



MAKING FINANCIAL REPORTING SIMPLER AND MORE USEFUL

The Way Forward

A report on roundtables convened by the Global Accounting Alliance

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The Global Accounting Alliance (GAA) released its report 'Getting to the Heart of the Issue: Can Financial Reporting be made Simpler and More Useful' in December 2008. This reported on a series of interviews undertaken across the globe as part of a GAA research project on two key issues affecting financial reporting: the structure and culture of accounting standards, often termed the 'principles versus rules' debate, and the growing complexity and detail contained in company financial statements. The report is available from any of the GAA member bodies or from the GAA website gaaaccounting.com.

This document reports back from a series of three Roundtable discussion events which the GAA subsequently held in London in March, in Beijing in April, and in New York in July. These discussed the themes emerging from our original report and sought to assess the degree of consensus on the key issues.

In some respects, December 2008 was not a particularly favourable time to issue our original report. The world was in the midst of a serious financial crisis and Governments and regulators were focusing on ameliorating the impact of the crisis and starting to think how they could 'ensure that this never happens again'. Specific aspects of financial reporting came under the microscope, particularly the need for a 'level playing field' between the US and Europe, and the issue of fair values.

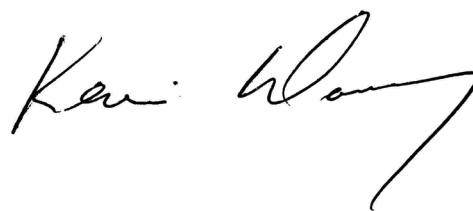
Our report seemed to push against the tide. A number of commentators had called for harsher regulatory regimes, and some had dismissed principles based frameworks as too 'soft'. This contrasted with the views expressed in our report which, in relation to financial reporting at least, would tend to the view that principles based frameworks which are properly and responsibly

enforced are much more effective at achieving the desired regulatory outcomes.

Additionally, calls were made for more disclosure in financial statements and annual reports, in the belief that such additional disclosure might have exposed the banks' unsustainable business models at an earlier stage. There is clearly a risk therefore that financial statements may become even longer and more complex, and this contrasts with our original report and the views emerging in the Roundtables which call for better quality communication and not just more disclosure.

The GAA would like to thank all those who participated in the three Roundtable events in London, Beijing and New York, for sparing the time to engage in this important debate: these are listed on the 'Acknowledgements' page.

The GAA looks forward to contributing further to the debate on how to improve financial reporting. We hope that this report, combined with our original report referred to above, will assist in providing some focus and direction to that debate, and help to move us towards a better communication framework for corporate reporting.



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President & Chief Executive Officer
Canadian Institute of Chartered Accountants

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Introduction - The Way Forward

“From a preparer’s perspective the report emphasises how we need to apply complex accounting standards to an intricate business environment. For us to do that effectively in a clear and transparent manner we need to step back and look at developing a principles-based or an objectives-based disclosure framework that allows us to communicate in a manner that’s more useful, organised, and transparent”.

That was how Frank D’Andrea, Director of Corporate Accounting and Reporting with Hydro One in Canada, summed up the key message of the previous Global Accounting Alliance report and how the financial reporting community could make its findings and recommendations into reality. He was speaking at one of the three Roundtables which the GAA organised to carry this work forward. The first was held in London in March 2009, the second in Beijing in April 2009 and the third in New York in July 2009.

The original report: ‘Getting to the Heart of the Issue: Can Financial Reporting be made Simpler and More Useful?’ was published at the end of 2008 and had brought together the findings from an extensive series of interviews carried out earlier that year with a wide range of stakeholders in financial reporting around the world. The objective had been to identify the barriers to the application of a more principles-based accounting regime and how the current complexity and detail in listed company financial statements could be reduced, so as to focus on better communication with financial statement users.

That report, full of insights into the process that might be required, passed on a series of issues for consideration and charged the key stakeholders in financial reporting to consider them and provide answers. The findings had suggested that there was one overall question: If everybody supports principles-based accounting why can we not move more towards it and why can we not get shorter, simpler, more principles-based standards? And hanging from those fundamental questions were others. Principles and rules are not mutually exclusive. Both are required and a balance is needed. The issue is where on the spectrum we should be.

The ideas around these fundamental issues were broken down into a series of more specific questions and those provided the foundation for the structure of the Roundtables held around the world.

This report provides summaries of the range of discussions and views expressed at the Roundtables held around the world. It then provides a lengthier section explaining where there was consensus, as well as examining the many emerging ideas, thoughts and actions proposed. A brief conclusion draws these together and proposes future actions which should lead, slowly but surely, to financial reporting becoming simpler and more useful.

