THE
INSTITUTE OF
CHARTERED
ACCOUNTANTS
OF SCOTLAND

Making corporate reports readable – time to cut to the chase

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FOREWORD

By Guy R Jubb
Investment Director
Head of Corporate Governance
Standard Life Investments Ltd

An ability to discern the wood from the trees is a tribute to effective communication. Over the last decade the corporate reporting wood has become undeniably dense and dark, especially in the banking and financial services sectors. Shareholders have been the so-called beneficiaries of more information than they could have ever believed possible. But more does not mean better. The reality is that more and more corporate information meant that directors and shareholders struggled silently to deliver effective accountability. Stewardship suffered and today we are slowly coming to terms with the painful consequences.

The UK Financial Reporting Council (FRC), and the US Securities and Exchange Commission's (SEC) Advisory Committee on Improvements to Financial Reporting have been considering the complexity of financial statements. The FRC has sought views on the issue, in relation to broader corporate reporting requirements. To address the issue of complexity, the US Committee has made a number of recommendations, including a new executive summary in the company annual reports and greater use of interactive data-tagging in financial statements.

It is time to enable shareholders to see the wood from the trees.

These are welcome developments but the rate of progress is agonisingly slow and in the meantime there is no respite as regulators gear up for a new era of regulation with a presumption that more does mean better. It is important that the accounting profession does not lose sight that accounts are primarily for shareholders and not regulators – they are for accountability and stewardship and not for financial stability.

Hence, the Institute's initiative to advance the debate and do so boldly by cutting to the chase is a breath of fresh air that has the potential to accelerate the winds of change. The proposals deserve serious consideration by all the cast involved in the production of corporate reports. We all have a part to play and we all have a right – and a responsibility – to let our views be known.

The Short Form Report, which is embodied in the report and is a blueprint for change, is a manifestation of what can be done to enable clear messages to be delivered about a company's past, present and future. Take note that it provides all the important information in less than 30 pages and in the future could harness alternative reporting technology, such as XBRL, to deliver a comprehensive suite of useful information. It banishes boilerplate narrative, which of itself is a major step to achieving relevance and clarity.

It is now in the gift of preparers, users, auditors, regulators and commentators to grasp the nettle of complexity and respond constructively to the Institute's proposals. In doing so, it is hoped that some will provide leadership and put the spirit of the proposals into practice. As President Obama pointed out in a speech marking the anniversary of Lehman's collapse, there is no need to await a new law or a new regulation to implement change. It is time to cut to the chase. It is time to enable shareholders to see the wood from the trees.

The Institute's Technical Policy Board and its Accounting Standards Committee are to be congratulated for seizing the initiative. ICAS looks forward to assisting in the debate on the future of corporate reporting and hopes that this report will make a major contribution to and advance the achievement of effective accountability and sound stewardship.

Guy R Jubb
Edinburgh
December 2009

INTRODUCTION

The state of play today

In a recent press release, The Institute of Chartered Accountants of Scotland (ICAS) noted that key business information and risks are being obscured by the volume and level of detail of disclosures in corporate annual reports. The release noted that "the corporate report does not tell a clear story about the performance of a business". We are by no means alone in this view.

In its May 2009 report on the banking crisis, the House of Commons Treasury Select Committee argued that the complexity and length of financial reports represent a missed opportunity to improve users' understanding of the financial health of companies. The Committee complained that corporate reports "do not tell the reader much of a story" and appealed instead for listed companies to set out in a short jargon-free business review what is their business model, how they have made (or lost) money and what the main future risks are judged to be.

It is simply not acceptable that annual reports which run to several hundred pages fail to tell the reader a compelling story.

In summary, few would disagree with the view that many UK corporate reports have become a lengthy exercise in regulatory compliance but fail to communicate a compelling account of how the business has performed. In other words, they are not obviously "decision-useful". If that is the case, what hope do we have that things will get better in the near term?

Where we are heading

In October 2008, the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) jointly released their Discussion Paper "Preliminary Views on Financial Statement Presentation". The objective was to create a standard that "requires entities to organise financial statements in a manner that clearly communicates an integrated financial picture of the entity." To effect this, the Boards proposed that companies follow two objectives:

- cohesiveness – formatting the information in financial statements so that a reader can follow the flow of information through the various statements; and
- disaggregation – separating information that responds differently to economic events.

There is not space to describe the paper fully here and do justice to its detailed proposals. But what can we glean from those who have commented on the paper?

Unsurprisingly, with over 200 comment letters, there was a mix of views. But many respondents, including ICAS and the Institute of Chartered Accountants in England & Wales (ICAEW), were concerned at the level of detail implied by the disaggregation objective. We seem to be heading for a world of even greater detail precisely when many users would rather see less information – but less information presented in a more relevant and vital way. Directionally, therefore, the Boards seem to have got it wrong. What might an alternative look like?

A blueprint for change

Imagine a world in which the primary statutory report – the Short Form Annual Report and Results Announcement ("Short Form Report") – had to comply with the following requirements:

- it must be produced in short form only – say 30 pages or less. It is, in other words, Top Management's summary of what they consider to be most important;

- it must be used as the centrepiece of a company's results announcement (or similar communication); and
- it must meet the minimum benchmarks specified in the box below

Minimum benchmarks for Short Form Reports

1. Be consistent with the full annual report presented on a true and fair view.
2. Explain the company's business model and strategy and its performance against these.
3. Deliver a clear message about management's stewardship of the company's assets – the past.
4. Deliver a clear message about the company's current asset-liability mix and liquidity position – the present.
5. Deliver a clear message about where the company is headed – the future.
6. Use alternative reporting technologies to allow readers to access the more detailed disclosure and regulatory information required by law, analyst requests and similar.
7. Report historic cash flow and liquidity information in a way which is meaningful to management.
8. Avoid repetition but provide all important information.
9. Ensure consistency of information presented. For example, management's commentary should be consistent with the results of the formal tools used internally to measure performance such as economic profit.
10. Make clear the significant judgements that have been made. These should reflect inter alia the content of the external auditors' report to the audit committee.

