A MATTER OF PRINCIPLES

THE FUTURE OF CORPORATE REPORTING

FINANCIAL REPORTING COUNCIL

DISCUSSION PAPER

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JOINT RESPONSE FROM:

United Kingdom Shareholders' Association

&

UK Individual Shareholders Society

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The future of corporate reporting

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1. Introduction

1. We welcome the FRC's initiative to conduct a major overhaul of corporate reporting. This is long-overdue for all the reasons stated in the discussion paper. We also applaud the discussion paper itself which provides an excellent basis for prompting a thorough debate among all potential stakeholders about the scope and opportunities for the reform of UK corporate reporting, as well as the practical implementation issues needed to make it 'fit for purpose'.

2. We have summarised below the key suggestions which we strongly support. We recognise that the discussion paper is a means of gauging reaction from stakeholders to possible opportunities for change and that the development of practical, implementable proposals for change will be the subject of further work. We have also highlighted a few areas in which we believe more thought is required. There are a few areas which are not touched in the discussion paper but which we believe need to be brought into the debate.

3. Subjects which we believe are well explored in the discussion paper include:

    3.1. The need for a more flexible reporting framework which reflects the differing information needs of a wide range of stakeholders. Regardless of views on who the primary stakeholders are, it is important that corporate reports are structured, presented, and written in a way which makes it easy for all stakeholder groups to access, understand and use the information they need. At the same time, there is a need to minimise repetition while also ensuring that information is complete and coherent.

    3.2. We believe that the revised network of reports with the mandatory Business Report at its core is the right starting point. At the centre of the Business Report should be the Business Model Report. If this is badly articulated it becomes impossible for shareholders to make judgements about the longer term sustainability of the business and the true impact of risks discussed in the risk report. It will be important that any developments in corporate reporting are more user/stakeholder led than preparer led. There will be a need for preparers to engage properly with stakeholders to ascertain what they should be reporting.

    3.3. We strongly support the principle that reporting should be 'communication focused'. Much of current non-financial reporting fails miserably in this respect. The content communication principles described in Section 2 of the discussion paper provide a sound basis for developing guidance to ensure that future reporting is clear, concise, appropriately brief but comprehensive, relevant, free of boilerplate and consistent in its use of terms and metrics. It also has to get the balance right by providing information and conclusions and not just quantities of data from which users have to make their own minds up on what it is telling them.

3.4. The points about materiality are well made. A one-size-fits-all approach to corporate reporting is an incitement to companies to publish worthless compliance boilerplate while chasing meaningless tick-in-the-box targets. For example, in environmental and climate reporting the issues that investors want to see considered and if possible addressed will be very different for companies involved in, say, high-temperature processing (glass manufacture or steel-making) from those involved in, say, food retailing (supermarkets).

3.5. We like the idea of having regulatory standards for non-financial reporting. Enormous effort has been put into creating regulatory standards for financial reporting over many years. The way in which non-financial information is currently presented is a free-for-all. The introduction or regulatory standards will be helpful in:

a. Developing detailed guidance and principles on how non-financial information should be drafted and presented so as to ensure that it meets the needs of investors and other stakeholders.

b. Ensuring consistency and comparability between those using the same standards.

c. Providing a system of oversight which ensures that principles are applied and standards maintained.

d. Ensuring that the standards remain under review so that non-financial reporting can be further improved over time.

3.6. We strongly support the view that corporate reporting should be 'digital by default'. The current system which involves digital presentation of content that was designed for paper is very unsatisfactory. However, we also recognise that:

a. Digitisation of material such as company reports is still in its infancy. The technology is likely to develop rapidly in coming years bringing further opportunities for improvement. It is important that this development is planned for and encouraged.

b. For the time being, the limitations of digital reporting mean that the ability to revert to paper copy remains an essential prerequisite for many private investors. They do not enjoy the benefit of sophisticated

IT support and find paper copy indispensable when, for example, preparing for and attending AGMs.

4. We are less convinced by:

    4.1. The commentary on KPIs in the discussion paper. More thought is needed on how corporate objectives are defined and articulated and how the chosen KPIs support the achievement of objectives.

    4.2. The need for a Public Interest Report which aims to do more than bring together content which already exists in the annual report, such as Section 172 reporting and certain elements of ESG reporting. We do however, like the idea of putting this existing content into a separate Public Interest Report within the wider reporting framework.

5. Two areas in which we would like to see clear proposals are:

    5.1. The integration of the proposed new format for reporting into the wider corporate reporting landscape; this includes AGMs, interim reports and, possibly, other periodic reports. We are mindful of the fact that the FRC is already looking closely at these components of corporate reporting. However, there is a need for a holistic and integrated approach to the reform of corporate reporting.

    5.2. A plan of action for the reform of corporate reporting. We believe that the FRC's view that the overhaul of corporate reporting will be a ten-year project is pragmatic and appropriate. It is also going to be a complex project with a need for constant monitoring to ensure that the changes made are having the intended outcomes. We accept that a 'plan of action' would have been premature in the discussion paper. However, it will be a vital next step.

6. Our answers to the specific questions in the discussion paper are shown below in Section 12 of our response.

2. About UKSA and ShareSoc

7. **UKSA (UK Shareholders' Association)** is the oldest shareholder campaigning organisation in the UK. We are a not-for-profit company that represents and supports shareholders who invest in the stock market.

8. There are many agents and intermediaries active in financial markets. Unlike them, we are an organisation solely representing people who are investing their own money.

9. UKSA was formed to provide private shareholders with a voice, influence and an opportunity to meet like-minded fellow investors. It is structured as a non-profit making company with annual subscriptions. An elected Chairman and Board of Directors (all volunteers and individuals with a wide range of backgrounds and experience) monitor a regional organisation. Each region benefits from oversight by an elected regional Chairman and Committee.

10. As a voice for individual shareholders, we develop relations with regulators, politicians and journalists to ensure that individual shareholders' voices are heard as law, regulation and financial markets develop.

