

Briefing on FRC/ASB Paper on 'Cutting Clutter' in annual reports

1 Background

- 1.1 The Financial Reporting Council (FRC) and the Accounting Standards Board (ASB) have indicated that they see 'clutter' as undermining the usefulness of annual reports and accounts (financial statements). Annual reports and accounts exist to provide information that is useful for decision making and assessing the stewardship and governance of an entity and 'clutter', by obscuring the important, inhibits this role.
- 1.2 This briefing paper summarises the issues contained in the FRC/ASB paper '*Cutting Clutter – Combating Clutter in the Annual Report*' published in April 2011. The FRC/ASB see their paper as providing a catalyst to help change reporting behaviour but also prudently recognise change will not happen overnight.
- 1.3 Although the FRC/ASB paper focuses primarily on listed companies with the more complex disclosure framework provided by EU-adopted IFRS and the Combined Code, there is nevertheless a number of issues identified that will be well recognised by preparers of charity annual reports and accounts.
- 1.4 The FRC/ASB paper should be seen as an initial stage in a process that may bring about change over time. This briefing paper seeks to inform the SORP Committee of this FRC/ASB agenda and offers an opportunity to reflect on the SORP's development in that context.

2 Length of charity annual reports and accounts

- 2.1 Deloitte's 'Review of Charitable Trustees' Annual Reports' of UK's largest charities published in 2010 found:
 - the average length of Trustees' Annual Reports and accounts to be 36 pages;
 - the average Trustees' Annual Report was 12 pages with a range of between 4 to 35 pages.
- 2.2 Unfortunately, Deloitte did not define what they mean by the UK's largest charities. Examples can certainly be found of both Trustees' Annual Reports and financial statements that significantly exceed both the average length and range that they have identified in their findings.
- 2.3 However, even the lengthier reports and accounts that can be readily identified for larger, more complex charities (e.g. Wellcome Trust at 92 pages or Oxfam at 72 pages) do not approach the length of reports made by complex, commercial multi-national entities, for example the 192 pages provided by Royal Dutch Shell or the more modest 185 pages (in small font) produced by BAT.
- 2.4 A reasonable, but untested, hypothesis is that the adoption of full EU-adopted IFRS adds to the length of accounts and the adoption of the

Briefing on FRC/ASB Paper on 'Cutting Clutter' in annual reports

Combined Code, despite its comply or explain mantra, adds to the length of annual reports and accounts.

- 2.5 However, there is no room for complacency as the length and the perceived clutter created by certain disclosures is certainly an issue that is also raised in the context of charity reporting. The 'behavioural' influences leading to clutter, identified by the FRS/ASB paper, are perhaps also just as relevant in charity reporting as in commercial reporting.

3 Three calls for action

- 3.1 Responses to an earlier FRC publication *'Louder than Words'* suggested that materiality was often overlooked by preparers and 'generally, if regulations require a disclosure, it goes in the report – regardless of the materiality or importance to the business'. This failure to have a clear grasp of what is meant by materiality in relation to disclosure is central to the problem. A second issue is that reports often contain explanatory information that remains unchanged from year to year and this adds clutter to reporting.
- 3.2 The blame for 'kitchen sink' reporting is, according to the FRC/ASB, shared by preparers, regulators and standard-setters with even auditors and professional institutes contributing to the problem. The report makes 'three calls for action':
- a debate around what materiality means for disclosure;
 - an investigation into how to tackle the issue of reporting standing information (which does not change from one year to next); and
 - an engagement with stakeholders about their information needs.
- 3.3 Engagement with stakeholders was thoroughly explored in the research project in 2008/09 which included an examination of the SORP's framework and its relevance to stakeholders' information needs. These research findings have been actively informing our approach to the SORP's development.

4 A need to focus on the important – materiality

- 4.1 The FRC/ASB paper suggests there is a lack of agreement over what materiality means from a disclosure perspective. By looking at materiality from the 'disclosure perspective' the emphasis is placed on information provided in annual reports and in note disclosures to accounts rather than the concept of 'materiality' simply in the context of quantitative information in primary statements.
- 4.2 The drivers for clutter are identified as: the lack of agreement on how materiality applies to disclosures combined with the observation of the behaviour of others, reliance on check-lists and examples. These drivers result in each reviewer erring on the side of caution when preparing reports and accounts rather than focus on what to include and what to

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leave out because it's not important. The FRC/ASB are not advocating abandoning check-lists, manuals and the provision of examples but rather stressing the need for preparers and auditors to understand they are not templates. They need to be used in the context of what is material – that is a context of what informs decision-making and the assessment of stewardship and governance.

