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Financial Reporting Council

By Email: futurereporting@frc.gov.uk

5 February 2020

Dear Sirs

A Matter of Principles – The Future of Corporate Reporting (“the discussion paper”)

We welcome the opportunity to comment on the above discussion paper.

About us

We are a firm of chartered accountants, tax, and business advisers. From offices across the UK, we provide a full range of financial and business services to enterprises and individuals helping them to achieve growth and long-term success.

For more details on our firm please visit <https://www.macintyreHUDSON.co.uk/>.

Our response

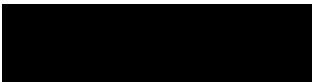
We are grateful that the FRC is providing thought leadership and providing a potential solution that will ensure that financial reporting remains at the heart of the corporate reporting process, but in a more distinct manner as an overall interconnected corporate reporting network.

Corporate reporting needs to evolve from its current position otherwise it will be left behind as technology advances. In our view only technology and innovation can provide the catalyst for corporate reporting to be fit for a more connected future.

Our detailed response is set out in the appendix to this letter.

If you would like to discuss our response, please contact us.

Yours faithfully


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Appendix – MHA MacIntyre Hudson Response to the Discussion Paper

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

We are impressed with many of the ideas and concepts in the discussion paper. Now is the right time to open the debate on the future of financial reporting.

The electronic transformation of corporate reporting must be an inevitable consequence of the recent and rapid changes in the use of technology that has affected all of our daily work processes.

We believe that the timescales for rolling out any consequent requirements should be achievable in this decade. For many years, the UK is a world leader in corporate reporting and can provide leadership in this process across the globe.

Implementation

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?

We set out the practical challenges in the table below:

Key Practical Challenges	How challenges can be overcome
<p><i>Company Law</i></p> <p>Company law will need to evolve to legally reflect many concepts, this might involve redefining what an annual report filed at Companies House means, what legally constitutes approval of financial statements in a digital world, and what is the actual boundary of the financial statements in a digital world, for example when does the audit opinion no longer extend to information that may be referenced by a link or does the audit process cover all information linked to an annual report.</p>	<p>Working closely with BEIS at an early stage and other regulators should ensure a stable platform from both a legal and practical standpoint.</p>
<p><i>Validity of information</i></p> <p>How is the validity of information ensured on an ongoing basis? How will users know that information has not been amended since being subject to audit (where relevant) and uploaded, and if amended is there a track record of any amendments?</p> <p>How can users determine that information is authentic? For example, is an auditors' report the genuine report that is unaltered?</p>	<p>Specific controls should be placed over certain information.</p> <p>Biometric techniques could be applied to the uploading and verification process.</p>

Key Practical Challenges	How challenges can be overcome
<p><i>Security of information</i></p> <p>Information uploaded could be the target of cyberattack, hackers and others with malicious intentions. How is the security of information safeguarded and who is responsible for security?</p> <p>Who will be responsible for the entire portal? Will this be the government?</p> <p>Will the platform be stable? Will it be able to cater for many users at a given point in time?</p>	<p>Systems will need to be tested to destruction before going live.</p> <p>Security would need to be established on an on-going basis and reviewed regularly for potential weaknesses.</p>
<p><i>Navigating the reports</i></p> <p>Given the possible variety of reports any portal should enable easy navigation through the contents for users. This could be achieved through effective indexing and book marking.</p>	<p>Ideally the level of organisation of information should be consistent for each company so that users have no difficulty in obtaining the information they need.</p>

Costs

Our main comment on costs is whether the government will be responsible for developing the software infrastructure and hardware that stores the information? Will those costs be passed on to companies?

We believe that companies will incur costs in tagging information and uploading information. However, the use of XBRL is becoming more commonplace and advisers are on hand to provide support services without undue cost.

For smaller entities we envisage that the costs of compliance will not be significantly different to requiring electronic filing of information at Companies House.

Benefits

Larger companies should be used to uploading information on a website by virtue of the requirement to provide a modern slavery report, gender pay gap reporting, and supplier payment reporting. It would be beneficial if information is uploaded using one specific portal.

We believe that users will benefit from the using a network of reports as the information they require will be more readily accessible where it is stored in one location.

Objective-driven

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

We believe that the “primary user focused approach” has served users well in the past. For a variety of reasons information contained in an annual report now goes beyond the traditional role of helping the decision-making processes of investors.

With the onset of more detailed narrative disclosure requirements covering the environment, social matters, the community, carbon emissions, energy use, actions taken to improve energy use, human rights, anticorruption and bribery, and a gender-based analysis of the board and senior management, the annual report has been used as a default vehicle to disseminate information that is of more general use to a wider group of stakeholders.

More recent developments have required transparency over their actions and decision-making processes. Directors of large companies are required to disclose how they have had regard to their statutory responsibilities under s172 (a) to (f) of the Companies Act 2006 when undertaking their duties. Enhanced disclosures are also required as to how directors have had regard in their decision making to employees and other stakeholders in a business relationship with the company.

