

Cutting clutter.

Combating clutter in annual reports



Financial Reporting Council

The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment.

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www.frc.org.uk

The FRC published *Louder than Words: Principles and actions for making corporate reports less complex and more relevant* in June 2009. One of the actions we wanted to progress related to 'cutting clutter'. This publication seeks to be a catalyst to help all of us to change our behaviours and how we approach removing unnecessary text and data from annual reports.

Cutting clutter: FRC discussion paper

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Foreword

Cutting clutter

Clutter in annual reports generates debate. All agree that a problem exists: most say that someone else is the cause and that they need to change first. As regulators our actions, and the way others respond to them, also contribute to the clutter we often see in annual reports and accounts.

Clutter undermines the usefulness of annual reports and accounts by obscuring important information and inhibiting a clear understanding of the business and the issues that it faces. We are committed to being a catalyst for change – to move from debate to action, and to being an active participant in the change process to ensure that our actions are proportionate and targeted so reducing clutter, not adding to it, wherever possible.

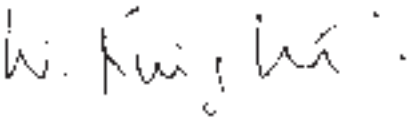
Cutting clutter cannot be achieved just by taking a red pen to a late printer's proof. Making a significant and permanent change has to be addressed at the planning stage for the next annual report through a clear idea of the desired outcome and how change will be achieved. A good time to start this process is at the debriefing meetings reflecting on the current year's annual reports, which for many companies will be taking place over the next few months.

The Government, the FRC and many others have called for improvements to companies' narrative reports. The debate continues on exactly how such reports should be restructured. But whatever is decided our aim must be to make the text clear and clutter free.

This publication contains a number of aids for reducing clutter which we hope will be used to start making change a reality. The FRC intends to follow through on this initiative in a number of ways, for example by working with the Government on its review of narrative reporting. In addition, as proposed in its recent *Effective Company Stewardship* consultation, the FRC would like to create a ‘financial reporting lab’ where constituents can get involved by developing and testing ideas (without liability) to enable greater innovation.¹

We welcome comments on this paper. We plan to hold a meeting with interested parties in the autumn to share experiences and to identify best practice as it develops.

Cutting clutter will not happen overnight. But the benefit in the longer term will be significant – reducing the time, energy and cost of preparing unnecessary disclosures and increasing clarity for investors.



Bill Knight
Chairman, Financial Reporting Review Panel



Roger Marshall
Chairman, Accounting Standards Board

“

Clutter undermines the usefulness of annual reports and accounts by obscuring important messages...

”

What do we mean by clutter?

The annual report's primary purpose is to provide "investors with information that is useful for making their resource allocation decisions and assessing management's stewardship."² It can also help stakeholders assess the company's governance and whether, in the words of the FRC's *UK Corporate Governance Code*, it enables the board and management to deliver on the long-term success of the company.³

Clutter makes it more difficult for users to assess a company's progress by obscuring relevant information. Due to the time and effort involved in preparing such disclosures, clutter is also a big issue for preparers.

The FRC's publication *Louder than Words* identified clutter in annual reports as a problem because key messages are getting lost. Respondents agreed. *Louder than Words* noted that "generally, if regulations require a disclosure, it goes in the report – regardless of the materiality or importance to the business."⁴

We have used the term ‘clutter’ throughout this paper as comprising two problem areas:

- immaterial disclosures that inhibit the ability to identify and understand relevant information; and
- explanatory information that remains unchanged from year to year.

Immaterial disclosures are remarkably common, for example detailed notes supporting line items that are small – often the case for share-based payments. However, reports also contain explanatory narrative information that is either wholly or largely unchanged from year to year. It is the changes that can often be illuminating but, without comparing the precise text, it is often difficult to identify them.

What we have done so far?

Understanding behaviours

Those interviewed when researching *Louder than Words* gave a number of reasons for ‘kitchen sink’ reporting – most of which were the result of behavioural barriers. Importantly, respondents noted that it was not just the behaviour of preparers that can lead to clutter, but regulators and standard setters also bear a degree of responsibility, including parts of the FRC. In addition, those providing guidance to preparers, such as auditors and institutes, contribute to the problem.

Understanding the behavioural influences leading to clutter is key. All of those involved in the annual report process are influenced by others’ behaviours; the combined effect is often a barrier to cutting clutter. For example, the lack of agreement over what materiality means from a disclosure perspective results in each reviewer erring on the side of caution.

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Practical examples

Despite these constraints, some change can be achieved without changing standards or guidance. With input from the Advisory Panel (see page 48) and a small number of preparers we developed illustrations of what disclosures could look like without the clutter.

Three areas commonly found to contain clutter have been considered. They come from different parts of an annual report – both the narrative usually contained in the front of the annual report, as well as examples within the notes to the financial statements. The illustrations are not templates. The focus is not on the detailed wording provided in each disclosure – some of the text is in Latin – but on providing some pointers to things to think about in order to improve the disclosures and cut the clutter, in part by moving explanatory information onto a website.

We are aware that currently, where required by law or IFRS, explanatory information would still have to be provided and included in an appendix within the annual report, rather than separately on a website. While this isn't ideal, as it requires preparers to continue to produce the information year on year within the annual report, it lessens the clutter effect for users.

“
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Making change happen

We are well aware that achieving change will not be easy. However, we believe there *are* some steps that can be taken to start to combat a number of the barriers and to give confidence that removing clutter is achievable even in the short term.

This paper includes three steps:

1. We have set out *three calls* for action which we believe are essential to start combating a number of barriers to cutting clutter and provide better reporting.
2. We have developed a *behavioural aid* that preparers can use at suitable times during the annual report process to help overcome some of the barriers.
3. We have developed *three disclosure aids* to demonstrate what some key areas of the annual report could look like without the clutter.

These are explained in more detail in the following sections.

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What happens next?

We are particularly interested in your views on the challenges and ideas presented in this paper. Please send these to: clutter@frc.org.uk by 30 September 2011. Responses will be published on our website unless confidentiality is requested.