Extract from 2008 GAA Publication 'Getting to the Heart of the Issue: Can Financial Reporting be made Simpler and More Useful?'

Issues for further consideration

Based on the research, the GAA calls for the following questions to be considered by the key stakeholders in financial reporting:

1. Should an agreed international framework for accounting standards be adopted - with a clear hierarchy comprising: (i) the conceptual framework which sets out the fundamental principles; (ii) outcome-oriented and principles based standards which establish how the fundamental principles are applied to particular subject areas; and (iii) sufficient additional guidance to facilitate practical implementation of the standards?
2. Should guidance be provided for preparers and auditors on the exercise of judgement in the application of principles based standards and on the documentation of reasons for the judgements made, for example by means of an internationally accepted professional judgement framework?
3. Should regulators be encouraged to accept a reasonable degree of variation in accounting treatments and to take a more effective, outcome oriented approach to regulating, engaging more experienced staff as necessary to support this approach? As a first step, should we encourage a debate with regulators as to what is a 'reasonable degree of variation' in accounting treatments?
4. Should a single definitive set of general purpose financial statements be retained, or should we accept that it is impossible to fulfil the needs of all users with one set of financial statements?
5. Should standard setters, in conjunction with business, investors and other users, be encouraged to actively seek to drop requirements considered redundant or superfluous?
6. How can company boards be encouraged to focus on the communication value of the financial statements rather than the compliance aspects? Why are Warren Buffett's letters regarded as so effective?
7. By reference to existing precedents and market practices in this area, should an international framework for high level summary financial statements be developed which can provide information suitable for retail and less sophisticated investors, encapsulating summary financial information drawn from the general purpose financial statements and balanced and informative narrative information?
8. Should general purpose financial statements be developed and published in XBRL format so as to form an information database which allows users to drill down to whatever level of detail is required?
9. Should company communication be improved through the use of clearer language, less jargon and coded language, and a focus on clarity and transparency?
10. How has the recent financial crisis affected the debate on these issues?

London Roundtable

The London Roundtable was chaired by financial journalist Robert Bruce and consisted of Robin Freestone, CFO of Pearson plc, the publishing empire which includes the Financial Times, Bob Garnett, Board Member of the International Accounting Standards Board, Ken Lee, at that time Head of Accounting, Valuation and Research with Citigroup and Ian Wright, Director of Corporate Reporting at the Financial Reporting Council and the man behind the FRC's work on trying to reduce complexity in financial reporting. David Wood and Nigel Sleigh-Johnson from the Institute of Chartered Accountants of Scotland and the Institute of Chartered Accountants in England and Wales, both members of the GAA Project team, started the event with a brief presentation.

Throughout the event the emphasis was on the practical aspects of what could be done. The panel started by making their current thoughts clear. For Robin Freestone, the complexity was created largely to meet the many needs of a diverse investor community and for him the key was comparability. And he was also unsure about how far principles helped him as a CFO when he felt his deep desire was simply to comply. Though he, like others on the panel, felt that aspiring to explain financial reporting in what came to be seen as the 'Warren Buffett way' would help.

Bob Garnett pointed up some paradoxes. The IASB had introduced a principles-based standard on disclosing information about financial risk, IFRS7, which had asked people to describe, from the view of management, how financial risks were being handled. And what had happened? We got a lot of boilerplate, suggested Garnett. "We did not get any useful information whatsoever". He thought that an emphasis on narrative had additional benefits in that it became a discipline across the company itself as well as being useful to investors. He also questioned the

idea of assuming that people made decisions based on general purpose financial statements. He felt people used the information to build their own models rather than to make decisions based on the information. And he stressed the limitations of financial reporting data. In the pharmaceutical or biotech industries what people were interested in was what potential developments were coming through. And all that can be found in the financial reporting are undifferentiated expenses which do not tell you anything about what is happening. In the end he thought that the figures should not be allowed to dominate the reports at the expense of a clear explanation. Reports had to be shorter and concise, clear, reasonable and understandable, so that the chairman of an audit committee or a reasonably competent and sophisticated investor could understand what they are trying to portray.

It then fell to analyst Ken Lee to point out that analysts were very different people and came from very different standpoints and so needed a mass of information reflecting those differences in need. Some analysts would love more narrative and would love a 'Warren Buffett' approach, while analysts specialising in quantitative analysis would ignore narrative entirely and focus on data alone. He felt the answer was not just to make reporting less complex and simpler but also to attempt a type of layering so that investors could find the kernel of truth for which they were searching. He also introduced the idea that none of this would come about through a great moment of revelation, trying to achieve it all in one go. He felt it had to be nudged along, slowly and incrementally, through small steps, achieving better quality, better understanding, the use of technology, better audit understanding, better understanding of what users wanted, better drafting of the accounts by management, and so on.