We would welcome the Short Form Report being used as the centrepiece of a company's results announcement and replacing the company's annual review and summary financial statements. It would essentially tell Top Management's "story" and eliminate much of the boilerplate narrative which pervades annual reports today. And for those who might worry about the loss of disclosure, readers would be able to access such detail via alternative reporting technologies such as XBRL. Effectively, the full annual report we see today would still sit behind the Short Form Report.

The Short Form Report

The Short Form Report in the following pages sets out an illustrative proforma for a large international bank. We have chosen a bank because such institutions are particularly topical today and because they are among the most complex of organisations. However, the presentational ideas can also easily be extended to the generality of companies and we hope that these ideas will be considered in that context.

Although it is largely based on public documents issued by UK banks, there are some important differences which make the Short Form Report unique. In particular, it differs from the typical summary annual review in the following important ways:

- there is an exposition of the business model and how the business makes money;
- the most significant accounting policies are identified and summarised;
- the most significant notes and judgements are identified and summarised; and
- there is a single statement by the Chairman on behalf of the Board.

There are other less important differences, such as the inclusion of a short form statement of recognised income and expense as well as a short form cash flow statement. However, the main point is that the document seeks to be a self-contained summary of what is significant. This cannot be said of the typical annual review, which in most cases says nothing about the business model, accounting policies or significant notes and judgements. The same comments apply to most results announcements, with the qualification that these frequently do include explanatory notes – but usually at the expense of many more pages than the attached proforma.

Concluding comments

It is hoped that the Short Form Report could address a number of needs and perceived shortfalls in corporate reporting – not only in the UK but potentially overseas as well. As a short statement of what Top Management considers to be important, it would command attention and become an important source for understanding Top Management's view of their business – in other words, it would become the vehicle for management commentary considered so important by most standard setters, including the IASB.

Furthermore, we see no conflicts either with the EU Transparency Obligations Directive or with extant company law in the UK. This means that there is nothing to stop companies adopting these proposals with immediate effect.

Today's annual reports are no longer an effective tool for communication and we sense a growing loss of confidence in financial reporting in the wake of the financial crisis. It is simply not acceptable that annual reports which run to several hundred pages fail to tell the reader a compelling story. Something must be done – and the current crisis presents a golden opportunity to do so.

We would welcome comments on our proposals by 31st July 2010.

Please send comments to:
Karen Shaw (Secretary to Accounting Standards Committee)
Email: accountingandauditing@icas.org.uk

Model Bank Group plc

Short Form Annual Report and Results Announcement

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1. Highlights

	Year Ended 31.12.08 £m	Year Ended 31.12.07 £m	% % Change	Selected Definitions
Group Results				
Total income	XX	XX	xx	
Impairment charges and other credit provisions	XX	XX	xx	
Operating expenses	XX	XX	xx	
Gains on acquisitions	XX	XX	xx	
Profit before tax	XX	XX	xx	
Profit after tax	XX	XX	xx	
Profit attributable to equity holders of the parent	XX	XX	xx	
Economic profit	XX	XX	xx	Profit after tax & minority interests; less capital charge (average shareholders' equity & goodwill excluding minority interests multiplied by group cost of capital)
Basic earnings per share	XX	XX	xx	Profit attributable to equity holders of the parent over the basic weighted average number of shares excluding own shares held in employee benefit trusts and shares held for trading.
Dividend per share	XX	XX	xx	

	Year Ended 31.12.08 £m	Year Ended 31.12.07 £m	% % Change	Selected Definitions
Performance Ratios				
Return on average shareholders' equity	XX	XX	xx	Profit after tax divided by equity shareholders' equity during the year, which is made up of share capital, retained earnings & other reserves
Cost:income ratio	XX:XX	XX:XX	xx	Ratio of operating expenses to total income
Cost:net income ratio	XX:XX	XX:XX	xx	Operating expenses compared to total income less impairment charges

	Year Ended 31.12.08 £m	Year Ended 31.12.07 £m	% % Change	Selected Definitions
Profit Before Tax by Business				
Model Retail and Commercial Bank	XX	XX	xx	
Model Investment Banking and Wealth	XX	XX	xx	

	Year Ended 31.12.08 £m	Year Ended 31.12.07 £m	% % Change	Selected Definitions
Capital and Balance Sheet				
Risk weighted assets	XX	XX	xx	The assets of the bank multiplied by weightings established by the regulatory authorities to represent the relative risk of these assets
Equity Tier 1 ratio	XX:XX	XX:XX	xx	Ratio of called-up share capital and eligible reserves plus equity minority interests less intangible assets, to risk weighted assets
Net asset value per share	XX	XX	xx	
Total shareholders' equity	XX	XX	xx	
Total assets	XX	XX	xx	

2. Report of the Chairman on behalf of the Board to the Shareholders

Our Performance in Summary

2008 was an extremely difficult year for the economy and for the financial sector. Model Bank undertook a capital raising during the year and incurred credit market losses of approximately £XXm. Nonetheless, we made a profit before tax of £XXm.

The capital base of the bank has been strengthened as a result of raising over £XXbn in equity and Tier 1 capital in 2008. We also have over £XXbn of equity capital and reserves. We are working to increase liquidity and are managing down our risk-weighted assets in order to protect our capital position.

Share price performance during the year was disappointing and no dividends have been paid out. The Board intends to resume dividend payments in the second half of 2009, following the decision not to pay a final dividend for 2008.