What we intend to do:

- We will continue to work with preparers, standard setters and regulators to push for change in response to the issues we have identified.
- We will work with the Government on its proposals to simplify narrative reporting to make it clearer and more focused.
- We plan to hold a meeting with interested parties in the autumn so that we can share views, discuss progress and showcase developing good practice. Please contact us at clutter@frc.org.uk to confirm your interest.
- If there is support for the ‘financial reporting lab’ proposal set out in the FRC’s *Effective Company Stewardship* consultation, we will ensure that cutting clutter is a key agenda item for that group.
- We will keep constituents informed of our progress at:
www.frc.org.uk/about/cuttingclutter.cfm.

Now it’s over to you. All those involved in the annual report process can start to cut clutter now by building on the ideas and aids within this publication. We have provided some ideas of *further opportunities to cut clutter* on pages 41 to 43. We look forward to seeing examples of disclosures without the clutter.

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All those involved in the annual report process can start to cut clutter now...

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1.

Calls for action to reduce barriers

While there are some steps preparers can take now, some of the barriers to reducing clutter will take a more concerted effort. Accordingly, we make three calls for action we believe are necessary to remove some of the existing barriers:

- Encourage continuing debate around what materiality means from a disclosure perspective.
- Investigate how to tackle long-standing explanatory material in printed annual reports.
- Engage with other stakeholders around their information requests.

Further information starts on:

page 20

2.

Addressing behaviours

Our investigation into clutter has convinced us that one of the main causes is behavioural. As a first step to combat this, we have developed a short behavioural aid to be used by teams involved in the preparation and review of annual reports. A point of clarification – this is not a checklist to be completed by an individual in isolation – it is an aid to the teams to change some of the behaviours that currently serve as barriers to cutting clutter.

Further information starts on:

page 13

3.

Disclosure aids to enable preparers to tackle clutter now

During our investigations, individuals mentioned a number of common areas of clutter in annual reports.

We believe that preparers can tackle a number of these common areas now. To illustrate what we have in mind, and also to encourage preparers, we have developed a few disclosure aids.

These cover:

- Governance
- Accounting polices
- Share-based payments.

Further information starts on:

page 31

Understanding the role of behaviours

Louder than Words documented a number of reasons for including every disclosure in the annual report, regardless of the materiality or importance of the item to the long-term success of the business or to decisions that might be made by investors. These ranged from “simply repeating disclosures made in prior years” to “fear of challenge from regulators”.⁵

Most of the reasons given have at their core behavioural influences. An example of a behavioural influence is the way in which some preparers and audit staff use illustrative accounts. Such aids are prepared with the objective of covering every eventuality, assuming everything is material. They are not themselves a barrier to cutting clutter, but the unchallenging way they may be applied can be. The result – disclosures are reproduced without first addressing the relevance of each item to the individual company.

But it isn't just preparers' behaviour that is creating barriers to cutting clutter. Those involved in setting standards, regulating, auditing and advising preparers about their preparation of annual reports are also contributing. Examples include the ICAEW's guidance on materiality, which currently focuses on what to include rather than what could be taken out, as well as the big firms' manuals, where again the words can tend to result in a checklist for inclusion. Some of these actions are summarised on pages 16 and 17.

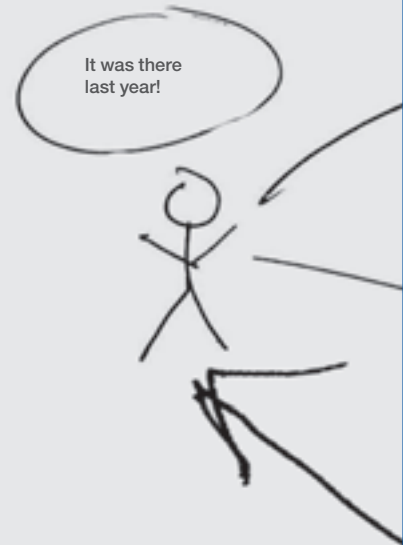
These well-meaning actions weigh down on the preparers; the overall result – a despairing preparer, as illustrated opposite.

However, it is possible to change the dynamic. To demonstrate how one group (preparers) can start to change behaviours in an effort to cut clutter, we have prepared a behavioural aid, which can be used at suitable times during the annual report process, see pages 18 and 19.

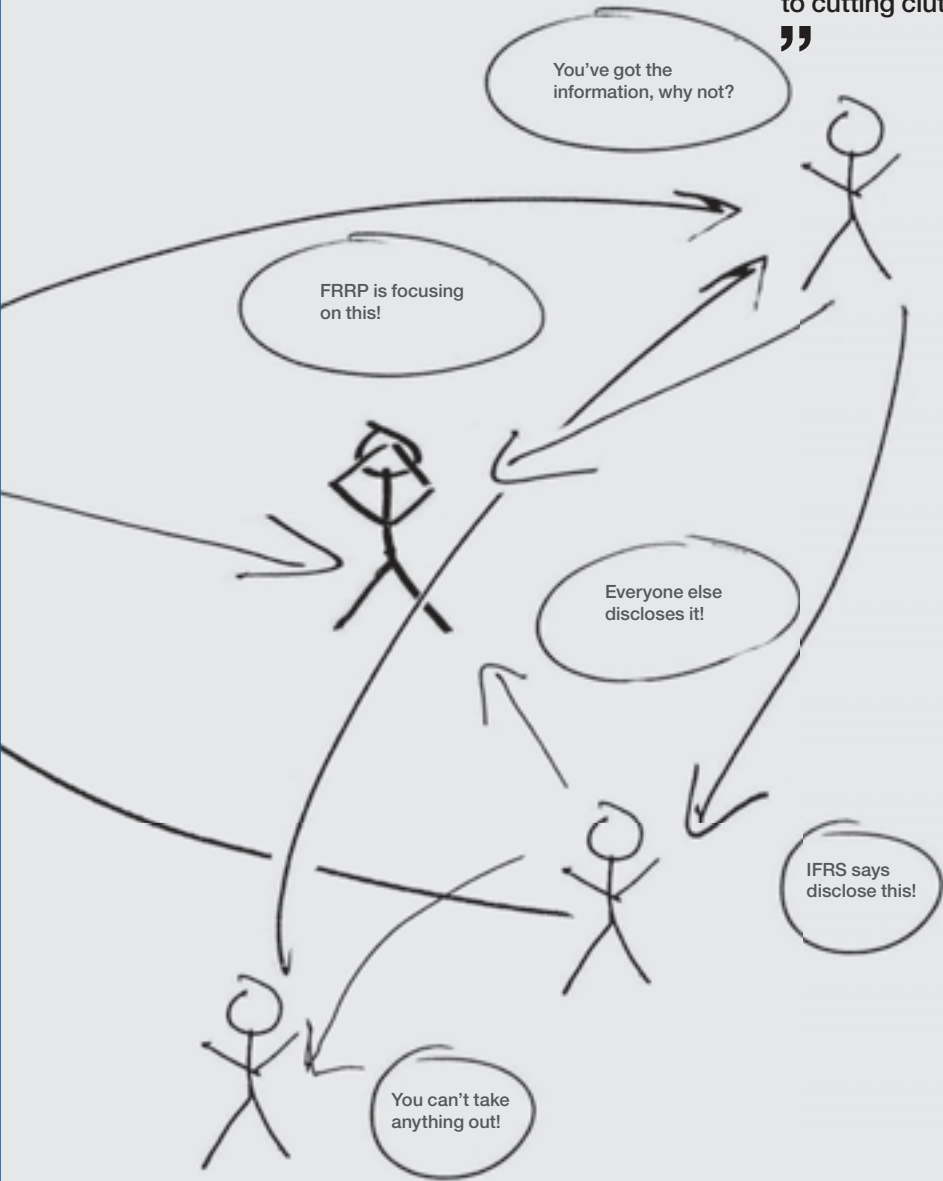
For more detail on how we assessed behavioural influences, see *Project methodology*, page 46.