Ian Wright felt that the nudging had to concentrate on people providing less, but more useful, information. There were an awful lot of debates about what can be added in but no one ever had discussions about what could be deleted.

In the subsequent lively discussion, people made the point that starting from the new SME standard might be a sensible benchmark. People could then ask how much more complexity the entity needed. Others worried that a regulatory space was opening up between what standard setters put in a standard and what happened in practice. The worry was that this space would be occupied by auditors and regulators, who would in effect be making a ruling and enshrining common practice as the default standard, which was not necessarily desirable. A straw poll was held which suggested that complexity was unlikely to be overcome. And in the final panel summing-up the emphasis was on the need 'to change our own behaviours' which was not something which derived from more regulation.

Beijing Roundtable

The Beijing Roundtable was chaired by Stephen Harrison, Chief Executive of the Global Accounting Alliance and conducted by Bill Palmer, Director, Asia, for the Institute of Chartered Accountants in Australia. The panel consisted of Sir David Tweedie, chairman of the International Accounting Standards Board, Dr Liu Yuting, Director-General of the Accounting Regulatory Department of the Ministry of Finance in the Peoples' Republic of China, Jeffrey Lucy, chairman of the Financial Reporting Council in Australia, and PM Kam, Group Financial Controller of Jardine Matheson and member of the IASB Standards Advisory Council.

Bill Palmer started the proceedings off with a view that the consensus was that financial reports were too complex and that principles needed to be retained. Sir David Tweedie followed on by pointing out that he had started his career in the days when there were no accounting standards and therefore judgement had to be used. IFRS now consists of about 2,500 pages, US GAAP is nearer 10,000 and the new IASB standard for SMEs 250. He suggested that much of the current complexity was due to that build up of what he called 'micro-accounting'. He suggested that a high level statement of: "Show the liability you had incurred by signing the lease contract and the rights to the asset you have attained thereby" would cover most of what anyone could possibly want from a leasing standard. And he reiterated his oft-quoted advice to people who ask what they should do in particular circumstances: "You do your best". The problem with the proliferation of, particularly US, rules was that you needed a search engine to do the accounting that way.

He was followed by Director-General Liu who stressed the need to increase the usefulness of financial reports. He reported that China's accounting systems were in good shape and that he had not found any problems with the idea of principles-based standards. It was a question of everyone in the financial reporting supply chain pulling together to address the issues of complexity.

Jeffrey Lucy stressed how much cultural change IFRS had brought about and suggested that another factor was the significant increase in regulatory intervention which, as he put it, had "taken a lot of oxygen away from the profession". In the years since Enron, the accountancy profession had been under greater stress from a higher level of expectation from the rest of the market. But he was cheered by the lack of demand for interpretations, which he had feared would undermine the implementation of IFRS. This enhanced the value of truly principles-based standards.

For PM Kam this was the great test. The danger of having too much guidance was that it would simply turn into rules whereas much of what was required was simple common sense. There had been far too much complication in accounting standards in the past and preparers had not helped by trying to be too creative. In the end standards had to be written in plain English so that even a student could grasp their gist. He thought that the gradual growth of information in financial reporting which had been driven by a need to satisfy every user in detail had changed the nature of the reports. The whole process had become a compliance exercise rather than a communication exercise. A new clarity project was required.

During the roundtable there were discussions of the issue of how regulators would deal with the inevitable disparity in treatment that a true exercise of judgement based on principles would bring about. Jeffrey Lucy argued that recent experience showed that regulators tended not to take on a preparer and an auditor where both had acted in good faith. Other questions covered the issue of what happened when some preparers became too creative in their judgement and PM Kam suggested that there might have to be some guidance, but very brief guidance, so that the essence of principles could be adhered to. In the end, he suggested it was a question of mindset. It might take a long time. But eventually it would work.

New York Roundtable

The New York Roundtable was chaired by Dan Noll, Director of Accounting Standards at the AICPA and moderated by Arleen Thomas, Senior VP at the AICPA for Member Competency and Development. The panel consisted of Frank D'Andrea, Director of Corporate Accounting and Reporting at Hydro One, Wayne Carnall, Chief Accountant of the Division of Corporate Finance at the SEC, Paul Cherry, Chairman of the Standards Advisory Council of the IASB, Neri Bukspan, Chief Quality Officer and Chief Accountant at Standard & Poors and Bob Herz, Chairman of the Financial Accounting Standards Board.

Frank D'Andrea started the event off by reminding everyone that what they were discussing was an age-old problem. Users of financial statements had long echoed their concerns over the complexity of financial reporting. He felt they had to step back and think the issue through anew, and then move on it.

