FINANCIAL REPORTING COUNCIL

COMPLEXITY IN REPORTING PROJECT

CBI RESPONSE TO LOUDER THAN WORDS CONSULTATION **November 2009**

INTRODUCTION AND SUMMARY OF CBI POSITION

1. The Confederation of British Industry (CBI) is pleased to respond to the FRC consultation.

2. We welcome this initiative by the FRC. It is important to seek to promote clear and understandable financial and corporate reporting, and identify where areas of complexity might be reduced and clarity and relevance improved. The Discussion Paper provides a useful analysis of the issues and some ideas on how progress might be made.

3. We support the Principles for better regulation set out in the consultation - Proportionate, Targeted, Clear and Co-ordinated. They generally correlate with the Government's own Better Regulation Principles, to which the CBI gives strong support. However we consider that the Government's fifth principle, Accountability, including accountability for stewardship, should also be included.

4. The financial crisis has put financial reporting and IFRS under much greater scrutiny, and the FRC review provides an opportunity to re-examine the purpose, relevance and usefulness of financial reporting, and the role that it plays in the global economy.

5. In this connection we believe that greater importance should be placed on assessing the results of stewardship as an objective of financial reporting, and that stewardship should be identified as a separate objective of financial reporting in the IASB's proposed updated Conceptual Framework. We are concerned that Stewardship was dropped as an Objective when the IASB last consulted on this in 2006.

6. It would therefore be very helpful in promoting understanding of the aims and objectives of financial reporting, if the IASB could make speedier progress in developing the proposed new Conceptual Framework. This should in turn also assist in reducing complexity or being better able to cope with necessary complexity. Establishing the objectives of financial reporting and the presentation and measurement alternatives best suited to meet those objectives will provide a basis for financial reporting that is fit for purpose and less complex.

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7. As is acknowledged, much of the potential for further action seems to lie in the hands of others, but we believe that the FRC can play an important role in providing leadership to encourage, propose, and stir appropriate action by these other bodies.

8. We note that the users whom the FRC spoke to in preparing the DP generally do not consider annual reports too complex overall. However there are many different types of investor, and who often have different information needs. Also, investors' requirements for information are met in a variety of ways, and not just by annual reports. For example, investors also welcome the key headline information contained in preliminary announcements ahead of all the detail in the annual report. Timely information is also obtained through the requirement to release price-sensitive information to the market as quickly as possible.

9. The FRC may wish to explore further how different users cope with the growing volumes of information available, and the added necessary and unnecessary complexity that this entails.

10. The DP defines complexity as ‘anything that makes regulations or the reports themselves unnecessarily difficult to understand, implement or analyse’. This is true, but complexity can also arise from overlapping or contradictory regulation.

11. Complexity in regulation can be mitigated to an extent if there is reliable guidance in place. Consideration could be given to further guidance on narrative reporting, for example - including updating the existing ASB guidance for an Operating and Financial Review to extend to the new Business Review requirements in the Companies Act 2006, and also the appropriate treatment of Non-GAAP measures in narrative reporting. However guidance should not inhibit clear communication.

12. In summary, the CBI supports the key principles identified in the DP for less complex regulation and for effective communication in reporting - to which we might also add Accountability, including accountability for stewardship. We agree that the primary purpose of financial reports aided by narrative reports is to provide investors with information that is useful for making their investment decisions and in assessing management’s stewardship.

13. This Project is therefore very much welcomed. The FRC has brought the issues to the attention of a wider audience. The FRC has the potential to take a leadership role in this area. But as so much also involves bodies such as the IASB and international stakeholders, the international dimension will also need to be addressed.

14. We set out overleaf our responses to the specific consultation questions.

II RESPONSES TO SPECIFIC CONSULTATION QUESTIONS

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

15. We believe that the four Principles proposed - Proportionate, Targeted, Clear and Co-ordinated - would help to reduce complexity if they were put into effect.