In addition to the requirement to prepare a strategic report setting out how directors have performed in their duty to promote the success of the company for the benefit of its members, public interest entities (PIEs) must also disclose, in the form of a non-financial statement, due diligence, objectives, policies, and processes in respect of human rights, anti-corruption, and bribery.

The effect is that the narrative reporting section of a PIE's annual report is now of considerable size in comparison to the financial statements section.

We believe that the rate of increase of disclosure requirements in a traditional annual report is no longer sustainable. The more topics that are covered to satisfy a broad range of stakeholders has broken the traditional model and have reduced the impact of annual reports as an effective decision-making tool.

On that basis we agree that a new approach is needed and we agree with the principles outlined in the discussion paper. By putting communication at the heart of the objectives of reporting users can be served in a much better way.

Communication is the most fundamental aspect of corporate reporting; poor communication inevitably leads to poor reporting.

In our view the needs of stakeholders must also remain at the heart of a communication driven process, so that relevant information is delivered. This new model should facilitate a better relationship between users and boards, and therefore improve overall quality and usefulness of reporting.

We would hope that the new network reporting model retains many of the reporting features that exist now but delivered using much better methods.

One set of principles

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?

We believe that the proposed report network model forms an adequate basis for transforming corporate reporting.

System level attributes

We agree with the system level attributes that are described in the discussion paper.

It is fundamental that information is both accessible and transparent. In terms of transparency, directors should not be required to disclose information in respect of impending developments or matters currently in the course of negotiation where it is believed that providing that information

would be seriously prejudicial to the interests of the company provided that non-disclosure does not prevent reports being fair, balanced, and understandable.

Internal consistency of each report is fundamental, without which the usefulness of information and the impact of reporting on decision making is diminished.

We agree with the use of a consistent set of defined terms and expressions, and the use of reconciliations and explanations to ensure reports are consistent and cohesive. Effective signposting and linkage are both critical features of the reporting network.

Report level attributes

We agree with the proposed continuation in use of the “fair, balanced and understandable” and “true and fair” attributes. Additional attributes will inevitably be necessary for some reports.

Content communication principles

We are in agreement with the four content communication principles.

Information should be neutral and free from bias; this is an essential feature of transparent reporting.

An additional principle that we recommend is that of reliability. The reports should contain information that is reliable, and where reliability is questionable then the inherent limitations and uncertainties surrounding information should be explained.

Reporting network

We believe that describing the reporting model as a reporting network is an easy concept to understand.

Each report or subnetwork of reports (e.g., public interest report, business report and financial statements) must be able to stand as reliable information on its own merits, but also work well as a whole, just as an effective network should operate.

In order to provide a clear purpose, each individual report should set out its specific objectives. Clarifying purpose helps the user understand why information is prepared, and why it might not contain information that might otherwise have been expected.

Other reports

The auditor is only briefly mentioned. Is the audit report intended to be part of the financial statements or will it stand outside of the network, but will be accessible from it? It would also be necessary to consider where directors’ remuneration reporting, and any assurance on it, sits in the report network.

In table 1 on page 23 the discussion paper sets out various information themes which are also fundamental aspects of reporting. Corporate governance would appear to be a specific report.

We can envisage AIM listed companies and very large private companies including their corporate governance reports in the reporting network.

The disclosure of principal risks is traditionally part of the strategic report where disclosure of their mitigation is essential to the objective of that report being to disclose how directors have performed in their duty to promote the success of the company for the benefit of members.

We can see how such disclosures feature as part of a separate risk and resilience report that is linked to the business report and financial statements along with going concern and an assessment of longer-term viability.

Later in this response we question what information would be filed at Companies House.

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

We agree.

Materiality

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?**

We believe that materiality based on accounting standards remains relevant to the financial statements of a company but otherwise agree with the proposals

The application of materiality is essential in the creation of clear and concise reports and information that is not relevant can obscure important information.

Each type of report will be unique, so it makes clear sense that the materiality benchmarks that are set are determined by reference to the nature of the report.

We agree that each report should contain disclosures as to how materiality (both qualitative and quantitative) has been determined.

Significant judgements will be required when applying materiality. So as to ensure consistency of practice we recommend that comprehensive guidance on materiality is prepared to assist the preparers of reports envisaged in the reporting network.

Non-financial reporting

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?**

In our response to the recent consultation by the IFRS Foundation on sustainability reporting, we warmly welcomed the IFRS Foundation initiative in looking to establish a way forward which we hope will help to drive global consistency, comparability and efficiency in sustainability reporting. We would welcome similar initiatives to improve consistency, comparability and efficiency of wider non-financial reporting.

Regulatory standards

We support regulatory standards for each type of financial reporting and recommend that mandatory assurance frameworks are developed for such information. Non-financial information should be subject to an external assurance framework.

