
Practical guide to IFRS

Streamlining the annual report

At a glance

We are in a period of significant change and innovation in corporate reporting. The demand for change is being driven by various interested parties, including forward-thinking companies, investors, government and regulators. This is because, under the current regime, key messages can be lost in lengthy reports that are hard to navigate and contain immaterial or repetitive disclosures.

The intention of those seeking change is to improve reporting so that it gives an insightful picture of corporate performance, sufficient to assess the quality and sustainability of that performance. Various bodies are seeking views on the best way forward, and we are likely to see changes to the reporting framework in due course. But even before any such changes, we can see momentum building.

Companies are increasingly revisiting their annual reports to see how they can make improvements within existing legal and regulatory requirements. This practical guide considers that issue as it applies to IFRS reporters in the UK, although similar considerations may apply to UK GAAP reporters.

We have invested in over a decade of research with investors and companies to determine the information they need to understand the quality and sustainability of corporate performance. The findings from our latest survey (see [‘Corporate reporting: From compliance to competitive edge’](#)) continue to show developments in narrative reporting, but there is still considerable room for improvement.

The expected changes in the reporting regime present an opportunity for companies to re-examine the information needs of users and how those needs can be met. We have supported many

companies in their efforts to improve their reporting, taking an innovative approach. We encourage companies to adapt their reporting in this changing environment so that key information is delivered more effectively to their stakeholders.

Background

Current initiatives include the following:

- The Financial Reporting Council (FRC) has issued a consultation paper, [‘Cutting clutter’](#). This paper addresses how ‘clutter’ might be removed from annual reports and how the most relevant information might be brought to the fore, including in the financial statements. Two main areas of clutter have been identified by the FRC: immaterial disclosures and explanatory information that remains unchanged from year to year.
- The [FRC Financial Reporting Lab](#) is bringing management and investors together to shape reporting to meet users’ needs more effectively.
- The Department for Business, Innovation and Skills (BIS) has issued a consultation paper, [‘The future of narrative reporting’](#). This aims to address the length and complexity of current reporting to make key information easier to find. It proposes to divide the annual report into: a ‘strategic report’, with key messages about the company (including its strategy, results, summary financial information, risks and remuneration); an ‘annual directors’ statement’, published online, giving detailed information that underpins the ‘strategic report’; and the full financial statements.
- The International Integrated Reporting Committee (IIRC) has issued a discussion paper, [‘Towards integrated reporting: Communicating value in the 21st](#)

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[century](#). The IIRC is developing an international ‘integrated reporting framework’ to enable management to communicate a broad set of information to assess the company’s long-term prospects in a clear, concise, connected and comparable format, focusing on ‘value creation’.

- A two-year [IIRC pilot](#) focused on innovation to better integrate reporting is attracting significant interest from companies, investors and other key stakeholders. The idea is that the process of companies experimenting and innovating with the principles and content of the IIRC integrated reporting framework will go beyond simply informing the development of the framework; it will also demonstrate the benefits for companies and investors and define best practice.
- ‘[Losing the excess baggage –reducing disclosures in financial statements to what’s important](#)’, a ‘joint oversight group’ of the Institute of Chartered Accountants of Scotland and the New Zealand Institute of Chartered Accountants, recommends deletions and changes to IFRS disclosures.

Emerging themes

Although there are a variety of reports and discussion papers, we can see some common themes are emerging. These themes fall into two broad categories: improving the transparency and connectivity within the annual report; and removing clutter – that is, immaterial and duplicate information.

We believe that the transparency and connectivity of the information is the most important factor in effective reporting. It is not the volume of disclosure that matters but its quality and the way it is organised. In the main, users complain not about the length of the annual report but about finding it hard to access the information they need. The inclusion of immaterial disclosures usually makes this problem worse but, in a well organised, integrated annual report, users will often be able to bypass much of the information they consider unimportant. This is particularly feasible for those using online reports – where users can navigate from one web page to another to look at only those matters of

interest to them – but even in this context, it is preferable to eliminate immaterial information altogether.