11. **ShareSoc (UK Individual Shareholders Society)** is the UK's largest retail shareholder organisation, acting in all areas of the UK stock market, with more than 7,000 members. It is a not-for-profit company.

12. ShareSoc is dedicated to the support of individual investors (private shareholders as opposed to institutional investors). We aim to make and keep investors better informed to improve their investment skills and protect the value of their investments. We won't shirk from tackling companies, the Government or other institutions if we think individual shareholders are not being treated fairly. See www.sharesoc.org

3. Answers to your numbered questions

Q1 What are your views on our proposals as a whole? Are there elements that you prefer to others?

13. In principle we commend the main proposals that the FRC makes. In particular we welcome:

    13.1. Looking at corporate reporting holistically.

    13.2. The development of a new framework for corporate reporting focusing on system level attributes, report level attributes and content communication principles.

    13.3. Acknowledging that corporate reporting should meet the needs of multiple stakeholders. However, we believe that further thought and debate is needed in this area, particularly with regard to the identification and prioritisation of stakeholders. We comment in more detail on this in our response to Question 3 below.

    13.4. Moving away from the paradigm of a single report and replacing it with a reporting network so as to better meet the differing needs of different stakeholder groups.

    13.5. Designing the system for digital reporting as the primary mode of communication, unlike the present system which assumes a paper paradigm.

14. While there are no specific elements that we prefer we believe that:

    14.1. The implementation of many of the proposals will be a gargantuan task; there will need to be a clear plan of action for achieving the proposed reforms. The proposed ten-year timescale for achieving reform makes the requirement for a robust plan of action particularly important.

    14.2. The future of corporate reporting needs to be set within the wider context of reforms to the AGM (already under way by the FRC) and other aspects of communication between companies and their stakeholders.

Q2 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 consider that more attention needs to be given to the following factors.

Definiteness

16. At present, there is a clear process for the approval of a company's annual report, including the application of a wet ink signature, and its issue to members.

17. Digital reporting needs to build in similar processes so that there is no doubt what is the company's Business Report, Public Interest Report, and Financial Statements for a particular period. That should include verifiable electronic signatures, and the legal obligation for such reports to be uploaded to a central repository with the company having no further capability for removing the report from the central repository or amending it. Such central repository needs to be freely accessible to all citizens.

18. The issue becomes even more critical with the peripheral items in the reporting network, namely the Supporting Detail, Standing Data, etc.

Directors' certification

19. The reporting framework needs to specify the responsibility of the company's directors for each part of the reporting network, and the penalties for negligent or fraudulent reporting.

Auditor involvement

20. Clear rules are needed regarding the extent to which the auditor provides any form of assurance regarding reports beyond the Financial Statements.

21. Our preference is to have the auditor engaged to some extent with all reporting by the company, albeit with varying levels of auditor assurance depending upon the reports concerned.

Quality and usefulness of current narrative reporting

22. Much of the narrative / non-financial content provided by most companies is currently very poor. An enormous amount of work will be required if the principles set out on Page 12 of the consultation document under Content Communication Principles are to be met. In particular, most reports fall well short of the most basic standards on brevity, comprehensibility and usefulness

in areas such as the business model report, the wider strategic report, environmental reporting and, often, risk reporting.

23. Much of what is currently presented is either compliance boilerplate, promotional 'puff', waffle or obfuscation. Much of it is unenlightening and some of it is patronising. KPIs often bear little direct relation to strategic objectives which themselves are very poorly articulated. Risk reports are often little more than a random list of uncertainties with little real thought given to the true risks facing the company, the likelihood of them materialising and their potential impact (other than high, medium or low). Aided, it seems, by lawyers and compliance experts, far too much corporate reporting manages to tell the truth and nothing but the truth but fails to tell the whole truth.

24. Reporting on matters of corporate governance, the work of the audit committee and on Section 172 issues is often process-driven with little reference to outcomes and barely any attempt at answering the 'so-what?' question. There are fundamental cultural issues here which will need to change if the quality and usefulness of non-financial reporting is to improve. We consider some of these issues further in our responses to Questions 4, 5 and 7 below.

Q3 Should corporate reporting focus on a wider group of stakeholders through multiple objective-driven reports, instead of a primary-user focused approach?

25. While we applaud the proposal that corporate reporting should meet the needs of different stakeholders we believe that its primary aim should still be to meet the needs of investors and others with very similar interests. The discussion paper correctly acknowledges that the main purpose of corporate reporting is to enable stakeholders to:

    25.1. understand the company performance and how it generates and sustains value,

    25.2. make decisions, and

    25.3. hold the company (and management) to account.

26. We believe that in seeking to achieve this purpose the shareholders should be seen as the priority stakeholders. While it is entirely appropriate that corporate reporting should be useful to other stakeholders, it cannot be all things to all stakeholders and it needs to be recognised that for many other stakeholders specific channels of communication already exist.

27. Employees, for example, have their own specific communication requirements for which there is already provision in the vast majority of organisations. Similarly, while customers may want of check the financial viability of a company as a potential supplier, many will buy off-the-shelf reports from organisations such as Dunn and Bradstreet

28. It was suggested within the UKSA team that the state should be ranked first amongst stakeholders because:

    28.1. it is the state that enables the company to come into existence,

    28.2. the company is primarily a legal entity and

    28.3. the state needs to be able to ascertain whether the company is complying with its many legal requirements.

29. Although this may be true, we concluded that it did not justify making the state the primary stakeholder in corporate reporting. It was also felt that the concept created serious risks for the reform of corporate reporting. We already have a situation in which corporate reporting consists of far too much compliance content which serves only to meet a legal requirement. Making the state the primary stakeholder could add to the scope for further legalistic obfuscation in corporate reporting.

30. In other areas, the state and its agencies, such as HMRC, will have an interest in the financial affairs of the company but these agencies nearly always have their own formal and informal lines of communication into companies, some of which may also have legal backing.