Profit before tax decreased xx% to £XXm in 2008. The results included the following significant items in Model Investment Banking and Wealth :

- gains on acquisition of new businesses of £XXm,
- credit market losses and impairment of £XXm, or £XXm net of related hedges of £XXm and gains on own credit of £XXm.

In addition, the results included impairment charges in Model Retail and Commercial Bank of £XXm. Further detail is given in section 11.

Profit after tax increased xx% to £XXm.. This reflected an effective tax rate of xx% (2007: xx%). Earnings per share were Xp (2007: Xp), a decline of xx% from 2007.

Operating expenses increased xx% to £XXm. We continued to invest in our distribution network in the Model Retail and Commercial Bank businesses. Expenses fell in Model Investment Banking and Wealth due to lower performance-related costs. The Group cost: income ratio deteriorated by xx percentage points to xx%.

The equity Tier 1 ratio was xx% at 31st December 2008 and our Tier 1 ratio was xx%. Our capital ratios reflect a xx% increase in risk-weighted assets to £XXbn during the year. This was driven by the combined impacts on risk-weighted assets of the weakening of Sterling and the pro-cyclical effects of the International Basel Accord as well as lending growth in 2008. Our capital ratios reflect this risk-weighted asset growth and benefited from the increases in capital.

Total assets increased £XXbn to £XXbn in 2008. Of this increase, £XXbn was attributable to an increase in derivative assets and £XXbn was attributable to increased loans and advances. Other assets declined by £XXbn. Volatility in reference rates and yield curves used for pricing have led to significantly higher values for derivative assets and liabilities.

Outlook for 2009

We expect 2009 to be another challenging year for the banking industry. We anticipate that the impact of credit market losses will lessen, but we also expect the recessionary climate in our major markets to increase the loan loss rates on our loans and advances. The general lack of lending is a cause for concern. Interest rates in many jurisdictions have been reduced significantly in response to the recession. This will have the impact of substantially reducing the spread generated on our retail and commercial banking liabilities. The impact on Model Bank will be reduced to an extent by our interest rate hedges.

3. Overview of the bank today

(i) Key facts

Model Bank is a major global financial services provider listed in London.

Senior Management	
Group chairman	–
Group chief executive	–
Chief executive, model retail and commercial banking	–
Chief executive, model investment banking and wealth	–

Model Retail and Commercial Banking	
Number of countries operated In	XX
Number of customers	XX
Number of employees	XX

Model Investment Banking and Wealth	
Number of countries operated In	XX
Assets under management	£XXm
Client assets	£XXm

(ii) Our Business Model

Model Retail and Commercial Banking

- **Income is earned in essentially two ways:**
  - interest margin on lending in various forms, along with related charges/penalties, and against which must be set impairment losses on non-performing/delinquent loans; and
  - fees for services of various types.

Lending:
- interest margin represents the spread earned from lending funds out versus our borrowings (net interest income);
- lending comes in many different forms but includes most notably:
  - ❖ **loans to corporates and other institutions**, which take many forms and characteristics, for example: secured, unsecured, variable rate, fixed rate, term; and
  - ❖ **loans to individuals**, again in many forms and characteristics: secured (mortgages principally), unsecured (personal loans and credit cards principally), variable rate, fixed rate, term;
- charges and penalties are levied for late payments, unauthorised borrowings/overdrafts and non-compliance with loan agreements/covenants;
- all lending takes place within authorised limits which reflect: credit risk, country risk, sector/concentration risk, availability and quality of collateral; and
- where loans become non-performing or delinquent, impairment losses are recognised as appropriate.

Fees are earned for a variety of services performed including:
- arrangement fees for setting up loans;
- commitment fees for maintaining undrawn facilities;
- syndication fees for arranging multiple borrowers on larger corporate/institutional borrowings;
- transaction fees for processing electronic payment transfers (including foreign exchange) and certain cheques;
- transaction fees for ATM usage (although some usage is free);
- overdraft protection fees;
- annual fees for certain credit cards; and
- a wide range of other fees relating to account administration.

Investment Banking and Wealth

Investment Banking and Wealth earn income as described below.

- **The Investment Banking Division** helps clients raise funds in the debt and equity markets, as well as advising clients on merger and acquisition activity. The investment banking division is divided into industry and product coverage areas. Industry coverage groups focus on a specific industry such as healthcare or technology. Product coverage groups focus on financial products including leveraged finance, equity, and high-grade debt.

- **The Sales and Trading Division** of the bank is described below. The sales teams work to generate orders from clients and pass accepted orders to traders for pricing and execution. Income is earned from the spread at which buy/sell trades are executed. The main sales and trading areas for these so-called "flow" products are:
  - equities – including cash, derivatives and equity-linked notes;
  - commodities – including cash, derivatives and commodity-linked notes;
  - fixed income and interest rate products – including cash, derivatives and notes;
  - credit products – including notes and derivatives;
  - foreign exchange – both cash and derivatives; and
  - money markets – both cash and derivatives.

- **Structuring** involves the creation of more complex products which typically offer greater margin and returns than the higher volume "flow" products described above. Such structuring typically involves the creation of bespoke products which are tailored towards the specific risk appetite of the client. The structuring areas mirror those of the Sales and Trading Division.

- **The Proprietary Trading Division** takes principal risk positions on behalf of the bank and seeks to profit by timely management and exit of positions. The proprietary trading areas mirror those of the Sales and Trading Division.

- **Wealth** earns fees from the professional management of securities on behalf of both institutional and private clients. The securities managed are principally equities and bonds. Fees are earned in a number of different ways:
  - management fees;
  - advisory fees;
  - brokerage fees; and
  - performance fees where returns exceed pre-defined criteria.

  In addition charges and penalties may be levied in certain situations, principally in relation to early surrender of term products.

4. Segmental Performance

(i) Retail and Commercial Banking

Income in Model Retail and Commercial Banking increased by £XXm (xx%) on 2007 and was particularly strong in overseas business. This growth was achieved despite the need for greater stringency in the extension of credit.

