RESPONSE TO THE KAY REVIEW OF UK EQUITY MARKETS AND LONG-TERM DECISION MAKING: INTERIM REPORT

27 April 2012
ICAS welcomes the opportunity to respond to the Department of Business Innovation and Skills’ (BIS) interim report on the Kay review of UK equity markets and long-term decision-making.

ICAS is the first incorporated professional accountancy body in the world. Our Charter requires us to act primarily in the public interest, and our responses to consultations are therefore intended to place the general public interest first. Our Charter also requires us to represent our members’ views and protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Any enquiries should be addressed to Amy Hutchinson, Assistant Director, Technical Policy.
We welcome the opportunity to provide further evidence in response to this interim report and have the following observations on chapter 4: measurement and reporting.

**The ICAS view of corporate reporting**

ICAS has made many important contributions to the development of financial reporting over the years – more recently, with the publication of reports such as 'Principles not Rules: a question of judgement' (2006), 'Making Corporate Reports Readable' (2010), 'Losing the excess baggage: reducing disclosures in financial statements to what’s important' (2011) and 'Making Corporate Reports Relevant' (2012).

Effective corporate reporting is crucial to the smooth functioning of the capital markets – the content, format and frequency of corporate reporting are key elements in ensuring that companies are able to explain to the market how their business has performed, and in enabling users to identify and access the necessary information to assist their decision-making and assessment of management’s stewardship. ICAS believes that there are two main improvements needed in the field of corporate reporting – the application of properly principles-based financial reporting standards and a more fundamental re-think of what information is required and how this should be presented. We explain why these changes are necessary in our comments below.

**Level of disclosure**

We strongly support the Review’s focus on the quality as well as the quantity and range of information provided in corporate reports, and the questioning of the general principle that more disclosure is necessarily better. As we have discussed in our 2011 publication, *Losing the excess baggage*, we believe that the current level of disclosure in financial statements is excessive and is hampering effective communication within these documents.

Whilst our report focussed on financial statements, the same view is true of the ‘front-end’ of annual reports which are subject to extensive legal and regulatory requirements. When viewed in isolation, each new piece of information required to be reported may appear sensible, but the totality of increasing requirements means that the key information is obscured by immaterial and irrelevant detail. In addition, highly prescriptive and detailed disclosure requirements can result in boiler-plate, uninformative disclosures. Linked to this, we agree with the report’s suggestion that the current quarterly reporting cycle is excessive, as this only serves to exacerbate the problem of information overload. We would support a review of the frequency of financial reporting for listed companies.

**Principles-based reporting requirements**

Principles-based reporting standards are key to the development of a more effective reporting model; impacting both the quality and the quantity of information reported. Reporting requirements that are based on broad principles requiring the exercise of professional judgement by preparers and users of the information, rather than detailed and prescriptive rules, should result in more targeted and relevant information being reported, as they provide the flexibility to report specific information rather than generic data. Principles have the flexibility to deal with new and different situations as they arise, and reduce the opportunities for financial engineering and deliberately opaque reporting. Principles-based financial reporting standards are therefore crucial to enabling companies to communicate more effectively with their stakeholders.

ICAS continues to support IFRS as the global financial reporting language – whilst IFRS has its critics, we believe that it is important that the UK, with its strong background in financial reporting, supports IFRS and works with IASB to improve and develop its standards. The interim report notes respondents’ concerns about certain aspects of IFRS, for example, in relation to marking to market, but such critics are rarely able to point to an alternative reporting system that provides relevant information and is free of problems. The benefits brought by IFRS in terms of international harmonisation of financial reporting far outweigh these criticisms.

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1 All of the ICAS reports referred to can be downloaded from www.icas.org.uk
A new reporting format
We agree with the report’s comment that skill, judgement and experience are needed to interpret financial reports – it is important that users understand the context and limitations of financial reporting. Judgement is an integral part of financial reporting and as such there is always a level of subjectivity inherent in the process which must be accepted by users of financial reports. Reporting is often criticised as being excessively complex, but it is important to recognise that much of this complexity results from the underlying business structures and transactions being reported. Because of this level of complexity, it is unreasonable to expect that one report can provide all of the information that users might want to find, but a good corporate report should explain how the business operates, highlight the key financial and non-financial information and provide the means for users to access additional information they may require.

To this end, ICAS proposed a new annual reporting format in our 2010 publication Making Corporate Reports Readable. We proposed a short form report, which would deliver a clear, concise and consistent message about a company’s past, present and future in 30 pages or less.

This report would describe the business model, strategy, key risks and how they are managed, summary financial information, KPIs and significant judgements – and would be consistent with the full financial statements. The financial statements and other detailed information would still be available and readily searchable. Ideally the report would form the centrepiece of a company’s results announcement - thereby aligning the results announcement with the company’s annual reporting.

With the development of XBRL, which will enable users to ‘drill-down’ within a report to the requisite level of detail, a high level summary report will act as a road-map for users while also providing a clear and balanced overview. We believe this type of reporting format has the ability to improve significantly the quality and quantity of information reported by companies, and would be further enhanced by a new assurance model. The 2010 ICAS publication ‘The Future of Assurance’ proposed a new ‘balanced and reasonable’ opinion on the front-end of the annual report, which would utilise the auditor’s knowledge of the business to provide comfort over the narrative information, thus enhancing the communication between preparers and users.