A despairing preparer

Standard setters, regulators, auditors, internal teams, specialist users and others, all play a role in influencing each other and preparers.



“
... it isn't just preparers' behaviour that is creating barriers to cutting clutter.
”



Behavioural influences

Understanding why we act the way we do, and specifically in the context of this report, why preparers include clutter in annual reports, requires an appreciation of the behaviours of all those involved.

Influence of authoritative sources

IASB – global accounting standards

- Some disclosure requirements appear to be derived from an anti-abuse viewpoint.
- Verifiability can lead to disclosures detailed enough to enable users to (re)perform calculations.

Regulators need to be seen as effective

Influence of authoritative sources

UK implementation

Persuasive

- Guidance, for example, ICAEW materiality guidance, focuses on inclusion rather than exclusion.
- Manuals of Accounting produced by 'Big Four'.
- Illustrative accounts and GAAP checklists produced by accounting firms address all disclosure eventualities.

Regulatory

- Reviews by FRRP and AIU may give an appearance of seeking 'tick-box' compliance with disclosure requirements.

Want to minimise risk of adverse comment

Auditors

- The prospect of internal firm review and/or external review by the AIU can induce auditors to take a ‘tick-box’ compliance approach to avoid challenge and adverse publicity.

Influenced by what everyone else is doing

Existence of illustrative accounts

Preparers (Including finance teams, investor relations, in-house lawyers and Audit Committee.)

- Opinions provided by internal teams (for example, in-house lawyers) and external auditors tend to focus on what to put in, not what to take out, in order to ensure that the financial statements comply with every disclosure.
- Prospect of external review by FRRP can further reinforce a ‘tick-box’ approach as far as disclosure is concerned, to avoid challenge and adverse publicity.

Build on previous years’ disclosure

Driven to comply fully with all disclosure requirements regardless of materiality



Fear – err on side of caution

To help preparers cut clutter we have developed two short aids to be used by the annual report team at key points in the annual report process.

1.

Significant changes to disclosures will not be achieved without planning. At the start of the annual report process the following issues should be discussed by the annual report project team, ideally steered by the project sponsor.

Planning phase/Kick-off

- Who is the project sponsor?
- What are the overall objectives for the annual report?
- What is the overall tone of the annual report?
- What are the learning points from the prior year and areas of focus for this year?
- What is the agreed approach to materiality and clearly trivial in financial statement disclosures?
- Who will be the single author empowered to take a high-level view of the annual report and edit it based both on the significance of individual disclosures to the report as a whole, and consistency with the overall objectives?
- What plans are in place to ‘cut clutter’?
- What plans are there to communicate more effectively, for example, highlighting key information and changes for users?

2.

Time pressure can mean that some of the initial ‘good intentions’ are lost along the way. Before the annual report is approved the project sponsor, along with others, should assess whether the objective of cutting clutter and improving communications is still on track.

Review phase/Time out

- Is the annual report still meeting the overall objectives?
- Do new disclosures, added since the planning phase, enhance clarity/understandability?
- Do new disclosures partially duplicate/replace other disclosures that can now be eliminated/refined?
- Does the emphasis placed on various elements of the annual report accurately reflect the significance/risk to the business as a whole?
- What are the learning points for next year and areas to focus on for cutting clutter?

Other barriers to tackling clutter

There are a number of other barriers as well. The most important are discussed below.

The lack of clarity around materiality

IAS 1 states that “An entity need not provide a specific disclosure required by an IFRS if the information is not material.”⁶ Yet it is exactly these immaterial disclosures that we observe and define as clutter. Is this message not understood or not getting through, or does it need to be refined to change the default of including everything?

One of the key reasons for including all disclosures given by interviewees was a “lack of confidence in making the judgement between disclosures that are material and those that are not.”⁷ It is apparent that the lack of clarity around what materiality means from a disclosure perspective continues to be a significant barrier in both preparing and auditing financial statements.

We are convinced that users suffer from the provision of immaterial disclosures, as these can obscure relevant information. In our own conceptual framework (published in 1999), materiality was seen as a “threshold quality” that sat above the qualitative characteristics.⁸

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Extract from ASB December 1999 Statement:

3.29 Materiality is therefore a threshold quality that is demanded of all information given in the financial statements. Furthermore, when immaterial information is given in the financial statements the resulting clutter can impair the understandability of the other information provided. In such circumstances, the immaterial information will need to be excluded.