Impairment losses remained at levels well below the banking sector as a whole, reflecting management's strong focus on credit selection and management. Nonetheless, we expect impairment losses to accelerate somewhat in the next 12-18 months.

Operating expenses increased xx% to £XXm as we continued our programme of investment in the distribution network and our general upgrading of branches.

Overall Model Retail and Commercial Banking continues to build a strong and competitive business which is increasingly diversified overseas. We are well placed to take advantage of market opportunities as the global economy emerges from recession.

A detailed analysis of the income is shown opposite:

Retail and Commercial Banking

	Corporates and institutions		Individuals		Total	
Net interest income on lending:	**£m**	**% total income**	**£m**	**% total income**	**£m**	**% total income**
Secured – fixed rate	XX	xx%	XX	xx%	XX	xx%
Secured – variable rate	XX	xx%	XX	xx%	XX	xx%
Unsecured – fixed rate	XX	xx%	XX	xx%	XX	xx%
Unsecured – variable rate	XX	xx%	XX	xx%	XX	xx%
Charges and penalties on lending:						
Secured – fixed rate	XX	xx%	XX	xx%	XX	xx%
Secured – variable rate	XX	xx%	XX	xx%	XX	xx%
Unsecured – fixed rate	XX	xx%	XX	xx%	XX	xx%
Unsecured – variable rate	XX	xx%	XX	xx%	XX	xx%
Impairment losses on lending:						
Secured – fixed rate	XX	xx%	XX	xx%	XX	xx%
Secured – variable rate	XX	xx%	XX	xx%	XX	xx%
Unsecured – fixed rate	XX	xx%	XX	xx%	XX	xx%
Unsecured – variable rate	XX	xx%	XX	xx%	XX	xx%
Fees						
Arrangement fees	XX	xx%	XX	xx%	XX	xx%
Commitment fees	XX	xx%	XX	xx%	XX	xx%
Syndication fees	XX	xx%	XX	xx%	XX	xx%
Transaction fees – processing	XX	xx%	XX	xx%	XX	xx%
Transaction fees – ATM	XX	xx%	XX	xx%	XX	xx%
Overdraft protection fees	XX	xx%	XX	xx%	XX	xx%
Total	XX		XX		XX	

Further detail on the above income split may be found at our website at www.xxxx.

(ii) Investment Banking and Wealth

The Investment Banking and Wealth division was affected by the severe market conditions of 2008, with income falling by £XXm (xx%) on 2007. This reflected the credit market and impairment losses of £XXm referred to in section 2.

Setting aside the difficult credit market environment, underlying performance in the Investment Banking and Wealth division was sound when compared to 2007. All other sectors grew or remained broadly flat in gross income terms, with the exception that structuring activity was curtailed in comparison to previous years. This reflected customers' diminished appetites for complex products.

The business performance of the Investment Banking and Wealth division was adversely affected by the difficult market conditions, with income falling by £XXm (xx%) on 2007. However, we won a number of new mandates in 2008, growing our client base by XX. This equated to £XXm of new funds. Expenses were well controlled across the whole division, with costs falling £XXm by xx% overall. We remain well positioned to grow as the economy emerges from recession.

A detailed analysis of the income is shown opposite:

Investment Banking and Wealth

	Total	
	£m	% total income
Debt markets	XX	xx%
Equity markets	XX	xx%
Mergers and acquisitions	XX	xx%
Total	**XX**	**xx%**
Sales and Trading		
Equities	XX	xx%
Commodities	XX	xx%
Fixed income and interest rate products	XX	xx%
Credit products	XX	xx%
Foreign exchange	XX	xx%
Money markets	XX	xx%
Total	XX	xx%
Structuring		
Equities	XX	xx%
Commodities	XX	xx%
Fixed income and interest rate products	XX	xx%
Credit products	XX	xx%
Foreign exchange	XX	xx%
Money markets	XX	xx%
Total	XX	xx%
Proprietary Trading		
Equities	XX	xx%
Commodities	XX	xx%
Fixed income and interest rate products	XX	xx%
Credit products	XX	xx%
Foreign exchange	XX	xx%
Money markets	XX	xx%
Total	XX	xx%
Wealth		
Management fees	XX	xx%
Advisory fees	XX	xx%
Brokerage fees	XX	xx%
Performance fees	XX	xx%
Charges and penalties	XX	xx%
Total	XX	xx%
Grand total	**XX**	**xx%**

Further detail on the above income split may be found at our website at www.xxxx.

5. Independent auditors' statement to the members of Model Bank Group plc

This page is intentionally left blank. We believe that some form of auditor's report would be required in practice but we do not pre-judge its format for the purposes of this document.

6. Significant accounting policies

This section is an abridged version of the group's accounting policies, the complete version of which may be found at our website at www.xxxx. This section identifies the bank's most significant accounting policies in the sense that they relate to those items involving the greatest judgement, complexity and/or assumptions.

i. Reporting entity

These financial statements are prepared for the Model Bank Group plc. Model Bank Group plc is a public limited company, incorporated in the United Kingdom and having a registered office in England.

ii. Basis of preparation

The consolidated financial statements of the Model Bank Group plc have been prepared in accordance with International Financial Reporting Standards (IFRSs) and related interpretations. The consolidated financial statements have been prepared under the historical cost convention modified to include the fair valuation of certain financial instruments. They are stated in millions of pounds Sterling (£m), the currency of the country in which Model Bank Group plc is incorporated.

iii. Consolidation

The consolidated financial statements combine the financial statements of Model Bank Group plc and all its subsidiaries, including certain special purpose entities (SPEs), up to 31st December. SPEs are consolidated when the substance of the relationship between Model Bank Group plc and the SPE indicates that the SPE is controlled by Model Bank Group plc.

iv. Foreign currency translation

The consolidated financial statements are presented in Sterling, which is the functional currency of the parent company. Items included in the financial statements of each of the Group's entities are measured using their functional currency, being the currency of the primary economic environment in which the entity operates. Foreign currency transactions are translated into the appropriate functional currency using the exchange rates prevailing at the dates of the transactions. Monetary items denominated in foreign currencies are retranslated at the rate prevailing at the period end. Foreign exchange gains and losses resulting from the retranslation and settlement of these items are recognised in the income statement except for qualifying cash flow hedges or hedges of net investments.

v. Financial assets

Financial assets are classified in the following categories: financial instruments at fair value through profit or loss; loans and receivables; held to maturity investments; and available for sale financial assets. Management determines the classification of financial assets and liabilities at initial recognition.