Transparency and connectivity

Annual reports now contain a wide range of information and reports including:

- Financial statements (called ‘accounts’ in legislation);
- Directors’ report (including business review);
- Directors’ remuneration report;
- Corporate governance statement; and
- Other reports, such as a corporate social responsibility (CSR) report.

Some simple principles that we advocate for improving annual reports are as follows:

- Make the report easy to navigate so that users can drill down easily from the high-level information to more detail on the areas that interest them.
- Give the most important and summary information the highest profile, with the detail playing a supporting role.
- Connect the various pieces of information; for example, link strategy to objectives; link objectives to performance; link performance to remuneration. This will enable management to demonstrate how the business is actually run: remuneration is based on performance, which is a result of the objectives that implement the strategy.
- Avoid reporting in silos. Strategy reporting should be comprehensive, covering all aspects that are necessary for an understanding of the company. For example, link CSR reporting to the company’s strategy, instead of reporting CSR matters in isolation. If information is not necessary for an understanding of the company, consider whether it should be disclosed separately online or at all.
- Relegate standing data to the background where possible, such as to an appendix.
- Consider the quality of the disclosures, not just the quantity. Disclosures should be specific to the organisation, not bland statements of the obvious. For example, does the

disclosure of the revenue recognition accounting policy tell the full story of the link between the delivery of the company's particular goods and services, covering all material revenue streams, and the recognition of revenue? Are the key estimates and judgements involved in applying that policy fully disclosed?

Removing clutter

We believe the following efforts would be valuable in removing excessive information.

- Avoid immaterial disclosures.
- Remove 'boilerplate' disclosure. There's no point in telling users what they already know. Replace it with company-specific information.
- Avoid duplication. Use cross-referencing instead.

Making changes now

Some of the suggestions in the proposals from the bodies described above would require changes in the law or accounting standards before they could be fully implemented. But there are some steps that companies can take now to improve their communication with their stakeholders. Management considering improving their reporting in the current period should first answer these questions:

Who are the users of the annual report?

The users can be divided into two broad categories: those who have an entitlement to receive the annual report and to whom the directors have a responsibility, and those who have no such entitlement but nonetheless have an interest in it.

The law prescribes who is entitled to the annual accounts and reports; and IFRS, in describing the purpose of financial statements, sets out who the primary users of financial statements are.

Under the law, directors have a duty to promote the success of the company for the benefit of the members as a whole. [Sec 172]. This duty is performed with regard to various other parties (for example, in the interests of the environment and of employees, suppliers

and the community), but the directors do not have a duty towards those parties, only to the members as a whole. Only members, holders of debentures and other persons entitled to receive notice of general meetings are entitled to be sent the annual accounts and reports. However, quoted companies are required to make the annual accounts and reports freely available on the company's website, which makes the annual accounts and reports available to a wider group than just the company's investors.

Under IFRS, the objective of general purpose financial reporting is to provide financial information about the reporting company that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the company.

Despite the fact that, under the law and IFRS, they are not the primary audience for the annual accounts and reports, other stakeholder groups – such as government, employees and suppliers – have information requirements that companies often wish to address.

What information do they need?

Having identified the target audiences, management will have to determine those audiences' information needs. They should assess what is material to each user group (see below).

How should that information be provided?

Companies provide information to address the needs of users other than investors and creditors, but we believe that such information, in so far as it appears in the annual report, may be better communicated with an investor focus. This is not to say that the annual report should be purely focused on financial information for investors. Quite the contrary: many of the developments in corporate reporting point to the wider information set that investors need in order to make decisions about an company, such as business model and strategy information and sustainability reporting. The broadening of the information provided in annual reports means that investors have a more rounded picture of the business; it also means that the annual report appeals to a more diverse audience.

However, in our view, the primary (but not the only) purpose of the annual report should be to provide shareholders and investors with information that is useful in making their investment decisions and in assessing management's stewardship. This is the position under the law and IFRS. However, in recent years, companies have increasingly sought to address the additional information needs of other groups through the annual report. We recognise that various other stakeholders have an interest in some or all of the annual report, but we question whether the annual report is the best medium for communication of information that is specific to their interests.