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Understanding what materiality means is made harder by the use of different terms in law, standards and other guidance to describe the threshold above which information should be disclosed. For example, companies are required to report the “PRINCIPAL risks and uncertainties”, not simply list all their risks and uncertainties, but many provide extensive lists. Is this because the threshold has been misunderstood?

This ‘threshold problem’ could be reduced by agreeing a small number of thresholds and how they relate to each other. For example, at what point would you judge it necessary to make a disclosure for each of the following descriptors drawn from IFRS and company law? Or do most of them mean the same thing?

Different descriptors triggering disclosure:

- Critical
- Essential
- Fundamental
- Important
- Key
- Main
- Major
- Primary
- Principal
- Significant

The IASB is currently developing an updated conceptual framework for financial reporting. In the first phase of the project, completed in September 2010, materiality is not considered a ‘qualitative characteristic’ of useful financial information.⁹ The rationale for this is provided in the background to the framework, which states that “... immaterial information does not affect a user’s decision.”¹⁰

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... a clear message
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”

We encourage the IASB to refine its thinking as it finalises its revised conceptual framework – a clear message that clutter should be eliminated could well be a catalyst for change. To contribute to the debate we have been working with EFRAG as they seek to develop a framework for disclosures and are expecting to contribute to similar work being considered by the IASB.

Another possible contributor to clutter is the way in which auditing standards are interpreted and applied. For example, auditing standards require auditors to communicate uncorrected misstatements to those charged with governance unless they are “clearly trivial.”¹¹ There is an interaction here with accounting standards permitting non-disclosure where an item is not material (see above), but the thresholds are different. However, to reduce the risk of items being reported, preparers can, again, err on the side of caution and include immaterial disclosures in annual reports and accounts.

We welcome the actions of the IAASB which is now seeking to better understand these issues and has included the issue of materiality for disclosures and evaluation of disclosure misstatements in its January 2011 discussion paper *The evolving nature of financial reporting: Disclosure and its audit implications* (open for comment until 1 June 2011).

Call for action one:

Continue to encourage debate about what materiality means from a disclosure perspective.

Immaterial disclosures can obscure relevant information. Users have limited time to process information and immaterial disclosures make it difficult for users to filter the information so that they can focus on what is relevant.

A number of projects have been started, partly as a result of the FRC's Call for action in *Louder than Words*, and we support that debate continuing. Specifically, we would encourage the IASB to clarify what materiality means from a disclosure perspective.

These initiatives will take time to develop. To start to make change happen now, despite the difficulty in making assessments of materiality, there are ways preparers can work with their auditors to agree significant reductions in disclosures, and with little or no risk of regulatory challenge.

One topic often cited as giving rise to a disproportionate number of pages of disclosure is share-based payments.¹² Feedback suggests that preparers simply provide all the prescribed disclosures about every single share scheme whatever the scheme's size and impact.

To act as a catalyst for change we have produced a disclosure aid aimed at encouraging preparers to:

- disaggregate the cost of share-based payment schemes;
- make full disclosure only about those schemes that are material; and
- provide only brief details of immaterial schemes.

Our thinking is illustrated on pages 38 and 39 (Disclosure aid 3).

**Action**

The ASB and other FRC bodies will continue to encourage and participate in the debate the FRC started about materiality for disclosures.

Explanatory information

Annual reports contain a number of types of information. These can be classified into three categories. Information that is:

1. entirely new each year;
2. refreshed to reflect changing circumstances; and
3. unchanged or where the changes are trivial.

To meet the practical consequences of current legal requirements the annual report and accounts is produced as a single volume that contains all such information. As a result every document contains every disclosure even when it is identical to that made in prior years. It is the third category of information – referred to here as ‘explanatory information’ – which we believe offers a significant opportunity to reduce clutter.

For example, accounting policies can be made more relevant and easier to evaluate. The summary of ‘significant’ accounting policies required by IAS 1 often remains unchanged from year to year, with individual policies even copied from IFRSs or illustrative accounts and can easily run to eight or more pages. Refinements to these policies may be informative, yet unless they represent a change in policy, would not trigger additional disclosures.

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Such standing data could be presented separately within the annual report and with regulatory change it could be possible for such standing data to be included on a website. This would be similar to the current approach adopted for interim financial statements and to the typical content of company preliminary announcements.

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Preliminary announcements

In preliminary announcements (prelims), accounting policies are not usually provided, unless there has been a material change in a policy. Instead there is a simple statement making it clear that the financial statements are prepared under EU-adopted IFRS. Importantly, this statement is accompanied by a further statement as to where the full accounting policies can be found. So the full information is available, but just not in the prelims each year.¹³

We believe that there are significant potential benefits for many users of annual reports from separating standing data from information about what has changed during the period under review.

In view of the current requirement that the entire annual report and accounts must be provided in a printed document, we have sought to develop some practical thinking about how it might be possible to separate such standing data and include it in an appendix or otherwise distinguish it within the annual report. To illustrate the potential benefits of separating recurring explanatory information we have developed an illustration of what might be the most relevant and easily read information on accounting policies. This is set out on pages 36 and 37 (Disclosure aid 2).

Call for action two:

Investigate the possibility and potential benefits of separating explanatory information within or outside the printed annual report.

Annual reports contain a significant amount of information that is repeated year after year. Some of this information is boilerplate, providing little or no added value and should simply be removed. In relation to the rest, any change in the information such as amendments to policies or processes is likely to be more highly valued than their existence. We encourage a reconsideration of how to display the most relevant information in a way that separates it from background clutter, such as continuing policies and processes. We believe that alternatives to the current requirement to repeat explanatory information in every printed annual report year after year should be investigated. We also encourage companies to experiment with how such data is presented within the confines of the current requirements.

Non-accounting information

The discussion and analysis so far has concentrated on the financial statements. Further opportunities exist to develop strategies for reducing clutter in other parts of the annual report. To illustrate some of the potential to achieve change we have looked in particular at governance and Corporate Social Responsibility (CSR) reporting.

Governance

Only 18 of the 52 provisions of the *UK Corporate Governance Code* (the Code) require disclosure to demonstrate compliance.¹⁴ For the other 34 provisions, companies are only required to report when they do not comply, and explain why. Despite the ‘comply or explain’ philosophy at the heart of the Code, practice seems to be to explain everything.