Financial instruments at fair value through profit or loss are classified as such if they are held for trading, or if they are designated by management under the fair value option. Gains and losses arising from changes in fair value are included directly in the income statement. This category includes all derivatives, certain structured notes and certain private equity investments.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and which are not classified as available for sale. Loans and receivables are initially recognised at fair value plus direct and incremental transaction costs. They are subsequently valued at amortised cost, using the effective interest method.

Held to maturity investments are non-derivative financial assets with fixed or determinable payments that the Group's management has the intention and ability to hold to maturity. They are initially recognised at fair value plus direct and incremental transaction costs. They are subsequently valued at amortised cost, using the effective interest method.

Available for sale assets are non-derivative financial assets that are designated as available for sale and are not categorised into any of the other categories described above. They are initially recognised and subsequently held at fair value. Gains and losses arising from changes in fair value are included as a separate component of equity until sale when the cumulative gain or loss is transferred to the income statement. Interest determined using the effective interest method, impairment losses and translation differences on monetary items are recognised in the income statement.

vi. Financial liabilities

Financial liabilities are measured at amortised cost, except for trading liabilities and liabilities designated at fair value, which are classified at fair value through profit or loss. Financial liabilities are derecognised when extinguished.

vii. Hedge accounting

Derivatives are used to hedge interest rate, exchange rate, commodity, and equity exposures and exposures to certain indices such as house price indices and retail price indices related to non-trading positions. Where derivatives are held for risk management purposes, and when transactions meet the required criteria, the Group applies fair value hedge accounting, cash flow hedge accounting, or hedging of a net investment in a foreign operation as appropriate to the risks being hedged.

viii. Impairment of financial assets

Each balance sheet date, the Group assesses whether there is objective evidence that loans and receivables, or available for sale financial investments, are impaired. The loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. The loss is recognised in the income statement. Following impairment, interest income is recognised using the original effective rate of interest. In the case of available for sale financial investments, a significant or prolonged decline in the fair value of the security below its cost is also considered in determining whether impairment exists. Where such evidence exists, the cumulative net loss that has been previously recognised directly in equity is removed from equity and recognised in the income statement.

ix. Goodwill

Goodwill arises on the acquisition of subsidiary and associated entities and joint ventures, and represents the excess of the fair value of the purchase consideration and direct costs of making the acquisition, over the fair value of the Group's share of the assets acquired, and the liabilities and contingent liabilities assumed on the date of the acquisition.

x. Employee benefits

The Group provides employees worldwide with post-retirement benefits mainly in the form of pensions. The Group operates a number of pension schemes which may be funded or unfunded and of a defined contribution or defined benefit nature. In addition, the Group contributes, according to local law in the various countries in which it operates, to governmental and other plans which have the characteristics of defined contribution plans.

7. Short form consolidated income statement

For the year ended 31st December	2008 £m	2007 £m
Net interest income	XX	XX
Net fee and commission income	XX	XX
Net income from trading activities[a]	XX	XX
Total income	XX	XX
Impairment charges	(XX)	(XX)
Net income	XX	XX
Operating expenses	(XX)	(XX)
Share of post-tax results of associates and joint ventures	XX	XX
Profit on disposal of subsidiaries, associates and joint ventures	XX	XX
Gains on acquisitions	XX	XX
Profit before tax	**XX**	**XX**
Tax	(XX)	(XX)
Profit after tax	**XX**	**XX**
Profit attributable to minority interests	XX	XX
Profit attributable to equity holders of the parent	XX	XX
Dividends		
Interim dividend p (2007: xp)	XX	XX
Proposed final dividend p (2007: xp)	XX	XX
Earnings per share		
Basic earnings per share[b]	XX	XX

a This comprises £XXm of gains and £XXm of losses

b The calculation of basic earnings per share is based on the profit attributable to shareholders over the weighted average number of shares (which includes shares that will be issued following conversion in full of the Mandatorily Convertible Notes) and represents the level of earnings generated per ordinary share.

The full consolidated income statement is available at our website at www.xxxx.

8. Short form consolidated balance sheet

For the year ended 31st December	2008 £m	2007 £m
Assets		
Cash and other short-term funds	XX	XX
Trading and financial assets designated at fair value	XX	XX
Derivative financial instruments	XX	XX
Loans and advances to banks	XX	XX
Loans and advances to customers	XX	XX
Available for sale financial investments	XX	XX
Reverse repurchase agreements and cash collateral on securities borrowed	XX	XX
Other assets	XX	XX
Property, plant and equipment	XX	XX
Total assets	**XX**	**XX**
Liabilities		
Deposits and items in the course of collection due to banks	XX	XX
Customer accounts	XX	XX
Trading and financial liabilities designated at fair value	XX	XX
Liabilities to customers under investment contracts	XX	XX
Derivative financial instruments	XX	XX
Debt securities in issue	XX	XX
Repurchase agreements and cash collateral on securities lent	XX	XX
Other liabilities	XX	XX
Subordinated liabilities	XX	XX
Total liabilities	**XX**	**XX**
Shareholders' equity[a]		
Shareholders' equity excluding minority interests	XX	XX
Minority interests[b]	XX	XX
Total shareholders' equity	**XX**	**XX**
Total liabilities and shareholders' equity	**XX**	**XX**

The short form consolidated income statement and the short form consolidated balance sheet were approved by the Board of Directors on xxxx and signed on its behalf by the Group Chairman.

a Represents the residual interest of shareholders in the Group and largely consists of ordinary share capital and accumulated retained earnings.

b The interests of others in certain subsidiaries of the Group.

