ICAEW
REPRESENTATION 24/21

THE FUTURE OF CORPORATE REPORTING

Issued 1 March 2021

ICAEW welcomes the opportunity to comment on The Future of Corporate Reporting discussion paper published by Financial Reporting Council in October 2020, a copy of which is available from this link.

Corporate reporting is at a critical juncture and we welcome the FRC's discussion paper, which is a thoughtful and valuable contribution to current debate around the future of corporate reporting. Regular and robust challenge of the current reporting regime is important. It provides an opportunity to reflect on challenges, both new and old, and to consider how well the system is adapting to developments and pressures more broadly. It may, however, be helpful to revisit the proposed model outlined in the discussion paper once there is a clearer picture of the outcome of the forthcoming BEIS consultation on corporate governance and audit reform and of ongoing developments relating to non-financial reporting standards.

This response of 1 March 2021 has been prepared by the ICAEW Financial Reporting Faculty. Recognised internationally as a leading authority on financial reporting, the faculty, through its Financial Reporting Committee, is responsible for formulating ICAEW policy on financial reporting issues and makes submissions to standard setters and other external bodies on behalf of ICAEW. The faculty provides an extensive range of services to its members including providing practical assistance with common financial reporting problems.

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KEY POINTS

ROBUST CHALLENGE IS GOOD

1. We welcome the Financial Reporting Council's thought leadership paper, which explores ideas for changes to the corporate reporting system with a view to making it more effective and engaging for those with an interest in a company. We believe that regular and robust challenge of the current reporting regime is important. It provides an opportunity to reflect on challenges, both new and old, and to consider how well the system is adapting to developments and pressures more broadly. It is also an opportunity to remind ourselves of what works well and to acknowledge progress made in improving the overall quality of corporate reporting.
2. We also support the emphasis in the discussion paper on reporting being a communication tool and providing an active dialogue between a company and its stakeholders. As noted in the discussion paper, reflecting on how well corporate reporting facilitates meaningful engagement with stakeholders will lead to improvements and practice-led innovation.

CORPORATE REPORTING AT A CRITICAL JUNCTURE

3. Corporate reporting is at a critical juncture. Sir Donald Brydon's Independent Review into the Quality and Effectiveness of Audit led to a number of far-reaching recommendations being published in 2019, including many in relation to corporate reporting. These recommendations will soon be discussed as part of a BEIS consultation, including matters relating to how companies report on their public interest obligations and other non-financial reporting matters.
4. Another important element relates to ongoing developments towards a set of international non-financial reporting standards. In particular, we note the IFRS Foundation's recent consultation on sustainability reporting, which proposed the formation of a Sustainability Standards Board to set sustainability reporting standards. The Foundation's and other related non-financial reporting initiatives show significant demand for and momentum behind the development of a truly international corporate reporting system. With further announcements from the Foundation due in March and September 2021, as well as rapid developments in Europe, progress on this front is expected in the coming months.
5. We welcome the FRC's discussion paper, which we believe is a thoughtful and valuable contribution to current debate around the future of corporate reporting. However, we are clearly in the midst of a period of change which could have a significant impact on the UK corporate reporting landscape. While some of the forthcoming changes may address challenges highlighted in the FRC's discussion paper, other challenges may remain, or even evolve. As such, we believe it would be useful to revisit the proposed model outlined in the discussion paper at a later date and when there is a clearer picture of the outcome of the forthcoming BEIS consultation on corporate governance and audit reform, and of ongoing developments relating to non-financial reporting standards.

INFLUENCING GLOBAL REPORTING DEVELOPMENTS

6. Another important consideration is how the proposed model would interact with reporting regimes internationally. In particular, adopting a reporting regime that is radically different or incompatible with that found in other jurisdictions would present a major challenge for companies with cross border listings. We believe that when the FRC revisits the proposed model in the discussion paper, consideration should be given to how any fundamental changes to the UK reporting regime would interact at an international level.
7. That is not to say that the FRC should not continue to monitor and influence global developments in corporate reporting. Indeed, the UK has often been a leader in corporate

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reporting matters. For example, the introduction of the Strategic Report in 2013 was a crucial step towards companies providing a broader and more integrated narrative on their position, performance, and prospects alongside the financial statements. Another example is the work of the FRC's Financial Reporting Lab, which has been successful in highlighting and promoting best practice in corporate reporting. We believe the UK still has an important role to play in this respect. However, the focus right now should be on monitoring, influencing and supporting current developments, particularly in relation to global initiatives and efforts to standardise non-financial reporting.