31. Other members of UKSA and ShareSoc made it clear that they saw the shareholders as being the primary stakeholder in corporate reporting because, as suggested in paragraph 18 above, corporate reporting exists primarily to ensure they receive the information they need as investors. What is useful to shareholders as providers of the ultimate risk capital should also cover most of what will be useful to other stakeholders.

32. In Appendix 1 we have included a list readily identifiable stakeholders. This includes the media and, in particular, the many financial journalists who do excellent work in helping to hold companies to account, exposing poor governance, bad practice and egregious behaviour as well as simply reporting on company performance. The media provides an important information channel to another stakeholder group, namely ‘wider society’. In Appendix 2 we have given a few examples of recent press comment on Rolls-Royce which summarise more clearly and succinctly the business model for aero-engines than the Company’s 2019 annual report manages to. Rolls Royce is not alone

in this respect. It is a poor reflection on company management that the media is left to articulate their business model for them in a form that is accurate an intelligible.

33. We strongly support the suggestion in the discussion paper that corporate reporting should be ‘communication focused’. Regardless of whether some stakeholders rank above others and regardless of their interests, corporate reporting must present information so that it is as easy as possible for users to understand, assimilate and use. The content must be structured in such a way that it is easy for users to find their way around and identify the topics that are of interest to them (newspapers are very good at this). This should include providing appropriate links to related content so that users can move easily from one section of the report to another (or to a separate report) and back again. We comment further on this in our response to Question 4 below.

Q4 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? (p 11&12)

34. We believe that the principles set out on pages 11 and 12 of the discussion paper are appropriate and would help greatly in improving both the quality and usefulness of corporate reporting. We have a number of comments in respect of each of the three areas as follows:

    34.1. **System level attributes**: we certainly applaud greater consistency of terminology. There is every reason to expect individual companies to use terminology consistently across their own suite of reports and in any subsequent reporting. Achieving consistency of terminology across all companies is likely to be more difficult to achieve and in some cases inappropriate. The important requirement here is that if companies are using certain terminology in a way that is peculiar to them or their industry then this should be clearly explained

    34.2. With regard to KPIs, these will vary from company to company and it is very likely that the same terminology will, for some measures, mean something different from company to company. In this case it really is best if individual companies are required to state what is meant by a particular KPI and how it is measured. It is also important that companies should make it clear:

    - if they have changed the definition of a particular KPI or the way it is measured; if so they should explain the reason for the change;

- if they have added a new KPI, deleted an old one or replaced an old measure with a new one; again, reasons for changes should be given;
- if they relate to any disclosed audited financial statements transactions or balances, they are reconciled to these.

34.3. We comment further on the use of KPIs in our response to Question 7 and in Appendix 2. KPIs should relate to strategic objectives. KPIs are nothing more than a way of monitoring progress towards the achievement of objectives. Consequently, without clear objectives KPIs tend to be meaningless. Much company reporting fails miserably on this count.

34.4. **Report level attributes:** we agree with the requirements set out in the discussion paper.

34.5. **Content communication principles:** we strongly support the principles set out in the discussion paper. However, we suspect that the implementation of these principles and the change of culture they require is going to prove difficult. The task should not be underestimated. We discuss this further in our response to Question 7 below.

34.6. While we commend the work that the FRC has undertaken for the discussion paper, much more work will be required to develop clear guidance for preparers of reports. This will include specifying the various reports, the recommended processes, and the legal changes required in order to make the new system function properly.

35. Appendix 3 contains notes submitted by UKSA member Dr Nick Steiner in which he comments specifically on the findings of other work carried out by the FRC (Citizens Juries) looking at the relevance and ease of use of current corporate reports.

Q5 Do you agree with our proposals to improve the relevance and accessibility of information, involving more concise reports distributed across a reporting network?

36. Nobody could object to the goal of improving the relevance and accessibility of information and making reports more concise.

37. One UKSA member who is a serious user of company reports commented that the proposals in the discussion paper seem to suggest more content rather than less and feared that we might end up with the corporate reporting

equivalent of the Encyclopaedia Britannica. We take his point, although, perhaps paradoxically, it would be helpful if corporate reporting took a few cues from the Encyclopaedia Britannica; it was clear, well structured, provided the key information the user needed, stuck to facts rather than its own opinions and was easy for the reader to find their way around. It will always be important to ensure reporting gets the balance right; provides information and conclusions and not just quantities of data from which users have to make their own minds up on what it is telling them.

38. Currently, there is far too much repetition in corporate reporting which contributes to a bewildering lack of structure. Most annual reports contain a chairman's statement, a CEO's review and then a financial review from the CFO - often unhelpfully divorced from the financial statements by reporting on corporate governance, the work of the nominations committee, the report of the audit committee and (in many cases) an impenetrable door-stopper of a report on directors' remuneration. UKSA member Phil Clarke, who makes extensive use of corporate reports when preparing to attend AGMs, gave us similar feedback. The notes from Dr Steiner in Appendix 3 also support these views.

39. Work will inevitably be needed to decide how reporting should be restructured and, at the same time, how irrelevant and duplicated content can be eliminated and avoided. Similarly the framework of mandatory and voluntary reports and the content that should go into each need to be discussed in more detail and agreed.

40. We also recognise that the way the reporting framework integrates with company law, as well as the necessary changes to company law and the reporting and audit processes will need to be fleshed out in much more detail before any change can be contemplated to what is done today.

Q6 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.

41. We agree wholeheartedly with the FRC's 'overarching principle' for materiality (Discussion paper sections 4.3 and 4.4). We also agree that there is a need to disclose the basis of materiality judgements. For example, much risk reporting, as evidenced in Appendix 2, is based on management judgements about perceived 'uncertainties' rather than on any analytical assessment of 'risk'. Often there is no clear justification for management's prioritisation of uncertainties. Too often they look like a 'laundry list'.

42. We also agree that materiality may need to be defined differently for each report in the reporting network. In this respect it will be essential to prescribe the materiality test for each part of the network and to promulgate that as part of any change to the proposed new system.