Companies should therefore consider how the information should be provided to groups other than investors and creditors. For example:

- Is the annual report the best medium for communication?
- Would a separate report be better?
- Would online communication be preferable?
- Does the timing of the provision of information need to be the same as for the annual report? Could it be provided more or less frequently or at different times in the year?

Materiality

Disclosure items fall into two broad categories: those that must be disclosed regardless of their materiality and those that must be disclosed only if they are 'material'. In general, the first category is those items whose presentation or disclosure is required by law (see 'Materiality and the legal framework' below); the second category is those items whose presentation or disclosure is required by accounting standards (see 'Materiality under IFRS' below).

Although IFRS defines what is meant by 'material', it remains a matter of judgement. This, coupled with the fear of regulatory challenge, has led many companies to take an 'if in doubt, disclose' approach, resulting in an increase in the length of annual reports.

The question of materiality is discussed in the FRC's 'Cutting clutter' consultation paper. The FRC is encouraging debate in

this area – between companies, investors, standard setters, government, regulators and other interested parties – with a view to breaking down the barriers to removing clutter (which would include immaterial disclosures).

Materiality and the legal framework

The law contains a number of exemptions from its disclosure requirements. However, where no such exemption exists, the disclosure must be made, regardless of its materiality.

Under the law, quoted companies must prepare financial statements, a directors' report (including business review) and a directors' remuneration report. The Listing Rules and the Disclosure and Transparency Rules have an additional requirement to produce a corporate governance statement, and the law also requires this statement to be filed if it is prepared.

UK companies prepare their annual reports under Part 15 of the Companies Act 2006 ('the Act') and SI 2008/410, 'The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008'. For IFRS reporters, the main requirements relating to the form and content of financial statements are delegated to IFRS. IFRS rules on materiality apply to these items.

However, in addition to those IFRS requirements, the law contains further disclosure requirements which apply to the financial statements and accompanying reports; these must be given regardless of their materiality unless the law specifies otherwise. For some disclosures, SI 2008/410 specifies a *de minimis* below which disclosure is not required. For example, charitable donations need not be disclosed if they do not exceed £2,000. Certain of the directors' report business review disclosure requirements, which are contained in Section 417 of the Act, are required "*...to the extent necessary for an understanding of the development, performance or position of the company's business...*", which amounts to a requirement to disclose only those matters that are material in that context.

Materiality under IFRS

The determination of what is material is a matter of judgement under IFRS. The issue of materiality is considered in ‘Losing the excess baggage –reducing disclosures in financial statements to what’s important’.

This report highlights that IFRS identifies three categories of financial reporting disclosures:

- Material items (that is, line items in the primary statements);
- Material information (that is, disclosures in the notes) and
- Those items that are immaterial.

The report argues that where an item is material and reported separately, it does not always follow that the related note information is also material (see Appendix 1, question 9), and the report encourages companies to reconsider their disclosures in this light.

Whether a line item or notes disclosure is material depends on various factors, which could include:

- Numerical size;
- The nature of the business (for example, financial asset impairment disclosures are likely to be more important to users of the annual reports of banks than retail entities, whatever their size);
- Whether the item is related to a key performance indicator;
- Whether significant estimates were involved in determining the carrying value;
- Whether significant management judgement was involved in determining the classification and accounting treatment of the item (for example, whether another company is a subsidiary of the reporting company,

and whether a lease is a finance lease or operating lease);

- The potential volatility in the carrying value of the item;
- Whether the item is relevant to assessing compliance with loan covenants or other contractual requirements that are important to the future of the company;
- Whether the transaction is on normal commercial terms;
- The counterparty to the transaction (related party transactions will typically have a lower materiality threshold);
- Matters that reflect on management’s stewardship in legal terms (for example, fines) (which will typically have a lower materiality threshold).

