THE
INSTITUTE OF
CHARTERED
ACCOUNTANTS
OF SCOTLAND

PP/BPC-SUB/mb

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Dear Ms Kerr

**LOUDER THAN WORDS: PRINCIPLES AND ACTIONS FOR MAKING CORPORATE REPORTS LESS COMPLEX AND MORE RELEVANT**

The Institute's Business Policy Committee and Accounting Standards Committee are pleased to respond to your request for comments on the above document.

As the Institute's Charter requires, we act in the public interest, and our proactive projects, responses to consultation documents etc. are therefore intended to place the general public interest first, notwithstanding our charter requirements to represent and protect our members' interests.

The Committees are in general supportive of the discussion paper and welcome the view taken that emphasises principles rather than rules and that it is appropriate to support businesses by enabling them to present their financial statements in a clear, uncomplicated and effective manner which portrays a transparent and unambiguous view of their performance. It was noted however that the discussion paper lacked a list of specific action points to be undertaken and we would draw your attention to the need for specific outcomes to be clearly identified.

ICAS will shortly be issuing a discussion document which may be of interest to you in which we attempt to develop a short form corporate report that can be regarded as "decision-useful" for a wide range of users but which does not replace the full financial statements which would remain available.

The Committees are of the opinion that financial statements are more complex than they need to be because they are aimed at too many users, who each have their own requirements as to what information they require from the financial statements. The financial statements can be confusing to readers as they would normally contain information based on both historical cost and fair value and those fair values that are used are often based on a series of assumptions the exact basis of which is not adequately, if at all, conveyed to the reader in a clear, concise and understandable manner.

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Businesses and transactions have become more complex in the last 30 years or so and an inevitable outcome of this has been that the reporting of these has also become more complex.

In tandem with this, the changes in the business environment to one where large corporations are ever mindful of the threat of litigation has led to the perceived need for pages of detailed disclosures that do not add to the readers understanding of the financial statements, but are only there to make sure that the threat of any potential litigation is kept at a minimum.

Accounting standard setters also contribute to the complexity in financial reporting. One only has to look at the topics of financial instruments, pensions accounting and share-based payments, to identify areas where accounting can be complicated and where significant explanatory disclosure is needed.

It is by no means an easy task in striking a balance between what corporate reporting will need to show in order to be meaningful and effective and what the many differing and varied users of the corporate reports find useful and informative.

A reduction in the complexity in corporate reporting can only be achieved if all those involved; the regulators, the preparers and the users, can adjust or modify their behaviours sufficiently and in a combined effort to work towards a common goal. The collective buy-in, not self-interest, is essential in addressing the complexity issue and reaching a satisfactory outcome for the future of corporate reporting.

**Specific Questions:**

*Q1. Can the principles for less complex regulation we propose help reduce complexity? Are there other principles that should be considered?*

Having regulation that is targeted, proportionate, co-ordinated and clear and which helps to produce financial statements that have the same characteristics can in our view only be a positive influence on financial reporting in general and should help reduce the complexity we have at present. However, it is hoped these are themes that regulators should already be aspiring to achieve and it is therefore not clear to us what impact the FRC's proposal will have in practice.

We think it unlikely that a set of high level principles can be developed and implemented which will be robust enough to satisfy the needs of all of the regulators and users of financial statements.

*Q2. 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.*

We believe that there is a need for improvement in cash flow reporting. This is an ongoing problem area in a global context and not one that is confined solely to the UK. ICAS responded to the IASB in April 2009 on their discussion paper "preliminary views on financial statement presentation". The discussion paper contained a number of useful ideas on how to improve cash flow reporting such as the cohesiveness objective and the separation of business and financing activities for certain entities, but in other respects the proposals would lead to more clutter and complexity in its reporting. A copy of our response is available from our website or on request.

We would support the FRC in its actions to launch a project to further investigate users' needs for cash flow and net debt reporting.

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*Q3. Proportionate: Should accounting standards and other regulations be based more on the information that management produces internally?*

Information in all businesses is produced for a variety of reasons and it is recognised that not everything is generated for the sole purpose of its inclusion in the financial statements. There will be information that management produces internally in order to be able to make informed decisions on a particular course of action and it will not be appropriate in every scenario that this information should find its way into the public domain via the published financial statements. Internal management information by its very nature will be specific to each individual entity and produced in a myriad of formats which makes standardisation of such information difficult. There would also be an additional cost element involved in complying with this as it is unlikely that a finance director would issue any internally generated financial information unless there has been some external assurance provided before publication.

*Q4. 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?*

We would agree that a thorough review of disclosures would be helpful, but any review must be mindful of the fundamental principle that the different stakeholder groups (and even different elements within those groups) who use the financial statements will have different views on what they would regard as the most important disclosures. A balance would have to be struck to keep the financial statements of a readable, manageable size whilst at the same time not diluting the quality of the information they have to contain. It is also the case that certain investors will be unwilling to forfeit any information which they currently receive.

