



Financial Reporting Advisory Board Paper

Simplifying and Streamlining Statutory Annual Report and Accounts – Initial findings and presentation on emerging recommendations

Issue:	HM Treasury is currently undertaking a project aimed at simplifying and streamlining the presentation of the statutory annual reports and accounts produced by central government entities so as to better meet the needs of the users of the accounts and to remove unnecessary burdens from the preparer community. The project has now progressed to the stage when initial recommendations are emerging which are being “road tested” with the Board and other key stakeholders.
Impact on guidance:	Not at present
IAS/IFRS adaptation?	Not at present
Impact on WGA?	Not at present.
IPSAS compliant?	N/A at present
Interpretation for the public sector context?	N/A at present
Impact on budgetary regime?	N/A at present
Alignment with National Accounts	N/A at present
Impact on Estimates?	N/A at present
Recommendation:	That the Board note the work undertaken to date on the Simplifying and Streamlining Statutory Annual Report and Accounts project and comment on the initial recommendations highlighted by the project team in the presentation that will be delivered in the meeting.
Timing:	Changes are expected to be introduced in the 2015-16 FReM

DETAIL

Background

1. At FRAB 117 the Board was updated on the Simplifying and Streamlining Annual Report and Accounts project that HM Treasury had begun earlier this year. The overall purpose of the project is to simplify and streamline the presentation of the statutory annual reports and accounts produced by central government entities so as to better meet the needs of the users of the accounts and to remove unnecessary burdens from the preparer community.

2. The project has been broken down into five key stages, with a sixth implementation stage to follow once recommendations have been finalised. These stages are:

Stage 1 – Initial review of current ARA requirements and comparison of ARAs as they are currently prepared.

Stage 2 – Identifying users, their needs, and the extent to which these needs are currently being met.

Stage 3 – Understanding the preparation process - examination of key areas of concern and understanding the preparation process with preparers of ARAs.

Stage 4 – Private sector and international comparisons - Review of private sector “cutting clutter” projects and international public sector best practice.

Stage 5 – Recommendation report - Initial recommendations for changes to streamline and improve clarity of accounts, comparison with IFRS and statutory requirements, testing with key stakeholders and final report.

3. Stages 1 to 4 are almost complete, and we are now at a position to “roadtest” initial recommendations with stakeholders including the Board. The findings from Stages 1 to 4 are noted below, and initial recommendations will be presented to the Board during the meeting via a presentation from the project team.

Stage 1 – initial review

4. Five main themes emerged from stage 1 which framed the simplification and streamlining review process going forward. These were:

- How public sector entities report risk - typically weak discussion of the principal risks and uncertainties affecting organisations, with little link to the results and overall narrative;
- Use of materiality in government reporting - average length of central government annual reports is significantly longer than the average length for FTSE 350 companies, a result that was mainly due to a box-ticking compliance checklist approach or use of templates without tailoring;
- The uniqueness of the public sector user and their needs (use of an ARA as an accountability document in the public sector context) - fundamental difference in approach changes the nature of some of the narrative links in the annual report, and means there is less of a natural flow between discussion of activities and the reported accounts;

- Narrative flow of reporting – in general annual reports and accounts were not as well signposted as they could be. In particular, the links between risks, performance indicators and financial outturn in the accounts could be significantly improved; and
- Complexity, detail and purpose within government accounts - entities appear to be following template guidance to the letter rather than considering the materiality and/or relevance of certain disclosures/items.

Stage 2 – user perspectives

5. A large number of interviews and focus groups were held to ascertain user and potential user perspectives. A public consultation was also held to which approximately 40 responses were received. The key issues raised by users are summarised below:

- Users are each interested in disparate and specific information; some of which is published in the ARA but also available elsewhere;
- The ARA is important as an accountability document. The process of audit that the ARA is subject to is especially valued;
- Appropriate detail to evidence accountability at different levels of the public sector was seen as important (Dept accounts v Service delivery ALBs);
- Users want to see trend data which is consistent with the financial statements and aligned to delivery outcomes – common core tables while useful to some users are not providing this;
- "Following the pound"; tracing expenditure to outcomes is a high priority;
- Appropriate and detailed segmental reporting is required;
- A move to a greater distinction between Parliamentary accountability and financial accounts would be a positive step;
- Widespread agreement that the ARA should only describe and disclose "material" items;
- ARAs are viewed as lacking in flow; more signposting would aid usability;
- Narrative reporting was largely ignored by users as it was deemed to be "political" rather than an honest attempt to "tell the story";
- Multiple methodologies for determining, and the necessity to regularly change, discount rates was deemed confusing and hindered the ability of users to understand underlying trends; and
- The financial instruments note was deemed impenetrable by many users.