Typically, materiality considerations are more easily addressed in relation to primary statement line items, with companies experiencing little difficulty in deciding how or when to aggregate line items that are individually immaterial. The difficulty arises in relation to disclosures in the notes. Practice has, up until now, generally been to insert a disclosure if there is an item to report, with little consideration of whether it is a material item that warrants disclosure. Some companies are now reconsidering this practice with a view to eliminating those immaterial disclosures.

Where to go for more information

For more PwC guidance on corporate reporting, visit [pwc.com/corporatereporting](https://www.pwc.com/corporatereporting) and, in particular, the publication: [*Corporate reporting: From compliance to competitive edge.*](#)

Appendix 1 – Frequently asked questions

1. Can I omit immaterial accounting policies?

Yes.

Accounting standards require disclosure of ‘significant accounting policies’. [IAS 1 para 117]. IAS 1 para 119 states that, in deciding whether a particular accounting policy should be disclosed, management considers whether disclosure would assist users in understanding how transactions, other events and conditions are reflected in reported financial performance and financial position. In other words, disclosure of accounting policies that are not significant is not required.

IAS 1 para 119 refers to disclosure that would ‘assist users’. This has much in common with the assessment of materiality of disclosures, with an item being ‘material’ if it could ‘influence decisions that users make’.

2. How do I determine what is a significant accounting policy?

There isn’t a simple answer to this question because what is ‘significant’ is a matter of judgement and will vary between companies and industries.

The following factors are among those that would point to a policy being considered ‘significant’:

- The numerical amounts involved are large in either the current period or the previous period, or earlier transactions continue to impact the financial statements (for example, business combinations).
- The accounting policy is industry- or company-specific.
- The matter is not covered by accounting standards and the company has developed its own policy.
- The policy requires the exercise of significant judgement by management or involves management using experts (for example, valuers or actuaries).
- IFRS permits a policy choice.

- The policy has changed since the prior year.

Generic disclosures of accounting policy that are little more than a ‘cut and paste’ from the accounting standards are of little use. The FRRP has commented on the tendency of companies to provide ‘boilerplate’ descriptions of accounting policies and has urged companies to take a more focused and thoughtful approach. We believe that where an accounting policy is prescribed by IFRS and is widely known and understood by users, it may be sufficient to state that the particular item(s) has been measured, presented and disclosed in accordance with the relevant accounting standard(s).

For example, it is common to see the following disclosure of accounting policies on provisions: “A provision is recognised in the balance sheet when the Group has a legal or constructive obligation as a result of a past event, it is more likely than not that an outflow of resources will be required to settle that obligation, and a reliable estimate of the amount can be made.” As there is no alternative to that policy, the question is: what does this tell the reader that he or she didn’t already know? Of more importance are the judgements management has made in applying that policy.

On the other hand, a revenue recognition policy will be significant for most companies, and it should detail how revenue is recognised for each material type of income stream that the company receives. Again, of equal if not more importance, is disclosure of the judgements and estimates that management has made in applying those policies.

The position is different for UK GAAP reporters. In PN 03 (issued in 1992) the FRRP, having taken legal advice, commented on the legal requirement for companies to disclose their accounting policies: “*The inclusion in the notes to the accounts of a statement that the accounts have been prepared in accordance with applicable accounting*

standards, required by paragraph 36A, does not satisfy the requirement in paragraph 36 to state the accounting policies of the company.” [FRRP PNo3]. In other words, it is not permissible for companies to disclose separately only those policies where accounting standards permit a choice of policy. This remains the case for UK GAAP reporters because the law (now contained in SI 2008/410 remains the same for those companies. However, companies are now permitted or required to prepare their financial statements under IFRS and, for those companies that do so, the Schedules of SI 2008/410 requiring disclosure of accounting policies do not apply. Instead, IFRS reporters comply with IFRS, including the requirement to disclose ‘significant accounting policies’. The law applying to UK GAAP reporters requires disclosure of ‘accounting policies’, not just ‘significant accounting policies’.

