A Matter of Principles: the Future of Corporate Reporting

UK Finance response to the FRC discussion paper

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Sent to: futurereporting@frc.org.uk

Introduction

UK Finance is the collective voice for the banking and finance industry. Representing more than 250 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation.

Corporate reporting has progressed considerably in recent years with many reporting institutions responding positively to the call for stakeholder engagement and reporting through a Section 172 lens in which an account of company performance is given by reference to key stakeholder interest, including customers, employees and the wider community, including through environmental, social and governance (ESG) reporting.

In this regard, the UK Corporate Governance Code and the Guidance on the Strategic Report prepared by the FRC, including revisions made as recently as 2018, have both made a positive influence on the quality of corporate reporting of longer term value creation and board responsibility to wider stakeholders as set out in Section 172. This of course remains work-in-progress, but provides a firm platform for further enhancing ESG reporting, including under the recommendations of the international Financial Stability Board-sponsored Task Force on Climate-related Financial Disclosures (TCFD).

It has also been encouraging to see proposals emerging in recent months for the International Financial Standards Board (IFRS) Foundation being given responsibility for the introduction of a global framework for corporate reporting through the establishment of a Sustainability Standards Board (SSB). As can be seen from the 500+ comment letters in response to the IFRS Foundation's consultation, this has gained widespread support.

UK Finance sees substantial benefit in the establishment of an international framework that would bring into a unifying structure the varying approaches that have developed across the globe and in response to the consultation acknowledged the IFRS Foundation as representing a highly suitable guardian in which to entrust the task of drawing together global and regional ESG reporting standards to achieve global harmonisation. We further added that we view the Covid-19 crisis as providing a backdrop in which a high degree of consensus has emerged in favour of environmental and social factors being built into economic recovery measures as we look to 'build back better'. By looking to capitalise on work already undertaken by others – with their consent and cooperation - the SSB should benefit from a tailwind enabling relatively rapid progress to be made.

We consider that the FRC has made a positive contribution to the quality of corporate reporting in recent years and (in its reorganised from) will have has a significant part to play in ensuring that the corporate reporting framework is suited to current and future expectations for good quality corporate reporting extending beyond the financial statements.

A fundamental question in respect of the proposals set out in the discussion paper is whether the FRC is setting out proposals that it would contribute to the international dialogue or whether it is proposing a radical restructuring of UK corporate reporting in isolation.

We can support the FRC encouraging thought leadership in this area as part of the reporting dialogue opening up internationally. We would be sceptical, however, about the positive contribution to be made by these proposals if the FRC were proposing such a radical shift unilaterally on the part of the UK that has the potential to diverge from, or add significant complication to, the creation of a global framework for corporate reporting.

Specific questions

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

   Our position on the proposals is heavily dependent upon whether the FRC has set out a position that it would intend to contribute to the international dialogue on corporate reporting or whether it is proposing a radical shake up in a purely UK context.

   Until we have a clearer understanding on this, we would say that we can see a stronger case for the new assurance statements in light of the Brydon Review than a major restructuring of UK corporate reporting at this point in time.

   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 proposals?**

   We consider that considerable progress has been made by a good number of firms in recent years in improving the quality of strategic reporting. We are unclear therefore that the benefits attracting to e.g. the addition of a public interest report outweigh what might be achieved by providing more time for corporates and others reporting under the only recently revised model to improve the quality of their reporting.

   We are further unsure that it is helpful to reorganise reports in such a way that in headline terms implies ‘business’ interest differs from the ‘public’ interest. While the division of reported information between ‘financial’ and ‘non-financial’ might be intended only to signify whether information has or has not been prepared by reference to financial reporting standards, it also brings the implication that the information contained in the strategic report is not of financial relevance. We would not wish for any new reporting system to perpetuate the perception that the issues covered in these reports are anything other than core to business interest.

   Objective-driven

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

We are supportive of Section 172 director duties and broader stakeholder engagement in concept and practice, but are uncertain as to whether what is proposed within the discussion paper represents a constructive step forward.