16. Complexity has a cost for companies in terms of compliance costs, including education, training and professional fees, for example, which costs are ultimately borne by shareholders. Standard setters and regulators are also concerned with “anti-abuse”, which can create requirements which are complex and require significant resource to deal with.
Too much change can also be an issue, where sometimes it is difficult to see what benefit outweighs the costs.

17. The four principles proposed by the FRC are similar to the Government’s five Principles of Good Regulation, by which the FRC is itself bound.
‘Proportionate’ and ‘Targeted’ appear in both lists.
‘Clear’ and ‘Coordinated’ in the FRC’s list may be regarded as equivalent to ‘Transparent’ and ‘Consistent’ in the Principles of Good Regulation.

18. However, the Government’s Principles also include ‘Accountable’, which is missing from the FRC’s list. We consider that Accountability, including accountability for stewardship, is an important principle, and likely to lead to better regulation. We are also concerned that accountability for stewardship is also missing from the most recent draft of the IASB’s proposed revised Conceptual Framework.

19. In view of the ever-increasing length (and therefore the complexity) of the annual report, it may be some of the information could be made available purely on the company website.

Q. 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.

20. We support the suggestion in the DP that there is a need for a reconciliation of opening and closing net debt, which would provide helpful information for investors.
The best way of making any changes would probably be through amendments to IFRS.

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

21. Yes in principle. The closer accounting requirements are to management practice the better, and since management uses the internal information, this should also be relevant information for shareholders. The greater the divergence of external requirements from internal information, the more non-GAAP measures will be used, and less attention will be paid to the GAAP financial statements.

22. Therefore there needs to be a focus on relevant information, and information which is material and cost effective to produce, consistent with the other Principles identified.

Q. 4 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 ?

23. There is constant growth of accounting disclosure requirements. On the one hand, there are calls for shorter, less complex reporting, whilst there are also demands for greater disclosure in the light of the financial crisis. As mentioned above, a greater understanding of shareholder and user requirements for relevant information is needed, and provided it is material and cost effective to produce.

24. There may be scope to set criteria for standard-setters and regulators against which to judge whether disclosures should be mandated. Relevant criteria might include evidence as to the disclosures' use, whether they are required in order to understand other necessary disclosures, and so on. This approach could include sunset clauses on new disclosure requirements, thus requiring evidence for renewal.

25. We also note the US Financial Accounting Standards Board's recently launched project on a disclosure framework, which might be able to develop a useful approach to these questions.

Q. 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?

26. The main users of the accounts of wholly-owned subsidiary companies may be lenders, customers, suppliers, employees and tax authorities. It is still unclear for many subsidiaries what exactly is required by which users and the most cost effective way of meeting these needs. We would hope that some of the work coming out of the ASB's review of the future of UK GAAP will add more clarity on these issues.

27. Groups generally structure themselves as a combination of legally separate entities for sound business reasons. Taxation issues can also be a factor in corporate structures. A further reason for complex group structures may be historical, related to acquisitions, joint ventures, and the like.

28. If taxation is a factor contributing to complexity in corporate reporting, there are unlikely to be easy answers. Simplification of the corporate tax regime is for the Government and has proved difficult, including the need to avoid unintended consequences, such as reducing the UK's competitive position with other jurisdictions.

29. The Accounting Standards Board's proposals for the future of UK GAAP would potentially allow subsidiaries of publicly traded companies to use the IFRS for SMEs unless those subsidiaries themselves have public accountability. Thus, subsidiaries would be able to prepare accounts with substantially fewer disclosures than would be the case under full IFRS.

30. We welcome development of this Standard by the IASB for non-listed entities. Indeed some CBI members would be interested in consideration being given to establishing a separate body of simplified IFRS specifically for subsidiaries.