The scope of the regulatory standards should at least cover the specific disclosure requirements. We believe that the overall scope should be considered via a separate consultation process to support the drafting of standards.

Placing non-financial reporting on an equal footing with financial reporting

We believe that placing 'non-financial' information (for the purpose of the discussion paper defined as relating to employees, suppliers, customers, the community, the environment, and human rights) on the same statutory footing as financial reporting is a reasonable step forward.

For example, the current policing of non-filing of supplier payment reports, gender pay gap reports and modern slavery reports generally relies on tip offs as the government does not actively monitor whether such information is filed either in a timely manner, or at all.

What is the meaning of non-financial reporting?

The term 'non-financial' reporting can unintentionally mislead. For example, in the UK a non-financial report is part of the strategic report of certain PIEs and consists of narrative reporting.

Supplier payment reporting and gender pay gap reporting are examples of discrete financial reporting but are considered to be non-financial reporting.

We would welcome a clear definition of the meaning of 'non-financial' reporting.

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

Yes, we agree with the proposals.

Please note our comments below regarding gender pay gap reporting, supplier payment reporting and modern slavery reporting.

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

We agree with the proposal to introduce a Public Interest Report.

The discussion paper includes gender pay gap reporting, supplier payment reporting and modern slavery reporting as part of the scope of the public interest report.

The supplier payment regulations currently relate to certain large companies and LLPs and no differentiation is made by virtue of a company or LLP being a PIE. Gender pay gap reporting currently applies to entities with a headcount of 250 or more employees. Enterprises with a turnover of £36 million or more are required to publish a modern slavery statement.

We are concerned that important disclosures currently applicable to many larger companies might only be required by PIEs.

One objective of the supplier payment reporting regulations was to highlight which large companies were perceived to be poor payers. By restricting supplier payment reporting to PIEs then a lot of important cumulative data regarding supplier payment practices will be lost and therefore will not pay close attention to modern slavery in their supply chains, or provide useful gender pay gap information.

We believe that supplier payment reporting, gender pay gap reporting and modern slavery reporting should be dealt with in a manner that is consistent with the current reporting requirements. Therefore, this information could be included in the business report for entities that meet the appropriate reporting thresholds.

Technology

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?

General comments

We agree with a “digital by default” approach but also welcome the option for access to printed copies of reports.

Development of structures

The discussion paper notes that work is needed to develop and explore:

- A full set of corporate reporting schemas/structures to support tagging of all reports in the single network
- A single storage location/data portal that works across regulatory reporting requirements (listed and unlisted companies) to provide a consistent and efficient source of regulated company data
- New search and analytic tools that utilise the reporting network.

We are interested in how Companies House will be an integral part of the overall system which involves the storage of information and whether this will lead to changes in filing requirements at Companies House. BEIS have recently consulted on whether to mandate digital filing however these proposals still permit printed copies of reports.

Will information that is uploaded be frozen or can it be amended later? Companies House must be able to freeze information filed with it but is there a possibility that information filed at Companies House could end up not being consistent with information reported elsewhere?

Would procedures contained in company law for amending defective accounts be applicable to reports uploaded in electronic form?

System level attributes

In terms of being able to access information, a search function is essential to guide users towards relevant information. The use of a standard index would also help users access the information.

Where information is in a machine-readable format there is merit in exploring the use of artificial intelligence to check for consistency of reporting, numerical errors and whether internal links are operating effectively. Where information is uploaded these checks could be automated and an exception report could be generated identifying problems that need resolving.

We believe that the overall system should be capable of providing high level analytical information to enable benchmarking and comparison of data between companies.

Proportionality

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

In recent history, the government has taken a think small first approach, and has sought to cut red tape in small company reporting.

We note that small entities are not mentioned in the report. BEIS are currently consulting on small and micro-entity reporting and filing requirements at Companies House. Subject to the outcome of that consultation we would be interested to understand how such a system caters for small entities and micro-entities.

We welcome clarification that different reporting requirements for medium-sized and large companies (for example in the strategic report) will remain.

Please also see our comments in previous questions regarding the status of supplier payment reporting, gender pay gap reporting and modern slavery reporting.

Other

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?

Whilst these requirements are intended to apply to companies, we would expect similar requirements will apply to LLPs. The current regulations covering the form and content of LLP accounts and reports do not contain requirements for a strategic report or a members' report.

We would welcome clarification as to how the proposed requirements for a business report and a public interest report are intended to apply to LLPs.

We also would welcome clarification of whether transparency reports of audit firms are part of the corporate reporting structure as envisaged in the new reporting model.

Finally, we welcome whether the forthcoming requirements will be rolled out to Charities, companies incorporated under Royal Charter, and companies that are incorporated under other acts of parliament (for example Co-operatives and Buildings Societies).