5 February 2021

Sir Jon Thompson
Chief Executive Officer
Financial Reporting Council

By email: futurereporting@frc.org.uk

A Matter of Principles: The Future of Corporate Reporting

Dear Sir Jon,

The International Integrated Reporting Council (IIRC) welcomes the Financial Reporting Council's (FRC's) thought leadership paper, "*A matter of principles, the future of corporate reporting*" and, in particular, we are pleased to take the opportunity to join this progressive discourse. The FRC's proposals highlight the important role corporate reporting can play in creating a cohesive and effective business information system that drives sustainable development.

The IIRC is keen to contribute proactively to the development of these proposals and help deliver the single comprehensive system of corporate reporting that stakeholders demand and the world needs.

The ideas and recommendations that we share in this letter reflect a decade of expertise, including the release of the International <IR> Framework which is today signposted by over 40 stock exchanges and adopted by c.2,500 businesses globally. We believe strongly that the FRC's thought leadership in this area is closely aligned to many of the key concepts and principles of integrated reporting and would like to see a further strengthening of this connection so that the market is presented with a unified vision, clarity over its purpose and consistency in respect to the principles that will guide the implementation of specific disclosure requirements.

We do have two principal concerns which I would highlight as follows:

a) The paper's focus on the suite of reports risks missing the point that **a report is the output of a corporate governance process**. The quality of the report is therefore dependent to a significant degree on how the business is being run. Our experience of studying leading practice corporate reports shows that the reporting process is underpinned by the business model and its interaction with the external environment. This provides insight to the company's principal stakeholders on how the board and management are running the business, delivering on its purpose on an integrated basis. By considering the process in this way the business is better able to communicate its value creation process to different audiences based on a single set of data. We would therefore recommend much greater consideration being afforded by the FRC to the business model and how it underpins corporate reporting. We believe this is a critical component to instilling integrated thinking and the effective management of all principal risks and opportunities faced by the business, and supports the FRC's corporate governance and resilience agendas.

b) We are concerned that the illustrations used in the paper do not indicate **the vital importance of the connectivity of information**. We believe it is essential to present the different reports as connected or overlapping to avoid the perception of siloed and disconnected reports. In this respect technology will play a key role and we would recommend an increased focus on both connectivity and technology as this work evolves.

These are not academic matters. The evidence shows that corporate reporting influences business and investor behaviour. Corporate reporting that is connected, reflects the governance process and is an expression of the Board's collective mind is shown to attract more long-term investors, reduce the cost of capital and increase performance.

The paper advocates a consistent set of principles, the importance of focusing on long-term value creation and information that is decision-useful and drives accountability, all of which we view as fundamentally important. In these, and in all other respects, the IIRC would welcome the opportunity to work with the FRC to build even greater cohesion and consistency between national, regional and global principles. This alignment is, after all, what market participants are requesting of all organizations concerned with improving the quality of our corporate reporting system for the benefit this and future generations.

Corporate reporting system – towards a global consensus

The IIRC advocates an approach that seeks to create a connected, coherent, comprehensive and accountable system for corporate reporting on a global scale. A cornerstone of this system is the connectivity of information and the breaking down of silos between information sources, principally relating to the different resources and relationships (or capitals) used by a business to create value over time. We believe this helps to underpin effective corporate governance and stewardship, enabling the timely management of multiple risks and opportunities faced by a business in an era of interconnected, simultaneous and systemic challenges.

We believe the FRC's proposals respond to the increased demand for information from a wider-range of stakeholders and the requirement to bring clarity and cohesion to the fragmented corporate reporting landscape. As we highlight in the International <IR> Framework, we believe a principles-based approach strikes the right balance between flexibility and prescription. This approach both recognizes the need for regulatory intervention to achieve consistency and comparability, and the importance of being responsive to individual market needs. A consistent and mutually agreed set of principles on a global scale will be pivotal in enhancing trust in the corporate reporting system, facilitating effective board oversight and enabling robust assurance of non-financial information.

The collaboration between the leading integrated and sustainability reporting organizations (CDP, CDSB, GRI, IIRC and SASB) in 2020, and the proposed merger between SASB and the IIRC to form the Value Reporting Foundation, are important milestones in the development of this system. This work is intended to be supportive of, and consistent with, the recent announcement by the IFRS Foundation about its intention to establish a Sustainability Standards Board (SSB) and efforts at a European level to build on existing frameworks and standards to support the implementation of the EU Green Deal and non-financial reporting directive.

These initiatives exemplify the changing dynamic of a business's fiduciary duty. The Dasgupta review, IFAC's Way Forward paper and the FRC's thought leadership highlight that a business which understands how an ecosystem determines its ability to create value sustainably and, in turn, how the organization's business model can affect its ecosystem, is one best placed to identify risks, build resilience and succeed in the 21st century.