43. However, while you say you believe materiality as a concept is reasonably well understood, we are mindful that determiners of what is material appear to fall into the trap of only using it quantitatively and thus miss qualitative issues because they cannot be counted or precisely quantified.

Q7 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?

44. Any new reporting framework should prescribe what companies say in their non-financial reports, and set out appropriate requirements for auditor assurance, in the same way that rigorous constraints apply to what can be said in financial statements.

45. As already mentioned above, much non-financial reporting is at present very unsatisfactory. Much of the content is seemingly constrained only by the need to avoid making statements that the auditors would consider to be categorically untrue. Sometimes it seems as if every element of content in any corporate communication, no matter how innocuous, mundane or anodyne, has been shaped by an over-zealous desire to achieve complete legal compliance (Appendix 4). Moving from this to a situation in which companies publish information that meets the content communication principles set out in the discussion paper is going to be a major task.

46. One of the key concepts of the FRC's proposed reform of corporate reporting is that the Business Report is central to the usefulness of the whole network of reports that is proposed. The discussion paper proposes that:

> *'The Business Report would provide information that enables users to understand how the company creates long-term value in accordance with its stated purpose'.*

47. However, much business reporting, including the business model report, the strategic report and other supporting content, provides little meaningful insight into how individual companies really create value in accordance with their stated purpose. Appendix 2 provides an example. For the business report to be of value to users this has to change. This can only happen if clear standards are set and enforced.

48. The areas of non-financial reporting that should be covered by regulatory standards include:

49. **Narrative content:** This includes:

    49.1. Reporting on matters relating to the environment, governance, risk, Section 172;

    49.2. all narrative content which is used to support financial reporting; for example, it should not be possible (as in the case of Carillion) for the Chairman's or CEO's statement to give an upbeat assessment of the outlook for the company while the financial statements on close inspection provide a much less positive outlook

50. **KPIs**: these are a particular problem. Often they appear:

    50.1. inconsistent (see Q4 response above);

    50.2. to bear little real relationship to corporate objectives;

    50.3. unclear in terms of the method and rigour of measurement and,

    50.4. irrelevant in terms of the benefits derived from achievement of the target.

51. All too often it seems that KPIs are chosen largely because they provide a basis for setting undemanding targets which trigger large bonuses for senior management.

52. More though is needed on KPIs. The discussion paper mentions, for example, the possibility of having KPIs for:

    52.1. Hours of training undertaken, and

    52.2. Percentage of employees completing training programmes.

53. It is suggested that these KPIs are 'outputs'. In reality, they are 'inputs'. They tell us nothing useful about their purpose or whether they were effective in achieving benefit for the company and its stakeholders. True, the discussion paper goes on to list a number of 'outcomes' and 'impacts' flowing from training but in reality many of these (for example, 'Measurement of estimated future uplift in lifetime earnings as a result of training') are almost impossible to measure with any degree of certainty.

54. Another UKSA member commented adversely on the metrics-examples given on page 26 of the discussion document, saying:

> "*That is a great example of a fatuous set of reporting – it would be a massive imposition to report that data, immensely expensive to collect, it would drive perverse behaviours and not benefit anyone (other than the hordes of consultants lining up to assist with new reporting requirements)".*

55. **Corporate objectives**: We note that the discussion paper in Sections 6.9 and 6.10 makes no reference to objectives and objective-setting. As already mentioned, KPIs are simply a way of measuring progress towards objectives. The starting point for setting KPIs is always the definition of clear objectives and as such they require regulatory standards.

56. **Internal controls**: We would also like to see meaningful reporting on internal controls. This also should be covered by regulatory standards. Both Sir John Kingman and Sir Donald Brydon commented on the development of a reporting framework based on some of the principles of the Sarbanes Oxley regime in America. Sir Donald recommended that:

    "*The CEO and CFO provide an annual attestation to the board of directors as to the effectiveness of the company's internal controls over financial reporting and that this attestation be guided by new principles on internal controls reporting to be developed by the Audit Committee Chairs Independent Forum and endorsed by ARGA.*"

Q8 Do you agree with the need for companies to provide information about how they view their obligations in respect of the public interest?

57. It is hard to argue with Sir Donald Brydon's proposal that:

    "…the directors should set out in a Public Interest Statement…how they view the company's legal, financial, social and environmental responsibilities to the public interest. This Statement should explain how the company has discharged its self-declared public interest obligations and responsibilities, what actions it has taken to mitigate any externalities it has caused during the period, and how effective these actions have been."

    To some extent this should be covered by the Section 172 statement.

58. We also support the FRC's proposal that this should be a separate report from the proposed 'Business Report' and the 'Financial Statements'. Handled correctly this should:

    58.1. Provide a better framework for reporting on matters such as ESG and sustainability issues as well as 'people-related' issues and wider corporate governance issues including action taken to comply with concerns about bribery and modern-day slavery and the protection of whistle-blowers.

58.2. Make it easier to provide appropriate links for users between references to these issues in, say, the Business Report and more detailed analysis and explanation in the Public Interest report.

58.3. In the light of the above, make it easier for readers to navigate their way around the information contained in the whole suite of reports.

58.4. Help to avoid some of the repetition that occurs in much reporting at present; there is, however, a risk that if badly handled it could increase repetition, incoherence (between reports) and general confusion and obfuscation.

59. We have serious doubts about the proposals in Appendices 6 and 7 of the Brydon review which look as though they could involve an enormous amount of additional work – for example, the requirement that directors would have to give an account of how they had balanced and prioritised the conflicting requirements of different stakeholders when making strategic decisions.

60. We believe that much more work is needed to define the exact nature and content of the Public Interest report to ensure that it really is helpful and useful.

61. Some of our members have commented that the only public interest obligation of companies is to comply with the law. Beyond that, they say, it is for companies to decide how to conduct their business, taking into account the impact on the attitudes of existing and potential employees, customers, suppliers, and shareholders.

62. They consider the concept of any public interest reporting to be entirely otiose, except to the extent that the company wishes to create a marketing document, noting that companies often give to charities in a very public manner as a way of soliciting the approval of customers, employees and society at large.