CLARIFYING THE ISSUES

8. We recognise and agree with the challenges to the corporate reporting system highlighted in the discussion paper. However, the extent to which these challenges require a radical overhaul of the current corporate reporting regime is less clear. While we suggest above that the FRC revisits the proposed model at a later date, further analysis to identify the underlying issues affecting the quality of corporate reporting would be beneficial.
9. For example, is the length of the annual report by itself the problem or rather that it increasingly contains information that would be better suited elsewhere? If the latter, then would having a clear objective for the annual report help? Similarly, to what extent are issues around the quality of corporate reporting related to non-compliance rather than flaws with the underlying regime? If non-compliance is the issue, would greater enforcement for reporting problem areas be an option? And finally, is regulatory focus on the annual report alone, rather than across the entire reporting system the right approach? If not, should we consider again the scope of the regulatory framework for corporate reporting more broadly?
10. Overall, we believe that further analysis of the challenges and the extent to which they affect the quality of corporate reporting is needed. Doing so will provide greater clarity around the most appropriate solution. This could, for example, be in the form of adjustments to the current reporting regime, new or enhanced guidance, or increased enforcement activity. Taking this approach could result in marked improvements to the current regime, without the need for a major overhaul and within a shorter timescale. For example, setting a clear objective for the annual report could help streamline current reporting requirements while also providing discipline over any future requirements.
11. There may of course still be areas where more radical reform might be considered. However, it is important to have a clear understanding of the underlying issue, its causes, and why this cannot be resolved within the current reporting system. The risk otherwise is that these underlying issues remain unresolved and continue even under a revised model.

STRENGTHS OF THE CURRENT REGIME

12. As noted above, one of the positive outcomes of reviewing the current reporting system is a renewed focus on what works well. Indeed, through our deliberations of the FRC's discussion paper we have again heard how the annual report is considered by many to be a valuable source of information. There is much benefit to be gained from having a single document which brings together information from across an organisation, some of which is subject to audit or assurance, all signed-off at the same time, and published on a regular basis. The positive aspects of the current regime must not be lost when formulating proposals for change.
13. We have also heard positive feedback on the progress made in recent years towards the integration of financial and non-financial information in annual reports. Indeed, the concept of integration has been highlighted as critical to the future corporate reporting. While much work is still be done to improve integration of information in annual reports, we believe it is important to build on the recent experience and best practice that has developed in this area.

ANSWERS TO SPECIFIC QUESTIONS

Question 1. What are your views on our proposals as a whole? Are there elements that you prefer over others?

14. Please see our comments in the key points section above.

Implementation

Question 2. What do you see as the key practical challenges of implementing our proposals? Do you have any suggestions on how these could be overcome? What do you see as the costs and benefits of the new model?

15. We believe a key practical challenge of the proposals would be the timescale required for implementation. The proposed model outlined in the discussion paper would require changes to be made to UK regulation, which can be a lengthy process. However, even before reaching the stage of regulatory changes being proposed, much more detail would need needed on the model, including how it is expected to work in practice and the associated costs/benefits.
16. In normal circumstances, a long timetable might be expected, and even desired, for major changes to corporate reporting. However, as noted in the key points section, the corporate reporting landscape is currently at a critical juncture with major reforms already expected as result of the Brydon review and developments relating to non-financial reporting. It is likely, therefore, that some aspects of the FRC's vision for future corporate reporting will be overtaken by these events.
17. Another challenge, as noted above, would be how the proposed model would interact with reporting regimes internationally. While we strongly support continued UK efforts to innovate and lead in corporate reporting matters, consideration must also be given to how more fundamental changes would interact at an international level.
18. Other practical challenges with the proposed model are highlighted, as relevant, in our responses to the remaining detailed questions below.