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?**

While the model set out may have intellectual attraction, we are not in favour of the UK adopting a new set of principles if this means that UK reporting diverges significantly from the approach adopted in other leading economies.

Reporting network

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 do not as yet share the FRC's vision that its proposed reorganisation of corporate reporting would result in more concise reporting or an improvement in the relevance and accessibility of information that stakeholders would wish to assess in order to gain an overall understanding of the strategic and financial positioning of a company.

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?**

Our principal expectation is that financial reporting and corporate reporting standard setters and regulators come up with a single approach that can be universally applied on a global basis. Within this context, we would agree that the current test for materiality based on accounting standards is not suitable for non-financial information provided within non-financial corporate reporting.

In commenting upon the IFRS Foundation consultation on this, we commented that the double materiality test, and the strategic vision this brings, is an integral part of appreciating the benefit of assessing company performance by reference to the broader environment and social setting in an ever-changing world, in order to be effective in promoting transparency and investor protection, further adding that within Principle 3 of a UK Finance white paper on multi-year commitments to sustainable finance[1] we observed:

"In determining whether or not finance should be defined as 'sustainable' firms will need to be cognisant of differing forms of materiality that may apply. In the EU, for instance, materiality for non-financial information is currently based upon a dual perspective of the

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[1] White paper 'Sustainable finance: establishing a principles-based framework for multi-year commitments', UK Finance, November 2020.

impact on both the firm and environment or society. While this has parallels elsewhere, it is not a universally accepted concept. The statement of intent issued by the five leading voluntary framework and standard setters in September refers to the concept of ‘dynamic materiality’, in which issues once considered relevant only to social value can rapidly become financially material. It observes that in this sense sustainable value creation lies at the intersection of social and corporate value.”

We consider that the complexities associated with combining financial materiality with a broader materiality concept can be overcome by promoting a strong cooperation amongst the major international standard-setters and framework providers in this field.

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?**

If part of the proposition is that the three separate reports - the Business Report, the Financial Statements and the Public Interest Report – could be subject to a level of external assurance considered appropriate to the varying nature of the content then we would agree this to be worth exploring, irrespective of whether the relevant content was marshalled into separate reports as proposed.

The underlying issue here is that there are conceptual and practical challenges to achieving comprehensive external assurance. While this should be the objective across corporate reporting, it needs to be appreciated that what might be reasonably achievable within the short term might differ significantly from what should be achievable over the medium to long term. It may therefore be that for some content ‘limited’ assurance is more realistic and in keeping with what can reliably be provided. In any event, the expectation is for transparency in terms of the level of assurance provided.

It needs also to be appreciated that progressing in this area under the umbrella of an international reporting standard on sustainability would make it easier to adopt an international assurance standard. The position of the IFRS Foundation in the international landscape may also ease the interaction with the International Audit and Assurance Standards Board (IAASB). The existence of a single reporting standard would also make it possible to bring assurance of non-financial statements closer to the level of assurance on financial statements. We favour this being approached internationally.

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

This is implicit in our support for Section 172 reporting on stakeholder engagement as part of directors acting in the long-term interests of a company.

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

We are unclear that the gap that the FRC is seeking to fill merits the approach proposed within the discussion paper.

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?

We certainly believe that a dialogue on the relevance of technology to the presentation and content of corporate reporting is over, but consider this best conducted in an international context.

Proportionality

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

The proposal within the discussion paper is that medium and large companies be required to prepare Business Reports, i.e. as currently applies for Strategic Reports, but that the requirement for the new Public Interest Report extend only to public interest entities as defined in Company Law. This, by definition, would achieve a measure of proportionality.

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?

A theme running constant through this submission is the need for the outcome of any review of UK corporate reporting to be consistent with UK government support for the IFRS Foundation being charged with the creation of a global framework for corporate reporting.

If you have any questions relating to this response, please contact Paul Chisnall, Director, Sustainability paul.chisnall@ukfinance.org.uk

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