Wayne Carnall urged both preparers and auditors to stop looking at financial reporting documents as compliance documents but to look at them instead as informational documents, and then urged them to not write them just to protect themselves from litigation or to satisfy a regulator.

Paul Cherry said it was important to admit that there was a serious problem and that chipping away at the edges was not going to accomplish anything. A strategy was required. But the problem was that everyone was out firefighting and never devoted enough time to really sorting the issue out. People had to decide whether or not they really cared whether people could understand financial statements or not.

Neri Bukspan followed on by suggesting that it was time for "pencils down", as he put it. The solution did not lie in fixing accounting. The solution lay in thinking whether the information was clearly packaged. But he warned that in reducing complexity it was important to avoid diminishing utility.

For Bob Herz, the starting point was reiterating that financial reporting was a means of communication between companies and the providers of their capital. Unfortunately, as the process had developed, it had

become more useful to accountants, auditors, lawyers and regulators. The original purpose had become lost. He also wanted to distinguish between avoidable complexity and unavoidable complexity. And he was sorry that the notion of a 'judgement framework' had, in this post-crisis period, come to be seen as deregulatory and frowned upon by some. He felt that getting issues like measurement and presentation in financial statements right would help. Paul Cherry agreed. It would lead to clearer, simpler standards that are objective-based. But it came down to the point of whether people were comfortable with the current style of a typical financial report. He said that, personally, he was not.

Wayne Carnall bemoaned the pressure on the SEC to keep coming up with immediate solutions. It only incrementalised the problems and brought greater complexity all round. Frank D'Andrea said that what was needed was an environment where professional judgement would be accepted, but that meant variability which made it difficult for outsiders. He wanted something closer to the internal accounting which management used to run the business rather than the external reporting which too often became a compliance checklist.

As at the London Roundtable, there was a discussion about perhaps stratifying information and providing different levels of reporting. But, as Wayne Carnall pointed out, once you have let people have a particular amount of information they are not going to put up with less, regardless of its quality. He reminded people that back in the 1990s proposals for summary information received a very negative response.

Bob Herz emphasised that 'Warren Buffett' style narrative reporting was fine if you trusted the people concerned but, although 'hard to believe', some people liked to spin. Wayne Carnall added that the increase in the volume of pages of disclosure in a financial report does not necessarily mean an increase in the value of information. The difficulty, all agreed, was in

turning financial reporting from being compliance-led to being communication-led.

Bob Herz noted that many investors and other users are interested, but suggested that some professional investors and analysts liked opacity because it meant they could derive some perceived competitive advantage by digging further. Neri Bukspan agreed. He felt companies were often penalised by the market for disclosing information which their peers were not. He didn't want accountants to provide predictive information but wanted them to provide information from which predictions could be made.

Principles-based standards could work, Bob Herz said, with good implementation, good education, and good policing. But, he added, there should also be sufficient implementation guidance. Neri Bukspan thought such a system would settle down and converge around a mean.

Further discussion suggested that we might be moving to a world where the audit firms, all trying to maintain consistency, one-with-another, started to become the standard-setters as they provided the advice on what judgement should be reached. It was felt that the financial crisis had not helped. Fire fighting meant, as Paul Cherry explained, another spate of piecemeal changes. "Every addition to the literature", he said, "...once it's there it's bloody hard to get rid of this stuff".

The Heart of the Matter

The Transforming Effect of Principles and the Exercise of Judgement

There was almost overwhelming agreement that the use of principle-based standards and the consequent exercising of judgement would stand accountants, auditors, preparers and users of financial statements in much better stead. There is no doubt that a consensus exists for this position. The problem arises from what people perceive as a principles-based system and the exercise of those principles. One man's principle turned out to be another man's rule. And for accountants in business it often seemed to be a red herring, an irrelevance to their main objective which was simply to comply with whatever the regulators decreed and let the users get on with it.

The opening point from Sir David Tweedie, Chairman of the IASB, at the Beijing Roundtable puts the issue in context. His point was that when he started out as a young accountant dealing with recalcitrant audit clients in the dark Scottish industrial heart of Glasgow, standards, in the formal sense, did not exist. So he, and all accountants, had to exercise judgement. It was simply what professional accountants did.

He brought his audience up to date. The rulebooks had burgeoned. Now IFRS was about 2,500 pages, US GAAP was nearer 10,000, and the new IASB standard for small and medium-sized enterprises ran to 250 pages. Principles, for Tweedie, were an attitude of mind. He took leasing as an example. In the US there were some 12 separate standards on leasing. Yet a perfectly acceptable principles-based standard could be reduced to one simple sentence: 'Show the liability you had incurred by signing the lease contract and the rights to the asset you have attained thereby'. It would be a simple, short standard, wholly understandable and ready and waiting for judgement to be applied to the practical issues which might arise.