Objective-driven

Question 3. Should corporate reporting focus on a wider group of stakeholders through multiple objective-driven reports, instead of a primary user focused approach?

19. We agree that setting an objective for a particular type of report can be helpful for preparers in determining what information should be included. Additionally, as noted in the discussion paper, having a clear objective can be helpful for regulators when deciding on the location of new reporting requirements. However, we believe that setting objectives without a clear understanding of the primary user(s) of a report will be problematic. It may be that an objective is interpreted differently by different user groups, resulting in multiple and varied information needs. As a result, information may become diluted in the report and could even result in boilerplate information as companies seek to accommodate all stakeholders needs.
20. In our view, identifying the primary users of a report is essential to making assessments on materiality and understanding if the objective of the report has been met. Without this clarity, there is a risk of reduced clarity and comparability in reports.
21. It is also important not to lose sight of the fact that corporate reporting springs from the accountability in law of boards of directors to the company's owners, who have provided the equity capital and who hold power over that board as their agents. The board's legal obligations in respect of stakeholders' interests, on the other hand, are set by subject-specific laws such as employment or environmental law. Retaining the shareholder focus (as in the s172 statement) is critical, not least for capital markets, and there would be far reaching legal

implications if it were otherwise. Retaining this focus is also consistent with global developments in non-financial reporting, such as integrated reporting.

One set of principles

Question 4. Do you consider the set of principles (system level attributes, report level attributes and content communication principles) in section 2 would be helpful in improving the quality of corporate reporting today and in the future?

22. We broadly support the system level attributes, report level attributes and content communication principles set out in the discussion paper, although we have made some observations below:
    - We are not entirely clear what the difference is between the report level attributes and content communication principles as both concern reporting at the individual report level.
    - The communication principles of 'usefulness' and 'relevance' would depend on identifying the users for the report, which is not proposed under the objective-driven report model.
    - We question whether having a communication principle of 'brevity' is appropriate and suggest that 'concise' might be a better alternative.
23. More fundamentally though, we note that many of the principles and attributes in the discussion paper are broadly consistent with those recognised under the current reporting system. As a result, we believe it would be helpful to understand which principles are not being complied with under the current system or are not well understood, and to explore the reasons why. This might help identify any issues affecting the quality of reporting. For example, if the principles are clear, well-understood and appropriate, then non-compliance might have less to do with the principles themselves than how they are enforced.
24. We also recognise that the existing principles relating to reporting are predominantly focussed on the annual report, rather than across the entire reporting system. For example, they would not cover other types of communication from companies such as investor presentations. In many ways, there is already a 'reporting network' in the UK, but the underlying principles do not extend to cover all information reported within that network. It may, therefore, be more helpful to first consider how to improve consistency across the existing reporting system, as this may help go some way to address the issues highlighted in the discussion paper.

Reporting network

Question 5. Do you agree with our proposals to improve the relevance and accessibility of information, involving more concise reports distributed across a reporting network?

25. As a starting point, we agree that the corporate reporting system should be set up in a way which enables, rather than hinders, a company's ability to provide information which is relevant and accessible to users. However, we do have some concerns with the proposal for a reporting system comprised of a network of reports, as discussed below.
26. In particular, we are concerned that the proposed network model would result in a more fragmented reporting system. It seems that the proposed model might encourage silos to emerge, with different reports being produced by different internal teams, at various points during the year. We believe this would be a step in the wrong direction and would undo the good progress made in recent years towards greater integration and cohesion in the overall corporate reporting process. Other concerns include:
    - Increased risk of different messages being communicated in various reports, reducing overall consistency. This might be due to different teams working on reports or due to the timing of when reports are issued.

- Possible duplication of information between various reports. This might occur if companies do not have a clear idea of where information should be included, or where the same information meets the objectives of multiple reports.
- Increased chance of information being missed out completely. It may be more difficult for preparers to control and review the information provided across the entire network, resulting in omissions.
- Increased burden on reporting teams if the number and frequency of reports increases throughout the entire year.
- More difficult to hold the board to account if information is dispersed across different reports which are published at different points during the year.
- Reduced accessibility of information if users are required to access various reports in order to gather a complete picture of the company's activities. For example, would an investor now be required to refer to the Business Report, full financial statements, and other separate reports providing more detailed information on certain aspects of the Business Report?