The full consolidated balance sheet is available at our website at www.xxxx.

9. Short form statement of recognised income and expense

	2008 £m	2007 £m
Net movements in available for sale reserve	XX	XX
Net movements in cash flow hedging reserve	XX	XX
Net movements in currency translation differences	XX	XX
Tax	XX	XX
Other movements	XX	XX
Amounts included directly in equity	XX	XX
Profit after tax	XX	XX
Total recognised income and expense for the year	XX	XX
Attributable to:		
Equity holders of the parent	XX	XX
Minority interests	XX	XX

A more detailed version of the statement of recognised income and expense is available at our website at www.xxxx.

10. Short form cash flow statement

Reconciliation of profit before tax to net cash flows from operating activities	**2008 £m**	2007 £m
Profit before tax	XX	XX
Adjustment for non-cash items	XX	XX
Changes in operating assets and liabilities	XX	XX
Tax paid	XX	XX
Net cash from operating activities	XX	XX
Net cash from investing activities	XX	XX
Net cash from financing activities	XX	XX
Effect of exchange rates on cash and cash equivalents	XX	XX
Net increase in cash and cash equivalents	XX	XX
Cash and cash equivalents at beginning of period	XX	XX
Cash and cash equivalents at end of period	XX	XX

A more detailed version of the cash flow statement is shown at at our website at www.xxxx.

11. Significant notes and judgements

These notes to the financial statements set out areas involving a higher degree of judgement or complexity, as well as areas where assumptions are significant to the consolidated financial statements. The significant judgments identified here are consistent with those identified by the external auditors. This section is an abridged version of the complete notes to the accounts, which may be found at our website at www.xxxx.

(i) Fair value of financial instruments

As described at section 6, some of the Group's financial instruments are carried at fair value. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Where a valuation model is used to determine fair value, it makes maximum use of market inputs. Financial instruments with a fair value based on observable inputs include valuations determined by unadjusted quoted prices in an active market and market standard pricing models that use observable inputs. Financial instruments whose fair value is determined, at least in part, using unobservable inputs are further categorised into 'Vanilla' and 'Exotic' products as follows:

At 31st December 2008 £m	Valuations based on observable inputs	Valuations based on unobservable inputs	
		'Vanilla' products	'Exotic' products
Trading portfolio assets	XX	XX	XX
Financial assets designated at fair value	XX	XX	XX
Derivative financial assets	XX	XX	XX
Available for sale assets	XX	XX	XX
Total assets	**XX**	**XX**	**XX**
Trading portfolio liabilities	XX	XX	XX
Financial liabilities designated at fair value	XX	XX	XX
Derivative financial liabilities	XX	XX	XX
Total liabilities	**XX**	**XX**	**XX**

- 'Vanilla' products are valued using simple models such as discounted cash flow or Black Scholes models. Some of the inputs are not observable.
- 'Exotic' products are over-the-counter products that are relatively bespoke, and their valuation comes from mathematical models where some of the inputs are not observable.

The table overleaf shows the Group's financial assets and liabilities that are recognised and measured at fair value analysed by valuation technique.

As part of our risk management processes, stress tests are applied on the significant unobservable parameters to generate a range of potentially possible alternative valuations. The financial instruments that most impact this sensitivity analysis are those with the more illiquid and/or structured portfolios. The stresses are applied independently and do not take account of any cross correlation between separate asset classes that would reduce the overall effect on the valuations.

Sensitivity Analysis

At 31st December 2008 £m	Potential effect recorded in income		Potential effect recorded in equity	
	Favourable	Unfavourable	Favourable	Unfavourable
Trading portfolio assets	XX	(XX)	–	–
Financial assets designated at fair value	XX	(XX)	–	–
Derivative financial assets	XX	(XX)	–	–
Available for sale assets	–	–	XX	(XX)
Total assets	**XX**	**(XX)**	**XX**	**(XX)**
Trading portfolio liabilities	XX	(XX)	–	–
Financial liabilities designated at fair value	XX	(XX)	–	–
Derivative financial liabilities	XX	(XX)	–	–
Total liabilities	**XX**	**(XX)**	**–**	**–**

(ii) Allowances for loan impairment

The methodologies discussed above have resulted in incurred losses as follows:

	2008 £m	2007 £m
Investment Banking		
– Drawn Loans	XX	XX
– Undrawn Facilities/ Guarantees	XX	XX
Wealth		
– Drawn Loans	XX	XX
– Undrawn Facilities/ Guarantees	XX	XX
Commercial Banking		
– Drawn Loans	XX	XX
– Undrawn Facilities/ Guarantees	XX	XX
Retail Banking		
– Drawn Loans	XX	XX
– Undrawn Facilities/ Guarantees	XX	XX

Allowances for loan impairment represent management's estimate of the losses incurred in the loan portfolios as at the balance sheet date. Changes to the allowances for loan impairment and changes to the provisions for undrawn contractually committed facilities and guarantees provided are reported in the consolidated income statement as part of the impairment charge. Provision is made for undrawn loan commitments and similar facilities if it is probable that the facility will be drawn and result in recognition of an asset at an amount less than the amount advanced.

For small loans, statistical techniques are used to calculate impairment allowances on a portfolio basis, based on historical recovery rates and assumed emergence periods.

