The future of corporate reporting

Building an effective reporting regime to meet user needs

The Association of Investment Companies (AIC) represents some 360 closed-ended investment companies with assets under management of over £214 billion as at 31 December 2020. Our members are listed on public stock markets, most frequently the London Stock Exchange.

Investment companies are closed-ended funds that invest in a diversified portfolio of investments, which may include quoted and unquoted shares, debt, infrastructure, property and other assets. They provide shareholders with the benefits of expert asset management and an investment return.

The AIC is pleased to respond to the Financial Reporting Council's (FRC) consultation on the Future of Corporate Reporting. The AIC supports the FRC's ambition to review the current reporting regime and create a more agile approach to reporting in the future.

In particular we support the proposal to split the annual report into component parts. This is something we have been recommending for a number of years. These changes would result in better reporting delivered in a less onerous and more accessible way. Investors will have access to the same information that they do now, but this will be organised and presented in a clearer way, resulting in corporate reports being more effective documents.

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

Annual reports currently provide shareholders with historic financial information about the company. They also seek to provide investors with an understanding of how a company is governed, its strategy and how it operates in the best interests of its shareholders.

Investors are increasingly demanding more information about companies. Not only about their financial position, but also about every aspect of their operations. Companies should seek to provide their shareholders with the information they want. However, continuing to increase the scope of the annual report to address other aspects of a company's operations is not sustainable or appropriate. There needs to be a balance between meeting the needs of shareholders, meeting the needs of stakeholders, and making the reporting regime fit for purpose.

The AIC welcomes this review, and we support the proposal to split corporate reporting into separate component parts which have different, clearly identified objectives. This will make each report a more effective tool for shareholders and stakeholders.

The AIC agrees that the 'Business Report' element should be the core element and that it should be based on the current Strategic Report. This should be a concise report to enable users to understand how the company operates, focusing on matters that are of strategic importance to the company.

The AIC also **recommends** that flexibility is maintained in setting the content of the Business Report to allow companies to tailor this document to their individual circumstances such that it avoids boilerplate disclosures.

The AIC also agrees with the FRC's proposal to have a network of other reports that are standalone documents, such as the Financial Statements and corporate governance report. These documents should provide further detailed information about the company. The AIC agrees with the FRC and **recommends** that this network of other reports may include standing data which does not need to be updated annually. These other reports may also not need to be provided on the same date, or cover the same period as the Financial Statements.

This would allow the reporting network to change and adapt over time.

The AIC agrees with the FRC's proposed approach to the 'Financial Statements' element. However, again we **recommend** the FRC provides companies with the flexibility to tailor the content requirements. For example, the FRC proposes that this document includes information about intangibles. However, it is unlikely that investment companies will have any intangibles, therefore there should be no requirement to include details about this or to explicitly state that the company has not got any intangible assets and therefore no disclosures have been provided in this regard.

The AIC **recommends** further thought is given to the content requirements of the proposed 'Public Interest Report'. The current proposal is that this report will "*provide information to understand how the company views its obligations in respect of public interest, how it has measured its performance against those obligations and to provide information on future prospects in this area*". The report would be underpinned by standards and metrics and would include information about the impact of the busines on the company's stakeholders and society.

As standards develop in this area, the FRC should review its proposals and ensure they remain relevant and appropriate.

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

Many of the recent reviews concerning corporate reporting and audit reform have recommended increased disclosures to try and meet the needs of shareholders and stakeholders. More is not always the right approach. Transparency is a good thing, but simply increasing the amount of information provided to shareholders will not equip them with the information they need to make informed decisions.

Corporate reporting should help shareholders make informed investment decisions, but the wealth of information included in annual reports at the moment masks key issues that companies are trying to convey. More worryingly, it potentially also masks fundamental problems that could lead to the demise of companies.

Legislators and regulators need to balance the increasing demand for companies to provide more information with having a proportionate, fit for purpose, reporting regime that supports a transparent capital market and gives shareholders and stakeholders the information they need in a clear, succinct and understandable format.

This review provides the opportunity to improve the quality of reporting, reduce the volume of unnecessary disclosures, increase transparency for users and reduce the administrative and cost burdens placed on companies.

The AIC **recommends** that in developing the new corporate reporting regime a wider review is undertaken to remove some of the current legal and regulatory requirements from annual reports, particularly where this is not material to understanding the nature and performance of the company.

For example, investment companies do not have employees or premises. Accordingly, many investment companies currently state in their annual reports that the company has no greenhouse gas emissions. These types of disclosures do not add value. They detract from the key issues that annual reports should seek to address and communicate to their shareholders.