"Yet a perfectly acceptable principles-based standard could be reduced to one simple sentence. It would be a simple, short standard, wholly understandable and ready and waiting for judgement to be applied to the practical issues which might arise."

This is the helpful side of principles-based work. The Beijing Roundtable also brought out other benefits. The Chinese representatives stressed how helpful the basic assumption that standards had to be based on principles had been in their recent work in bringing standards into line with international practice. And in London there was also a general consensus for the primacy of principles to be upheld. "The truth is that great accounting standards have principles in them", said one panellist, "well expounded, so that everybody can understand. They have lots of rules in them. And they have lots of examples". He was happy with this. For one thing it meant that, should the regulators ask him questions, he would have the answers and a context in which to explain them.

But this also led to one of the reasons why the place on the spectrum between principles and rules is always going to be blurred. For a preparer the achievement of compliance was the most important thing. And preparers tend to think that a regime which emphasises principles over rules does not help them in that objective. One example was the question of how much profit would be recognised on a transaction this year at the point of the transaction. The answer the preparer did not wish to hear was a discussion about how it could be this much, or it could be that much, depending on which principle you wish to give more weight to, and perhaps it would be best to wait until the year end and see how much we could declare. For preparers there was always going to be a much greater reliance on the mix of principles and rules, present practice within that industry, and what line the regulator was likely to be taking.

This issue of how preparers find rules very useful when dealing with other parties in the process also came to the fore in New York. One panellist was 'shocked' to have recently found that some preparers were not very supportive of what, in the

US, are referred to as 'objective-based' standards. The preparers had been taken aback at this reaction and had explained that frankly rules helped them to avoid conflict. If someone told them what to do then they didn't need to have a fight with the CEO, or the auditors.

There was also a view that some people held to the perception that a shift to greater principles-based judgements would create greater uncertainty. But panellists were keen to argue that experience showed that this was not so. Wayne Carnall from the SEC made the point that there have been very few instances in which they told companies that they were required to restate their financial statements because of differences in view regarding areas of professional judgement. The overwhelming majority of instances in which they required restatement were from situations in which the company hadn't followed the technical requirements of a rule.

Another danger was that this may just prove to be the wrong time to be trying to shift the system towards more judgement. In the lingering aftermath of the financial crisis, there was a feeling that the environment would not welcome any moves towards something which was perceived to be, or felt like, a lessening of regulation, or a lessening of the burden of regulation.

There is also the danger of principles not achieving the improvement in financial reporting which they were designed to create. This largely happened where standard setters hoped for improvement through better disclosure, when in fact industry chose to decline that invitation. Bob Garnett of the IASB made this point at the London Roundtable. He said that IFRS7, which was intended to provide the market with much more information about how companies were handling financial risks, resulted in 'a lot of boilerplate'. "We did not", he said, "get useful information".

Despite all these caveats and observations it was generally felt that the important element was to have the influence of principles extend through not only the standard-setting process but also that of implementation.

The Need to Reverse the Growth of Complexity

The greatest consensus coming out of the roundtables was that complexity was the real problem with financial reporting. Possibly the most heartfelt comment in all of the roundtables came in New York where one panellist simply asked for 'pencils down'. There was a feeling that the whole issue of complexity was one which could be dealt with but, like the idea of finally agreeing on a conceptual framework, was an issue which was always being shelved because something else more urgent, like a financial crisis, came along. Many people in all of the roundtables complained that so much of their life was spent 'firefighting' rather than achieving the long-term and much more useful strategic issues. This would apply to grand plans to rid the accounting world of complexity as well.

But there is frustration. One of the panellists in London made the point that it was very sensible to have as an objective making financial reporting less complex, simpler and more understandable. No one would disagree with that. It was laudable. But he doubted it was achievable.

It was felt that, to state the obvious, one of the reasons for complexity in financial reporting was the growing complexity of business activities and, running in parallel, the growing complexity of accounting issues. Added to this was a perception that there is a natural tendency to add further elements of disclosure when there is a problem but have no mechanism on the other side of the equation which gets rid of stuff which no one needs anymore. Financial reporting shares this problem with tax systems around the world.

There are many recipes for trying to bring about change. One was to recognise the difference between unavoidable and avoidable complexity. The unavoidable complexity is the stuff which is the natural result of the acceptance that the world of business is not getting any simpler and is unlikely to do so. The reason the avoidable complexity still exists is down to laziness. Particular needs, biases, special treatments, exceptions, options, different models for similar things, and so on. The list is endless. One

panellist pointed to the exponential growth in the disclosure of key performance indicators. Beyond a certain point the number of KPIs confused rather than provided insight.

