus emerged about which specific issues should be addressed as initial priorities.

### **Other areas**

3.37 There were also other areas mentioned by a number of responses that were not addressed in any detail in the Discussion Paper. These are:

- (a) **Technology:** Sixteen respondents supported better use of technology as an antidote to complexity in corporate reporting – suggestions included greater use of XBRL, moving standing data to websites and questioning the assumption that the annual report is a printed document.
- (b) **Non-GAAP measures:** Seven respondents mentioned the use of non-GAAP measures, although views were mixed in relation to what, if anything should be done in this area.
- (c) **Purpose of reports:** Four respondents called for a fundamental rethink of how the annual report is used, while ten other respondents emphasised the importance of understanding users' needs when trying to combat complexity.
- (d) **Narrative reporting:** There were nine comment letters that emphasised the importance of narrative reporting in reducing complexity. A preparer noted that:

*'because the financial statements themselves are becoming more and more opaque for analysts, we have to give more meaningful information elsewhere'.*

There were several calls for the FRC to undertake a project that provides a road map for narrative reporting, linking together the various different sources of overlapping regulation companies must follow in the UK. One respondent called on the FRC to:

*'issue a document which provides companies with a complete and logically ordered guide to narrative reporting'*

Another noted that the ASB's narrative reporting guidance should be updated to better link to the business review requirements in the Company's Act 2006.

3.38 The FRC will continue to keep the areas above under review.