This is an area where there is an onus on the companies themselves to be more proactive. One approach to this could be to have for example published accounts for reference by stakeholder groups such as institutional shareholders/market analysts and a slim line version that would be more widely used by the generality of users. The ICAS discussion document mentioned above reflects this approach.

*Q5. Targeted and proportionate: Who are the main users of wholly-owned subsidiary accounts? Should the subsidiaries be required to file audited accounts with full disclosures? Is a more simplified reporting regime appropriate?*

These companies are still separate legal entities and as such should still be required to follow the Companies Act. It may be the case the company is not always going to be a subsidiary – and in this respect there is a need for it to have a traceable public track record. The main users would be customers, suppliers, HMRC and banks (on the basis there is no parent guarantee) and it is important that their information needs are not compromised by the lack or dilution of available published financial statements.

However, this is an issue that has also been raised by the Accounting Standards Board in their consultation paper "The Future of UK GAAP" issued in August 2009.

We think that any decisions in this area should be deferred until the outcomes of the ASB consultation are made public.

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*Q6. 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?*

Please refer to the answer to question 5.

*Q7. 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?*

We are supportive of the move towards one set of global accounting standards which have an emphasis on principles as opposed to rules.

It is however difficult to envisage this being fully effective in practice as the different legal systems in place throughout the world would make it challenging to bring about an outcome that led to a complete reduction in complexity.

*Q8. Clear: Would an emphasis on delivering regulations and accounting standards in a clear, understandable way reduce complexity? How can we move best towards clearer regulations and accounting standards?*

There is a need here to work back and gain an understanding of what the users want out of a set of financial statements and then frame the regulations around this. This again works from the premise that all users want the same information from a set of financial statements and this is not the case. It may be an idea to canvass different users and ask what they look for when reviewing corporate reports. A response on what information users find of value from financial statements from say a fund managers' perspective will probably be different from the views of say suppliers or bankers. It is only after this is clearly understood that regulators can set about delivering clearer regulations and accounting standards.

*Q9. Do you agree that the principles for effective communication can reduce complexity in corporate reporting?*

The principles for effective communication should help to reduce the complexity in corporate reporting. However this depends on the means by which the principles are implemented.

The main purpose behind effective communication must be to let the user know what the organisation does, how it does it and the final effect of these – and all of this in a concise, readable report. Much of the material found in financial statements is there to fulfil the entity's public filing requirements and as such can be accessed by those users who would find this of value by reviewing the public records. It would also be appropriate for this type of information to be web based and therefore more easily accessible to a wider audience.

The Committees also had concerns that accounts are now becoming less accessible to readers without some accountancy knowledge/background and that with the current crisis of confidence in the economy there was an opportunity to address this. This can be further compounded by the media in the way they can make headline grabbing and over-simplistic comment on complex accounting issues.

*Q10. What are the barriers to more effective communication? How might these barriers be overcome?*

The most fundamental barrier to more effective communication is the ability to identify the core information that has to be communicated. This will require a change in the mindset of all those involved in corporate reporting – the preparers, the reviewers and the regulators.

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The core information that has to be communicated is the business model of the entity, how the entity has performed against that business model and how it is placed in the future to stimulate growth in the business model.

This will result in less boiler plate narrative and lead to more timely and effective communication.

The perspective of the preparer must also be considered as it is likely that time and cost are the main barriers they face in providing more effective communication. Considerable time has to be spent in constructing reports that are clear, concise and relevant to the user. Preparers may not find this a particularly good use of their resources and so will place more reliance on standard disclosures to complete the task as soon as they can.

The knock on effect to this is that costs would rise if the time to produce the report is increased, or it could be the case that the skills necessary to do this have to be outsourced.

Preparers will also be mindful of the legal and regulatory implications they are faced with and so will be more inclined to weight their reports in favour of compliance as opposed to quality communication.

*Q11. 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?*

For so long as the project is looking to identify principles for reducing complexity and increasing effective communication in corporate reporting, there is probably not a lot to be gained by debating the merits or otherwise of considering specific topics.

The ICAS discussion document mentioned in the fourth paragraph of this response promotes the use of a short form report aimed at telling the whole story of even the most complex of organisations in no more than 30 readable pages, with the full annual report and accounts sitting behind this document and accessible via alternative reporting technology such as XBRL.

We would like the opportunity to take this further and to extend an invitation to arrange a joint event with the FRC in London to consider our discussion document in the context of the responses which the FRC receive from this consultation.

Please do not hesitate to contact me should you wish to discuss any of the above points further.

Yours sincerely

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