3. Can I move my accounting policies or certain directors’ report disclosures onto my website?

Not at present, but BIS has issued proposals for companies to be required to prepare a ‘strategic report’ with an online ‘annual directors’ statement’. These proposals could be seen as a first step along the road towards online reporting. However, for now, this approach is not permitted by the accounting standards or, for directors’ report disclosures, the law.

The requirement in IFRS is to disclose the accounting policies in the financial statements (which include the notes to the financial statements). This can be achieved by incorporating by cross-referencing to another report presented with the financial statements but not to the website or to another document presented separately.

The BIS publication ‘Guidance on changes to the directors’ report requirements in the Companies Act 1985 – April and December 2005’ clarified that where the directors’ report and a voluntary OFR are published together, it is acceptable to cross-refer from the directors’ report to the OFR. This guidance is considered to be relevant to similar provisions of the Companies Act

2006. The cross-reference must clearly refer (by page numbers, paragraph numbers or headings) to the specific section in the OFR. The guidance provides example wording for such a cross-reference, as follows: *“The information that fulfils the requirements of the business review can be found in the OFR on pages x to y, which are incorporated in this report by reference.”*

Although this is in the context of the directors’ report disclosure requirements rather than financial statements, the same logic could apply to financial statements: information presented outside the financial statements could only be deemed to have been incorporated in the financial statements if the document in which the information is contained is presented with the financial statements and there is a specific cross-reference.

A similar approach is taken under IFRS in respect of certain IFRS 7 disclosures. IFRS 7, ‘Financial instruments: Disclosures’ states: *“The disclosures required by paragraphs 31–42 shall be either given in the financial statements or incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete.”* [IFRS 7 App B para B6]

As the website is not part of the financial statements or directors’ report, or a document presented with them to which cross reference could be made, the significant accounting policies or any information that is required to be presented in the directors’ report cannot be moved to the company’s website.

4. Can I move my accounting policies into a note at the end of my financial statements?

Yes, but this may not be appropriate in all cases.

IAS 1 requires entities to provide a summary of significant accounting policies in the financial statements but

does not prescribe where this disclosure is given.

Currently, companies typically include a long list of accounting policies as the first note to the financial statements. It is a matter of judgement how the accounting policies are presented, and there is no requirement that they are presented together.

Where all the company's accounting policies are prescribed by accounting standards and there have been no changes in policy during the year, it may be sensible to move the accounting policies to a note at the end of the financial statements. On the other hand, in cases where there are industry- or company-specific policies, more prominent disclosure is likely to be appropriate, particularly in areas that involve significant judgement or estimation uncertainty. In such cases, it would be permissible to disclose those policies separate from the other significant accounting policies in the summary of accounting policies. An alternative approach would be to disclose the accounting policy in the note to which it relates (for example, disclose the accounting policy for pensions in the pensions note – see question 6 below).

5. Can I move my accounting policies to an appendix in the annual report?

Yes, but this may not be appropriate in all cases.

The accounting policies must be disclosed within the financial statements. However, this can be achieved by a specific cross-reference to an appendix to the annual report that includes the financial statements; such an approach is deemed to incorporate the appendix into the financial statements. This is only possible where the appendix and the financial statements are presented together.

Whether such an approach is desirable is another matter. Similar considerations would apply to this situation as to the presentation of accounting policies in the last note to the financial statements; that is, are the accounting policies being given the right level of prominence?

6. Can I put each of the accounting policies in the relevant note (for example, the share-based payment accounting policy in the share-based payment note)?

Yes. This might even be the best approach, especially if most users view the financial statements online, clicking through to various sections rather than reading the financial statements from beginning to end.

Of course, some of the accounting policies won't fit neatly into a single note but instead affect many of the line items in financial statements (for example, foreign currency translation). These accounting policies would be best disclosed together.

7. Do I need to disclose new accounting standards that will not affect my company's financial statements?

No.

Where a new standard or interpretation has been published, but has not yet come into effect or been early adopted, IAS 8, 'Accounting policies, changes in accounting estimates and errors', requires entities to disclose information on the possible impact of the new standard or interpretation on the company's financial statements.

