



FINANCIAL
REPORTING
FACULTY

Information for Better Markets

DEVELOPMENTS IN NEW REPORTING MODELS

Abstract



Abstract

Business reporting has to change to reflect changes in business, in information technology, and in users' needs. This is a perpetual process. Business reporting cannot be static or it will fail. But how radical do changes in business reporting need to be? Should existing practices be thrown away so that a fresh start can be made? Or is a more evolutionary process of development needed?

In recent decades, there have been many calls for a new reporting model. We examined a number of them in an earlier report, *New Reporting Models for Business* (2003). This looked at 11 proposals for reform of business reporting that had appeared in recent years, analysed them from a change management perspective, and raised a series of questions for further discussion and research. *Developments in New Reporting Models* is a follow-up to *New Reporting Models for Business*.

There has been no falling away in the frequency of calls for a new reporting model since that earlier report appeared, though their criticisms of current practice have in some respects moved on. If anything, the demands for reform have been given renewed force by the financial crisis and its aftermath. Some of them focus on financial reporting, while others call for extensive non-financial disclosures. Some also demand less complexity in reporting. *Developments in New Reporting Models* looks at the calls for a new model in relation to both financial and non-financial reporting, and identifies underlying features of the development of business reporting. In the light of this analysis, it suggests a more realistic way of framing the debate on the future of business reporting.

The report considers some of the most important arguments that financial reporting information is not useful or is fundamentally misleading, and which might therefore justify calls for a new approach. However, there is no single financial reporting model, so criticisms of 'the model' need to be seen as referring to specific practices.

Financial reporting certainly has limitations, and these are widely acknowledged. But these limitations are also related to its strengths, especially in terms of its relevance and reliability. *Developments in New Reporting Models* finds that there is ample evidence that financial reporting does in fact provide useful information. This does not mean that financial reporting cannot be improved. But it does mean that financial reporting should not be dismissed as useless or irrelevant.

The claim that the absence of many intangibles from the balance sheet shows that current financial reporting practices are inappropriate is not a credible one. Financial reporting does provide useful information on intangibles, though not all the information that users need. They also need and get non-financial information on intangibles. But while this reflects the limitations of financial reporting, it does not show the need for a new approach to it. The evidence suggests that if financial reporting attempted to reflect all intangibles at current values this would not provide useful information.

The financial crisis has sharpened and refocused older and sometimes conflicting claims that a new approach to financial reporting is needed. While it is too early to make confident assessments of the role of financial reporting in the crisis, at present the charge that financial reporting either caused it or made it significantly worse is not well supported. Most explanations of the crisis focus on other issues as being of far greater importance.

For non-financial reporting, practice has moved strongly in the direction called for by reformers, so that for many companies their non-financial disclosures are now longer than their financial reporting. But companies rarely follow any externally prescribed model that covers all their non-financial information. And there seems to be no realistic possibility of a prescriptive reporting model that would cover all non-financial reporting and provide a detailed blueprint applicable to businesses generally. The information that different businesses disclose and should disclose is too diverse to be captured by such a model.

Similar objections would not apply to high-level principles for non-financial reporting. Such principles would mean that businesses:

- disclose information that is relevant to their particular circumstances;
- vary their disclosures as circumstances change; and
- experiment in their reporting.

In deciding what to disclose, it is sensible for individual businesses to engage with their stakeholders and other users of their reports. In this way, they can judge what works and what does not, and where additional disclosures may be needed.

Developments in New Reporting Models argues that business reporting is best viewed, not in terms of models, but as a complex social institution, which constantly evolves in response to changes in its environment. It also needs to be seen in the wider context of the supply of information about businesses – in which it is just one source, competing with others, but with certain competitive advantages.

Market forces, regulation, ethical and emulatory motives, and pressure from participants in public debate all push business reporting to adapt to changing circumstances. So it would be surprising if, except on rare occasions, it could justifiably be said that ‘the reporting model is broken’. Business reporting will always be controversial and there will always be a degree of dissatisfaction with it. But there are grounds for optimism that it should be reasonably well adapted to users’ needs and, as long as it continues to evolve, should remain so in the future.

Sometimes there will be a need for radical change, but this will usually be when there have been radical changes in the context of business reporting. Moreover, if people are concerned that business reporting is not fit for purpose, it may be more productive to investigate the environmental causes of its problems, rather than simply to prescribe a new model.

Business reporting for many companies has indeed become long and complex, but this is a rational response to changing circumstances. While unnecessary length and complexity should be removed, the real issue is often ‘How do we cope with length and complexity?’ One way of doing so is to produce shorter and less complicated reports for those who want them. Another is to rely on intermediaries such as analysts and journalists who filter long and complex reports, and aggregate them with other sources of information, into forms that the ultimate consumers of information can digest.

Advocates of new reporting models are participants in a public debate in which there is a struggle for attention. And framing the debate in terms of the search for a new reporting model is a rhetorically attractive strategy. But it presents too dark a picture of the current state of business reporting and encourages unrealistic expectations of how much can be achieved.

The debate on the future of business reporting needs to be reframed – not as a stark choice between an old model and a new one – but in terms of the need for continuing evolutionary improvements. Proposals for reform have to be assessed on their merits and many of them will be justified. So a series of small debates on particular issues is more likely to be fruitful than a big debate on grand schemes of reform.

But precisely because business reporting evolves in response to its environment, it is also possible for that environment to push it in the wrong direction or to stunt its evolution. Excessive or misguided regulation, for example, or a defective legal framework that encourages a focus on liability problems rather than communication, may lead reporting astray. So the forces that shape reporting – as well as reporting itself – need to be kept under constant and critical review.

Developments in New Reporting Models identifies a need for further research on a number of matters. The quality of the debate on the future of business reporting would be improved if more effort went into looking at how far proposals for change either are supported by existing research findings or can be tested by future research.

Printed copies of the full report may be obtained by calling the ICAEW on +44 (0)20 7920 8466 or by sending an email to bettermarkets@icaew.com. To download a pdf of the full report, visit www.icaew.com/bettermarkets.

The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall PO Box 433
Moorgate Place London EC2P 2BJ
T +44 (0)20 7920 8466 F +44 (0)20 7920 8780
E bettermarkets@icaew.com
www.icaew.com/bettermarkets

TECPLN8876
December 2009



In line with the ICAEW policy on environmental sustainability, this abstract is printed on Greencoat 80 Velvet, an FSC-certified paper containing 80% post-consumer recycled waste (diverting waste from landfill) and 20% virgin fibre sourced from well managed forests.