The AIC also **recommends** that a policy decision is taken to establish the principle that future legal or regulatory information that companies will be required to report should not be included in the Business Report or Financial Statements unless it is material to the company's operations and/or pertains to accounting standards.

Unless these two recommendations are adopted, there is a real risk that the new corporate reporting regime will not be fundamentally different from the situation we find ourselves in today where the annual report is trying to be all things to all people and the length and complexity of this document continues to grow.

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

The AIC **recommends** corporate reporting continues to primarily focus on shareholders. They are the ones who effectively pay for the company to generate corporate reports and for auditors to audit those reports. Therefore, they are the ones who should primarily benefit from those reports.

Section 172 of the Companies Act 2006 already requires companies to have regard to other stakeholders. Extending this requirement further will result in longer corporate reports as companies continue to strive to meet the increasing information needs of a growing group of stakeholders.

The focus on shareholders does not mean that other users, or their information needs, will be ignored. For example, we would also expect reporting to continue on the environment and wider ESG matters which are of concern and interest to stakeholders and shareholders alike. Other issues, such as payment practices, which may be of more concern to stakeholders than shareholders, will continue to be reported on. Such matters are also of concern to shareholders, as they demonstrate a company's values and culture. However, it is important that companies are able to tailor their reporting to address the most appropriate issues facing their company. It should not be a one size fits all approach and the network of other reports, in particular 'non-financial reports', will allow companies to respond to information needs of stakeholders. But the primary focus should remain the shareholders.

Unless the scope of corporate reporting is clearly defined and focused on shareholders, there is a risk that these proposals do not achieve their full potential. As the FRC states in its consultation paper the current annual report ""*is a document that is confused about its intended audience and purpose*". To avoid this situation in future, corporate reporting should remain principally for the benefit of shareholders.

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

The AIC supports adopting a principles-based framework which maintains the current requirements to be "*fair, balanced and understandable*" and "*true and fair*". Corporate reporting requirements should not become overly prescriptive or burdensome to companies. At the same time, they should provide investors with the information they need to make informed investment decisions.

The AIC also supports the content communication principles which the FRC proposes would apply to each corporate report, being:

- Brevity, comprehensibility and usefulness;
- Relevance;
- Company specific; and
- Comparability.

The AIC has long been concerned about the length and complexity of annual reports, applying these principles should help improve the quality of corporate reporting.

The AIC **recommends** that when the regulators set reporting requirements for each corporate report, care is taken to avoid unnecessary duplication of content. Regulators should work together to ensure the information required by companies is cohesive and ensure that any new disclosures required by companies are made with the overarching principles for corporate reporting in mind.

Please also see our response to questions 2 and 5.

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

The AIC supports the FRC's aim to improve the relevance of information in corporate reports. Adopting these proposals will significantly enhance the quality of reporting not only for shareholders but also for other users of annual reports. Investors will receive the information they need in a digestible and accessible format.

Each report will be focused. Currently, annual reports and accounts contain an extensive amount of information. This does not help users see the wood from the trees. In adopting these proposals, the FRC should have regard to removing superfluous information from each reporting component.

The AIC agrees with the FRC's proposals and **recommends** that not all reports included in the reporting network will be mandatory, some may be voluntary where, for example, companies wished to provide further information about a specific issue.

The aim of this review is not to require companies to provide further information, but instead to ensure that the information that is provided is presented in the most appropriate way. The AIC **recommends** that this is kept in mind as the project develops, to avoid any scope creep.

Additionally, any information that is currently provided should only be provided in the new regime where it is relevant. Companies should not be required to report on a uniform basis about matters that may not be material to their operations, or of value to their shareholders.

As noted in our response to question 3, corporate reporting should continue to focus primarily on the needs of shareholders. There is a risk that increasing the scope of reporting to a wider stakeholder group will dilute the FRC's ambition to ensure corporate reports are clear and concise. Information that may be relevant to one set of stakeholders may not necessarily be relevant to others.

Technological advances are enabling companies to improve the accessibility of information for users. It is vital that investors and other users of corporate reports can access the information they need and know where to go to look for it. By splitting the annual report into various component parts users will know where to look for the information they need as it will be organised and presented in a better way. Reports should also provide links to other reports setting out where further information can be found on relevant topics.

However, the AIC does not agree with the FRC's proposals that as technological advances continue and reports are tagged electronically, users would be able to "*create something akin to a 'build-your-own' thematic report*". This could potentially be dangerous as relevant information could be left out which would not provide the user with "*true and fair*" information on which to make an investment decision.