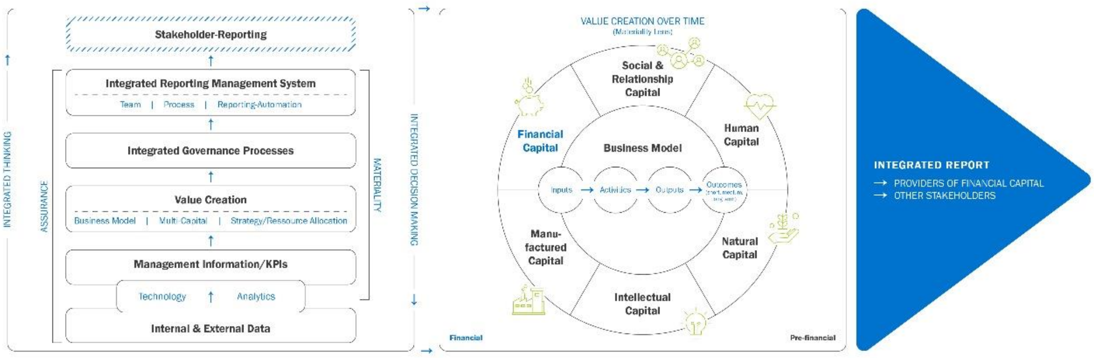
However, the importance of harmonizing and evolving corporate reporting to integrate sustainability-related information on a global scale must be recognized. Thus, the building block approach highlighted by the group of 5's [Statement of Intent](#) paper describes how the existing network of frameworks and standards are mutually reinforcing and, by adopting the dynamic materiality concept, create the pathway for achieving a globally-accepted comprehensive corporate reporting system.

It is therefore vital that a single set of global principles for sustainability information disclosure related to enterprise value creation is agreed within an overall information architecture that meets the needs of all stakeholders. It is also essential that a conceptual framework is developed to achieve durable connectivity between these building blocks of long-term value creation.

Given these observations, we believe there is scope to further develop the FRC's paper to address some critical issues for the future of corporate reporting.

A strategic approach to reporting
The first area for development is recognising the benefits of a strategic approach to corporate reporting and, in particular, the link between corporate reporting, governance and business practices. The FRC's paper's main focus is on the reports, not on the ability of corporate reporting to be based upon better business practices, corporate governance and strategy, and crucially how the underlying principles of better reporting can develop new corporate cultures, innovative thinking and create various forms of value for businesses. For example, Figure 1, taken from the International <IR> Framework, highlights how an integrated report, prepared using the Framework, is the end product of embedding a system of integrated thinking within a business's processes and decision-making mechanisms.

Figure 1 – Integrated Thinking Flow Chart



Integrated thinking, leading to an integrated report which tells the value creation story, are strategic tools that develop an organization's understanding of its role within an interconnected and interdependent system of capitals, connecting an organization's strategy, performance and culture to its external environment. This method supports executives and managers in understanding how the interconnectivity of financial and non-financial aspects of a business drives their value creation mechanisms over the short, medium and long term.

This process highlights that the transformational impact corporate reporting can achieve comes not through a report itself but the underlying principles and thinking that demonstrates how an organization undertakes its reporting and how its board, managers and employees think about value creation over the long term. Consequently, the FRC's proposal may benefit from re-evaluating how the underlying principles described in the report will translate through the reporting network and into corporate governance, strategy and culture. Expanding on section 5.8 of the report to further outline how specific metrics and KPIs can be linked to organizational purpose, values and strategy would be a useful addition.

Interconnectivity, integration and increased complexity
Our second point on the paper concerns the implications of the proposed "Network of Reports" and the separation of corporate reporting into potentially three or more annual reports. While we agree with reporting that addresses the information needs of different audiences, the risk inherent with multiple voluntary reports is that a 'hierarchy' is created, either by the business itself or in the market. Any hierarchy risks further embedding organizational silos and reducing the interconnectivity of the information available for decision making executives. Furthermore, we believe corporate governance and reporting continue to be a significant strength of the UK and it should use this position to demonstrate international leadership, not by creating bespoke models but by accelerating the shift towards a globally accepted comprehensive system based on an agreed set of aligned principles.

The introduction of new terminology at this stage risks adding to the perception of complexity, potentially increasing the reporting burden and reducing adoption. A model that does not fit with the global standards and frameworks also risks reducing global comparability and consistency which is what investors and other stakeholders wish to see.

