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Dear Madam

Response to "Louder than Words": Principles and actions for making corporate reports less complex and more relevant

We respond to the invitation to comment on the above named discussion paper.

We strongly support this FRC initiative on the topic of complexity in corporate reporting. Our latest Deloitte survey "A telling performance" found that the annual reports of UK listed companies had increased in length by 3% on 2008 and by 41% compared to 2005 (from an average of 69 pages in 2005 to 99 pages in 2009).

While we support many of the principles put forward in the discussion paper, we believe that a more focussed position on the actions to be taken is needed to ensure that progress is made in a meaningful and timely way. As the title suggests, "actions speak louder than words". We are disappointed that the five proposed urgent actions in the paper are unlikely to result in change in the short term particularly as most of these call for further projects and investigations.

We recommend that the FRC implements the following three points in the short term to make corporate reports less complex and more relevant.

1. **Make the IFRS for SMEs available for use in 2010**. This would allow companies without public accountability who currently use full IFRS to use the IFRS for SMEs next year. It would also enable such companies who currently use UK GAAP to move to IFRS for SMEs at their convenience over the next two years.

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2. **Adopt one implementation date each year for all FRC (including its operating bodies) pronouncements and seek to influence relevant government departments to adopt the same date**. Keeping track of what comes in when is time-consuming for British businesses. Having one date, backed up by the FRC issuing an annual reminder list on what comes into force and what is withdrawn on that date, would assist preparers and users of corporate reports.

3. **Issue a document which provides companies with a complete and logically ordered guide to narrative reporting.** The aims in doing so would be to assist:

   - first companies in preparing their narrative sections in their annual report; and

   - second regulators to identify overlaps, gaps and differing approaches in the present competing regimes. The FRC would then be in a leading position to seek change to rules so that British businesses are provided with a coherent list of requirements.

Our comments on the specific questions in the discussion paper are in the Appendix to the letter.

We hope that the FRC will meet with those who comment on "Louder than Words". Please contact Tom Hopkins (0121 695 5967) or Isobel Sharp (020 7007 0894).

Yours faithfully

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

The proposed principles have merit but need to be supported by focussed plans for action. On a specific point, the principle of co-ordination refers only to co-ordination between regulators, not to individual regulators acting in a co-ordinated manner.

An issue not covered by the discussion paper is the appropriate format and content of an annual report. In earlier years, the annual report may have been the only substantive information on a company readily available to many shareholders and as such inclusion of all information relevant to them in that single document was necessary.

In the information age, shareholders usually have access to a company's website which gives much greater potential for flexibility in obtaining the desired information (indeed, many listed company websites already give the option of accessing individual sections of annual reports in isolation from the main document). Given that, there should be a fundamental consideration of what core information needs to be in an annual report to give a true and fair view of the year and what could be included separately on a company's website. However, care must be taken not to increase the overall burden on companies. We are concerned that this approach may lead to "dumping of data" on websites.

We set out in our covering letter three other actions that should be considered for action in the short term.

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.**

In our opinion, cash flow reporting is in need of improvement. As well as providing an important focus on the use of an entity's most important financial resource, a cash flow statement should be understandable to casual users of the financial statements who may not be conversant with the accounting methods and terminology used in the balance sheet and income statement.

The observation on net debt reporting is a good one. It is telling that many preparers of financial statements, who are observed elsewhere in the discussion paper to be of the opinion that financial statements contain too much information, choose to include reconciliations of net debt even though this is not required by IFRS.

There are other factors which we consider add complexity to (or, at least, reduce clarity in) cash flow reporting under IAS 7.

- The IAS 7 statement of cash flows measures movements in cash *and cash equivalents*. Inclusion of cash equivalents adds a level of subjectivity and complexity to the statement of cash flows. A casual user of the financial statements might expect that 'cash' refers only to cash in hand and current bank balances, whereas this is often not the case.
- The IAS 7 statement of cash flows classifies cash flows according to the function of the cash flow (i.e. operating, investing or financing activities) rather than its nature (i.e.

receipts from customers, interest payments, capital expenditure etc.). This leads to some application of judgement or accounting policy choice in the preparation of a statement which should be (as far as is possible) a simple statement of fact. For example, interest cash flows may in some cases be classified as operating, investing or financing.