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

This is potentially an attractive option. However, the AIC **recommends** that the implications of having different materiality thresholds are assessed and the costs and benefits are analysed in detail and consulted on prior to such proposals being recommended. If different materiality thresholds are applied differently to each corporate report, the AIC **recommends** this is done in a proportionate way so as not to result in companies having to provide more detailed information than is already required.

It is not clear how the FRC's proposal that "*the time frame for reporting and materiality decisions should also be communicated*" will work. The AIC **recommends** further work is undertaken in this area to ensure any changes to how materiality is applied is clearly understood by companies and by users of corporate reports.

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

The AIC agrees that 'non-financial reporting' is in its infancy and that different standards and models are being developed covering a wide range of topics, such as climate change, ESG and payment practices. We agree that in the longer term having a more standardised approach to such reporting will provide investors with more comparable information, both in terms of consistency year-on-year and comparability across companies.

In time, it may be that this element of reporting has the same importance as financial information, but we do not consider that to be the case at the moment.

As non-financial standards develop, it is important that companies are able to tailor their reporting to address the most appropriate issues facing their company. It should not be a one size fits all approach as there are so many aspects that could be covered in a 'non-financial report'.

The AIC **recommends** that the FRC undertakes further consultation work in this area if it intends to develop such standards.

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

The current requirements in this area come from various legislation and regulations covering a wide range of topics. There is no cohesion between these different statements that are currently all included in a company's annual report and accounts.

There is a risk that this element of the corporate report becomes a 'dumping ground' for future regulatory requirements that are not directly connected to the performance of the company.

As stated above, the AIC **recommends** that the FRC undertakes further consultation work in this area to develop a cohesive scope for this element of the corporate report.

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

Please see our response to questions 7 and 8.

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

The AIC **recommends** that the FRC does not introduce tagging requirements that go further than the European Single Electronic Format (ESEF) requirements as adopted in the UK. These will require companies preparing IFRS consolidated financial statements to tag their primary financial statements included in their annual report and accounts for financial years beginning on or after 1 January 2022.

The AIC **recommends** this is not extended to other companies that do not prepare IFRS consolidated financial statements. This would add unnecessary time and cost burdens to these companies.

The AIC also **recommends** that there is no move towards companies being required to tag financial information on a line-by-line basis in their annual report and accounts.

Requiring companies to go further than EU legislation would create additional cost and regulatory burdens for UK companies. This would be an unnecessary administrative barrier to companies incorporated in the UK.

Instead, the AIC **recommends** that all corporate reports are published in searchable PDF. This would meet investor needs to easily identify the sections of a report that are of the most interest to them. Additionally, if the proposal to separate out corporate reports is adopted, investors and other users of corporate reports will have a clear menu of reports to look at, which should enable them to quickly identify and navigate to the area they are most interested in.

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

As stated throughout our response, the AIC **recommends** that a flexible approach is taken allowing companies to tailor their reports to only address the content elements that are applicable to them. This will help avoid boiler plate disclosures.

In addition, companies should be encouraged to adhere to the content communication principles set out by the FRC to ensure corporate reports are clear and concise. There should be no expectation that information should be included where it is not material or relevant to a company's business.

Furthermore, the AIC **recommends** that the only content element that requires auditing is the Financial Statements, please see our response to question 12. This will ensure the boundaries and focus of an audit are clear for companies, shareholders and stakeholders. It will also help to achieve a proportionate reporting regime.

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

The AIC **recommends** any future proposals in this area clarify that the only content element that requires auditing is the Financial Statements. Currently, while the audit function is well understood and valued by shareholders, confusion often arises over which parts of the annual report are audited, and the role the auditor has in reviewing other parts of the annual report, the so-called 'expectations gap'.

Splitting corporate reporting into different components will enable there to be a clear boundary set around the role of the auditor and their obligations with regard to the Financial Statements.

Where companies or their shareholders require external assurance over other corporate reporting elements, this can be provided by a reporting accountant, or other appropriate consultant, with knowledge and experience in specific fields. This should not be mandatory. Where such assurance is sought, it would be based on a defined and agreed scope. Different levels of liability could also be agreed depending on the work undertaken and the contractual agreement between the supplier and the company.

In addition, as stated in our response to question 2, the AIC **recommends** that in developing the new corporate reporting regime a review is undertaken to remove some of the current legal and regulatory requirements from annual reports, particularly where this is not material to understand the nature and performance of the company. These types of disclosures do not add value. They detract from the key issues that annual reports should seek to address and communicate to their shareholders.

January 2021

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