We believe this issue can be addressed through strong internal processes, a clearer focus on the interconnectivity of the information between reports and/or an acceleration in technology to enable the better ordering, layering, presentation and accessibility of information relevant to different stakeholders. Without these processes or technology, an increased number of concise reports with different objectives fails to reflect the required connectivity between financial and non-financial information.

These challenges could be easily overcome, however, through clear signalling of the FRC's intent to build on existing practices, frameworks and standards, clear signposting that the Business Report is substantially equivalent to an integrated report and strategic report, and more clearly defined parameters around the Social Interest Report. This response would reduce any semantic confusion, support the growing trends for harmonization and address any risks of market fragmentation.

Objective-driven reporting
While objective-driven reporting has the advantage of broadening the lens a company uses to analyse its stakeholders, this approach raises concerns particularly regarding materiality, accountability and alignment with global trends.

Firstly, as we have highlighted above, the market, civil society, regulators and governments are calling for greater convergence, comparability and connection between financial and sustainability reporting. However, the FRC's materiality approach driven by a report's objective appears to misalign with the ongoing convergence of standard setters and frameworks for sustainability-related disclosures.

The proposed merger between the IIRC and SASB to form the Value Reporting Foundation is consistent with the findings from the two exhaustive consultations used to revise the International <IR> Framework, where 1,470 individuals across 55 jurisdictions highlighted the continued demand for stakeholder-driven reporting. We believe, without defining a stakeholder objective, the report risks losing focus and accountability to a specific group of stakeholders.

Maintaining a stakeholder-led focus within a business report, integrated report or public interest report will provide greater clarity in reporting objectives for preparers and increase the conciseness of each document through the removal of duplicated information where stakeholder information requirements overlap.

Materiality

The IIRC supports a dynamic approach to materiality, one that encompasses a wider range of stakeholder needs as well as develops a greater understanding by businesses of how the external environment materially impacts a business and how this business materially impacts the external environment. Figure 2 below highlights the approach the IIRC supports on materiality and is explained in greater detail in the recently published paper "Reporting on Enterprise Value" from the Group of 5, facilitated by the Impact Management Project.

Figure 1. Comprehensive corporate reporting

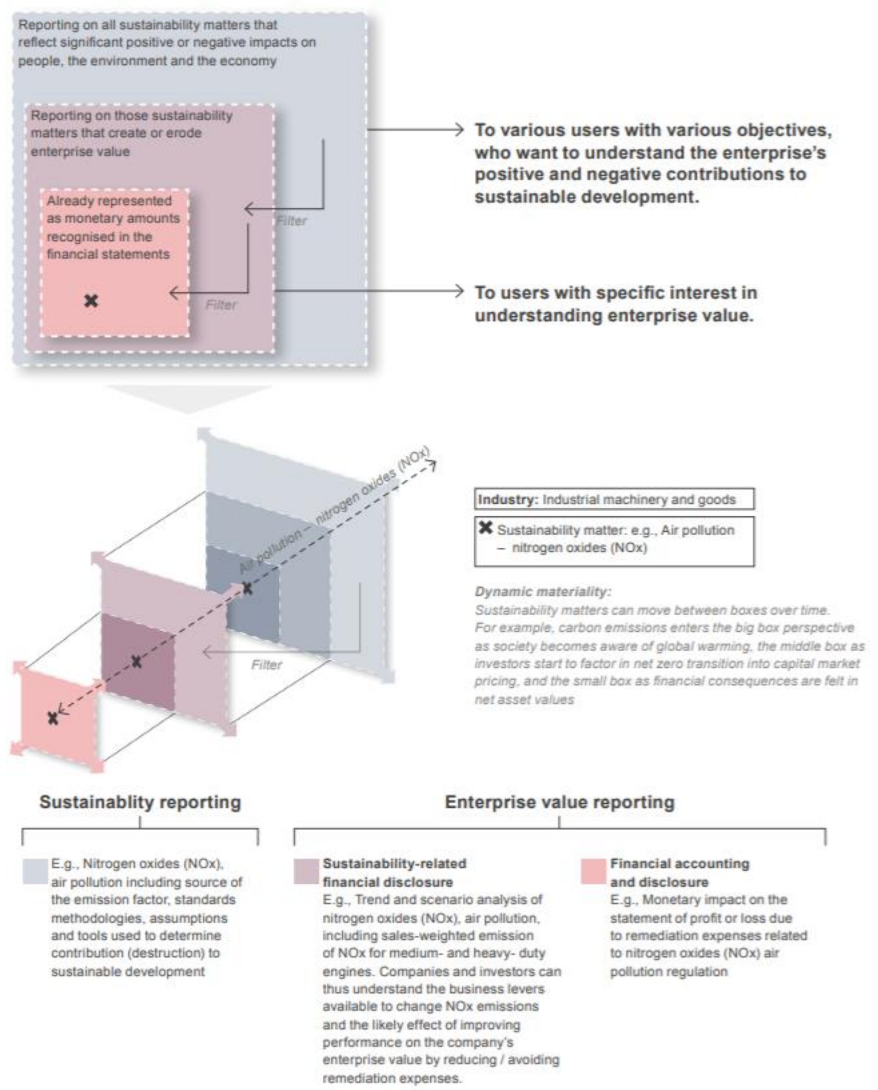


Figure 2 – Nested materiality model.

