Financial Reporting Council

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Dear Pantelis

Re: The Future of Corporate Reporting – creating the dynamics for change

The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment. We promote high standards of corporate governance through the UK Corporate Governance Code, and encourage engagement between investors and Boards through the Stewardship Code. We set standards for corporate reporting, audit and actuarial practice and monitor and enforce accounting and auditing standards. We also oversee the regulatory activities of the actuarial profession and the professional accountancy bodies and operate independent disciplinary arrangements for public interest cases involving accountants and actuaries.

We welcome the opportunity to comment on FEE's discussion paper on the Future of Corporate Reporting. The paper is a valuable contribution to the on-going debate on how corporate reporting should develop to maintain and enhance its relevance in a changing world. The increase in corporate social responsibility reporting shows companies recognise the need for them to provide information to a wider stakeholder base. Greater comparability in the form and content of reporting on matters that cannot easily be expressed in purely financial terms can improve the quality of reporting to all stakeholders. International debate and co-operation can provide the incremental changes needed to bring about these improvements.

Many of the themes explored in the paper can be seen in UK company law and in the regulatory framework for corporate governance and reporting for which the FRC is partly responsible alongside, for example, the UK Listing Authority of the Financial Conduct Authority. However, more can be done, and we will be focussing in the coming years on further embedding and improving the implementation of recent improvements to the reporting framework. We would welcome the opportunity to share our experiences to date as your work proceeds and to learn from the results of your consultation and experience from other jurisdictions.

Whilst not responding to each of the individual detailed questions in the paper, we respond below to some of its key themes, highlighting recent UK regulatory responses, such as the UK Corporate Governance Code or the Strategic Report, where relevant.

Summary of our comments

- We agree with many, though not all, of the ideas underpinning the CORE and MORE model. In particular, we recognise the legitimacy of the calls for information from other stakeholders who are impacted by companies and their activities and the importance of aiding navigation through multiple reports.
- However, we consider any CORE report should focus on the needs of shareholders rather than multiple stakeholders. This approach would ensure greater clarity on content and permit the practical application of a materiality threshold, whilst still requiring disclosure on a broad range of subjects that are also of interest to other stakeholders.
- Both financial and non-financial information are crucial to a full understanding of a business and how long term sustainable value is created and maintained.
- Many of the benefits of the proposed CORE and MORE model can be achieved without radical changes to current requirements or the development of new reporting technologies.
- Greater international co-ordination of corporate reporting regulation generally, and non-financial information specifically, would be helpful. However, such co-ordination should not become a barrier to innovation, both by preparers of corporate reports and the national regulators developing frameworks. A period of experimentation by National Regulators should be encouraged before seeking convergence.
- Technological developments may facilitate more timely information, though the potential for continuous or real-time reporting to foster short-termism or inappropriate decision-making based on data without contextual information requires further consideration.

A growing audience for corporate reporting

We agree that there are growing and legitimate demands for corporate information from stakeholders other than shareholders, which reflects the broad societal impacts of businesses. As members of the society in which they operate, businesses should be accountable for these impacts and transparency of reporting to stakeholders is the first step towards such accountability.

The CORE and MORE model described in the paper provides useful insights into how these differing demands for information could be met whilst promoting the interconnectivity of the resulting reports, simplifying the navigation of corporate information and minimizing unnecessary duplication.

Addressing the CORE report to shareholders

Whilst agreeing that there are demands for more information from other stakeholders that should be better met, we believe that the CORE report in any CORE and MORE model should focus on the needs of shareholders on both conceptual and practical grounds.

Shareholders are the owners of the company and have entrusted risk-bearing capital to management. The principal-agent relationship between the owners of a business and its management creates significant information asymmetry which should be addressed by placing reporting to shareholders at the heart, or CORE, of the model.

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There are also practical benefits from focussing the CORE report on the information needs of shareholders.

It would be untenable to expect a company to provide every piece of information that every stakeholder might be interested in, especially not in a summary CORE report as considered in the paper. A preparer must have access to some principles to help guide the boundary between the information to be included and that to be excluded. The application of the materiality concept can help identify this boundary.