63. While UKSA does not necessarily agree with these views, we firmly believe that the introduction of public interest reporting should not be allowed to become a platform for corporate virtue-signalling.

Q9 Do you agree with the introduction of a Public Interest Report and the suggested content as set out in Section 6?

64. As stated above in our response to Question 8, we see merit in bringing together in a Public Interest Report issues that are already covered in the

existing annual report, such as Section 172 reporting and certain elements of ESG reporting. We are comfortable with Sir Donald Brydon's concept of a Public Interest Statement and believe that this might possibly provide a framework for a Public Interest Report. However, we do not support the idea of introducing even more public interest content into corporate reporting.

65. We are not opposed to companies providing additional public interest reporting if they wish to. This could be published at any time during the year or even at intervals of two or more years as appropriate. We would expect it to conform to certain minimum regulatory standards (as would apply for all non-financial reporting).

Q10 Do you see any other ways that new technology could be used to facilitate the proposed model, and support the system level attributes of corporate reporting identified in Section 2?

66. As mentioned above, we support the concept of "Digital by Default." However, if the proposals are to succeed, we consider that two things are required:

66.1. A standard technical specification for the digitisation of company reports; this should apply to all listed companies and should cover all aspect of the annual report and interim reports. The aim must be to ensure that common standards are adopted from the outset.

66.2. A clear technical specification for reading technology required by stakeholders to access the digitally published company information. The specification must ensure that the software is:

- Readily available;
- Inexpensive;
- Easy to download, install and use;
- Appropriately reliable and secure (e.g. tamper-proof)
- Compatible with other commonly used software on such as MS Windows as well as the standard software used on Apple computers, Android and iOS tablets and phones.

67. This specification should envisage and meet the needs that most users are likely to have for the foreseeable future. These are likely to include:

67.1. The ability to print digital information onto paper,

67.2. The ability to add notes and comments in the margin of the digital copy (similar to the comments option in the Review facility in MS Word) so that users can annotate their digital copy as an 'aide memoire' for asking questions at the AGM. Ideally, it should be possible for the user to enter all their questions / comments onto a single ‘notes page’. By clicking or tapping on any item on the notes page they should be able to go directly to the relevant section of the company report which would also show (in the margin) any other notes or comments they had made.

68. The technical specification must not constrain:

    68.1. Further ongoing software development for the digitisation of company reports or their use by stakeholders;

    68.2. Innovative developments from publishers and creators of digital reports and information. However, there must remain a common base so that all readers can sensibly access information published by all companies.

    68.3. The ability of users with older software to access digital company reports and continue using certain basic features and functionality.

69. It cannot be left to companies to devise their own standards. This is likely to result in unnecessary cost and complexity and could also threaten the quality information provision.

70. While the long-term objective should be to phase out paper reports, there must be an appropriate period of time (perhaps ten years) during which those who wish to continue receiving paper reports can do so. As one of our members has commented, there are many private investors for whom the convenience and practicality of a paper report remains indispensable – particularly when they are attending AGMs. These people are often doing their analysis unaided from their spare bedroom. They do not have the support of a well-resourced IT department that a professional analyst or fund manager can rely on.

71. Any review of the ongoing use of paper is undoubtedly clouded by the fact that almost everything that is produced by companies at present is designed to be read and used in paper format. Many of the features that lend themselves well to the publication of information in paper format do not work well in a digital format. As new formats designed specifically for digital reporting emerge and their benefits become clear even those who thought they would never be able to dispense with paper may be willing to reconsider.

72. Further comments on the use of paper and digital reports are include in Dr Steiner’s commentary in Appendix 3.

Q11 Do you agree that the model we propose will achieve a proportionate reporting regime for companies of different sizes and complexity?

73. If properly implemented to reflect our concerns above, we see no reason why this approach could not be used for all listed companies, irrespective of size.

Q12 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?

74. The annual report is an integral part of a wider corporate reporting framework which includes the AGM and other reports such as interim reports, trading statements, profit updates and profit warnings. It is important that corporate reporting is considered holistically and that the annual report is designed to support and enhance the benefits that investors and others derive from the AGM and other communications from companies. This is an issue that has already been formally raised by the FRC's working group on AGMs. We note also that FRC is also currently looking at the issue of interim statements.

75. Section 7 of the discussion paper focuses heavily on the use of technology to support and enhance traditional methods of corporate reporting. There is an important need, however, to look beyond this. Online AGMs are now a reality but are in their infancy. It is not fanciful to believe that in the not-too-distant future it will be possible for stakeholders to join an AGM on a virtual reality basis or vote directly on general meeting resolutions online. In the longer term this could open up other opportunities for closer direct engagement between stakeholders and a company's business activities and operations. This may not be appropriate for all businesses but for some (and the investors) it could be useful. The potential longer-term opportunities offered by technology should at least be considered. Dr Steiner's notes in Appendix 3 include further, detailed observations about the role of the AGM and it links to the whole corporate reporting regime.

76. There will also be a need to ensure that corporate reporting cannot use confidentiality and commercial sensitivity or similar excuses to hide or obfuscate matters. Any corporate reporting standards will need to require that any use of such excuses be properly explained.

77. We note the ten-year time frame that the FRC is suggesting for the reform of corporate reporting. This reform is a major undertaking and the ten-year time frame looks realistic and pragmatic. However, as with any major project running over a ten-year period (or possibly more) there are major complexities and many uncertainties. We would like, therefore, to see an outline plan showing the key stages of the project and how it will be implemented and managed.

78. The aim of the plan should be to consider how the proposals in the discussion paper can be developed to a point where they are implementable This will

include specifying the proposals much more precisely, identifying the legal changes required before they can come about, and specifying the technology standards for companies which create reports – as well as technology standards to enable stakeholders to access the information published - in an appropriate manner.