Q. 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?

31. This issue was considered a few years ago by the Company Law Review in investigating the scope for modernisation of UK company law, which eventually culminated in the Companies Act 2006. However, the Company Law Review decided against any proposing such a change. One factor from the business perspective was that in securing banking and funding arrangements from a range of capital providers for the business as a whole, many companies considered it detrimental to offer legally-binding parent company guarantees, and that remains the case.

32. Following publication by the IASB of the new IFRS for SMEs, some CBI members are interested in the possibility of a bespoke separate body of IFRS specifically for subsidiaries, as mentioned above.

Q. 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?

33. We support increased working together by international and national regulators, and amongst international regulators. It would be good if this did indeed reduce complexity, overlap or duplication.

34. We have supported the moves towards a single set of global accounting standards using IFRS, but quality standards is the key, not convergence with US GAAP at any price. Convergence can lead to compromise which satisfies no-one. The most important objective and focus must be the development of quality IFRS supported and underpinned by an effective and updated Conceptual Framework.

35. National standard setters can both contribute to the development of global IFRS, as well as develop accounting standards in their own jurisdiction which can benefit from consistency with IFRS, for example.

36. In terms of overlapping regulations in the UK , an example is the overlap between the Companies Act and the Listing Rules on disclosure of directors' remuneration.

37. Another current area of regulatory overlap (or dislocation), which may produce difficulties for companies and their advisers, is the introduction of XBRL. HM Revenue & Customs and Companies House seem to be working independently of each other on this question, particularly in terms of timing. Neither seems to be paying much attention to the problems companies will have complying with new rules when the underlying development of XBRL is far from complete.

Q.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?

38. Yes indeed. See also our comments elsewhere in this response.

39. The DP includes an excellent example from IFRS 2, Share-based Payments, of how the drafting of standards could be improved.

40. Whilst it is recognised that in some cases it is difficult to make the language plain and simple, there have still been many instances where even technical experts struggle to see exactly what is intended.

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

41. Everyone would welcome corporate reporting that is focused, clear and understandable, not misleading, and interesting and engaging. Making corporate reporting interesting and engaging will always be a challenge, whilst also being compliant with regulatory requirements.

42.The new requirements in the Companies Act 2006 for a Business Review provides the opportunity for companies to set out clearly its business model, strategy and objectives, including core activities, trading results, and risk exposures. We believe there is scope for more guidance on narrative reporting, which we discuss elsewhere in this response.

43. Development by the IASB of an updated Conceptual Framework should also assist in providing clarity to the aims and objectives of IFRS and the fundamental accounting concepts which are intended to underpin financial reporting using IFRS. We look forward to the IASB making more progress with its work in this area.

44. Developing an updated form of Summary Financial Statements might also be appropriate.

45. Also there is no substitute for effective engagement between a company and its major shareholders on all aspects of the performance of the business and the board's aims and objectives, and risk exposures.

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

46. Examples of barriers to effective communication are time, ability, motivation, and legal liability. Drafting is a skill, and typically, it takes more time to draft something clearly.

47. One of the penalties for poor communication may be higher cost of capital.

48. Companies also need to take care that they meet all legal and regulatory requirements, Failure to do so may carry financial penalties and other sanctions, including reputational damage.

49. There is no simple way to overcome these barriers.

50. See also our comments elsewhere in this response, including in response to Q.4.

Q. 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?

51. We are broadly comfortable with the list of topics mentioned in the consultation paper, most of which seem to be for the IASB. Indeed in the financial instruments area for example, the IASB is already heavily engaged.

52. We have also suggested one or two topics in this response :

- Completion of the new Conceptual Framework by the IASB, including a Stewardship Principle;
- Use of authoritative guidance to mitigate complexity, such as guidance on narrative reporting and the Business Review;
- Explore the needs of users in connection with subsidiary accounts, and the scope for creating a separate body of simplified IFRS for subsidiary companies;

53. Generally, the FRC may be able to make the most effective contribution by focusing on specific topics or projects where it has the prospect of producing, or contributing to, significant improvements.