Our view is that disclosure under IAS 8 is not necessary in respect of standards and interpretations that are clearly not applicable to the company (for example, industry-specific standards) or that are not expected to have a material effect on the company. Instead, disclosure should be given in respect of the developments that are, or could be, significant to the company. Management will need to apply judgement in determining whether a standard is expected to have a material effect. The assessment of materiality should consider the impact on previous transactions and financial position, and on reasonably foreseeable future transactions. For pronouncements where there is an option that could have an impact on the company, management's expectation as to whether the company will use the option should be disclosed. The aim of the disclosure is to enable the user to assess the possible impact of the

new standard or interpretation on the company's financial statements and not to provide a general update on accounting developments.

8. *Can I remove my share-based payments note?*

Perhaps.

The information disclosed in the share-based payment note is a requirement of accounting standards. Accounting standards apply to material items only. So, if the share-based payments are immaterial, there is no need to disclose them.

The determination of materiality is a matter of judgement. For share-based payments, this may go beyond whether the income statement charge or any balance sheet liability is a large number. Often, share-based payments are part of key management compensation to which a lower numerical threshold of materiality will typically apply. But sometimes the disclosures required by accounting standards do not help users' understanding because of information disclosed separately as directors' emoluments or in the directors' remuneration report.

It may be that some of the share-based payment schemes are material but others are not. In such cases, it would be open to companies to make separate disclosures in respect of the material schemes but to aggregate or omit the disclosures for the immaterial ones.

9. *Can I omit the note that sets out the movements on property, plant and equipment and movements in depreciation?*

This will depend on the materiality of property, plant and equipment (PPE).

It is possible for a line item in the balance sheet to be material but for the note on that item to be immaterial. This is described in the ICAS/NZICA report 'Losing the excess baggage – reducing disclosures in financial statements to what's important'. This report suggests, for example, that in a power generation business, PPE 'relating to power generation' is likely to be material. On the other hand, in a financial services

company, PPE may be relatively small, such that the additional information that would be contained in the PPE note is not material

The report also suggests that while a defined benefit pension scheme may be a small amount on the statement of financial position, the potential volatility in this item may mean that additional information would be material to the users of those financial statements.

10. *Can I disclose the list of subsidiaries on the website or in an appendix to the annual report?*

There is a legal requirement to disclose the company's subsidiaries in the financial statements (or, if this list would be of excessive length, a list of the principal subsidiaries). The company's website is not part of the financial statements; disclosure on the website would not therefore meet this requirement.

Disclosure in an appendix to the annual report containing the financial statements would meet the requirement, provided there is a specific cross-reference from the financial statements to the appendix.

As described in question 15, BIS proposes to change the law such that financial statements need only be published on the company's website.

11. *Can I present some of the notes to the financial statements in the business review instead?*

Information that is required to be disclosed in the financial statements can be presented in attached reports and incorporated into the financial statements by including a cross-reference in the notes to the financial statements. For example, it would be permissible to disclose information about benefits to directors (disclosure required for quoted and unquoted companies by Sch 5 of SI 2008/410) in the directors' remuneration report, provided that the notes to the financial statements include a cross-reference to the directors' remuneration report, describing the specific place where the information may be found (for example, page number, paragraph

number, paragraph title). Similarly, information on financial risk management may be presented as part of the business review and cross-referred from a financial instruments note.

Whether this approach is sensible should be assessed on a case-by-case basis. One difficulty that may arise is that the inclusion of audited information within a report that is otherwise unaudited might confuse the user about the audit status of different parts of the annual report. The current requirements for auditing financial statements, while reviewing for consistency the other reports presented with them, does not lend itself easily to the combination of audited and unaudited information within a single set of financial and narrative information. This presents a challenge for both preparers and auditors, and we would welcome opportunities to explore with companies how this difficulty might be overcome in their particular circumstances.

An additional issue to consider is whether important information may be given less prominence by being moved out of the financial statements and referred to by cross-reference. For example, it would not be appropriate to include the income statement in the business review with a cross-reference from the financial statements because IAS 1 para 11 requires all the primary statements to be presented with equal prominence. In addition, IAS 1 para 12 requires that, where the company prepares a separate income statement, it is presented immediately before the statement of comprehensive income.