The application of the materiality concept requires a preparer of a report to consider what matters to the user of the report. This can be difficult enough if one focuses only on shareholders, who are not a homogenous group; meeting the multiple needs of many stakeholders would inevitably result in conflicting conclusions on what is material,

The increased scrutiny of companies and their corporate reports by other stakeholders allied to the developments in communication technology and the use of social media has increased investors interest in and demand for non-financial information. There is greater convergence with the matters of interest to investors and those of interest to other stakeholders.

As the paper notes, there are difficulties in defining non-financial information, but it can be taken to include information on corporate governance, business model and strategy, corporate values, and environmental, social and human impacts. Shareholders are increasingly interested in such non-financial information to the extent material to their understanding of a business's financial performance, position and prospects.

A focus on shareholders would not result in the CORE report being irrelevant to other stakeholders. Significant topics of interest to other stakeholders are most likely also of interest to shareholders. Differences in their information demands will be in the degree of detail requested or, in other words, how materiality would be applied by the different stakeholder groups.

To summarise using the paper's terminology, the MORE reports can be used to provide more detailed information to all stakeholders, but the CORE report should provide financial and non-financial information relevant to shareholders' assessment of the business and its prospects and the stewardship by management of resources entrusted to it by the shareholders.

The Strategic Report – a model for the CORE report?

A Strategic Report is a legally required component of the Annual Report to shareholders in the UK. In the FRC's Guidance on the Strategic Report ("the Guidance"), we mirror some of the proposals in the paper by encouraging the explanation of linkages between components of the Annual Report and the provision of references to further information outside of the annual report. We would welcome the opportunity to share our experience on the development and implementation of the regulations and guidance in the UK as you further develop proposals.

Important linkages can be made between, for example, disclosures on business strategy and objectives, key performance indicators, principal risks and uncertainties, directors' remuneration and the financial statements. These linkages can and should cover both financial and non-financial information. References to further information sources could include hyper-links or website references to a Corporate Social Responsibility Report providing further information on company policies and impacts in respect of the environment, employees and community matters.

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UK company law permits businesses to distribute to shareholders, in lieu of the full Annual Report, only the Strategic Report which can be supplemented with additional information such as extracts from the financial statements. Such a report would, in our view, be an appropriate starting point for developing the contents of a CORE report as described in the paper.

Content of corporate reporting

The paper highlights the growing gap between company valuations and the net assets reported in company balance sheets. This gap might be narrowed, to some extent through the recognition in the financial statements of more intangible assets, but it will never be removed completely. Financial reporting, with its inherent limitations, can provide information useful to the valuation of businesses but cannot replace market driven valuations.

Furthermore, the confirmatory value of the Annual Report and its role in providing information crucial for assessing management's stewardship should not be under-estimated. The effectiveness of reporting should not be assessed, as might be inferred from elements of the paper, purely by reference to its predictive value or its direct depiction of market values.

It is clear from our outreach activities that investors require information beyond that which can be presented in purely financial terms, even before one considers the needs of other stakeholders. This fact is reflected in the many initiatives to expand the content of corporate reporting to non-financial matters that are highlighted in the paper. It should also be noted that many companies have reported on non-financial matters for many years, pre-empting and shaping such initiatives.

Corporate reporting continues to develop, progressive companies continue to innovate and the need for further experimentation still exists. However, greater consistency in content and quality should be encouraged over time, whilst permitting innovation by both individual regulators and preparers.

The UK non-financial reporting framework has advanced significantly in recent years, although the regulatory interventions like the UK Corporate Governance Code and the Strategic Report are primarily aimed at the Annual Report and at reporting to shareholders. We believe some of the principles applied could also be relevant to wider stakeholder reporting and we look forward to future debates that might help improve such reporting.

Our experience shows that a non-financial reporting framework needs three key elements: a description of required content, the principles for providing and communicating that content and, most importantly, corporate governance that elevates discussion of corporate reporting to the highest level so corporate thinking, behaviour and reporting are integrated.