For larger accounts, impairment allowances are calculated on an individual basis and all relevant considerations that have a bearing on the expected future cash flows are taken into account.

(iii) Goodwill

The most significant amounts of goodwill are:

	Carrying Values		Impairment	
	2008	2007	2008	2007
	£m	£m	£m	£m
xxxx	XX	XX	XX	XX
xxxx	XX	XX	XX	XX
xxxx	XX	XX	XX	XX
Totals	**XX**	**XX**	**XX**	**XX**

Management has to consider at least annually whether the current carrying value of goodwill is impaired. The first step of the impairment review process requires the identification of independent cash generating units, by dividing the Group business into as many largely independent income streams as is reasonably practicable. The goodwill is then allocated to these independent units. The first element of this allocation is based on the areas of the business expected to benefit from the synergies derived from the acquisition. The second element reflects the allocation of the net assets acquired and the difference between the consideration paid for those net assets and their fair value. This allocation is reviewed following business reorganisation. The carrying value of the unit, including the allocated goodwill, is compared to its fair value to determine whether any impairment exists. If the fair value of a unit is less than its carrying value, goodwill will be impaired.

(iv) Retirement benefit obligations

The Group provides pension plans for employees in most parts of the world. Arrangements for staff retirement benefits vary from country to country and are made in accordance with local regulations and customs. For defined contribution schemes, the pension cost recognised in the profit and loss account represents the contributions payable to the scheme. For defined benefit schemes, actuarial valuation of each of the scheme's obligations using the projected unit credit method and the fair valuation of each of the scheme's assets are performed annually in accordance with the requirements of IAS 19.

The actuarial valuation depends on a series of assumptions:

- Interest rates – based on consensus economic estimates
- Mortality – based on standard national mortality tables
- Investment returns – based on market yields at valuation date
- Inflation – based on long-term expectations of both earnings and retail price inflation

The Group's position in respect of retirement benefit obligations may be summarised as follows:

	2008	2007
	£m	£m
IAS 19 Pension Deficit (All schemes)	XX	XX
Net Recognised Liabilities	XX	XX
Comprising		
– Retirement benefit liabilities	XX	XX
– Assets	XX	XX

(v) Off balance sheet arrangements

In the ordinary course of business and primarily to facilitate client transactions, the Group enters into transactions which may involve the use of off-balance sheet arrangements and special purpose entities (SPEs). These arrangements include the provision of guarantees, loan commitments, retained interests in assets which have been transferred to an unconsolidated SPE or obligations arising from the Group's involvements with such SPEs.

Guarantees
The Group issues guarantees on behalf of its customers. In the majority of cases, the Group holds collateral against the exposure, has a right of recourse to the customer or both. In addition, the Group issues guarantees on its own behalf. The main types of guarantees provided are: financial guarantees given to banks and financial institutions on behalf of customers to secure loans; overdrafts; and other banking facilities, including stock borrowing indemnities and standby letters of credit. The nominal principal amount of contingent liabilities with off-balance sheet risk is £XXm.

Loan commitments
The Group enters into commitments to lend to its customers subject to certain conditions. Such loan commitments are made either for a fixed period or are cancellable by the Group subject to notice conditions.

Special purpose entities
Transactions entered into by the Group may involve the use of SPEs. SPEs are entities that are created to accomplish a narrow and pre-defined objective. There are often specific restrictions or limits around their on-going activities.
Transactions with SPEs take a number of forms, including:

- the provision of financing to fund asset purchases, or commitments to provide finance for future purchases;
- derivative transactions to provide investors in the SPE with a specified exposure;
- the provision of liquidity or backstop facilities which may be drawn upon if the SPE experiences future funding difficulties; and
- direct investment in the notes issued by SPEs.

Depending on the nature of the Group's resulting exposure, it may consolidate the SPE into the Group's balance sheet. The consolidation of SPEs is considered at inception, based on the arrangements in place and the assessed risk exposures at that time. SPEs are consolidated when the substance of the relationship between the Group and the entity indicates control. Potential indicators of control include an assessment of the Group's exposure to the risks and benefits of the SPE. The initial consolidation analysis is revisited at a later date if:

(i) the Group acquires additional interests in the entity;
(ii) the contractual arrangements of the entity are amended such that the relative exposures to risks and rewards change; or if
(iii) the Group acquires control over the main operating and financial decisions of the entity.

A number of the Group's transactions have recourse only to the assets of unconsolidated SPEs. Typically, the majority of the exposure to these assets is borne by third parties and the Group's risk is mitigated through over-collateralisation, unwind features and other protective measures.

The Group's involvement with unconsolidated third party conduits, collateralised debt obligations and structured investment vehicles is described further at our website at www.xxxx.

12. Additional shareholder information

(i) Risk management

Risk management is a fundamental part of Model Bank business activity and an essential component of its planning process. To keep risk management at the centre of the executive agenda, it is embedded in the everyday management of the business. We are proactive in taking steps to reduce risk where internal limits are approached or breached.

The following are considered to be the most significant risks:

Credit risk

Credit risk is the risk associated with a loss or potential loss from counterparties failing to pay financial obligations. It is Model Bank's most significant risk, and arises mostly from wholesale and retail loans and advances. We manage credit risk by controlling the taking of credit risk and by ensuring it is consistently priced across the business by avoiding undesirable concentrations of order risk. Model Bank uses ratings models to provide a quantitative assessment of our credit risk and these models are subject to an analysis of credit exposures. Further detail is available from xxxx.

Market risk

Market risk is the risk that Model Bank's earnings will be adversely affected by changes in the level of volatility of market rates or prices such as interest rates, credit spreads, commodity prices, equity prices and foreign exchange rates. We manage market risk by setting position limits and then managing actual risks rigorously against these limits. Measurement techniques used include Daily Value at Risk, Expected Shortfall and stress testing. Further information on these models is available from xxxx.