4. Appendix 1

Summary of key stakeholders

Stakeholder	Needs that corporate reporting should meet
The state. We include the state because it is the state that enables the company to come into existence, in that the company is the creature of law. We also include here agencies of the state such as regulators, HMRC and organisations such as the Pension Protection Fund. These all have important stakes in the quality and usefulness of corporate reporting.	The state needs to be able to ascertain whether the company is complying with its many legal requirements and take sanctions against it for failure to do so. Agencies of the state also have a legitimate interest in the company's on-going ability to meet its obligations to them.
The shareholders. It is shareholders who provide to the company capital that is at greatest risk, who have the residual claim on the company's assets once all other obligations have been satisfied, and who elect the directors and auditors. While legally shareholders own nothing other than their shares, it is broadly accurate to describe shareholders as the owners of the company.	Shareholders need to be able to assess the quality of stewardship provided by the directors they have elected. In the case of listed entities, shareholders need information to enable them to decide whether to retain their shares or to sell them. Shareholders also need their auditors to consider their interests first in providing assurance on financial statements or other reports they are asked to audit.
The Lenders. In this category we include banks, bondholders and other providers of capital who are not equity shareholders and who are not, therefore, owners of the company but may still have a significant financial stake in the business.	Lenders want to know that the capital they have provided to fund the business is safe, that interest payments will be made in full on the due date and that the principal will be repaid in full as agreed
The trade creditors. In this category we include all suppliers of goods and services including, for example, landlords.	Trade creditors need to be able to assess whether the company will be able to pay them under the terms agreed in their supply contacts.

The customers. Customers and suppliers often have symbiotic dependencies on each other. From the outset customers will want to be assured that suppliers have the financial strength to supply their needs.	Customers want to know that they have a viable source of supply. This is particularly true when a customer is heavily dependent on a supplier - for example, sole-supply of critical components, supply of unique services / products, relationships involving shared business knowhow and IP or where the customer has funded specialist tooling for a supplier.
The Directors. Although the directors are employees of the Company (see Employees below) we have identified them separately because, as the officers of the company, they have specific legal obligations under the Companies Act 2006 to the shareholders and other stakeholders.	The directors have an obligation to ensure that the company operates within the law and that it is able to demonstrate that it is doing so. The directors are also responsible for the stewardship of the company and are answerable to the shareholders in this respect. The directors are responsible for the Company's corporate reporting and for its fairness and accuracy.
The employees. Employees undoubtedly have an important 'stake' in the company. For most, the company provides them with a livelihood which enables them to meet day-to-day financial commitments and obligations as well as supporting their dependents and planning for longer-term or major items of expenditure.	Affirmation, based on audited accounts, of the future viability of their employer and the likely security of their livelihoods and (where relevant) their pensions. However, because of their close relationship with the company and those who manage it, many of their information needs will be met through other channels of communication – some formal, some informal. Many of these channels will operate on a day-to-day basis and will provide more detailed and insightful information than most third parties (including investors) can ever hope for.
The members of society. Some of these will be groups with an interest in a specific aspect of the company or its activities. Some of these may relate, for example, to very specific environmental issues.	In a liberal democracy, citizens are reasonably entitled to information regarding companies' activities in order to assess whether they wish to do business with such companies. An example would be whether a company is goods made by prisoners in

	internment camps in the Xinjiang Uyghur Autonomous Region in China.
The media. The media includes radio, television and the press (newspapers, periodicals and other specialist publications) both in hard copy and digital format. We are not including 'social media' which we see as being an extension of 'members of society' (above).	In the UK we are fortunate in having a free press. The media, whilst not infallible, play a key role in helping to ensure that members of society are informed about matters that are or might be of interest to them. The serious financial media performs this role very well in most cases. Company reports are a potentially important source of information for journalists which they complement with comment from their own contacts and information from other research.
Auditors. Traditionally, auditors have probably not been seen as an important stakeholder. However, this is changing in the light of increased interest in auditors' responsibilities towards the shareholders and other stakeholders.	Until recently, the auditor might have been ranked as a stakeholder alongside any other supplier of services to a business. However, recent audit failures have cast a sharp light on the role and responsibilities of the auditor in ensuring that, as far as possible, company reports provide a true, fair and accurate account of the company's performance and prospects as a going concern. Unlike other trade suppliers, the auditor's primary responsibility is to the shareholders – not the company management. As some auditors are finding, serious audit failings are likely to be extremely damaging to their reputations.

5. <u>Appendix 2</u>

Rolls-Royce Annual Report 2019

79. Rolls-Royce is well regarded FTSE 100company. Any basic failings in its reporting cannot be dismissed as those of a third-rate organisation which takes matters of reporting and governance lightly. However, the following is what the company has to say about its civil aerospace business which in 2019 accounted for over 50% of the Company’s total revenue:

    ‘Civil Aerospace is a major manufacturer of aero engines for the large commercial aircraft, regional jet and business aviation markets. The business uses engineering expertise, in-depth knowledge and capabilities to provide through-life support solutions for its customers’[1].

80. Leaving aside the fact that it is not clear what this means as a description of the business model, the company confidently proclaims*:*

    ‘We believe we have a sustainable business model which will create value for all our stakeholders over the long term’[2].

81. Anyone reading the first statement could be forgiven for thinking that Rolls Royce builds and sells aero engines in the same way that housebuilders sell houses – except that in the case of Rolls-Royce it achieves additional revenue from selling a range of after-market services.

82. However, contrast the Rolls-Royce statement with a comment in the Financial Times on 5th October 2019:

    'Like other engine manufacturers, Rolls-Royce loses money on the sale of its power plants and makes profits on the service and maintenance when they are flying'.

83. In an article in December 2020, The Times was even more specific:

    Rolls supplies Trent 1000 engines to the Boeing 787 Dreamliner and the Trent XWB for the Airbus A350. In normal times the company has annual revenues in excess of £15 billion, more than half of which came from civil aerospace. Half that income is tied to the engine flying hours of the airline customers which include British Airways and Virgin Atlantic.’