6. The responses were consistent across user groups which included individual Members of Parliament and Parliamentary Committees, Clerks of Parliamentary Select Committees, the Parliament Scrutiny Unit, Academics, ARC members and non-executives, think tanks and the general public.

Stage 3 – preparer perspectives

7. Preparers were also engaged through interviews and focus groups. Those who contributed their perspectives ranged from Director General's finance and Finance Directors to those responsible for the actual production of the ARAs. The key issues raised by preparers were:

- A move to a greater distinction between Parliamentary accountability and financial accounts would be seen as a positive step;
- There is limited use and application of existing guidance on materiality (with some exceptions);
- Early engagement between finance and auditors to discuss materiality of disclosures is required if progress is to be made on streamlining;
- ARAs are viewed as including superfluous tables and reports which hinder “telling the story”;
- Including graphics and tables would aid usability;
- Strong feedback that specific disclosures should be reduced and tailored. Most notably, the financial instruments note was cited by preparers as being irrelevant and burdensome to prepare;
- Consideration should be given to whether a “small entities” FReM could be developed to reduce the burden of account preparation on smaller entities; and
- Questions given the development of consolidated group accounting under CLOS as to whether every entity needs to prepare a full annual report and accounts

In addition to the responses above, preparers also echoed many of the sentiments of users in their capacity as taxpayers and users/potential users of ARAs.

8. Interestingly, the project team found that there was a distinction between the preparers at DG Finance, Finance Director and other senior finance levels who were interested in “telling the story” of the entity, and other finance staff who still viewed the preparation process as more of a compliance exercise.

Stage 4 – international and private sector comparisons

9. For stage four a review was undertaken of the cutting clutter projects being undertaken by various UK and international bodies (including the Financial Reporting Council (FRC), the International Accounting Standards Board (IASB) and the US-based Financial Accounting Standards Board (FASB). A review was also undertaken of public sector financial reporting in other jurisdictions.

Private sector cutting clutter debate

10. The key messages from the private sector cutting clutter debate in many ways mirror those of our own project. They include:

- (i) Identifying the users of the ARA: the users must first be identified so that disclosures can be framed with the users in mind, having regard to relevance and materiality;
- (ii) The concept and application of materiality: there is little guidance for preparers on how to classify items as being ‘material’ or not. The issues around application of materiality are, in part, behaviour-driven, as preparers feel pressured into making full disclosures in areas which may not always be material simply to avoid lengthy debates with the auditors or challenges from regulators;
- (iii) Disclosure requirements are becoming too onerous;
- (iv) The use of ‘standing information’, often of an explanatory nature. Information which is repeated year-on-year without material change can be seen to clutter up the ARA; an

example of such information is the accounting policies disclosed within the financial statements;

- (v) Disclosures throughout the ARA should be risk-focused, as this is how investors view the information; and
- (vi) The ARA should 'tell one story', with cohesive and balanced messages from both the 'front half' and the 'back half'.

International Public Sector findings

11. A review of whole of government account (WGA) equivalents of Australia, Canada, New Zealand, Switzerland and the United States of America provided an understanding of how governments abroad report at that level. Key findings were:

- (i) Focus was on financial statements with only limited narrative;
- (ii) The approach to the limited narrative reporting was less focussed on policy outcomes and instead takes the approach of stating the significant balances, their movements and the reason for the movement without comment on whether the movement represents good or poor performance;
- (iii) The narrative reporting tended to include longer term historic data but other specific reporting areas such as risks, sustainability, remuneration and KPIs were limited, with the United Kingdom's WGA including the most comprehensive reporting on these elements; and
- (iv) While none of the countries produce a 'glossy' ARA with photographs or images, all of the countries used graphs and charts to illustrate trends in their narrative reporting and many used colour. In addition to the visual navigational tools, Australia, Canada, the United Kingdom and the United States release summary user guides to their accounts.

12. A limited review was also taken of reporting at an entity/Departmental level in these jurisdictions. In general annual reports and accounts were being produced by individual Departments, although in the case of Canada full external audit was not undertaken at the Departmental level, only specific notes and the whole of government position were audited.

Key Themes

13. From the outreach work undertaken, the review of the cutting clutter debate and a review of public sector reporting in other jurisdictions we have been able to identify the following key high level themes that have been suggested would bring most value from an annual report and accounts:

- Accountability: How much was spent against budgets and estimates and how the entity is accountable to parliament;
- Financial information: Detail on the categories of spend;
- Performance: Measurement against objectives and plan and reasons for variances; and
- Materiality: Highlighting areas of particular relevance and importance to the entity.

14. These key themes have helped guide the initial recommendations for change that are highlighted in the project team presentation to the Board.

Summary and recommendation

15. That the Board note the work undertaken to date on the Simplifying and Streamlining Statutory Annual Report and Accounts project and comment on the initial recommendations highlighted by the project team in the presentation that will be delivered in the meeting.

HM Treasury
10 October 2013