Action

Companies and standard setters should investigate separating explanatory material within or outside the printed annual report.

Many companies tell us that they are responding to others' demands. They feel under pressure to report against each provision of the Code because of proxy voting services and other analysts who compile checklist based score sheets to assess governance compliance. Our research has shown that often these additional disclosures take the form of simply repeating the wording of the relevant Code provisions each year. One effect is that they can detract attention from those parts of the governance section that are of most importance to investors, as well as adding to its length. In particular, it makes it much harder for readers to identify the more relevant company-specific information about governance issues and practice.

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To help act as a catalyst for change, we have developed some ideas about how a report on governance might be developed to highlight the relevant company-specific information and separate it from generic information about compliance with the Code. The illustrative example is set out on pages 34 and 35 (Disclosure aid 1).

Corporate Social Responsibility (CSR) reporting

Our earlier research into narrative reporting conducted in 2009 resulted in the publication *Rising to the challenge*. We concluded that “CSR sections of annual reports contain significant immaterial clutter that is not necessarily essential for making resource allocation decisions.”¹⁵ We also concluded that one of the potential reasons for this is social pressure making it difficult for a company to disregard specific CSR areas, regardless of the importance of each area to its particular business.

Extract from *Rising to the challenge*

Companies are feeling their way in developing their CSR reporting and there is significant social pressure in this area. But some have fallen into the trap of delivering unnecessary clutter such as: “football coaching” for an insurance company and “donating chocolate gifts to the community at Easter” for a service company – these are worthwhile activities but in our view are not material to understanding a company’s performance and position.

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Nine companies had a CSR section longer than their financial review.

Only 20% of the sample provided a convincing explanation of why CSR is important to their business.

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In *Rising to the challenge* we noted that there was an “evolving plethora” of sustainability reporting requirements in the pipeline, and since then we have seen a number of consultations taking place on CSR, narrative and integrated reporting. These are likely to lead to further reporting requirements. In our latest response to the European Commission on *Disclosure of Non-Financial Information by Companies* we support the objectives of a framework of integrated reporting (for example, by showing the broader and longer-term consequences of decision-making).¹⁶ However, we guard against: increasing the length and complexity of the annual report; and the risk of the report being ‘captured’ by particular interest groups at the expense of the needs of the long-term investor.

We encourage all regulators to consider how they ensure that any change to reporting requirements does not increase clutter, and that there is a clear understanding of what is necessary to be reported rather than just nice to have.

Call for action three:

Engage with other stakeholders regarding their information requests

As set out in *Louder than Words*, there is a need to refocus annual reports on their primary purpose: providing investors with the information that is useful for making their resource allocation decisions and assessing stewardship. However, there continues to be a number of other stakeholders requesting that further information is added to an already lengthy annual report.



Action

The ASB will continue to engage with other stakeholders and regulators to ensure that their legitimate information needs can be met without adding clutter to annual reports.

Addressing common areas containing clutter

During our work it became apparent that there are many areas within an annual report that commonly contain clutter and some progress could be made in the short term. We also wanted to illustrate what various aspects of an annual report would look like if we could achieve more significant change. Our target was to deliver on the first principle of effective communication that we set out in *Louder than Words*, namely that reports should be focused – they should highlight important information and avoid distracting readers with immaterial clutter.¹⁷

We have developed three disclosure aids, covering different parts of an annual report, which we have discussed with a small number of people involved in annual reporting. In addition to attempting to cut clutter, we have also borne in mind the other three principles of effective communication, namely that reports should be: open and honest; clear and understandable; and interesting and engaging.¹⁸

How to use the disclosure aids

Our aids are not templates and cannot be applied without careful thought on a case-by-case basis. Each one contains a screen capture of a spread from an imaginary annual report. However, the spreads themselves are deliberately not complete. What we have presented is an illustration of what is possible, and surrounded them with some hints and tips for implementation.

Each of the three aids addresses one of the areas commonly containing clutter in an annual report today, from the narrative provided up front, to detailed notes relating to a specific amount contained within the financial statements. In addition to selecting different areas of the annual report, we wanted to illustrate how the two different types of clutter could be addressed, namely immaterial disclosures and explanatory information.

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Each of the three aids addresses one of the areas commonly containing clutter in an annual report today...

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We are sensitive to the difficulty of judging what is material. In the share-based payment example we have assumed that one of the four schemes passed that threshold but the others do not. In the debate that follows the publication of this report we hope that greater understanding can be developed about what is material. This should provide preparers and auditors with greater confidence that their reasonable decisions should not be challenged by regulators.

In addition, we are acutely aware that currently explanatory information cannot be provided on a website. In developing our disclosure aids, we have assumed that progress is made in this area. Unfortunately we are not there yet. Accordingly, in the current environment we suggest moving explanatory information into an appendix within an annual report. While this isn't ideal, as it requires preparers to continue to produce the information year after year within the annual report, it lessens the clutter effect for users, as the two page summary envisaged effectively does the work for the reader. The full information currently required would still be available, although deeper within the annual report.

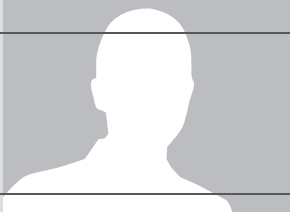
“
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”

Have the Chairman report personally in the Governance section.

Discuss key challenges as context for the letter, and the steps taken to operate effectively including:

- Board balance (skills, experience, diversity, etc).
- Succession planning.
- Board evaluation and director development.
- Engagement with shareholders – if any significant governance concerns have been raised by shareholders, indicate how the board has responded.
- Any other significant decisions reached by the board, for example, new remuneration policies or structures.