27. We have also observed that the discussion paper does not make entirely clear where certain important information would be located within the proposed model. In particular, information on governance which is critical to an investor's understanding of a company. Similarly, we are unsure where information on sustainability reporting would sit. Greater clarity on how the network of reports, including the information to be included in the proposed mandatory reports, would have been helpful to better understand the proposed model.
28. We note that there will also be audit and assurance implications of the proposed model. For example, care would be needed when cross referring between reports which are subject to different levels of assurance. Developing and publishing an Audit and Assurance Policy – in line with proposals in Sir Donald Brydon's independent review into the quality and effectiveness of audit – may help in this regard. Implementation of Sir Donald Brydon's proposal would see audit committees publish a three-year rolling Audit and Assurance Policy, to be put to an advisory vote by shareholders and, in doing so, make audit and assurance activities more accessible, meaningful and educational for a broad range of users. Following an extensive programme of outreach with key stakeholder groups, we have found strong support for such a policy. An ICAEW report that makes recommendations and sets out actions that will be needed to implement such a policy is due to be published in March 2021.
29. We do, however, support the proposal that standing data might helpfully be reported outside of the annual report. ICAEW has long called for greater flexibility in this respect and has suggested, for example, that such information might be better placed on a company's website.
30. Overall, while we agree that there are many challenges to the current reporting system, as highlighted in the discussion paper, there are also many strengths. Indeed, we understand that many users highly value the annual report and accounts, which has undergone a rigorous process of production, with some parts subject to audit or assurance, and bringing together different parts of the company with the shared goal of producing a single document once a year. The benefits of the annual report should not be forgotten when seeking to address the challenges it faces.
31. With this point in mind, we would also encourage wider use of audit and assurance over financial and non-financial information outside of the annual financial statements. In our response to the Call for Views published on 10 April 2019 by Sir Donald Brydon's Independent Review into the quality and effectiveness of audit, we describe a 'strong case for assurance over such information', recognising that it would enhance its reliability and therefore be of benefit to investors, as well as other users.

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Materiality

Question 6. We are proposing that there should no longer be a single test for materiality that is based on accounting standards but instead materiality will be dependent on the objective of a report. Do you agree with this approach, please explain why?

32. We have some concerns with the proposal that materiality for each report would be judged with reference to the objective of that report. In our view, it will be difficult for preparers to identify what information, and the level of detail, is necessary to meet the objective of the report, without having identified the user(s) for the report.
33. While we accept that different materiality thresholds could be applied to different types of report according to the end user, we do not agree it is helpful to have different 'definitions' of materiality for different reports based on the objective of that report. In our view, this will add complexity to the reporting system for both preparers and users.
34. As an alternative, we suggest that the FRC explores the approach to materiality set out in the Statement of Intent to Work Together Towards Comprehensive Corporate Reporting issued by the CDP, CDSB, GRI, IIRC and SASB in 2020. This statement makes a distinction between users with various objectives who want to understand a company's positive and negative contributions to sustainable development; and a sub-set of those users whose primary objective is to improve economic decisions. In our view, this approach provides a useful way to understand how the objectives of different user groups could be accommodated within a broader corporate reporting system, while still having providers of financial capital as the primary user group for the annual report.
35. We also note the proposal to introduce network materiality which would require companies to consider information at the reporting network level to ensure that the network as a whole is complete. As noted in our response to question 5, we believe the risk of information being omitted across the network is increased under the network report model. Assessing network materiality will not be a simple task and would likely place a disproportionate burden on companies.

Non-financial reporting

Question 7. Do you believe that there is a need for regulatory standards for non-financial reporting? If so, what do you consider the scope of the information that should be covered by these standards?