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[1] Rolls Royce Annual Report 2019 – Page 3

[2] Rolls Royce Annual Report 2019 – Page 13

84. This is the sort of business model information that investors really need to know. Armed with this knowledge no one can be surprised at Rolls Royce's announcement at the end of the 2020 trading year that with two thirds of its engines in service lying idle it was going through its reserves at £1bn a quarter. So much for a sustainable business model!

85. The real question for investors (actual and prospective) is, if journalists can tell us clearly and succinctly how the company's business model works, why can't the company? A similarly pertinent question is, what does this inability to articulate the company's business model tell us about the management?

86. Reading further in the Rolls-Royce AR for 2019 (Business Review P25) and looking at the financial overview for civil aerospace there are indications that the business model as stated may not be what it at first seems. There are references to 'underlying services revenue' (without any clarification of what this is) and a list of 'metrics' which includes 'large engine invoiced flying hours' – but with no clear explanation of how this translates into revenue.

87. Similarly, in the risk report (P50) there is no serious attempt to identify the key risks that are inherent in the business model. There is instead a random jumble of possible factors that could disrupt the business (failure of a key supplier, earthquakes, floods, or political events) followed by a few vague assurance peppered with business jargon and cliches about how these will be managed (Incident management framework — Business continuity readiness assessment etc.)

88. Elsewhere, the non-financial sections of the reporting are similarly unenlightening in terms of both content and relevance. The report on People and Culture (P45), for example, is long on process and short on outcomes:

    'During 2019, we invested £28.7m in employee learning and development (2018: £27.1m), delivering 1.4m hours of training (2018: 1m hours).'

89. This prompts the question, why? What was the purpose and what did it achieve?

90. In the same vein Rolls-Royce reports on its 'inclusion' targets, in particular the percentage of female employees at various levels. While it is not clearly stated, it appears that the targets for 2020 were met. This, however, prompts the question, why those targets? Why was a target of 17% set for the female employee population in 2020? Why not 15% or 25%? And what was the purpose of the target? The Company says that these are 'inclusion' targets. But what is the purpose of inclusion – apart from just being a 'good thing'. One

might hope and expect that the aim is to engender greater diversity of thinking within the business. If so, this is to be applauded; but once again, it prompts the question of whether this outcome is being achieved. As with so much target-setting by businesses, the reporting seems to be all about hitting the target while completely missing the point.

91. As stated in the response to Question 7 there must be a major change to the basic approach to drafting the narrative sections of the annual report as well as the way in which information is selected and presented. This will not happen by itself. Current poor practice is deeply ingrained. It will only happen if clear standards are set and enforced. Without this the aspiration of creating a network of concise reports which are comprehensible, relevant, appropriately brief and useful to the user is likely to be unattainable and will undermine many of the other excellent reforms that the FRC suggests.

6. Appendix 3 From Dr Nick Steiner

Corporate reporting notes 01

92. In 'A MATTER OF PRINCIPLES - THE FUTURE OF CORPORATE REPORTING[3]' Sir Jon Thompson writes:

    92.1. "This thought leadership paper explores ideas for changes to the system of corporate reporting with a view to making it more effective and engaging for all those with an interest in a company.

    92.2. In the future world, we question whether the traditional concept of the annual report remains fit for purpose. We continue to hear that the annual report is too long and impenetrable. How do we balance the need for more concise reporting against demands for more transparency?"

93. Today the annual report is widely seen as the set piece of corporate reporting. In recent years it has been pushed and pulled to meet increasing demands from traditional and new users. The result is a document that is confused about its intended audience and purpose[4].

Views on corporate reporting[5]

94. Participants were given the annual reports of three FTSE 350 companies as a case study, and the companies were chosen to show a variation in company size and industry. Regarding corporate reporting, the jurors reported that overall, they found annual reports to be long and inaccessible, and would be difficult for a 'non-expert' to navigate and comprehend. As a mechanism for regulating company activity, the jurors considered corporate reporting to have the following benefits:

    94.1. Promoting transparency in companies' activities, making detailed information available in the public domain.

    94.2. Making it mandatory for companies to report on important information, especially financial information in annual reports as well as, more recently, gender pay gap information.

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[3] FRC Discussion paper October 2020

[4] Page 2 FRC Discussion paper October 2020

[5] Page 33 Appendix Citizens' Juries FRC Discussion paper 2020

94.3. Providing a basis for comparability between different companies and industries to contextualise analysis of their performance and viability.

95. However, they identified some of the limitations of corporate reporting as:

95.1. Corporate reports are inaccessible for non-expert audiences, including the language used, format and length of annual reports specifically.

95.2. Information jurors identified as important, including information about environmental sustainability and company values, was not mandatory for companies to report on.

95.3. The information presented in annual reports was largely to be taken at face value and trusted to be accurate.

96. In addition, the jurors were surprised that non-financial information, including on sustainability, was not mandatory for companies to include. In particular, they considered information on environmental concerns and employee treatment should be mandatory, given the possible impact large companies can have in these areas. Jurors also acknowledged the burden on companies to produce annual reports, and the challenge of providing useful and up-to-date information in a fast-moving political and economic environment.

Current arrangements

97. Hard copy Annual Reports (AR) vary from photocopied A4 sheets stapled together, colourful diagrams, photos, those competently written and those of poor quality. Due to regulations and shareholder demands the size of ARs has grown over the years and can be quite heavy (Compass AR 2020 1.25kg) to send and if this is only for the recipient to place it the recycling bin is clearly uneconomic. Character Group AR 2020 (Aim) 225g, a stapled collection of pages.

98. Hard copy AR are supplied cost free to those named on the share register. As this is a cost to the company many are sending requests to these shareholders to move to virtual copies. The choices being offered:

98.1. to provide an email address so member can be informed when AR is available,

98.2. continue with hard copy and,

98.3. for those that do not reply defaulted to online.

99. The last means that those members may receive voting forms but no information for assessing how to cast their vote. Table 1 shows relative

numbers with those being defaulted well over 70% of members. Do these members visit the website to read the AR? It seems unlikely. Lloyds Bank have refused several times to provide figures which is regrettable because with members being over 2 million this information could be useful. They recently sent the choices request to members so they may release figures once this exercise is completed.