Operational risk

Operational risk is the risk of direct or indirect losses resulting from human factors, external events, and inadequate or failed internal processes and systems. A standard process is used across Model Bank for the recognition, capture, assessment, analysis and reporting of risk events. The most significant operational risks are used as inputs to the capital model which allocates operational risk capital on a risk sensitive basis to business units in the form of economic capital charges.

Future developments

The events of 2008 have highlighted that risk management within the banking industry may not have been sufficiently robust. Model Bank will undertake a review of our risk management approach beginning in 2009.

(ii) Corporate governance

Corporate governance framework – Role of the Board

The Board is responsible for managing the Group on behalf of its shareholders and must ensure that an appropriate balance between promoting long-term growth and delivering short-term objectives is achieved. The role and responsibilities of the Model Bank Board are set out in 'Corporate Governance in Model Bank', available online at xxxx.

The roles of the Group Chairman and Group Chief Executive are separate. There is a strong independent element on the Board and at least half the Board are independent non-executive directors. At the date of this report, the Board is comprised of the Group Chairman, X executive directors and X non-executive directors.

Although the Board of Directors has collective responsibility for the success of the Group, executive directors are directly responsible for business operations, whereas non-executive directors are responsible for bringing independent judgement and scrutiny to decisions taken by the Board. The non-executive directors must satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust.

Board Audit Committee

The Committee's areas of focus in 2008 were dominated by the continuing disruption to the credit markets, and the Committee has spent considerable time looking at the accounting for and valuation of complex financial instruments, as well as scrutinising the key internal controls by which risk is managed.

Board Risk Committee

During 2008 the Committee monitored Model Bank's sub-prime exposures, as well as monitoring the risk exposure to other areas affected by the crisis. The Committee will play an active role in the forthcoming review of Model Bank's risk management model.

Future Developments

Model Bank recognises that governance processes can be strengthened and is monitoring the outcome of external reviews currently underway in this area. Model Bank is committed to taking appropriate action as a result of these review, and has begun a review of the appropriate size and skills mix of the main Board and its committees.

(iii) Corporate sustainability

Sustainability and Model Bank

To measure our success in integrating sustainability into our business we have addressed the broad sustainability agenda through four key themes:

- **Customers and clients**

Our record of lending responsibly has allowed us to continue mortgage lending in the UK, increasing our share of net new lending from xx% in 2007 to xx% in 2008.

We increased lending to UK SMEs by xx% to a total of £XXbn. We also provided support to small businesses in the UK and South Africa, including significant investment in the Model Bank Business Support team which is dedicated to helping business customers in financial difficulty in the UK.

- **Inclusive banking**

We have dedicated accounts for people on low incomes across several countries in Africa. In 2008, these basic accounts made up xx% of our total current and savings accounts in Africa.

We continued to support better access to financial products and services in the UK, including through partnerships with community finance organisations and charities which help excluded and vulnerable people in society.

- **Diversity and our people**

In 2008, a new role of Diversity Champion was established to drive the Model Bank diversity agenda. Initiatives in 2008 included establishing the requirement that every senior executive has a diversity objective linked to their performance goals.

- **Environment**

In 2008, Model Bank set environmental targets that apply to our global operations. We will measure our performance over three years from 2009 to 2011 against a 2008 baseline. The targets are to reduce by xx% per employee (achieving an average of xx% reduction per year): CO_2 emissions; energy use from buildings (excluding data centres); and water use.

We have made our operations carbon neutral by offsetting emissions from energy use and travel.

(iv) Remuneration report

Within the authority delegated by the Board, the Remuneration Committee has established frameworks for the governance of remuneration. The current frameworks set out key financial ratios achieved by Model Bank and its competitors and have been used by the Committee to inform its decision making process when approving bonus plans, share plans and other long-term incentive plans and when agreeing the individual remuneration packages of executive directors and other senior employees taking into account the pay and conditions across Model Bank.

The current Remuneration Strategy includes the following elements:

- Assessment of reward with reference to clear and relevant objectives within a balanced scorecard framework, including efficiency, risk mitigation and customer development as well as financial objectives;
- A focus on total compensation with variable pay differentiated by performance;
- The use of judgement and discretion in assessing the extent to which performance has been achieved; and
- A significant proportion of remuneration being deferred into Model Bank shares to retain key talent and to tie recipients to the future performance of Model Bank.

Directors' remuneration	**2008 £m**	**2007 £m**
Aggregate emoluments	XX	XX
Gains made on the exercise of share options	XX	XX
Amounts paid under long-term incentive schemes	XX	XX
Actual pension contributions to money purchase scheme	XX	XX
Notional pension contributions to money purchase scheme	XX	XX

Information on individual directors' remuneration may be found at at our website at www.xxxx.

About ICAS

The Institute of Chartered Accountants of Scotland (ICAS) is the world's first professional body of accountants, receiving its Royal Charter in 1854. Since then, ICAS has played a leading role in the accountancy profession.

ICAS was the first to adopt the designation 'Chartered Accountant' and the designatory letters 'CA' are still an exclusive privilege in the UK for its 17,800 members. CAs hold key positions right across commerce and industry, the public sector and private practice.

There are currently 3,700 student members of ICAS, which is the only UK professional accountancy body to both educate and examine all of its students. The CA qualification is known around the world for consistency and high standards and ICAS enjoys a widely recognised reputation for providing the 'gold standard' in accountancy education.

The Institute's main objective is to uphold the integrity and standing of the profession of Chartered Accountancy in the interests of society and the membership through excellence in education, the development of accountancy, the enforcement of professional standards and service to members.

Global Accounting Alliance

The Institute of Chartered Accountants of Scotland
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