- 4.3 IAS 1 states that 'an entity need not provide a specific disclosure required by an IFRS if the information is not material'. Whilst the FRSME deals with materiality in the context of error or misstatement and setting accounting policies, it does not appear to offer a similarly clear statement in relation to materiality and the disclosures that the standard requires.
- 4.4 The debate about defining materiality certainly needs to be taken forward by ASB in part by influencing the IASB framework and standards but also in its own post-consultation development of the FRSME. There is little that the SORP can do to limit the disclosures required by a standard and we need to recognise that significant change will require time, debate and due process. However the SORP can assist by stressing the need to focus on the important (the material) and developing a narrative that encourages behavioural change in both preparers and auditors.

Questions:

- **Does the SORP module on accounting policies give sufficient weight to the importance of 'materiality' in the financial reporting framework?**
- **Is there more that we could do to encourage those writing TARs to focus on what is material i.e. the information that informs decision-making and the assessment of stewardship and governance?**
- **Are there any other steps we could take to stress the need for preparers to focus on material items and disclosures?**

5 Standing information

- 5.1 The issue of standing information was identified by our own SORP Research in 2008/09. There was a strong endorsement of the importance of explaining activities (what we do and how we go about it), achievements and plans and the need for SORP to provide a framework for reporting. The importance of activities, achievements and plans to decision-making and to stakeholders' assessment of stewardship was understood even if not articulated in terms of materiality.
- 5.2 The FRC/ASB paper echoes the SORP research findings that that standing information can clog up reports. FRC/ASB paper notes that

Briefing on FRC/ASB Paper on 'Cutting Clutter' in annual reports

reports can contain explanatory narrative information that is either wholly or largely unchanged from one year to the next.

- 5.3 There is a similar recognition in the FRC/ASB paper that the use of the web to present standing information needs to be explored. However, the FRC/ASB paper recognises that law and standards often require particular disclosures. The SORP Committee's view was that whilst additional information could be provided through websites, the annual report should continue to provide core governance information.

Question:

- **Is there more the SORP could do to encourage the use of the web to provide additional explanatory narrative where information is not specifically required by law and/or where the information is not material to decision-making and the assessment of the stewardship and governance?**

- 5.4 The FRC/ASB paper identifies the possibility of using an annex to the annual report to present standing information. There is some evidence of this practice already be used within the charity sector with information on 'reference and administrative' details, on occasions, being presented as a 'schedule' at the end of the annual report. The examples given in the FRC/ASB paper include share based payments and governance arrangements which are not particularly relevant to charities as share based payments are rare in our sector and much of the governance information that the paper suggests could be delegated to website disclosure relates to Combine Code issues which are not required by the SORP.

Questions:

- **We have already moved 'reference and administrative' data towards the end of the TAR module. Would there be any merit in stating that this information may be presented as an annex to the report? Or,**
- **would simply labelling information an annex to the TAR simply be cosmetic?**

- 5.5 The third example provided within the FRC/ASB paper relates to accounts and involves focusing accounting policy disclosure on those that have changed or are critical to results with more detailed disclosures delegated to an appendix (or websites in the longer term). Accounting policy disclosures in charity accounts are usually contained within two pages, or perhaps three, in the context of particularly large and complex charities.

Briefing on FRC/ASB Paper on 'Cutting Clutter' in annual reports

5.6 What is encouraging is the list of possible disclosures that might be considered in the future. This list needs to be read as 'opportunities for the future' and includes statutory directors' report information and a number of the problematic accounting disclosures including financial instruments and post-retirement benefits. Whilst the debate is to be welcomed, it is too early at present to modify the SORP.

6 How this agenda impacts on SORP development

6.1 The FRC/ASB have indicated that they are particularly interested in views and ideas on taking forward the challenge of 'cutting clutter' and have asked for responses by 30 September.

6.2 The following table summarises some of the key points of the FRC/ASB paper and indicates a possible response:

Issue	How the SORP could respond
Debate needed about what materiality means from a disclosure perspective.	In the 'How to use SORP module', we could stress the importance on focusing on the material disclosures.
Deal with long-standing explanatory material (information which does change year on year).	We could attempt to influence this agenda but need to be careful that we do not move in a direction that deepens the dichotomy with company reporting.
Need to engage with stakeholders about their information needs.	To an extent our research addressed this issue. But the prime responsibility rests with charities understanding stakeholders' needs. Issue could be highlight in 'annual report' or 'how to use SORP' modules.
Address behavioural issues – habits and expectations of preparers and auditors adding clutter.	A very useful check-list has been prepared by FRC/ASB and we could draw on this in our SORP launch material.

Questions:

- Do we wish to respond to this request for views and ideas? And, if so,
- what particular points do we wish to make any response?