Communication not compliance

Presentation to IASB Roundtable
January 2013

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What’s the problem?

“The review of these financial risk disclosures shows that there remains a need for financial statement preparers to shift away from ‘tick-box mere compliance’ with disclosure requirements. Preparers should adopt a meaningful communication mindset aiming to convey risk exposures and risk management policy effectiveness, as well as to foster a dialogue with investors.” CFA Institute 2011

“we generally favour disclosure requirements that are written for an entity for whom those disclosures are material, and that appropriate materiality judgements be made under IAS1 ... we want transparent and comprehensive disclosures ... We continue to be more concerned by gaps in company disclosures than by too much disclosure” CRUF letter to EFRAG 2012

Accounts are overburdened by material which is not material, potentially obscuring what is important and relevant. Clear communication seems to comes a distant second to compliance
What should we be trying to do?

- Accounts are for accountability: clarity of understanding must be the key.
- Management and boards are entrusted with assets to steward on behalf of shareholders; reporting should demonstrate clearly that they have discharged that trust effectively and well.
- Disclosures and information must thus be entity-specific and materiality must be a core focus for decision-making – and decisions must be made, judgement must be taken.
- All corporate reporting, including disclosures, needs to hang from the core of the business model, the corporate strategy, business performance in delivering this strategy.
EFRAG and FRC principles

Information should:

- be entity specific
- be current
- be clear, [balanced,] concise and written in plain language
- [inform and] explain the substance of transactions[, going beyond the IFRS requirements if necessary]
- provide a clear link between an entity’s business, financial performance and position

EFRAG communication principles

- be organised
- be linked

FRC principles
Judgement is required

The report and accounts are a window into the controlling mind of the corporation
- Too often they reveal a failure to exercise judgement, a failure to focus on what is important
- Is the controlling mind in control?

Auditors that sign off on accounts which are compliance documents bring their profession into disrepute
- Investors pay for judgement. Do they see this delivered in practice?

Investors need to be willing to make judgements based on disclosures and the level of trust engendered by management
So what are the barriers?

FRC Cutting Clutter project on why clutter occurs:

- Due to time pressures, preparers simply repeat disclosures made in prior years rather than considering whether they are still material.
- Lack of confidence in making the judgement between disclosures that are material and those that are not.
- Just as much work being required to conclude on materiality as to prepare the disclosure.
- Desire to avoid lengthy debates with the auditors.
- Following the leader: if another company makes a disclosure, it can influence others to follow.
- Fear that a missing disclosure will be challenged by regulators.

Investors are always asking for more information

Do inspection regimes foster the exercise of judgement?
What needs to change

- Understanding and delivering materiality
- Investors need to be more discerning in their requests, and companies more discerning in the requests they listen to
- Companies need to take a view, and disclose information that is specific to them
- Investors and companies to collaborate on solutions
- Auditors need to use judgement and not slip into compliance mindset
- Regulators need to set open-ended standards which facilitate this, not set compulsory checklists; address performance reporting issues at an early stage
- Investigatory regimes need to foster judgement not compliance
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