Table 1. Means of accessing the annual report

Company[6]	No of Members	Hard copy	Email	Website	Nominee
M&S	150,000	3,200	33,000	113,800	0
		2%	22%	76%	0%
LandSec	9968	754	1924	7290	?
		8%	19%	73%	?
National Grid	707,506	5,482	102,644	599,380	?
		1%	15%	85%	?
Lloyds Banking	2403545	?	?	?	?

Table 1 *Showing overwhelming numbers defaulted to the web. Note single figures for receipt of hard copy annual report. Lloyds Banking refused to answer both by email and as an AGM question. They have since then sent a circular to members; a non-response will mean default to the web.*

The AGM

100. Members are invited to the AGM to vote on the resolutions. The Board[7] may decide to hold this at a convenient time in an easily reached location or they may choose to make it difficult by an early time at a difficult to reach location.

[6] This is a very small sample so it would be worth obtaining more data.

[7] Compass, for example, moved their AGM to Twickenham Stadium at 1100 and was well attended as it allowed for off peak travel. The chairman changed and it was moved to 1000 and attendee numbers dropped significantly.

Attendance by members will vary from thousands to zero[8] (because of this a common figure for a quorum is 2 and covered by the directors in attendance).

101. To vote sensibly, members need information on the resolutions which is provided by the AR. However, further information may be given by presentations (if given) and Q&A.

102. Attendance examples at three FTSE 100 AGMs are shown in Table 2 below.

Table 2. Attendance at AGMs

AGM	Member	Corporate Rep	3rd party proxy	Guest
M&S	518	75		93
LandSec	25	7	3	3
National Grid	246	7		36

What is in an AR includes?

1) A letter from Chairman and Chief Executive
2) Strategic Report
3) Board of Directors
4) Chairs Committee reports include:
    a) Corporate Governance
    b) Audit
    c) Corporate Responsibility
    d) Nomination
    e) Directors' remuneration
5) Auditor's report
6) Consolidated Financial statements
7) Shareholder information (this may include a shareholder analysis)

103. Investment Trusts and Asset Managers in their ARs write about their investments and this provides a different reading experience to other companies.

[8] Directors are usually members but are discounted here.

104. Those members that ask questions[9] at an AGM are likely to have read the AR. Questioners are a small proportion of the attendees. More questions may be asked on an individual basis if the directors circulate after the meeting.

105. In 2014 BP asked me to provide a panel to consider their AR. Each panel member was given a form to complete.

106. We ended up with a 60-page Strategic Report as an alternative from the full report. This ran for a year or two when BP decided to only issue the full report.

107. Impax Asset Management have just released their AR. It consists of two documents:

    107.1. Governance & Financial Report with introductory letter from the Chairman

    107.2. Strategic Report with introductory letter from the Chief Executive.

108. Many companies give a lot of thought into how they present their AR and with smaller companies it is often a learning process. For example, ECO Animal Health took the opportunity on the retirement of the Entrepreneur to greatly improve their AR.

109. Views on what members gather from an AR varied considerably and this is also picked up below.

110. In addition, the results from the survey of FRC stakeholders suggest that the potential users of corporate reporting and the purposes for which they are seeking information are more diverse than the conventional view suggests (i.e. a defined set of users with a single objective).

    110.1. 44% of respondents look at companies' corporate reporting from multiple user perspectives, including a mix of preparer, investors and other stakeholder perspectives.

    110.2. 85% report that they have more than one 'very important' information seeking objective in considering information about a company.

    110.3. The expectations of investors and other stakeholders in our survey converge on most aspects of corporate reporting.

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[9] Questions are usually taken from information provided in the AR and include items such as dividend, ESG, Auditors report, whistleblowers, KPIs, Remuneration report and Financial report. Employee and Community questions are common in larger companies and can be time consuming.

110.4. The highest ranked communication objectives in our survey are to judge the performance of the company (68% of respondents), to gain an at-a-glance view of the company (58%), to establish if management can be trusted in running the company (52%), and to make comparisons over time and across entities (also 52%).

111. This note picks up the question what information is required by private shareholders for the AGM. Currently this is contained in the company's annual report.

112. Most members do not receive a hard copy of the AR. Those that do have to remain alert to continue receiving them as regular requests are made to opt for giving an email address or get defaulted to the web. It is reasonable that those who receive the AR read it to some degree. Those who provide their email address may read it online and those who are defaulted to the web receive nothing (maybe a voting card) and probably do not read the AR.

113. Only a small proportion of members attend the AGM. Requests by attendees for a hard copy AR are common. Often but not always these are available.

114. Best practice on conducting an AGM should be for:

114.1. A presentation by the Chairman

114.2. A presentation by the Chief Executive

114.3. Q&A

114.4. Circulation by the directors amongst members after the meeting.

115. The conclusion is that a small number read the AR and a hard copy is preferred by those that ask questions. Others will use information from the presentations.

116. FRC stakeholders found 58% liked an at-a-glance view of the company. Intuitively this should be readily read by recipients and hard copies of this could be sent to all members at little cost thus retaining positive links between the company and members. (Note: I anticipated that Lloyds Banking would say that this what they did, but they have chosen to remain silent).

117. FRC could consider the content of an at-a glance view of the company.

118. Reading the FRC discussion paper suggests that whilst guidance would be useful a detailed 'how to do it' less so. This together with monitoring what

members receive and whether attending AGMs is facilitated or made difficult. Treatment of nominees[10] should be included.

119. Communications outside of general meetings include RNS, shareholder meetings, interviews, media and analysts' comments.

[10] Nominees are not dealt with here, but it should be a question of removing barriers.

7. <u>Appendix 4</u>

'Sometimes it seems as if every element of content in any corporate communication, no matter how innocuous, mundane or anodyne, has been shaped by an over-zealous desire to ensure complete legal compliance.' (Response - paragraph 45).