In any event, users would expect to see such highly important financial information presented within the financial statements – a principle that may be relevant to some notes to the financial statements. It would not be desirable for the notes to the financial statements to become a series of cross-references to other places in the annual report. Financial statements are a structured representation of the financial position and financial performance of an company (IAS 1 para 9), and there is a limit to how much repositioning of disclosure can be performed without undermining that structure and, indeed, the true and fair view that the financial

statements must give; where this limit lies is, however, a matter of judgement.

The key here is for the disclosures to receive the appropriate level of prominence and to be transparent and cohesive, and for the audit status of the information to be clear.

12. Can I publish the corporate governance statement online instead of within the annual report?

No.

The Listing Rules (LR 9.8.9) require the corporate governance statement to be included in the company's annual report; in effect, this currently prevents the statement being presented separately from the annual report in the UK. This is despite the fact the Disclosure and Transparency Rules do permit the corporate governance statement to be published on the company's website, provided there is a cross-reference from the directors' report. [DTR 7.2] The FRC has yet to eliminate the inconsistency.

13. How can I reduce the length of the corporate governance report?

It may be difficult to reduce the length of the corporate governance report under the current regime, but it may be possible to restructure the report to bring out the most important messages. The FRC's 'Cutting clutter' consultation identifies the corporate governance statement as a common source of clutter and provides a disclosure aid to illustrate how that problem might be addressed.

The Listing Rules require listed companies to make a two part statement setting out:

- how management has applied the main principles set out in the UK Corporate Governance Code ('the Code'), in a manner that would enable shareholders to evaluate how the principles have been applied; and
- whether the company has complied with the provisions of the Code and, if it has not, details of the relevant provisions and the reasons for non-compliance (a 'comply or explain' approach to reporting).

In complying with the first of these requirements, there are some specific disclosures that must be made (contained in Sch B to the Code); otherwise, companies have discretion in how the requirement is fulfilled. Often, in fulfilling the requirement to demonstrate how the main principles have been applied, companies refer to compliance with the supporting principles to show that the company has complied with the main principles. This has led, in some cases, to a ‘cut and paste’ of those supporting principles into the corporate governance report, which does not add to the user’s understanding of the company’s governance and, more importantly, detracts attention from the company-specific information.

It is not permissible to omit the parts of the corporate governance report required by the Listing Rules. Nevertheless, it may be possible to structure the corporate governance report such that the routine information on corporate governance (that is, the parts of the report that are not specific to the company’s particular circumstances or to events during the year) are relegated either to a separate section of the report or to an appendix in the annual report (included by cross-reference into the corporate governance statement).

14. I’d like to reduce the number of principal risks disclosed. Can I omit from the principal risks disclosure those risks that have been mitigated by management’s actions such that the potential threat has been reduced?

No, but there may be scope for reducing the disclosures in other ways.

The disclosure of principal risks and uncertainties continues to be an area of focus for the Financial Reporting Review Panel (FRRP). The FRRP is concerned about how companies are reporting the principal risks and uncertainties facing their business. Appendix 2 reproduces an extract from the relevant FRRP press notice, PN 130.

In PN 130, the FRRP makes it clear that companies are required to disclose how its principal risks and uncertainties are managed, as well as the principal risks and uncertainties themselves. The

company’s actions to mitigate risk is part of its management of those risks. Mitigation of a risk does not eliminate the risk but aims to reduce the adverse consequences that may arise. Disclosure of the ways in which management has sought to mitigate risk allows the reader to assess whether management’s response is likely to be effective.

However, as the FRRP points out, the disclosure of principal risks and uncertainties is an area where many companies can improve their reporting. Many entities disclose too many risks, some of which are not ‘principal’ and some of which do not relate to the specific circumstances of the company. A more focused description of principal risks and uncertainties as envisaged by the FRRP may shorten the disclosure but improve its quality.