Governance overview



John Smith
Chairman

Other committee letters

My colleagues chairing other board committees provide an overview of their activities this year as well. These can be found as follows:

- Audit – page xx
- Nominations – page xx
- Other – page xx
- Remuneration – page xx

Dear shareholder

Dolupiet perepel lentus perum exerro beat et mos magnime ndipiet, im culpa con cus, nis reped modio blabroessus nihit venihit velliqui officauerum, sitam dolore, velende prrohendi aut aut endest

Our activities in 2010

Text heading

Ota ne et latust lam quatis apitaquissum nos et ditio bl cte conecto tatum fugia que elessimi, tem quam rerupta et autestotaque sit venimendem sinturibus modignam

Text heading

Ota ne et latust lam quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto tatum fugia que elessimi, tem quam rerupta et autestotaque sit venimendem sinturibus modignam

Text heading

Ota ne et latust lam quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto tatum fugia que elessimi, tem quam rerupta et autestotaque sit venimendem sinturibus modignam

John Smith
Chairman

Continue the personal reporting in short letters from the NED Chairman of the board committees. Focus should be on activities, not policies. Provide clear signposting as to where these can be found.

Governance update

Compliance statement

Ota ne et latust lam quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto tatium fugia que elessimi, tem quam rerupta et autestotaque sit venimendem sinturibus modignam

Board evaluation

- Process: [Internally or independent assessor]
- Assessor [where used]: XY Jones
- [If there are recommendations that the board is content to make public, add details. Otherwise indicate that recommendations are being implemented.]

Where you can find other information

- Internal control statement – page xx
- Other specific disclosures required to comply with the UK Corporate Governance Code – page xx
- Business model – page xx

Changes to our process

[Describe significant changes to governance processes made during the year.]

Epitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto tatium fugia que elessimi, tem quam rerupta et untionecab incto quati temolup taecte um fugia que

Experience of your board

Instead of the usual lengthy CVs for each board member accompanying the board pictures, we have summarised the skills and experience we believe is relevant to their position on our board.

See page xx



For our full governance arrangements visit www.asbplc.co.uk/information

Annual Report and Accounts

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Explicitly state compliance with relevant corporate governance codes, or explain where and why the Group hasn't complied.

Do the work for the reader by drawing out relevant skills and experience of the board.

Consider what information you can provide to demonstrate that the evaluation process was robust and its recommendations are being acted on.

Do the work for the reader by highlighting significant changes to governance processes made during the year.

Rather than repeating the provisions of the Code, separate out longstanding process information. Clearly signpost where the information can be found either on a website or in an appendix.

In order to comply with the Code there are a limited number of specific disclosure requirements, many of which have already been covered (for example, committee reports, board evaluation statement). Clearly signpost where the remaining disclosures such as the internal control statement can be found.

Articulate the basis of preparation of the financial statements.

Explicitly state whether or not the adoption of new standards etc has resulted in a material change.

Make it clear whether or not there have been any other changes.

Similarly discuss the impact of accounting developments not yet adopted.

Notes continued

1. Accounting policies

Basis of accounting

[Describe the basis of preparation, for example, EU adopted IFRS or full IFRS.]
quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto tatum fugia que elessimi, tem quam rerupta et autestatust lam quatis apitaquissumo blam, cor auda est, untionecab incto quati temolup taecte conecto

Accounting developments and changes

Developments – during 2010

[Describe any material change to the financial statements due to the adoption of new accounting developments in the current year.]

Other changes

Other than changes arising from new accounting developments, we have not made any changes to our accounting policies during the year.

Developments – not yet adopted

[Describe whether or not it is anticipated that issued, but not yet adopted, accounting developments will have a material impact.]

Choices permitted under IFRS

IFRS provide certain options available within accounting standards. Material choices we have made, and continue to make, include the following:

Financial instruments

Ota ne et latust lam quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto tatum fugia

Timing of goodwill impairment reviews

Ota ne et latust lam quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto tatum fugia

Heading

Ota ne et latust lam quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto tatum fugia

Heading

Ota ne et latust lam quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto tatum fugia

Do the work for the reader by explicitly noting what choices have been made under IFRSs and why.

Critical accounting policies

Revenue

Ota ne et latust lam quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto tatium fugia que elessimi, tem quam rerupta et autestoatust lam quatis apitaquissum

Hedge accounting

Ota ne et latust lam quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto tatium fugia que elessimi, tem quam rerupta et autestoatust lam quatis apitaquissum

Heading

Ota ne et latust lam quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto tatium fugia que elessimi, tem quam rerupta et autestoatust lam quatis apitaquissum

2. Sensitivities to accounting estimates

In order to illustrate the impact that changes in assumptions could have on our results and financial position, the following sensitivities are presented:

Assets carried at fair value

Arede est, untionecab incto quati temolup taecte conecto tatium fugia que elessimi, tem quam rerupta et autestatust lam quatis apitaquissum nos et ditio

Pensions and other post-retirement obligations

Arede est, untionecab incto quati temolup taecte conecto tatium fugia que elessimi, tem quam rerupta et autestatust lam quatis apitaquissum nos et ditio

Impairment

Ota ne et latust lam quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto tatium fugia que elessimi, tem quam rerupta et autestoatust lam quatis apitaquissum



For full accounting policies and developments visit www.asbplc.co.uk/information

Summarise the critical accounting policies and how they have been tailored to the entity.

Illustrate the possible impact of changes in assumptions to amounts recognised in the financial statements.

Provide a clear link to where a full list of accounting policies and developments can be found, either on a separate website or in an appendix within the annual report.

Bring together all the profit and loss charges related to share-based payment into one section of the note, rather than scattering them throughout the note.

Most groups have several share-based payments schemes. Present a disaggregation of the total profit and loss charge so that it is clear which, if any, of the individual schemes is material. In this example, only the Long-Term Incentive Plan is material.

Do the work for the reader by focusing the disclosures on the material plans.

Notes continued

6. Share-based payments

Analysis of profit and loss charge:

| | 2010 | 2009 |
|-------------------------------|--------------|--------------|
| | £k | £k |
| Long-Term Incentive Plan | 957 | 924 |
| Executive Share Option Scheme | 189 | 181 |
| Share Incentive Plan | 64 | 200 |
| SAYE Scheme | 269 | 261 |
| Total | 1,479 | 1,566 |

[Describe the number of share-based payment arrangements within the scope of IFRS, under which there were grants in the current or previous year as well as a profit and loss account charge.]