One action which would make a difference was the idea of always trying to turn the argument from ‘what more should we put in?’ to ‘what could we take out?’ There was a suggestion that when compiling a comment letter, for example, people should, instead of simply compiling a list of what they wanted, could compile a list of what they wanted taken out. In particular, it was thought that industry groups might take better note of the overall objective of simplicity and refrain from advocating specific, often detailed, measures to suit the circumstances of their industry.

It is also a side-effect of being part of a profession. The accounting profession, like all other professions, feels a need to always be making a contribution. Everything is geared to providing more, not to providing less. The ability to make a professional judgement has come to depend on a considerable and ever-growing corpus of learning. That grows in tandem with the importance of the profession. The American legal profession, often blamed for the growth of rules and complexity in the US business world, is not immune from this either.

Regulators argue that part of the problem is people coming to them and demanding more regulation, which in turn means ever more complex disclosure. And once people had that extra disclosure they would always vote against reducing it because of their perception that somehow they would be less well informed as a result.

These were the difficulties. One panellist in New York tried to turn this mass of seemingly impossible obstacles into advantage. “Don’t look at financial reports as a compliance document”, he suggested, “look at them as an informational document”. For many people this was what people forget as they labour under the weight of the information. A fellow panellist added to this by suggesting that the profession had to admit that it had a serious problem and that simply chipping away at the edges was not going to accomplish

anything. And at some point another uncomfortable truth had to be faced: does the profession, and do all the participants in financial reporting, really care whether people understand financial statements or not? If they do care, then how do they think that something around 500 pages long is really serving anyone’s purposes? Another panellist suggested that we should think of annual reports as packaging and think how we reduce that. Part of the problem was also that these reports were originally designed to be a means of communication between companies and their providers of capital: the accumulation of extra detail has partly come about because a whole framework of accountants, regulators, lawyers, all of them on the supply side of the equation, had steadily pitched in.

One example which had reduced complexity was cited as a possible way forward. This was the proposed standard on financial reporting for small and medium-sized enterprises which the IASB recently published and which Sir David Tweedie praised in Beijing for being only 250 pages long. There was much support from the audience at the London Roundtable for the idea of simply saying that it should be used as the starting point. It should be taken as a base and everyone should measure themselves against it. Then the burden would be on people to explain in a formal statement the reasons why they needed more complexity in a particular area, or more disclosure, or additional reporting. They would have to justify everything they added on top of the basic reporting. The suggestion was that the level of disclosure and complexity of a private entity should be the base case for everyone.

The whole issue of complexity was seen as an age-old problem. One panellist in New York quoted from a speech made by the then SEC Chairman fifty years previously which, while not mentioning complexity specifically, discussed many of the same issues about the nature of the financial reporting which the accounting profession created. The panellist said that, fifty years on, was an opportune time to bring about change. The stars were aligned to do it. There had been a great financial crisis. There was the

“Don’t look at financial reports as a compliance document, look at them as an informational document.”

evolutionary process going on between the two main systems of accounting standards and the two main standard-setting boards. There is a time of change and harmonisation in the air.

Another panellist in New York emphasised this need for determination. “I think there has to be someone who says: ‘We are committed to making this happen’”, he said. And if you don’t have that and some accountability, I think we’ll just drift, and we’ll take some steps forward, some backwards, and hopefully it’ll be a net gain. But I think there’s an opportunity for a significant move forward. But it requires us to break a lot of old habits. And it doesn’t happen easily’.

The view was that, collectively, everyone had to make a difference. There was no single event or initiative which would suddenly stop the growth of complexity in its tracks. It was a question of changing behaviours. It was a question of getting hold of a set of accounts, looking through them and working out what could be taken out. The shorter they are the easier they are to read and understand. There was much discussion of the contemporary ‘nudge’ theory which suggests that change which previously seemed intractable can be brought about in small increments. Instead of retreating defeated by the enormity of the problem and the lack of a single obvious answer, the strategy is to push the difficulties back one small step at a time. It would be a question of nudging it along to achieve better quality and better understanding. Technology might help. Nudging the auditors to bring about incremental improvements, getting better attuned to what users want, helping the audit of the accounts to work better, helping the management to draft the accounts in the best way possible, just nudging small changes along. This was seen to be practicable and, in the long-term, transformational.