Determining the content of non-financial information

Many of the content elements identified in the paper are already required, either mandatorily or on a comply-or-explain basis, in UK Annual Reports to shareholders. To provide a basis for further discussion of the UK experience and the extent to which it adequately addresses the concerns set out in the paper we list below some of these key requirements:

- An explanation of a company's business model and strategy, supported by key strategic objectives. This focus on how value is created and maintained is central to addressing the gap between balance sheet and market valuations;

- An explanation of the principal risks and uncertainties faced by the company;

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- A fair, balanced and comprehensive analysis of performance and position, including underlying trends and factors

- Key financial and non-financial performance indicators

- To the extent material to an understanding of the company's financial performance, position and prospects, information on environmental, employee, human rights and social matters;

- A statement of the Board's reasonable expectations of the future viability of the company and underlying assumptions

Whilst ensuring a degree of comparability of content between reports, these content elements are described at a sufficiently high level to allow innovation and flexibility in the provision of non-financial information. Further research into the needs of other stakeholders would be necessary before the content elements for more detailed MORE reports could be developed.

The FRC's Financial Reporting Lab has instigated a project on the reporting of business models bringing together investors and preparers to identify and promote best practice. Further projects on other areas of non-financial reporting are expected and we would be delighted to share the insights gained as your project develops.

Principles of communication

Whilst it is too soon in the evolution of non-information for prescriptive standards on detailed content, and it is arguable that such standards are not necessary, high level principles can be set to ensure relevance and reliability. The UK experience has shown that clearly articulated principles can provide a catalyst for improvements in the quality of reporting, especially when allied to wider stakeholder engagement and commentary on quality. Initiatives such as awards for applying widely accepted principles of high quality reporting can stimulate competition between preparers and the proliferation of best practice.

The UK Corporate Governance Code requires that the Annual Report, taken as a whole, must be fair, balanced and understandable. This overarching principle, whilst simply stated, has proven powerful in improving the quality of Annual Reports and can be extended to other forms of corporate reporting. Indeed, the UK Corporate Governance Code requires that Boards' apply the principle in all communications with shareholders.

The FRC's Guidance encourages other principles of communication to ensure the quality and credibility of reporting in the Strategic Report, which could equally form high-level principles for the forms of corporate reporting proposed in the paper. These include:

- making disclosures Clear and Concise, to ensure understandability and relevance

- careful application of materiality which, as discussed above, requires consideration of user needs

- consideration of the placement of information, both within the Annual Report with clear-cross-referencing, when it is necessary to meet its objectives, and outside of the Annual Report when it is not. The careful placement of information can improve its understandability and provide greater context by grouping together related issues. As discussed in the paper, this principle can be equally applied to the structuring of the notes to the financial statements

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- the use of clear sign-posting to sources of further information outside of the Annual Report, for example on company websites. This echoes the suggestion in the paper for navigational aids between the CORE and MORE reports and can be achieved without the development of new or advanced technologies.

- highlighting the linkages between elements of the Annual Report. For example, explaining the links between strategic objectives and key performance indicators provides clearer context on performance and ensures the indicators presented are those that matter. The resulting transparency provides the rigour needed in the choice of information provided without the need to revert to prescriptive detailed requirements that would hinder flexibility.

Corporate Governance

As the paper notes, there is increasing focus on business ethics, and corporate culture and values. The FRC is currently examining the role of the Board in assessing, shaping and embedding a company's corporate culture and will report shortly. Communication with stakeholders is important in both shaping and explaining corporate values.

The links between corporate governance and reporting are central to addressing the issues identified in the paper; reporting requirements, if carefully developed, can influence behaviour whilst information that does not reflect actual behaviours is valueless. Therefore it is important that the Board is seen to take ownership of corporate reporting and strives to achieve high quality, and we encourage FEE to explore means of ensuring Board engagement.

UK experience has shown that greater Board engagement in reporting can be achieved by requiring the provision of explicit statements of compliance. For example, a statement that the Annual Report is fair, balanced and understandable and that the Board have made a robust assessment of the risks the company faces.