36. As discussed in our recent comment letter to the IFRS Foundation's consultation paper on sustainability reporting, we believe there is a pressing need for the development of a global set of high quality, authoritative non-financial reporting standards. In our letter, we outlined our support for the IFRS Foundation's proposal to establish a Sustainability Standards Board (SSB) which would set sustainability reporting standards. We also note that the UK Government has publicly supported the IFRS Foundation's proposals and that the Foundation plans announce more detail on its plans over the course of 2021.
37. Regarding scope, in our response to the IFRS Foundation we agreed with its proposal that the SSB should start by developing a sustainability reporting standard on climate-related disclosures. However, we also noted that a standard on climate-related disclosures should not be produced in isolation, particularly as climate is related to many other sustainability topics such as water, biodiversity and inclusion.
38. We believe the scope of information that should be covered by non-financial reporting standards requires further research. If plans to establish a SSB go ahead, we believe it will be important for this new body to set out a 5-year plan, explaining what standards it expects to produce, including in what order, the matters to be covered, and its proposed timetable. This plan should also set out any priority areas and which topics require further research.

Question 8. Do you agree with the need for companies to provide information about how they view their obligations in respect of the public interest?

39. We agree that there is growing demand for companies to provide information to a wider range of stakeholders with details of their obligations in respect of the public interest. Indeed, Sir Donald Brydon's recommendations, issued in December 2019, suggested that 'directors present an annual Public Interest Statement, which explains the company's view of its obligations to the public interest, whether arising from statutory, self-determined or other obligations, and how the company has acted to meet this public interest over the previous year.'
40. We broadly support these developments and will be responding to the forthcoming BEIS consultation paper on corporate governance and audit reform in due course.

Question 9. Do you agree with the introduction of a Public Interest Report and the suggested content as set out in Section 6?

41. The discussion paper proposes that the objective of the Public Interest Report would be to provide information that enables users to understand how the company views its obligations in respect of the public interest, how it has measured its performance against those obligations and its future prospects in this area. The report would focus on how the business interacts with the ecosystem in which it sits and provide information about how it interacts with its stakeholders.
42. While we broadly agree with this proposal, we have not yet explored the proposed content in detail. That said, on initial review, it seems that much of the proposed content of the Public Interest Report might also be of interest to users of the Business Report, resulting in duplication across the network. As discussed elsewhere, further consideration should be given to the need to identify users of specific reports and also the approach to materiality.
43. Broadly speaking we believe it would be helpful for the FRC to wait for the outcome of the BEIS consultation before progressing any proposals regarding the Public Interest Report. Similarly, it may be helpful to reflect on the requirement for certain companies to produce a s172 statement as part of these deliberations. This could include a review of the level and quality of information produced by companies and any emerging best practice.

Technology

Question 10. Do you see any other ways that current and new technology could be used to facilitate the proposed model, and support the system level attributes of corporate reporting identified in section 2?

44. While we are not able to comment at this time in detail on what current and new technology might facilitate the proposed model, we do suggest that a broader view should be taken, looking beyond technology relating to structured data ie, tagging. That is not to say that tagging of information in corporate reports is not useful, but we had expected this paper to push the boundaries further. For example, consideration of the implications of technology that permits continuous reporting, or technology which can present or extract information in a new and efficient way.
45. The work of the FRC's Financial Reporting Lab might helpfully be drawn on here, for example with their work relating to AI and VR. We also suggest that the FRC engages with the technology sector more widely to consider the potential and impact of technological developments on corporate reporting in the longer term.

Proportionality

Question 11. Do you agree that the model we propose will achieve a proportionate reporting regime for companies of different sizes and complexity?

46. While our initial thoughts are that the proposed model would be challenging for even the largest companies to implement, we believe more detail is needed before being able to comment more conclusively on whether or not it would be sufficiently proportionate.
47. More broadly, we agree that corporate reporting regimes must be proportionate for companies of different sizes and complexity and welcome the FRC's consideration of proportionality within this project.

Other

Question 12. What other areas do you see being necessary or relevant to the development of a model for corporate reporting that is fit for the future?

48. The focus of the discussion paper is on larger companies, and in particular public interest entities. However, for a model of corporate reporting to function well, consideration must also be given to how it would work for small and medium-sized companies.

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