The Challenge of Regulators and Audit Firms

Another concern was what would happen in the future when finance directors and CFOs sought advice when they were about to apply some judgement. The assumption was that they would call in their auditors, which were likely to be one of the large international firms. The audit partner would check in to central

office or check the existing guidance within the firm. The firms would have checked with each other. The end result would be an effort at conformity. As a preparer panellist in New York said, the goal would be uniformity. The result of this is that standards would, in effect, be set by the large international firms. There is a regulatory space that has to be filled between what the standard-setter puts in the standard, said one legal adviser at the London Roundtable, and then how it is applied in practice. Where does that regulatory space get filled? It gets filled by the auditors and by regulators.

The Needs of Analysts

At the London Roundtable one presentation from a panellist from the analyst community illustrated just how hard it would be to reduce the complexity and the sheer quantity of information in the blizzard of disclosure. Analysts differed, he said. Some required great technical detail, others wanted to deal more with the state of the market. But, frankly, what they all wanted was a vast pile of information which they could dig into. He gave the example of investors who had asked him why banks did not outline exactly how they valued each derivative or different class of derivative. They have over 200,000 different types of derivative instrument, he had answered, and they have hundreds and hundreds of different models. He had pointed out that the resulting accounts would be around 1,000 pages long. Investors would always say they wanted more. But often they didn’t understand the implications and, had they done so, would not have wanted the extra information.

The Warren Buffett Panacea

At many stages in the Roundtables around the world people who felt themselves to be drowning in the mass of principles, rules and the complexity of financial reporting started to reach out and clutch at the straw represented by the sort of narrative reporting personified by Warren Buffett and his homely, straightforward and perceptive ruminations in the annual report of his company Berkshire Hathaway.

The preparer on the London Roundtable probably expressed it the most clearly: “the Warren Buffett Narrative’ is the thing everybody points to and says what a wonderful way it is to talk about your accounts and performance in the year”. The Buffett narratives were agreed to be excellent though people did suggest that lawyers had never been anywhere near them and that was how they maintained their purity of expression. The Buffett approach was seen to be difficult to achieve but should remain an aspiration. It was also seen as a very good way to force the management of a company to provide the most useful information that investors could have, which was an insight into what the management really believes about the business. Narrative reporting was seen as a very useful step in this direction, though it was accepted that there was only one Warren Buffett and that many others might struggle to follow his example. The result could be just as much boilerplate as other methods had engendered. The point about Buffett is also, of course, that he *wants* to do it. Others may not. Bob Herz of FASB pointed out at the New York Roundtable that he knew that this might be hard to believe, but some people do like to spin and be very selective about what they talk about and emphasise.

The Value of XBRL

XBRL, once seen as the electronic panacea to the problems of complexity, received more of a muted performance amongst the many participants around the world. Once it was seen as possibly the best solution. Electronic tags would enable users to effectively do their own re-ordering of the financial information to suit their own models and purposes. At the London Roundtable Ian Wright, onetime PricewaterhouseCoopers partner, told of his own early days on the XBRL project. “The first IFRS XBRL taxonomy was written on my kitchen table over one weekend”, he revealed. “It had 200 tags in it and it seemed to me that was all that was necessary”. He eventually parted company from the pioneering XBRL group “because it had been taken over by individuals

who wanted to create a 20,000 item version”. The programme had, in his view, started to become part of the complexity problem. “I did not believe that what the market needed was a 20,000 item version of XBRL taxonomy because I fear the same outcome, which is that you generate more and more numbers. More and more numbers by themselves are not terribly useful. The more numbers you get into the more you question the reliability of the individual numbers”. Numbers, as he pointed out, do not convey information. It is only when you get management to explain numbers that you manage to achieve something rather better.

The same sentiment emerged in New York where it was felt that accountants were expecting too much of XBRL. “We just dump things in”, said one panellist, “and standard-setters don’t think about it as a communication”. Overall it seemed that XBRL might be part of any solution to the complexity issue but should no longer be seen, as newish technologies often are, as the long-awaited complete answer.

The Dead Hand of the Lawyers’ Influence

One panellist in New York, talking about the possibility of filing the full 10K corporate reports with the SEC but adding a short summary at the front, summed up much of the difficulty in making something simpler, short, and understandable. “The lawyers will go nuts if we go down this path”, he said.

Conclusion - Consensus and Action

The 2009 Roundtables, which followed up the original GAA report and research, have shown conclusively that there is wide consensus on many of the areas of discussion.

There is no doubt that, broadly, the idea of principles-based, or objectives-based, financial reporting standards has won the day. There are arguments about where on the spectrum between pure principles and a mass of rules they should fall. But that is detail. What is accepted is that a financial reporting process based, to a greater extent, on principles and judgement would make the whole process simpler. The challenge is in generating the necessary leadership, commitment and actions to achieve this in practice.

It was clear that for preparers and auditors, and also for regulators, some agreed framework for the exercise of professional judgement would be helpful. Whilst it would seem that regulators would not normally confront preparers and auditors where judgements have been made in good faith, it would be helpful to set out the broad terms under which judgements would normally be accepted.

