

Dear Sir/Madam,

Thank you for the opportunity to comment on the FRC's Draft Plan & Budget and Levy Proposals 2017/18 which was discussed at the Priorities Meeting I attended on 1 February. My comments follow.

Best regards,

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### **FRC Priorities Meeting 2017**

#### ***Draft Plan Proposals 17/18,***

Response to the Priority, '*Promoting high quality corporate reporting*'.

Comments, below, are in answer to Consultation Questions responding to the FRC's Plans, and their Indicators; they primarily apply to, and focus on, Intangible Assets (IA) – mainly Intellectual Capital (IC), etc., related to organisations' internal capital rather than external relational considerations.

#### **Consultation Questions:**

Q1, Comments on priorities and work programme: *Review sectors* prioritised, to include medium- to high-technology sectors and the development of *sector specific* APMs (on the hypothesis that performance measures may differ between sectors), and

Q4, Risks to quality of Corporate Governance and reporting not addressed in work programme: 'The purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of the company.'<sup>\*</sup> *Intangibles*, representing 50-80% of many companies' value and long-term potential, are addressed, but perhaps with insufficient emphasis/focus on/attention to, their details/breakdown/granularity, and development of their Clear and Concise measures in reports. The current 'low profile' of IA results in the (continued) undervaluation of many companies (especially med- to high-tech), causing such companies to have undervalued shares and thus at risk of being taken over ('stolen') by either speculators or competitors (national or corporate) to obtain IA, especially IC.

<sup>\*</sup>The UK Corporate Governance Code, September 2014, page 1, paragraph 1.

#### **Plans - During 2017/18:**

##### *Priority focus sectors:*

Why 'property, travel & leisure, and support services' sectors? In the light of increasing IA interest, reported by the panel at the Priorities Meeting on 1 February, in that 50-80% of many companies' value is IA, why not include focus on the medium- to high-tech sectors,

and perhaps those sectors with short life-cycle (PLC) products - including support services in the City - with their increasing IC dependence?

*Thematic studies – Alternative Performance Measures (APMs):*

See below, ‘Guidance on Strategic Report’.

*Financial Reporting Lab.*

Maintain the positive/open mindset of the Lab. The implied work sequence stated in the Draft Plan, of ‘reporting on Principal Risk and Viability statements’, could be perceived as having negative/limiting/restricting connotations; however, one would maintain the entrepreneurial approach of Positive Mental Attitude (PMA) by looking first at the positives in company Viability, from Objectives through Strategy to (Intangible) Assets, etc, and then addressing prudence in looking at their associated Principal Risks - rather than risks followed by viability as stated – noticing the sequence of ‘entrepreneurial’ and ‘prudent’ in the purpose of corporate governance quoted in Q4, above. Thus, it is more appropriate to look first at long-term viability overall in the entrepreneurial foundation for companies’ future, and then the risks to it, not the other way around. Through this approach, Corporate Culture of more companies might be led towards looking at the positive aspects of entrepreneurial risk in the sustainability of success over the long-term – not just avoiding risk (negative), but intentionally taking critically analysed risks in innovation (positive) to develop and exploit IC - Reward Risk.

[In a similar way, SWOT may be a useful mnemonic (see ‘Business model reporting’, FRC Lab, October 2016, page 20, figure 1.) but it should be *applied* as OSTW or OTSW so that the internal weaknesses examined do not prematurely cloud the entrepreneurial opportunities for longevity – Mindset or Culture?]

*Influence the development and endorsement of the IFRS.*

The FRC’s work on specific aspects of IA could complement the IASB’s Work Plan in their ‘current research project on Goodwill and Impairment’. One assumes that the IASB will include IC in IA acquired (especially by IT and pharma companies) through take-overs – currently obfuscated by its inclusion within goodwill purchased with the acquired company.

..... and so, to emphasise the research proposal in the FRC’s Corporate Reporting Research Activities programme of December 2016, *to influence the development of IFRSs* and the attitude of the IASB to IA beyond Goodwill and Impairment.

*Guidance on the Strategic Report.*

Why, in this *Guidance*, is Strategy written before Objectives in several phrases (eg 4.6, 7.5), whereas these are more logically considered and delivered in the reverse order - namely Objectives then Strategy? Table 1 is more logical – consistency might help those being guided. The section relating to Strategic Management states in ‘7.4 Strategy, objectives and business model ...’, thus listing them illogically, but then goes on, rather apologetically, to say that, ‘Different businesses may ... approach them in a different order.’ It can only be hoped for! Why not address them throughout the *Guidance* in the more logical sequence of Business Model (what the company does to capture value), Objectives (what it has to achieve in pursuit of where it is going), then Strategy (how it intends to achieve the stated aim/objectives)?

Perhaps, in following comments made by the panel, the *Guidance* could usefully include more emphasis on IA/IC; this could act as an introduction to continuing progress towards (general non-mandatory guidance on) forward-looking narrative/qualitative information in the form of APMs; then further evolving these APMs to include increasing development and eventual adoption of forward-looking quantitative measures (in the form of innovative KPIs) integrating Strategic Reports and Financial Statements. This seems to be the increasingly wanted/needed Clear and Concise reporting of long-term value, with the greater granularity sought by shareholders - and stakeholders in general.

**Indicators:**

*Prioritise* technology dependent sectors with their high IA/IC dependence; see ‘Priority focus sectors’, above.

*Impact of Lab’s initiatives* – Preservation of consistent entrepreneurial culture in (infectious!) PMA – corporate viability first, risks second; see ‘Financial Reporting Lab’, above.

*Development of, and Impact on, international standards* – FRC’s IA specifics, such as IC, complementing IASB’s Work Plan and research pipeline; see ‘Influence the development and endorsement of the IFRS’, above.

*Thematic reviews* – Adoption of APMs in Strategic Report focussed on more granular examination of IA – qualitative/narrative initially, evolving over time to quantitative and eventually linked to, and integrated with, the Financial Statements; see ‘Guidance on Strategic Report’, above.