The CORE and MORE model

As the discussion above shows, we recognise many of the ideas discussed in the paper. We have argued that any CORE report should continue to focus on shareholders needs as business owners, reflecting the characteristics of the principal-agent relationship and because such a focus provides a clearer reference point for applying the materiality concept.

We would question whether all forms of corporate reporting, from the Annual Report to investor briefings to ad hoc communications such as press releases, can practicably be linked in the way suggested in the paper or whether this is necessary. We also question whether the benefits of the model can only be achieved through the use radically different technologies than those already applied. Hyper-links to information stored on a company's website can easily be embedded in documents such as pdf reports without creating new technological architectures.

A simple way forward could be to encourage the provision of such links between the key reports published and the development of consistent protocols for the indexation and organization of all communications on companies' websites. Most listed companies already include an investor relations section on their website and these could easily be expanded to become stakeholder relations sections with consistent and comparable "drop-down menus". Some consistency already exists – for example, many AIM traded companies have coincidentally developed similar website structures built around the discrete reporting requirements of the market.

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We note the suggestion that the primary statements could be separated from the detailed notes. As the paper notes, any future concrete proposals on the corporate reporting model must also consider the implications for assurance and, in particular, the clear identification of the boundary of any assurance opinion. Setting aside these important issues for the purpose of the current discussion, we recognize that even amongst investors there is varying appetite for the detail with some concentrating on management commentary and the primary statements and others focusing on the development of detailed analytical models driven by information in the notes.

In the absence of the seamless technological links envisaged in the paper, we continue to believe there is a need for an Annual Report to shareholders that brings together management commentary, non-financial information, primary financial statements and detailed notes to provide a single comprehensive and cohesive picture of the company's financial performance, position, cash flows and future prospects. This could still sit alongside a shorter CORE report, but the confirmatory value of the Annual Report and its importance for shareholders assessment of management's stewardship support its retention.

Timeliness

We note with interest the discussion on the use of technology to provide more timely information which is likely to be more relevant to decision making. It is clear that full financial statements take time to prepare and do not "move markets". However, we are not convinced that this undermines their relevance; the confirmatory value of Annual Reports is paramount to engendering trust in other financial and non-financial information that is provided including, where relevant, preliminary announcements.

It is not evident that the provision of a CORE report, encompassing key financial and non-financial information and management commentary would be any quicker than earnings announcements or preliminary statements.

The FRC intends to instigate research on the relationships and differences between preliminary statements and Annual Reports and how they are used by shareholders and would welcome co-operation in this area. We believe it is important to better understand the trade-offs between timeliness, completeness and the extent of independent assurance.

Technology may play a role in providing more timely information – indeed some argue that the provision of real-time financial data is already feasible. However, we do share some of the concerns on this matter that are noted in the paper. Real-time financial data without the context provided by, for example, the discussion of strategy and performance in management commentary may not be conducive to long-term sustainable investment and growth and may be inadvertently misleading. Developments in this area should proceed with caution.

Approach to policy making and innovation

We agree that experimentation and innovation is key to improving the quality of corporate reporting generally and of non-financial information specifically. We believe that regulatory intervention that sets high level content requirements, sets principles for communication and disclosure and elevates reporting decisions to those charged with governance can stimulate improvements. It improves quality, provides greater comparability and provides space and flexibility for innovations by preparers.

The integration of reporting requires integrated thinking by management, i.e. the incorporation of financial and non-financial considerations so as to achieve sustainable value creation. But it also requires integrated regulation. There are multiple regulators and legislators impacting

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on the form and content of corporate reporting and we welcome calls in the paper for greater co-ordination internationally, particularly with respect to agreeing mutually compatible objectives for reporting.

However, such co-ordination should not become a barrier to innovation *by regulators*; the benefits of some flexibility for preparers to develop best practice reports apply equally to the development of best practice regulation.

Any regulator interventions must reflect the needs of market participants entering into constructive dialogue together to lead innovation. We would encourage models like FRC's Financial Reporting Lab to encourage such dialogue.

I trust these comments will be helpful in your future deliberations and debates and would happy to discuss experiences in the UK further. Please feel free to contact me or Anthony Appleton (a.appleton@frc.co.uk).

Yours sincerely

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