There is also a consensus that the current levels of complexity in financial reporting cannot be allowed to continue. Again, the real question is how to achieve this. No single compelling course of action was identified which would speed the demise of complexity. The answer which emerged was that, unlike much in financial reporting, this was not wholly a technical issue.

There was unavoidable complexity, which related to the growing complexity of business and the accounting which underpinned it. And there was avoidable complexity, the simple accretion of unnecessary detail. Accepting one while ridding reports and accounts of the other has to be the aim.

There would also be changes leading through from the gradual move towards principles-based standards. The current problems, which often stem from financial reporting being dominated by the objective of compliance, would change as the objective of communication slowly gained the upper hand.

It is a question of human behaviour. The continual urge to add more and more refinements and additions to the financial reporting process has to be curtailed. There has to be an active effort to remove elements which are now either unnecessary or have been found wanting.

Action is required to keep the issue in the minds of everyone in the financial reporting world so that they would be deterred from creating further complexity which could be avoided and encouraged at every opportunity to remove redundant complexity. The roundtables revealed a consensus behind the idea of steady, determined, incremental change being the way forward.

The Global Accounting Alliance wishes to express its support for:

- A single set of globally accepted financial reporting standards, as called for by the G20 Governments – with a primary focus on transparency and the needs of the capital markets, rather than stability and the needs of prudential regulators.
- Such standards to be part of an outcome oriented, principles based financial reporting framework.
- The preservation of the independence of the International Accounting Standards Board, subject to appropriate governance and oversight, and free from undue influence of vested interests other than through the normal due consultative processes.
- Proportionate regulation to support a principles based financial reporting framework, including a framework for professional judgement agreed by regulators to provide guidance to preparers and auditors involved in judgements on accounting treatments.
- Preparers and other stakeholders in financial reporting moving away from a legally constrained ‘tick box’, or compliance, mentality, to a focus on quality communication.

The GAA will be pursuing these goals by seeking to ‘nudge’ all the players in the financial reporting debate – standard setters, preparers, auditors, regulators, analysts, investors and other users - to make the necessary changes so as to achieve the objective of a simpler, principles based standard setting framework, and more accessible and understandable financial statements.

THE GLOBAL ACCOUNTING ALLIANCE

The Global Accounting Alliance (GAA) was formed in November 2005 and is an alliance of leading professional accountancy bodies in significant capital markets. It was created to promote quality services, share information and collaborate on important international issues. The Alliance works with national regulators, governments and stakeholders, through member-body collaboration, articulation of consensus views, and working in collaboration, where possible, with other international bodies, especially IFAC.

The Alliance facilitates a co-operation between eleven of the world's leading professional accounting organisations:

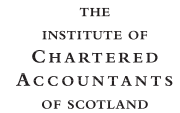
- American Institute of Certified Public Accountants (AICPA)
- Canadian Institute of Chartered Accountants (CICA)
- Hong Kong Institute of Certified Public Accountants (HKICPA)
- Institute of Chartered Accountants in Australia (ICAA)
- Institute of Chartered Accountants in England and Wales (ICAEW)
- Institute of Chartered Accountants in Ireland (ICAI)
- Institute of Chartered Accountants of Scotland (ICAS)
- Institut der Wirtschaftsprüfer in Deutschland (IDW)
- Japanese Institute of Certified Public Accountants (JICPA)
- New Zealand Institute of Chartered Accountants (NZICA)
- South African Institute of Chartered Accountants (SAICA)

These organisations represent over 775,000 professional accountants in over 165 countries from around the globe.

The GAA was established to promote quality services, share information, and collaborate on important international issues, whilst operating in the interest of a quality accounting profession and the public interest. The overriding objectives of the GAA are those of operating in the interest of a quality accounting profession and the public interest.

In addition the GAA has the objective of:

1. Enhancing the accounting profession and business through global leadership in the areas of thought leadership and research.
2. Assisting the development of national accounting institutes and their national qualifications.
3. Promoting the brands represented by the member bodies through their linkages with the GAA, enabling growth for the member organisations.
4. Increasing advocacy leverage with national regulators, Governments and stakeholders through member body collaboration, articulation of consensus views and working in collaboration with other international bodies such as IFAC.
5. Increasing member benefits through overseas support mechanisms and value adding services.
6. Promoting the international portability and recognition of the respective national qualifications, including specialisations, while ensuring that we always act in the public interest and do not set up any real or perceived barriers to other professional accounting bodies being able to conduct their business in any country.



The Global Accounting Alliance is an alliance of eleven of the world's leading professional accounting organisations