This dynamic approach to materiality is consistent with the building block approach described above and we believe the overarching end goal for Non-Financial Reporting Standards should cover a full range of sustainability issues described by this dynamic materiality definition, reflecting the required flexibility in identification of relevant risks and opportunities for all stakeholders, in addition to aligning with the public interest.

Principles

As we have explained, the IIRC strongly supports a principles-based approach to corporate reporting and we believe this is consistent with the proposals advocated by the FRC. We would encourage the FRC to consider aligning the content elements for the Business Report (5.8) to those of the International <IR> Framework as a minimum including, for example, governance. We would also caution against presenting the content elements as a "check-list" or hierarchy which may become a compliance exercise in practice, and instead encourage connectivity and an exercise of management judgement.

A principles-based approach is in line with a market-led philosophy, ensuring responsiveness to market needs and relevance to the information needs of all stakeholders. We believe that the International <IR> Framework has achieved sufficient maturity and adoption to provide the basis for international agreement on a set of consistent corporate reporting principles. To avoid market fragmentation, we would encourage the FRC to strengthen its alignment to, and endorsement of, the fundamental concepts, guiding principles and content elements in the <IR> Framework.

Assurance

The creation of robust assurance mechanisms is critical to drive trusted and credible information. The market for assurance services is already beginning to develop and we believe that global consistency in the adoption of corporate reporting principles and concepts will accelerate this trend. Regulators can play an important role by encouraging the integration of material financial and sustainability issues so that investors can assess the impact of these factors on enterprise value.

Technology

We strongly support the FRC's focus on technology as a vital part of corporate reporting's progression. We believe digitization has the potential to transform corporate reporting, enhancing the efficiency of accessing data within the business in real-time, recognising the connectivity between financial and sustainability performance, alerting management to key risks and opportunities and improving the ease of reading the information from a user perspective.

On top of the proposals outlined in the discussion paper, we believe thought should be given to several technological advancements that would benefit the future of corporate reporting. These include automated integration of financial and sustainability data, the use of artificial intelligence for data analytics and the formulation of strategic planning, forecasts or risk management scenarios. We do not underestimate how challenging it will be to adopt these changes in practice and encourage the FRC to work with global standard-setters and framework providers to continue to explore ways in which technology can be utilised to increase the accessibility and interconnectivity of various stakeholder's information needs.

Proportionality
We agree with the general intention behind the principle of proportionality, especially when viewed against the current structure of corporate reporting, which can create additional burdens for small and medium-sized enterprises.

However, we believe that a principles-based approach, founded on integrated thinking, can be applied more broadly than a compliance-based system and support good governance and resource allocation for all enterprises. We also believe that the discipline of integrated thinking brings benefits throughout the value chain, not just to larger businesses.

We would therefore propose a voluntary pilot study among a selection of smaller and medium-sized businesses to trial where a set of generic corporate reporting principles are applied and adopted. This would enable the better understanding of the benefits of a principles-based approach and the benefits for smaller companies – for example, in developing strategies for growth, accountability through supply chains and gaining access to investment. The IIRC would be pleased to work with the FRC on this study should there be an appetite to take forward this proposal.

We also believe, as a matter of principle, that the transition to more equitable and sustainable economies should be inclusive of all economic actors in a genuine partnership, consistent with SDG 17.

Conclusion
The FRC has published its thought leadership paper on the future of corporate reporting during a period of great change, when the global standards and frameworks organizations are advancing a joint vision and structure for a cohesive and connected system, the IFRS Foundation is developing its plans to create a Sustainability Standards Board (SSB) and IOSCO is encouraging the development of a comprehensive global approach. Against this backdrop, the FRC has put forward a set of ideas that has the potential to have significant influence in a world that is demanding concrete and scalable solutions.

I conclude this letter by reiterating the IIRC's commitment to working with the FRC to develop these ideas and, more importantly, achieve a connected, responsive and technology-enabled corporate reporting system that advances prosperity and contributes towards sustainable development.

Yours sincerely,

[redacted]

Charles Tilley OBE
Chief Executive Officer
International Integrated Reporting Council (IIRC)