From: Alistair Blair [a7461blair@pobox.com]
Sent: 16 June 2009 13:17
To: Complexity
Cc: Ian Wright
Subject: Louder than Words

Dear Melanie

Here follows an article about Louder than Words which will appear in Friday's Investors Chronicle (and should be on its website by Thursday am).

I am sending you a copy because I would like you to consider it a serious piece of feedback.

Please do not circulate this to anyone until Thursday morning... if you might have done so.

(Sending it to you on Thursday am is just too much to organise!)

Yours

Alistair Blair

PS to Ian – thx for the call. Hope you're not too upset by this….

I thought "May contain nuts" was brilliant.

No Free Lunch for 19 Jun 09

"…like stamping 'May contain nuts' on every consumer food product"

If you're wondering whether an annual report really needs to carry six pages of reporting on share-based payment when its net effect on profits is less than 0.7 per cent, then you should send your views to Melanie Kerr. This anonymous example, which refers to a FTSE 100 company, is one of several contained in an admirable but flawed document just released by the Financial Reporting Council, which is intended to provoke a debate about the complexity of annual reports. The Financial Reporting Council is the UK's top regulator for accounting.

"Louder than Words", available from frc.org.uk, is a very readable account of why annual reports have become so complex, whether this complexity is a genuine problem, and if so what might be done about it. The report is convincing on the first two matters, but it fails to grasp the nettle concerning what should be done. Melanie Kerr is the Financial Reporting Council's executive charged with receiving comments on Louder than Words.

Incidentally, the report also reveals that another anonymous FTSE-100 company's share-based payments amounted to an incredible 22 per cent of after tax profits. I'll bet the seven pages over which the company covered this topic did not make that figure clear. As to the Financial Reporting Council's policy of anonymity when citing examples from company reports, we'll return to that.

BT's just-released 2009 annual report is 166 pages long. Eyes glazeth over. Those extraordinary mortals who attempt to read it will struggle to understand much of the material. Call me boring, but I happen to have on my bookshelf about 15 BT annual reports going way back. In 1995, BT's annual report was 57 pages long, its typeface larger and the line spacing more generous. I'd suggest that the number of words has inflated by 300 per cent.

No sensible person would suggest that this inflation has been matched by shareholders' understanding of BT. But I would argue, as did several professional users of annual reports interviewed by the Council, that there has been a modest gain and this gain is useful. It does not matter that you or I will be pushed to get to grips with pages 130 to 135 of the current BT annual report headed "Financial instruments and risk management". Nor with a lot of the other fine print. It is nevertheless beneficial that these details are on the public record, thereby enabling some pointy-headed analyst buried in some investment bank—or some diligent fund manager who holds a lot of BT shares—to figure out what BT's risk position is and take a view on it. Sure, that view will take time to percolate through to you and me (if it ever does), but this process is as good as you are ever going to get.

We should have just a tiny bit of sympathy for the finance directors, auditors and audit committees who prepare annual reports. As Louder than Words relates, they have to comply with many sets of rules which are rarely well-synchronised. A UK-quoted company (a term which is itself capable of at least three interpretations) must comply with The Companies Act, the International Financial Reporting Standards issued by the International Accounting Standards Board, the Council's own Combined Code on Corporate Governance and two separate rulebooks issued by the Financial Standards Authority. That must be at least 5,000 pages of gumph, to be trawled through and complied with. No wonder they end up with what the Council describes as reports "full of immaterial clutter… rather like stamping 'May contain nuts' on every consumer food product."

But we should have no sympathy at all for the chairmen and chief executives who preside over this process. Let their minions deal with the mere rules. It is open to any chief executive, in his annual statement, to cut through the, er, “cackle” and describe what is really important. Like, “Our share-based payments consumed 22 per cent of our after tax profits”. But they’re simply not going to do that, are they? Information is power, and those in possession of it are inevitably going to disburse it sparingly. That is the way of the world.

Which brings me to the chief flaw in Louder than Words. If fine examples and exhorting companies to communicate “honestly, clearly and interestingly” worked, we would have had the results decades ago. Instead of hand-wringing and exhortation, the Financial Reporting Council should simply issue its own ratings of FTSE-100 annual reports. It should bin its policy of anonymous examples. A few “four out of tens” would have a much better result.

Alistair Blair, a past winner of the Business Writer of the Year Award, has worked in investment banking and fund management. Email: a7461blair@pobox.com