Possible responses to these issues could be:

- restriction of 'cash' to a clear, well understood definition. If information on movements in 'cash equivalents' is needed, it could be included as a single item at the foot of the statement of cash flows; and
- additional segregation of cash flows by their nature. Single items for interest paid, capital expenditure and so on would be clearly identifiable and would remove the current level of subjectivity in their classification.

We do not consider the suggested action in this area to be sufficient. Best practice guidance alone will not resolve the difficulties in application of IAS 7 or in making a statement of cash flows prepared under that Standard understandable to a casual user. The Accounting Standards Board, as the UK's representative in an international context, seems best placed to develop proposals for changes (possibly fundamental changes) in cash flow reporting under IFRS and to lobby the IASB for implementation of these changes.

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

Recent accounting standards (in particular, IFRS 7 and IFRS 8) have attempted to incorporate this idea. However, they also include extensive "minimum" disclosures which must be given whether or not they are used internally.

If accounting standards were based wholly on internally produced information, this may be at the expense of comparability across companies as they could produce different information sets. Thus, while we believe that more use of internally-used information is attractive in theory, we believe that further research is needed to prove that such information would be acceptable to users of company reports.

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

We strongly support such a project. Our research provides us with considerable evidence of what is taking up the pages in corporate reports. We believe that there is considerable scope to reduce disclosure requirements. Furthermore the work which the IASB has done in producing the IFRS for SMEs with about 300 disclosure points compared to 3000 or so in full IFRS indicates that the time is ripe for such a project.

We are disappointed that the call for action in "Louder than Words" refers to "ideally.... another organisation could constructively kick off this work .....". We ask that the FRC identifies such an organisation or that it leads the work in this area. In doing so, it is very important that the voice of business on whom the compliance burden falls, is heard loudest.

Similar projects which have asked users have failed because typically users do not ask for less. To succeed, any future project must differentiate between what is necessary and what is simply nice to know.

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?**

The users of wholly-owned subsidiary accounts identified in the discussion paper are reasonable. We observe that trading subsidiary accounts are also 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. That noted, a parent company guarantee under an Elective Regime may also reduce customers' and suppliers' need for subsidiary accounts.

As the discussion paper notes, taking advantage of the exemption in the Seventh Directive, and thus following the example of countries such as The Netherlands and Ireland, was explored as part of the Company Law Review. We support the proposed action in this area. But we are concerned that, partly because this may involve primary legislation and mindful of the complexities involved through our participation in that 2001 review, this project may be time-consuming and unlikely to produce benefits to business in the short term.

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?**

See above

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?**

It would decrease complexity (in the sense of allowing easier comparison between companies from different territories) if regulators worked together in the right way. There is a risk of complexity being imported into some jurisdictions (although this risk is possibly limited in the UK and other territories which are relatively highly regulated). But this could be mitigated by allowing an appropriate level of flexibility in co-ordination among regulators and by a focus on principles. There will always be country-specific issues which need to be addressed by national regulators, but which may not be applicable in other territories. Any co-ordination between regulators should allow for this.

National regulators should continue to have a role in providing a voice for preparers and users of corporate reports in their countries and in challenging international regulators and standard-setters.

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?

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.

These principles could usefully be employed in drafting new accounting standards or, in some cases, rewriting existing ones to add clarity.

In addition, it is planned to update the IFRS for SMEs only once every two or three years. If such a discipline were applied to amendments to full IFRS, it would allow preparers and users of financial statements time to get used to new requirements and would aid comparability among financial statements. It might also reduce the pressure on the EU endorsement process, which currently adds further complexity and confusion to the situation.

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

We support the principles for effective communication in reporting. Indeed, it would be difficult not to do so. However, it is unrealistic to believe that publishing these will reduce complexity in current reporting without any further regulatory change. We therefore urge the FRC to take specific actions, as indicated in our covering letter.

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

There are many barriers to effective communication (the nature and length of the regulations, the resources of preparers, the demands of particular users and so on). There is no easy answer on how to overcome these barriers. They have to be dismantled systematically.

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 areas identified on pages 54 and 55 as areas for action to reduce complexity all have merit. However existing projects, such as the re-writing of IAS 39, mean that action on numerous points would not be timely. Furthermore, while some of those could be actioned as part of the IASB's annual improvements project, we do not believe that individually these would produce any significant benefit in reducing complexity. Indeed in the short term they would add to complexity. We recommend that the FRC should focus on projects which will produce significant improvements rather than those who tinker in particular aspects of certain topics.