15. I like the idea of the ‘strategic report’ and an online ‘annual directors’ statement’, proposed in the BIS consultation. Can I implement this approach now?

No, but you can go some way towards it. It is possible to prepare a ‘strategic report’ and the reports that would be contained within the annual directors’ statement, but it is not permissible to only publish these online.

It is envisaged that the ‘strategic report’ will be a concise report that sets out high-level information about the company’s business model, strategy, objectives, performance, financial information, risks and remuneration. The ‘strategic report’ would incorporate the content currently required to be disclosed in the business review in the directors’ report but would go further than the current business review requirements.

The ‘annual directors’ statement’ would contain certain disclosures required by the Companies Act 2006 and Listing Rules that are currently reported in the directors’ report; it would also contain the directors’ remuneration report and corporate governance statement.

The current legal requirement is to produce a directors’ report (including business review), a directors’ remuneration report and a corporate governance statement) in addition to the

financial statements. It would be possible to structure the annual report such that it follows the structure of a 'strategic report' (incorporating the business review) and an 'annual directors' statement' (incorporating the directors' report, directors' remuneration report and corporate governance statement). However, care would need to be taken that the right information is included in the rights sections of the annual report, by cross-reference if necessary.

We believe that an executive summary – which is what the 'strategic report' would be – is a useful communication to stakeholders and that this can be provided in the annual report under the current regime. Corporate governance is not one of the issues currently proposed for inclusion in the 'strategic report', but we believe it would be useful to include high-level corporate governance information in any executive summary. Users can then drill down to more detailed information provided elsewhere in the annual report. In other words, there is scope for companies to improve the front half of their annual report in order to produce a section that provides the information that would be given in a 'strategic report'.

Quoted companies are required to place their reports and financial statements on

their websites; but, in addition, under the current law (Sec 423), they must send those reports to their members. However, the vast majority of members elect to receive the annual report electronically (usually via an email notifying them of the availability of the report on the company's website).

The BIS proposal for the 'strategic report' envisages that the option to prepare summary financial statements would be replaced by a requirement to include equivalent financial information in the 'strategic report'. Most entities do not currently prepare summary financial statements; they have become less popular with the availability of electronic communication under the 2006 Act. According to Black Sun Plc's report 'Telling the story - Annual analysis of FTSE 100 reporting trends 2010', in 2010, 19% of the FTSE 100 companies prepared summary financial statements compared with 61% in 2006. Under the current regime, it would be open to companies to prepare summary financial statements (subject to the existing conditions) as part of the 'strategic report' or to prepare a 'strategic report' (with financial information that does not purport to be summary financial statements) accompanied by full financial statements.

Appendix 2 – Extract from PN 130 of the Financial Reporting Review Panel

The Financial Reporting Review Panel of the FRC is concerned about how companies are reporting the principal risks and uncertainties facing their business.

The Companies Act 2006 requires directors' reports to contain a business review which must itself contain a description of the principal risks and uncertainties facing the company. The Act states that the purpose of the business review is to inform members of the company and help them assess how the directors have performed their statutory duty to promote the success of the company.

The business review falls within the remit of the Panel, which has commented on a number of occasions on the issues it has encountered in assessing whether directors' reports comply with this requirement of the Act. In particular, the Panel has challenged a number of companies where:

- The directors' report does not clearly identify which risks and uncertainties the directors believe to be the principal ones facing the business.
- A long list of principal risks and uncertainties is given and the list raises a question as to whether all the risks and uncertainties on the list are actually principal ones.
- The description given of a risk or uncertainty is in generic terms and it is not clear how that risk or uncertainty applies to the company's circumstances.
- The disclosure is of a risk framework rather than of the risks or uncertainties themselves.
- The principal risks and uncertainties disclosed are not consistent with other information given in the report and accounts.
- The directors' report does not state how the company manages its principal risks and uncertainties. As the purpose of the business review is to inform members of the company and to help them assess how the directors have performed their duty to promote the success of the company, the Panel believes that a Board should state how the company manages its principal risks and uncertainties.

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