Long-Term Incentive Plan (LTIP)

Ota ne et latust lam quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto tatum fugia que elessimi, tem quam rerupta et autestoatust lam quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto tatum fugia que elessimi, tem quam rerupta et autestatust lam quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto

Inputs into the model

Ota ne et latust lam quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto tatum fugia que elessimi, tem quam rerupta et autestoatust lam quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte ecto tatum fugia que elessimi, tem quam rerupta et autestoatust lam quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto tatum fugia que elessimi, tem quam rerupta et autestatust lam quatis apitaquolup taecte conecto tatum fugia que elessimi, tem quam rerupta et autestatust lam quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto

The key inputs into the XYZ model were:

| | 2010 | 2009 |
|--------------------------------------|-----------|-----------|
| Share price at grant date | £1.70 | £1.00 |
| Expected volatility | 50% | 40% |
| Risk-free interest rate | 2.5% | 4.5% |
| Expected dividend yield | 3.0% | 5.0% |
| Fair value per share awarded | £0.47 | £0.26 |
| Number of conditional shares awarded | 1,500,000 | 3,000,000 |

Assumptions

[Set out the assumptions used in the model.]

ne et latust lam quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto tatium fugia que elessimi, tem quam rerupta et autestoatust lam rerupta et autestatust lam quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto

Movements during the year

[Describe the movements during the year.]

Eree et latust lam quatis apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup taecte conecto tatium fugia que elessimi, tem quam rerupta et autestoatust lam quatis apitaquissum nos et ditio blam

Other schemes

Executive Share Option Scheme

[Provide a short description of the scheme.]

Arede est, untionecab incto quati temolup apitaquissum nos et ditio blam, cor auda est, untionecab incto quati temolup tato tatium fugia que elessimi, tem quam rerupta

Share Incentive Plan

Arede est, untionecab incto quati temolup taecte conecto tatium fugia que elessimi, tem quam rerupta et autestatust lam quatis apitaquissum nos et ditio

SAYE scheme

Arede est, untionecab incto quati temolup taecte conecto tatium fugia que elessimi, tem quam rerupta et autestatust lam quatis apitaquissum nos et ditio

Provide all of the inputs to the model in one table, rather than burying them in dense narrative.

Break up the narrative by providing relevant descriptors, so that a reader can find the information they are looking for quickly.

Provide a brief explanation of the other schemes, such as number of participants, and whether or not:

- Awards have been made in the last two years.
- Previous awards have lapsed.

Alternatively, provide this information in an appendix or on a website, clearly signposted.

Further opportunities

During our research, many of the individuals we interviewed identified a number of common areas of clutter in annual reports, which were added to the results of reviews of annual reports undertaken by some of the FRC's operating bodies over the past 18 months or so.¹⁹

The areas identified as offering good opportunities to reduce clutter are listed on the following two pages in alphabetical order. We would be very interested in receiving good examples of disclosures in these areas where clutter has been reduced to a minimum or eliminated completely. We acknowledge that it may not be possible to fully address all areas immediately, given the constraints of accounting standards and company law.

Further opportunities

Area commonly containing clutter

Tentative thoughts on how it may be possible to reduce clutter

CSR reporting

Focus on those elements that are relevant to the company and have a significant impact on its long-term success.

Provide a cross-reference or link to where detailed CSR information is provided on a website or separate CSR report.

Deferred tax

It may be possible to present information on deferred tax in a simplified form depending on the complexity of the deferred tax charge.

Directors' report – other statutory information

Investigate the possibility of having this information provided in a standard form, such as an annual return. In the meantime, some of this could be located in an appendix, and incorporated into the Directors' report by cross-reference.

Financial instruments

Address only the risks that are material to the entity – many companies only have significant exposure to some financial risks, but still provide detailed disclosure about others.

Intangibles, particularly impairment testing

If the process for assessing impairment is unchanged year-on-year consider including this as part of 'standing data' and focus on current or future changes.

List of principal subsidiaries

Could be provided alongside other 'standing data'.

Area commonly containing clutter

Tentative thoughts on how it may be possible to reduce clutter

Movement tables

Focus on the materiality of movements where reconciliations are required, for example, provisions. Consider whether it may be more efficient to provide information on significant movements in a non-tabular format – can it be achieved in a single sentence?

Post-retirement benefits

Start with disaggregations of the amounts in the profit and loss charge and balance sheet, so that the materiality of each pension scheme is clear. Provide detailed disclosures only for material pension schemes.

The background to the pension schemes and details around valuation methodology could be provided alongside other ‘standing data’ except where it has changed.

Principal risks

A description of principal risks that focuses on those that are specific to an entity, rather than a generic list of risks that are common to all businesses or to an industry.

Remuneration report

Focus on areas of change and disaggregation – information that does not change, such as an explanation of all the schemes, policies and procedures could be located with other ‘standing data’.

Other information

Glossary

| | |
|------------|---|
| ACCA | Association of Chartered Certified Accountants |
| ASB | UK Accounting Standards Board |
| BIS | UK Department for Business, Innovation and Skills |
| 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. |
| Clutter | Both immaterial disclosures that inhibit the ability to identify and understand relevant information, and explanatory information that remains unchanged from year to year. |
| EFRAG | European Financial Reporting Advisory Group |
| FASB | US Financial Accounting Standards Board |
| FRC | Financial Reporting Council |
| FRRP | Financial Reporting Review Panel |
| FSA | UK Financial Services Authority |
| GAAP | Generally Accepted Accounting Practice |
| IAASB | International Auditing and Assurance Standards Board |
| IAS | International Accounting Standard |
| IASB | International Accounting Standards Board |
| ICAEW | The Institute of Chartered Accountants in England and Wales |
| IFRS(s) | International Financial Reporting Standard(s) |
| Regulators | All government bodies, accounting standard setters and others involved in setting regulations. |

Footnotes

1. *Effective Company Stewardship: Enhancing Corporate Reporting and Audit*, page 20.
2. *Louder than Words*, page 5.
3. *UK Corporate Governance Code*, page 1.
4. *Louder than Words*, page 42.
5. *Ibid.*, page 42.
6. IAS 1 paragraph 31.
7. *Louder than Words*, page 42.
8. ASB *Statement of Principles for Financial Reporting*.
9. IASB *Conceptual Framework for Financial Reporting 2010*, first two chapters published in September 2010, paragraph QC11. The conceptual framework sets out two fundamental qualitative characteristics (relevance and faithful representation), as well as four further enhancing qualitative characteristics. Materiality is viewed as an “entity specific aspect of relevance.”
10. *Ibid.*, paragraph BC3.18.
11. ISA (UK and Ireland) 450, paragraphs 5, 12–13 and A2.
12. *Louder than Words*, page 43.
13. The FSA’s Listing Rules (LR 9.7A) set out minimum content requirements for those companies that voluntarily provide preliminary announcements. The minimum content requirements are very high level, with the content of prelims being significantly driven by the information requests of users.
14. The *UK Corporate Governance Code* published June 2010, pages 32 and 33 set out 18 specific disclosure requirements.
15. *Rising to the challenge*, page 11.
16. See the ASB’s response to the EU on *Disclosure of Non-Financial Information by Companies*, 21 January 2011. Go to FRC website www.frc.org.uk, ASB section, Publications, ASB responses, Responses to EU Reviews and Directives.
17. *Louder than Words*, page 40.
18. *Ibid.*, pages 40 and 41.
19. See in particular *Rising to the challenge* issued by the ASB in October 2009 and the FRRP’s *Annual Report* published in August 2010.
20. *MINDSPACE*, page 18. More detailed explanations of the influences are provided on pages 19 to 28.

Project methodology

Louder than Words summarised a number of reasons why interviewees for the project believed clutter ended up in annual reports.

As most of the reasons given are behavioural, a first step in this project was to focus on the behavioural influences leading to clutter. Understanding why individuals act as they do is being considered by a number of organisations currently, including the work done by the Cabinet Office and the Institute for Government as set out in their joint publication *MINDSPACE: Influencing behaviour through public policy*.

MINDSPACE, along with the general focus on behavioural change in public policy, has at its origin Thaler & Sunstein’s 2008 book *Nudge*.

Given the desire to understand how behaviours affect disclosures, one of the authors of *MINDSPACE*, Ivo Vlaev, agreed to be a member of our Advisory Panel and to help guide our work.

MINDSPACE sets out “...nine robust influences on human behaviour and change. These principles are underpinned by considerable research from the fields of social psychology and behavioural economics. They are therefore presented as the most robust effects that policy-makers should understand and, if appropriate, use.”

These ‘influences’ were identified as:

Messenger We are heavily influenced by who communicates information.

Incentives Our responses to incentives are shaped by predictable mental short cuts such as strongly avoiding losses.

Norms We are strongly influenced by what others do.

Defaults We ‘go with the flow’ of preset options.

Salience Our attention is drawn to what is novel and seems relevant to us.

Priming Our acts are often influenced by subconscious cues.

Affect Our emotional associations can powerfully shape our actions.

Commitments We seek to be consistent with our public promises, and reciprocate acts.

Ego We act in ways that make us feel better about ourselves.

In order to understand better the potential causes of clutter we:

- reviewed the evidence that we had obtained in producing *Louder than Words*;
- obtained input from the Advisory Panel;
- held meetings with a small number of preparers; and then
- linked the causes we identified with the *MINDSPACE* influences.

We undertook this exercise for both financial statements including the notes, as well as the narrative section of an annual report. Part of the output is shown on pages 16 and 17; the overriding message – everyone’s behaviour is leading to clutter.

Influences can either encourage positive behaviour or create barriers. Examples of the key behavioural barriers that we identified included:

Incentives The risk of being brought to the attention of regulators or singled out by users can drive preparers and auditors to err on the side of caution. ‘When in doubt’ include additional disclosures.

The annual report process does not start with an expectation that clutter can be avoided nor that project teams will be praised for doing so.

Norms Levels of disclosure are influenced by what everyone else is doing. Clutter is an industry-wide problem so extensive notes are seen as the norm. Accounts may commonly be seen as a compliance rather than communication exercise.

Defaults It is easier to replicate or build on previous years’ disclosures than to think afresh. Prior years’ accounts were heavily influenced by the transition to IFRS when few had experience of what could be left out.

Priming Existence of illustrative accounts and example disclosures lead to excessive disclosures.

Salience Checklists of all possible disclosure requirements can also lead to excessive disclosures.

Cutting Clutter Advisory Panel

We would especially like to thank members of our Cutting Clutter Advisory Panel, namely:

- **Ian Wright** (Chairman), Former Director of Corporate Reporting, Financial Reporting Council
- **Andrew Palmer** Senior Independent Non-Executive Director, SEGRO
- **Ben Binnington** Director, Accounting Policy Team, Barclays
- **Charles Tilley** Chief Executive, CIMA
- **David Potter** Consultant, British American Tobacco
- **Ivo Vlaev** Senior Lecturer in Psychology, Faculty of Medicine, Imperial College London
- **Jennifer Walmsley** Director, Hermes Equity Ownership Services
- **John Hitchins** Partner, PricewaterhouseCoopers
- **Jonathan Hayward** Partner, Independent Audit Limited
- **Michael Power** Professor, London School of Economics
- **Paul George** Director, Professional Oversight Board
- **Richard Aitken-Davies** Past President, ACCA
- **Teresa Graham** Independent consultant

The Cutting Clutter project team – Jenny Carter, Deepa Raval and Janice Lingwood – were supported by members and staff of the operating bodies within the FRC, particularly the Accounting Standards Board and the Corporate Governance Team.

Sources and further reading

ASB: *Statement of Principles for Financial Reporting* (1999)

ASB: *Rising to the challenge* (2009)

Cabinet Office and Institute for Government: *MINDSPACE: Influencing behaviour through public policy* (2010)

FRC: *Effective Company Stewardship: Enhancing Corporate Reporting and Audit* (2011)

FRC: *Louder than Words: Principles and actions for making corporate reports less complex and more relevant* (2009)

FRC: *UK Corporate Governance Code* (2010)

IASB: *The Conceptual Framework for Financial Reporting 2010* (2010)

Thaler & Sunstein: *Nudge: Improving decisions about health, wealth and happiness* (2008)



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